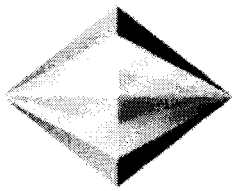


R&R Consulting

Bringing science back to financial engineering

May 25, 2010

Mr. Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Dear Chairman Gensler:

My name is Ann Rutledge, and this is an unsolicited letter of support for the Cantor Fitzgerald Cantor Futures Exchange. I am an adjunct assistant professor in the Hong Kong University of Science and Technology department of finance.

With Sylvain Raynes, I co-authored two books on the structured finance market, ***The Analysis of Structured Securities: Precise Risk Measurement and Capital Allocation*** (2003) and ***Elements of Structured Finance*** (2010), both published by Oxford University Press. I am also the co-founder of R&R Consulting, an early critic of structured finance ratings and highly regarded credit risk measurement service provider.

In the last 15 years, my professional focused has been structured finance and asset securitization, but in the early 1990s I headed J.P. Morgan's Asian prime brokerage business and consulted to the Hong Kong Futures Exchange (now part of HKEX, on clearinghouse reform, new listings (including the successful Hang Seng Option, plus some failed contracts) and managing external relations with Chinese reformers studying the role of exchanges in improving the circulation of information and goods through the Chinese economy.

Most of the arguments I have read for and against DBOR are standard arguments about the risks and benefits of futures exchanges or new contract markets, generally. They do not specifically address the risks and benefits of film futures. Certainly such arguments are still relevant to the case of DBOR because all futures markets have certain attributes in common, namely—

- They allow the commercial producer or processor to manage the risk of its business flows by hedging (taking the opposite side of their natural position);
- They have the backing of a clearinghouse to manage price volatility and counterparty risk;
- They have a central administration to design the contract market and make the rules and regulations for membership, trading, reporting, disciplinary action and other key functions, which they enforce.

It may be difficult for the layman to understand how these points relate to film production, which, at first blush, seems to have nothing in common with agriculture or finance. Film studios, like any other commercial institution, must sell what they produce at a profit. Although they have managed to convince the public that film economics cannot be rationalized, studios nevertheless manage to run profitable businesses.

In the lingo of futures, a film studio that makes films is a natural "long." The existence of a futures market in films gives studios an ability to sell contracts on unmade films at an internal target to hedge their price risk. A distributor of these films, or rights to them, is a natural "short." Distributors can lock into profits by taking the other side of the trade, i.e., selling contracts on the unmade films. If the long and short interest is in balance, liquid interest will develop around the futures contract, which will encourage further buying and selling by smaller, speculative institutions that give the contract market liquidity. This enables the commercials to rebalance their positions flexibly as they require. The availability of a symmetrical risk management tool is expected to have a salutary effect on the film industry generally as it shifts the focus of film studios and distributors from extracting surpluses from each other to monetizing the films they make and distributing them at fair value.

From the foregoing explanation, it should be easy to understand why commercial producers are almost always the slowest to accept a futures market. They have a powerful information edge over the rest of the market, and they believe they lose far more by opening up their price advantage to competitive bidding than they gain from access to a risk transfer mechanism. This is how banks originally viewed financial futures, and film studios are no different. It is as natural for the studios to resist the establishment of film futures in the 2000s as it was for banks in the 1970s to reject financial futures, even though they later adopted financial futures wholesale. Their adverse response is not simply a maneuver to hide the industry's accounting games, as Dr. Chance suggests in his testimony, though that may be part of the motivation as well.

The second and third bullets above are further reasons to consider the timeliness and advisability of creating a film futures market. As Dr. Chance mentions, the studios have dabbled in the nascent OTC securitization market for film since 1996, when the credit rating agencies began rating royalty receivable backed transactions. (Sylvain Raynes developed the method for Moody's.) In this decade, some studios used the film slate deal format to lay off the risk of failed films on to unsuspecting investors at a price that did not reflect intrinsic value.

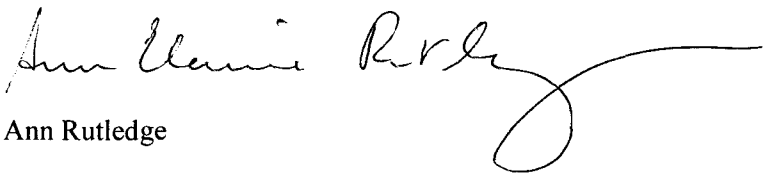
As we are learning from the Subprime Crisis, the OTC market format lacks key controls of a formal exchange. Credit rating agencies fulfill some of the roles of the administrator in the OTC market, but they do not ensure continuous price (rating) feeds or clearinghouse protection from the impact of counterparty defaults. Given that the studios are already using financial engineering to redistribute the risks of the films they make, bringing this activity into an organized exchange offers investors better protection and may to some extent curb the production of bad movies that get made because they can be fraudulently off-loaded.

Many people doubt that the studios could actually engage in adverse selection because they do not believe film revenue cannot be estimated reliably. R&R disagrees. We have devoted considerable internal resources to developing a predictive algorithm for the revenues of independent film in the $7-$20 MM category at script stage (i.e., before the first box office weekend), and the revenue estimates from it achieve an R^2 of over 90% when compared to a database of over 500 films. While these results do not provide an open-and-shut case for revenue certainty, they do provide evidence that revenue benchmarking is possible in the indie category, and that trading in an exchange venue could be quite robust because the variance could be small enough to attract a tradable bid-asked spread.

Finally, Dr. Chance is right to observe that the DBOR market may fail on its own, even if Congress approves it. Then, no one will be the worse off, because very little trade will have taken place and the risk exposures will be *de minimus*.

On the other hand, if DBOR is a good idea but the industry needs time to come around to it, we may be worse off if Congress votes it down. It is not common knowledge that the Chicago Mercantile Exchange's wildly successful Eurodollar market, built in the 1970s, stumbled for a decade until banking system and capital reforms in the 1980s gave U.S. banks a motivation to join. Yet the Eurodollar market laid the foundation for swaps and other engineered products that put the U.S. financial system in the driver's seat of change and progress. It is easy to overstate the unintended negative consequences of change, but the unintended negative consequences of delaying inevitable change may be much more costly.

Sincerely,



Ann Rutledge

cc:
Commissioner Dunn
Commissioner O'Malia
Commissioner Sommers
Commissioner Chilton