UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

ENERGY POSITION LIMITS AND HEDGE EXEMPTIONS

Washington, D.C.

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Panel 3:

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P R O C E E D I N G S

(9:05 a.m.)

CHAIRMAN GENSLER: Good morning. I call to order the meeting of the Commodity Futures Trading Commission. This is the last of three hearings which were considering whether federal position limits should be set by the CFTC for commodities of finite supply. I would like to start by thanking my fellow Commissioners and our distinguished witnesses for being here today. I might note I particularly want to thank those on the second and third panel for your patience with three panels, and we'll try to stay in touch with you as the day proceeds to get you free as you can.

Last week the CFTC held its first two hearings on setting position limits in the energy markets. We have a very productive discussion on the legislative history of position limits, the current state of federal limits and exchange set accountability levels and who would be best to set position limits if we were to move forward. Of

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not, several major market participants including exchanges and traders suggested their support for position limits. The Chicago Mercantile Exchange announced its support for adoption of a hard limit regime including single month and all months combined. This is a welcome and tangible change.

In addition, major traders testified that they believe position limits in the energy realm would be beneficial to the market. During this hearing we will continue to discuss the details of any possible limits including who should set them, what level, whether noncommercial exemptions should be granted, but the signal that the exchanges and certain major traders sent of their support to protect the markets and the American public was very helpful.

I believe we should seriously consider setting position limits in the energy markets. Let me just outline three quick reasons and it will help the panelists as we go forward because my questions will be around this. First, it's in our statute. In 1936 the Congress said to the

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CFTC said that we shall impose limits on trading on positions to limit, diminish or prevent undue burdens that may come as the result of excessive speculation. So first we're directed by statute to do it to protect the American public. Secondly, while we current set and enforce position limits on certain agricultural products, we don't do so for energy markets. I believe that position limits should be consistently applied across markets for physical commodities for finite supply. There are some differences between energy markets and agricultural markets to be sure. Agricultural markets are smaller than energy markets. We are fortunate as a nation that agricultural markets -- we're more an export nation and in energy we're more an import nation and there are other differences for sure, but I'm not sure that those differences suggest that there should be position limits in one market and not the other.

The CFTC is directed by statute to protect market integrity and I believe that we

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can't simply step back because the energy markets are larger than the agricultural markets. There has also been a lot of change since the early 1990s when the assumptions that embed why energy markets aren't covered right now, and that was by this Commission in the early 1990s when the first exemptions were granted and when accountability levels came into place. I think a lot has changed in the markets in those 18 years. The size and effects of the markets on the day-to-day lives of the American public make it that much more important that we aggressively fulfill our mandate in the energy space just as we do in the agricultural markets.

Thirdly, I believe that at the core, promoting market integrity is ensuring markets do not become too concentrated. This is even more relevant today because financial markets have become more concentrated since the first exemptions were granted in 1991, and the position accountability level regime was first implemented around that time as well. The financial crisis

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has highlighted the risk to the markets and the American public brought about by large concentrated actors on the financial stage. When the CFTC set position limits for certain agricultural commodities, the agency sought to ensure that the markets were made up of a broad group of market participants with a diversity of views. This is not the only place if I might note that we do this in economic regulation. In a very different context no doubt, we prevent market concentration at the heart of our antitrust laws. Similarly, even the FDIC has limits on how much the aggregate of one bank could have on deposits to protect the deposit insurance fund.

The very important question then to me becomes how much concentration is too much? At what point can market concentration, having a trader being very large in a market detract from liquidity rather than enhance liquidity or detract from market integrity rather than enhance market integrity? I think we'd all agree that if one party controlled half a market, that party is more

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likely to lessen liquidity than enhance liquidity. So position limits I believe should be put in place to enhance market integrity, enhancing liquidity by promoting more market participants rather than having one party that has so much concentration that it might actually lead to a decrease in liquidity and market integrity.

I look forward to hearing from today's witnesses on this very important issue. Last week we heard a diversity of views and I look forward to having additional experts and market participants. Our record will stay open until August 12, 2009. Please visit our website cftc.gov for a link and instructions on how to submit written comments for the record. I will now turn to Commissioner Dunn for any opening remarks.

COMMISSIONER DUNN: Thank you, Mister Chairman. I will save any remarks for closing remarks on the hearing itself, but during the course of these hearings I have received and I'm sure the rest of the Commissioners have received a

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lot of faxes and other mail from the public as a whole and I want to ensure everyone that that will be included as part of the public record and hopefully that will take place.

CHAIRMAN GENSLER: Yes. I believe the record is open until August 12 and whoever actually makes sure it's in the record will do so. Commissioner Sommers?

COMMISSIONER SOMMERS: Thank you, Mister Chairman. I just wanted to take a couple of minutes to point out what I think have been several important takeaways over the 3 days of hearings that we have had the witnesses who have been so gracious with their time to participate in this dialogue with us. I think all of our witnesses have supported increased transparency in our market and the Chairman has outlined some very important immediate steps that this Commission can take, but I think it's important for us to continue to use all of our existing authority to look at what we can do to provide additional transparency to our markets.

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As the Chairman just pointed out in his opening remarks, many major market participants have also supported going forward with this proposal to impose hard limits. I think that applying these limits to the OTC markets is going to be challenging, but we've heard a number of different good suggestions and views about how to do this, whether we have the current authority and how this limits should be applied, but I think across the board everyone has supported us getting the needed authority that we need in this area. Finally, for me there's the issue of the global standards. We've heard a number of our witnesses tell us that it is imperative as look to go forward with this that we have consistent regulatory regimes across borders.

There are a number of challenges ahead of us as we look for workable solutions to these complex issues end I ask for all of your patience and your continued cooperation. I appreciate all of these witnesses taking time out of their busy schedules. Our mission is to protect the price

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discovery and hedging functions of the U.S. futures markets and I know that this Commission is committed to doing just that. Thank you all for being here.

CHAIRMAN GENSLER: Commissioner Chilton?

COMMISSIONER CHILTON: Thanks, Mister Chairman. I don't have much to say other than I did notice a letter that was addressed to the Chairman from the Commodity Markets Oversight Coalition. I'm sure it will be included in the record. One of the things that was important to me as Commissioner Sommers was talking about is this is a dual track. Whatever we do here, we do need to have Congress involved in regulatory reform also. I think a number have made that point over the last several weeks and months and I'm glad that the Commodity Markets Oversight Coalition agrees with that.

I just want to again commend the Chairman. These hearings show that we can be an adaptive regulatory interested in anticipating changes to the market and what we do will depend

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in large part by what we hear from you, what we've heard in the last several hearings, and what we will hear from the public as we do a comment period, assuming we do a comment period. But it's a very helpful in that regard and I again thank the Chairman for setting on this new course. Regardless of what we do, it's good effort and I thank you and I thank our witnesses for being here.

CHAIRMAN GENSLER: I thank my fellow Commissioners. This is a team effort, so when they keep thanking me, we wouldn't have even had the hearings if we hadn't been able to decide to move forward. I'm going to turn to our panelists. We'll probably just to left to right. If you can, there's a little light over here that might give you a heads up. If you could summarize in 5 minutes. You've all given wonderful written testimony and we've had a chance to read it in the last few days. But if you'd maybe give us the highlights in 5 minutes, and then we're going to try to do questions in 5 minutes apiece as well.

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Thank you.

MR. HYLAND: Good morning, Chairman Gensler and Commissioners. I appreciate the opportunity to speak with you today on behalf of the United States Commodity Funds. We have already submitted written testimony to the Commission including data and charts, and I will briefly discuss our filing's main points.

In recent months, a number of reports have attempted to make the case that last year's run-up in crude oil prices and natural gas prices were the result of investments made in the futures market by large unleveraged and passive index funds such as USO and UNG. The management of USO and UNG believe these reports are completely inaccurate. Our data contained in our written filing shows that USO was a seller of contracts in 2008 while prices were rising, a buyer when prices were falling, and a seller again in 2009 as prices have been rising. The pattern is essentially the same for UNG as well.

Since our funds' actual buying and

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selling actions were not consistent with driving prices higher or lower as others have indicated, management strongly believes that the activities of USO and UNG could not possibly have caused the extreme swings in the price of crude oil or natural gas as alleged. Some of these claims amount to to be quite honest little more than self-serving statistical gibberish. If the Commission would like to have me run through some of this data in this hearing during the questions, I would be happy to do so, but we believe that instead of disrupting the futures market, the funds provided a steadying force by adding significant liquidity to the market and potentially reducing the price volatility. USO and UNG are highly transparent, unleveraged passive index funds that allow hundreds of thousands of retail and nonretail investors to access commodity exposure. In that sense, the funds behave as pass-through conduits as opposed to acting like a single investor. We believe that the following key attributes of the funds provide

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significant protection against concerns raised about their impact on the energy futures market.

First, the funds are widely held. In 2008, nearly 325,000 investors gained access to the futures market through investments in our two funds. For 2009, we estimate that the total number of shareholders is likely in excess of 600,000 investors. We further estimate that 75 percent to 90 percent of our shareholders are ordinary individual investors, not institutional or even high net worth investors, and these investors certainly do not think of themselves as speculators out to manipulate the markets. Rather, they believe they have an investment interest in obtaining commodity exposure or a desire to hedge themselves against potentially higher inflation. Last year our average shareholder typically owned shares that would equate to about one to two futures contracts worth. Even among our nonretail investors, we have not observed any very large concentrations by a very small number of investors. For example, we

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have rarely had an investor file a 13(g) or a 13(f) with the SEC indicating that they own 5 percent or more of our shares for any of our funds. A review of which brokerage firms are shares also shows them widely held with no large concentrations at just one or two brokerage firms.

Finally, the funds can see with a lag our shareholder activity come tax reporting season. As such, we can observe just how big our biggest shareholders have been. The numbers are surprisingly modest. For example, on December 31, 2008, the number of USO shareholders who held enough shares to indirectly exceed the NYMEX reporting threshold for crude oil which is 350 contracts was four. On that particular day, USO had 79,608 shareholders. All of the funds' positions held by the funds may appear to be large in relation to each fund as the legal holder of such positions. These investments represent the aggregation of demand from hundreds of thousands of individual shareholders seeking to reduce their financial risk through hedging in the Community

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Futures Market. Our funds are not market participants themselves. They are flow-through vehicles.

In addition, the funds are highly regulated by the CFTC, SEC, FINRA, NFA and NYSE Arca. The funds are not levered, thus eliminating our funds as likely sources of settlement risk to the exchanges. And the funds' pricing and investments are transparent with information on the funds available on the funds' own website, on NYSE Arca's website and from many other data providers.

In conclusion, we understand that the CFTC is currently reviewing its regulation of energy markets. If it is determined that limits are deemed appropriate for the energy markets, we believe that the CFTC should extend futures position relief or a hedge exemption to exchange traded commodity funds tracking single commodity benchmarks such as the funds if as we believe our commodity funds are merely acting as highly efficient aggregators of investment demand and not

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as agents of demand themselves, we believe it is in the interests of the markets that we be treated as such and dealt with as a flow-through vehicle that could provide liquidity without actually driving prices. Alternative approaches could have the unintended effect of reducing market liquidity while also harming our 600,000 shareholders. Should the CFTC be concerned about the activities of large investors who own shares themselves and thus indirectly have exposure to futures contracts, we believe fairly simple steps can be taken to capture such information and permit adequate surveillance.

CHAIRMAN GENSLER: Mr. Hyland, if you just want to try to --

MR. HYLAND: We're almost there. We strongly encourage the CFTC to codify its prior staff's position about index funds as potentially useful investment strategies and we look forward to seeing the results of the CFTC's current regulatory review process. Thank you for your time.

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CHAIRMAN GENSLER: Thank you very much. Mr. Cicio?

MR. CICIO: Chairman Gensler and Commissioners, thank you for the opportunity to appear before you.

The Industrial Energy Consumers of America is a trade association of manufacturing companies with over $900 billion in annual revenues and with more than 900,000 employees nationwide. Natural gas is a vital fuel and feedstock for the manufacturing sector and its price often determines whether we are competitive in global markets and whether we increase or decrease jobs.

Excessive speculation in the natural gas market is real. From January to August 2008, the price of natural gas more than doubled because of excessive speculation, not supply-demand fundamentals. During that same time period, production of natural gas rose by 8 percent, inventories were well within the 5-year average, and demand was essentially unchanged from the

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previous time period. The result of excessive speculation cost consumers over $40 billion in that short period of time. We believe that speculative aggregate position limits are essential. Other forms of position limits will not work as well because traders will simply move to platforms and products to avoid them. The creation of the futures market was not intended to be a substitute for a gambling casino for Wall Street banks, hedge funds, sovereign funds and index funds. The futures market was created to serve the direct needs of buyers and sellers of commodities and the managing of financial risk associated with these transactions. Financial speculators have an important role, but we must keep speculative transactions tied to the physical commodity as much as possible or we destroy the integrity and price formation.

At the heart of excessive speculation are these exempt financial speculative transactions that are not tried directly to managing risk of the underlying commodity.

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Speculative transactions based on other investment objectives like diversification of investment portfolios and a hedge against inflation is not consistent with the managing of risk of the underlying commodity. One example that we would like to highlight is the United States Natural Gas Fund that is exempt from speculative position limits and a long only passive fund. It differs in significant ways from the historic functioning of the futures market in how price formation occurs. The objective of their investors are unrelated to financial risk management transactions of the underlying commodity. For example, their transactions have nothing to do with what is happening and supply and demand of the underlying commodity. Saying it a different way, if prices go up, they but it. If prices go down, they buy it. It doesn't matter. Unlike other players, they predictably roll their positions forward each month, and unlike other players, they predictably let everyone know when they are doing it. The combination of these

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characteristics and their significant volume relative to other players and the size of the physical market damages price formation.

Mister Chairman, price formation is not passive. It is dynamic. It is a combination of reaction and proaction and without a pattern. Price formation is unpredictable, not predictable, and it reflects changes in supply and demand of the underlying commodity. Buyers and sellers of futures do not buy every month, they do not sell every month and they do not buy and sell at the same time every month. Banks like Morgan Stanley and Goldman or natural gas producers like BP and Chesapeake Energy, and my companies, industrial manufacturers, do not announce to the market how much they are going to buy or sell or when they are going to do so. Importantly, it is clear common sense that there is market evidence that this fund has in fact increased the price of natural gas over the course of the last few months. As the assets of this fund grew from $727 million in just 4 months to $4.5 billion this

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spring, the price of natural gas rose from $3.32 per million in May to $3.95 in July. That is a 19 percent increase. At the same time, each month compared to the same month of the previous year, domestic production rose, national inventories rose and domestic consumption fell. Common sense says that prices should have fallen.

The fund currently has 3 million shares and that represents about 30 percent of the prop market which is significant in its own right. Of great concern, this fund is petitioning the SEC for 1 billion, and we are quite concerned. Is there any doubt that if one player has 30 percent, 40 percent, 50 percent, that they are not going to impact price formation? In conclusion, Mister Chairman, we urge the Commission to ban this fund and ones like it from participating in the futures market.

CHAIRMAN GENSLER: Thank you, Mr. Cicio. Mr. Graham?

MR. GRAHAM: Good morning, Chairman Gensler and Commissioners. My name is Steven

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Graham. I am Vice President of Schneider National, a large trucking company based in Green Bay, Wisconsin. I appear before you today on behalf of the American Trucking Association.

Trucking is a highly competitive industry with very low profit margins. The dramatic rise in diesel prices combined with soft demand for freight transportation services have left trucking companies struggling to survive. Diesel is the second highest expense for most trucking companies. Every 1 cent increase in the price of diesel costs the trucking industry an additional $397 million. Schneider National typically uses heating oil derivatives contracts on the New York Mercantile Exchange to hedge our exposure to diesel price movements. However, there is a difference between hedging, speculating and excessive speculation. While we cannot quantify the extent to which excessive speculation is responsible for the recent and dramatic increases in the price of crude oil, we believe that it is part of the problem.

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A recent example of the disconnect between oil prices and market fundamentals occurred earlier this year. On February 12, oil hit a short-term low of $34 a barrel, yet during those 4 months, global demand remained weak, crude oil inventories in storage was well above average and the dollar declined only 9 percent relative to the euro even though oil went to $72 a barrel. In the face of these market realities, excessive speculation is the only other variable left unaccounted for.

To address this market disconnect, we believe that the federal government should take steps to increase the transparency of derivatives markets and establish reasonable aggregate position limits. The establishment of aggregate position limits will require CFTC to understand the amount of influence that over-the-counter and other off-exchange contracts have on the market. Requiring reporting of these dark transactions will provide valuable information on the positions of entities that participate in the derivatives

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markets and allow CFTC to establish position limits that prevent excessive speculation while maintaining essential market liquidity.

We are concerned with the positions taken by index funds. While we are not alleging that these funds are manipulating the market, we believe that the cumulative impact of their enormous long only positions may contribute to the disconnect between market prices and market fundamentals. In establishing aggregate position limits, CFTC must distinguish between commercial participants that take possession of the underlying commodity and noncommercial participants or speculators. CFTC must redefine who meets the definition of commercial participant or bona fide hedger. In petroleum markets, a commercial participant must take physical possession of a petroleum product. The trucking industry typically hedges diesel by purchasing heating oil and crude oil derivatives. Recognizing these hedging surrogates is important to determining the status of various commercial

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participants. At the same time, those who seek to hedge against inflation by purchasing petroleum derivatives contracts should not be considered commercial participants as these so-called hedgers are more akin to pure speculators.

The next step in setting position limits for commercial participants is to recognize that each participant has a different need to hedge a different amount of product based on their physical possession of the underlying commodity. To account for seasonal differences, organic growth of the company and other business changes, position limits applicable to commercial participants should vary based on their physical consumption of the underlying commodity over time. Increasing market transparency and establishing reasonable aggregate position limits that distinguish between commercial and noncommercial participants have no potential downside that we can discern. Under a worst-case scenario, the transparency of the market is improved but the price of oil remains unaffected. More

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optimistically, these remedies would reduce speculative bubbles, restore investor confidence in futures markets and limit the participation of asset accumulators in the futures markets, strengthening the link between commodity prices and market fundamentals. Thank you.

CHAIRMAN GENSLER: Mr. Graham, thank you. I thank all of our witnesses. We'll probably end up with a couple of panels but limit ourselves to 5 minutes as well and then if need be go through a couple times.

I'd like to find common ground where we can. In listening to Mr. Cicio and Mr. Hyland, I was going to ask Mr. Hyland first, I think there is common ground while there are many differences of course between your two testimonies. Did I take it, Mr. Hyland, that you said that you feel I think it's in your written testimony that the funds that you manage, the oil fund and the natural gas exchange traded fund, are price takers? The start of your third paragraph says "as price takers." Were you referring to your

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funds, that they're price takers in the markets?

MR. HYLAND: Yes.

