UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

ENERGY MARKETS ADVISORY COMMITTEE MEETING

Washington, D.C.

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P R O C E E D I N G S

(1:00 p..m.)

CHAIRMAN LUKKEN: Good afternoon everyone. Welcome. I'm Walt Lukken, Acting Chairman of the Commodity Futures Trading Commission and on behalf of my colleagues I want to welcome everybody to the first meeting of the Energy Markets Advisory Committee, or as we call it the EMAC here in the building.

Obviously, given the unprecedented market conditions of the day, this meeting is occurring at a critical and opportune time. Recent substantial increases in the price of crude oil and other commodities have put considerable strain on American families, farmers, and businesses. These issues are of intense focus at the Commission due to the key role that the futures markets place in the price discovery process. The CFTC is committed to ensuring that our nation's futures markets operate fairly and efficiently and that the commodity prices are determined the fundamental forces of supply and demand rather than by abusive or manipulative forces. We share public concerns about the need for the utmost transparency and integrity in the energy futures markets and we are devoting all available resources to fulfilling our mandate to protect and ensure the integrity of the community futures and options markets. Our dedicated staff works tirelessly each day to pursue this important mission and we have a history of taking strong enforcement action to punish market manipulation and fraud.

Such times require regulators to remain diligent in their efforts to protect the markets from abuse and enhance market oversight in order to serve the greater public interest. Just last week the CFTC announced its national crude oil investigation and several other important energy initiatives including an agreement with the U.K. Financial Services Authority to expand the data received from institutions trading crude oil products across borders.

The CFTC also announced that it will use its authority to demand more detailed data from energy market participants on the amount of index money coming into the markets and to examine whether these funds are properly classified for regulatory and reporting purposes. These initiatives are critical and we're working hard to implement all of them expeditiously.

Today the CFTC also announced the formation of a CFTC led intra-agency task force to evaluate developments in commodity markets. The task force which includes staff representatives from the CFTC, Federal Reserve, Department of Treasury, the SEC, Department of Energy, and the Department of Agriculture will examine investor practices, fundamental supply-and-demand factors, and study the role of speculators and index traders in the commodity markets. It is intended to bring together the best and brightest minds in government to aid public and regulatory understanding of the forces that are affecting the functioning of these markets and will strive to complete its work quickly and make public its results.

Today's Energy Markets Advisory Committee meeting grew out of a hearing the Commission held last fall to examine the oversight of trading on exempt commercial markets. Many of you participated in that hearing. As a result of that public forum, the Commission proposed legislative changes to Congress to bring greater transparency and oversight to these markets. These recommendations which were largely adopted last month as part of the Farm Bill will provide the CFTC with important new authorities to regulate the energy markets and we appreciate all the hard work that went into making this the law of the land.

Last fall a CFTC report also recommended the Commission form an Energy Markets Advisory Committee to facilitate public discussion surrounding the regulation and policies of the energy markets and I am confident that this standing forum will better enable the Commission to listen and learn from the insights of those directly participating in and impacted by the energy markets.

As the Commission moves forward with the implementation of its energy market initiatives, this Committee will be critical to ensuring that the Commission is fully informed of industry developments and innovations so that the Commission can rapidly respond to changing market conditions and ensure that these markets are functioning properly and not subject to foul play. The Commission has selected you to become members of this Committee because of your knowledge in energy markets and insights that you can provide this Commission. We hope that involving a cross-section of the industry and public will allow participants to learn from each other and assist the Commission in its oversight in understanding of the energy markets. I would like to personally thank each of you for making the time for this Committee's important work, and I would especially like to thank Guy Caruso of the Energy Information Administration of the

Department of Energy, Kevin Kelly of FERC, Patricia Galvan of the FTC, as well as Bill Hederman of the Congressional Research Service for attending today's meeting as government observers. I look forward to an informative and energetic meeting today.

With that I will turn it over it over to my colleague Commissioner Mike Dunn for an opening comment.

COMMISSIONER DUNN: Thank you, Mister Chairman, and I commend you for leading today's meeting, and I thank the participants who are here today.

This is a vitally important area for us and I look forward to hearing from the industry participants that you have gathered here today to speak about transparency in our energy markets and potential best practices that can provide consumers with confidence in our market's utility, vitality, and security. Our goal as a Commission is to ensure that the energy markets we regulate function properly and are free of manipulation and abusive practices. As is evident by our recent announced energy initiatives and lengthy enforcement track record in these markets, we take this mission very seriously. Even so, Americans are feeling the effects of high energy prices at the pump on the family farms and at the workplace. They are looking to us for answers and wondering why are they paying record prices for their energy needs.

My hope today as we begin a dialogue with the Committee's members is to allow us to answer this and other questions. As you all know, a key function of the futures markets is price discovery and if all we are doing is discovering the price I say to Congress and the American people don't shoot the messenger. It is what it is. But if there is manipulation going on and prices are being pushed upwards for some reason or another, then I think they have a right to shoot us all. I look forward to hearing of the experiences of our panelists, and once again, Mister Chairman, I thank you for calling today's meeting.

CHAIRMAN LUKKEN: Thank you, Commissioner Dunn. Commissioner Sommers?

COMMISSIONER SOMMERS: Thank you, Mister Chairman. Good afternoon and thank you for being here with us.

These are extraordinary times for U.S. energy and commodity markets. Crude oil for July delivery surged over $10 on Friday after touching a record of $1.3901. Clearly concerns about whether world oil production can keep up with rising world oil demand has led to sharply higher oil prices. The decline in the value of the dollar and more recently the return of geopolitical tensions which create uncertainty about the availability of future oil supplies have combined to push oil prices faced by American consumers even higher.

Finally, some, including several witnesses testifying at recent congressional hearings believe that speculative trading in futures market, particularly commodity index trading and trading taking place on foreign boards of trade, is driving the price of oil well above levels that can be explained by economic and geopolitical factors. I believe that it is prudent for this regulatory agency to enhance market oversight for our energy markets. To that end we have announced a number of initiatives to increase the transparency in our energy futures markets. Under a new agreement with the United Kingdom Financial Services Authority and ICE Futures U.K., our agency will receive expanded information for surveillance of the West Texas intermediate futures contract that trades on both NYMEX and Ice Futures U.K. In addition, the Commission will use its existing special call authority to require traders in the energy markets to provide the agency with monthly reports for their index trading to help the Commission further identify the amount and impact of such trading in the markets.

The Congress recently enacted the Farm Bill which includes legislation that reauthorizes the CFTC and provides the agency with increased oversight authority over contracts traded on exempt commercial markets. If such contracts are determined to play a significant role in price discovery, this new authority will bring the level of regulation over these markets on par with contracts traded on designated contract markets. This new authority was the result of careful deliberations between the CFTC, our House and Senate Oversight Committees, as well as Senators and Levin and Feinstein, and provides this Commission with the important tools necessary to monitor the integrity of the energy markets.

I'm very much looking forward to the discussion today at the Energy Markets Advisory Committee and believe that this will be an important source of input to this Commission on these issues. The Committee includes a wide range of representatives who possess a great deal of knowledge and about and experience with our energy markets. I also want to welcome all of the staff from the other regulatory agencies and congressional staff that are with us today, and thank you all for taking time out of your busy schedules.

CHAIRMAN LUKKEN: Thank you, Commissioner Sommers. I also want to welcome those who have come from the Hill up here to get a better understanding of how these forces in our markets are playing into the prices of crude oil and other commodities. So thank you for being here and I think we're all going to learn something here today.

On a housekeeping note, I would just ask everybody if they could silence their cell phones and Blackberries. They often interfere with mikes and it would be helpful if everybody is able to do that. As well, I remind everybody that when they want to speak if you can put up your placard it makes it a little easier for me to see and I'll try to call on you, and you'll have to push the button on your microphone in order to speak. I missed somebody to my left here, an important member of our Commission. Before I say anything more, I'll turn it over to Commissioner Chilton, and I apologize profusely. Commissioner Chilton?

COMMISSIONER CHILTON: I was going to say I don't have a placard to raise up. I'll be brief. Welcome.

The folks here tell me we're supposed to be commodity blind and price neutral, but that's really tough with crude oil at $140 a barrel and people as Commissioner Dunn was talking about making the decision between food and fuel. I know people like this and it's tough for them. So we've been searching for any answer we can, and that's one of the reasons that you all are here today. But I sort of feel like a blindfolded boxer. I'm swinging around trying to find out what's going on and whether or not it's the devalued dollar which certainly has a significant impact with the horrible economy, or the subprime and the securitization of the derivatives industry, or whether or not it's speculators, or whether or not, as I've said, we need to look at the WTI contract, the look-alike contracts, or whether or not it's sovereign wealth funds or a myriad of other things. We just keep swinging and we haven't really found any sufficient single answer. So I'm hopeful that you can provide something, maybe not the sufficient single answer, but at least help provide us with something that maybe we haven't thought of. What don't we know?

I was sort of surprised and frustrated with Secretary Paulson yesterday to just come out and say that speculators weren't to blame, at least he said maybe not to any significant degree. Fifty cents on the price of a gallon of gas is significant to a lot of people. But maybe he has a crystal ball that we don't have, and I'm not saying that speculators are to blame, but I am saying that this is something we need to look at and the jury is still out and we're looking at more information and I think it's a premature determination to make and I think for us to say that we know the answer and it's not that would be a dereliction of our duties and that's why it's important. What don't we know, to hear it from you all.

Marshall McLuhan used to say it's hard to go forward when you're only looking in your rear-view mirror. The people you're going to hear from today, John Fenton, he gets up every day and works on this stuff and he is looking in the past to find out what we've done and where these markets have gone, but he's doing the best he can along with the other dedicated staff here to figure out are there other things we need to be looking at down that road. But that doesn't mean we can see everything, so I'd ask you tell us again what don't we know that might be out there.

Justice Powell of the Supreme Court was by no means a liberal, he was really an ultraconservative, but he used to hire these liberal clerks because he knew what the conservative position was. It's always comfortable to get with your colleagues and Mike and I are Dems and we agree on a lot of things, we're comfortable, we both like to golf, et cetera -- most of the time comfortable -- but the most comfortable thing doesn't mean that's the right thing. What don't we know? Anyway, I look forward to hearing your answers. Thanks.

CHAIRMAN LUKKEN: Thanks, Bart. Sorry I skipped over you. I apologize.

Now I think it's time if we would go around the room to introduce ourselves so that everybody knows who is at the table and what organization you're from. I think it's appropriate if we start with Sean Cota here on the corner and we'll work our way around the room.

MR. COTA: Thank you, Acting Chairman Lukken. I'm Sean Cota from Cota & Cota Fuels, a third-generation heating oil and propane gas retailer in Vermont and New Hampshire. I've been doing commodity trading for many years as it relates directly to the end consumer. It's an odd bit of our business that's evolved. I represent the New England Fuel Institute, a heating oil industry trade group and the Petroleum Markers of America, I observe on their executive board, and between all of these groups we represent nearly all the retail consumers of gasoline and nearly all the retail consumers of heating oil. We have many concerns which we have expressed before and will bring whatever insight that we can. We see the consumer every day so we have an immediate impact in what we see. Thank you.

MR. COLLINS: I'm Bo Collins. I run my own proprietary trading group that specializes in energy derivatives, both natural gas and crude oil, and formerly the President of the New York Mercantile Exchange and trader of the natural gas book for El Paso Energy.

MR. HORVATH: Skip Horvath of the Natural Gas Supply Association. My members are the large major and independent natural gas producers. We are mostly physical traders, however, we also market gas for ourselves, we hedge using futures, and some of our members conduct marketing trades for other third parties and we help them understand the market, so we sort of straddle both markets.

MR. CASTURO: Don Casturo from Goldman

Sachs. I run our global investor product trading book which includes index trading.

MR. OPPENHEIMER: I'm Ron Oppenheimer. I'm the general counsel of Merrill Lynch's global commodities business. Thank you for including us in this discussion.

MR. CICIO: My name is Paul Cicio. I'm the president of the Industrial Energy Consumers of America. We are a trade association of the large energy intensive manufacturing companies, the steel companies, commodity chemicals, plastics, fertilizer, aluminum. Our competitiveness to a large extent is dependent upon the cost of energy as we compete in world markets. So we're delighted to be here, and thank you for holding this.

MR. ANDERSON: I'm Bob Anderson. I'm executive director of the CCRO. The CCRO is a professional association of financial and risk officers from energy companies of all types ranging from utilities to ENP companies to merchants and our association works to publish white papers of best practices related to all aspects of risk management ranging from governance and compliance to specific risk measures. Thank you for including me in the group.

MR. FOX: My name is Kevin Fox. I work at D.E. Shaw in New York and I manage the energy strategy.

MS. CAMPBELL: My name is Laura Campbell. I'm the assistant manager of energy resources for Memphis Light, Gas and Water, and LGW is the largest three service municipal in the country, and I'm representing the American Public Gas Association which represents the majority of the public gas systems within the United States.

MR. PANTANO: Good afternoon. My name is Paul Pantano with McDermott Will & Emery and I'm appearing today on behalf of the Futures Industry Association which is the trade group that represents futures commission merchants and other service provides to the futures industry.

MR. SHORT: Johnathan Short. I'm the general counsel of IntercontinentalExchange. We are the parent company that owns ICE Futures Europe formerly known as the International Petroleum Exchange which is a U.K. based and U.K. regulated futures exchange overseen by the Financial Services Authority. It trades the benchmark Brent crude futures contract and along with NYMEX a WTI or west Texas intermediate crude contract. Thank you.

MR. HEIMLICH: I'm John Heimlich, chief economist of the Air Transport Association of America. We represent U.S. passenger airlines and six U.S. cargo airline who carry more than 90 percent of the passenger and cargo traffic of this industry. And as you can imagine, we are deeply interested in the outcome of this deliberation. Thank you.

