UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

ENERGY AND ENVIRONMENTAL MARKETS

ADVISORY COMMITTEE MEETING

Washington, D.C.

Thursday, February 26, 2015

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Opening Remarks

Commissioner J. CHRISTOPHER GIANCARLO

Chairman TIMOTHY MASSAD

Commissioner MARK WETJEN

Commissioner SHARON BOWEN

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ADAM SIEMINSKI, Administrator, U.S. Energy Information Administration

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STEVE SHERROD, Senior Economist, Division of Market Oversight

TOM LASALA, Chief Regulatory Officer, CME

ERIK HAAS, Director – Market Regulation, ICE Futures U.S.

CRAIG PIRRONG, Professor of Finance and Energy Markets, Director of Global Energy Management Institute, Bauer College of Business, University of Houston

Open Discussion

A G E N D A

Panel II: Designated Contract Market Experience with Position Limits and Trading Liquidity

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TOM LASALA, Chief Regulatory Officer, CME

ERIK HAAS, Director – Market Regulation, ICE Futures U.S.

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Closing Remarks

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P R O C E E D I N G S

(10:05 a.m.)

COMMISSIONER GIANCARLO: Good morning, everyone. Welcome to the inaugural meeting of the CFTC's reconstituted Energy and Environmental Markets Advisory Committee, the EEMAC. I want to give a hearty welcome and a thanks for all of you to brave the snow; to come in either from in town or out of town. I don't know if this is the fourth or fifth snowfall we've had here in Washington this year, but it reminds me of a quip often attributed to Mark Twain, and that is that everybody complains about the weather, but nobody does anything about it.

So the EEMAC has a broad mandate, but thankfully one of its tasks is not to do something about the weather. But we do have a very broad mandate. Congress as you know created EEMAC as part of the Dodd-Frank Act because Congress recognized a critical need, and that was a need for a dedicated forum in which exchanges, firms, end-users and regulators could advise the

Commission of their concerns regarding energy and environmental markets and their regulation by the CFTC. In fact Congress was so concerned that the Commission know the effect of its rules and policies and their effect on energy and environmental markets that it mandated that the EEMAC hold at least two public meetings each year. Disappointingly no EEMAC meetings have been held in almost five years. So as a new Commissioner, and as a sponsor of the EEMAC, I take the Dodd-Frank mandate quite seriously, and I'm pleased to convene the first of what I hope are many productive EEMAC meetings to maintain a healthy dialogue between the Commission and participants in U.S. energy and environmental markets.

And that dialogue is especially crucial now because Commission policies have a significantly more profound impact on energy markets in the wake of Dodd-Frank. And at the same time global energy and environmental markets are undergoing the most sweeping technological and structural changes in a generation or more. American technological leadership in horizontal drilling and hydraulic fracturing has transformed worldwide energy production. And as a result we have all noticed a dramatic fall in the cost of everyday fuel, with gasoline prices close to $2 per gallon.

In my first year as a CFTC Commissioner I have had the pleasure of meeting with coal miners in Kentucky, oil refiners in Texas, and natural gas pipeline operators in Louisiana. They all impressed upon me deep concern over the form and substance of the Commission's proposed position limits regime. The CFTC has already held two public events to solicit feedback from market participants on its current proposal. In view of the dramatic changes in U.S. energy markets a further session exploring the unique concerns of energy market participants regarding the position limits proposal is quite appropriate and I hope we can have a lively dialogue today.

Our first panel will examine the

research and data supporting the proposed position limits rules. In 2011 when the Commission voted on its first proposal to implement the new Dodd-Frank Federal position limits regime former Commissioner Mike Dunn, who is with us here today, registered his belief that price volatility in physical commodities is primarily driven by changes to supply and demand. He asserted that at that point in time CFTC staff had been unable to find any reliable economic analysis to support either the contention that excessive speculation is affecting the markets, or that position limits would prevent excessive speculation. Well, fast forward to today, the current position limits proposal relies primarily on studies of two major market events dating to 1979 and 2006 to conclude that position limits are necessary to control excessive speculation. I hope that our first panel and subsequent Federal Register comments augment the Commission's assessment of the efficacy of position limits, especially in light of current conditions in U.S. energy markets.

The second panel will consider the experience of the two major U.S. futures exchanges in balancing position limits and trading liquidity. As I have noted in other contexts, liquidity is the vital component of healthy and vibrant derivative markets. Congress recognized this concern and in instructing the Commission to set position limits in a way that maintains liquidity for hedgers. The Commission should heed the prescription of Dodd-Frank and carefully analyze the effects of its rules on available liquidity. Today we will hear from folks with decades of front line experience administering position limits for energy markets while fostering vibrant trading liquidity.

And last, but certainly not least, our third panel will tackle a critical component of the position limits rules: the bona fide hedging exemption. Congress instructed the Commission to write rules exempting bona fide hedgers from any position limits rules. Crafting proper bona fide hedge exemptions has long been a challenging proposition with several Commissioners on both sides of the aisle expressing concerns that the Commission's definitions of bona fide hedging are too narrow. I and others have expressed concern that the proposed bona fide hedging rules not be structured in a way that imposes federal regulatory edicts in place of business judgment in every day commercial risk management. This afternoon's panel should give us a better understanding of the likely impact of the proposed rules on U.S. energy markets and whether those concerns are apt.

As we get started this morning, however, I want to welcome Administrator Adam Sieminski of the U.S. Energy Information Administration who will give us an update on the current market conditions. I also thank other witnesses who have prepared thoughtful presentations that we will hear during the day. And in addition I want to thank all of the Commission staff and my fellow Commissioners who have worked so hard to arrange and support this meeting. And of course I'd like to thank all the members of the EEMAC for volunteering their time and expertise; we are grateful to you for your service.

Since the EEMAC has no statutory Chairman, each meeting will be chaired by a different member of the Committee. I'm pleased to announce that Jim Allison, an EEMAC member, has agreed to chair today's meeting. Thanks, Jim.

All right, now I would like to recognize Chairman Massad and the other Commissioners to make their opening remarks.

CHAIRMAN MASSAD: Thank you, Chris. I also want to welcome all of you here to this first meeting as Chris put it after a long hiatus of the Energy and Environmental Markets Advisory Committee. I'm very pleased that we're able to have this. I look forward first of all to meeting each of the members of the Committee individually. I got here just a few minutes ago so I didn't have the chance to do that with everyone, but I look forward to seeing all of you, and I also welcome all of our guests. You know, this meeting like all of our Advisory Committee meetings is just a very important way for us to get input and so I really appreciate everyone taking the time to be here. I also want to thank Chris for his sponsorship of the Committee. And the way we do our Advisory Committees, each of us sponsors one of them and he's taken the lead in coming up with the agenda, and in this case reconstituting the Committee and identifying people who are willing to serve. So I really appreciate his effort in that, and also appreciate the work of his staff in making today's meeting possible.

I look forward to the agenda. I think it will be a very constructive and interesting day for us. I think the sessions related to the position limits rule should be very helpful. As all of you know we did put forward a proposed rule to comply with the Congressional mandate that we implement position limits. I look forward to hearing the staff's presentations. I will just say the fact that we're reopening the comment period is really just a good governance, good government kind of practice. Given that we're holding this meeting we want to the extent that there are people who want to comment on what is presented or said today, they can do that. So we want to make sure people have that opportunity. I don't believe it will affect however the timing of our overall process in terms of working our way through this. It's a complicated rule and staff has been hard at work at that.

I also know the staff has worked very hard for this meeting, and I know they'll benefit from this. Of course they are not in a position to opine sometimes on some things, but I again thank them for the work they're doing. And again I know all the information that we get today will be very helpful.

So with that, thank you again, Chris, and also thanks, Jim, for chairing the meeting. Or, Adam, I'm sorry. Chris, thank you.

COMMISSIONER WETJEN: Thank you, Mr. Chairman, and thank you, Chris, for reviving this Committee. It's great to have it reconstituted and in a position to help us through this particular rule making, which of course is the rule making that keeps on giving. And I've lost count on the number of round tables and meetings and the like we've had on position limits, but all of these gatherings are very, very important. We always learn something every time it happens and with the panel that's here today I know that's going to be the case.

Before I turn it back over to Chris let me just say something about Commissioner Giancarlo. Chris has been such a wonderful addition to this Agency. He is such a professional, he is among the most courteous and polite people I've ever met, he's among the most conscientious people I've ever met, and it's just a real pleasure to have someone like Chris as a colleague here at the Agency. And I'm amazed and respect to a tremendous degree the level of commitment and contribution he has made to this place even in a short number of months. I know that's as I said going to continue here today and into the future. But I just wanted to make sure we took a moment to acknowledge Chris and all his hard work since he joined the Agency. And we as an agency have benefitted, but the public of course I know is going to benefit as well. So thank you very much.

COMMISSIONER BOWEN: Thank you. It's a privilege to be here today at the first meeting of the new Energy and Environmental Markets Advisory Committee. I want to commend Commissioner Giancarlo, the members of the Committee, and the Commission staff for the time you've devoted for today's meeting.

As many of you know I'm particularly interested in the subject of position limits. I look forward to hearing your comments on how we can enhance this rule. A core principle of the futures market is that they are designed to allow end users to hedge. We need to make sure that the rule is not only faithful to this ideal, but that the rule also works.

Since we have reopened the comment

period once again I want to encourage anyone who may be attending this meeting or watching this on line who has a unique perspective to please submit your ideas and comments. However, as I've said before we cannot remain in a listening mode forever. It's been nearly five years after we were required by Dodd-Frank to establish a position limits regime. Leaving this rule unfinished harms consumers and end users who are looking for protection against excessive speculation and market manipulation. It also deprives the industry of critical certainty as to the state of our regulations. I continue to believe that we can and should finalize this rule before the end of this year, and I really look forward to accomplishing that.

Thank you.

COMMISSIONER GIANCARLO: Thank you, Sharon. I'm going to now turn it over to Adam Sieminski, the 8th Administrator of the U.S. Energy Information Agency.

MR. SIEMINSKI: Well, thank you very

much, Commissioner Giancarlo, thank you Chairman Massad, Commissioners Wetjen and Bowen. It's a real pleasure to be invited from the Energy Information Administration here to speak to this group. It's kind of interesting; I think the last time I was here was about two years ago, eighteen months ago, and I was asked to come over and explain why oil prices were so high. (Laughter) So I think there might be a lesson here. Very briefly, I applaud your idea of an Energy and Environmental Markets Advisory Committee. Within EIA we actually have an office of energy and financial markets, and Lynn Westfall and Bruce Bachs from that office are here with me today. Raise your hands guys. So if anybody wants to speak with them later, please do that. We are looking at a lot of these issues, position limits, hedging, high speed trading, speculation, and manipulation. And, Commissioner Bowen, I'm glad you separated those two words because I think they're very different, and I think that's important.