CHAIRMAN GENSLER: Maybe there is a similarity because I think Mr. Cicio was saying that he feels that these large index funds are more price takers than participating in the price.

MR. CICIO: Yes, that is a major point, that the futures market is dynamic and each player is very inconsistent in their buying and selling while, and yes, they are a price taker, that is all they are. That is not the way the futures market works. Being a price taker does not reflect the dynamics of price formation.

CHAIRMAN GENSLER: But on that common ground then you divert a little bit on conclusions. I'm back to Mr. Hyland. You think that there should be no position limit set for any speculative participants in the market, or it just that they shouldn't be set on exchange traded funds?

MR. HYLAND: Our position is largely twofold. The first is that despite Paul's comment

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that common sense indicates X leads to Y, anytime anybody tells you that common sense tells you something, that's just a way of saying we don't actually have the data to support it. We believe our data is crystal clear. We are not driving prices higher by our buying in the last run-up in natural gas, we're not driving prices lower in this current bout. The data shows that at best you could make the argument that you UNG and USO are acting to moderate price swings by being a seller when prices are rising and a buyer when prices are falling. Arguably, and I'm sure there will be some academics who come on later in these panels, they will argue that actually we are price neutral. We certainly know that the studies done by the CFTC staff last year, studies done by the exchanges, have strongly indicated that buying and selling by index participants is price neutral.

So our believe is that there is a big difference if you are asking what should be the position limit for somebody like us who's aggregating the demand of hundreds of thousands of

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individual investors who are all on a given day buying or selling their positions and comparing that to the situation of a single trader sitting at a hedge fund somewhere, it's a night and day situation and we believe that there should be exemptions on the position limits for us precisely because we are flowing through lots and lots of transactions and are not the fund itself taking a position.

CHAIRMAN GENSLER: I'm sorry because my time is almost up and I'll have to come back, and I don't want Mr. Graham to feel like I'm not thinking of you or the 17,000 employees you have or your positions. Mr. Hyland, I understood that you thought that USO and UNG should not be subject to position limits, but I wasn't quite sure. Do you think that position limits promote market integrity possibly for other investors not exchange traded funds?

MR. HYLAND: The exchange traded funds are more transparent. They are typically unlevered.

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CHAIRMAN GENSLER: I understand that. My question for you is where are you on the hedge funds or others?

MR. HYLAND: Should hedge funds, should trading desks at a Morgan Stanley be more tightly watched and controlled? I believe that's fair because those are people making a single directed trade, so I think it's fair that they certainly should have greater oversight and transparency.

CHAIRMAN GENSLER: Should position limits be applied to them?

MR. HYLAND: I think that to the extent that they are the ultimate decider of what's being bought or sold, then that's a fair direction to go.

CHAIRMAN GENSLER: I thank you. I'll turn to Commissioner Dunn.

COMMISSIONER DUNN: Thank you, Mister Chairman. I think it's going to be difficult for us to get all our questions answered. Let me start again with Mr. Hyland. One of the letters that I received was from a doctor from New Jersey

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who indicated that he thought being able to invest in an ETF allowed him to do hedging against energy. Do you see that as the role of your fund?

MR. HYLAND: I'm going to guess that he's a shareholder of one of my funds. Since I have about 600,000 of them, he's probably one of them. That I believe is why we exist. We exist to allow people to take these kinds of positions whether they have an investment objective in the energy field or whether they want to hedge anticipated and unanticipated inflation changes, and we give them an efficient method of doing it that doesn't necessarily require them to directly hold futures. He is the answer to why do we exist and what's our purpose.

COMMISSIONER DUNN: So you view yourself as the democratic opportunity for individuals to be able to take part in the futures market?

MR. HYLAND: Absolutely. There's a saying that I've given to some of the surveillance staff before. George Soros doesn't pay retail. If you're the George Soroses of the world or

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you're Morgan Stanley or Goldman Sachs, you don't need USO, you don't need UNG, and you're certainly not going to pay the 45 basis points or 60 basis points that we charge. You would just do it directly through futures or you'd do it directly through swaps. We exist to serve people who otherwise would find it difficult or undesirable to themselves to buy futures, so we are a passive vehicle for them.

COMMISSIONER DUNN: Thank you. Later on we'll hear from Mr. Masters. I think he's on our third panel when we get there. He advocates that there ought to be a 5 percent level for these passive investors. Mr. Cicio, I think you say there should be a 10 percent level. Mr. Graham, you put together different levels for different classifications of folks and I've looked at that. One of the points that I highly agree with Mr. Cicio on is that we need adequate funding to be able to do this and some of the things that you're indicating I think are going to be very, very costly for us. I'd like to hear from all three of

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you as to what do you think is an adequate level? Is it 5 percent or 10 percent or 40 percent? Is there a point in time when these passive investors then become the accidental market manipulator?

MR. HYLAND: Are you referencing the 5 percent or percent or whatever the number as a limit for passive indexers or for anybody?

COMMISSIONER DUNN: Since I quoted Mr. Masters, let me say no single noncommercial entity should ever be allowed to represent more than 4 percent of the market's total open interest under any circumstances. So in that case, that's how he comes up with the 5 percent.

MR. HYLAND: Forget the hedge funds and the trading desks and everybody else. I don't work for them. We would argue that the real question is what percentage of a commodity market or for that matter what percentage of the S&P 500 is it acceptable from a market regulation standpoint to be held by passive indexers in the first place? Is it okay for 40 percent of the S&P 500 to be held by index funds, 60 percent? This

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is a question maybe some of the academics will deal with. Within that you then have a separate question of let's say the result is 50 percent of a market can be held by passive indexers and the other 50 will simply determine the price. Is there a rational reason then to say 50 percent is going to be held by passive indexers, from a market regulation or a market dynamic standpoint, does it really make any difference whether 40 percent is held by one index fund and the other 10 is held by three or they just equally split it up? Arguably you get less liquidity if you split it up. That's almost certainly a true statement. So I'm not really sure what the net benefit is. You're just going to get 10 index funds instead of three.

COMMISSIONER DUNN: May we hear from the other two panelists?

MR. CICIO: Commissioner, the accidental market manipulation is here. The United States Natural Gas Fund has 300 million shares. They're petitioning for 1 billion. They already have

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approximately 30 percent of open interest. Those mutualization essentially of the futures market is going to destroy the integrity of futures. Remember, futures is special because it needs to reflect the underlying supply-demand fundamentals of the commodity. We don't want this to turn into like a stock or a bond mutual fund kind of program here. Supply of that commodity is essential.

Getting to your question, in our testimony we call for aggregated position limits. We think that is the way to go. It's more efficient and better than let's say monthly and all months position limits. But short of aggregated position limit limits, we have suggested no more than 10 percent of the physical market.

MR. GRAHAM: As a commercial participant, we want to be able to obviously hedge what we hold in possession from a noncommercial participant. We certainly need the liquidity to make the markets work. We would want to see it limited to the point where it can't drive the

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price artificially high. Commissioner Sommers's comment of extremely complex I think holds very true. I don't have a percent number. I would say it would be relatively small, but enough to give market liquidity but not enough to fix the markets or drive prices up.

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

COMMISSIONER SOMMERS: Thank you, Mister Chairman. I'm going to continue on this line of questioning with Mr. Hyland and ask you if your funds are subjected to hard position limits, how you envision you would gain exposure for your 600,000 participants, what you would then do, your business plan to move forward.

MR. HYLAND: Obviously it would be a disadvantage to my shareholders because any of the alternative choices we would go to would probably be either more expensive, expose them to a potential credit risk or expose them to tracking error against the desired benchmark. Certainly you can go OTC, certainly you can go overseas,

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certainly you can do other things. Alternative, remember that the strongest law in Wall Street and in Washington, D.C., is the law of unintended consequences. One of the possibilities is our fund would get smaller. We'd just simply have to cap ourselves out and take some steps. All that's going to lead to is all my competitors are going to get larger. You are going to be in exactly the same boat. My 600,000 shareholders may become my 300,000 shareholders and 300,000 shareholders at Barclays. That's why I'd raise the issue.

The real question is can you actually justify with data and not with common sense what amount of the market can be held by passive indexers without having the benefit of additional liquidity be overwhelmed by some sort of distortion to price? That's your real question to ask yourselves. Beyond that, the question of how many commodity EFTs share that amount is totally a secondary question. Arguably I could just split the fund up four ways. What does that gain everybody? It's more expensive for my

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shareholders and liquidity goes down. In technology there's Metcalfe's Law which says that as connections increase you get an exponential benefit to a network. In trading it's the same way. The market is better with bigger pools of liquidity and not splitting it up into smaller pools of liquidity.

COMMISSIONER SOMMERS: Thank you. I had a question for Mr. Cicio. In your oral testimony you said that you thought we should ban these funds from participation. Is there any way that you would support them gaining this kind of exposure in cash settled contracts out of the spot month? Just for your views on how index funds could gain exposure to commodity markets.

MR. CICIO: We cannot see resolution to that. Remember, I'm sorry I'm going to repeat this over and over again, but futures are special. Each transaction reflects supply and demand of the underlying commodity and when you have these lazy EFTs, these passive funds that don't buy and sell and are not active and proactive where they're not

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planned purchases and notification of purchases, those things are all inconsistent with how the futures market works. I might add that the futures market worked great. None of my companies complained about the futures market prior to CFMA and the creation of enormous exemptions and we did fine before the United States Natural Gas Fund existed. So we are not concerned about banning EFTs.

COMMISSIONER SOMMERS: Thank you. I still have time for one more question for Mr. Graham. Mr. Graham, in your written testimony you suggest that there are electronic exchanges and exempt transactions not regulated by the CFTC that have been a problem, and I was wondering if you could elaborate if this is the ECMs that you're talking about or what other kinds of markets, if this is OTC.

MR. GRAHAM: Our view and my view would be they would fall in even with the regulated, that simply we can't explain through fundamentals looking at supply, looking at demand day in and

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day out trying to predict and trying to forecast what the price of fuel is going to do to our business. There just isn't a good connection between market fundamentals and prices. So I would categorize those with even the exchange funds. To the extent there's excessive speculation, the way our fuel surcharge programs work when we have prices that used to move 4 and 5 cents in a year, now you're happy for a day when the price only moves 4 and 5 cents. It's just difficult for us and other trucking companies to keep up. So my comments would be to categorize those all together and simply say they constitute excessive speculation.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Commission Chilton?

COMMISSIONER CHILTON: Thanks, Mister Chairman. Mr. Hyland, do you have a market intelligence and research are at your company?

MR. HYLAND: No. We're an indexer, so, no.

COMMISSIONER CHILTON: Do you have a

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view as to what you think these price swings were due to if not supply and demand?

MR. HYLAND: Do we want to start with crude oil last year?

COMMISSIONER CHILTON: Crude oil last year, you can go with it as to why is it up 60 percent with the highest supply and lowest demand this year.

MR. HYLAND: Actually, inventory has come in since the lows in early February. I think there are about 370 million barrels.

COMMISSIONER CHILTON: It was 60 percent, we had the lowest demand and highest supply maybe it was a month ago or so and it was up 60 percent. I think prices are still up 60 percent. I think it closed at $71.17 yesterday.

MR. HYLAND: Two comments. First, remember that since early February USO has been a large-scale seller. So any attempt to suggest that the run-up in price was USO is gibberish.

COMMISSIONER CHILTON: I wasn't casting and aspersions. I was asking what do you think it

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is? You think it's not you.

MR. HYLAND: I know it's not me.

COMMISSIONER CHILTON: What is it?

MR. HYLAND: Remember, we're indexers. I don't care whether oil goes to 100 or it goes to 50. It doesn't make any difference to me. I'm an indexer. I just follow it. I'm not surprised at the run-up. You have to remember that in early February the world was coming to an end. Everything was going to hell in a hand basket. Now the world is not coming to an end. So is anybody really surprised that the price of oil has gone up? Remember, Americans are still caught up in this whole thing that American demand is down and the next thing. The marginal price is no longer being determined exclusively by what goes on in the United States. It's China, it's India, it's other people. Was I bit surprised that we ran from $38 to $70 in this timeframe? I thought it was a little premature because I'm not a big proponent of green shoots at the moment. But if you believe in green shoots, this is rational.

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The inventory has come in significantly from where it was in February. Cantango has shrunk dramatically as a result. This is not all that irrational. And to the comments that there's volatility, everything is more volatile in these last 2 years. Your home price is more volatile. The price of GM stock is more volatile if it still trades. Why anybody would for the slightest reason believe that somehow commodities were going to go off on their own little path while what happened in September and October occurred, of courses the price of commodities collapsed and with people believing that maybe there are green shoots if not this year, next year, the price is coming back up. If the green shoots are real, maybe oil goes to $100. If the green shoots aren't real, oil goes back to $40 or $50.

COMMISSIONER CHILTON: Mr. Cicio, what do you say about that?

MR. CICIO: Futures is a special market and it is based on the fundamentals of supply and demand of a given commodity in a given point in

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time. When you have lots and lots of production in the case of natural gas, plenty of inventory and lower demand, one can mock the common sense point of view, but if there's more supply than demand, prices should fall. So we know that there is something going on here that is interfering with price formation.

COMMISSIONER CHILTON: We don't have all the answers and this is why we're doing this, but a lot of times I think that the questions needed to be reversed. Somebody will say you can't prove that excessive speculation has this amount of a percentage. Turn it around. Prove that it's not. Again, as the Chairman has talked about both at the first hearing and again today, the statute requires us to be adaptive and to guard against possibilities. So a possibility that something is happening is something that is in our charge, our mission, our mandate, or mantra, if you will, to guard against.

I'd like to turn the question around some times and I know we'll have panelists that

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will do that later. Prove that excessive speculation isn't having an impact. There's a key word here and a lot of times, I talked about this the other day, I think people talk past each other, that there's a difference between driving prices and having an impact. So just because excessive speculation whatever that is may not be driving prices doesn't mean that there might not be some sort of impact. I think what the Chairman started off this round of questions with was that some common ground is important because for me if it has the potential to have some uneconomic impact divorced from supply and demand, it's something we need to be looking at. I'm not predisposing what we're going to do, but it seems that's our responsibility in our jobs. We're not businesses. We have lots of motives. But as I said last week, none of those involved the word profit. Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. As you can see, we'll have some more questions. I'm going to try to start

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with Mr. Graham in my round. I take it, Mr. Graham, that you're recommending that we do adopt position limits. Is that correct?

MR. GRAHAM: Yes, I would say that's correct, but being very careful to say we know there must be speculation to create market liquidity. We need that market liquidity. Without it there's a problem.

CHAIRMAN GENSLER: Right. By the way, I agree with you that speculators are an important part of our functioning capital markets and our functioning futures markets as you said. But I also take it that you suggest that you would still want, and maybe you could explore this with us, limits on the swap dealers as well, these position limits would be set on swap dealers, but as I read your testimony, you would have some pass through that if the swap dealer had commercial hedgers on the other side, if you could just tell me a little bit more about that.

MR. GRAHAM: I'm certainly not an expert on how these markets work, but to the extent a

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swap hedger has customers who are wanting to hedge a physical product using oil as a surrogate, certainly those swap hedgers would not be limited by a certain percentage or a certain amount. If a trading company had as a customer one of our shippers who ultimately pays us for the fuel that we burn in our trucks, certainly we would want that shipper to be able to go to a trading company had have those treated as a hedge position as a commercial position.

CHAIRMAN GENSLER: That is helpful. Mr. Hyland, by green shoots are you referring to something that Larry Kudlow refers to at CNBC? The only reference for my staff to green shoots was something about Mr. Kudlow, so maybe you could tell me.

MR. HYLAND: I was under the impression that the green shoots reference was a common reference about nascent economic recovery of the economy.

CHAIRMAN GENSLER: I see. That's what you're saying.

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MR. HYLAND: If you believe that's coming, oil prices are completely rational in my view as somebody who doesn't really care whether oil goes to $100 or $50. If you don't believe it's coming, then oil prices are going to go back down and I think that's rational as well.

CHAIRMAN GENSLER: Did I take it that you said that you're somebody who doesn't care of oil goes to $150?

MR. HYLAND: I'm an indexer. If it goes to $150 or if it goes to $30, it's pretty much the same to me and my job is to follow it. If you actually looked at the filing we did, however, professionally we have a slight benefit because clearly the data shows that we get more shareholders as the price falls and we get fewer shareholders as the price rises. I'm better off it oil goes to $10 personally, but from a forecast standpoint, oil seems rational if you believe the economy is going to go up.

CHAIRMAN GENSLER: I think that's the best indication that you're a price taker and as

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an indexer you're saying that your business model is whatever it goes to. You said something earlier, I'll probably get one last question. You said you believe that markets are better when there are bigger pools of liquidity and I took that to mean that if the U.S. Natural Gas Fund was bigger instead of being its current portion of the market, it's a bigger portion of USO is bigger, that somehow markets would be better. I don't really understand that because to me that's not a bigger pool of liquidity, that's one party with a bigger market share and the bigger the market share is -- do you have any studies you can point to that the bigger the market share somebody is provides more liquidity? I'm using the word liquidity because you did.

MR. HYLAND: The fallacy is you're still thinking of us as a single position. We're not. View us this way instead.

CHAIRMAN GENSLER: I thought you were referring to markets work better with bigger pools of liquidity. So you weren't referring to any

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participant, you're just referring to you as an exchange traded fund?

MR. HYLAND: Think of USO or UNG as contributing pools of liquidity to the broader market. If you fractionalize them, the aggregate amount of liquidity being provided by shareholders through these pass through vehicles will decline because if you take four liquidity pools and add them up --

CHAIRMAN GENSLER: I'm sorry, Mr. Hyland, my time is almost up. I get that you don't want more index funds because it would be better for your business model if you don't have competitors. You'd earn your 60 basis points and 45 basis points. My question is you're a man of finance. Just broadly speaking, do you think that markets work better if there are only two or three or four participants that are the big market players, or does it work better for liquidity if you have 10 or 20?

MR. HYLAND: Not to be difficult, but I think you're trying to categorize us as saying

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what if there were three or four hedge funds and they dominated the market and you're kind of lumping us in with them. That's not probably the analogy we're driving for.

CHAIRMAN GENSLER: I have to turn to another Commissioner, but that is at the core of at least this Commissioner's thinking, we're supposed to protect and promote fairness and orderly markets and what's at the core of our agricultural limits is that there's got to be at least a minimum number of actors on the stage.

MR. HYLAND: I have 600,000 actors. That's a hell of a lot more than probably play in most markets.

CHAIRMAN GENSLER: I'm going to turn to Commissioner Dunn.