MR. FENTON: I'm John Fenton. I'm the deputy Director for Market Surveillance in the Division of Market Oversight, and my group, the Market Surveillance Section, monitors the markets and reports to the Commission to make sure that the markets are fair and not being manipulated.

MR. ARBIT: My name is Terry Arbit. I'm the general counsel at the CFTC.

MR. NEWSOME: I'm Jim Newsome, the president and chief executive officer of the New York Mercantile Exchange, former commissioner and chairman of this institution, and Mister Chairman, I want to thank you and all the commissioners for all the effort that goes forward to putting this type of panel together. I think we should have an interesting dialogue today.

MR. PICKEL: I'm Bob Pickel, the chief executive officer of the International Swaps and Derivatives Association, the trade association that represents the over-the-counter or privately negotiated derivatives business. Our members are engaged in derivatives activity of all types, not just related to commodities and energy, but also credit, interest rates, and various other underlying exposures.

MR. PARIKH: I'm Satu Parikh. I run the global commodities business at Lehman Brothers. Thank you for including us in the panel.

MR. FELMY: Good afternoon. My name is John Felmy. I am the chief economist of the American Petroleum Institute in Washington, a trade association representing all segments within the oil and natural industry, and thanks for inviting us.

MR. STAINTON: Good afternoon. My name is Mark Stainton and I run the energy investment portfolio at Citadel.

MR. MANSFIELD: My name is Anthony Mansfield. I'm from the law firm Heller Ehrman. I'm here as a representative of Shell Trading (US) Company. And I'd also like to thank the Acting Chairman and the Commission for allowing us to participate in this discussion.

MR. KELLY: I'm Brian Kelly. I'm with Colonial Energy in Fairfax, Virginia. We are involved with the physical supply and transportation of natural gas to markets from the Gulf Coast through New England.

MR. MCCOY: I'm Bill McCoy. I'm managing director at counsel at Morgan Stanley's legal and compliance department and I lead the legal coverage for the futures brokerage and commodities groups here in the U.S.

MR. PROKOP: My name is Mike Prokop. I'm with Amerex Brokers. We are a wholly owned subsidiary of GFI Group, one of the largest over-the-counter energy brokers.

MR. SHELK: Good afternoon. I'm John Shelk. I'm president of the Electric Power Supply Association -- national trade association for competitive electricity suppliers, both generators and marketers, so we engage in hedging and trading both as producers of electricity and as consumers of all types of fuels because we use all types of fuels to produce electricity. And again, thank you for including me.

MR. SMITH: Good afternoon. My name is Foster Smith. I run North American natural gas and power trading for J.P. Morgan Chase.

CHAIRMAN LUKKEN: Thank you very much for the introductions. We have a full agenda ahead of us here so we won't delay any more. But to lay it out for folks, we're going to have John Fenton, our head of market surveillance give an overview of the energy markets and what we're seeing in the markets to date. And also our general counsel Terry Arbit will then give an overview of the recent energy initiatives we've announced to try to tee up some of those issues for discussion. Then we will turn to lead discussants throughout the day to discuss the different issues on the agenda including index trading, commitment of traders reports, as well as the Foreign Board of Trade issue. So with that we'll give it to John Fenton.

MR. FENTON: Thank you, Chairman Lukken. I'd like to join Chairman Lukken and our Commissioners in welcoming you today. I think it's a great idea to have this committee and I think we're going to benefit greatly by the experience and the expertise that you folks have.

I think this first chart which shows crude oil prices going back to January 2001 probably explains as well as anything why we're here today. Back in January 2001 prices started the year at $27. They fell after September to as low as $16.70 as the world economy went into a recession and global travel fell sharply. Since the end of 2001 we've seen prices persistently rise with relatively minor corrections or fallbacks, but we've seen prices rising now for year after year. I'm not going to try to explain why prices have risen. I don't want to prejudge and I think people here probably have good as or better ideas as to what's behind it. Certainly some of the factors I can mention are the relentless growth in world demand for oil, the relatively difficult production conditions to add to production of oil, the chronic shortage or small amount of excess production capacity so we're always sort of at the precipice when any geopolitical event might tip us over, and then of course geopolitical events have been a factor all along and I think they've had a bigger impact because we are on the razor's edge in the supply-demand sphere, and the dollar of course has been part of the reason why crude oil prices have gone up in dollar terms. But I think what would be most useful for this group for me to talk about is some of our data and our commitment to trader report which is going to be the subject of the next section, but I can commitment report and the things that go into it and some of the changes we made last year for the agricultural markets which I think have been very helpful in adding transparency with regard to index trading, and I can explain to you why we have not as of yet been able to do that in the energy and metal markets.

Certainly the focus in a lot of quarters has been the role of speculators in index trading and how much of an impact they may or may not be having. Our data is an important part of that discussion. I think we're the only entity in the world that puts out this kind of market composition data and it's useful for sure, but it's got its limitations and people need to understand that and we certainly are taking initiatives to try and add clarity certainly to ourselves internally so that we have a better picture of what's happening and potentially also to the public if some of the information that we get under initiatives we're taking we deem that it's in the public interest to publish some of that data.

This is an example of a commitment of traders report that was released last Friday as of a week ago. It's the report that we've been putting out for markets since 1962. When we started, little did we know the significance that it would have in the markets. I was not around at the time, but I presume there were about four or five markets that it covered so it was a relatively task. We're now doing it for over 100 markets. It was also easier back in those days because there was a relatively clear dichotomy between uses of the market, you were either a speculator or you were a hedger. In fact, we used to call the categories speculators and hedgers. We changed the terms to noncommercial and commercial for technical reasons, but it's been a dichotomy that you're a speculator, you have a view of price, you may be a short term scalper or a much longer term speculator, you may be a spreader, you may be basing it on technical analysis or fundamental analysis, but you have a view of price. The commercials were people who had a physical exposure in the underlying physical market and they use the futures markets to hedge that price risk.

So there were two important ingredients in the price discovery process. The speculator presumably had some expertise in understanding market factors and provided liquidity, but they also improved price discovery if they were informed speculators. And since the commercials' trading was based on activity in the underlying physical markets that sent signals to the marketplace about activity in the physical market and that was certainly information in the price discovery process.

Just looking at this report, we categorize traders into noncommercial and commercial, then the total of the reportable, and then the nonreportable. The reporting level in crude oil is 350 contract. That sounds like a high number but in fact we get 97 percent of the long and short open interest so we have virtually every position in the market and certainly every important position in the market. In the noncommercial category are as I said speculators. It would also include index traders who are trading directly in the futures market. So if an index fund was trading directly in the futures market, they would be in the noncommercial category. If a pension fund was doing index type trading directly in the futures market, they would be in the noncommercial category.

The commercial category is as I mentioned before physical commercials, merchants and dealers in the underlying physical market, but increasingly it includes swap dealers who are engaged in OTC activity, in marketing swaps, and in many cases index swaps, and taking futures positions to hedge the price risk as a result of that OTC activity. When this trading first began we had a choice of putting them in the noncommercial or the commercial category. They are commercially engaged in activity, they use the futures markets to hedge, so it seemed the more appropriate choice to put them in the commercial category. It certainly has become controversial. We looked at this issue around this time 2 years ago and we did modify and put out a supplemental report in the agricultural markets that I think has broken out this trading in a way that I think is useful, and I'll explain a bit later, but in a two choice world it seemed the best place was in the commercial category.

Going back to the noncommercials for a second, I want to point out that in crude oil, and in fact in many of the energy markets, a very high percentage of the noncommercial trading is spread trading. It can be calendar spread trading between months in futures, or to a great extent it's spread trading between options and futures, and this is actually an options and futures combined report. So if you're short options and long futures or the other way around, you'd be in the spread category. You can see 914,000 contracts of long and short open interest are held by spread traders, by the far the biggest activity of the noncommercial traders.

Then you take the long and the short and often times people look at the net of those two to see the net speculative opinion in the market and potentially the net speculative impact in the market and currently that's around 95,000 contracts. To put that in a little bit of context, that's the equivalent of 95 million barrels of oil, sounds like a lot, but it's about one day of world oil consumption, and we produce and consumer around 87 million barrels a day and so it's just a little above one day's production and consumption.

Looking at a breakout between these categories of noncommercial and commercial going back around 2 years, this is the graph. The green line here are the noncommercials, the red line are the commercials, and you can see that they're pretty close to mirror images of each other, and in a way they have to be because we're getting close to 100 percent of the open interest, therefore the net exposure of noncommercials almost necessarily has to be mirror of the next exposure of the commercials. But looking at these traders and especially over the course of about the last year if you go back to around here where it peaked at around I think 170,000 contracts, it's pretty steadily traded in a range of 100,000 contracts to 150,000. I think a lot of people probably have the impression that based on the sense that the market is being moved by speculation that this number would be going up and it really hasn't been. It's been going sideways. In fact, most recently it's been going down. As I mentioned, the most recent number is 95,000 and it had been as high as 170,000. Certainly we have to point out the potential weakness of the numbers that we publish in that the commercial category does as I mentioned include swap dealers and swap dealers as I'll show in a couple minutes are very much involved in index trading. So the commercial category does include index trading and they're the other category of trading that a lot of people are focusing on. This is data that we don't normally publish but it looks at the swap dealer portion of the commercial open interest and it's the net position. If you looked at the gross position, swap dealers have over a million contracts long and over a million contracts short, but to look at the net exposure of the swap dealers as a trading community they have been as high as just under 100,000 back in it looks like about March 2007 and that number has also been going down and it's actually been negative recently and currently I think it's around 13,000 contracts long.

Obviously swap dealers if they're doing index trading would have long positions and in the near months the predominant positions of swap dealers are long and that no doubt does represent index trading, but they're also doing other things in their book that would put them short and that's in fact the main reason which I'll probably talk more about, but that's really the reason why we couldn't put out clear, accurate numbers representing index trading, about 85 percent of index trading comes through swap dealers into the futures market. The swap dealers' book is a mix of many different things including internalizing part of their book that doesn't even need to come to the futures market so there was no real way based on the data we were getting to publish reliable numbers and I think the numbers we would have published would have been misleading and wouldn't have been helpful in the way the numbers we published in the ag markets I think have been very helpful.

This is a schematic of where index money originates and how it can come into the futures market. The left most block here is the ultimate customer, the entity who wants to have a position in commodity exposure. I'm sure everyone knows here that pension funds, endowments, people who have portfolios of assets including stocks, bonds, real estate and other things that in recent years have wanted to diversify into commodities and I think there are both theoretical and empirical research that for a given level of risk, performance is enhanced, and for a given level of performance, risk is reduced by having commodities in a portfolio, so that's the trend that people have gotten into.

This is the group, institutional investors, individual investors, who want to have exposure to commodities and they can do it in a number of ways. The predominant way, and certainly the way pension funds predominantly do it, is they go to a financial intermediary, an investment bank who is operating as a swap dealer, and do an OTC swap or other derivative contract that's linked to one of the indices. Then the swap dealer has an exposure to the commodities that are in the index and have to take positions predominantly the futures market, they could hedge it a different way, but typically they would take an offsetting position in the futures market. So they're short the swap and then they go long the individual futures components of the swap and that's this arrow here going into both designated contract markets which are the markets that we regulate, could go into an OTC market, could go into a foreign market. In fact obviously a number of the commodities that are part of indices are not based in the United States, LME for the metals and hedging of crude oil can be done on ICE Futures Europe both in the Brent contract and in the WTI contract. So this path going through here is as I mentioned before what ends up in our commitments data as commercial activity.

The other paths could be that people could give money to a commodity trading adviser who is a fund that mimics one of indices and that would be this path and if this path were followed, that is if the trader in the futures market was an index fund, that would end up in our noncommercial category.

The final path is traders, you would

have to be big, but pension funds can do it, trading directly in the futures markets to recreate the index. So they have positions in all of the underlying futures in the proper ratios to recreate the index and that would be this bottom half. We see some of that, and that commitments data would shown as noncommercial positions.

I just want to run through the commitments for wheat to show you how the new supplementary report takes positions from the dichotomous world to the trichotomous world that we've created a third category. This is the standard commitment report which we still produce and people find it useful. It breaks out the numbers between noncommercial and commercial just they I've described. But we have now added this supplemental report which creates this third category of index trades so that we have the noncommercial, the ones who have a view of price and are willing to put their money at risk, we have the commercial, and when you pull out the swap dealer out of the commercial category it's the physical commercials that are left. So it's those who have an exposure in the underlying physical market and when they buy in the futures markets it's passing a signal of a buying activity in the cash market. Finally, then you have index traders who you could say are really not sending a specific signal into the futures market related to wheat in this case or crude oil. They're not trading there because they think prices are going higher, they're certainly not trading there because their trading is related to activity in the physical market, so that's where those kinds of traders end up. It's obviously predominantly long, 215,000 in the case of wheat, and this shows you where the numbers have come from, that the commercial category has been reduced by 184,000 because of the movement of swap dealer positions out of the commercial category and so that makes up 184,000 of this 215,000, about 85 percent of the 215,000. Coming out of the noncommercial category, 30,000, that's index funds and pension funds trading directly in the futures market and that represents around 15 percent and I think that's pretty representative of all of the markets that are part of the indices, that about 85 percent of the positions are coming from swap dealers and around 15 percent are coming through index traders trading directly in the futures market.

This looks to be the 12 agricultural markets we are publishing data for. The bar shows the number of contracts held by index traders and the square is the percent of open interest that index trader positions represent and that's over on the right axis. So cattle is not the biggest in terms of contracts but the biggest in terms of the percent of open interest at just under 45 percent with hogs around the same and then you go down through cocoa is the smallest at around 17 percent. One thing to point out here, and we've been looking very hard at index trading trying to see what we could see about its potential impact. We have not been able to find a strong correlation between the markets in which index trading is the highest such as cattle and hogs and those being the highest prices. In fact, cattle and hogs happen to be among the weaker prices in the commodities. So that's one of the things we've looked at and we have not been able to confirm the impact of index trading in this regard. I just want to mention one thing to make sure so that I haven't mislead you here. When we pull the positions of swap dealers out of commercial and into the index trading, we can't based on the data we have differentiate between index trading and other things they may do. The reason we felt like we could do it in ags is because swap dealers were not doing very much other than index trading so that there as a very close correspondence between their positions in the ags and their index trading, so this number is a highly reliable number but it will potentially include some amount of noise that is not index trading and certainly the short positions here are probably not related or almost certainly not related to index trading.