Now that's about as close as I'm going to come to saying anything about policy because EIA is a statistical organization. We try to be non-partisan and we'd like to remain independent. And one of the ways I do that is to not comment too much on policy. I'm about one policy remark away from returning to the private sector. (Laughter) When I was in the private sector I talked about this a lot, so I understand the issues, I understand the struggles that you're going through in trying to deal with it. And I applaud you for your efforts to bring together a group of people to discuss these issues.

But what I'd like to do, and I'm going to watch the time here; I'm going to try to do this in 10 minutes. I know you had said there would be some more time, but maybe we could then get Craig Pirrong on. He's got a hard stop at 11:00 and we'll try to go through that. I thought that what people might be interested in is how did we get into this situation with -- let's see, I'm going to make -- who knows how to make this work?

There we go; thank you. And maybe I can use the silver button to make it go again. This is not the first time, at least not in my career, that I've seen a drop in oil prices. So this chart shows you back to 1970. I actually started as an oil analyst back in the 1970s. And there were like two really big drops, one in 1986, another one in 2008, and now the one that we're going through today. There were a few smaller drops in there too, and then of course the increases. I counted them up and there were 12 or 13 times we've had fairly significant upward or downward moves in oil prices. So it's not like it's new. I think that what happens, and I'm trying to make a promise to myself that I'll get bearish the next time oil goes to $130 because I think that when anything that lasts for three years, and we had oil averaging -- let's go one more slide and we'll go back. Can you go forward one? Thank you. One more. There we go. I'm going to let the experts run that. We had that flat period there for $110 Brent crude oil prices that lasted for nearly three years. And I was doing some research on the psychology of events. Anything that lasts three years everybody begins to think it's permanent. Oil prices started going down. One of the things that you can see in this particular chart here is that despite EIA's forecasts that oil should average a little less than $60 this year and maybe $75 next year, the market implied -- and what we do is we use the futures and options prices, we use those prices to derive a range of volatility assessments for crude oil, and what we have come up with is that all the way through 2016 the market is implying or options prices are implying that oil could be as low as $35 and as high as $100 a barrel. That's a really wide range and I'll talk a little bit about some of the reasons behind that.

Let's go to the next slide. First of all in our estimate this isn't driving our forecast, the recovery that we're talking about for prices doesn't look a whole lot different than the recovery that we saw in 2008, '09, and '10 for crude oil prices, so the upward movement. So getting back to $75 a barrel by the end of 2016 is not a huge leap of faith from the $55-$60 level that we've been trading at recently.

Let's look at the next slide. Let's talk a little bit about supply and demand. In demand for oil the most important thing is what economic growth is going to be. Most of the economic forecasts for the world are looking for roughly four percent GDP growth year over year. That generally translates into a little over one percent per year growth in crude oil. So now let's look at the next slide. And one percent of ninety million barrels a day, you know, maybe a little bit higher than one percent, gives you about a million barrels a day of growth per year in crude oil on a global basis. So that's what you see there for 2015 and 2106, roughly a million barrels a day increment and oil demand on a global basis taking production on that left hand scale from the 90 million barrels a day or so that we had in 2014 to 92 to 93 million, 94 million barrels a day in 2016.

Let's look at the next slide. You can see from this slide, and this is growth in world crude oil and liquid fuels production, 2014 and then our forecast for 2015 and 2016, that yellow bit, North America, and that's the U.S. And Canada and Mexico included as well, but most of the growth is really coming in the U.S. and Canada, especially the U.S., especially shale oil. Over a million and a half barrels a day while oil demand globally is only going up a million barrels a day, we had shale oil, and oil sands coming on at more than a million and a half barrels a day. This was causing inventory to accumulate and created too much supply. So we had a lot of supply. In fact we had a three year experiment that -- and energy economists could only love -- what is the elasticity of supply with respect to price, and what we discovered is $110 oil gets you a lot of supply. And it's not getting you enough demand, markets were out of balance, something had to happen.

Now what we're saying -- go back one and I'll just quickly finish up on this one -- is that the growth in North American supply will definitely slowdown in 2015. It will slow further in 2016. We'll get down below a million barrels a day. Total growth in world demand probably creeps up a little bit on lower prices, supply definitely gets constrained. Inventories which are building now start to get drawn down later this year and in to 2016, and that's what rebalances the markets.

Now let's go forward one. The world that I came out of and when I look around the table many of the people in this room kind of think of low oil prices as being a problem. It certainly reduces the rig count; it's going to lower production. It creates economic issues in oil producing states in America like Texas and North Dakota and Alaska, Louisiana, Oklahoma, Wyoming, New Mexico, and so on. One thing to keep in mind is this is having a huge positive effect on consumers, and I think I heard that in the opening remarks as these lower prices are definitely having a positive impact on gasoline purchases by households. And in the northeast where heating oil is a big fuel it's lowering heating bills there which I'm sure they're going to be very grateful for given the really cold temperatures and the extra fuel that they're going to be burning. EIA's calculations essentially suggest that the average household in the U.S. in 2015 will probably save something like $750 a year in gasoline prices alone, and up in the northeast it might be a similar amount on heating fuels, particularly oil. That should help boost the overall economy in the U.S. Roughly speaking in the U.S. every $10 drop in oil prices translates into something close to .2 percentage points of increased GDP growth. So we've had about a $50 drop in oil prices. That could actually add almost a percent to GDP.

Let's take a look at the next slide. Here's how those numbers stack up. As you can see things really do get a whole lot better in 2015 especially on the transportation side, and that's mainly gasoline. This should help keep the economy going, should help strengthen household's ability to pay for the colder winter and that should be a real plus.

I think we might be very close to the end. Let's take a look at one more slide. You know, a lot of presentations that I used to go to as an oil analyst, the companies would start off with a huge disclaimer slide that would say we want to be very careful about these forward looking statements that we're making and we want to let you know that there's a lot of uncertainty in this, and I want to end on uncertainties. What could make this forecast that we think that oil could get back to $75 next year when the market implied range itself runs from $30-$35 to a little over $100? How do you get to the top of that range, how do you get to the bottom of that range? Let's talk about how you might go to the top. Social unrest in a country like Venezuela which is producing more than 2 million barrels a day of oil, exporting 800 or 900 thousand barrels a day to the United States, for example. Lots of problems down there with employment, inflation, the economy is in really bad shape. If there were to be strikes in the oil fields and oil were to be disrupted, that could have an upward impact. Similarly the rebel groups in Iraq could interrupt supplies there. Tightening of Iranian sanctions if the negotiations which are underway were to fail to make it through the next few months. Social unrest in other countries that are dependent on oil supplies. Let me just name a few, Nigeria, Russia, and Algeria; you know, the list is actually fairly long there. Or the possibility that OPEC gets together and decides that they've had enough of testing how low prices can go and tries to figure out a way to cut production.

What could make prices go down even further than they are? World economic growth. We know that there are problems in China; the Chinese economy has been struggling. Oil prices rose actually the last couple of days mainly on the back of statements that the Chinese economy looked like it was improving and that the Saudis thought that demand might be responding. But if we don't see that, that could be a problem to the downside. Saudi Arabia keeping production high, perhaps staying in line with the increases that we're seeing coming from Iraq. The Saudis don't want to give up market share in Asia to Iraq, and if the Saudis were to build production that could drive prices down even further. Reduction and unplanned outages. That's actually what happened in the summer with Libya coming back on line unexpectedly, adding almost a million barrels a day to the oil markets in a period where they weren't expecting it, and that's how prices started falling in August and September. That kind of thing. Another one -- and this would actually be the good news -- if Secretaries Kerry and Moniz who were over in Geneva just this past weekend are successful in bringing these nuclear negotiations with Iran to a positive conclusion, the sanctions on Iran would come off, Iran oil production could go up and it could create another problem. There are lots of opportunities for the price to be different than the path that I set up, and I think one of the lessons that we probably learned here in the last six months is that the opportunities for further things to change and shift these prices around is pretty high.

I went two minutes over the time that I said I would do, but I'm going to stop here, Commissioner, and turn it over to you. I'd be happy to let Craig go ahead, and if we wanted to do questions -- if you want to do some Q & A now, fine, or if you want to go to Craig that would be all right too.

COMMISSIONER GIANCARLO: What I'd like to do if it's all right with you is we'll go to Craig because he has a hard stop at 11:00; have him give his presentation and then at that point perhaps we can take questions for you and Craig together before hearing from our other presenters.

MR. SIEMINSKI: That would be fine.

COMMISSIONER GIANCARLO: Okay.

Professor Pirrong?

MR. PIRRONG: Yes, I'm here.

COMMISSIONER GIANCARLO: Great. You have a rapt audience.

MR. PIRRONG: All right. That's great. Well, I hope all (inaudible) much of a pleasure to be here; I appreciate the opportunity. And I'm sorry about the unconventional way of presenting here, but where there's a will there's a way.

And so what I'm going to talk about is some of the academic research relating to speculation in position limits. And sort of the key issue is about detecting excessive speculation. Position limits are intended to prevent excessive speculation that causes unreasonable or unwarranted price fluctuations. But that raises the question, how do we know what's unreasonable or unwarranted and how do we attribute any such unreasonable or unwarranted fluctuations to speculation? It's a challenging issue because commodity prices are inherently volatile. As Mr. Sieminski just noted that just look at the price ranges that the options markets are forecasting as being in a reasonable range. Essentially we have a 70 or so dollar range in prices over the next several months and picking out from prices that are that volatile, the impact of speculation is a challenging issue.

To put it differently, you know, how do we know what the right price is? And, you know, in some respects if we knew that well we wouldn't need markets or we'd all be rich and (inaudible), and we're not there; we're in the snow and so we have this problem of identifying what are the causes of price loops. And even doing that after the fact is a challenge. I mean people are still redefining 2008 in terms of what caused price movement during that period of time. So looking forward and forecasting prices is difficult, but even looking back and trying to attribute past price loops to particular causes is not an easy task in itself.

Now what economist typically do in order to try to perform this task is to use statistical methods, econometric methods. And one of the challenges here is that econometric evidence in a non manipulative context -- and I'll second Mr. Sieminski's point that manipulation and speculation are very different things -- I do believe that statistical evidence can provide powerful means of detecting manipulation, but things are much more challenging when it comes to talking about speculation, and that's because of the fact that economists or econometricians can't observe the most relevant data on demand and supply. And in my view the best approach here is going to rely on quantity data, in particular inventory data as well. And the reason for that is that prices are signals, and prices provide incentives that lead people to make decisions regarding how much they consume and how much they produce, that is prices guide quantity choices. And so if prices are distorted, quantities are going to be distorted too.