COMMISSIONER DUNN: Thank you, Mister Chairman. Let me start on this end of the panel this time, Mr. Graham. In your written testimony you say, "It is critically important that investment banks, hedge funds, swap dealers and other market makers whose analysts offer

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predictions on commodity prices be required to prominently disclose their net positions that they and their customers hold at the same time that the analysts' position is offered. The concept of establishing a Chinese Walls between a firm's analysts has not worked and these entities should not be allowed to manipulate the market by holding positions and then issuing an analysis that fairs their positions." Could you amplify on that on why you think that is important?

MR. GRAHAM: I think by saying that we're simply saying as I talk to folks in our industry we hear people saying oil is going to $200 a barrel. Shippers and other trucking companies get concerned when they see that. They believe that maybe there is some truth that. If the person who's making that statement benefits by making that statement, that would be to me market manipulation. I'm not a lawyer and I don't fully understand what manipulation means from a legal standpoint, but it would appear to me that that is manipulating to try to drive prices higher. We're

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not opposed to analysts making those comments, but if you're long in the market before you make those comments, we believe you should disclose that you have taken that long position to add perspective and balance to the analysis that you're providing. Does that make sense?

COMMISSIONER DUNN: I understand your concept. We had heard an earlier panel say that these firewalls exist but they are internally regulated. Would you feel more confident if an outside entity such as the CFTC had control over that regulation?

MR. GRAHAM: I heard unintended consequences said earlier, and I think be careful what you wish for. That's something I would be very cautious with, but I think it's something that certainly should be considered and looked into, but too much control would not be a good thing either.

COMMISSIONER DUNN: Again I'd like to thank you for your very, very thoughtful testimony because you actually went through and gave us some

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examples of how you thought that speculation limits ought to be set for various categories and that was helpful. I would like folks to know that annually there are about 6.6 billion trades in the futures and options markets and about 10 percent of those or 11 percent of those are in the energy area. Again picking up on Mr. Cicio's testimony, for us to be able to do the types of things that are being advocated, it would be very, very human and fiscal intent would be tremendous and I want people to know that and I would ask you are you willing to pay a transaction fee to ensure that you've got that type of oversight?

MR. GRAHAM: Wanting to? No. Willing to? That's a hard one to answer. Certainly we don't want to, but certainly within reason we understand that that possibility exists. A small fee, maybe. Willing? Yes. Wanting? No.

COMMISSIONER DUNN: That was such a great answer, I won't ask anybody else that question. There has been a little banter back and forth about the types of data that is included in

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whether or not conclusions are based on empirical data. Mr. Graham, you said that spec limits is the only other variable, and Mr. Cicio, you said it was common sense. Later on we're going to hear from a panelist who says a good part of this is the result of environmental regulations. Did you two take that into consideration when you looked at your testimony?

MR. GRAHAM: As you raise it, that's an interesting question to think about. Did I take that into consideration? No. The impact of ultra low sulfur diesel, biodiesel, it's a good question. I didn't think about it.

MR. CICIO: No, sir, I'm sorry we didn't consider that.

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

COMMISSIONER SOMMERS: Thank you, Mister Chairman. My question is for Mr. Cicio. In your written testimony you state that you believe the CFTC has the existing authority to implement position limits. I was wondering if you have a

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view on more specifically how we would impose those limits on the OTC market, whether or not we use our information through the special call, how you impose limits on swap dealers, on the ultimate end user commercial hedger that may go through a number of different swap dealers, if you have any views on those complexities.

MR. CICIO: Thank you for that question. We have not sufficiently put pen and paper together to address the details of those important questions, so unfortunately I can't answer that question. They are all the right questions. We had assumed that after these hearings there would be opportunities driven by the CFTC asking those specific details for us to respond to.

COMMISSIONER SOMMERS: The next question is for Mr. Graham and this goes back a little bit to what Commissioner Dunn was asking you about your specific views on how to impose these limits, and you did give us some very detailed recommendations on your views. One of the views is that the swap dealers' and market makers'

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position limits should rise and fall depending upon the trades they exercise for their clients. I'm wondering if you could elaborate on how that would work for either their commercial clients, their own internal book, how we would do that.

MR. GRAHAM: Our position would be for the swap dealers who are in position to support commercial participants whether a trucking company is adding trucks and growing the size of their fleet, other fundamentals that would increase and decrease the amount of product they actually consume, we want the swap dealers to have the flexibility to increase based on those market changes. I think that's all that I was trying to say with that. We don't have a steady need at all times. Our business goes up and down and we just want to be able to flex up and down, and so the extent the swap dealers are working with a participant who consumes the product, they need to increase and decrease those amounts.

COMMISSIONER SOMMERS: As a follow-up, I want to make sure that I'm understanding this

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correctly. Do you think that the position should be imposed on the dealer, not looking through to the end user, or are you saying that the end user's need or limit may rise and fall?

MR. GRAHAM: I think the end user's limit may rise and fall and if the dealer that they're working through is acting on their behalf, then they would be able to rise and fall the same amount.

COMMISSIONER SOMMERS: Do you know if trucking companies and members of ATA use a number of different dealers for their business? I'm just wondering how that would work.

MR. GRAHAM: I know that we do, so I would believe it would be safe to assume that they would as well.

COMMISSIONER SOMMERS: How would that work? If you're using a number of different dealers, how does that work if we're imposing the limit on the dealer?

MR. GRAHAM: I guess that gets into the reporting requirements and the transparency

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requirements. Before I dig myself into too much of a hole, I dealt with from my perspective of having to buy and to explain to customers why prices go up and down, some of my written contributions were about the realities of what happens, the how to. I must admit that I don't claim to be an expert on that area.

COMMISSIONER SOMMERS: That's okay. Thank you. I appreciate your views.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Commissioner Chilton?

COMMISSIONER CHILTON: A question for Mr. Graham. In your testimony you talk about how 1 cent equals $397 million to the trucking industry, a 1 cent increase in diesel. I want to highlight that only because what I was saying earlier about even if there is just a little impact that it can have a big reverberation in individual sectors of our economy and in the aggregate. So thank you for that. But Mr. Graham, with regard to position limits, do you think there ought to be additional categories

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beyond the commercial and noncommercial categories that we currently look at?

MR. GRAHAM: At the risk of being difficult or not, having good knowledge of the breadth of the topic, as a trucker who has to buy the fuel, we're very sensitive to price volatility, probably more to the volatility than the absolute price as it goes up and down, and there are probably other users who have legitimate needs that I'm not aware of. I try to represent our industry and probably don't have the breadth to represent others.

COMMISSIONER CHILTON: You're doing a good job. Mr. Cicio, since you support aggregate position limits, do you think traders in other physical commodities like metals, and I know that's not your particular area of expertise, but generically do you see a reason why we should treat them differently? A follow-on to that is do you think there is a difference between the physical and the financials? Should we be looking at them all the same? Are there important things

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that distinguish them each?

MR. CICIO: The futures market is about supply- and-demand fundamentals of a given commodity, so these basics that we've been talking about should apply to all futures markets, metals included. The question on the financial organizations, every transaction, every player is linked in market dynamics, so we need the same rules of the road that apply to all players. The key here to making this market work the way it is supposed to is ensuring that each transaction, when we get to this issue of exempt financial transactions without position limits, I think we've been too lax in giving exemptions away that are not necessarily tied directly to the underlying commodity and that has caused a big part of our problem. So everybody needs to be included with the same rules of the road.

COMMISSIONER CHILTON: Mr. Hyland, I'm going to go back to what the Chairman was asking about disaggregation of funds. I realize that you have a parochial interest and I respect and good

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for you for having a thriving business. But why would it be a bad idea to have more competition in these markets? I know you're not going to be able to take your hat off, but if you can just a little bit, why would that be a bad idea to have more competition in these markets?

MR. HYLAND: Aggregate liquidity in the natural gas, crude oil or whatever our market is will drop which will increase price volatility. That's the simple answer.

COMMISSIONER CHILTON: Yes, but you said that somebody else would pick it up, either your competition or you would make it into four funds. So the money would still be there. If you have four funds and they're all yours it's just a shell game.

MR. HYLAND: Aggregate liquidity would still drop. Look at the other way. If you have four pools and each has X amount of liquidity and then you combine it into one pool, you don't have 4X liquidity, you have 8X liquidity or 12X liquidity. As I referenced in technology that's

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known as Metcalfe's Law, and I'm sure one of the academics can give you a similar name for this function. So are you fractionalize it and liquidity goes down, volatility goes up. Whether that actually changes the ultimate price outcomes except at the extremes is a more difficult question. Clearly, the behavior over the last 2 years of the passive index funds have been to dampen the volatility because we were net sellers, oil prices were rising and net buyers and prices were falling. The more you interrupt that, you're just buying yourself more volatility and less liquidity and that's going to be probably a bad thing I would think.

COMMISSIONER CHILTON: Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. With the patience of other panelists, at least the Chairman has some more questions. So I think we're going to have a third round, but it will be the last round. And with the patience of Mr. Graham and Mr. Cicio, I do want to come back to what you were just talking

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about with Mr. Chilton. I think we have a difference, you and I, in terms of liquidity. I'm not familiar enough with the law that you just cited in technology, but what you're suggesting is that if one party internalizes the extreme, the whole market, there would be more liquidity. I don't think so at all. I think if one party whether it's a hedge fund, whether it's a large financial institution or even an exchange traded fund internalizes all of that liquidity then the tens of thousands of other users don't get to see the bids and the offers, they don't get to see the marketplace, and there's not competition. We would say that the auto industry would be more efficient if there were only one auto supplier or the trucking industry would be more efficient if there were only one trucking company or airline. We could. And somebody might say that and they might even quote some law on technology. But in markets which I've been around for my whole adult life, I believe that competition in markets is a good thing, and as I said, we promote that

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elsewhere in the antitrust laws. So there just may be a difference. I don't know if you want to reply, but I'd love to know if there is an individual study you can point to that says that trading markets, capital markets or futures markets, are better off if you had fewer actors.

MR. HYLAND: I'll leave that. I know that you have at least one academic coming up on a later panel. I'll leave him for the studies.

CHAIRMAN GENSLER: Do I take it your answer is you are not familiar with any study?

MR. HYLAND: No. Like you though, I've been in the markets a long time and I'm pretty sure if you fractionalize markets that you get less liquidity and not more.

CHAIRMAN GENSLER: Mr. Hyland, you say fractionalize. We're not talking about putting one market in the U.S. and one market on the moon. We're talking about one market that has more participants or fewer participants. That's not fractionalizing a market. It's bringing to one market, hopefully it's still a global market,

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these are pretty significant markets, but just more actors on that stage.

MR. HYLAND: View USO or UNG not as an actor but as a specialized form of exchange where every day 30 or 40 million shares get traded that represent equitized versions of the futures. It's a highly efficient market and the bigger it gets the more efficient it becomes and more liquid it becomes. If you were to take it and split it up four ways, you don't go from 40 million shares trading a day to 10 million each, you go to 5 million each.

CHAIRMAN GENSLER: What if I stipulate I'm not talking about exchange traded funds. I'm trying to get your best expert thought about markets and liquidity in markets.

MR. HYLAND: If the question was if you had a limited number of participants who were sole directors of their trading rather than the EFTs which are really balancing these 40 million trades, then you're going to end up in the scenario that's going to look remarkably like iron

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ore where there are three non-American companies that are the buyers, the Chinese steel companies, and there are three non-American producers, and those six people decide the price of iron ore for everybody and there is no real futures market. In a sense, if you follow some of the logic that some of the other have suggested, that's the direction you go. When people say let's get rid of those evil speculators, as Commissioner Chilton said, let's turn that around. What you're really saying is the only people who should be allowed to trade crude oil are oil companies and Morgan Stanley? I'm not sure that's a good idea either. You want lots of participants. I've got 600,000 of them in my little subpocket which funnel liquidity and price discovery and all these other things into the broader market. Split it up and you get less of that beneficial impact and volatility will rise.

CHAIRMAN GENSLER: As I suspect, we still have a difference between us.

MR. HYLAND: Yes.

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CHAIRMAN GENSLER: Commissioner Chilton was I think not accurately quoted there. But in any event, Mr. Cicio, did you have a comment on our little back and forth here?

MR. CICIO: Yes, sir, Mister Chairman, I do. As I said earlier and I stand by it, my companies and my boards of directors are made up of the top energy managers in these companies and they represent the largest integrated steel companies, recycled steel companies, paper companies, commodities, chemicals, fertilizers, specialty food processors, you name it, brick, cement. These individuals will tell you that prior to the CFMA and prior to EFTs the markets worked just fine. The market worked better without them. I think that if we longer had EFTs the market would work just fine. We support the idea that multiple players participating in this market with transactions that are tied to the commodity is what makes this market a great market.

CHAIRMAN GENSLER: Thank you. I have no

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further questions. Commissioner Dunn?

COMMISSIONER DUNN: Thank you. First I want to thank some great staffing that I've had here. The Chairman has pointed out that I have been mispronouncing Mr. Cicio's name. I apologize for that. On an earlier panel, John Lothian was here and gave us a hard time about how we pronounced his last name. Unfortunately, John writes a newsletter and he pointed out that I used an M at the end of his name and he asked how would I like that if he did the same to me. It doesn't work out with Dunn very well.

The other great staffing from Jason Gizzarelli who is the staff member who sits behind me here pointed out when I said there were 6.6 billion trades, what I had inadvertently done was in the notes that he had given me on the trading that takes places, there's 2.8 billion in futures and 5.12 million in options and the total he wrote down was 3.3 billion and in my exuberance I added all three figures. So I doubled it. So it was only 3.3 billion, but almost 11 percent of that is

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in energy and it's still a large number.

Mr. Hyland, in your testimony you indicate that the CFTC staff has granted no action letters to two index based funds and you said that you thought we ought to do ahead and codify that and also extend it to positions to single commodity tracking funds or the funds itself. I understand what you're recommending here, but my point is that this Commission as a lot of Commissions do, do things on a shorthand method sometimes by the no action caveat. I have trouble with that because often times that is interplay that goes on between Commission staff and the person or entity that asks for that no action letter. I think you make an excellent suggestion that it ought to be codified. That to me means rule making through the Administrative Procedure Act that would allow all of the participants that may be affected by this an opportunity to have insight and make comment on that. Does the panel feel that this is a better way? Senator Sanders when he was here was very adamant about what we

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ought to be doing with no action letters. So could I hear from the panel on that?

MR. CICIO: Yes, sir. We think that would be a terrific step forward.

MR. GRAHAM: The same.

MR. HYLAND: I would agree. Commissioner Chilton had raised the issue concerning do there need to be more categories. Let's be blunt. The current setup is pretty outdated. It never envisioned that there would be swap dealers. I'm not a swap dealer, but I think there probably should be codified rules for them that distinguish them from both speculator/investors and from commercial participants. They should have their own rules. They should have a brand new set of reporting requirements. I think there should be a separate designation for those that are pass through vehicles like ourselves. I think it's long overdue to really kind of bring this setup, so we would absolutely agree that it needs to be brought into the 21st century.

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CHAIRMAN GENSLER: Thank you, Commissioner Dunn. Commissioner Chilton?

COMMISSIONER CHILTON: Just briefly. Thank you for that. Mr. Hyland, you said I think in your testimony that you're highly regulated. How does that impact you on a daily or weekly basis? The accountability levels don't appear to be regulating you. Right?

MR. HYLAND: We're subject to them. I've had people say we're not subject to position limits. We are. We're not subject to accountability. We're subject to them.

COMMISSIONER CHILTON: But they're not enforced.

MR. HYLAND: That's discretion that the CFTC has granted the exchanges and the exchanges I think have looked at our flow through nature and have heretofore not seen the issue that perhaps others have. I'm not going to badmouth the exchanges. They might get mad at me, but it's just the way it is.

COMMISSIONER CHILTON: I'm sorry to

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interrupt. What I'm curious about is if you set up different categories, and I agree with you that I think it's outdated and we need to look at things differently, but how would you develop a limit if we decided to develop sort of a hard limit for EFTs? You say that they're not impacting, so maybe your answer is there is no limit, everybody else has a limit, but not us.

MR. HYLAND: I like that idea.

COMMISSIONER CHILTON: I thought you would.

MR. HYLAND: The overarching question, and I think it's probably may also be similar to the issue of swap dealers who are essentially flow through, they have people on the other side of the swap, so I think you really need to be looking at them, and with us you really need to be looking at our shareholders and you need to change the rules to make that permissible. The real ultimate question is based on actual hard evidence, what percentage of the total market will you conclude can safely be held in aggregate by passive

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indexers, that number could be a number anywhere from 20 percent to 90 percent, and you can talk to the SEC about how they feel about S&P 500 index funds. Once you've got that worked out, I then think you have to decide how you envision this aggregate position being parceled out among one or multiple players or do you just let the market decide, because the market's preference is one big player because there's more liquidity that way. That's why EFTs invariably end up in any given sector, stocks, bonds, commodities, you end up with one big player and several small players because everybody wants to trade in the big swimming pool. Nobody wants to trade in the wading pool. You have to decide whether you want to let the market determine that or whether you want to impose something by fiat.

COMMISSIONER CHILTON: Thank you. Your testimony has actually been very helpful, all of you, but your testimony has been helpful, Mr. Hyland. I did want to clarify what I was saying earlier. You tried to paraphrase me. I'm not

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suggesting that we only need commercials in these markets. I think we need all players. This Commission has never been about saying you're not tall enough to ride. But we may have said you have to go with an adult or we have to put certain sidebars on the trading. So speculation isn't a four letter word and if people want to do it they should be free to do it, but from my personal perspective, I'm just concerned that there is an unintended consequence of the aggregate long only or passive speculation. I'm not suggesting that it's the driving and it's the only force there, but as I said earlier to Mr. Graham, even just a little bit can have a huge impact on industries or on our economy and it's our job to look out for this and hopefully we're going to get it right. So I thank you all.

CHAIRMAN GENSLER: I thank our panelists, and I apologize to Mr. Hyland, I didn't know if you wanted to clarify. The last thing you said about the exchanges because you're in a public hearing, did you want to clarify the

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exchanges -- there are two of them that you trade on I know, ICE and NYMEX -- have said to you about position limits or your size on each of their respective markets?

MR. HYLAND: No.

CHAIRMAN GENSLER: No, you don't want to clarify?

MR. HYLAND: Our general comment was that obviously there are position limits are under the current rules not really applicable to us. We never hold far enough into them. There are accountability limits. We have discussions with the exchanges on these topics. Some people have represented that we're not subject to them. We are subject to them but it's at their discretion and obviously we have ongoing discussions. What the actual nature of those discussions are we wouldn't publicly comment on because it has potential unintended consequences and I'm sure the exchanges would feel the same.

CHAIRMAN GENSLER: I thank all of our witnesses and for your patience. We've got this

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little green light system over here. If you'll watch it and if you're submitted some very detailed and expert testimony, but if you could try to summarize it would be great in 5 minutes and then we'll try to keep ourselves to that same discipline. Mr. Chambers?