This looks at the index trading. It's a

layered graph showing each of the layers where there's a different commodity. The bottom most one is corn and it layers the commodities above it. Over the past 2 years you can see that taking the top most line here going back in June 2006, there was about 1.3 million contracts of index trading in these 12 markets and it's now grown 2 years later to around 1.9 million contracts. Some people have been using these numbers as a proxy for index trading generally and there is a certain amount of logic to that, but there is certainly a caveat that is necessary that you have to correctly assume the proper weights of the various indices, you have to assume that these positions are in the major index, the standard index, not in some sub-indices, and you have to assume that it doesn't include any single commodity swaps or other activity so that one needs to be cautious of reverse engineering. Having said that, since February and especially during the last 2 months using our ag data as a basis, it doesn't look like there's been a whole lot of new index trading activity in the last several months.

We would love to be able to publish similar data for the energy markets and I think I've explained the reasons why we can't, but the Commission has announced several initiatives in the energy markets. Terry is going to talk in some more detail about it, but I'm just going to mention that we are going to be sending special calls to swap dealers to try and parse out their book in a better way. It will not I don't think directly affect how we can publish commitments data, but it is potentially information that we will use internally for sure and externally probably in some manner to provide some greater transparency and clarity about the phenomena of index trading it not only energy markets but in other markets as well. This is not quite carved in stone, but the kinds of things we're going to be asking are to report the notional value of all outstanding OTC commodity index transactions to break it out between the major standard indices and any sub-index that may be part of it, to report the futures equivalent positions in each commodity that is part of an index, break it out by commodity index transactions and single commodity swaps, so in that that actually will help us understand even the ag market somewhat better. Here what we mean by futures equivalence is that even if the position doesn't result in the need to take a futures position, that is you've done an OTC swap, you've been able to internalize it on your books against something else you've done, it doesn't come to the futures market, we're still going to ask to see the futures equivalent of that index trade to be able to characterize how big it is in comparison to the futures market, and we're going to ask at some threshold level to report the counterparties to OTC activity involving this activity.

MR. HEIMLICH: Does that apply to any U.S. person or entity? Who is governed by these proposals?

MR. FENTON: We're going to be using our 1805 authority which is an authority that we can inspect the books and records of any trader who holds a reportable futures position. So it will be based on the entity who holds a position in the futures market, so that's our hook.

MR. HEIMLICH: And irrespective of their geography and their residence?

MR. FENTON: That's right. Finally I just want to very quickly go through the enhancements that we're going to be getting through the FSA. We work by the way very closely with the FSA, we've got a great relationship, and they've been very helpful to us. They've been providing information from ICE Futures Europe for 2 years now and it's going to be enhanced. We're already getting daily reports. Prior to that we were getting weekly reports, daily during the final week of an expiration, but we're already getting daily reports. It's going to cover all futures months until now, it's covered the nearby 2 months, but it will be all months. There's going to be an enhanced trader identification so that we will know who the trader is without any ambiguity. We're very hopeful that it will come in a way that we'll be able to integrate it seamlessly into our surveillance system, that all of our sophisticated surveillance capabilities will treat this as just another futures position that we can combine in our view of activity in other markets. And ICE Futures Europe will notify us in instances where a position in their market would be above the position accountability level at NYMEX in this case, and for example in crude oil, the position accountability level is 20,000 contracts in any individual month or all months combined so that this I think this will be very helpful to us. With that I'll turn it over to Terry.

CHAIRMAN LUKKEN: Thank you very much. Terry Arbit, our general counsel.

MR. ARBIT: Good afternoon, Mister Chairman, members of the Commission, and members of the Committee. Thank you for the opportunity to appear here today.

With the recent and dramatic increases

in crude oil futures prices, on May 29 as many of you know 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 focusing primarily on their international aspects.

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, and the ICE Futures Europe Exchange. John has ably identified what many of the provisions of the agreement will require, so let me try to help set the table by providing some legal and historical background on how the Commission got to where it is today.

Section 4(a) of the Commodity and Exchange Act generally requires that all futures trading must be done on designated contract markets, but it also contains an exception for futures contracts that elicit 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 and regulations that govern and 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 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 in the United States so that it need not become a designated contract market.

This has proved to be quite a vexing question and has promoted extensive debate over the years. The concern has been voiced that a definition of an exchange's location that has cast too broadly could obstruct the development of global futures trading by subjecting exchanges to duplicative and inconsistent regulatory requirements. Having received voluminous public comment 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, one, if Commission staff has determined that the foreign board of trade is a bona fide exchange and that the exchange and its regulatory abide by comparable regulatory objectives; and two, 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.

This process also proved to be

consistent with the intent of Congress as was subsequently expressed in Section 126 of the Commodity Futures Modernization Act of 2000. There Congress found among things that regulatory impediments to the operation of global business interests can compromise the competitiveness of United States businesses. The CMFA also included the sense of the Congress that the Commission should encourage among other things, one, the facilitation of cross-border transactions through the removal or lessening of any unnecessary legal of practical obstacles; two, the enhancement of international supervisory cooperation; three, the strengthening of international cooperation for customer and market protection; and four, improvements in the quality and timelessness 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. Of the three, the one that has developed the most significant liquidity is the West Texas intermediate crude oil contract. Even 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 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 that I think many of you participated in to evaluate its approach to foreign boards of trade that seek to place direct access terminals in the U.S. As a result, the 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 that 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 regulatory needs to detect abusive or manipulative trading practices in these related futures contracts. Since 2006 the FSA has provided the Commission with weekly trading information and daily information on the final trading week to facilitate oversight of trading in linked WTI contracts traded on NYMEX and ICE Futures Europe. As was envisioned by the memorandum of understanding, the Commission and the FSA continually review this oversight framework with the 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. As John noted, the agreement includes, one, immediate implementation of expanded information sharing to provide the Commission with daily large trader positions in the ICE Futures Europe/WTI crude oil contract; two, extending trader information sharing to provide crude oil large trader information data for all contract months in the WTI contract, not just the nearby months; three, a commitment to enhanced trader information to permit more detailed identification of market end users; four, a commitment to provide improved data formatting so trading information can be seamlessly integrated into the Commission's surveillance system; and five, 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 exchange rate will as John mentioned use its 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 futures markets and review whether classification of these types of traders can be improved for regulatory and reporting purposes; and third, the Commission will review the trading practices for index traders in 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's not surprising that the creativity and innovation in 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 CFTC 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.

CHAIRMAN LUKKEN: Thank you very much, Terry. This is the part of the program that everyone around the table gets to earn their keep so we're going to first kick off the first topic that was teed up nicely by Dr. Fenton on index trading and we've asked some of the index providers to kick off the discussion beginning with Don Casturo from Goldman Sachs. Thank you, Don. Again, as we go along, this was meant to be an interactive discussion so please raise your placards and jump right in if anybody has questions.

MR. CASTURO: Thank you, Mister Chairman, and thank all the Commissioners for inviting me to speak here today. It's understandable with commodity prices where they are, it's commendable that you're looking to do a thorough examination of all the forces at play in these markets and I welcome the opportunity to speak to one of those forces which is index trading. Clearly, by some of the statements in the press recently, there is some misunderstanding of exactly how index investing in the commodity space works and I'd like to address some of those basic principles with what I'm calling the who, what, where, why, and how of index trading.

I'll start off with the why, and that really gets to why did this even start? Why are there index traders in the commodity space? It started back in the early 1990s when the commodity derivatives markets were just starting to open up and there was an interest in the producing community to place forward hedges in the oil space and there was not an offset to that position that naturally existed among the swap dealers. So the GSCI was created to provide some of that liquidity to offset our flow and interest in flow of doing commercial hedging. Of course just creating a product, you need to have some interest on the other side and some rationale for the other side to be interested in taking that and the way the product was packaged, it represented an opportunity for the buyers of index trading to mitigate some of their risk as well which came down to wanting to diversify their portfolios and protect against inflation.

To go a little bit further into that why market, if you'll turn to the second slide, I want to talk about the interrelation between the spot market and the forward market in the commodity space both of which by the way are governed by economic principles. The spot market though is the place where 100 percent of producers and 100 percent of consumers actually come to the marketplace. There may be some incremental difference which results in change in inventories, but it's 100 percent participation of those two entities in that space. In the forward market as I addressed earlier, because producers are much more centralized, they're more likely to want to mitigate their risk in the forward market versus the consumers which are decentralized and don't have a collective interest in buying their consumption 2 or 3 years forward; 50 percent of U.S. consumption is individual drivers who are not likely to be collectively trying to hedge their forward exposure. So for that reason just for the supply and demand balance equation and the way it would work in the forward market, another class of participants was required to be involved and that really was what the index provider does in these marketplaces. You could say that that could result in imbalances between the forward and the spot market, but again a properly constructed futures contract will bind the two and relate the two because there should be convergence between the forward futures market and the cash market which should hold the relationships in an economically explainable manner.

Turning to the next slide, I'd like to address what is commodity index investing. The main point I want to make here is it's largely a well-diversified broad basket of commodities. Again, if you go back to the interest of the investor in index commodity products, what they're after is to mitigate a broader inflation hedge in the diversified portfolio so the nature of that investing doesn't require specific single perhaps even speculative investment in any single part of the commodity space and it's a broader basket which should mitigate any effects in any one place. Equally, the other point I wanted to make on this what slide are the two broadest benchmark indices, the S&P GSCI and the Dow Jones -- index have strict liquidity and price history requirements that they consider before even placing that futures contract in the composition of their index to mitigate any unwanted effects.

Next I'd like to address the where of commodity index investing. As Dr. Fenton already mentioned, 85 percent of this investment takes place in the over-the- counter markets, and I just wanted to make sure there's an understanding of why that's the case. Firstly, the nature of investing in 24 commodities as a passive continuous investment requires quite a bit of maintenance in that you need to roll those futures contracts to always stay in the commodity and the fact that there are 24 different commodities means that it's a relatively time-consuming process if you ever try to engage in doing that yourself, so swap dealer with large staffs are well equipped to handle that and take that burden off of the index investor. Secondly, there is execution risk in performing that function, and even if you did have the staff, you wouldn't want to expose yourself to missing the index or missing the settlements in such a way, and by setting it up this way and giving it to an OTC swap dealer, they bear that risk. Lastly, and this is a little bit more complicated point, the GSCI for example does have a futures contract which trades on the CME, but that doesn't satisfy the need of all the index investors because it can only represent one rolling strategy and we have found that investors like to diversify that risk and maybe not just stay with exactly the defined rolling mechanism of the S&P, GSCI, or Dow Jones manuals which stipulate fifth to ninth business day of first and second year by contracts or further out depending if it's Dow Jones to something that may be more customized and modified, and for that reason modified rolls have developed which are really only possible in the over- the-counter space because it's not generic enough to be suitable for the futures contracts.

The next point I want to address is the who are the participants in these markets. This was also commented on by Dr. Fenton. The point to be made here is that it is really a broad, well-diversified class of investors ranging from pension funds, foundations and endowments. No single entity has an exceptional concentration of interest in this space that could really create any singular force in these markets; it's really well diversified.

Lastly, turning to the how, I've put a few pages in here that describe the rolling mechanism of these index investments because I think that's key to the understanding of the effects they would have on these marketplaces. Whether it's the standard generic roll that's defined by the investment manuals or it's the modified rolls that have been created by the swap dealers to go over different times, the key point is index investing is a passive continuous investment that never takes physical delivery of any single commodity, so hoarding commodities is not really a concept of what the index investor does. To elaborate a little further on that, investments are typically made in the first near by futures contract, but at some time prior to expiration of that futures contract, which if it's well designated that futures contract should be heading toward the physical price of that commodity, the index investor needs to role out of that contract and into a more deferred contract thereby selling his investment back to the marketplace in the spot of the market that is closest to the physical market and investing something further down the curve. It's that key mechanism that is key to understand to make sure that there is a relationship between physical supply and demand fundamentals and the price that is being paid by the index investor.

Lastly, the point I would like to make on the how, and I think I find this relevant because there have been so many publications of the dollar amount invested in index investments in the commodity space that been quite prevalent in the press recently to truly understand and what that data is telling you. Unlike corporate hedgers which invest in commodity units, for example, an airline knows what their consumption is and needs to buy a certain quality of jet fuel or a producer knows what he produces and sells a certain number of barrels into the forward market, index investors are primarily concerned about the dollar amount of their investments. So when we get an order on an index desk to participate in the commodities via an index swap for example it will be stated, I would like to buy $10 million worth of an index. Why that's important if the cumulative investment hypothetically in January 2007 in commodity index represented $100 billion worth of commodities, today that investment would be worth $174 billion without a single new commodity futures contract being purchased. The futures contracts that were purchased back in 2007 just due to price appreciation alone would now be worth $174 billion so there would be a $74 billion increase on the amount invested in commodity futures by index investors that is what you see in the press without a single new barrel or bushel or BTU of futures contracts being consumed by them and I think that's consistent with Dr. Fenton's data showing that there hasn't been a large increase in index investor future length in these markets but at the same time it's consistent with the fact that there is actually more index money in the commodity space purely due to price appreciation.

CHAIRMAN LUKKEN: Thank you, Don. Real quick we'll turn to Bill McCoy from Morgan Stanley and then open it up for comments and questions.

