

COMMODITY MARKETS OVERSIGHT COALITION

March 25, 2010

The Honorable Blanche Lincoln
Chairman, Committee on
Agriculture, Nutrition & Forestry
United States Senate
Washington, DC 20510

The Honorable Senator Saxby Chambliss
Ranking Member, Committee on
Agriculture, Nutrition & Forestry
United States Senate
Washington, DC 20510

Dear Chairman Lincoln and Ranking Member Chambliss:

The undersigned organizations would like to commend your efforts as you work on new legislation to reform the U.S. derivatives markets. We understand that your committee will soon introduce a draft of this legislation. It is in light of this that we write you today.

Formed in 2007, the Commodity Markets Oversight Coalition is an informal alliance of industry groups, consumer advocates and academics, representing commodity producers, processors, distributors, retailers, and residential, commercial and industrial end-users. We believe that policy in the commodity trading markets should aim to strengthen oversight, transparency and stability to address inadequacies in the existing derivatives markets, both regulated and over-the-counter.

Commodity Markets are in Need of Reform

We believe that commodities trading, including swaps, futures and options and related markets and exchanges, were established as a price discovery and risk management tool for *bona-fide hedgers* of physical market exposures. Speculators play a role in these markets by facilitating the risk-taking needed to keep markets functional and liquid. However, the CMOOC has expressed concern that, due to watered-down oversight and the rise of complex and opaque trading environments and products, the purpose of these markets - tools for legitimate commercial industry - has been compromised.

Since the mid-1990s, the commodity markets have transformed greatly, and are now dominated by financial institutions rather than commercial participants. The traditional "open outcry" exchanges such as the NYMEX and the CME saw a migration of market activity to new competitors, namely over-the counter, electronic and foreign boards of trade. In order to remain competitive, these markets implemented policies to attract new investor business. This included scrapping firm speculative position limits in energy commodities for softer and often unenforced "accountability limits," thereby allowing speculators to take controlling positions in a particular commodity. Exchanges also saw increased trading from exchange traded funds (ETFs), which take rolling, long-only "passive" positions in commodities with disregard for underlying market fundamentals.

At the same time, the Commodity Futures Trading Commission (CFTC) took a back seat to market self-regulation while the U.S. Congress codified exemptions for swaps traders and electronic and over-the-counter (OTC) derivatives markets in the Commodity Futures Modernization Act of 2000 (CFMA). Commodity trading in these "dark" and unregulated or under-regulated markets grew from two times the size of the traditional exchanges to more than twelve times between 1998 and 2008.

As a result, financial speculation began to dwarf the physical value of commodities these markets were meant to discover. Commercial hedgers experienced unprecedented volatility and inexplicable price shocks. This culminated with the largest commodity bubble in U.S. history in 2008, when for example, crude oil reached \$147 in July and consumers were paying more for fuel, food and home energy bills and were asking "why?" They soon got their answer. When Wall Street collapsed that

September, billions of speculative dollars fled these markets while commodity prices tanked. Regulators had either enabled or acquiesced to a commodity price bubble whose beneficiaries then received taxpayer-funded bailouts from the Congress to rescue their financially insolvent firms.

A Call to Leadership and Reform

Unfortunately, federal regulation has not kept pace with the dramatic changes the commodity futures markets in the last fifteen years. Thankfully, the new CFTC Chairman and his fellow Commissioners have recognized the need to respond to these challenges and have engaged in numerous studies, enforcement actions and new rulemakings, including proposed rules to re-establish speculative limits on energy and metal trading and to revise exemptions for swap and index traders. We applaud their efforts.

However, the Commission is hamstrung by limitations on its regulatory authority. The CFTC's authority over so-called "dark market" activity was stripped from it by the CFMA ten years ago. Their ability to monitor the entirety of the commodity trading markets and to prevent potential fraud, manipulation and excessive speculation therein is tied to Congressional action and to the legislation that you are now drafting.

This week, the U.S. Senate Banking Committee, under the leadership of Senator Chris Dodd of Connecticut, approved new legislation to reform the financial services industry. Title VII would reform the over-the-counter derivatives markets. We understand that before this legislation moves to the floor your committee will finish work on its own derivatives proposal that will have emphasis on commodities trading.

We are pleased that the committee, under your leadership, is taking on this challenge. We take this opportunity to urge that your legislation include the following reforms:

- **Mandatory exchange trading for standardized derivatives contracts** to ensure adequate transparency and federal oversight, and to reduce systemic risk.
- **Mandatory clearing requirements for all other contracts** that are not being utilized by *bona-fide* commercial hedging interests to manage risks, but rather by swap dealers, banks, or other purely financial market participants.
- **A narrow end-user exemption** to clearing and collateral requirements that will allow *bona-fide* non-financial hedgers continued flexibility and choice in hedging products; however this exemption should be written so as to avoid any new "loophole" for truly non-physical market participants.
- **Additional authorities to the CFTC to establish speculative limits** on all markets and in the aggregate across all markets; and to access activity on foreign boards of trade that allow U.S. access or that trade derivatives on commodities destined for U.S. delivery.
- **New enforcement authorities to the CFTC** so regulators may prosecute "reckless" manipulation in the same manner as its sister-agency, the SEC.
- **Additional financial and personnel resources** should also be afforded federal regulators in order to implement and enforce new mandates and authorities.