MR. CHAMBERS: Mister Chairman and fellow Commissioners, thank you for the opportunity to testify today. I'm Elliot Chambers, Corporate Finance Manager for Chesapeake Energy Corporation. In that capacity, I am responsible for Chesapeake's risk management activities including out use of over-the-counter or OTC derivatives.

I'd like to begin by saying that Chesapeake Energy Corporation appreciates and encourages regulatory efforts to prevent excessive market speculation. As an end user that extensively utilizes OTC commodity derivatives as a vital risk management tool, we strongly support increased transparency, accountability and market integrity. Chesapeake is the most active -- and

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the largest producer of U.S. natural gas. As such, we play a significant role in helping enhance America's energy independence. Notably, we reinvest 100 percent of our free cash flow directly into finding and producing clean burning natural gas right here in the United States.

With average daily natural gas production of approximately 2.2 billion cubic feet per day or about 3-1/2 percent of total U.S. production, Chesapeake Energy's industry leading efforts have helped the nation achieve extraordinary growth in natural gas production and reserves. Currently, Chesapeake has approximately 12-1/2 trillion cubic feet equivalent of proven reserves and an inventory of over 36,000 net drilling locations. In short, we have a lot of natural gas to produce.

One of the reasons we are here today is because commodity prices can be extremely volatile with natural gas being no exception. For example, on June 30, 2008, the NYMEX natural gas spot price was approximately $13 per MMBtu. As of Friday,

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July 31, 2009, that price is approximately $3.60, representing a 72 percent drop. Given such market volatility and our active exploration and production program, we heavily utilize risk management tools such as OTC derivatives to provide cash flow certainty while never creating additional exposure through speculation. Without the benefit of stability in our cash flow, whether we drill one additional well or develop a new potential gas field becomes a very problematic decision. A prime example that our risk management strategy helps enhance U.S. energy independence can be seen with our discovery and announcement of the Haynesville shale natural gas plain in March 2008. The Haynesville in Louisiana and Texas is possibly the largest natural gas field discovered in North America and is estimated to hold $245 trillion feet of natural gas, or approximately 10 years of U.S. Consumption at current levels.

Chesapeake appreciates and supports the efforts of the CFTC to help make U.S. markets

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transparent, effective and efficient. We also believe the Commission's concerns about excessive speculation in the commodity markets are certainly worthy of analysis and discussion. However, our concerns around excessive speculation differ in many cases to what has been discussed in the media and by consumers of commodities. We do not agree that commodity prices increased last year solely because of speculative hedge positions. Instead, we believe basic economic principles of supply and demand served as the main cause of prices increasing and subsequently decreasing.

With respect to the focus of this hearing today, Chesapeake has serious concerns that position limits on energy futures and a more restrictive application of hedge exemptions could negative impact our risk management efforts. These concerns are primarily focused on reduced market liquidity and related price instability. Chesapeake is not specifically opposed to position limits, but we do have concerns that if the limits are too low, they will remove vital liquidity from

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the marketplace. For the same reasons that Chesapeake is not actively selling our production forward at currently depressed prices, we cannot count on purchasers of natural gas to make a market for us when prices increase and we want to hedge. Thus, if too low a contract position is implemented, we believe it will significantly dry up liquidity needed for producers to protect themselves. Chesapeake also has concerns regarding removing hedge exemptions for swap dealers. Without swap dealers, Chesapeake's risk management program would not be possible. Typically, when we place a hedge with a swap dealer they quickly offload the risk by entering into an offsetting position, thus running a balanced derivative book. This is a vital risk management activity. We believe that both sides of this equation should be exempt from position limits since our activities are inherently risk producing.

I appreciate the opportunity to speak here today and to reiterate that Chesapeake is

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supportive of your efforts. At the same time, as a company that uses risk management tools to responsibly manage our core business of finding and producing natural gas, stringent position limits and more restrictive hedge exemptions could significant hurt our ability to continue protecting our company.

In summary, if producers like Chesapeake cannot mitigate commodity price risks, then we will be forced to reduce drilling which will reduce our nation's supply of clean, affordable American natural gas. A reduction in the supply of natural gas will put upward pressure on prices paid by American consumers and weaken our nation's energy independence efforts. We look forward to continuing to work together to address these important issues. Again, thank you, Mister Chairman and fellow Commissioners.

CHAIRMAN GENSLER: Thank you, Mr. Chambers. You were within the light limit. That was very helpful. If you could help me just so I pronounce your name correctly.

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MR. VERLEGER: It's Verleger.

CHAIRMAN GENSLER: Verleger.

MR. VERLEGER: There's a leg in the middle.

CHAIRMAN GENSLER: Thank you.

MR. VERLEGER: Thank you, Mister Commissioner. I've been studying and writing on energy for 35 years. As an official in the Treasury Department in the Carter administration, I played a critical role in the removal of price controls and I was an author of the Windfall Profits Tax along with others who now decline to claim credit. At Drexel Burnham I played a major role in the creation of the crude oil futures markets. I have written and worked on energy commodity markets for three decades. In that period I've observed the great success of the commodity industry in breaking the control over the energy market once held by OPEC and the integrated oil companies. I believe consumers have reaped billions of dollars in benefits. I'm going to make five points today.

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First, the price increase from August 2007 to July 2008 was caused by a shortage of light sweet crude. Passive investors and speculators played no role in the price increase. The price increase was called by the fall in output in Nigeria, the policies of the Bush administration related to the strategic reserve and new environmental regulations introduced by the E.U. The price collapse started the week DOE stopped filling the SPR following the order from Congress. Coincidence? I think not. I saw the problem coming and wrote about it in 2006. I testified to Congress in December 2007 that this was coming and I was right. The IAEA this June vindicated my views. I attached to my testimony after working the IAEA the price section which described in detail what happened.

Second, flows of cash into the ICE and NYMEX light sweet crude contract have on impact on price changes in the spot crude prices. I have developed data on the cash flow in and out day by day into these two contracts. If there were an

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influence, one would have observed on my left, your right of this graph, a percent change in investment, percent change of prices.

CHAIRMAN GENSLER: Is there a way that they can put that on our screen?

MR. VERLEGER: They all lie on that straight line. In fact, if you look to the next graph on the hypothetical relationship, the points are all over the place. The correlation is zero. You have to go to the fourth decimal place to find a point. There is no influence between cash flow into or out of the WTI contracts. This is -- observation in the change price.

Third, contrary to the suggestions of those who have not examined the data, passive investment in oil as a commodity exerts an stabilizing force on prices. Portfolio managers as we heard seem to sell as prices are rising while buying when prices fall. Evidence is on this third graph on my right. The oil prices graphed in yellow on the right, the number of contracts held by the index funds as calculated

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derived from CFTC data is shown on the left. There is a strong countercyclical view. This countercyclical view is reinforced by the next graph which shows that the change in WTI prices versus the percent change in open interest moves in a countercyclical fashion. That is, as prices rise, we see liquidation. This is a stabilizing force.

Fourth, investment in commodities promotes inventory accumulation. Inventory accumulation has been a goal of those interested in energy security for three decades. In the last year we've begun to see large accumulation of private stocks. These stocks as the IAEA points out do not represent speculative stocks because they're a hedge. We are seeing what happens in the grain markets for 100 years what's been written by many. They are private stocks which add to the buffer in case of emergency. As you can from this last figure, world inventories are now nearing record levels.

Finally, I would argue that these

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markets are a essential component to continued development of oil and gas reserves in a competitive energy sector. Dependence on OPEC and integrated oil companies has been reduced by the entry of small firms. These firms continue to develop new reserves. To do so, they require the ability to hedge. They hedge to the financial institutions such as J.P. Morgan. As Mr. Masters pointed out last week in your hearings, these banks book together the positions taking as security values of assets which rise and fall with prices. Imposition of position limits on banks or increased margin requirements on EMP firms will make it more costly and more difficult for firms in the EMP business. Thus I strongly urge the Commission not to impose limits on these parties. The effect of such limits is really the effect of capitulation to OPEC. I strongly encourage the Commission not to impose position limits on index traders through the spec energy market. I'll leave out the agricultural markets. They're different. Imposition of such limits could reduce

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the stabilizing impact of these investors. Prices could fall causing reduced investment. The fall in prices would cause less to be invested in both oil and gas and alternatives. We would fall behind in our efforts to develop alternatives. Again, the consequences would be greater dependence on OPEC. I strongly encourage you not to capitulate to OPEC. Thank you.

CHAIRMAN GENSLER: Thank you, Mr. Verleger. Mr. Arnold?

MR. ARNOLD: Thank you, Chairman Gensler, distinguished Commissioners and staff of the CFTC. Thank you for the opportunity to appear before you today. My name is John Arnold and I run a commodity focused hedge fund named Centaurus Energy. We are active in a variety of businesses and have over 70 employees in eight cities. Our primary focus is financial trading of North American natural gas.

We share the Commission's goals of promoting efficiency, transparency and integrity in the economic markets. We rely almost

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exclusively on fundamental analyses to guide our trading strategies. As such, we depend on a market that is governed by supply and demand and that produces fair prices. Each market has unique characteristics and demands a customized regulatory framework. Today I will speak to specifically about natural gas.

The challenge that the Commission faces is how to temper unnecessary volatility and promote transparency without damaging a market that is generally robust and well functioning. I would like to share with the Commission my views on the factors that it should consider in designing and managing an effective limit structure of the natural gas market. In that regard, I propose the following. First, the Commission should impose hard limits on physical natural gas futures as they approach expiry. The expiration month limit should decrease in stair step fashion at regular intervals as expiration approaches. No hedge exemptions to these limits should be granted to any party.

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Second, the Commission should consider replacing accountability levels with hard limits on the forward physical natural gas futures based on maximum positions in any one month. There should be no all month limit. Finally, the Commission should have transparency and oversight into all financially settled contract positions on exchange and over the counter but should not impose hard limits on financial contracts. Like any market, natural gas needs rules to ensure fairness and to safeguard its participants from abuse. But as is also true of any other market, the wrong regulations can be just as harmful as no regulation at all. On June 5, two months prior to these hearings, the NYMEX amended its rules to establish hard limits on all financially settled natural gas contracts effective next month with the expiration of the October contract. If allowed to take effect as currently structured, the new NYMEX limits will have a range of detrimental effects on the market including pushing trading from exchanges to the less

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efficient and less transparent over-the-counter markets, increasing volatility, reducing liquidity especially during bid week, and increasing costs for commercial hedgers. We already have started to see traders move positions over the counter in anticipation of this rule. I urge the Commission to intervene immediately to take control of the limit setting process and to suspend or rescind the new NYMEX rules until the Commission can implement a more appropriate regulatory framework.

In these hearings and several other recent meetings, the Commission has received a great deal of input regarding limits and exemptions. I encourage the Commission to take a considered, reasonable approach to the issue rather than allowing each exemption to adopt discrete regulations that are ineffective, harmful to market efficiency and likely inconsistent with the Commission's goals. I hope the resulting structure will promote a well- functioning market that continues to allow participants to effectively manage risk. I thank Chairman Gensler

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and the Commissioners for the opportunity to share my thoughts.

CHAIRMAN GENSLER: I thank all our witnesses. I found as I was digging into your testimony that we've got a great panel of nine witnesses, they were terrific last week, but you had such varied things I could myself probably go three panels with any one of you. So I apologize in advance get to all my questions. Mr. Arnold, if I could just start with you. It's going to get a little technical. You suggest with regard to setting hard limits in the spot month and no exemptions from that. Is that right?

MR. ARNOLD: Right.

CHAIRMAN GENSLER: Then you would also have limits on any deferred month but not a combined month regime, and I just thought I'd like to understand why the first and not the latter.

MR. ARNOLD: I think the physical futures contract is vital to the industry. It's used as a benchmark both to settle financial trades as well as privately negotiated

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transactions with physical gas. The deferred contracts are used as a price discovery mechanism. The problem with having limits on the combined position is that you're reducing liquidity and increasing transaction costs of the commercial hedger who's trying to access the back of the curve. So if you put a total limit on the speculative community, you're incentivizing the large speculator to concentrate his liquidity in the front of the curve.

CHAIRMAN GENSLER: You're recommending setting position limits not only on the nearest or what's called the spot month, but also the deferred contracts moving forward, the deferred physical contracts?

MR. ARNOLD: Right. I think if you establish a limit on the combined positions, you're incentivizing the large speculator to concentrate my positions in the front of the curve that are naturally more volatile. A large speculator is a natural liquidity provider in the back of the curve. If you try to put a limit upon

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the activities of any one individual trader, I think there is a natural tendency to move positions to the more volatile part of the curve which is in the front.

CHAIRMAN GENSLER: You mean the liquidity providers, the risk hedge funds are more likely to move to the volatile part because, there's an old expression from Wall Street, volatility is our friend? It's where they can make more possible risk premiums and risk profits?

MR. ARNOLD: I think the deferred part of the curve is naturally less volatile than the prop month. So if I'm confined on the amount of risk that I can take, I don't want my limits in the deferred part of the curve that has very little volatility. I'm going to move that position to the front. So whenever a producer is looking for a 5 year hedge and they call the bank and the bank approaches the market, I think you're reducing the liquidity and increasing the transaction cost.

CHAIRMAN GENSLER: This is helpful. I'm

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going to try to sneak one more question because it's flashing green. Mr. Chambers, in terms of what you laid out, I think in my next round I'm going to talk about the over-the-counter derivatives part of it which would be very helpful. With regard to position limits you said don't set it too low. You're not opposed to it, but don't set it too low. Do you have a view as to what too low would be? If we were to move forward, this is a very relevant question now as to what level.

MR. CHAMBERS: I think that at the end of the day there needs to be more analysis, more information gathering to say what is the appropriate level and that's the reason we were hesitant to put a level into our testimony. Listening to the various testimonies today and reading the testimonies from last week, there are widely divergent views. More transparency coming from the marketplace would help arrive at the right decision. We said too low because if the limits are too low, frankly it ruins our risk

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management efforts.

CHAIRMAN GENSLER: If it's not a competitive disadvantage, how many dealers do you deal with right now? What's the universe of swap dealers that you can hedge your risks with right now?

MR. CHAMBERS: Between 10 and 15.

CHAIRMAN GENSLER: So between 10 and 15?

MR. CHAMBERS: Yes.

CHAIRMAN GENSLER: Thank you. Commissioner Dunn?

COMMISSIONER DUNN: Thank you very much, Mister Chairman. Mr. Verleger and Mr. Chambers, you both indicate that you think basic economic principles of supply and demand and also environmental regulations served as the main cause of price increases and subsequent declines. We're going to hear on the next panel Mr. Masters and Mr. Greenberger argue the exact opposite. Why are you correct and they are wrong?

MR. CHAMBERS: From the information that we have been able to review, since the second

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quarter of 2008 to the second quarter of 2009, demand has dropped approximately 5 percent, meanwhile supply has increased approximately 2 percent. So the drop in natural gas prices seems evident to have been caused by a demand destruction primarily coming from the industrial sector. On the flip side of that, going back to 2007 to 2008, there was more demand than supply, half a percent to 1 percent greater, so that's what's driving our conclusions.

MR. VERLEGER: Sir, as I said, I laid out the case for it, the International Energy Agency which is the arbitrator in this has confirmed the case and that's why I attached it, that it was the light sweet crude that created the constraint. There was a surplus of heavy crude last year in June that couldn't be sold when oil was at $147 a barrel because you couldn't make low sulfur diesel meeting European standards or our standards. For the first time last year we were exporting diesel fuel to Europe because of their switch and the strength of the euro. This year

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when prices were so low, something happened that has happened a few times in the history of commodity markets. Essentially it became extremely profitable to build inventories. I had a case that I described in my written testimony on how J.P. Morgan has picked up something like 2 million barrels of heating oil. They bought it and they sold in the forward market. According to Bloomberg they are earning a return of anywhere between 50 and 100 percent on that return. They can do this because they can borrow at 1 or 2 percent or 3 percent through the Federal Reserve Board and the forward prices are there promoting inventory accumulation.

Part of the reason that we heard in the previous panel is that forward prices are higher than cash prices because investors fear inflation. We saw the same thing in 1988 and 1999 when crude prices collapsed to $10. The market didn't expect crude prices to stay at $10, and they shouldn't. We need something like $40 to $50 a barrel according to the engineers to develop the oil.

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Chesapeake would say you need something I suspect around $3 or $4 a thousand cubic feet, maybe $6 to develop the natural gas so the forward prices stay higher. What happens when you have high forward prices and low cash prices as this agency has known for 80 is that inventories accumulate. We have just seen the most rapid development of inventories all of which are sold forward. As the IAEA says, this is not speculation, this is just plain transferring to the future. I helped create the Strategic Petroleum Reserve in the Carter administration and one of the things we were trying to do is build inventories because inventories are a buffer against price spikes, and we have just managed to get the first large private increase I think I've seen in 30 years. It's all fundamentals. I've made a living and I now teach at the University of Calvary writing on this and working with companies trying to take advantage of market advantages. This is cash and carry. This is how Cargill the great grain company became so large from nothing. It's just

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buying when the forward price is there.

COMMISSIONER DUNN: In my agricultural parlance, then it's the cost to carry.

MR. VERLEGER: It's cost of carry. I've read it as cash and carry. There's long literature. Jeffrey Williams at the University of California at Davis has written about this. One of the great things that has happened over the last 20 years is we've applied all the things we learned in agricultural economics to energy markets. They are more competitive and the consumer benefits.

COMMISSIONER DUNN: That would indicate why Mr. Chambers for you it's so important to understand what your break evens are.

MR. CHAMBERS: That's correct. We've spent a lot of time analyzing our cost to find and produce our gas and that's why we pay a lot of attention to where we can layer in our hedges to affect our risk management efforts.

CHAIRMAN GENSLER: Commission Dunn, we'll definitely have more rounds. Commissioner

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Sommers?

COMMISSIONER SOMMERS: Mr. Verleger, I'm going to continue on with some of the interesting concepts that you have in your testimony. One of the things that you talk about in your written testimony is the concept of the missing long and how the index investor has filled in this role, if you could just talk about that for a minute.

MR. VERLEGER: Thank you, Commissioner Sommers. When the oil market was first created and you looked at other commodity markets, one of the problems we had was in general, there were firms that wanted to sell forward such as Chesapeake and there were very often no longs. The one exception was heating oil where consumers in New England wanted to lock in their heating costs and they were large enough consumers. The logical long is the gasoline market and the Petroleum Marketing Practices Act essentially prevents that because there is no way that a company like Shell can sell gasoline to the consumer like you can sell a phone card because

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that would be telling an individual gasoline station what you can charge for gasoline and that's illegal. We didn't have Costco and Walmart. Costco and Walmart can do this now because they own their own business. So essentially a large portion, if you think of a seesaw and the one side, we didn't have the end users the way we have the Bakers, the Millers and other commodity markets that have made the grain markets work so well for 50 or 100 years. The investment funds first in 1990 and 1991 started coming in with Gold Sachs and their first commodity index, and then working forward created that long and essentially created the balance and then an imbalance to a certain extent which has caused perhaps more inventory accumulation than some would like. But essentially we did not have any commercial end users because I the gasoline consumer or you as a gasoline consumer cannot be offered the opportunity to lock in our gasoline prices under the current legislative situation we have.