MR. MCCOY: Thank you very much, Mister Chairman and Commissioners, and given that many of Mr. Casturo's comments are similar to what many of the traders at my firm have viewed regarding that, I thought I would just take a few minutes to elaborate a little bit more on the issues of how the index trader implements trading in the futures and the OTC markets particularly in the context of the regulatory framework both of the CFTC and actually just as if not often thought of, but the SEC. Specifically, obviously as we have heard, it's very difficult for an index investor to implement the strategy by buying and selling the futures and options on futures of the underlying futures components so some undoubtedly have put together a desk that's capable of doing so. There are the specific indices that the CME has of the S&P, GSCI futures contract and -- Dow Jones AIG contract but in order to try to conduct the activity regarding it as we've heard, Dr. Fenton indicated the majority of trading by the pension plans and investment funds and other types of institutions that are given access to among others individual investors indirectly has been done through transactions with dealers in the OTC markets and I wanted to highlight that it sometimes forms one or two different types.

One, using a pension plan as an example may do so by entering into an over-the-counter bilaterally negotiated contract, a swap agreement, of a form that will arrange for the payment to be made based on the performance of the index. In order to qualify to enter into one of these bilateral OTC transactions, the counterparties must qualify as what are called eligible contract participants under Section 1(a)(12) of the Commodity Exchange Act. As the Commissioners all are well aware, this was a definition that was incorporated into the Act under the Commodity Futures Modernization Act after Congress amended the Act in order to address concerns that existing in the industry regarding the legal certainty of swaps that people had raised prior to such amendments. So in order for an entity to enter into a bilaterally negotiated contract of this type it would have to be what is often referred to as an ECP.

The other type of product that is often offered to types of institutions are structured notes. Structured notes would come generally in the form of a note that the pension plan might pay the principal amount of where the return is linked to interest rates as well as a return based on a formulary return based on the actual index. In order to issue the note essentially the issuance must be subject to various SEC regulations here in the U.S. For example, the note might be registered with the SEC and therefore made available to a broad class of investors subject to the various types of protections such as prospectus delivery and the like. Similarly, the issuance might be pursuant to SEC regulations that would permit providing the note under other conditions such as the party would have to qualify as an accredited investor under what's called SEC Regulation B or may be sold pursuant to the private placement rules of the SEC. I don't want to go into obviously the details in the interests of time, but obviously there are a number of regimes that address that.

I thought in the interests of time I'd just like to summarize that the structure is similar to what we've heard Dr. Fenton describe with respect to the swap dealers may use the futures markets on the designated contract markets or other exchanges or perhaps contracts with other dealers in order to manage the risk of the payment of the transactions whether it is from acquiring the exposure under the swaps or the notes. With that perhaps I'll just turn it back to yourself, Mister Chairman, if you want to open it up to questions.

CHAIRMAN LUKKEN: Thank you, Bill. Let's open it up to questions both from the Commission and around the table. Any thoughts or comments?

MR. COTA: This is a question for Don Casturo. When you were talking about the who in the market and you listed investment funds, endowments, foundations, high net worth, where do sovereign wealth funds come into that?

MR. CASTURO: They are participants in the commodity index products market as well. I don't believe they're any more significant than the other classes of investors within that space, and again, it just broadens the depth and the diversity of who participates in commodity index investing. index investing.

CHAIRMAN LUKKEN: John?

MR. HEIMLICH: I think most of the

people around the room agree with the statement that in the end, fundamentals are what's determining prices, but I think there's an issue on timeframe and I think we need to amend that to say that it's perception of the fundamentals that determine the prices. Just today Mr. Casturo's very talented agency raised the forecasts for short term for this year to 122 per barrel I believe for crude oil and next year to 126. In December they were at 87 and I think they've been playing catch-up and I would have to believe part of the reason is that historically all their resources have been poured into looking at physical supply and demand fundamentals and they're trying to get more resources to capture risk and dollar and financial contribution.

What I'm getting at is if these very companies which do a terrific job for their clientele have the ability to influence perception of supply and demand fundamentals by putting reports from their research arms that may benefit the trading arms, isn't it more than just the actual inventories around the world and what we do or do not know about places like China in the sense that they have the incentive to read the news or interpret IEA reports with a somewhat bullish lens. I'm not saying that there is impropriety, but it's part of the perception of how tight the markets are and what you expect for a price. In particular in the last month or so it has been precipitated large spikes of investment money by research reports predicting something analogous of a super spike. Isn't this an inherent conflict we face as long as there are particular exemptions on position limits?

MR. CASTURO: I'd first like to say that there's a very clear separation between our research department and our trading department. We act well within the laws in terms of having no advanced notice whatsoever, no insider trading advantage whatsoever to what our research is publishing. Secondly, I would just offer that index investing as I'm trying to point out with the separation between the spot curve and the forward curve, if the physical markets really did not demand these products and these prices and the index investor in the forward curve had driven them to levels that were unwarranted, when he went to roll those positions, the price that he would have to sell back to the market when he was doing his rolling mechanism would be significantly lower than where the forward curve is which could actually develop for a short period of time but ultimately the cost of that rolling would be so prohibitive that eventually the index investor would be motivated to exit those markets. In the oil market recently not only has that not happened, but when the index investor got out of the oil futures that represented where their position was, the physical market which was represented by the future heading into expiration actually outperformed the contract in which the index investor was in.

COMMISSIONER CHILTON: I have a quick question. This is totally out of left field. When Congress did Sarbanes-Oxley they separated the accounting from a government relations shop. I'm not sure that some people don't regret a lot of parts of that law, but that particular provision seemed to have made sense for people. I wonder about the same thing between the research arm and the trading arm. They clearly I think could have an impact on one another, and do people think, and I'll just throw that out to everybody, that that's some distinction that should be made either by regulation or law or not at all?

I'd got a question then, far be it for me to let it sit too long, for Mr. Fenton. John, you said that swaps traders who are hedging their swaps activity with index traders were considered commercials because of the swaps activity. Do they have a hedge exemption, and if so how many of them are there?

MR. FENTON: In the energy markets, for example crude oil, there are no federal limits so swap dealers would not pursue a hedge exemption with the CFTC. In the ag markets where there are federal limits, swap dealers can and have applied for hedge exemptions in those cases related to index trading. There have been more hedge exemptions because it involves multiple commodities, but 12 to 15 entities have requested such hedge exemptions.

I just want to point out that it's not just index trading that would be at issue here, but any OTC activity, that it may not related to index trading but that also could potentially qualify for hedge exemption.

MR. COTA: One of the concerns that we've had in general, and this question is going to be Morgan Stanley and Goldman Sachs because they're the best at what they do from what I understand, I normally trade in the physical market so the aspect of the index funds and the derivative types of programs I'm not as familiar with. The concerns that have come up recently are with the increasing flow into the commodity markets in general from former equity markets and former dollar trades, that as this flow comes into what is a relatively small market, how do the roles of margin accounts and the derivative programs affect the multiplier effect as it moves into these markets? Because eventually things tie out to the commercial markets and I know how DCM works, but I don't know how this works. Is there an increased amount of leverage and how does this flow increase the total value?

MR. MCCOY: From what I understanding in talking about traders, the positions generally are unleveraged and of course they're selling out of the spot position shortened buying the deferred month long and I would assume therefore it wouldn't have an impact, but Mr. Casturo, do you have any additional comments?

MR. CASTURO: I think the key point that you made is that by and large these investments are fully collateralized, that they represent money that these entities actually have and have put 100 percent into the commodity space. Us as hedgers may not have to put up this same cash because we're hedging with the futures market, but we're only doing that on behalf of fully collateralized unleveraged participation on behalf of our clients.

MR. COTA: So there's no leverage with these groups moving in?

MR. CASTURO: No, by and large there is not for the end investor.

MR. COTA: I'm not sure I understand that fully, but I'm a quick study and I'll work on it.

CHAIRMAN LUKKEN: John?

MR. HEIMLICH: Just to clarify, Dr. Fenton, I'm not sure I heard you right. Are there or aren't there position limits on oil contracts?

MR. FENTON: NYMEX has position limits during the last 3 days of expiring futures. Those limits are 3,000 contracts. For single months and for all months combined there are position accountability rules. There are not hard limits. I think the number there is 20,000 contracts. Dr. Newsome perhaps can talk about what NYMEX does to implement those accountability rules.

MR. HEIMLICH: Depending on the

intermediary, aren't some exempted from those limits that are in place?

MR. FENTON: Yes, NYMEX grants hedge exemptions during that last 3 days.

MR. NEWSOME: I think the confusing comment was the federally mandated position limits which are mandated in the ags. The others, energy doesn't have federally mandated position limits but we have internal position limits. So the end effect is the same that there are position limits.

The only exemptions that we give are to commercial participants who show the ability to either make or take delivery from a physical component and those are the only exemptions and we consider those on a case by case basis and make those exemptions based upon that need to either make or take delivery of the physical product.

MR. FOX: Staying with that for a minute, John, the last bullet item on the last page of your presentation said that ICE Futures Europe would be providing position accountability levels. Those are soft limits as we say. What

I'm asking is are you going to be getting the same information from ICE Futures Europe on the 3 day limits which are hard limits, and let's be frank, they're a lot more onerous?

MR. FENTON: First of all I just want to be clear that I didn't mean to imply by that bullet that ICE Futures Europe was implementing position accountability rules. I think the idea is that when there's a position that would be at or above the position accountability rules that apply to the U.S. exchange, in this case NYMEX, that we would be notified.

It is my impression that we would be notified for positions above the spot month 3,000 contract limit. I think it's a good thing that we be notified. I think it's an affirmative action on the part of ICE to do that, but we will be getting the large trader data. We will have seen it for ourselves. We will know that the position is at that level.

CHAIRMAN LUKKEN: Dr. Newsome, and then a couple of Commission comments.

MR. NEWSOME: Thank you, Mister Chairman. I wanted to follow-up on Kevin's question. I guess at the end of the day, getting the information is one thing, John. How will you use that information particularly if you have concerns about the positions?

MR. FENTON: I think if we had concern about the size of the position on either exchange or in combination, we would pursue it jointly with the FSA to take action in both markets if that were necessary so that I think it would be a collaborative effort on the government regulators and ultimately the exchanges themselves that the right think be done, but I think it would involve joint activity.

COMMISSIONER DUNN: John, if you would pull up your second slide which is your commitment of traders report on NYMEX crude which is the WTI. ICE has somewhere between 25 to 35 percent of that contract in their market. What do you see in this commitment of traders report from ICE and what is reported in this?

MR. FENTON: There is nothing in this report regarding ICE's positions. There are just positions on NYMEX.

COMMISSIONER DUNN: So we're not seeing somewhere between 25 to 35 percent of the total package then in this report?

MR. FENTON: No, not in this report.

COMMISSIONER DUNN: Will we be able to see that as we begin implementing this new agreement that we have with FSA and ICE?

MR. FENTON: I think we'll have information that is similar to the information that goes into this report, so internally we will have this kind of information, but we have produced commitment to traders reports for the markets that we regulate.

COMMISSIONER DUNN: But it won't be transparent to the rest of the consumers at large then?

MR. FENTON: If we didn't make it public, it wouldn't be known to the public.

COMMISSIONER CHILTON: On this vein I've

got a question for Dr. Newsome and Mr. Short. Let's step back. Whether or not there's anything going on in the look alike contracts, we don't know and we're gathering this information, but I'm going to set the stage. Dr. Newsome, say you had company X that had trading positions on NYMEX below the position level, but since we don't have similar position levels on ICE Europe, if those were say twice the amount of the position limits that you have on NYMEX, would that be a concern for potential manipulation of the crude oil market?

MR. NEWSOME: Commissioner, I think certainly it wouldn't necessarily indicate that there was manipulation, but it's one of the primary tools that both we and the CFTC utilize to evaluate whether or not there is possible manipulation. So the bottom line answer is, yes, that would cause concern and we would think it should be looked at much more closely.

COMMISSIONER CHILTON: So then we have the situation where, and again this is theoretically, company X is just under the position limits on NYMEX, they've got twice or two-thirds as much on U.K., then we've got to work with as what Mr. Fenton was saying with the FSA and with ICE to try and reduce that. So that makes it sort of difficult because as Mr. Arbit said, we don't have the legal certainty, in fact we have legal certainly in the negative, we can't regulate a foreign board of trade now. We can work with them with our no action letters, et cetera, but we don't have the ability to tell ICE and the U.K. you have to set position limits and you have to reduce them. Before I go to Mr. Short, as I do have a question for him, I just wanted to ask Mr. Newsome one more. So you are on the Dubai exchange. You have a no action letter for a WTI contract there that's not trading yet. Do you or will you have position limits on that and is so what will they be? Will they be akin to, if you have them, the positions on NYMEX?

MR. NEWSOME: Currently with regard to the Dubai Mercantile Exchange, WTI is not traded.

We only trade the Amman physical contract. If and when a WTI is traded of which we do have regulatory approval to list a cash TI, we have not listed it yet, when and if we do, we will submit large trader reports and have position limits similar to what NYMEX has today.

COMMISSIONER CHILTON: Mr. Short, one, this information that ICE has been providing via FSA is very helpful. We thank you for it, you've been cooperative, and we look forward to improving it both in how we receive it and looking at what we think will be helpful. Feel free to comment on anything I've asked now, but I'm interested more in your global perspective. We don't produce all this oil in the U.S. This is a global oil market. How are we going to deal with that in the future? These are 24-7-365 markets around the world. How do you think we should be looking at that as regulators and as an industry?

MR. SHORT: I'd be happy to answer that. Just quickly giving some background information, ICE Futures Europe presently has a position management system. It's not exactly the same as the NYMEX system. We look at contracts, the first PROMOF (?) contracts coming into expiration and delivery and positions are monitored with an eye toward preventing distortions. Getting back to the question that Commissioner Chilton asked about what would happen if NYMEX saw a position being exceeded and had a concern about manipulation or distortion in the market, I assume there would be a dialogue with the CFTC. If we had a communication from NYMEX, the CFTC, or the FSA that they thought that a market participant was engaging in any kind of manipulative activity and needed to be ordered down, we would order that market participant to decrease their position, no two ways about that. There should not be any concern about actually enforcing either NYMEX or going back the other way if we had a concern about market manipulation about that order being carried out.