And so one of the things for example that you would expect in a commodity market like an oil market, if speculators were indeed causing prices to be artificially high, what would happen is that those high prices would choke off consumption and they would also encourage additional production. What does that mean? less consumption, more production means that inventories would be accumulated. So inventories would be accumulating at the same time prices are rising. What's more, you would expect to see the inventories accumulating and the people that are allegedly willing to pay the excessive price at the margin, that is the speculators. So not only would inventories be rising, but the inventories would be not in the hands of commercials, but they would be in the hands of the speculators and they would have to accumulate this inventory in order to have the positive price effect.

Now one complication is that what I've just said is that well one badge of speculative distortion would be that inventories and prices are moving in the same direction. So my academic research and some of the academic research that other folks have done have shown that well we can have that positive co-movement between prices and inventories even when the market is functioning well. So for example, an increase in uncertainty can lead people to accumulate inventories and have prices go up. So one way of characterizing it is that, you know, sort of the positive co-movement between inventories and prices is probably a necessary condition for the existence of speculative distortion but it's not sufficient. I mean it is one of the things that good scholars have looked at.

In terms of going to the current state of the debate, and -- sorry, I should be advancing slides here, so we're on the slide here, we're on current state of the debate. Dozens, hundreds of studies of this issue. I was asked to summarize them and, you know, in a few minutes that would be a challenge, even in a few days it might be a challenge. So I'll just try to summarize in relatively broad strokes what the empirical evidence says. I think it would be a fair characterization to say that most empirical studies of recent commodity price movement fail to find evidence of distortions, or that speculators caused the distortions. In particular focusing on the 2008 issue, no spike in inventory occurred at the time that oil prices were spiked. In fact the reverse was true, inventories were drawn down to fairly low levels and that's exactly what you would expect during a situation where there is essentially a substantial demand relative to supply for the commodity. And that that's a fundamentally driven demand-supply balance. You know, there are very few things on which Paul Krugman and I agree, but this is one of them. That essentially if you look at the evidence, in particular the price and quantity evidence during 2008 it does not support the view that prices were distorted through that period of time or that speculation caused prices to be excessively high. I should relate to that as well that what did see happen, well when prices collapsed post-Lehman we saw inventories accumulate in vast quantities.

And that's exactly what you would expect to see in response to a big decline in fundamental demand.

Now there has been some contrary empirical and theoretical papers on this. The one empirical paper that has gotten the most attention is by a very well-known scholar named Kenneth Singleton. Unfortunately that paper had some very serious flaws. It relies on an improper method for inferring what speculative positions, in particular index trader positions, where if you correct that flaw the end result that he finds goes away. I've also documented that if you extend the sample period, or if you look at a broader sample of commodities and you measure index trading participation correctly you don't find the effect that he purports to find.

In terms of theoretical papers there's a paper by Sockin and Xiong, and they claim that due to informational problems in the market place you can observe as a result of speculation, prices rising and inventories rising, and so that is not necessarily a good test of whether the markets are distorted or not. And unfortunately, you know, there are some very serious problems with the model here. So even though it's been cited rather substantially, you know, I think that there are just fundamental flaws with that model.

And I would just again reiterate that we have the knowledge problem. It's going to make definitive answers elusive and so this debate is going to be a hardy perennial. If you go back and you look, you know, in the late 19th century, in the 1920s, in the 1930s, you know, up to today, people have been making very similar arguments about the impact of speculation on prices. And the reason that that argument doesn't go away is that it's inherently difficult using statistics in order to prove one way or another what that impact is.

Let's go to the next slide. Now whenever there are big movements in prices, commodity prices, energy prices, up or down, the blame is almost always cast on the speculators. It reminds me of the famous scene at the end of Casa

Blanca where Claude Rains shoots the Gestapo officer right in front of a bunch of witnesses and turns to his assistant and says, "Round up the usual suspects" -- or Humphrey Bogart shoots him and the policeman, Claude Rains, says, "Round up the usual suspects." So whenever prices move a lot, speculators are always the first suspect rounded up. And the recent decline in oil prices is a case in point. OPEC, Russia for example, Rosneft CEO Igor Sechin and others have pointed the finger at the speculators as has a somewhat hopefully less interested party, the Bank for International Settlements. Now in my view, and Mr. Sieminski and I are on the same page on this, is that I think fundamentals are clearly at work here. A combination of steadily growing supply is the result of the shale revolution in the United States combined with a slacking in demand growth in my view explains the decline in prices.

And going back to the quantity information that I talked about before, if you've been following the news lately, there are all sorts of stories about inventories accumulating, and storage filling up, and traders chartering tankers in order to store oil. And so this is sort of a classic example of a market response to a supply and demand imbalance, a fundamental supply and demand imbalance.

Now the BIS study that I mentioned earlier tries mightily to point the blame at financialization and I would say that its conclusions are unsupported and implausible. It makes some sort of story about the large of debt taken on by shale producers, but how that relates to the speculation and even financialization is sort of difficult to see. And it also has some arguments in there about well, maybe if banks had withdrawn from the intermediating and the swap markets, then that's led to more activity in the futures market. And there's a lot of hand waving there and when you get past the hand waving and there's not much substance that really supports any implication that speculation or financialization is in any way a material cause of what is happening in the oil market since the middle of last year. Next slide please.

Then it turns us to our next question which is if the empirical evidence is hardly supportive of a view that excessive speculation has caused price distortions, but even if you accept that it can, will position limits be the efficient or effective way of deterring or preventing that sort of excessive speculation? Now the way that position limits are set up is that they constrain the positions of individuals and single firms. As Commissioner Giancarlo noted the CFTC NOPR -- and the rule basically points to two examples of single large traders that purportedly had an impact on the market, and that would be the Hunt Brothers in the early '80s, and Amaranth about going on 10 years ago, 9 years ago now. And position limits may work against those kind of market participants, but they would be ineffective against broad based speculative waves which are sometimes vying for distorted prices. So position limits wouldn't impact speculation involving a very large number of modestly-sized market participants for example.

What's more, limits may constrain efficient risk transfer by unduly restricting hedging or limiting risk bearing capacity. So maybe some of the big speculators whose activities are constrained, those folks are big because they are the efficient risk bearers in the market and constraining their activities limits inefficiently the risk bearing capacity of the market. Put differently, you know, position limits have the potential to be both over inclusive and under inclusive. They will constrain some efficient activity and may not effectively constrain some inefficient activity. What's more the limits impose substantial compliance burdens and so -- and this is a compliance burden that often falls on folks that are essentially very unlikely to ever really come close to the speculative limits. And so, you know, the cost benefit here is clearly an open issue.

And with that I'll finish my prepared

presentation here. And I have a few minutes before I have to run off to Court to take some questions.

COMMISSIONER GIANCARLO: Thanks, Professor Pirrong. This panel does have to come three more presentations from Steve Sherrod of the CFTC, Tom LaSala, and also Eric Haas, but before we do I'd like to just turn it over to Jim Allison just to moderate a few questions from the Committee for Professor Pirrong and Administrator Sieminksi.

MR. ALLISON: Thank you, Mr. Commissioner. Craig, Jim Allison; I'm going to start with one question. So you talked about the difficulty of full blown empirical analysis on the question of excessive speculation. Let me focus for a moment on half that question, the issue of false negatives. Given realistic assumptions about what data are actually available and assuming good econometric practices, if excessive speculation were present in a market how likely is it that we would fail to spot it? Is that a question that can be answered?

MR. PIRRONG: Well, I mean it is a question that can be answered. The statistical buzzword for that is what is the power of our test, what is the power of our statistical test, what is our power to detect excessive speculation. And essentially power would be measured on a continuum here. Now in my view, a rather extreme case, so for example like the Hunts, that is something that one could detect, you know, potentially the impact. You saw the Hunts, you know, essentially had a -- they were accumulating an inventory, inventories were growing dramatically. When they released their position prices feel dramatically. So certainly in some cases we probably -- some of the more extreme cases one should be somewhat confident that we would have the statistical power to detect these things.

In other cases that are less severe our power is diminished accordingly and one could be less confident. Although I would say that the other important thing to note is sort of from an economics perspective the social cost of a price distortion is related to the square of the size of the distortion. So missing small distortions is not really a big deal given that.

MR. ALLISON: So if I can translate that, so the distortions that are likely to be of most impact on consumers are the distortions we are most likely to be able to find?

MR. PIRRONG: That's correct.

MR. ALLISON: Thank you. Other questions for --

MR. PIRRONG: And I would say that going back in years of data, you know, essentially, you know, you can count -- Three Finger Brown, the former pitcher for the Chicago Cubs could count these episodes on one hand.

(Laughter)

MR. SLOCUM: Hi, Craig, it's Tyson Slocum with Public Citizen. Thank you very much for your presentation. So in your power point you wrote that you can't observe most relevant data.

And I assume this is tied to the knowledge problem.

MR. PIRRONG: That's correct.

MR. SLOCUM: So right now the primary data sets, it's my understanding, are the CFTC's Commitment of Trader Reports, which are very thin, and then there are some very expensive, non public, proprietary data sets out there which are kind of scattered. So the question is would your job be easier if the CFTC required more detailed disclosure in its Commitment of Trader Reports to the level where you could actually determine some of these missing data sets, more details on specific traders and positions for example? On a time lapsed basis.

MR. PIRRONG: In my view the data issue is less related to our ability to measure futures positions or positions. In my view the big gap in our data relates to -- is data on fundamentals. So in particular we have really good data on the United States for example, in particularly due to Mr. Sieminski's organization, but sort of looking for data on demand and supply from places like China is where we face a problem. But I would note that even if you had relatively good data, I mean essentially we would still be in a situation where it would be a relatively coarse representation of real supply and demand situations.

MR. ALLISON: Commissioner Wetjen.

COMMISSIONER WETJEN: Thanks, Jim. Professor, could you elaborate just a little bit more on your views as to why the financialization of the energy markets doesn't have quite the impact as suggested by this BIS study? Help me understand your view of that a little bit more.

MR. PIRRONG: Sure. Well, I mean there's the specifics of the BIS study and there's the issue of financialization generally. I mean it's just -- you know, I have a post on my Streetwise Professor blog where I go into some detail critiquing the BIS study and, yeah, it doesn't measure what it's purporting to measure and it just doesn't really tell a coherent story as to what they purport to measure could have such a substantial impact on prices.

Speaking to the issue of financialization more generally, the way that I would characterize is that financialization is really about risk transfer. It's not in final analysis about supply and demand of the actual commodity, it's actually about the supply and demand for risk. And so that the relevant price that financialization is going to effect is going to be in risk premiums. And in fact there is considerable evidence that during the period of time when financialization took off in the mid 2000s, that risk premiums in energy did come down. And that's actually a good thing because a risk premium is essentially a cost that hedgers pay in order to hedge their risk. And so I think that the data on financialization needs to focus on the real price that financial market participants affect, and that's the risk premiums or the price of risk associated with commodities.