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COMMISSIONER SOMMERS: Thank you for that explanation. I have a couple of questions for Mr. Arnold on his testimony, specifically just to clarify the NYMEX rules amendment that you are asking to be rescinded, I think if I understood you correctly you talk about how the unintended consequence of that would be for those positions to move OTC and move off exchange.

MR. ARNOLD: Correct. I think that's the first response by the industry is to move positions over the counter. We've already seen it start.

COMMISSIONER SOMMERS: Because there would not be those hard limits imposed?

MR. ARNOLD: Exactly.

COMMISSIONER SOMMERS: One of your other suggestions is that we don't impose limits on the OTC market. Wouldn't that have the same effect? If we're imposing the hard limits on the physically delivered contract and not the OTC market, will we see some migration of positions from exchange to the OTC market?

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MR. ARNOLD: I think if you maintain the positions and strengthen the position limits on the physical futures contract, that business stays on the exchange. The question is where does the financial hedging and the financial trading end up. Is it over the counter or is it exchange? I think there's been movement by the industry over the past 10 years to put this onto the exchange. Credit like the credit intermediation that the exchange brings. Ninety-eight percent of our positions are on the exchange for that reason. The NYMEX rules run counter to that industry trend and try to move that business back off the exchange, but I think the physical contract is going to maintain on exchange.

COMMISSIONER SOMMERS: Just to clarify, help me understand that, because there are two separate reasons for conducting business? There are rules that should apply?

MR. ARNOLD: Exactly. The physical futures contract and the financial contracts serve different purposes. The physical futures contract

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helps to manage physical exposures in the industry. It also creates the benchmark where there is industry indifference on expiration at that price where there's supply and demand for physical gas for following month meet, and so the industry is very comfortable using that as the benchmark. The financial contract is used for a number of reasons but it's not for physical. It's used to hedge financial exposures in the industry, it's used for speculation, it's used to arbitrage, but these are two different products and they have different purposes. The industry historically has used the physical futures contract as a proxy to hedge financial risk and I think that creates the problem and creates excessive volatility in that physical futures contract and that's why I propose you strengthen the position limits on the physical futures contract to decrease that excessive volatility.

COMMISSIONER SOMMERS: Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Commission Chilton?

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COMMISSIONER CHILTON: Thanks, Mister Chairman. A while back I talked about people talking past each other. Another observation is that it's a common debating tactic to label people and put people into a certain category. Dr. Verleger said that those who seek to impose position limits would be capitulating to OPEC which is a little bit stronger than you said in your formal testimony. I don't think any of us are going to be capitulating to OPEC and I think it's an unfair categorization. It reminded me in talking about OPEC, we had an economist here last week who talked a little bit about OPEC and it made me think about these sovereign wealth funds. UAE has $627 billion in a sovereign wealth fund, Saudi Arabia, $431 billion. Don't think for a minute that they're not using some of that for OTC swaps on energy. I don't want to unfairly characterize the doctor, but it seems to me that appropriate regulation of the OTC market makes some sense.

Mr. Arnold, I really appreciate your

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testimony. In part I was particularly interested when you said that you look at the market and you place bets if they are biased and yourselves to identify what's forcing the market to price a product in an unfair value, and then you get in and you try to push the price back to that value. Do you think that the prices we've seen over the last 2 years have been forced into an unfair value?

MR. ARNOLD: You have to draw the distinction between prop month and expiration which is in supply and demand of physical gas for the following month in the forward curve. There has been a lot of academic literature done about the forward curve is not the best price indicator of where those contracts are. It is supply and demand of forward price hedging. At times that differs from where I foresee fair value and that's how I try to make money in the industry is I try to buy things whenever they're trading below what your analysis shows to be fair value and sell things whenever our analysis shows that the

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forward curve is higher than our analysis of fair value.

COMMISSIONER CHILTON: You said, Mr. Chambers, in your written testimony that you didn't believe that commodity prices of last year were due solely to speculation. I don't believe they were solely due to speculation either. Can you elaborate on that? Do you think there was some part that was due to speculation?

MR. CHAMBERS: I think speculation had a role to play, but we would argue that that speculation is necessary for the fact that as prices increase, Chesapeake and other producers like ourselves who are already long the product will look to sell in the future. So we need that speculation on the other side to buy our production forward. So I think it does have an impact, but it's a positive one and it helps us cap the price.

COMMISSIONER CHILTON: I'll try to get one more in, Mister Chairman. This is particularly for something that we're working on

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now and I notice we have some congressional staff here, so maybe it will be helpful to them, maybe not. You talk about clearing of OTC products and how you used your assets as collateral and that if you didn't have that freed-up capital you wouldn't be able to explore, et cetera. Can you explain that a little bit more? Why would requiring clearing impact your business in a negative fashion?

MR. CHAMBERS: In summary it boils down to the end result of our strategy is to lock in cash. If we are to hedge out into the future and we are forced to clear, that creates a very big cash question near term for our long term strategy so that there is a disconnect in and of itself. It really negates the whole point behind the strategy.

COMMISSIONER CHILTON: Your swaps are collateralized already.

MR. CHAMBERS: Yes.

COMMISSIONER CHILTON: And then you use that capital for research or exploration, et

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cetera. So if you had to put up additional capital to clear, it would impact your ability to explore? Is that fair?

MR. CHAMBERS: Absolutely. A perfect example of that is in 2008 when natural gas prices were so high, we had been selling in the market actively that price was above our break even. So we had a fairly substantial mark to market loss around June 30 of last year in excess of $6 billion. If we would have had to post that as collateral on an exchange and cash collateralize that, frankly, we don't know if we would have been able to find that cash, number one, but it definitely would have impacted our drilling efforts.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. I'm going to follow-up on that very briefly on your testimony, Mr. Chambers, that was very helpful. With regard to posting of collateral, is it your position though that you think that posting something other than cash collateral, this is on the subject of

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over-the-counter derivatives and not position limits, with regard to the administration's proposals and this Commission's proposals as well to bring regulation to over-the-counter derivatives, we've promoted use of centralized clearing but also regulating the deals for capital on margin, and then in your testimony you raise the issue of whether that has to be collateral or noncash. I don't know if you saw Chairman Peterson's and Chairman Frank's joint press conference last week where they actually in a couple of pages of bullet points said that they thought they would be moving forward the market regulators, the CFTC and SEC, able to write rules so they could accept noncash collateral. Is your point of view similar to what they were saying or are you suggesting that there be no posting of collateral whatsoever?

MR. CHAMBERS: Chesapeake's position on that would be that we are completely fine and supportive of posting collateral. It helps us achieve our aims. To the extent for that to be

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arbitrarily set, or maybe not arbitrarily, but for that to be set through regulatory means makes us a little concerned because you could get to a much different answer than what we have today. Going back to whenever we owed over $6 billion in our mark to market on our hedge positions, we had around $11 billion worth of oil and gas properties pledged. It's a question mark whether a regulatory answer would have been $11 billion, $16 billion, $20 billion, $5 billion. It's a big question and does cause us some concern.

CHAIRMAN GENSLER: I appreciate that. I hope that anything that Congress does in writing the statute or what this Commission or other commissions do wouldn't be arbitrary. You're right. It would be important to get it right. You also mention in your testimony about customized versus standardized products, so if I can just address that. You don't need to respond. I've testified on this a number of times and am a firm believer that we have tens of thousands of end users who still need to use risk management

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customized products in the marketplace for over-the-counter derivatives, but the only way to bring regulation is to regulate the dealers fully and the dealers would have to report all those trades and have business conduct standards and capital for both customized and standardized and then we've mandate moving the standardized product, not the customized but the standardized products, into clearing and centralized exchanges. You don't need to comment, but your testimony had raised that point.

Mr. Verleger, in terms of your charts, I think it was chart six that was here, but if I have the number wrong, I apologize, really goes to what I'll call the macro view of a market. You were looking at changes in total investment, and it said total investment to the change in prices. What I'm interested in is not what you researched here which was interesting as well, but I'm interested in a micro market question if I can borrow a phase that you're probably more familiar with because you have the Ph.D. and I don't, about

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the structure of markets, and I'm also interested in Mr. Arnold's answer to this too. If we look at liquidity in markets, if we look at the market integrity of how a market is structured, are we better off limiting the maximum size of any one participant in the market?

MR. VERLEGER: I listened to your questions in the previous panel. You are absolutely correct, we would be better on liquidity and I think volatility if we had five ETFs to one ETFs and the five ETFs each presumably would follow slightly different policies of how they rolled their positions rather than having a single ETF going forward. I've been a student of your reports for 20 years and you look at the detailed reports and you see the number of firms and the percentages and I've always wanted Herfindahl indices out of there so I could see the real measure of the whole stream of things.

You're absolutely right, put a position limit on and if other EFTs enter the business because there's a position limit, it promotes more

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competition, just as, and I apologize for using the capitulation word but I've been fighting this battle for so long, as we got more producers in the international oil markets, as my friend Andy Hall complains, he's one of the people who broke OPEC, that we want more producers and that tends to give us lower prices. That's why the CFTC pushes for these things.

CHAIRMAN GENSLER: Mr. Arnold, it could be extended to hedge funds and other funds, this concept of a micro market structure.

MR. ARNOLD: I agree on the physical futures contract that there needs to be real concern about market concentration. With respect to the financial market, I think first of all it's very hard to define what open interest and what total financial risk exposure is on the financial risk of natural gas. So to say that one participant is 30 percent of the open interest on the Intercontinental Exchange in a financial product for 2011 I think is largely irrelevant given that that exposure relative to total risk in

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the market is very small.

Second, I think I need to point that financial trading is the single most competitive market in the world. It allows competition solely on the basis of price. The individual trading one month is on the same playing field as ExxonMobil trading thousands. If the individual wants to be the most competitive buyer or the most competitive seller, they have that right and I think you have to allow the market to make the decisions about who is the best buyer, who's the best seller, who provides the best product with respect to an ETF, who provides the best product with respect to index funds.

CHAIRMAN GENSLER: Thank you. I turn to Commissioner Dunn.

COMMISSIONER DUNN: Thank you, Mister Chairman. Mr. Arnold, in your written testimony you're critical of the NYMEX granting exemptions and their ability to monitor that. Could you amplify a bit on that, and if in fact the Commission were to be granting these exemptions

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rather than the exchanges, what would you say we ought to be doing in monitoring these exemptions and the directions that they're going?

MR. ARNOLD: I think if I can comment on hedge exemptions and little bit broader, I believe that the 1,000 lots limit on last day in natural gas is enough for any foreseeable commercial situation. So if you start from there and say that no commercial necessarily needs more than 1,000 lots in the history --

COMMISSIONER DUNN: Your point was in your testimony that it's expanded to 3,000?

MR. ARNOLD: Right. People have hedge exemptions that allow them to have 3,000 to 5,000 lots on the second to the last day or the third to the last day. I think hedge exemptions on the physical futures contract is a Pandora's Box and once you open it up and allow one counterparty to have a hedge exemption then it's hard to stop, and not let much of the industry to have hedge exemptions, I think that would create volatility in the market because you have participants who

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are hedging financial risk in using physical contracts and they're keeping these contracts off the market until the very end, the last day or last 30 minutes or expiry and the market has a hard time balancing and it makes the market more opaque because the market doesn't know whether those markets represent real demand for the physical gas or whether they just represent a proxy hedge for some financial risk. I think hedge exemptions are prone to misuse and abuse. I think the abuse is that they're granted for a 1 year period based upon some claim that a commercial has in the market based upon that risk on that day. The NYMEX doesn't know and I think it would be hard for the CFTC to know the next day if that risk disappears should that hedge exemption still be there. I think they're very difficult to monitor in real time. I think it's misused because the industry continues to use the physical futures contract as a proxy to hedge financial risk and financial risk is best hedged by the industry using a financial product.

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COMMISSIONER DUNN: Thank you. Mr. Verleger, in looking at your charts, figure number 3 in your chart is the one that I labeled wow. At a time when diesel was very, very high here in the United States, we were exporting.

MR. VERLEGER: Yes.

COMMISSIONER DUNN: Explain how that happens and also the impact that the strengthen and weakness of the dollar has in this.

MR. VERLEGER: This graph shows by month data on net exports of distal fuel oil as reported by DOE and it goes from 1990 through 2008, and what you can see is there was a surge. The story began when Europe started to shift to ultra low sulfur diesel in 2008. We had shifted in 2006. This is 10 part per million diesel. European refiners could not produce enough of it. The European refiners could produce gasoline, and Total on is website has complained that European governments pushed everybody onto diesel but they haven't built the refineries to make the diesel. So what happened is we had the capacity, demand

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was down here as the witness from Schneider would explain because the recession had already taken hold here and pulled it up. What happened is that the dollar went from I think it was 1.3 to the euro to 1.6 to the euro at that point in time, and of course the marginal buyer of diesel at the time was the European consumer paying in euros. So as the dollar strengthened, they were paying in euros, the dollar price of diesel has to rise, and essentially that sucked diesel fuel from the United States to Europe. If you believe in free trade as I do, the system is working. But that pulled things up, and actually what we saw because refiners couldn't take the sulfur out of crude oil, the desulphurization units were full, essentially all they could do was buy sweet crude oil. A minor factoid is there are three kilos of sulfur in a barrel of sour crude, about 100 grams of sulfur in sweet crude, so what you do is you go for the sweet crude. This is why myself and a number of other people were trying to get DOE to sell sweet crude from the SPR during this time of

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the exports. That would have eased the situation and that would have stabilized the price. I have been using this graph. This is the telling sign of how our trade patterns got distorted and why we were seeing such a pull on the price of sweet crude oil last April, May, June and July.

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

COMMISSIONER SOMMERS: Thank you, Mister Chairman. My questions are for Mr. Chambers. I appreciate your views specifically on this as a user of the OTC markets and when we are considering imposing position limits, what your views would be on how we would impose those limits on swap dealers and how that could affect your ability to hedge and how we may look through or impose them on the commercial end users.

MR. CHAMBERS: We think that if position limits were imposed on swap dealers it would have a very negative effect on Chesapeake and other hedgers, and it's not just whether you're long or short the product. They frankly make the market

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for us. Otherwise we would have to pick up the phone and try to find somebody to enter into an OTC derivative as you had to do 25 to 30 years ago. We need them to help make this market. It's the most efficient way. They help us find that efficient price, and if you take away their ability to do that, it would be very damaging.

COMMISSIONER SOMMERS: Just to follow-up, can we make a system work where we allow you the commercial end user to have a hedge exemption even if you're going through a swap dealer?

MR. CHAMBERS: I think that Chesapeake and other end users would definitely need the hedge exemption. We would argue that the swap dealers would need it too to the extent that they're offloading whatever business we take to them and whatever business they offload to someone else. Admittedly, and for the reasons we think that speculation is a good thing for us is that they help make that market and if they offload our exposure to a speculator, to us that doesn't

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negate the fact that they are offloading a risk, so they should be exempt.

COMMISSIONER SOMMERS: Thank you. Mr. Verleger, in your testimony I want to try to clarify what your views on the current system for accountability levels, for position limits in the last 3 days, the fact that we give edge exemptions and no action relief to these index funds. Am I right in assuming that you think the way the current system works is what you would suggest?

MR. VERLEGER: Not entirely. As I said in my testimony as I tried to work through this, and I'm not a lawyer, I think there need to be some sort of limitations in the last three contracts. I picked the last three. I think it's important empirically and test these. We saw in February and March very serious disruptions in the oil market when U.S. oil was rolling their positions. Now they've their positions and there's less impact. I believe that there are other instruments that are more suitable for investors. I cut out of my section of my

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testimony a discussion of the BP Royalty Trust. I've been following this for 20 years. It's a way that the investor can buy a piece of oil and it's like a true asset where you have a flow of cash. The assay gives you a flow of cash. The index funds don't and they bother me that way. If you buy a bond you get a flow of cash. The BP Royalty Trust price is closely correlated with the price of WTI so they can get the same exposure and I think to a certain extent there should be some encouragement of organizations to create a royalty trust. In Canada we have a problem. I'm an American but I teach up there. In Canada they've decided that royalty trusts were costing them too much money and they've limited them. But to answer your question on the position limits, I think as Mr. Arnold said that in the physical market one wants to start imposing limits as these contracts approach delivery and I actually am one of the few people around here who remember the Hunt silver thing and I was listening to Mr. Jarecki and his testimony and he said it's an

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historical -- so there are a whole series of things, and these are very complicated, and unless you get down into the nitty-gritty of them, it's very hard to come up with the exact prescription, but I think you've got to go in that direction. One concern I have is the banks which are writing to Chesapeake and have bundled this risk from all these different parties and take all these things and I really worry about putting position limits on them because then they'll stop lending and that will turn the lights out in Calgary.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Commissioner Chilton?

COMMISSIONER CHILTON: Dr. Verleger, I want to pick up on what Commissioner Sommers was saying. Did you see movement in crude oil prices that you would attribute to the U.S. oil roll?

MR. VERLEGER: Yes, I did.

COMMISSIONER CHILTON: I know you're talking about the final days here and they changed their roll to a 4 day roll.

MR. VERLEGER: Yes.

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COMMISSIONER CHILTON: Have you seen any price movement with other EFTs?

MR. VERLEGER: The U.S. oil is the only one that was so public and the largest, and for years I've been following what's called the supply of storage curve. It's an agricultural economics tool of the spreads, and it went totally out of whack in Cushing where it should apply in February/March just at the period of time when it rolled, and so you could see it there. That was the one time I really noticed it, but the thing is I watched from Colorado or from Calgary so I don't have the inside information on what's going on. You hear all these anecdotes and most of the anecdotes turned out to be wrong.

COMMISSIONER CHILTON: Thank you, Doctor. Mr. Arnold, I'm going to pick up on another thing that Commissioner Sommers started to ask about but a little bit different. Do you have a position on the no action process with regard to ICE Futures Europe and the NYMEX linked WTI crude contract? What issues do you see being raised by

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continuing to allow those two trading venues to exist without hard position limit?

MR. ARNOLD: As a user I appreciate that there is competition between two exchanges. The problem with one exchange obviously is that they can charge monopolistic fees. So I certainly support two exchanges. I think the presence of two exchanges is exactly why the CFTC needs to assume responsibility for much of the regulatory oversight. One exchange cannot do it on its own, and essentially this unique situation with this no action letter where ICE has to follow NYMEX regulations you get a strange situation where NYMEX gets to put regulation on their competitor. So I think the CFTC needs to assume responsibility for much of the regulatory oversight that's now done at the exchanges and create rules that are good for the market as a whole.