We feel by including the above reforms, your legislation will provide regulators the tools and resources necessary to return stability and confidence to these markets.

Again, we commend you for your leadership and commitment to reform, and we look forward to working with you and your colleagues on the committee as this process moves forward.

Sincerely,

Agricultural Retailers Association
Air Transport Association
American Cotton Shippers Association
American Feed Industry Association
American Trucking Associations
Americans for Financial Reform
Arkansas Oil Marketers Association
Arkansas Trucking Association
California Black Farmers and Agriculturalists Association
California Independent Oil Marketers Association
Colorado Independent CattleGrowers Association
Colorado Motor Carriers Association
Colorado/Wyoming Petroleum Marketers Association
Congregation of the Holy Cross
Consumer Watchdog
Florida Petroleum Marketers Association
Food & Water Watch
Friends of the Earth
Fuel Merchants Association of New Jersey
Gasoline and Automotive Service Dealers Association
Georgia Motor Truck Association
Global Foundation for Democracy and Development
Grassroots International
Illinois Petroleum Marketers Association/Illinois Association of Convenience Stores
Independent Beef Association of North Dakota
Independent Cattlemen of Nebraska
Independent Cattlemen of Wyoming
Independent Connecticut Petroleum Association
Indiana Motor Truck Association
Institute for Agriculture and Trade Policy
Iowa Motor Truck Association
Kansas Cattlemen's Association
Kansas Motor Carriers Association
Louisiana Oil Marketers & Convenience Store Association
Maine Energy Marketers Association
Maryknoll Office for Global Concerns
Massachusetts Oilheat Council
Michigan Trucking Association
Mid-Atlantic Petroleum Distributors' Association
Minnesota Trucking Association
Mississippi Trucking Association
Motor Carriers of Montana
Municipal Electric Systems of Oklahoma, Inc.
National Association of Convenience Stores
National Association of Oilheating Service Managers
National Association of Truckstop Operators
(continued...)

National Farmers Union
National Latino Farmers & Ranchers Trade Association
Nebraska Petroleum Marketers & Convenience Store Association
Nebraska Trucking Association
New England Fuel Institute
New Mexico Petroleum Marketers Association
New Rules for Global Finance Coalition
New York Oil Heating Association
New York State Motor Truck Association
North Dakota Motor Carriers Association
North Dakota Petroleum Marketers Association
North Dakota Propane Gas Association
North Dakota Retail Association
Ohio Petroleum Marketers & Convenience Store Association
Ohio Trucking Association
Oil Heat Council of New Hampshire
Oil Heat Institute of Long Island
Oil Heat Institute of Rhode Island
The Organization for Competitive Markets
Pennsylvania Motor Truck Association
Petroleum Marketers & Convenience Store Association Kansas
Petroleum Marketers & Convenience Stores of Iowa
Petroleum Marketers Association of America
Propane Gas Association of New England
Public Citizen
R-CALF USA
Society of Independent Gasoline Marketers of America
South Dakota Petroleum & Propane Marketers Association
South Dakota Stockgrowers Association
South Dakota Trucking Association
Tennessee Oil Marketers Association
Texas Motor Transport Association
United Egg Producers
Vermont Fuel Dealers Association
Vermont Truck & Bus Association
West Virginia Oil Marketers and Grocers Association
Western Peanut Growers

cc: Members of the Senate Committee on Agriculture, Nutrition and Forestry
Hon. Chris Dodd, Chairman, Senate Committee on Banking, Housing & Urban Affairs
Hon. Richard Shelby, Ranking Member, Senate Committee on Banking, Housing & Urban Affairs
Hon. Jack Reed, Bipartisan Banking Committee Task Force on Derivatives Reform Legislation
Hon. Judd Gregg, Bipartisan Banking Committee Task Force on Derivatives Reform Legislation
Hon. Gary Gensler, Chairman, U.S. Commodity Futures Trading Commission
Hon. Michael Dunn, Commissioner, U.S. Commodity Futures Trading Commission
Hon. Jill Sommers, Commissioner, U.S. Commodity Futures Trading Commission
Hon. Bart Chilton, Commissioner, U.S. Commodity Futures Trading Commission
Hon. Scott O'Malia, Commissioner, U.S. Commodity Futures Trading Commission