Just getting back to your last question about how do you get your arms around the crude oil market, I think it's a very good question because crude oil is by definition a global market. We in this country import I think it's approximately two thirds of our oil that we consume so the idea that you can regulate crude oil trading just by looking at one contract or one market I don't think holds up at the end of the day. There are lots of other parts of the world that not only use the WTI contract, but they use our Brent crude futures contract. And ultimately I think any legislative or regulatory solution has to involve mutual recognition of regulatory regimes that are comparable and ultimately regulatory cooperation if you want to get your arms around the question.

MR. HEIMLICH: First of all, that last recommendation I completely concur with, that we need to look at this in the global context. Perhaps ultimately it's going to take a treaty or some type of global agreement. I think a lot of this activity is going to be over the counter too and it's not going to be enough to address ICE and

NYMEX or even Dubai. By the way, I do believe you have regulatory authority over U.S. persons or U.S. entities who trade abroad and that's one way of doing at this.

Commissioner Chilton, I appreciate that you did get to a clarification of the question I had for Dr. Fenton about the new reporting initiatives which as he and Dr. Arbit were I was saying this is a wonderful step in the right direction, but it does sound like it's more transparency to the regulator but not to the general public and I would suggest that it's still short of full transparency. So for example when Mr. Harris goes up before the Senate and testifies and talks about growth in commercial net length versus commercial net length, we don't have the level of granularity to say is this right, is this wrong. We need I think as the public to be able to dig into this new level of reporting granularity that the regulators themselves will, otherwise it's in the dark.

Lastly, if I could just add, if the

majority of people around the room think that 137, 150, or 200 is completely supported by fundamentals out there, I have a tough time believing that it's very hard to find someone in the production business, and perhaps Mr. Felmy can comment, who can tell me that the marginal costs of production of a barrel of oil these days is triple digits or at least above 110 or pick your number, but I can only take that inversely as the conclusion. John, can you shed some light on that?

MR. FELMY: Certainly for most of the production it's not, but that's not the point. It's the fundamentals of supply and demand irrespective of the cost of production. This is a very complex issue and there are a lot of very smart people on both sides of it, but in terms of that I just look at if you really believe that the price is artificially high for any reason then think about your econ 101's supply and demand curves. Then you have a situation where supply is greater than demand and you should see something happening like inventory accumulation. We're not seeing that. Or is it perhaps that producers are managing the situation so you don't have inventories? Or is it a vertical demand curve in the sense of extremely low? That's possible. Or finally it is just the data is bad? So those are really the fundamentals you've got to sort through, otherwise just from simple econ 101, I can't disagree that it's the fundamentals.

CHAIRMAN LUKKEN: I just want to comment too about the commitment of trader data and the information we're receiving from FSA. Certainly we want first to get the information, to improve it, to increase the transparency so that we understand the participants and the end users in the markets. There's a separate question of whether we then publish that for the public as part of the commitment of trader reports and that's something we'll consider. I don't want to make it sound like we've made a decision yet. We have not crossed that bridge yet as the Commission. There are things we'll have to consider what the public value of that might be. But certainly that's something we'll consider as a Commission and try to make decisions as that information is improved. With that let's turn to Laura Campbell.

MS. CAMPBELL: Thank you. My question is for Mr. Casturo and Mr. McCoy. When an index fund rolls forward, how far into the future do they roll forward?

MR. CASTURO: Within the construct of the benchmark S&P/GSCI, in the case of oil it's from the first to the second year, by some of the other commodities it may skip a year or two, but key factor is the benchmark ones are always rolling from the first to the more deferred either second or slightly further contracts. The modified rolls that over-the-counter and swap dealers are now starting to implement are rolling them a little bit further out the curve. We have things that go in the case of oil out to the sixth or twelfth year -- but generally it's first to second or third.

MS. CAMPBELL: Thank you. I guess my concern as we're talking about economics 101 is that there seems to be a lot of money that's in the short term and not in the long term. It also occurs to me that if you are an investor and you're looking for this exposure, why not just invest in an oil company like Exxon who I think goes to great lengths that they follow that, they don't do any hedging themselves, such that we can bring the supply and demand picture back to where we have more supply? Do you have any sense on the commercial side why you have more people rolling to the commodity side as opposed to equities?

MR. MCCOY: I think as Mr. Casturo had indicated and I think our traders are seeing the same that the primary interest that we're getting from institutional investors is broad diversification, diversifying their equity in bond portfolios and with other interests and to protect against inflation as well. So conceivably they could take the course of just a broad diversification in the equities market, but they're seeking diversifying further.

MR. CASTURO: I would add that companies like Exxon are not capital constrained, they don't need the investor to make infrastructure investments, and what the investor in the commodity space is doing is giving them the signal that it's a safe environment to put their capital to work in investing in infrastructure because the forward curve price provides some certainty that they'll return to employ that capital.

CHAIRMAN LUKKEN: I think Laura raises a good question though and I think it's something that the Commissioners think about too, these practices developed by index traders over the years developed many years go, the 5 day Goldman roll that everybody is familiar with and how the two nearby months -- my question is do we need to rethink the practices of index funds and how they enter the market? I think concerns in the public are maybe this is an elephant sitting in a hot tub, that it's sort of raising the water level for everybody here, but are there ways to displace that? If you're looking for broad exposure, it should be a 5 day roll, should it be a 10 day roll, should it be a 30 day roll, should it be in multiple months that may help actually the commercials in farther out months looking for exposure over the long term that maybe benefit from that liquidity that you bring to the markets that we agree that is beneficial? Are these some of the things we should be thinking about as to how index traders develop practices and how they come into the markets?

MR. CASTURO: I think the industry has already addressed that with what we're calling enhanced strategies. The OTC business on our desk right now is only 50 percent invested in the generic initial benchmark indices and the other 50 percent is modified rolling strategies that get exactly to your point. So whether we did it on an OTC basis or the benchmark strategy is really the difference that we're talking about. I think it actually makes more sense to do it on an OTC basis, again going back to my point of the diversification. If we try to do it on the benchmark then we just have a concentration in different places because there would be only one possible solution, that one benchmark, and by doing it OTC we can customize and let people distribute their investments all over the curve on a case by case basis.

COMMISSIONER DUNN: Mr. Casturo, your handout I found very educational. It was very helpful to me. But I'm wondering as we have the notional values of these as they increase in value in the example that you gave from January 2, 2007, to June 5, 2008, where it went up $73.74 billion. Then I go back and look at the initial investment or the weight of the initial investment in commodities. Are those readjusted over the time? Say you start off with 20 percent crude oil and 5 percent wheat, the crude oil does very good, the wheat doesn't do well, do you readjust to get back to this original pie during the course of holding this index?

MR. CASTURO: Yes, the index is

continuously rebalanced to make sure that the returns are representative of the index distribution that's the targeted index distribution of commodities.

COMMISSIONER DUNN: And that's done during the roll?

MR. CASTURO: Yes.

CHAIRMAN LUKKEN: Just to clarify, products that have increased proportionally higher than other commodities you're actually selling into this markets versus buying into others that were underperforming? Is it countercyclical in some ways?

MR. CASTURO: The mechanism you're describing is correct. To keep the ratios -- where they're targeted ratios, if one were to overperform -- the one that underperforms, there would be some redistribution of that.

CHAIRMAN LUKKEN: And a related question, too, we saw a very large run-up in prices on Friday to over $10. Is that something that index trading typically -- it sounds like it's sort of the buy and hold strategy. Is that something that index traders get involved in and that's sort of a one day price move or were index monies putting more money into that market during that period of time?

MR. CASTURO: I guess my only comment on that would be that the typical index investment is by nature of the participants in index investing done on a much longer term time horizon and it's usually the process of a board approval to put their endowment assets or pension fund assets to work and not really relative to any short term price signals in the market.

CHAIRMAN LUKKEN: I wonder if your government observers have any thoughts or questions or comments? Guy, do you have anything to add? I'll take two more comments and then I think we're going to take a short break for some coffee and let everybody break. Let's first turn to Paul Cicio, actually.

MR. CICIO: This has been very helpful. Thank you. There are still a lot of things I'm not sure I quite understand, but it's helped my educational process. I think what I'm hearing is that index funds are not contributing to the higher price of natural gas and crude oil. And at the same time, crude oil, you have the major oil companies saying that it should be somewhere between $50 and $70, you have OPEC saying that they think the price should be $70. On natural gas it's not a global market, it's a regionally priced product. We have adequate supply versus demand, adequate inventories, yet over the last year we've seen a 65 percent increase in the price of natural gas. So something fundamental has continued to happen or evolve in the marketplace. If it's not index funds, what is it? I don't have the answer, but I hope we do get there. Thank you.

CHAIRMAN LUKKEN: Skip?

MR. HORVATH: Yes. I actually have a pretty basic question for John Fenton. John, when you talked earlier about I'm going to call it anecdotal evidence that there's no correlation between the curves you showed and the price of the commodity, is there more rigor behind that in terms of have you analyzed, put a correlation on it, you actually showed a negative correlation, is it negative or is it zero, and for other commodities as well and not just oil?

MR. FENTON: My surveillance group has not done that. I think our chief economist folks have looked at categories of traders and I believe it includes index traders and have not found a correlation. I think that actually in their case they're looking at within a market, trading activity, not across markets, but within a market do changed positions correlate with or associated with price moves. I wish they were here but I think generally they have found that both managed money traders, a subgroup of speculators in general or larger professional managed money traders, have found that they don't tend to lead prices. I'm not sure if they're done the same thing for index traders, but the long and short of it is I think my group monitors trading day to day and positions day to day, and yesterday's trading activity is an example now. I frankly had not looked at the data to say on Friday there was any reason to believe index traders were involved in the market. I suspect they were not. So in dealing with experiences in the various markets -- appraising market earlier this year, we have not found that when for example wheat prices or crude prices are particularly strong that it's associated with the build-up of index trader positions.

For the reasons I mentioned earlier, we don't have a complete handle on index trading. The data is not good enough for the energy markets and we're going to be improving it. But in the ag markets where I think the data is quite good, we have not seen a correlation between trading of index positions and price moves, but it not based on a rigorous study, it's based on watching the market and a feel for the market.

MR. HORVATH: I guess the follow-up question is, and maybe you can't answer this and maybe it's not even appropriate, but why is there this widespread perception among the press and on Capitol Hill that there is a strong correlation? It seems almost to be conventional wisdom at this point.

MR. FENTON: That probably isn't for me to answer. In a way it's understandable. The feeling is if there's $200 billion or whatever the right number is that has come into the market in the last few years and it's all on the long side, I think the view is it's too much money chasing too few goods and that doesn't necessarily have to have an upward price effect. I think there are some flaws in that reasoning. I'm not completely dismissing it as a possibility. Certainly we're open to the possibility that it is having an effect on the market. But futures markets and futures contracts are not fixed goods or fixed demands. Your effect on the market is if you're a buyer, first of all, you don't want an effect on the market. You don't want your buying to be at ever higher prices and ultimately your effect is the amount of price effect that is necessary to draw liquidity on the sell side. Then one could imagine that it must have some effect when it comes into the market, but does it persist? Is it embedded thereafter in the price or does it dissipate?

CHAIRMAN LUKKEN: One more question and then we're going to take a short break. Commissioner Dunn?

COMMISSIONER DUNN: I had to ask you when I saw your presentation if you'll go back to your first slide that you have of the increase in the price of crude oil. Looking at that I'd asked you to prepare a similar chart based on the value of the dollar versus that of the euro. Do you have that chart with you? I know you're not here to try to determine what is causing the increase in crude oil, but it certainly is an educational piece for me to see that the U.S. dollar is about 48 percent of that of the euro and it would occur to me that our monetary policies have a great deal to do with the run-up in price of crude oil.

CHAIRMAN LUKKEN: Let's take a break. There's plenty more to talk about. Fifteen minutes for coffee and then we'll jump right back into it.

(Recess)

CHAIRMAN LUKKEN: Welcome back. We're going to try and pick up on some of the topics we were already discussing and I wanted to start by talking about the Foreign Board of Trade program issue that we had raised earlier in the program. The program that we've developed over time, obviously we are trying to in a global atmosphere develop a network of regulation around the world that recognizes globalization. Something that has been happening here at the CFTC since 1996 is our Foreign Board of Trade no action process to allow U.S. customers to foreign boards of trade overseas. Obviously the WTI contract listed on ICE raised some questions 2 years ago and we did a thorough rule making and hearing to try to address some of those concerns. But my concern is by shutting off that type of a program we may lose access to all of those markets and I'm not sure we can really control the flow of money to those markets even if we decide to turn it off. I may not like the evening news, but turning off the TV does not stop the news from happening. So I want to make sure that we have a found program that makes sense, that's getting us the right regulatory information to do our job to ensure that there's not manipulation in the markets, that people aren't gaming one market against another.

I thought it would be useful to turn to an unlikely suspect to talk about this issue who is Jim Newsome, somebody is competing against somebody who is operating a foreign board of trade, delisting a contract in competition to Jim. You've had my seat before. We're trying to figure this out. Are we doing the right things? Are we asking for the right information? I wanted to talk about you, that if we did shut it off, what would be the ramifications not only for us in the U.S., but also what would your competitive ramifications as you try to seek access overseas and in other markets that may retaliate against such actions in the United States? I just wanted to get your views on this issue.

MR. NEWSOME: Thank you, Mister Chairman. I'm more than happy to give you my views, and fully recognizing that it is a very sensitive topic. Also recognizing that the no action process has worked very, very well for both U.S. markets as well as foreign markets and provided the kind of access to differing customer bases without having to become regulated entities of that foreign jurisdiction.