COMMISSIONER CHILTON: I happen to agree with you. Would you have it be an aggregate hard position limit between the two exchanges? Would you have it be a percentage of open interest? How

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would you do it?

MR. ARNOLD: I support tighter limits on the physical futures contract which is only traded on the NYMEX. On financial positions, I don't think that there should be an position limit. I think they increase volatility. I think they reduce liquidity and the cost of commercial hedging.

COMMISSIONER CHILTON: I have a little more time and I'll try to get one more in and then I'll be done, Mister Chairman. Mr. Chambers, this is another one that may help our Capitol Hill colleagues who are here because it's about OTC and not necessarily about position limits or the hedge exemptions. But this issue of standardization, I cannot quite wrap my arms around that is defined. If it's only defined as what a clearing entity can make money on then that's easy enough. But how would you define it? And don't we need to cover more than just things that are standardized? I understand what we were talking about earlier about your concern about clearing everything, but

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this issue of standardization, have you thought about it any?

MR. CHAMBERS: Absolutely. The standardization question is key for a risk manager for end users, really any risk manager. Take for instance if Chesapeake issues debt that matures 10 days from this date. To force that to be standardized would immediately create inefficiencies in the hedge because you're not for sure there will be a contract specific to hedge that risk that you could put in a standardized form onto an exchange. That in and of itself creates problems from an economic offset perspective as well as an accounting perspective. And in some cases you might very well get the economic offset that you seek, but you might not get the accounting you see, so you're going to have near term volatility in your income statement that could quite frankly be confusing to investors.

COMMISSIONER CHILTON: Thank you.

CHAIRMAN GENSLER: I'm going to allow

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myself a third round and any other Commissioners who want it. I said I could do three rounds, and any one of you may. Mr. Chambers, you said earlier that you have 10 to 15 counterparties, or if I could call them suppliers of risk management which we call swap dealers. I suspect that you feel that that's a good thing to have them competing with each other to have 10 plus competitors supplying you the risk management.

MR. CHAMBERS: Absolutely. The more suppliers we have to affect our strategies the better.

CHAIRMAN GENSLER: That seems to be consistent with my earlier philosophy that the more suppliers in a market, in this case suppliers of risk management which we call swap dealers, is a helpful thing to markets and to market liquidity. You had also said just don't set position limits too low, but if we set them in a way that would help protect that you would have 10 to 15 dealers as opposed to maybe as the automobile in this country concentrated down to

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three, I know that we had a lot of foreign folks, but a lot of industries get highly concentrated and not just in the financial services field. Wouldn't that be beneficial to Chesapeake and companies like yours to continue to have a diverse set of suppliers of this risk management?

MR. CHAMBERS: Certainly. The more participants in a market the better. We're supportive of that. Our chief concern with using position limits to effect that is just we feel there needs to be more analysis and more data gathered to get the position limit right, and that's where going back to my previous statements, that is necessary to make sure that we don't get too low of a limit.

CHAIRMAN GENSLER: I understand, but when we heard from the swap dealers last week that they didn't want, one of them used I think the term splintering of markets, I just thought they just want to have a very large market share and I would understand why that would be counter to your interests. Mr. Arnold, if I could ask you a

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question about what we've proposed in over-the-counter derivates. I know it's a little off the topic of your written testimony, but do you have a point of view, and if you don't I understand -- we've called for the use of centralized clearing for standard product and the posting of margin. Do you have a point of view as to the hedge fund community whether they should come under that? We've heard from Mr. Chambers that he thought that corporate end users maybe would post noncash collateral, but I was interested if you had a point of view of the hedge fund community participating in posting of collateral and whether that should be cash collateral.

MR. ARNOLD: I think it's very natural for hedge funds to want to clear on the exchange to access the credit intermediation and I think hedge funds would rather pay a small fee to the exchange than take a credit risk on accepting the swap dealer's credit, and vice versa, that the swap dealer is reluctant to take a hedge fund's

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risk. We don't have $10 billion of producing properties to set up as a reserve. We have cash that guarantees our trades. So that's why we clear 98 percent of our trades. I think it is important in order to maintain a vibrant market to understand that people access the market in different ways. Chesapeake accesses the market through the swap dealers. Centaurus accesses directly to the exchanges. Some small speculators access it through the UNG or USO vehicle. Participants access the market in different ways, but the Commission should support this and allow this.

CHAIRMAN GENSLER: I thank you. Commissioner Dunn?

COMMISSIONER DUNN: Thank you, Mister Chairman. Mr. Chambers, you say in your testimony on page 6 that, "Markets routinely overshoot when correcting for significant economic events such as we've seen since the second half of 2008." Doesn't having passive investors in there exacerbate that situation?

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MR. CHAMBERS: I'm not sure if I have all the information to answer that, but I was basing the concept of overshooting on really any market that sustains a massive downturn, typically the panic of unwinding your positions causes it to go past what some would call a fair value. So you do have investors jumping back into the market to get back to what could be accepted as fair value.

COMMISSIONER DUNN: But if you have an investor who is not reacting to market signals, doesn't that skew the market in some way?

MR. CHAMBERS: If an investor doesn't react to market signals and is not analyzing the data, I think that that would have an impact.

COMMISSIONER DUNN: Mr. Verleger, you looked up. Do you have a comment on that?

MR. VERLEGER: I think we've known for decades, I remember Keynes writing about how just because the price may fall to say 50 -- may be the right price, the price will fall well below it which is why he wrote of the need for commodity stabilization agreements when he was coming up

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with the World Bank and the IMF. It's interesting if you look at the data what happened is that these index funds will reallocate. I hope we get more data from the CFTC on their actual positions because you have to just approximate what their positions are in the oil community. They reallocate so if oil prices rise relative to the other commodities in the funds, they will sell oil and tend to buy these other commodities. So last year as prices were falling from $150 down to $30 at the end of December, they were actually buying and buffering. They actually seen to be a stabilizing force. I'm somewhat surprised to find that in the data, but it makes sense, and we heard from U.S. oil the way they work. It also makes sense in terms of portfolio allocation theory, that is that CalPERS or any of the other big retirement funds buying commodities if they have a rational portfolio allocation if they see something rise in energy they will sell those assets when they believe the price has risen too far to maintain the portfolio balance. Again this

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is why I have been on both sides of this issue. I think that the data seem to say that in case of crude oil, and I won't say it about anything else, they seem to have been exerting a stabilizing influence.

COMMISSIONER DUNN: Thank you both. Again Mr. Chambers, you go on to say that, "We believe all of this puts the CFTC and other regulators in a very difficult position." I agree with that wholeheartedly. But I'd like to get your thoughts, all the panelists' thoughts on this, that we're in a unique position as we look at the futures market and we look at the commodities that we oversee and Congress has different entities based on the jurisdiction of the enabling committees that also work in those areas. In our case it's FERC and the FTC and some of the futures on energy markets. What do you see the relationship between FERC and the CFTC ought to be and understanding the types of things that you've talked about on the supply that's out there, the supply that may be out there on a

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tanker somewhere that we can't see so that we have a better understanding about storage capacity and what's really taking place in driving the markets?

MR. CHAMBERS: I'll go back to my previous statements that one of the reasons why this puts the Commission and regulators in a difficult position is that you have a lack of information. I think that information about physical and financial positions would greatly help out in making the appropriate decisions. I'll leave my comments at that.

COMMISSIONER DUNN: In your opinion is there a need for greater communication between FERC and the CFTC, maybe even having joint meetings to address some of these?

MR. ARNOLD: It sounds like a good idea.

MR. VERLEGER: Absolutely. You also have the FTC with its new rules on what constitutes speculation and you left out the Federal Reserve Board, and the copper crisis I recall Mr. Volker being over here kind of beating on the CFTC to try to get them to do something.

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The silver crisis and not the copper crisis in 1980. I've watched this debate between the CFTC and the FERC. The confidence on markets is here. The experience on review of markets is here, whereas the FERC has the kind of competence in the pipeline regulation and the storage. As for data on storage capacity and so on, I think it's essential that you share information and that there be much greater communication. But the competence on markets and market regulation is here. That's where it's been historically. That's where the experience is and that's where it ought to be.

CHAIRMAN GENSLER: Thank you, Commissioner Dunn. Any others? Commissioner Chilton? I want to thank the panelists. It was an excellent review. I actually was delighted to see that there is some commonality between the professor from Calgary and, if I can, an investment or hedge fund manager in New York. Right?

MR. ARNOLD: Houston.

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CHAIRMAN GENSLER: Houston. I have to know where you live. On the possibility of setting position limits on the near months physical. I thank you also, Mr. Chambers, for your expert testimony.

(Recess)

CHAIRMAN GENSLER: I thank everybody. I want to particularly thank our third panel for not only their expert testimony but their patience. We have with us Mr. Masters, Mr. Young and Mr. Greenberger. I'll just turn it over again if it's possible to try to give us the highlights. There were very extensive submissions and it's all there in the record. Mr. Masters, do you want me to start with somebody else? There will be a green light that flashes about three and yellow at about 4 that gives you a sense of what Doug's doing over here.

MR. MASTERS: Thank you, Chairman Gensler and Commissioners Dunn, Chilton and Sommers, for the opportunity to be here today.

I strongly recommend that the Commission

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adopt the following measures. Number one, the CFTC should set aggregate speculative position limits that apply across all trading venues including designated contract markets, foreign boards of trade and the over-the-counter markets. Number two, the CFTC should target an overall level of speculation in the range of 25 to 35 percent of open interest. Number three, the CFTC should convene a panel of bona fide physical producers and consumers on a semiannual basis for each commodity group to advise on position limits and the level of liquidity in the commodity derivatives markets. Number four, the CFTC should wet a superlimit equal to 5 percent of open interest for any noncommercial entity receiving exemptions or engaged in spread trading. Finally, number five, the CFTC should prohibit the strategy of passive investment.

When I first testified in front of the Senate in May 2008, I raised the alarm concerning the damaging effects of index speculation and today I want to reiterate that all forms of

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passive investment in the commodities markets are clear and present danger to the economy and American consumers. As I detailed in my written testimony, Goldman Sachs has said repeatedly that commercial producers were pushing down commodity prices through their hedging transactions. They took it upon themselves without consulting anyone to create the long only passive indexer. This artificial consumer was designed to add buying pressure to the commodities markets and to prevent prices from falling. This dramatically altered the structure of the commodities futures markets. In fact, this passive indexer has grown so large that their buying pressure has overwhelmed the selling pressure of commercial producers and caused commodity prices to increase dramatically and remained elevated for an extended period of time. The presence of passive investors has led to enormous volatility which correlates with investment flows and has very little to do with supply-and-demand factors.

There are three primary reason why

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passive investment inflicts so much damage on the commodity markets. One, it drives prices much higher as money flows in. Without passive investment, prices would be much lower. Why should consumers have to pay more for the essentials of life because of an asset allocation decision by investors? When passive investors allocate large sums of money to these markets, they do so with disregard for supply-and-demand fundamentals. Therefore, commodity prices reflect forces other than supply and demand. This destroys the essential price discovery function of the commodities markets. Because passive investors are long term and they buy and roll their positions, they remove liquidity from the commodities markets. By consuming liquidity, they add dramatically to the volatility of these markets. This makes it much more difficult for hedgers to do their job and hedge.

For these reasons, passive investment strategies in the commodities markets should be prohibited. These markets exist solely for bona

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fide physical hedgers, and as much as investors want to take over these markets, nothing will change that fundamental fact. Capital market investors need to invest in the capital markets, not the commodities markets. The idea of buying and holding in stocks is helpful, but buy and hold in oil and wheat is harmful.

These are not just economic issues. In fact they are national security issues as well. Today the old derivatives markets are inscrutable to regulators because of the bulk of trading that takes place over the counter. Therefore it is quote conceivable that a rogue nation could use these markets to push up oil prices. This would cause tremendous damage to the U.S. economy. There are many important reasons why we need aggregate speculative position limits. The one in particular is to effectively deter our enemy's attempts to acquire large derivatives positions in our commodities futures markets and negative influence the outcome.

Having embarked on this set of hearings,

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the CFTC needs to take strong action to protect the commodity derivatives markets from excessive speculation. If it does not, then it will send a signal to Congress that strong additional authorities are not imperative and it will send the signal to speculators that it is okay to push billions of dollars back into these markets. America has only one chance to get this right. It would be better to do nothing so that at least consumers are aware of the risk rather than implement half-measures that have the appearance of doing something while in fact leaving our commodities derivatives markets open to fraud, manipulation and excessive speculation. Thank you very much.

CHAIRMAN GENSLER: Thank you, Mr. Masters. Mr. Young?

MR. YOUNG: Mister Chairman, as you know, I used to work at the Commission and when I came back here a few weeks ago people asked me whether there was electricity in the building when I worked here 30 years ago, so apparently I

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haven't caught up with the technology. Excuse me.

Mister Chairman and members of the Commission, my name is Mark Young. I'm appearing today on behalf of the Futures Industry Association. One good thing about being on the last panel of the last hearing is that you know how the time limits will be enforced and you know how active the questioning will be. I've been watching and I will try to brief.

FIA supports new authority and resources for the Commission. We support extending the Commission's transparent market surveillance and reporting powers to certain OTC and foreign transactions. We support changing the CO2 reports to make them more granular. We support granting the Commission standby position limit authority for markets that settle off the prices of U.S. futures contracts.

Giving the Commission new tools does not mean we believe the Commission must use every tool it has in every way. Reasoned, balanced analysis should drive regulatory outcomes. That is why we

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are pleased the Commission has held these informative hearings. We also understand the Commission is updating it's September 2008 report with new data. We look forward to public release of that report and hopefully to equally informative public hearings to examine its conclusion when issued.

FIA's written statement describes our views on price discovery and position limits. As we explain, our major concern is market migration. If the CFTC imposes rigid position limits we fear price discovery in U.S. Markets will move offshore or to less regulated venues. That will compromise the Commission's market surveillance capabilities and our members' business. We know many do not believe this concern is real, but I am sure everyone would concede that the world has changed since 1936. Through technology, globalization, financial engineering and the like, U.S. markets do not operate in a vacuum. We are part of the world.

Last month, Prime Minister Brown and

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President Sarkozy warned of the harms of market volatility but recommended more transparency and not position limits. If other regulators in other countries do not believe that position limits will not help price discovery in their markets, we have to ask ourselves why. Is it because they tolerate price manipulation or market disruptions, or their market surveillance systems are better than ours, or do their trading systems differ from ours? I think we would all agree the answer to these questions is no. This answer should give us pause. Unless regulators in other countries see position limits as a cure for their markets, FIA believes there is a real danger that imposing rigid position limits on U.S. markets will cause market migration. That shift would harm price discovery in the U.S. and the public interest that the Commission and the Commodity Exchange Act serve.

As our written statement makes clear, before imposing position limits, the law requires the Commission to find first that some level or

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form of speculation or speculative trading has caused or will cause price fluctuations and changes which are sufficiently unreasonable and unwarranted to burden commerce. Then the Commission must find that any limits it sets are necessary to diminish, prevent or eliminate such a burden. At this point, we see no consensus, and based on the last panel I don't see how anyone could see a consensus on whether the excessive speculation standard has been met. The Commission's update of its 2008 report will shed additional light on this important question. We look forward to reviewing it when it is available and to answering your questions today.

CHAIRMAN GENSLER: Thank you, Mr. Young. Mr. Greenberger?

MR. GREENBERGER: Thank you, Mister Chairman. I also as an alumnus of the CFTC want to congratulate you and the other Commissioners on what I think have been three very excellent days of hearings and probative questions. First of all, I thank the Chairman for inviting me, and I

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was asked by the steering committee of Americans for Financial Reform to speak on behalf of that coalition and its 200 members. It's made up of the nation's largest unions, civil rights organizations and public citizen's groups. They have a call to action seeking financial regulatory reform, and last week they forwarded a letter to the Hill leadership supporting the Obama Administration White Paper proposal that standardized contracts be moved onto exchange trading and that swaps dealers who have large volumes in these markets have their own regulatory requirements applied to them.

For purposes of today's hearing, the Commodity Exchange Act of 1939 may be old, but it still the act. It was proposed to Congress by President Roosevelt in conjunction with the Securities Acts of 1933 and 1934 and I think the SEC still finds those acts to be probative. I think the Chairman in his opening statements has made it clear that you feel yourself bound to the statute as it now presents it itself to you, maybe

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it should be changed, but in this regard it hasn't. And you noted, Mister Chairman, where there is a potential of burdening interstate commerce and excessive speculation is found, position limits have to be imposed. That issue has practically has been resolved for every physical market. There are position limits for every market. It may be you set them or the exchanges you regulate set them, but they're position limits. Nobody is coming here and saying abandon the idea of position limits. Once you accept position limits, you've accepted the possibility of excessive speculation.

With regard to speculation as my testimony points out and I think as you've tried to point out, Mister Chairman, there is a lot of confusion. The Commodity Exchange Act recognizes that speculation can be and is necessary. Physical hedgers cannot operate regulated exchanges on their own and speculators however they come to the exchange, whether as swaps dealers, individual investors, commodity index

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funds, may be needed to create necessary liquidity. Without the liquidity there would be no exchanges. What the statute says is speculation is good when it creates liquidity. When it goes beyond that it is excessive and there have to be controls. The controls are position limits and we have position limits today.

We are bound by that statute in how to go forward. There is a bona fide hedging exemption. Who is not going to be subject to the position limits? My reading of 4(c) is consistent with the purposes of futures market again as evidence as to what President Roosevelt wanted and what the agricultural committees did in 1936. The futures markets are unlike the equity and debt markets. The futures markets are designed to allow people to hedge their commercial risk. That is their exclusive purpose. They are not designed to have somebody come in and look at a company and say that company is selling for a small price. I can make $100 million investing $1 million. The purpose is to allow commercial hedgers to hedge

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their risk. The tension between producers and consumers in the hedging process creates a reflection of supply and demand fundamentals.

Futures markets are price discovery. Everybody accepts that. When you go to buy something in the spot market, you look to see what the futures price is. You are hoping and praying that the purposes of the Exchange Act are met by that tension of people who do care about what the price is, that it will be a reasonable, fair, open, orderly price. People are invited as speculators who as the USFO person said, I don't care what the price is. Yes, we want those people in to create liquidity, but if you have as the Senate White Report just reflected 60 percent of the wheat market being speculators, you lose the supply and demand function and consumers such as those I represent are not paying according to market fundamentals, they're paying according to people who don't care what the price is except that it meets its betting strategy. You have the power to control that and you should control it.

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CHAIRMAN GENSLER: Thank you, Mr. Greenberger, Mr. Young and Mr. Masters. If I could start with a question for Mr. Young. Are you familiar with General Counsel Berkovitz's testimony to the Commission on our first day of hearings about our legislative history and background?