MR. ALLISON: Other questions for

Professor Pirrong? Tyson, go.

MR. SLOCUM: Craig, one more question. So you indicated that the data issue is really more about supply and demand data. That is that contributes to this knowledge problem. Does that imply that traders themselves have inadequate data for their trading activity? How are they making the decisions if the analyses --

MR. PIRRONG: That's part of the genius of the market. And actually these are price discovery venues where people with -- where myriad numbers of individual traders and consumers and producers each with relatively noisy data, acting on that data together, interact in a way that produces a market price that effectively aggregates that information. And so that's sort of another aspect here is we don't want to put undue burdens on the market that can impede the price discovery process. And so the analogy that I like to use is that, you know, you think of the parable about the blind man and the elephant. Nobody sees the entire elephant, but the market helps put those pieces together. So yes, everybody would prefer more data to less, but this is more of a statement about how econometricians after the fact can see whether that price discovery process has actually discovered the right price.

MR. ALLISON: Let me pitch a variant of that question to Administrator Sieminksi. So we have far better data about U.S. markets than most parts of the world thanks in large part to what you've done over the last few years, so thank you. Do you have conversations with counterparts elsewhere, major supply and demand countries? Do we have much hope of better information about the rest of the globe?

MR. SIEMINKSI: The year that I got to EIA we actually because of a budget cut -- I arrived at EIA in June of 2012 and in the prior year EIA had suffered a pretty severe budget cut and had to eliminate a number of reports. One of those was our international energy outlook. One of my first acts as Administrator was to figure out a way to move money around internally so that we could start the international energy outlook up again and we've done that. I'm continuing to move funds internally to deemphasize some of the, I think superfluous, domestic reporting that we're doing so that we can continue to build on international efforts. Specifically, we've opened up a dialogue with several of the statistical agencies in China. I'll be in New York next week actually meeting with one of the heads of the Chinese energy statistics organizations. We are actively pursuing more knowledge of China, specifically Asia in general and the rest of the world because most of the growth and demand over the next 10 or 15 years is going to be coming from outside of the Organization of Economic Cooperation and Development, the OECD, the developed countries. So it's critically important.

One of the other things that we're doing that is international in nature is trying to beef up work with Canada and Mexico so that we have a broader understanding of North American energy flows, electricity, natural gas, oil, crude oil and products. For example, right now the EIA's energy infrastructure maps stop at the border to the north and south of us and I'm actually working with the energy secretaries of all three countries. Secretary Joaquin in Mexico, Minister Rickford in Canada, and Secretary Moniz here were actually building out a data reconciliation and mapping effort for all of North America that we should probably have done this year. So I think your question is actually really important, and I think understanding a lot of what's happening internationally is going to be critical to understanding U.S. energy activity going forward.

MR. PIRRONG: I'm going to have to leave here. I have to go testify in a case here in Chicago. I would be (inaudible) to express my gratitude for having the ability to participate here. I look forward to continuing views and anybody can feel free to sort of get a hold of me if I can answer any other questions that you might have.

MR. ALLISON: Thank you, Craig. And thank you for taking the time to be with us.

COMMISSIONER GIANCARLO: Jim, at this stage Administrator Sieminski has to leave and he wants to make final remarks.

MR. SIEMINKSI: Just one last comment. On this is there more than we could know that could help answer some of these questions, the answer is always yes. You know, part of it, I think, could involve again looking for ways to save money at EIA. I'm not here rattling my tin cup. I think there are actually ways that we can improve some of our data collection efforts to reduce our own internal costs so that we can do more. The more that we're thinking very seriously about doing is railroad data. There's a million barrels a day of crude oil moving by rail now and the knowledge base on that is very, very thin. I think that's critically important. Policy makers are struggling with this idea of crude oil exports, and understanding that issue depends I think on really having a good feel for what the growth in domestic shale oil production is going to be, and the quality of that oil. Things like API gravity which makes a big difference to how it gets refined domestically. And we are looking to expand our data collection and reporting capabilities in that area as well. So we will emphasize some of these international efforts, but there is a good chunk of new things that are happening right here in the United States or in North America that I think are going to be critically important to try to answer some of these questions.

COMMISSIONER GIANCARLO: Thank you. Please join me in thanking Administrator Sieminski and Craig Pirrong for their presentations.

(Applause)

MR. ALLISON: Thank you, Mr. Sieminksi. I think we need to move now to the remainder of the panel for which Craig has already given us the first presentation. So we have Steve Sherrod, Tom LaSala, and Erik Haas. Steve, many of us have worked with for several years, seemingly forever on some of these issues. Tom LaSala, CME, Erik Haas from ICE. And I notice they're sitting next to each other, so play nice guys. Who's going first? All right. Steve?

MR. SHERROD: Thanks, Jim. I'm Steve Sherrod, an economist in the Division of Market Oversight. The usual disclaimer applies, the views I'm expressing today are my own and are not necessarily reflective of the Commissioners or of other staff.

Today I'll cover three topics. First, I'll provide an overview of data collected by CFTC that we use in the surveillance program for derivatives on physical commodities. Second, I will review the limited amount of information the Commission collects regularly as to whether a trader is using a derivative to hedge or to speculate. And this limited amount of data in a regular collection for hedges is by design. It provides a low reporting burden on commercial enterprises that use derivatives to hedge. And third, I'll review table 11A published in the notice, reopening the comment period. That table provides counts of unique persons over percentages of the proposed position limit levels for the calendar years 2013 and 2014.

The Commission basically collects data on futures using the large trader reporting system that's codified in parts 15 through 19 of the Commission's regulations. For end of day reportable positions in futures the reporting entities, and those reporting entities are futures commission merchants, clearing members, and foreign brokers, they provide reports every day on reportable positions. When a trader first becomes reportable the reporting entity provides data on the identity of the larger trader with a reportable position, and we issue calls to those large traders to provide general data on the trader's use of the futures markets. Our regulation 15.03 lists the number of contracts that trigger reportable open positions. And for example, in light sweet crude oil an open contract position at the close of the day of 350 contracts would make a trader reportable. So when we say a trader is reportable -- when a trader is a larger trader in crude oil, they have 350 or more contracts generally. And the reportable levels give us insight into for most markets 80-90 percent of the open interest.

In terms of trading volume though as opposed to the end of the day positions, the futures exchanges provide a trade capture report for transactions every day. We're in the process of implementing rules called Ownership Control Reports, or OCR for short. That will enable the Commission to receive automated reports of the identity of traders that are in these trade capture reports. Currently this is a manual effort. The exchanges have facilitated that, working with the Commission staff, to obtain the name of a trader associated with the trader ID so that we can make use of that trade capture report and tie it back to the large position in the large trader reporting system. The volume quantity for that OCR report is set at 50 generally. And on February 10 of this year, DMO issued a No Action Letter that extended the implementation periods for certain provisions of our OCR rules.

So under Regulation 17.01 the reporting entities use Form 102 to identify large traders in futures that I mentioned. We'll ask the trader to fill out a Form 40. Question 19 on Form 40 asks the trader to indicate the business purpose or purposes for which the reporting trader uses derivative markets. If the trader identifies more than one business purpose for an individual commodity, they must indicate the predominant business purpose. So examples of business purposes including offsetting cash, or spot market input or output price risks, and offsetting cross price risks. So on the Form 40 a trader provides some indication of their general hedging use. The indication helps us classify the trader, for example, for purposes of the public commitment of traders report, but that indication is general, in the Form 40, and it doesn't indicate for each specific trade or position the trader has whether it's hedging or speculation.

So for traders filing a bona fide hedging exemption when they exceed the federal position limits in Regulation 150.2, they have to file appropriate 04 Series Report, and that's as of the last Friday of the month. So it's a once a month filing. If staff has concerns about a particular market, say because of a very large position held by one trader going into the delivery month, we may issue a special call to that trader for additional information about their use of futures for that particular time period. In the case of commodities that don't have federal position limits, Tom and Erik are here to talk a little bit about what they do and the next panel will address that as well. The Commission can access the applications and information that the Exchanges receive.

So turning to swaps, Swap Data Repositories, SDRs for short, they collect data under our regulation Part 45. To use that data for surveillance we first have to have reliable data, and then in order to understand a trader's position in both futures and swaps we have to link the counterparty name or legal entity identifier with the trader identification used in the large trader system for positions along with the trader IDs in the trade capture report. And further to combine swaps and futures, we need to convert swaps to a futures equivalent basis. So we're working on that complicated process, and in the meantime before we're able to fully utilize the SDR data, we can make use of data reported by clearing members of derivative clearing organizations, and swap dealers under Part 20. That data is submitted on a limited scope of 42 physical commodities, and that swap data has been converted to futures equivalents by those reporting entities. They use a Form 102S to identify the traders and then we can issue a call with a Form 40S for the swap market participant, the counterparty to the reporting entity, to give us general information on the trader's use of swaps.

There is no regularly reported data to classify particular positions as speculative or hedging beyond the once a month form that I mentioned. We do not have a regular data collection that requires a large trader to classify a derivative position as speculative or hedge. Historically the Commission did. It was an O3 Series report and the Commission eliminated that routine filing in 1981 to reduce burdens on commercials. In the energy spaces the exchanges can talk about their spot month limits, and there aren't typically single month or all month combined limits. Neither the exchanges or the CFTC have a regular data collection to require large traders to classify their derivatives as speculative or hedging position by position, or trade by trade. And I'll note that the exemptions the Exchange typically request an application and those -- I guess, Tom, they're once a year updates typically?

MR. LASALA: Typically.

MR. SHERROD: Typically. The statute does place a burden on persons to show that positions are a bona fide hedging position. Historically the Commission has imposed minimal regular reporting requirements on a person claiming a bona fide hedging exemption. And indeed as I mentioned, we currently have a once a month report for practically everything. We require only advance applications for unfilled anticipated requirements or unsold anticipated production. And as I mentioned, if we need more information, we'll ask for information under various different special call authorities.

I'd like to mention briefly the Table 11A that the Commission published. This is an update to a chart that was published in the December 2013 Notice of Proposed Rule Making. It provides summary statistical data that covers calendar years 2013 and 2014. And in the graphic that you see here, this is for NYMEX, Henry Hub Natural Gas, it's the core reference futures contract. So it covers all the referenced contracts in natural gas. For the 2013-2014 time period table 11A, the first row for example, the percentage of the proposed level, in this case it's the baseline proposed level, the spot month baseline proposed level was 1,000 contracts. So there were 187 unique persons that exceeded 60 percent of that 1,000 contract spot month limit, that's 600 contracts for those two calendar years. And you can see similar numbers for the spot month for the cash settled contracts, and very few traders that would have exceeded the proposed levels for the single month and the all month limits.