I think you are asking the right questions. If anything, I might add that maybe you're a little bit too sensitive in the way you're some of the questions, and I'll raise a couple of those thoughts. Certainly the big fear from the exchange standpoint, I know a fear of the Commission is that if you get too strict with regard to requiring foreign boards of trade to come in from a regulatory standpoint, then U.S. exchanges open themselves to retribution from other foreign jurisdictions who make it more difficult for us to access their customers and certainly that is a concern. Certainly that's not a path that we want to go down because right now it's a very open marketplace with all legitimate exchanges having access to global customers.

Some in the Congress have brought up that there should be a revocation of foreign boards of trade no action letters and I think that's the worst thing that could happen. I do think there's appropriate middle ground. The Commission is asking the questions that you need to to find that middle ground. But I guess when we raised the issue 2 years ago when there was a debate here at the Commission and among industry participants, a lot of people made it seem like it was a competitive issue between NYMEX and ICE and we never took the position that ICE shouldn't have the ability to list the contract. Our primary concern was unfortunately pretty much the situation we're in now in which the CFTC and therefore the U.S. Congress doesn't have access to transparent information on key U.S. contracts.

To me when you look at the foreign board of trade recognizing that it serves a very, very important role, I thin it's a slippery path to take if you started saying should we have to bring somebody in who's currently under the no action and require registration? That's a path that I don't think that we should go down. However, the reason that people come in for the no action letters is because they want access to U.S. customers and I think that's big stick for the Commission to have without requiring registration. I would contend that those no action letters could conditioned to say we're happy giving you access to U.S. customers but in cases that the Commission determines appropriate whether it's the sensitivity of the contracts at heart to say but for this access we're going to require large trader reports so that market can be completely transparent and we want to make sure there is some kind of position accountability.

Really the tools that John and his group use in market surveillance every day is the cornerstone of what the Commission does that I think is an appropriate tradeoff for access to customers here. So in general, Mister Chairman, those would be my thoughts.

CHAIRMAN LUKKEN: I think the Commission recognizes we're always open for improvements, enhancements and we do the best we can based on the information we have, but we want to always try to improve the program and harmonize with other regulators on how we oversee the market and that certainly is evidenced by our recent announcement on getting better data. Paul Pantano, I think you also had some thoughts from FIA's point of view on this issue.

MR. PANTANO: Yes, thank you. First I'd like to call everyone's attention to a statement the FIA issued today which is related to this topic, supporting the Commission's efforts to improve price transparency and enhance market surveillance. The FIA believes that the Commission's approach to the foreign board of trade issue has been productive in a number of ways some of which former Chairman Newsome mentioned, but it has definitely increased trading opportunities for customers, it's promoted some interesting developments in electronic trading, it has promoted competition among exchanges which is always a good thing for customers, and it has importantly fostered improved cooperation among international regulators. Commissioner Dunn pointed out today that this is an international issue that the Commission is struggling with and I think you've seen the benefit of the approach the Commission has taken with the recent agreement with FSA and ICE Futures Europe. We can't pretend that these other jurisdictions don't exist as you just pointed out, and it's important for the regulators to cooperate and obtain information in a number of different ways. John Fenton's slide today identified all of the enhanced information that the Commission is going to receive as a result of that agreement and if the Commission were to heed requests by some parties to withdraw no action requests, the Commission is going to lose access to all of that valuable information.

CHAIRMAN LUKKEN: There are a lot of traders around the room. I'd just be curious, what do you choose one market versus another? Is it price? Is it liquidity? Do the regulations, the rules of the road of the market matter that it's going to drive you to ICE because it's less onerous? There aren't the position limits in the last 3 days of days of trading as has been indicated. What are the factors that bring you to one place versus another? Any thoughts?

MR. STAINTON: I think maybe it's helpful just for me to brief description of how we run our business. Within the energy team at Citadel we're a fundamental investor so we spend our time evaluating supply and demand and making our investment decisions based off of that. So as we look at the different markets we can access, what really brings us to markets is transparency, liquidity, and oversea friction (?) costs. So those are really the driving points that bring us to the market and so as we evaluate the different instruments that we can use, those are key metrics for us.

CHAIRMAN LUKKEN: Bo, I think you had a comment.

MR. COLLINS: One of the huge drivers for any trader just simply because of the transactional nature and cost of transactions is liquidity, and liquidity is a funny animal in that it sort of begat -- so in the construction of any market or any contract for that matter, you end up reacting as a trader to a lot of very, very small nuances and subtleties and this is where I think it's reasonable to have a keen awareness of the potential competitive forces in foreign jurisdictions because once a moment of liquidity begins to shift to another jurisdiction or another exchange, it becomes very, very difficult to recover, and I would say simply the formation of liquidity is probably the biggest driver of what traders pay attention to in terms of where they want to conduct a transaction.

CHAIRMAN LUKKEN: Much has been made too about the fact that ICE is a cash settled contract not requiring physical delivery of the West Texas crude oil versus the NYMEX, the physical contract. Does that matter for regulatory purposes? Obviously we have position limits that are meant to ensure that one trader is not able to hold in the last month of trading a position that could corner or squeeze the market. That has been around since the beginning of the futures markets and the Hunt silver crisis and everybody knows about examples of those types of corners and squeezes. But should it matter from a regulatory point of view whether it's cash settled versus a physical settle? Do limitations still matter, the position limits in those types of market?

MR. COLLINS: I would say they certainly matter. It's something that you want to play close attention to. I do think ultimately it's important for a commodity contract to reflect the fundamental economic forces of the commodity it represents. So ultimately within the construct of either a contract or a series of contracts, you want one or some of them to be reflecting the physical activity of that flow of commodity and that's handled either through the reporting of indices, it's handled through physical delivery, or it's handled through having a series of contracts that relate to one benchmark as they do in the case of WTI and NYMEX. NYMEX has the physical contract that sets the settlement for the WTI contract and if you go through termination with a position in that contract, you're required to deliver it.

CHAIRMAN LUKKEN: Johnathan Short and then Sean.

MR. SHORT: I just wanted to pick up on one point that was made about liquidity and just give some people a perspective about ICE futures and Europe's markets. In talking about WTI, I would just make sure that people know that our other contract, the Brent crude futures contract, we have the deepest liquidity in our markets for that contract and a lot of the trading that occurs on ICE Futures Europe is actually spread trading between the Brent crude futures contract and the WTI contract and related trading. So I think that's one of the reasons that some people have looked to our markets.

MR. COTA: There is becoming a disconnection between the physical markets and the financial aspects of these. I was recently talking with an investment banking person and they said really right now there are three world currencies. There's the U.S. dollar, the euro, and commodities, and in particular energy within those commodities, and that you can have an economic model where you have demand destruction in the underlying commodity that won't affect the economic model of the financial instrument particularly if that physical portion of the market becomes a smaller and smaller portion. I'm almost unique in the trading environment where I'm actually taking physical delivery and bringing it out to the retail consumer but that's a very, very small amount. One of our concerns in the heating oil industry which although there's plenty of supply and just so you all know there's been demand destruction, sales are way down and EIA data is all delayed and I've got people chopping wood everywhere, so wood is going to replace me.

So what's happening is that as the financial models for these types of trades become a larger and larger portion, our supply network in hearing oil in particular more so than the other commodities relies on the physical delivery contracts and if the physical delivery contracts become marginalized because the financial segments overtake that so people no longer even care about the physical delivery, then I've lost my supply and that's critical. I think you're seeing it somewhat in the grain elevator scenarios where they've said we're not going to price off from the CME contracts, I think it's CME, because it's now to the point of ridiculousness that we're not going to be able to supply in these sorts of volumes and there's a disconnect and I'm afraid that we're getting the same disconnect. My concern is by the time that the large players, the investment funds that are doing the long term buying one directional, going long only, finally realize that there's been complete demand destruction, the market is going to collapse in a very short order and this bubble when it bursts is going to do it in a very disorderly way and I'm not sure how that serves either the economy, I as a person who buys futures contracts, or even the traders. We need to deal with that issue some place. There is a large group that is dominating the industry to the point where the physical markets are almost immaterial.

MR. HEIMLICH: I think this comes back in part to the transparency issue. I think everyone agrees here that we don't want to to the extent we don't think there is a problem and we don't want to push it to outside U.S. Borders, so I think one suggestion is to have a global consolidated commitment of traders report that is sufficiently granular to understand the categories of trades going on regardless of what geography they originate. I know that's a tough task. And it should be able to account for the fact that still I think oil on foreign boards of trade is not subject to some of the closing we had in the Farm Bill. We should look at the exemptions on reporting requirements, and I think the threshold is set too high now so that whatever that consolidated report ends up looking like, it should capture regardless of whether you're a large trader or not.

CHAIRMAN LUKKEN: We do capture a lot of -- I think John said 97 percent of the oil markets and I think it was intended to ensure that we get the large traders who can manipulate the markets, so that we would have to evaluate obviously what cost and value that getting that extra 3 percent might mean, but certainly the point is well taken that transparency is important for these markets.

Foster, I know you've been interested in commitment of trader issues as well and I'm going to pick on you since you're close to me. Do you have thoughts on what we might be doing differently in this area?

MR. SMITH: I think we hit on it a little bit before break, and unlike Don, I didn't have the benefit of preparation since I only found out a few minutes ago that you were going to call on me, so everybody will be pleased that that will probably keep me brief.

I think a lot of my peer group and colleagues over the last let's say 5 to 7 years probably all would agree that the information that's contained in the commitment of traders reports has become increasingly less useful and that's just been a function of industry participants changing and perhaps, I don't want to say you guys not keeping up with that because that's sort of an admonition and that's not what I'm trying to say, but that's why you're asking us how can we change it to perhaps make it a little bit more useful and I think a step in the right direction is the sort of collaborative agreement that you guys have announced with the FSA and that's great that you're going to be getting the information with respect to the WTI look alikes. But as someone else pointed out a little bit ago, if you just use that for your own kind of consumption and don't take the step to disseminate it in a more broad fashion then I think it really doesn't benefit the right people. So I for one would like to see just like for example 3 or 4 or 5 years ago when the NYMEX introduced the NN contract which is essentially the NYMEX look alike swap although I do think it's a futures contract that's just cash settled, you guys have included that Henry Hub swap in the composition of the COT report and I think that's added to the usefulness. But again in the interests of transparency and trying to see the big picture, it still is not telling the whole story if you look at futures and options combined and you look at swaps and I guess the NYMEX Cleared, the LN contract, options combined, you're still missing a large piece of what's going on. And to the extent that you guys are going to begin getting that information on WTI, I don't know, A, why you wouldn't be getting it on the nagas, and, B, why you wouldn't be disseminating it to the broader public.

MR. FOX: Let me start off by saying that I think the NYMEX is far more efficient today as a result of the competition from the ICE. Buy-ins are closing on 85 percent being traded electronically as opposed to calling down to the floor and executing in the pit, so that's a benefit that all traders are happy with.

To answer your question about physical versus financial settlement and whether it's important, I would say at least for natural gas it's critically important because most of the natural gas is priced on the last day. Most of the utilities, munies, co-ops, buy their gas at index on the last day or maybe on the average of the last 3 days or something along those lines. They really just want to buy their gas at the market so that their state regulators can be convinced that they were prudent in their buying practices and that they weren't speculating on flat price. It's important that the index that is settled at the end of the day represents the market, so really the last half-hour on the last day is where the bulk of the natural gas in the United States is priced. The limit for speculators on the last day is 1,000 contracts and that's 1,000 contracts for the entire entity. My firm, for example, has four different entities that trade natural gas and it includes option delta so you have to add up all the participants at your firm who trade natural gas including option delta and make sure that you are within plus or minus 1,000 on the last day. However, that does not apply to ICE. In fact, on the last day of trading I've seen some eye-popping volumes on the buy side and I wonder sometimes how people could buy such astronomical amounts of natural gas on the last day. Clearly you couldn't do it on the NYMEX because just the sheer size would cause you to exceed the limit, so that's why it's important that the limits apply to the financial settlements as well.

CHAIRMAN LUKKEN: Thank you. Obviously

I mentioned in my opening statement that we are implementing the Farm Bill provisions that would place responsibility on some of these types of contracts including the ICE natural gas look alike contract where they would be required to put position limits and accountability limits on these contracts after we do our rule makings in this area. Laura, I think you have your card up.

MS. CAMPBELL: Yes. I'd just like to add onto that you're exactly right, we do price most of our natural gas at that last hearing and I guess I'm wondering because there was a time when it was priced over a longer period of time. Perhaps there's a commercial reason why we've changed that, but I'm suggesting that perhaps it needs to be a longer period of time that we calculate that price. Frankly, we buy our physical gas often at the NYMEX price because we manage our basis that way, we do a basis swap and them just buy the physical at the NYMEX and it's great deal that natural gas is priced at that price. So unless somebody has a reason why that window has narrowed, I'd like for us to at least explore widening that window again.

CHAIRMAN LUKKEN: This is something I've personally been interested in since our ECM hearing last fall, why people benchmark off of certain periods of time on the markets and whether we can develop practices that might help smooth volatility for those who rely on these closing prices on the markets. There might be better ways to benchmark, and I agree that this is I think something that we need to address as a committee in the future about how we should look at these closing windows and how people benchmark against them. Comments?

MR. CICIO: I would just echo what was just said about the importance of trying to extend that from one day to a longer period of time.

Consumers are a suspicious group when you have high prices like we've experienced. We've already lost a lot of jobs, and CEOs from these companies are very concerned about maintaining their presence in the United States.

If you're not aware, we've lost 3.3 million manufacturing jobs just since 2000. That's 19 percent of all manufacturing jobs. Pretty shocking isn't it? A lot of those jobs were due to specifically the higher prices of natural gas. So we should to all we can to be responsive to helping price this product, and a longer pricing period would be helpful. It would make consumers a little more trusting of the system which they are not today.

COMMISSIONER CHILTON: Mr. Cicio, I'm curious, given that index funds roll their positions every month and that physical traders know that, doesn't that give a great comfort the traders to go long and to keep the price up over time?