MR. YOUNG: I read his report. I didn't see all of his testimony.

CHAIRMAN GENSLER: On that first day I recall asking him, and we could ask him to come back to the witness table, but if I can paraphrase what I remember asking him, was whether this Commission had to find that there actually was as you just said -- what I'm trying to say is he doesn't I don't think agree with what you said in your opening statement, that this Commission does under the Act, it says, shall set position limits where necessary to eliminate, diminish or prevent the burdens that may come to interstate commerce from excessive speculation. So if we see those burdens in the future, it's not about saying there

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was something in the past. That's how I recall his testimony. We could ask him to come back up and see if that's correct, but do you agree with what I'm paraphrasing I think our General Counsel told us?

MR. YOUNG: I have great respect for your General Counsel. He can probably show me how to use the microphone, and I'd be happy if he wants to join the discussion. I'd start by simply saying I agree with Michael Greenberger that you have to apply the statute as written. The statute says very clearly there are two components to the Commission's speculative position limit power. First, there is a finding of excessive speculation which has caused price fluctuations or price changes that are unreasonable or unwarranted.

CHAIRMAN GENSLER: I take the liberty of the Chair that General Counsel Berkovitz testified differently than that.

MR. YOUNG: If you'd like me, Mister Chairman, I'll read you the first sentence.

CHAIRMAN GENSLER: No, I'm going to ask

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General Counsel Berkovitz.

MR. BERKOVITZ: Yes, Mister Chairman, last week your summary was correct and basically stated that we did not have to actually find that there had been excessive speculation in order to impose a position limit. In 1981 as the testimony recounted, the Commission determined that the exchanges should set position limits for the commodities where the CFTC had not set limits when the commodities were expanded in 1974 to include all futures and the Commission exercised that authority at the time without such a finding that there had been excessive speculation in all those additional commodities.

CHAIRMAN GENSLER: Thank you. Mr. Masters, may I ask you a question?

MR. YOUNG: Mister Chairman, I never got to answer the question.

CHAIRMAN GENSLER: I just think there's a difference here, and he's our General Counsel.

MR. YOUNG: I'm perfectly comfortable with the fact that there's a difference. On this

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there is no difference. The Commission does not need to set position limits. There is no mandate to set position limits. If there were, you'd be in violation of that mandate today because in 1979 you determined that you didn't need any longer daily trading limits which you repealed having found that those limits were no longer necessary to prevent excessive speculation.

CHAIRMAN GENSLER: We can see that it's good to see where there are similarities, but what I think our General Counsel is saying is there is no need for this Commission to do anything more than what the statute says which is to determine whether it's necessary to diminish, eliminate or prevent the burdens that may come, and it's not an historical thing, it's also a prospective thing. Is that right?

MR. BERKOVITZ: That's correct.

CHAIRMAN GENSLER: You might even agree with him now.

MR. YOUNG: The words in the statute are to diminish, eliminate or prevent such burdens.

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You can't diminish, eliminate or prevent a burden if you haven't found it exists or could exist.

CHAIRMAN GENSLER: Could exist.

MR. YOUNG: Or could exist.

CHAIRMAN GENSLER: We are in the same place. Could exist. Future. Thank you. I'm going to turn to Commissioner Dunn.

COMMISSIONER DUNN: I'm not even sure you got one whole question out there.

CHAIRMAN GENSLER: To me it was an important one. It's our statute and our law.

COMMISSIONER DUNN: I have some concerns about the Commission unilaterally establishing position limits in the markets that we have oversight and what that means. Mr. Young, in your testimony you say that when we look at this we ought to look at international arbitrage as well, but it's been my experience since I've been on the Commission that when there are times that we have found people bumping up against accountability levels or position limits, what they simply do is move to another venue, sometimes an opaque venue,

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and that doesn't accomplish what we try to accomplish at all. It simply puts it out of our sight. I'm like all three panelists to address how we do assure that if the Commission sets a position limit that we're simply not setting ourselves up for only seeing part of the problem.

MR. YOUNG: Commissioner Dunn, I think that's a challenging question and I'm not arrogant enough to think that I can sit here and tell you the precise answer today. What we did tell you in our testimony is that international arbitrage is a consideration that the statute calls for you to contemplate, so it's not a matter of whether you'd like to or not like to consider it, the statute calls for you to consider it.

The other thing that we said in our testimony is that this is a challenge that not only the Commission faces but also the exchanges face. To date the exchanges have set position limits in energy commodities. I don't believe they've done it in a vacuum. The Commission has been their partner. The Commission has been there

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every step of the way. And the Commission can say to an exchange today your limit is too high or too low and you have to change it. You have absolute authority to do that. And the Commission can also say to an exchange today your hedge exemptions which all contain their own limit are set with a limit that's too high or too low. So right now what you have is a collaborative process and through the informed judgment of the exchanges and the Commission, you have an opportunity to set a position limit that keeps international arbitrage to a minimum and allows you, and this I think Commissioner Dunn is exactly where we were going with our testimony, to preserve the integrity of the price discovery process by making sure that price discovery occurs on U.S. exchanges.

MR. GREENBERGER: With regard to international arbitrage, I'm a little caught off guard to be candid where in setting position limits or hedge exemptions, international arbitrage is part of your statutory mission. And even if it were, I can assure the Commission the

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G-20 has just set up by order of its last meeting an international meeting to respond to this exact question. The International Energy Forum is the convener. I am a member of that group and I can tell you that every country save possibly one is greatly worried about this same problem.

Number two, after the economic meltdown, let's leave London to the side. Is Chesapeake really going to go to the Dubai Mercantile Exchange and rely on the credit mechanisms or any other Third World country?

Number three, if international arbitrage were really a problem, the Intercontinental Exchange Futures Europe would still have its trading terminals in London. They are claiming they are a United Kingdom. They claim they should be regulated by the United Kingdom, and as you know I have concerns about that. But they and 20 other foreign exchanges have come to this Commission asking for the privilege of placing terminals in the United States. When you're trading United States benchmark futures, WTI,

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Henry Hub, you've got to do it in the United States. If you didn't need to do it in the United States, ICE Futures Europe wouldn't be in this dilemma of having U.S. trading terminals, having conditions imposed upon them that make them almost a regulated exchange when they could be at the FSA right now who doesn't require position limits. People want to be in this country.

COMMISSIONER DUNN: My time ran out, but I would like to hear from Mr. Masters.

MR. MASTERS: Thanks. I would echo Mike Greenberger's comments and others'. There is little doubt if you act decisively that other members of the G-20 and the G-7 are going to follow along with what you do. Everybody knows that we have a problem. The idea that we don't have a problem, that there's not excessive speculation, is contrasted by the facts. We had the largest move ever in history in commodities prices unilaterally in the last 12 months. We've had world wars, we've had depressions, we've had various economic collapses, and we've had the

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largest single move in commodities prices in 12 months we've ever had in history. How else would we define excessive speculation? So I think that because this affects all nations it's very likely that anything you do will be unilaterally followed by other members of the G-7, and I think with respect to Sarkozy and Gordon Brown that they would echo those sentiments if they were here today.

Finally, with regard to fiduciaries themselves today, fiduciaries recognize that the world has changed a great deal. There is very little prospect for fiduciaries that run large institutional pools of money to go overseas to engage in regulatory arbitrage with credit counterparties who are suspect to say the least. We just went through a significant crisis where we had these issues. That's the last thing that fiduciaries want to do. They want to stay here and trade. They want to clear. They want to clear on U.S. regulated exchanges because their boards are telling them to. So at any rate,

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that's my answer.

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

COMMISSIONER SOMMERS: Thank you, Mister Chairman. I have a couple of questions with regard to the same line that I keep going down with every one of the panels, and they're for Mr. Young. In your written testimony you talk about the CFTC lacking the authority to impose limits on either the OTC markets or foreign exchanges and as Commissioner Dunn was talking about, the unintended consequences of pushing those trades to another market. Do you have a view on additional steps that we do have the authority to take at this point with regard to position limits?

MR. YOUNG: I don't see how under the statute as it's written now the Commission can impose position limits in the over-the-counter market. I also don't see how the Commission under the statute as it's written now can impose position limits on foreign boards of trade. I do understand how the Commission can attempt to

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negotiate with the regulators overseas when there is an exchange competition which we happen to like at the FIA. We like trading platform competition. When there is such a competition and one competitor is overseas and one competitor is in the United States, we believe the Commission has the authority has to negotiate, communicate, cooperate with their colleagues overseas, and if Mr. Masters's prescient observation about the prime minister and the president are correct that France and Great Britain would embrace position limits, a lot of our concern about migration would be dissipated.

COMMISSIONER SOMMERS: Another part of your testimony where I jut wanted you to clarify is with regard to hedge exemptions. I think what you suggest is that we should look at these only in linked contracts, and if you could explain why the Commission's authority is we should be looking at those linked contracts.

MR. YOUNG: When an OTC instrument or a foreign instrument is priced or settled against a

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U.S. dominant market price, we can understand how that linkage would have an impact on the Commission's ability to see the entire spectrum of the market for price discovery purposes and we believe that it is the most fundamental of the Commodity Exchange Act that the Commission preserve the integrity of the price discovery process. So we could understand how that kind of authority for the Commission would be consistent with what we believe to be the key purpose of the statute.

COMMISSIONER SOMMERS: Thank you. Another part of your written testimony is the commitment of trader's report and you talked about it a little bit in your oral testimony. I wanted to ask you if you had ideas about how we could break out that data to make it more useful in addition to some of the Chairman has talked about, if you had additional views on how we break that data down.

MR. YOUNG: I think the ideas that the Chairman has expressed are ideas that we've

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endorsed and we think that would be helpful to the marketplace. I think that there is a great deal of misinformation and misunderstanding about the different categories I think some people call spreader speculators because they're noncommercials. I think some people don't attribute appropriate positions to so-called swap dealers and appropriate positions to index traders. We are of the view that the best medicine here would be sunlight and the best thing to do would be to let as many people see who's really in the market and in what composition.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Commissioner Chilton?

COMMISSIONER CHILTON: Thanks, Mister Chairman. Mr. Young, I want to make sure. I may not have heard something correctly. I know that you said if foreign boards of trade implemented similar position limits that that would potentially alleviate some of your concerns. Did you say that if that were the case also if Congress legislation further regulating OTC

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transactions so that they would also have position limits? Essentially if you bought those on exchange, would that also alleviate your concerns?

MR. YOUNG: Yes, because if the concern is that the position limit is going to force people into other market venues if there are OTC positions that are priced off a regulated U.S. futures contract, then having those positions be subject to overarching position limit scheme adopted by the Commission would prevent the incentive that people might otherwise have to migrate to an OTC venue.

COMMISSIONER CHILTON: There was a lot of discussion on the Hill about which OTC products would be included. You just mentioned the standardized or the price discovery contracts. Do you believe that any others would be in the area that should be regulated?

MR. YOUNG: I think I mentioned price discovery contracts in the sense that if you have an OTC transaction and it is priced off a U.S. futures contract, the U.S. Futures contract we

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all know serves a price discovery function and therefore there would be a linkage there and a nexus there that we could understand would be the basis for imposition of some position limits. In terms of overall authority for the Commission to regulate the dealers as the Chairman and others have talked about, you've got us at a little bit of a disadvantage and you've got me at a little bit of a disadvantage. I understand there is some draft legislation circulating in Washington to do some of these things and we'd sure like to see before we comment further, but in general outline, the idea that we need some what I'll some gap-filling measures is something that the FIA considers appropriate.

COMMISSIONER CHILTON: It seems to me that there may be de minimis bilateral contracts that may not have that much interest for regulators or may be too time intensive or staff intensive rather for us to view. At the same time it seems like you could have one-offs so it's not exactly like a U.S. regulated contract, it's got a

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little bell or whistle on it. Would you agree that if Congress acts that we would need the ability to have some flexibility in order to address any of these one-offs that could potentially have impact on price discovery even if it's through an arbitrage mechanism?

MR. YOUNG: I think I was with you until even if it's through an arbitrage mechanism because I'm not sure what you meant by that.

COMMISSIONER CHILTON: You have a one-off where you have a WTI contract but it's delivered 100 miles from Henry Hub or something. Something that's a little bit different.

MR. YOUNG: If you and I, Commissioner, did a Henry Hub swap and we didn't tell anybody about it and we performed on that swap, I don't think that swap has any impact on price discovery.

COMMISSIONER CHILTON: What if I'm Saudi Arabia and I've got a sovereign wealth fund and it's a billion dollar swap and it's a one-off? Are you concerned then or should we be concerned as regulators?

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MR. YOUNG: Saudi Arabia should be concerned if they're taking my credit risk. But if Saudi Arabia did a completely private swap transaction that no one ever knew about, I don't see how that has a price discovery impact.

COMMISSIONER CHILTON: Mr. Masters, you got into that and you heard some of the discussion with Dr. Verleger earlier about OPEC, but you mentioned rogue nations. I'm curious if you have a view on what could happen in currently unregulated markets with some of these sovereign wealth funds or other problems that you see in that regard.

MR. MASTERS: As we put in our testimony, we think it is a big concern. If the regulator can't see what's going on in markets that directly affect markets that are traded on listed futures exchanges, for instance, it has a national security implication especially when from our data analysis the vast majority of that activity is trading on those markets. So I think that it's a very big issue. If you're going to

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have some kind of regulatory scheme that it should include those markets and it should include things that are substantially similar in the sense of to use the example that you just used with the swap, certainly that's going to have an impact on price discovery given the example that you set. So in my view from a national security perspective, it's a great argument for mandatory clearing and it's a great argument for regulators to be able to have the transparency they need to see what's going on. It's also a great argument for position limits because if hostile nations know that you have the tools at your disposal to be able to fight excessive speculation, then they're less likely to engage in that kind of activity in my view.

COMMISSIONER CHILTON: Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. I want to thank Mr. Young for pointing out that a trade association that lobbies the Hill thinks we're doing something right, that you don't have draft legislation that the Treasury has only shared with the CFTC and the

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SEC. So I thank you for making that observation that a lobbyist doesn't have draft legislation yet. Mr. Masters, if I can ask you on a more serious note some specifics. You picked a limit of 5 percent as a hard limit. What led you to that number and why not some other number?

MR. MASTERS: We picked that number because we thought that it was a reasonable number to pick, quite frankly. Certainly that number should be subject to some evaluation, but in our view, we looked at from the standpoint of a single participant that 5 percent or some other number that you look at is a reasonable approximation of economic power, that even if you're trading spreads or you're trading something like that you're going to have for instance during the roll period for instance some of the ETFs are in some cases bigger than that, they're going to have some market impact, and our thought was that you want to be able to limit that from the standpoint of almost as you would limit an monopolist.

CHAIRMAN GENSLER: May I ask, did I take

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it from your testimony also that you would have that limit, the 5 percent for any individual, and then were talking about a class of investors when you said 25 to 35 percent would also be limited?

MR. MASTERS: Right. We're making the argument that given that speculation is there to provide liquidity to the primary constituency which is bona fide hedgers that in no case should they ever be above 50 percent in terms of open interest. We came up with that number, 25 percent to 35 percent of the open interest and this is across markets, because that was the way it was 10 years ago and 10 years ago there was plenty of liquidity, we certainly wouldn't have been this testimony, the idea of excessive volatility and excessive speculation were issues that didn't have to be addressed because the regulations took care of things then.

CHAIRMAN GENSLER: Thank you -- unless it was just on my earlier comment about not having the legislation -- but Mr. Greenberger, you were honored to serve here at the CFTC as the head of I

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think it was called a different thing, but the Division of Market Oversight or Trading in Markets.

MR. GREENBERGER: Trading in Markets.

CHAIRMAN GENSLER: So I was curious about your perspective on the general subject of no action letters, not specific to ICE, but just generally, because I know that there no action letters certainly when you were here, there are probably some that you even signed because they date from every decade of this agency. Do you have a perspective on how we should look at the no action letter process throughout the agency?

MR. GREENBERGER: First of all, you wouldn't be here today if it weren't for the no action with regard to the EFTs and the ETNs I think. The no action process can be a very dangerous process. You can have staff taking you down a road that ultimately comes back to bite you because it used to be the practice that no actions were sent by the Commissioners just so they had notice. I don't know if that's still done today.

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But the ICE Futures Europe situation is the result of no action.

CHAIRMAN GENSLER: I understand. There are hundreds. I was just curious if you have a view on the whole process, not any one individual.

MR. GREENBERGER: I think they have to be used with the greatest degree of care. When we were here we set up a process because there used to be no rules as to how they were applied. When I walked in the door what I found is that you got a letter from some very prominent lawyer in the industry two pages long asking for a major exemption and you couldn't understand what the letter meant, and a lot of times it was approved. Frankly, the thesis at the time was what was more important than what was said in the letter was which lawyer sent the letter to the Commission, and we set up a set of rules that said what those letters had to look like. I very much worry, I think Commissioner Dunn said this, that no action processes are establishing global rules and regulations that come back to bite the Commission

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as a whole. I think that that was true in the foreign boards of trade having U.S. terminals, I think it's true in granting these exemptions from the hedge exchanges. What my advice to you would be as Commissioners, I think you have to make sure because they're designed to be a safety valve to take care of little problems.

CHAIRMAN GENSLER: I didn't want to cut you off. Mr. Young, do you have something on either of these questions?

MR. YOUNG: I actually had a response to both of them if I might. The assertion has been made that the only thing you should care about is sufficient speculation to service hedgers, that serving hedgers is the purpose of the Commodity Exchange Act. That is wrong. The Congress found that futures markets are affected with a national public interest by providing a means for managing and assuming price risks. That's one. Discovery prices. That's two. Or disseminating pricing information through trading in liquid, fair and financially secure trading facility. My

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colleagues, the Mikes, may not like the idea that price discovery and the integrity of price discovery is central to the Commission's mission and central to the Commodity Exchange Act, but Congress has already made it so. Price discovery is depend on supply-demand market principles.

MR. GREENBERGER: If you go back to Roosevelt's letter to Congress or the agricultural committees, the markets serve commercial hedgers. I think that's indisputable because commercial hedgers have an interest in assuring a fair price to sell and a fair price to buy. Speculators don't. If speculators take the markets over, the market no longer becomes price discovery. I think the wheat report shows that, and many of the physical hedgers who have come here today are abandoning these markets because they no longer serve price discovery, and what you have in the wheat report, 60 percent of the open is for speculators. That's a casino.

CHAIRMAN GENSLER: I'm going to hand it over to Commissioner Dunn, and any time you need.