I'd be happy to answer any questions about the table. And I look forward to the advice of the Committee on this.

MR. ALLISON: I think we should hold questions until we've heard from the entire panel in the interest of our timing.

So, Tom, are you next or is Erik next? All right, Erik next.

MR. HAAS: First, I'd like to thank the Commissioners for the opportunity to present before you today. My name is Erik Haas; I'm with ICE Futures U.S. Market Regulation Department.

So our first slide -- I'm going to set a high level -- this depicts the U.S. natural gas pipeline network. It consists of 300,000 miles of interconnected pipelines capable of transporting natural gas essentially to and from every state in the U.S., in the lower 48. This is the U.S. Electric transmission grid. Again it's actually four major grids or interconnections. Each one ties together all the generation within it so that power can flow across the grid and fulfill demand load in other locations. The purpose of both of these networks by design is to facilitate the transportation of the commodity to other locations.

COMMISSIONER GIANCARLO: Erik, pull your microphone a little closer to you so everyone can hear you. Thank you.

MR. HAAS: At ICE Futures U.S. we list for natural gas 175 futures and options contracts across the network. We list 281 electric power futures, and 119 environmental contracts. Unlike other commodities there is not one power contract, there's not one nat gas contract. There's Henry Hub, but there's 174 other contracts that while they all to a degree are tied to Henry Hub, they primarily fluctuate based on supply and demand fundamentals in all the different regions and locations of the U.S. I'm not going to go through 500 slides showing each contract's price moves with the change in fluctuation on who the participants are, but I think after we go through this you'll see that based on the make-up of these markets it will alleviate any concerns of one specific category of market participant having an undue influence on these markets. None of these contracts are big names. If I were to rattle off some of these power contract names it would just sound like alphabet soup to most people here, but the fact of the matter is these are all futures and any regulations aimed at the big name products, crude oil, or the individual agricultural products directly impacts all of these regional natural gas and power contracts. And anything that makes it harder to hedge is going to directly impact the price people pay to heat their homes. All of the electricity producers use these contracts to hedge where they're generating electricity and in different regions. If it costs them more to hedge, or their hedges become more difficult, like everything else it gets passed on to the end consumers of that service.

So, the next slide I want to show is -- the next two slides will show open interest in our energy contracts for natural gas, that's essentially everything, other than Henry Hub, powers, just kind of grouped everything together. We used data from CFTC Commitment of Traders Reports; it's a historical data, as much as available for these contracts.

Full disclaimer, some of these are available to 2012-ish, because they were deemed significant price discovery contracts. Others, the data starts in 2012 or 2013 as they came about, but the extent of what's available is covered here.

The blue category reflects the open interest held by hedgers, which we've grouped commercial participants and swap dealers; and the green area will be a speculative category consisting of managed money and the other category. As you can see in our cash-settled Henry Hub contract, hedgers hold 71 percent of the long OI, on average, during this period, and about 94 percent of the short.

Commercials in these categories are 66, 40 percent long-short. In other natural gas contracts, hedgers hold 91 percent of the long open interest, and 93 percent of the short, and commercials make up 80, 57 long-short. For power, hedgers hold 93 percent of long, 97 percent of short, and commercials are 80 and -- 88 percent respectively on the long-short. And environmental contracts hedgers are 88 percent long, 77 percent of short.

So as you can see in all these products, there really is a small amount of speculative interest, now a lot of this -- this is probably solely, because the makeup of these contracts, prior to 2012, these are all existed on an ECM exempt commercial market where you had to be pretty much an end user, or the category of who could participate in these markets, and it was primarily hedgers and swap dealers, and some pretty large funds maybe.

But once we converted to futures, the makeup of these products didn't change. We didn't get an influx of retail traders. There is not really, you know, a regular person with a day job, sitting there, day-trading on his E- Trade account, power in the Northeast. In these markets the commercial traders, practically, a counterparty to every transaction, and many transactions have two different commercials as counterparties.

The next slide reflects just a forward curve of open interest. We just used the recent day, and we compared Henry Hub and PJM West Hub, two of the bigger energy contracts, to ICE Futures

U.S., sugar and cotton. And what we want to show is that, these are unlike Ags, which pretty much every physically-delivered agricultural contract has relatively few contracts months with open interest, and the majority of that open interest is front-loaded in the first two or three contract months.

So, you know, I'll just quickly go through this; on the bottom left sugar, on this day, had OI spread across 12 months, 12 contract months, and 75 percent of the total open interest is in the front three months. Cotton, had OI across 10 months and 83 -- or 84 percent of the open interest is in the front three months. In the upper left Henry Hub had open interest across 142 different contract months, 20 percent of the total OI is in the front three months; when you go out the first year, and Henry Hub has a contract month each month of the year.

Out the first year only 50 percent of the open interest exists, and to get to 99 percent of the open interest you are going out 70 months out the curve. For power, it's a similar look. OI across 83 contract months; 15 percent of the total OI is in the front three months, 50 percent of that is out the front 12, and when you get to 99 percent of open interest, you are going 60 months out the curve.

So clearly these are different. There's open interest much out the curve, much further out the curve, and there definitely is a need to have liquidity in the longer-dated months in these contracts.

The next slide is -- in just depicting the number of unique market participants in each contract month. Again, it's just as of February 20th, 2015. You know, nothing really great with this, I just want to show that again, out the curve we have multiple participants. It's a smooth downward trend, there are no abrupt drops in the number of participants across any month, and just active participants. Given our open interest makeup it exists out the curve, these are going to be 70, 80 percent commercial companies, probably even more out the curve, so.

This slide is -- reflects convergence which, as everyone knows, is the key measure of how well a futures contract is functioning. And so what we did here, is over the past four years we compared Henry Hub settlement price to the corresponding price for monthly physical gas deliveries. During this time the average price difference between those two, was 9/10ths of a cent or -- I'm sorry -- 0.25 percent of the cash price.

Over this four-year period there are only six expirations where the difference was greater 2 pennies. We also looked at the Dominion South contract, and the PJM West Hub day ahead. Dominion South is essentially the Henry Hub of the Northeast, and in a lot cases it's bigger than Henry Hub, and a lot of talk about that, maybe even taking over Henry Hub as the primary index price of natural gas.

During the period we looked at Dominion South had convergence of 9/10ths of a penny which was about one-third of a percent of the cash price, and for our power contract average convergence was 50 cents, or just shy of 1 percent of the cash price.

So, what you should take away from this is that these are well-functioning markets, they have model convergence, primarily made up of hedgers. Every day transactions occur -- transactions occur out the curve which, again, is a sign of a healthy market in that market participants can enter and exit the market, not only in the spot month, but manage their risk out the curve.

All right. Just again, using February 20th pulling out the contract months that traded in Henry Hub; on this day there were 30 -- or 33 different outright contract months, 4 long-dated strips, 3 Cals and four quarterlies. Again, this is a sign that participants, at any time, can enter and exit the market based on our markup, the participant categories, these are commercial companies, moving in and out of the markets because there's liquidity and they are able to enter and exit out the curve.

These contracts -- a typical minimum quantity for a trade is one month's exposure to gas and power. And as you can see, it's common to trade an entire year's worth of exposure in one transaction. We point out the makeup of these markets, primarily to show that any regulations aimed at excessive speculation is a solution to a nonexistent problem in these contracts. And if you are targeting that in other products, you have to keep in mind that those regulations are directly impacting these contracts. So we are happy to take any questions after the presentations.

MR. ALLISON: Thank you, Erik. Tom?

MR. LaSALA: Thanks so much, Jim. Thank you, to all the Commissioners certainly --

MR. ALLISON: Tom, could you turn on your microphone?

MR. LaSALA: Oh, I'm sorry. Sorry about that. So, Jim, thank you. Thank you to all the Commissioners present, certainly Chairman Massad.

I'm happy to present to you today on behalf of CME Group.

For purposes of my presentation today, I've assembled a series of slides in this deck to address a number of matters that I think were front and center for this Panel. You know, the detection monitoring of the market, the composition, liquidity, and getting to the matter of, you know; is excessive speculation driving prices?

So I'd like to take you through my first slide, if I may. What we have here is, I've chosen to focus this presentation entirely on the crude oil market for, you know, time-wise, I think it's front and center with this group. So this is a summary of the data harvested from CFTC Commitments of Traders, which as Steve explained earlier, comes from, effectively, you know, 102 data; goes to CFTC and the exchanges every day.

This is assembled weekly by the CFTC. This covers a three-year period. What we effectively did, was we averaged all the weekly percentages and assembled both the long side and the short side of the market for that period, for you. We largely maintained the categories the Commission uses under commercial; included is producers, processors, merchants and users.

I think what you see here is, in fact, a marketplace that is extremely diverse in so far as its participation on both the long and the short side, and I stress the latter point there, the long and the short side is clearly participation by these entities on both sides of the market, and it's a key concept that's critical when I get to the subsequent slides in this presentation.

Move to the second slide. What I tried to capture for you to give some context about liquidity in the market is the number of users that we maintain on a -- this was one particular day, February 23rd, it was just a snapshot. We looked at the -- you know, the MPIs of the market participant IDs in the crude oil futures market on that day, and you can see the construct of the amount of participants in the market, ranging, like you would expect, the greatest numbers on the front end of the curve, and broadly decreasing as you go further out the curve.

Generally speaking we see open interest in futures ranging between 1.5 to 1.7 million contracts. And again, you would have -- I also will say to you, that curve would effectively look very, very similar to this.

If we move to the next slide, what we've captured here is the following. The CFTC collects and publishes; I guess what emanated originally out of a special call some years ago, end-of-month data that they harvest from participants regarding index investment in the WTI contract. What I've done is mapped the -- and this is again, we chose the -- we did the net long, so you had to choose as they are, you know, both sides of the market.

We looked at the longs; the short would certainly be the inverse, the same result. We chose the longs, mapped WTI index investment which is converted into contract equivalents for the period commencing June of '10, all the way through

December of '14. So this is the all month, WTI Index investment and, again, mapped with it, the front month price in the NYMEX WTI Futures Contract.

So if I can summarize for you, the decline in the net long index investment began July of 2011. Prices began declining during June of 2014, three years later. If you look at that index investment, and look at the price line, you know, I would conclude to you, there is no clear correlation in so far as, you know, the index investment and the pricing in the marketplace. As a matter of fact, as you see in 2014, as prices went down, index investment actually increased very slightly.