MR. CICIO: Actually that's a good point. It seems to be based on the charts that we saw earlier that all those dollars are being rolled forward and it appears that most of it's long. So if I were someone who was playing the market in the business to make money off of trading, and that's not my type of customer, my customers need raw materials to stay in business and be globally competitive. But to me if I were a trader, that buildup month after month after month is pretty predictable and if I were a trader that probably would give me an impetus to consider more long positions than short. It's common sense.

CHAIRMAN LUKKEN: There are a lot of traders around the room. That seems to be the public perception that these long only funds are pushing up prices. Is that your view as a trader in the markets? Does it create sort of a piling on effect?

MR. CASTURO: I'd first like to address the physical future contract issue. We have every vested interest even as paper players that futures contracts represent the true physical fundamental price for that commodity, otherwise our business isn't really based on anything and even our clients would have that same thought. I'm not convinced that it requires physical delivery of the contract. If a cash settled contract gets its price from the physically delivered contract, then essentially you've accomplished that. But by all means, it's vital to us that futures contracts do represent the physical and have some element of conversion.

Secondly, to address the point about whether it's predictable that index investors are driving the market up and wouldn't you just get long, I don't know at what point you could actually do that because the index investor does sell back their investment in the first near by as it's approaching the expiration, i.e., the point where it becomes the physical market. So if you were investing in the physical and hoping to capitalize from index length, the fact is they're actually going to be selling back to the market at the time where you as a physical holder would be hoping to capitalize and the flow would actually go the wrong way.

CHAIRMAN LUKKEN: Satu and then John.

MR. PARIKH: I wanted to address a

couple things. The first was again the physical financial debate that we're hearing. I think again that it doesn't really matter as long as you have a proper index settlement that the contract refers to rather than actual physical commodity. For example, euro dollar futures are one of the most liquid futures contracts in the world and they settle to a price index. You don't actually need to get a deposit in the house to ensure that you're getting the appropriate price for your interest rate, and similarly there are many different contracts around the world, in Asia there are plat settlements to swaps, there is obviously the lean hogs contract which is cash settlement. So you don't necessarily need to have a physical delivery contract to have a liquid market.

The second thing is I think to Laura's point and to Paul's point, at the end if the day if you want a market price, you want the tightest window at the end point of the contract. That's where the market is at. So assuming there's no market manipulation and assuming that no one is actually gaining the actual settlement at close, you actually are taking more market risk by having a longer window. So if you want to take that market risk that's fine, firms like our firm and many of our competitors can price that. If you want a 5 day window or 20 day averaging, no problem we can price that. I think we have to be careful that we're sort of not imposing regulation on some of the more customized solutions that firms could provide.

MR. HEIMLICH: I agree with Don that it makes perfect sense that you don't want to have a large position that doesn't reflect your perception of the fundamentals, but again that comes back to my earlier point about perception of what the fundamentals are. In the good old days when it was just EIA and IEA telling us in just an occasional news announcement, that was our source of everyone's perception of how tight the supply-demand relationship was out there.

But things are different now, 24-7 news, the internet age, Wall Street analysts' reports ping-pong around the globe and very quickly people can change their perception of how tight the market is. I know this may not be a popular proposal, but since the room includes some folks from other government agencies, I think we should consider whether there should be disclosure rules of the positions held by some of the companies either by site or the commodity indexes of what their stakes is in these investments. Boone Pickens can come on the news without disclosing anything and say I think the market's right, it's going to go to $200 by October and without any really fundamental news out there about a real supply disruption or perceived threat of delivery risk, you see the market respond instantaneously. I think just as we have disclosure rules now on the equity side, for example, airline equity analysts have to disclose their firm's stock holdings and who they do business with, I think perhaps we should consider extending that to other types of asset holdings.

CHAIRMAN LUKKEN: Other comments?

MR. PARIKH: I actually strongly disagree with that. People have the right to take positions in different markets and not have everyone else know about it. I think people have views of the different markets, they have the right to express them in a public forum, and again I think the question is are people manipulating the markets or are they using their own inside information to affect markets and that's a different question. But I don't know that the answer to that having everyone's positions for everyone else to see. That doesn't make sense.

COMMISSIONER CHILTON: Mister Chairman, I'm curious, for the traders from Morgan, Merrill, Lehman, and JP, to what extent do you believe that the bilaterals in the energy space are having an impact on price discovery?

MR. SMITH: I personally don't think they're having any impact whatsoever. I think like some of my competitors here, we do an enormous amount of bilateral business on a daily basis that ultimately ends up being disseminated back onto some electric platform, you either see it on ICE or you see it on ClearPort or you see it in the futures pits. So by and large when you see price moves in a day that are sort of outside of the norm, there was a piece of business that came in and then it manifested itself in the price that you guys see and that everybody sees when they check Reuters or look up at CNBC, so I would say that there's no impact whatsoever.

CHAIRMAN LUKKEN: Michael?

MR. PROKOP: Thank you. I would also submit that I would say over the last 3 or 4 years since we've seen the advent of clearing both from ICE and the NYMEX, we currently as a facilitator of these transactions, bilateral as well as those types of transactions, we've seen a great deal of those now go to clearing. Upwards to 65 percent of nor natural gas transactions are now being cleared on both the LCH, the ICE, and on the NYMEX and probably about 35 percent of our electricity contracts that we're doing right now.

CHAIRMAN LUKKEN: Bob?

MR. PICKEL: I was just going to comment on the bilaterals. The exchange serves as a price discovery function and it effectively is a clearinghouse for information, so anybody who's trading on that exchange is sending a signal to the entire market. In the bilateral situation, the only person I'm sending a signal to when I trade is my counterparty and they may read that and in turn hedge in some way or I may decide I need to hedge by going on the market, but that's the relevant action that's going to provide information to the broader marketplace, not that bilateral trade.

COMMISSIONER CHILTON: Thank you, and I should have asked you first, so I apologize for that. But in my example earlier where you have company X, they're long WTI on NYMEX, they're long on the WTI look alike, on ICE, they've got some OTC transaction, they've taken a large bilateral transaction, isn't that something that we should be concerned about, that it might have sort of a tangential impact on price discovery? Is there some reason why it wouldn't?

MR. PICKEL: Drawing the connection between the activity on the bilateral which doesn't have that price effect and the trading on either the exchange or on ICE, I don't know that you can draw that connection. Ultimately parties will decide that a portion of their position needs to be hedged on the exchange and then they're sending that signal to the marketplace that in turn everybody will interpret and with drive prices up or drive prices down.

COMMISSIONER CHILTON: So you don't think it matters in the aggregate? If you take all of their positions including bilateral and what they're doing on the exchange, you don't think that matters at all?

MR. PICKEL: I think there's more relevance. If I have 50 trades I've done on a bilateral basis, I may hedge 40 of those through a series of bilateral trades leaving me in kind of a net position where I might go out to the exchange.

I think that net position that people go out to the exchange for is the relevant analysis.

CHAIRMAN LUKKEN: On that issue, it's my understanding and this group knows better than I do, but a lot of these bilateral trades then come in through ClearPort and other mechanisms to clear and at that point we then start getting the large trader information that we typically get on futures contracts. Do people have a clue of how much of the business is coming into the clearing system at a time when people are critical of the credit- default swaps and other interest rate swaps that have no counterparty clearing mechanism? I would think this is something we want to keep encouraging come through not only for the counterparty risk but also for the regulatory purposes of us getting this transparency to this information. Johnathan, do you have any more information on how much --

MR. SHORT: I was just going to say the clear trend in our business is toward blocking in those positions for clearing. When you look at

ICE over time and the amount of bilateral trading and cleared trading, clearly the trend is toward clearing and then even transactions that occur bilaterally off the market are not typically blocked in through ICE, and I think Jim would probably say that that's happening through ClearPort as well.

MR. NEWSOME: I don't think there's any doubt that there's a trend toward clearing. It's substantial already in natural gas and it's growing in some other contract areas as well. I think one of the key questions is that the cleared OTC business from ClearPort gets rolled into futures and is submitted as part of our large trader report and is counted against position limits. But the other aggregated OTC volume is not transparent, so I think the trend is good that it's becoming clear that again it all goes back to the transparency which we've been talking about today in terms of who gets to see it and how you can use it.

CHAIRMAN LUKKEN: Laura?

MS. CAMPBELL: Actually, I'm very pleased to hear that a lot of people are moving toward clearing through ClearPort of one of those mechanisms. From the utility perspective we like ClearPort. For the credit risk, the concern that we have and where we have to find some balance is cash risk because now we're subject to the margining and moving a lot of money very quickly is not the utility's forte, so then it becomes a limitation to us on the cash side and that's just something to keep in mind, but we do like the transparency that it affords.

CHAIRMAN LUKKEN: Thank you. Michael?

MR. PROKOP: I think you touched on something there, Laura, that it is to the individual corporation the decision whether to do bilateral trades or clear trades on their economic portfolio. Doing bilateral trades, extending credit risk out to individual companies obviously carries risk in itself and the cost of capital putting aside that money to make those payments. But then again having your surety of these exchanges whether it's the LCH or ClearPort, NYMEX behind that, to have those guarantee funds behind those transactions to make sure that they will settle and not have that risk of default that we saw. And keep in mind also these clearing mechanisms came to be because of the credit situation in the marketplace. After the Enron debacle and the market fell apart, individual counterparties that had swap dealer agreements in place could no longer deal with each other but really came in the next morning and had nowhere to get out of their positions. So I would submit that it is in fact a great mechanism for the marketplace. It's allowed a great deal of different types of individuals, companies, even utilities and what have you to participate in the market where they did not have access before whether it be a restriction on a swap dealer agreement or some type of restriction because of their credit picture.

CHAIRMAN LUKKEN: Mark and then Kevin.

MR. STAINTON: I just wanted to comment

on the reporting and some of the comments I've heard around the table. I think as I mentioned earlier what's critical to us in the marketplace is transparency and liquidity. I think we've had a good discussion around the benefits of potentially extending some of that reporting and increasing some of that transparency. One thing, and maybe I'm extending a little bit, some of the comments I've heard and whatever in the press recently, one thing I think we should be very cognizant of is to the extent to which we extend that potentially thinking about over-the-counter markets can potentially increase costs quite a lot in the system or if you're asking individual participants to report as opposed to exchanges, that actually could change the dynamic of the marketplace quite significantly.

Ultimately, one thing that I think would be detrimental to the market is if you increase costs to the point where you move the number of participants out of the market. One of the things that we value very highly is markets where there are a large number of participants and therefore you're much more likely to get a fair and balanced pricing process. So I think as we think about extending this that it's something that we should all be cognizant of.

MR. FOX: Back to Commissioner Chilton's question about the aggregate of the three positions, the NYMEX, plus ICE, plus OTC swaps. I think it's very important that you do consider the sum of those three in the context that they exceed limits. Once again I'm back to limits. The purpose of limits as I understand it is to protect the small investor or the customer, the consumer, and we have limits on only one of those three right now. So my first point is that overall limits are too low. I realize that may not be a palatable recommendation to raise limits at this point, but the fact of the matter is we have limits on NYMEX positions. To the extent you want to exceed that there are two other avenues on which to do it, OTC swaps, and on ICE. So the fact of the matter is the limits are higher than

1,000 so we do need to consider the sum of those three in order to achieve the objective which is to make sure that participants stay within a stated limit. I would argue that the limit is too low, it needs to be raised, and it needs to be all inclusive, that you should be indifferent as to where a trader chooses to trade whether it be OTC, ICE, or NYMEX. What is important is the sum of those three positions and that it needs to be within some limit that protects the interests of the small investor.

CHAIRMAN LUKKEN: Jim Newsome and then Tony.

MR. NEWSOME: Mister Chairman, I'm going to have to leave in a few minutes to make some meetings on the Hill. I just wanted to make a couple of general comments.

Regardless of whether we've talked about foreign boards of trade or delineation of further information that's included in the large trader reports, I think mostly importantly the primary topic is transparency. We all know that transparency is key in competitive markets, and we do have competitive markets here. The fact that they're conducted in a U.S. market, in a foreign market, or OTC, really is immaterial. They're competitive markets and transparency is fundamental for competitive marketplaces.

I think the Commission and your leaders and the Commissioners' is appropriate and I appreciate you putting together this group. I know it's not easy. I know from experience that it's not easy, but I think these are issues that need to be addressed and quite frankly I think they need to be addressed quickly. Obviously, this is a touchy subject with the Congress, and even with the best intent of the Congress, I think in lieu of pretty quick action by the Commission, the Congress could take some action that would be damaging to the markets. The actions that are being talked about around this room today are actions that will be helpful to the market, but I do think we risk damaging action to the markets if we don't move and move on a quick basis, and I commend you and your fellow Commissioners for the action that you are taking.

CHAIRMAN LUKKEN: Thank you. Tony and then I think Commissioner Dunn has a question.

MR. MANSFIELD: Mister Chairman, I just wanted to follow-up on a point that Mark made which is I think one of the things we've heard from a number of the entities that are actively involved on the trading side is the paramount importance of liquidity and we certainly support and agree with that. I would also just make the follow-up point that we too have concerns about costs, and there was a point that was raised earlier about the notion of what if surveillance were to find something about this information which is going to flow from these enhanced sharing agreements and how would that be dealt with, and there was a recognition that it might involve multiple regulators dealing with different pieces. I would encourage as part of the discussion of transparency that to the extent that the Commission can continue to inform the marketplace about its views about how these types of issues are going to be handled, about its views about what issues may be of concern to a U.S.-based regulator versus an overseas regulator, that that too will enhance transparency and it certainly is very important to I think a lot of entities that are trying to identify and comply with the rules and making sure that they are staying consistent with what is expected and that obviously is a moving and evolving circumstance as the marketplace recognizes that it is more global. And I too thank you for today's discussion.

CHAIRMAN LUKKEN: Thank you, Tony. Commissioner Dunn?