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COMMISSIONER DUNN: Thank you, Mister Chairman. I'd like to reflect a little bit on Mr. Masters. When I left off talking with him you said that the G-20 would probably follow the lead of the United States on this, and in fact, Reuters has a report out today that the FSA and the oil industries are seeking a response to the CFTC. They're doing it a little differently. Apparently the FTC and Treasury will meet with oil industry representatives in response to U.S. pressures for more regulations in the commodity markets. It will be by invitation only is what I'm reading into this and it involves oil producers, traders, banks and funds. They expect 20 to 30 organizations to meet at the FSA building. I would much prefer this open and transparent method that we're using here. Your contention that the G-20 and the rest of the world is going to follow this, the G-20 has set up an FSB, they changed the FSF to the FSB. The chair of that has indicated that he thinks that there needs to be more harmonization internationally of financial

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regulations including those in the futures industry and has indicated that they are going to look for the IASCO, the international representation of securities groups, to bring forth some of the recommendations they have. The problem I have with that is even though we are associate members of IASCO and due to the diligence of our staff we have been very active on various committees on having input, but on the end of the day, this Commission, the CFTC, has no vote on what IASCO adopts. I think the American public would be very, very concerned if they thought that we had to acquiesce to an international body when we had no vote, and it's something that I hope gets changed in the future.

We began talking about no action letters and I'm probably famous or infamous in the industry for opposing no action letters. I think they should only be used for emergency purposes. I found out at one time that one division had over 600 no action letters out there. I have asked previous Chairs or Acting Chairs to review those,

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to go through those, because some of those were a couple of decades old going way back past the tenure of both of these members here. I think that they may in some cases be ticking time bombs out there, that we need to go through and review past Acting Chairs. When I was Acting Chair I had asked staff to begin going through and reviewing those. I know our current Chair has done the same thing. The problem is lack of resources to be able to do this. I'm sorry, Mr. Masters, this is an inside CFTC thing, but I will ask our two almea matres here about the level of resources that we have at the CFTC from what you saw when you were here and understanding the growth that we've had since the passage of the Commodity Futures Modernization Act, in your opinion as former insiders do we have the resources that we need to be an effective regulator?

MR. YOUNG: Commissioner, no. You asked me to use the frame of reference when I was here. That was a sly way of getting me to explain that I was here from 1977 to 1982 well before Mr.

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Greenberger arrived.

COMMISSIONER DUNN: Back when we had more staff.

MR. YOUNG: Back when you had, as you have today, very capable and dedicated staff. You could have used more of them then and you can use more of them now.

The one point I would make about the no action letters is that they grew out of a time when the CFTC did not have exemptive authority. That was created by Congress in 1992, and there were no action letters and it was the practice of no action letters before that time. After 1992 when the Commission got exemptive authority, the Commission itself could grant appropriate exemptions from different regulations and different provisions, and one of the things, Commissioner Dunn, you'll recall that the FIA proposed in the context of the foreign board of trade rules was that the Commission grant exemptions in that area in lieu of no action letters so that the imprimatur of the Commission

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was on the policy statement.

COMMISSIONER DUNN: So when we get into situations where an entity has to exceed a spec level or an accountability level such as the unwinding of Lehman for instance and we were looking for a counterparty to take over, we could use 4(c) to achieve that?

MR. YOUNG: I think 4(c) is a very flexible power and I believe you could use that if you move quickly enough to address a particular market exigency as the one you described. Yes, you could use it.

MR. GREENBERGER: And as was said, it's a transparent power. It's a public notice in the Federal Register, a public comment, public explanation. The no action process from what you're telling me is not even transparent within the Commission itself today or at least has been. With regard to staff, Michael Masters and I have testified together at many hearings that have been quite contentious over these issues. I think the one issue that there has been bipartisan support

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for is that the CFTC needs more staff.

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

COMMISSIONER SOMMERS: Thank you, Mister Chairman. A panelist on the previous panel today, Mr. Arnold, had an I thought interesting proposal on how we would impose limits. This question is for Mr. Young on how you feel that imposing these hard limits with no hedge exemptions just on the physical markets and for us to be drawing this very bright line between how we regulate the physical markets versus how we regulate the financially settled markets and how you view that.

MR. YOUNG: Even if I used the mike I'm afraid I wouldn't be of much help. I wasn't exactly sure the distinction that he was drawing between physical and financial markets or months, I wasn't sure whether he was talking about hard limits in the delivery month and the deferred months being financials. I was not clear exactly as to what he was sayings so I don't think I'd like to muddy the waters further on that.

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COMMISSIONER SOMMERS: I am not positive, but what I thought I heard him say was that we would regulate for instance the NYMEX physically settled contract differently than we would the ICE financially contract or OTC contracts, that there would be a difference, and if you think that that is prudent.

MR. YOUNG: There are differences in a deliverable contract and a cash settled contract. They do require regulatory considerations that are different. It's hard to question that. In the delivery month, mischief can be created by speculators and by hedgers, and since I don't think index funds are hedgers or speculators by index funds, if you want me to add that as well. I think most index funds aren't in the delivery month so you don't really have to worry about that. But I think the idea that's been expressed before here about these accountability levels that apply to the other months, it's inconsistent with my understanding of accountability levels and that's why I would tend to agree with the

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observation that was made.

The accountability levels are not ceilings, they're warnings, and when you get a warning you look to see what somebody is doing and that's part of the market surveillance process that the Commission has always applied to hedge exemptions for market participants in the commercial sector as well as I believe they apply with respect to dealer exemptions and any exemptions for index funds. So I think if you accept the idea that accountability levels are triggers for caution and for enhanced market surveillance and for jawboning and things of that nature, then that would make sense to me.

COMMISSIONER DUNN: I have time for one more quick question. This is for Mr. Masters. I wanted to clarify a question that the Chairman got into with you about the percentage levels. I'm not sure that I understand what you were referring to as the superlimit of the 5 percent and then how the Commission would practically impose a 25 to 35 percent level on a class. How do you make that

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fair to those participants in that class?

MR. MASTERS: There are theoretically a lot of ways to do that in terms of making it fair. With regard to the 5 percent, I believe that you already a large trader identification scheme where I think that you could probably use that at the control entity level to be able to determine their market impact. That argument really comes to the whole notion of not letting a single participant dominate from an economic standpoint. We want a diverse group of participants in the markets, we don't want someone dominating, and so we felt that 5 percent was a reasonable attempt at picking a number out to do that.

With regard to the other question on the open interest, open interest is published every night by the exchanges. Clearly part of setting position limits is having clearing, having the capability to understand what's going on in the markets. So the CFTC prospectively needs to be able to see what's going on in the markets to be able to effectively have position limits.

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Otherwise you'll drive people from an exchange to an over-the-counter market. So the idea is to bring CFTC's oversight to these various markets and then you're really able to see on basically a nightly basis, and if you didn't want to do that you could do it on a longer interval, you could potentially do it on a monthly basis or whatever, that the market was not excessively speculative in aggregate. Twenty-five to thirty-five percent was a range that the market existed in 10 years ago with regard to speculators and noncommercials versus hedgers. It's now the reverse. So that's the idea for that number.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Commissioner Chilton?

COMMISSIONER CHILTON: Thanks, Mister Chairman. I asked this week of one panelist, but as we have the possibility of having additional tools either Congress or things that we do as a possibility, I get concerned that we don't have criminal authority to actually put people in jail when they violate the Commodity Exchange Act.

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Seventy-five percent of our referrals to criminal entities are rejected, and it's not because they are crappy cases. One-hundred percent of those we win, so they're good cases, but they're often complex, and when Mr. Young worked here years ago there were still differences about what the law says, so you can imagine if you're a U.S. attorney in the hinterlands and you get a Commodity Exchange Act case, you may not want to take it up even though it's a good case. There's a provision in the House Agriculture Committee bill that was passed with bipartisan support that gives the Commission criminal authority, and I'm curious as to whether or not the panelists have thought about that and whether or not that's something that you think we should have.

MR. GREENBERGER: This goes beyond my brief for the people I'm speaking on behalf of, so I want to say that I'm speaking for myself on this issue, and also I have the wisdom of having left the Commission after 2 years and worked for Attorney General Reno for 2 years. I'm sure the

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Justice Department is not going to be happy about that, but I will tell you I would fully support the Commission being able to bring criminal prosecution. As Dr. Verleger said, you know these markets. Unfortunately as things now stand, if you walk into the Justice Department Criminal Provision with this kind of complexity, they're not geared for that and you are. Talk about increased staff. To move your Enforcement Division from what they do now to being experienced and able to bring criminal prosecutions is no small measure and you would really have to think that through very carefully on how you're going to hire and train, et cetera. But I think the future is that both the SEC and the CFTC will be given and should be given the ability to prosecute criminal cases.

MR. YOUNG: I agree with Mike about the resources and I think it would be better to allocate those resources to strengthening your market surveillance capabilities than it would be to developing the team of lawyers you'd need to

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handle criminal cases. Understandably you're not staffed now to do that. The biggest quarrel I have with this concept is that embedded in the concept is the idea that the Commission's current enforcement authority is somehow an inadequate deterrent, and in my experience being on the other side of that gun, that's just not the case.

COMMISSIONER CHILTON: Yes, I see it all the time.

MR. YOUNG: You can ban people from the market for life, you can fine people extreme amounts of money, and I think this Commission has been as good as they come in obtaining major fines from people who have committed violations of your Act.

COMMISSIONER CHILTON: Major fines, but it's do the crime, do the time, not pay the fine. There was a guy that we fined in Florida a few years ago for a Forex scam, we fined him and this year we got his wife, so that I don't think that there's enough of a deterrent, but I appreciate what you're saying about the staffing levels.

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Mr. Young, I had a question about your testimony where you say that, "There is a distinction between price risk offsetting hedging and pure speculation." I'm curious as to if you could elaborate on that a little bit.

MR. YOUNG: If I thought the market was going up or going down and I wanted to get that exposure one way or the other and I put on a position to obtain that exposure, I'd consider that speculation. If I had entered into a contract with Mike to my right and Mike to my left, and Mike to my right's contract was larger than Mike to my left's and I had the net price risk from that and I went to the futures market to offset that price risk, I consider that to be price offset, and that kind of price offset is what I believe is at the core of the concept of hedging in the Commodity Exchange Act.

COMMISSIONER CHILTON: I don't want to put words in your mouth. Are you comfortable with the status quo with regard to hedge exemptions?

MR. YOUNG: I'm comfortable with the

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status quo with regard to hedge exemptions if there's no additional change to the law. We have to be careful because we're dealing in two universes, current law and what new law could bring. But FIA has submitted to the Commission a strong letter in favor of retaining the current hedge exemption. That exemption doesn't mean that the people who get the exemption can do whatever they want. The dealers who get that exemption when they engage in speculation independent of their swap dealing business, they're subject to a position limit and the hedge exemption itself, as all hedge exemptions do, come with a position limit. So, yes, under current law we'd be comfortable with the current hedge exemption.

COMMISSIONER CHILTON: If I could just get the Chair's indulgence. I may not have another round.

CHAIRMAN GENSLER: As much as you want. I think the other Commissioners don't need another round, but if you need another one --

COMMISSIONER CHILTON: Thank you. There

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was some discussion between ICE and CME last week about this subject and I assume that you may have watched that about hedge exemptions and they were disagreeing about them I assume for competitive advantage which would make sense given the business they're in. It led me to the conclusion that we should actually be the arbiters of these hedge exemptions. When you say you pretty much support the status quo, would you object to the Commission establishing these exemptions?

MR. YOUNG: No. If the Commission established the same exemptions for swap dealers, no, we wouldn't object to that at all. The point you're making is a very good one and it is another core consideration for FIA. We've always been in favor of competition among trading platforms and when you have that competition which again is the purpose of the Commodity Exchange Act, you have two competitors who are each trying to win and the Commission does need to prove an extra measures of oversight and potentially some more affirmative regulation to make sure that the public interest

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is being served there when we have these what we think are welcome competitive battles among trading platforms.

COMMISSIONER CHILTON: We may want to change exactly the way that the hedge exemptions are established. Would you have any recommendations for how we would do that? Would anybody who applies be able to receive one?

MR. YOUNG: I don't consider it impertinent to say that I would never be in favor of an exemption process where anybody who applies can get any exemption. That would be bad for my business. But your question is, I think, and I think this is where we're going with this, should the Commission impose additional standards or additional considers in the context of those hedge exemptions?

COMMISSIONER CHILTON: Yes.

MR. YOUNG: I think as long as they're tied again to the preserving the integrity of the price discovery process, absolutely you should.

COMMISSIONER CHILTON: Thank you, Mister

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Chairman.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. I'm just going to check again if Commissioner Sommers or Commissioner Dunn had any further questions. I think that was a no.

We're going to have closing statements, and actually I've been advised by staff I'm supposed to go in reverse order.

COMMISSIONER CHILTON: I don't have a closing statement. My opening statement which was thanking you and suggesting that we were now being an adaptive regulator, and regardless of what action we take or don't take, the ability to do this and hold these hearings and talk with people I think is very important. I thank everybody who has been here and I thank the staff who I think does a great job, and I thank my fellow Commissioners for the education I think we've all received. Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. Commissioner Sommers?

COMMISSIONER SOMMERS: Thank you, Mister

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Chairman. I just want to quickly say how helpful these 3 days of hearings have been. I have pointed out several different times and I guess will do it one more time, these issues are very complex. I feel that the Commission is facing one of the greatest challenges that we have faced since I've been involved in this industry, and I just appreciate so much all of the participants in the last 3 days and the staff who have helped us prepare for this. It's extremely helpful. Thank you, Mister Chairman.

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

COMMISSIONER DUNN: Thank you, Mister Chairman. I would first like the panelists who have participated during the 3 days of our hearings. Their testimony has been very helpful and it will assist us with the difficult decisions that we will be making in the days ahead. I would also like to thank the Chairman for calling these much needed hearings. Finally, I would thank the staff of the CFTC for all the work that made these

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hearings possible.

During my opening statement last Tuesday I made a commitment to listen with an open mind to the information presented and to work with my fellow Commissioners to ensure that we have a functioning futures markets. In the coming weeks, I will begin to digest the conflicting information presented at these hearings and additional information from our staff and the public, and my commitment to keep an open mind on this subject still stands. Getting this right is of paramount importance to me and I will now be swayed by those seeking hastily made decisions without careful consideration of all consequences. Before I talk about speculative position limits, I would briefly like to mention two areas outside the stated purpose of the hearing that I think require the immediate attention of the Commission. First, I believe we must begin to review to determine that the proper firewalls between research reporting and trading divisions at financial institutions are in place, if they are adequate and whether

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oversight is necessary. I was delighted to hear that Goldman Sachs and J.P. Morgan welcome this type of review and possible regulation. I would ask that our staff immediately begin this process.

The second area of interest raised during the hearings was high frequency trading and collocation. As the exchanges we regulate migrate from open outcry to electronic trading, it's imperative that the Commission focus on new challenges posed by technological services. When I first raised this issue prior to the hearings I was encouraged by the Chairman's immediate directive to the staff to begin an assessment that high frequency trading and collocation might have on the marketplace. I believe that it is imperative that the CFTC acquire the human and technical resources to address technological issues as they develop.

During the 3 days of the hearings on speculation positions, we have received many recommendations on potential solutions to address the questions posed by the Commission at these

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hearings. The CME and ICE have indicated that they are working on approaches to address issues within their jurisdictions as self-regulatory organizations and I look forward to meeting with each of them in the very near future to discuss their preliminary proposals. However, after listening to all of the panelists and reading all of the written statements and background materials, it is clear to me that the CFTC does not have the authority to set speculative position limits in all venues that may be affected by excessive speculation, specifically, over the counter and on foreign boards of trade. Unilateral Commission action in only the markets we currently regulate may not have the desired the effect of reining in excessive speculation in the futures markets. Without similar steps in the OTC market and foreign boards of trade, those seeking to evade the limits we set could simply move to venues outside of our authority.

To achieve a true level of efficiency, two additional events must take place. First,

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Congress must act to grant the Commission jurisdiction to set speculative limits in the OTC markets. Treasury Secretary Geithner raised this issue in his May 13 letter to Congress, discussing steps needed to establish a comprehensive regulatory framework for over-the-counter contracts. Second, truly effective regulations in this area require greater harmonization of international regulatory regimes. Since the Commission issued its concept release, I have heard many people attempt to explain what constitutes excessive speculation and describe how excessive speculation has affected the futures markets. Many have concluded that if excessive speculation exists, then speculation limits must be set. What these limits should be, who should set them, how they should be set and who should be exempt from them are additional questions that have been raised. At the end of the day, the CFTC Commissioners are responsible to determine if action is needed, and if so, the Commission must do what is necessary to ensure that the markets we

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regulate are functioning properly. I also believe that if we do act, the Commission access the impact of those actions on a regular basis. I would be remiss in my duties as a Commissioner if I did not point out the obvious fact that many of the actions advocated in these hearings go well beyond the capabilities of the Commission given our current staffing and funding levels. Adopting a course of action by the Commission without the monetary and human capital needed to successfully complete the mission would be perpetuating a cruel hoax on the public and all interested parties. Again I want to thank everyone for their participation and hard work.

CHAIRMAN GENSLER: Thank you, Commissioner Dunn, Sommers and Chilton for all the thoughtful remarks. I want to thank our staff who did just a fabulous job these last 3 days in organizing this regarding the well over 20 witnesses that we have on the 3 days. I think it really helps to bring the public into this very important debate about whether we set position

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limits on the products of finite supply and particularly in the energy markets.

As I said at least in my opening remarks, why I think we need to seriously consider this is foremost because it really does affect markets and it's critical to the American public. Energy markets are at the core of every American whether it's just filling up their tank during the day or the effects on heating prices throughout the seasons. I think that it's in our statute, we do it in the agricultural markets, so I raise the question with my fellow Commissioners why we do it there and should we do it in the energy markets and what's the difference between the two. As we talked about more a little bit in the earlier panels, what is the best way to promote market integrity and liquidity in markets and to avoid what's necessary to diminish, eliminate or prevent the burdens that may come from excessive speculation, and in this regard with regard to concentration in markets? Is liquidity helped or hurt if you have a highly concentrated actor? I

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look forward to the dialogue amongst the Commissioners. The hearing record will be kept open until August 12.

I too want to associate myself with two comments made by Commissioner Dunn but in earlier live hearings with regard to firewalls between the trading side of the house and the research side of the house. It's something that we've already internally asked staff to take a very serious look at, first, what's in our statute. Our statute is different than the security statutes. What's in our statute, what we can do, whether we need to ask Congress for more authority or there are things we can do there within our current authority. With regard to high frequency trading and collocation, I don't know if it's gone out yet, but we're already drafting a pretty detailed letter to the exchanges on this to get behind what the current practices are. Again I thank everybody. I particularly thank my fellow Commissioners.

The next time we meet in public we'll

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actually be with the Securities and Exchange Commission as we meet specifically to hear from the public on the possibilities of harmonizing our approach to the markets.

(Whereupon, at 1:19 p.m. the PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

/s/Carleton J. Anderson, III

Notary Public in and for the
Commonwealth of Virginia
Commission No. 351998
Expires: November 30, 2012

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