In the next slide we relied upon, again, another CFTC information output, the Commitment of Traders, which Erik also referenced. This is swap dealer open interest and, again, harvested. The swap dealer positions, you know, I say net long, but in this case, while they go at 1 point slightly long they, generally speaking, are net short positions, and again mapped it against pricing in the spot months.

So from January 2011 through June 2014, WTI prices basically stayed in a range of 85 to $105 per barrel, for the most part, while the swap dealer positions trended from approximately net long of zero to negative 400,000 contracts. I will say that, pretty clearly there is no discernible impact that flowed from the swap dealer positions as it relates to the price in the WTI contract.

Since prices began declining in August of 2014, swap dealer positions, while still not short, have decreased their net positions by 200 to 250,000 contracts. In other words, the net long positions of swap dealers have substantially increased while prices were dropping.

If you can move to the next slide? Thanks. The next slide captured another segment, again mapping against the price of the NYMEX crude market. We are covering, again, the period January of 2011 through end of January 2015 here.

So between January 2011 and July 2014, prices fluctuated again between 85 and $105 per barrel. Money manager net long positions also fluctuated, approximately 250,000 contracts down to 100,000 contracts, and then back up to 325,000 contracts. There seems to be no discernible influence evident during this period emanating from money manager positions to price.

Money manager net long positions dropped sharply, about 125,000 contracts, just as prices dropped by about $10 per barrel. This is in the August through September 2014 period, but net long positions effectively still held steady as prices dropped another $47 per barrel, from October 2014 through January 2015.

I would conclude from this that the evidence is indicative that there were other forces in here, fundamental forces, that were indeed dictating the price, not in fact the activities and the investment, or the activities of the money managers in the NYMEX Crude Oil Contract.

If we could move next to the following slide, which is, again, harvested from the CFTC Commitments of Traders Report, here, what we've tried to capture is, you know, what's the commercial open interest doing during this period? Period, again, 2011 through 2015, so between January 2011 and mid-2013, these prices fluctuated again in that 85 to $105 range. Commercial net long positions rose by approximately 300,000 contracts. You know, effectively going -- forgive me -- thereafter prices continued to fluctuate until July of '14. Net commercial positions dropped by approximately 200,000 positions.

During this period there is no discernible influence emanating from commercial positions to price. Since prices began falling in August 14, commercial net long positions have been shadowing the decline, falling by approximately 70,000 contracts. So it appears the commercials have increased their short hedges during this time period which actually makes economic sense. According to the price decline -- according to the price decline it appears to have influenced adjustments to the net long positions of commercials.

So, again, it seems that the commercials, in fact, reacted to the price decline, and again, what I'm trying to shape here is a marketplace, effectively, most affected by fundamental factors. What I didn't include, and I just want to air to the Committee, and I apologize. Erik had referenced a conversion rate in the natural gas contract. I did look at that for 2014, it was 99.39 percent.

I'm certainly available to take questions but, again, I think the crux of what I want to put before the Commissioners and the Committee is a summary of the marketplace addressing the composition and comparing it into, in fact, pricing that occurred in the market. So I hope that this has been helpful, and I'm certainly happy to take any questions that you may have. Thank you.

MR. ALLISON: Thank you, Tom. We are at

the appointed end of this session, and we are going to have Tom and Erik with us next session, so I'm going to suggest we hold our questions for Tom and Erik until then. I'm going to take a minute or two for questions for Steve, if there are any. So, Ron?

MR. OPPENHEIMER: Would it be possible to put the slide 11A back up on the screen? All right. So, this obviously is just, you know, one segment of the entire Table 11 or Table 11A, but I look at the number 83 there of potential -- individual unique entities that would have exceeded the spot physical position limit for natural gas at 100 percent of the level being suggested. And I think it was characterized as a small number, and frankly, to me, it looks like a pretty large number, but I think that's, you know, a difference in perspective.

The question that I have, or it's probably more of a comment than a question, but if there's a response, that will be great too. Is, these are either hedgers operating under a hedge exemption from limits, and part of what we'll discuss this afternoon is that there is a significant narrowing in the proposal of what constitutes a hedge exemption. And so these 83 people may be hedgers who won't be able to continue with their hedging activities under the new proposal.

Or, alternatively, I guess they are speculators and under the proposal, won't be able to speculate, but I guess, they must be hedgers actually, and I will take it back, because there are spot and physical -- spot limits for natural gas already. So, these are 83 hedgers that if we narrowed the definition of hedging, will be impacted, and not only will they individually be impacted, but the liquidity that they afford to the marketplace will disappear, and that will affect the ability of other hedgers to get their transactions done as well.

MR. ALLISON: Stephen, any further comment on that point?

MR. SHERROD: I think Ron is accurate.

And in terms of my comments earlier about the few people, I was referring to the right-hand column for single month and all month. Definitely this is about the spot month, where a lot of traders receive exemptions from the Exchanges currently.

MR. ALLISON: Lael; and then Tyson?

MR. CAMPBELL: I'm going to break your rule. I'm going to ask Erik a question, because it kind of follows up on a point that I think Ron was making. But, you know, Erik, in your presentation when you were talking about the power markets, you noted in the electricity market it was like 94 percent of some of these markets were hedgers, and that just seemed, I mean I've never seen that before, that seemed shockingly high to me. I guess a two-part question. Have you noticed speculators or non-hedgers becoming less of a percentage of the market over the years? And what impact have you seen that have on bid-ask spreads?

MR. HAAS: There's definitely been a decrease in the number of speculators in the market, especially out the curve. Once we've converted our cleared swaps to futures, that number went down. Liquidity out the curve is -- at times it's, bid-asks are pretty wide. It's -- a complaint we hear a lot is that markets are too wide out the curve, there is not enough participation; what can you do to facilitate this?

The sign showing open interest out the curve, and the number of participants, that's Henry Hub but, again, a lot of those power commercials are using Henry Hub to hedge their generations, so that's probably reflective of some power commercials as well, hedging out the curve. The fact there is still open interest out there shows that commercials need the hedge, needs to happen. The markets are illiquid. Bid-asks are wider, but they still have to do it. It's getting more expensive and harder to do, but I guess, what's the alternative, there isn't?

MR. CAMPBELL: Well, I mean it's one of the 95 percent hedgers, I wish there were a lot more speculators in the market, because I mean, we -- it's not only about being able to hedge, it's also the transparency that these markets provide us when we are trying to price contracts in the physical space, and so on and so forth. I mean, it sounds to me like we may have an excessive hedging problem. That's really causing some trouble here.

MR. HAAS: And we do our best to facilitate participation out the curve, and we are trying to educate market participants on accountability levels. We have accountability -- and this kind of gets into the next Panel, so if you guys want me to stop, we can stop, but --

MR. ALLISON: Well, I think we can extend this session for a few minutes by taking the time out of our lunch break so, everything comes with a cost. But, Tyson, you've got a question?

MR. SLOCUM: Yes, please. So, Steve, is it possible to tell us what proportion of the total market participants this 83 number is?

MR. SHERROD: It's possible. Generally the Commission has been reluctant to release summary statistical information in the spot month, reluctant because we don't want to paint a picture of how to manipulate the spot month, by showing how many people are at various sizes. So this summary data covers two years, and we haven't given granular data, we haven't, you know, broken it out by first, second, third day of the spot month.

MR. SLOCUM: Mm-hmm.

MR. SHERROD: That's something we do in our -- in our Energy Surveillance Program, and what -- and Tom does as well, and so does ICE. Watch the market, and watch participants every day during the spot period in particular.

MR. SLOCUM: I guess, I think for the purposes of the comments to assess, you know, how onerous this position limit rule is, it's kind of important to quantify whether 83 is a big number as some say, or a small number, and that's relative to, you know, the total number of participants.

I do have another question about data.

You had mentioned that, if I heard you correctly, that there are elements of the Commitments of Trader Reports, where the traders are filling out their designation. So it's not necessarily based upon their market activity but what category they fill out in the form. Did I hear that accurately?

MR. SHERROD: Right. We don't know whether a particular trader's position today is hedge or spec. What we would know, for example, for a commercial participant, they may have indicated on their Form 40 that in general, they use the particular futures contract to offset price risks. And so they would be categorized on that predominant purpose of commercial.

MR. SLOCUM: Okay. And one last question, if I may. On data, you had mentioned one issue with the trader IDs and that the CFTC or another entity was having to manually enter that data. Are there any other challenges that the CFTC has with receiving large volumes of data, and convertibility problems which affect the ability to analyze some of this? Without compromising any market integrity issues, of course.

MR. SHERROD: It's always a challenge to have enough information resources to process high-volume data. In terms of identifying traders, we've had a lot of assistance from the Exchanges over the years. They have an interest in knowing from the trader IDs, who is trading during the day, and so that's the process that I mentioned that has been mostly manual, to identify and link those trader IDs for the trade capture report back to the end of the day position reports.

The OCR Rulemaking that the Commissioners have gone final with, is intended to try to automate, to a large extent, on our end, and it puts a -- it puts a significant burden on the industry to provide that information. But that's underway, and we've talked publicly a number of times about the challenges of trying to process the swap data.

MR. ALLISON: Mr. Chairman?

CHAIRMAN MASSAD: Thank you, Jim. I wanted to make sure I understand the tables, Erik, that you presented, and this kind of relates to the question and the comment that Lael made. You -- if I understand it, you are saying you are taking -- you've looked at the open interest and categorized it by what positions are hedging positions, and what positions are speculative, or what amount of the open interest? Is that correct? And I just want to understand how you do that.

MR. HAAS: We are using the Commitments of Traders categories, we are not -- I don't know, for the environmentals we adjust it a little bit, we thought a lot of companies were miss-categorized, and so as we --

CHAIRMAN MASSAD: So, it's just from our report?

MR. HAAS: This is straight from your report.

CHAIRMAN MASSAD: So what it represents is saying, commercial -- anyone who is in the commercial category is hedging. Is that correct?

MR. HAAS: Yes. For hedging we

included commercial and swap dealers.

CHAIRMAN MASSAD: Maybe, Steve can you clarify -- I don't think that's the nature of our report, is it?

MR. HAAS: Yeah, let me clarify. We are not saying that they are hedging or speculating, this is the makeup of the market participants. This is their category that they are in. This has not taken --

CHAIRMAN MASSAD: I'm sorry. So when you say hedge is 94 percent, that doesn't mean 94 percent of the open interest is hedging?

MR. HAAS: No. That means 94 percent of the open interest is held by a company in the hedge category.

CHAIRMAN MASSAD: So it's really hedge equals, if you designated yourself as commercial or swap, you are calling them a hedger, and if you designated yourself as the other categories, you are calling them a speculator. That's all this really says.

MR. HAAS: Yeah that's --

CHAIRMAN MASSAD: Okay. Thank you.