COMMISSIONER DUNN: Mr. Short, I'd like to follow-up on Mr. Newsome's theme about onerous regulations. I saw yesterday in "Gas Daily" that according to your CFO Scott Hill, IntercontinentalExchange is prepared to move its screens and trading companies out of the U.S. if Congress passes regulations that are too onerous. I'd like to know, first, is that a correct quote, is that threat applicable to CFTC regulations as well, and third, what's the definition of too onerous?

MR. SHORT: You've asked a lot there. I'll start with the easy part of that. That is an incorrect quote. There was no interview given. The statements that our CFO made were in response to hypothetical questions that were raised by a number of institutional investors who were quite concerned with some of the noise on Capitol Hill and were saying what will happen ultimately if legislation is passed, and our initial response was we're working very closely with the CFTC and with Capitol Hill and expect a reasonable legislative response here, and after being pushed on multiple occasions what if, what if, what if there's something that's really draconian, I think Scott's response was we will follow ultimately where the customers go and I think you need to view his response in that context. It was certainly not a threat to walk away from U.S. regulation or U.S. jurisdiction.

In terms of my view about what is too onerous, there have been some suggestions that anybody trading a WTI crude contract needs to be a designated contract market. I think our position has been clear on that over time that you can't really suggest that crude oil is a domestic contract, it's a global contract, and ultimately the answer has to involve regulatory cooperation. ICE Futures has been a recognized investment exchange overseen by the FSA since 1986. I think FSA regulation is comparable. I'm not suggesting that there isn't room for improvement as the expanded information sharing arrangement we recently announced suggests, but certainly ICE is not taking the view that it's running away from regulation or any of its market responsibilities.

CHAIRMAN LUKKEN: John?

MR. FELMY: Yes. I'd just like to get back into the spirit of the transparency to John Heimlich's point. I think, John, that if you have commentators, and we've had this discussion as I've had with Paul, going on and they know their positions that just as stock analysts have to, they should declare those positions. I just would wonder why that isn't the case in the energy or the trading markets, and not just complete disclosure I think the way you were referring to, but if you are going on, why don't you disclose your position?

MR. HEIMLICH: That's right.

CHAIRMAN LUKKEN: Ron?

MR. OPPENHEIMER: Thank you. I just want to maybe disagree slightly with something Jim said with respect to the need for speed here. A lot of the structures we have in place that oversee these markets have worked very well over time and a lot of them were put into place like the CMFA after years and years of debate and the Farm Bill as well. The Commission I think has done an excellent job over time showing restraint and allowing markets to function as markets and to not try to tinker with markets because we're uncomfortable with a particular price at a particular time or its impact on a particular constituency. I think speed is important at the current time, but it's not the overriding concern. I think the overriding concern is to get it right and I think the Commission is doing a terrific job in gathering people here today. I think there's a tremendous amount of pressure to act and I think the Commission needs to do what it's done historically and that is to consider what it's going to do before it does it to make sure that there aren't adverse unexpected consequences from what it does.

CHAIRMAN LUKKEN: Paul, and then we're going to turn it over to the Commissioners for one final question or comment.

MR. CICIO: On the comment of disclosure, let me give you a perspective. What you don't see in the marketplace is a paper company CEO standing up on Wall Street and saying 6 months from now the price of paper is going to be X. You don't see a steel company saying in 3 months the price of steel is going to be Y, and so forth. They're concerned about antitrust and that is a practice that's absent here, so we do need to address that. Thank you.

CHAIRMAN LUKKEN: Do my Commission colleagues have any further questions? It's getting late in the day and we're going to have to wrap things up.

COMMISSIONER CHILTON: I've got one, and thanks again for doing this, and thanks to the staff and thank you all for being here. This is a little bit out of the box, but like I said earlier, I'm sort of swinging around. There's this issue of sovereign wealth funds and they are monolithic in size. The Saudis are setting up one that's $900 billion. They own 10 percent of one of the folks around the table today, the giant Chinese sovereign wealth fund. So when we look at these, there's not country X's sovereign wealth fund as a trader, it's not as clear as that, but they might be working through one of you in legitimate futures business. My question for the traders is do any of the five who are here not have a sovereign wealth fund client? I'll take that as you all do. Thank you.

CHAIRMAN LUKKEN: Mr. Cota?

MR. COTA: One of our concerns in the industry where we're actually consuming the product is that the impact of sovereign wealth funds that relate to energy could have a real and significant impact particularly on how they're applied. It doesn't matter what the country is. There are plenty of countries that don't particularly like us. If it were Iran and they were able through a sovereign wealth fund to do a derivative deal where nobody would actually see what was going on so they wouldn't have that market visibility and visibility in markets is important, they potentially in my opinion could have leverage, they could damage the people that they don't particularly like economically, they could as part of that process rise the underlying value of their commodity that generates all this money, and in the opaque markets that we've got right now, nobody would see it. There would be no fingerprints. Why wouldn't they do it? Their returns would be ridiculously large at this point in the market. So that's one of the retail petroleum industry's concerns. This is just one particularly very large example of how an opaque market can truly damage not only the value of us participating in these commodities but also the economy and we're really concerned. We're seeing demand destruction. Just so the rest of you folks know it, again there is demand destruction occurring in the U.S. and at the refinery level it's showing up in refinery utilization. In my area it's people cutting down wood and my customers are bailing and going to alternative sources, so that that's occurring. At some point people are going to see that markets do react, but if the dark part of the markets are controlling what's occurring from a pricing mechanism and it's more of an economic model rather than a supply and demand model, then we're all being injured and that's my concern.

CHAIRMAN LUKKEN: Commissioner Sommers?

COMMISSIONER SOMMERS: I want to

follow-up on a couple of comments and make sure I understand what Mark and Tony are talking about when you talk about something that's too costly and make sure that we understand in the vein of regulations that are too onerous on businesses and what becomes too costly for a business when we're talking about reporting or the issues of transparency.

MR. MANSFIELD: Commissioner, I'll start. What I was referring to was working off of a question that was posed in response to the enhanced information sharing which is that if surveillance were to identify what it perceived to be a problem based on the information that it had received that the concept that was thrown out was that it might involve the FSA as well as the CFTC pursuing conduct in pieces of what they had found. I think what I was responding to or what I was trying to raise was that certainly to the extent that the roles of the respective regulators are evolving, to the extent that the CFTC may be playing a role that is advanced or different than it has historically, or the FSA, that there's a cost potentially to the marketplace in terms of we are spending a lot of time and effort trying to make sure that we are putting in place systems to conform and to act consistently with what we perceive or understand to be our regulator in a given marketplace. So all I was saying is that in the context of that and in an effort for transparency I think that there is also value to the extent there can be transparency from the regulator's perspective in terms of how they are viewing markets, how they see their roles as their roles are evolving and for that to be a part of the discussion as well.

MR. STAINTON: I would echo those comments. I think as I look at the costs there are a number of costs that can be introduced into the system, administrative costs, costs from regulatory uncertainty over how positions and entities will be governed, and I think ultimately it's difficult to gauge exactly where the barrier is, but I think at the moment we have very liquid and transparent markets and that that brings in a number of participants which provides great benefit to a number of companies and ultimately the end consumers -- costs for transactions and the transparency and confidence that they have in prices is clear in the market so that I think obviously actions that will be to the detriment I think would be damaging for the markets.

COMMISSIONER DUNN: First let me begin by thanking all of our participants. This has been very enlightening for me and I appreciate all of you giving up your time and coming and sharing your vast knowledge with us to help us get it right.

We've talked quite a bit about our working with the FSA but there seems to be some other externalities here even closer to home. The Energy Policy Act of 2005 has given FERC additional authorities and they have a definition of manipulation there. The Energy Independence and Security Act of 2007 has given the Federal Trade Commission authorities over manipulation.

I'd like to hear from those of you who would like to express this how you think we ought to go forward in working with those sister agencies here in the United States to ensure that we do not have a proliferation of regulations that really cripple our energy industry.

MR. HORVATH: I'll take a stab. I just think that both publicly and privately a persona of cooperation with the agencies that you have a common goal and pursue it. The reason that's so important is when you don't and there are public fights about jurisdiction, that raises regulatory uncertainty in the market's mind and increases prices unnecessarily and increases risk unnecessarily. So please I beg you to cooperate with your sister regulatory bodies.

This is not a unique situation. Congress never gets it right in terms of drawing arbitrary lines and expects you to cooperate, and other agencies have done so. I know nothing but highly competent people. All the regulatory bodies you mentioned, I know you're all competent to do that, and I'm telling you the industry expects you all to rise to that level of cooperation and collaboration.

CHAIRMAN LUKKEN: Laura?

MS. CAMPBELL: From a consumer's perspective, the consumer is hurt long before there's ever any enforcement even, so to have more cops on the beat so to speak is certainly fine with us, but I do think that perhaps we just need together. I'm no lawyer, I'm an engineer, and when there is something new that comes in to design, sometimes the electricals fight with the mechanicals on who's going to get the new opportunity, but typically we have a design meeting and we all sit down and we decide who's going to take the lead, but then also whoever is not taking the lead is usually providing a lot of support to the other engineer, so I would suggest that perhaps something similar needs to take place.

CHAIRMAN LUKKEN: Ron?

MR. OPPENHEIMER: I think this is a

critically important question. As somebody who has to give advice to traders all the time, we're starting to look at a situation that's getting very, very difficult. You've got statutes that have different standards in them, you've got regulations that have different standards in them, you have three different regulatory agencies that have different historical perspectives on how they look at things. The FTC is more or less a consumer protection agency to begin with or first and foremost, the FERC had a background that was basically rate making, the CFTC brings a different perspective to markets, and unless the agencies work together not only to share information about what they see in the markets but to develop common standards, legal standards, and to develop common enforcement approaches to the markets, the things that they see in the markets, people like me are going to have a very difficult time advising traders what to do and when traders don't have good advice of what to do they withdraw from markets because they're not going to take that

risk, they take trading risk and not legal risk.
So I think it's critically important that maybe the CFTC take a lead role I guess from my perspective as the agency that's looked at these markets for the longest period of time and foster a working relationship as I said that goes substantially deeper than just information sharing.

CHAIRMAN LUKKEN: This has stirred up a lot of conversation. We'll try to work our way around the table. Bob and then Paul.

MR. ANDERSON: Thanks. Just a real quick comment that I wanted to make. First, it's interesting that the discussion has been largely around regulating and understanding the markets as opposed to regulating and understanding behaviors and I think that maybe in a future discussion or additional work we should do, we might want to consider differentiating between the two. One I think is quite easy, the other one we may never get there. And I think it's important to remember when you talking about markets that you understand why companies are doing what they're doing. We've got lots of resources we can contribute on that which brings me to the short point which is on what Ron just said, in terms of what you could to, the energy companies that I deal with unanimously the number one concern they would have hoped that we had been talking about were some simple things, for example, can we come up with a single definition amongst regulators for what is manipulation? There are some very simple things out there that are in writing by the various regulators that kind of leave major participants in these markets at a bit of a stint on how to proceed, how to go forward, and I think there is certainly some material impact on behaviors as a result of some confusion around something as simple as defining market manipulation and maybe coming up with a standardized definition based on the three or four that exist and even this group could contribute in that area.

MR. PANTANO: Very briefly, Mister Chairman, the FIA obviously favors the Commission strongly defending its exclusive jurisdiction over the futures markets and I think just from a resource allocation standpoint we do have different regulators, we do have different definitions of manipulation and it would be really nirvana to get a consistent definition, but I think given the different statutes and the different regulations that's going to be difficult. But even just from a resource allocation standpoint, if the Commission could persuade some of these other agencies to let the CFTC take the lead when the futures markets are involved that it would be very favorable for the markets.

MR. PICKEL: I would largely echo what Ron and Paul have just said. First of all, I don't envy your situation in trying to work with all those agencies who have a federal legislative mandate to put in place those regulations. But I guess your focus is market integrity and that is very broadly speaking a lot of different issues, and manipulation however that gets defined, however has oversight for that, is one piece of that. So I think working with those agencies, the FTC and FERC, to make sure that they have a means to effect their legislative mandate but also their understanding that you have that broader charge from Congress is a very important basis for the discussions.

CHAIRMAN LUKKEN: Last comment. Tony?

MR. MANSFIELD: Just to echo some of the comments that have been heard, one of the things that was really interesting about the FERC's involvement in these recent processes was that because of their show cause process there was such an expansive discussion about the cases that they were bringing and the theories, and certainly from one perspective, if enforcement is ultimately going to encourage or deter future conduct, you look at the theories that came out of some of these companion actions and it's very difficult to try and articulate or come up with a way to have not run afoul of those companion actions because at least from one perspective the theories were very different in terms of what had been done that was problematic. So I think that that's something that we too would encourage very much, there to be discussion within the agencies and to the extent that there can be consistency because from a standpoint of trying to comply with what the agency or agencies have identified was a problem in the past, it's very difficult to do that when there seem to be such internal inconsistency in terms of the theories that they articulated.

CHAIRMAN LUKKEN: Thank you very much. It's been a great day. On this topic I start from the proposition that we are one U.S. government and we have to work together and that's one reason we invited FERC and FTC today to participate as government observers in this so that we can try to work together and coordinate our efforts. I just want to thank them and as well Bill Hederman from CRS for coming today to listen and learn from the discussions around the room.

I want to thank you for coming. I know you guys are very busy and to take time out of your day to come and help us get through some of these tough issues. It's very helpful. Most importantly, I want to thank CFTC staff. As was mentioned, there are a lot of efforts that go into making these days work and come together and the internet and everything that's happening while we put these events together it's imperative that we have good staff, and we certainly do have good staff here at the CFTC to put these events together.

Thank you so much again. We appreciate it. I know we're going to have topics that we didn't get to this time. Emissions trading potentially was an interest of this group, best practices that Laura brought up, and there are other issues. So we look forward to and hopefully can have another meeting before year's end. Thank you so much.

(Whereupon, at 4:45 p.m., the PROCEEDINGS were adjourned.)

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