MR. HAAS: Yeah -- We are just taking it directly from the Commitment of Traders Report, to demonstrate the makeup of the participant categories. We are not saying that this is reflective of how anyone is trading.

CHAIRMAN MASSAD: All right. Thanks.

MR. ALLISON: And Paul Hughes had a question. I think this will be the last question.

MR. HUGHES: Just real quick. And this is really for Erik or Tom. Great data obviously, but do you have any data that suggests kind of the overall growth of your markets or your Exchange when it comes to power or natural gas. In other words, are you seeing anything that would suggest a movement from the OTC markets, coming onto the Exchange?

MR. HAAS: I would say recently what we are seeing, and could be troubling is, participants leaving the futures market. It's less liquidity, it's harder to trade, it's harder to get exemptions. And I was going to address before, we'll hear from commercials, who are having a hard time hedging out the curve. What can we do to help? So we'll try and talk to other participants and say accountability levels aren't limits. You are able to exceed them, you know, as long as the markets are operating, and it's -- and we are undertaking an educational process with a lot of these participants.

These aren't, you know, the traditional futures, players I guess that, kind of really understand what it means. We have -- you know, noncommercial companies call us and say I'm going to put on this position out the curve, it's going to exceed accountability. Is it ok?

And it's tough, we try and tell them that, you don't have to call us, we don't want to -- we don't want to be the factor that disrupts the activity. If you have a well-intended position to put on, put it on. So getting back to your question, because of this, liquidity has dried up, people leave the market. We are seeing more and more participants exit the futures market, overall, going to, I guess, bilateral exposures with the counterparty instead of having their risks covered on an Exchange and cleared.

COMMISSIONER WETJEN: Have you guys looked at the reasons? So, it's one thing if they asked you how you can help as the Exchange Operator, but what do you speculate are reasons for the dry up?

MR. HAAS: From what we hear, and again we are not -- a lot of times we are not -- even if we ask we don't get the answers. Honestly, like, if they are going to take their business off Exchange. At least I'm (inaudible) on compliance, I'm not trying to kind of cross the line too much with how companies are operating, but their answer usually is; it's more expensive to trade futures right now. A lot of people would rather have the counterparty risk and deal with that, versus having to putting a futures position on out the curve.

There not being liquidity when they have to get out of it. If they have to get out of it, they are going to have to pay up considerably. Those are all risks that, I guess, these market participants are weighing and choosing to just have a bilateral exposure.

MR. ALLISON: Mr. Chairman. Do you have another question?

CHAIRMAN MASSAD: No. It's all right.

MR. ALLISON: Okay. Knowing from -- Let me put an end to this session for now. It is by my watch 11:46, I want to start the second Panel, promptly at noon. We'll have Tom and Erik back with us. So, Tom, I know I didn't call on you, but if you need to roll that comment into your next comments, feel free. You see the --

SPEAKER: (Inaudible) up until lunch.

MR. ALLISON: By my watch it is currently 11:45 and we are starting the next Panel at noon, it would be 1:00 o'clock in some time zone, but not the time zone we are in, I think. Join me, please, in thanking this Panel.

(Recess)

MR. ALLISON: So as we regather. Mr.

Commissioner, I know we did not take time this morning to introduce ourselves around the table. I think that might be a good practice while people are gathering. I'm Jim Allison, with ConocoPhillips. And Ron, if you'll pick up; and we'll just rotate around the table.

MR. OPPENHEIMER: Sure. Thanks. I'm Ron Oppenheimer; I'm representing the Commercial Energy Working Group.

MR. McCOY: I'm Bill McCoy; and I'm representing the Futures Industry Association.

MR. DURKIN: I'm Brian Durkin, and I'm representing the CME Group.

MR. SLOCUM: Tyson Slocum; I direct the Energy Program at Public Citizen, a non-profit consumer advocacy group.

MS. BROWN-HRUSKA: I'm Sharon Brown-Hruska, and I'm representing Tulane University's Energy Institute.

MR. JACKSON: I'm Ben Jackson; I'm representing ICE.

MS. SHARP: I'm Victoria Sharp, and I'm

representing Citigroup.

MR. JOHNSON: Vincent Johnson, for BP.

MS. WIGGINS: Dena Wiggins, with the National Gas Supply Association.

MR. CAMPBELL: Lael Campbell, here; on behalf of Exelon Generation.

MR. CREAMER: Rob Creamer, representing the Futures Industry Association Principal Traders Group.

MR. CREEK: Todd Creek, with ICAP Energy.

MR. GILL: Mike Gill, representing Independent Petroleum Association of America.

MR. HUGHES: Paul Hughes, with Southern Company.

MR. BRANDENBURG: Robert Brandenburg, with Peabody Energy.

MR. WASSON: Russ Wasson, with the National Rural Electric Cooperative Association.

MR. THORNHILL: I'm Herbert Thornhill, I'm with NRG Energy; a competitive power producer.

MS. KELLY: I'm Sue Kelly, with the

American Public Power Association; and probably most relevant to this group, all my members are considered Special Entities, Units of State and Local Government involved in electric utility matters.

MR. PROKOP: Mike Prokop, with Deloitte & Touche.

MR. COSGROVE: I'm Michael Cosgrove, with Vectra Capital; we are a proprietary trader.

COMMISSIONER GIANCARLO: And Jim, may I just add that I -- I just want to recognize Professor Brown-Hruska, who is not only a Distinguished Professor, but is also a Former Commissioner and Acting Chairman of the Commodity Futures Trading Commission, and we are honored to have you with us today. Thank you very much.

MR. ALLISON: Thank you, all. Tom and Erik. Erik?

MR. HAAS: So our second presentation is going to focus a little bit more on how we operate, and our procedures. Starting out, you know, we are asking; why is there a need for change? The existing regulatory regime for power and gas contracts works. Any undue influence on these markets, whether it's from regulations or market participants' activity, directly impacts commercial companies and end users; these markets are made up primarily of companies that operate in the energy industry, and the exhibit model convergence.

The one-size-fits-all approach to futures does not work. Again, all 500 of these smaller contracts are now futures. They are not the big names that most people think of, but every regulation, all the proposed regulations directly apply to them. Single and all-month limits will only serve to eliminate already thin liquidity out the curve. Spot month limits must be updated, and set at realistic levels, and on top of that three longstanding commercial hedging practices are at risk of being eliminated.

So can we start by explaining our market regulation process; to ensure our markets are not subject to influence from market participants, we take a bottom-up approach. We start out, we take in a lot of data from audit trail, position data, social media and new sources. We try to understand how participants utilize the market so that we can offer better guidance on complying with our rules.

We use all this data, and what market participants are doing, to try and identify indicators of market stress, whether it's in the current market or what could become stressful in the future. Our primary goal, since your compliance with the Exchange and CFTC rules, and proactively maintain the integrity of our markets, and confidence in our market participants; and to facilitate the price discovery and risk management process.

At a high level, the single and all month combined reviews are aimed at gauging a position concentration's impact on the market. These were never intended to serve as a real-time market protection; it should not be implied in such a way. To make a determination on the impact of a position concentration's influence on the market, takes a considerable amount of analysis. Many factors are considered, and rarely ever is the position itself, versus the level, the sole factor of determining whether it's going to have an impact on the market.

We utilize position accountability instead of limits. And this gives us the ability to provide the necessary oversight on any market participant when needed, but to also ensure that there's sufficient liquidity so that market participants can operate, and enter and leave the market.

We disagree with the 10 by 2.5 percent formula as a necessary level, and have honestly found that the level equal to the spot month's limit seems to work for these contracts, since -- as an accountability level that is -- since that's always the backdrop to a position out the curve. So if we are looking at a position three months out the curve right now, we can determine, at the current time, this position is not problematic, but our next question is going to be, as that position approach its limits, will that have an influence on the market? Will, unwinding or liquidating that impact the market?

So accountability levels give us the flexibility to make these determinations. The rules themselves, give the Exchange the ability to determine that a market participant cannot increase their position any further. In extreme scenarios we can force a participant to reduce their position in an orderly manner. Or, we can make a determination that the position is not having an impact, and just maintain an open dialogue with them or the participant throughout the process that position comes into the limit.

Next, we'll talk about deliverable supply estimates. We agree the spot month limits must be set based on updated deliverable supply. But critical to this is that the deliverable supply itself is calculated appropriately. Again, a one-size-fits-all approach does not work for futures. And the basis for deliverable supply in agricultural commodities does not apply to energy.

Given the interconnectedness of natural gas and power, as those maps on our first presentation show, we believe that the estimated deliverable supply needs to consider natural gas or electricity that are in a different location, but can still serve demand in a certain area through the transportation of that commodity.

For natural gas, we believe that means an estimate based on pipeline capacity, as an indicator of how much gas can actually be delivered. And for power, estimates must include transmission. It cannot be based solely on load or generation at a certain area.

So I'm going to go through a very, overly simplistic example of deliverable supply for natural gas. In this example, the supply in natural gas on the left is greater than both pipeline capacity and the demand. Peak demand is greater than pipeline capacity. Off-peak demand is generally less than capacity, but again, the pipeline itself can also serve as a version of storage to hold gas until demand increases and therefore prices increase for someone to resell it at a later date.

So this is, again, a very hypothetical example. During a period of peak demand using this example, the demand for gas is 650, it can be met given the supply is 1,200; however, the maximum amount of gas that actually be fulfilled or delivered to fulfill demand is only 600. At no point in this example, and this is typical in the Northeast, and that's why you see our polar vortex prices to heat your homes, and everything, go up; you are not going to be able to deliver the necessary amount of gas to meet that demand.

So we believe that the best estimate for deliverable supply for natural gas would be the pipeline capacity, as that is -- serves to reflect only the amount of gas that actually can be delivered. And in these interconnected markets it is readily available.

The next slide touches on bona fide

hedges, and the proposed rules putting at risk three longstanding commercial hedging practices. We strongly believe that cross commodity, anticipatory, and unfixed hedging must be recognized by the Commission, and the Exchange is given flexibility to review and grant exemptions based on exposures and where appropriate.

Our approach to these is no different than how we approach any other bona fide hedge exemption. Market participants, we require that the market participants demonstrate that their futures position is economically equivalent to the underlying risk. Require that they demonstrate that risk. The participant has to justify the exposure and the level, and in the end, the Exchange makes the determination on whether the exemption, even if it can fully be supported, is appropriate for the market.

And just because the full amount of what's requested can be justified based on market conditions, the Exchange can actually approve levels less than that, and step up the exemption level as needed, as the market can handle it.

Finally, I'll just say that we have -- we feel that the core responsibility of the Commission is kind of missing in some of the rhetoric. The CFMA amended the Commodities Exchange Act to include a section titled, Special Procedures to Encourage and Facilitate Bona Fide Hedging. I'll admit it's geared towards Ags, but everything we deal with is geared toward Ags, so I'm going to say it still applies for energy.

This section directed the Commission to consider rules that increased the ease with which producers may participate in contract markets. Provide flexibility and the minimum quantities to better allow producers to hedge risk, and most importantly, I think encourage contract markets to facilitate participation of producers.

So it's clearly intended that not only is the Commission is supposed to police and regulate these markets, but there is a responsibility to encourage participation and make sure that producers can operate. And part of that is making sure for someone to take the other side of the market.

I think what's shown today in the proposed rules, show it's just getting harder for, not only producers to operate and get exemptions, but it's harder for the contract markets to maintain the participants to take the other side of these positions. I'm happy to answer any questions about this. These presentations are done.

MR. ALLISON: Thank you, Erik. And again, I think it would be helpful to hear from both speakers before we take questions. So, Tom?

MR. LaSALA: Thanks so much, Jim. Thanks, Steve. Very good. Thank you. So I'd simply like to begin covering a couple key topics here which will be accountability and the administration of hedge exemptions. Just a quick backdrop on market reg resources and responsibilities at CME Group, just very quickly; approximately 180 employees dedicated to market reg and surveilling all of our markets.

I'm going to focus in the presentation today on energy, so I'm focusing on the activities of our Market Surveillance Team, which is composed of 56 employees in total across two locations, 20 of which are completely committed to energies and metals, and some of those is high- level duties they have.

You've heard before, you know, monitoring large trader data, detecting and deterring, preventing market manipulation, real-time price aberrations to the point that came up in the prior Panel, about volume during -- activities. Steve mentioned linking execution accounts to large trader accounts, just so the Committee understands.

We do have a manual process for that, and currently we can -- we have linked in excess of 90 percent of the execution accounts to the large trader accounts; which effectively means, if there were in price aberration, at some point in the day we very quickly run an analysis and can see, with a 90-plus percent accuracy, who were the accounts that were buying, selling trading during that price -- pricing period.

Again, this group further looks to ensure the orderly liquidations, you know, compliance with Exchange-imposed position limits; exemptions, accountability levels, EFP transactions as well as overseeing the delivery process; again, the focus here in this presentation, in Panel 2; accountability across the curve and the long history of managing spot limits.

So, first and foremost, position accountability. Most of you are familiar with it, and certainly many at the table, allows the Exchange to get more detailed information from the position holder. What's very special about it is we basically have the authority to order a trader not to increase the position, or to order a liquidation; if it's so appropriate.

We manage that responsibility outside of the curve. There's some science here. Just to put some context. You saw the slide I put up in

Panel 1, showing, you know, the amount of traders across the curve. As you get further out the curve there's less -- there's naturally less liquidity, less players. You have to have some kind of flexible mechanism, of realizing that the first trade in contract month, you know, Tom and Erik can trade 500 contracts, we own 100 percent of the open interest.

And you can't defer -- you know, you can't squash that; you need that liquidity to grow. But as we see open interest grow in these back months, we become more focused on those concentrations, and as you very well might imagine, our sensitivity around concentration changes along the curve. And I'll just give you some rough context around that. So in back months, we are looking at positions that are approximately, you know, 45 -- when you get to 45 percent of the open interest we are taking an interest.

In the third through the sixth month, you know, we are looking at them, at around the 30 to 35 percent level. Second month 20 percent to 30 percent, and in the front month we are very focused at 15 to 20 percent. So it's a measured approach on how to monitor and intervene, and I will say that as we look further in this presentation, on this slide, I think we have to realize that the current accountability thresholds are set very, very low.

I know in the past there have been presentations that the accountability regime has been termed as speed bumps with violations. And I think we need to get some context of what the bump is, and what the violation is. And so what I simply tried to map out for you, was looking at an average of what -- if you look at the front month, what that accountability trend level translates into, as an average percent of open interest; so in the front month, when it becomes spot, and let's look at crude oil, 10,000 contracts.

Yeah. Someone can have more than 10,000 contracts, it's generally going to represent 1.86 percent of the open interest. If you were to look at the crude oil again, the all-month accountability threshold, the 20,000-level, represents less than 1 percent; so the point I'm driving at here, is that they are set very, very low to maximize our regulatory authority to, where appropriately, intervene, ask questions, and take action.

And I'm going to get into some examples of what we've observed in 2014, with some specificity. I want to mention just additionally, that the accountability is applicable, not only on a futures equivalent basis, but on the futures only. And I note that was lessons learned from Amaranth, where, focusing a bit more on the futures only, you know, probably would have been effective a bit sooner in that process.

So we modified our rules as a result of that lesson learned, and we do, regularly review, not only on a futures equivalent basis, but on the futures only. And you can imagine, obviously, in some context where there's options activity that compresses that view.

Items considered on the next slide. In

terms of accountability, the size of the open interest, the nature of the customer's business; position relative to others, the type, where in the curve? What are the fundamentals? Is the market congested? Historical patterns, and is there some abrupt accumulation or uncharacteristic behavior by the participant?

On the following slide, I tried to capture for you to demonstrate, in real terms, what we observed in 2014 across our four core markets. And, again, for purposes of time, I'll focus on crude oil. So this is the application of accountability in these four core markets, doing a snapshot of one day a quarter.

What did we see? So, in crude oil, the range of the largest position in the front month was approximately between 10,000 and 62,000 positions representing anywhere from 1.8 to 11.12 percent; on average, 3.94. When you look at the all months, the range of parties in excess of the 20,000 the positions would range from 20,000 to approximately 78,000; again, less than a percent to 3.41 percent, or an average of 1.75. And again, there were 22 parties that were captured in the all, 18 in the front month.

What I don't have here is -- but I'll state it -- you can imagine that during this period of time, these parties were over these accountability thresholds, at these low levels we did not necessarily see a problem with that, and they were over for multiple days, at these low concentration levels.

So I'm going to, certainly limit the presentation to crude oil, but if anyone has any questions on the others, I'll certainly, later, be willing to respond to it. I will note to you that in 2014, we certainly did administer a host of holds. They were primarily in natural gas in single months.

We compared this to previous periods. It was less, and I'll just simply add for the Commissioners and the Committee, I think the reason we observed less was the fact that we have been vigilant and very active in communicating with market participants early in the process. Some of those horizons that I gave you in terms of open interest and concentration as to where we are going to get concerned. I think the market has come to understand those sensitive touch points, and before they get to a point of being significantly in concentration where we are reaching out and having to issue a hold, they are sensitive to that.

If I can now move just very quickly on exemptions in the spot month, again, just opening statement on the exemptions. We obviously, as Erik has stated, we believe in position limits in the spot month. We have them in all our contracts; we have had for a long time. We do believe they are an extremely, extremely useful tool in managing concentrations, managing, you know, what could be excessive speculation and, you know, setting them properly is, in fact, critical.

One set -- we've got three flavors, if you will, of exceptions, the straightforward 1.3(z) bona fide hedging. Risk management which is very much one that we are, here, on this Panel, focused on which incorporates some of the cross hedging, as well as the anticipatory merchandising, and arbitrage or spread exemptions.

On the following slide, I've laid a very detailed map for you, of the type of exemptions that we currently have outstanding across our four core contracts. So, again, let's just quickly go through it, so that you have some context as to this with crude oil, hedge. There are three exemptions where someone's -- where their party's exemptions are solely 1.3(z), so they haven't put forward to us in the application process that they are seeking to do any type of cross hedging, any type of anticipatory merchandising, any type of inter-market arbitrage, NYMEX versus ICE, or ICE Europe, there are three.

Then you see the different deviations, 14 open where the parties are a combination of hedge and risk; 3 where they are already in all three, and the other blends, if you will. So there are 38 open, if I ask you to go over to the total, so across all four, there are 154 flavors of exemptions open in the four core contracts. Eight-five unique entities, translation, there are obviously certain entities that have got multiple exemptions across the various markets.

Some of the key components of the exemption approval process; first, people request size, and they are approved for a certain position. This is not an open-ended exemption, a party could have all the physical anticipatory, whatever exposure that might -- you know, it might be real, but we evaluate what the market can handle. Is that position, in itself, going to potentially cause the concentration, regardless of if it's bona fide?

And we grant those exemptions, you know, based on serious consideration of not creating a concentration by size alone in any of these markets. We can certainly order a freeze or reduction in anyone's positions, even if they are subject to an exemption; we could modify those exemptions at any time. Steve mentioned earlier, they are generally open for a one-year period. At any point in time there, we can interrogate those exemptions, terminate those exemptions, modify those exemptions.

And again, all those deviations of what we can do, or on a case-by-case basis, based on the activity of the entity, market conditions, and so on. One of the points of key importance for us is, in the context of the exemptions which we administer in the spot month today, in the current proposal you've heard and know, there are certain types of exemptions that, seemingly, would cease to exist.

We have those allowable today in the spot market. Those, you know, under the risk management and the arbitrage. You know, we manage what might be those exposures in the outer month through accountability. It's my position that tuning down, taking away those types of exemptions, would in fact be detrimental to the marketplace, and I'll give you an example.

Cross hedging, someone cross hedging jet fuel in the spot month using ULSD. You know, we have granted those kinds of exemptions, and it has been our observation that those commercial participants provide a valuable, valuable role in the price discovery process. If you take them out, you know, there's a -- I'm very concerned, that you will strip out some of that liquidity, the bid-ask will get wider, and in the end, I'm not sure what good we've served here.

I know that administration of these exemptions is critical, we commit that time, but then, again, I would certainly caution the Agency to be very careful with how we handle the exemptions in a forward-looking kind of a way. Furthermore, to the extent that the Agency deems that a Federal structure for the spot month would be appropriate, on the topic of deliverable supply, and limits.

You know, we would urge the Agency to conduct -- review the deliverable supply analysis that exchanges have conducted, and then -- if, again, if we were going to a Federal structure, consult with those exchanges to, in fact, set position limits at an appropriate level up to 25 percent. And I stress the "up to" because I don't think that just tuning numbers to the 25 percent, which we can argue is arbitrary; we can have all kinds of debate on what the right number is, but I think there needs to be proper regulatory discretion applied on a case-by-case basis.

So, I wouldn't, hypothetically, although -- you know, deliverable analyses in these four core markets have been supplied. I wouldn't advocate in one fell swoop, moving and quadrupling limits. I think it would be an imprudent move on our part.

Lastly, I'll conclude by saying that I think the way we have managed the exemptive process, and the accountability paradigm, has been one that's promoted liquidity. I think, as you saw from the first presentation, in crude oil like the other core markets, we have a very, very diverse makeup of participants, speculators which are providing, valuable, valuable, liquidity across the curve, and it is valuable, and it has its place, that stated, the spot month period is a critical period, we need to have convergence, we think that that tool of limits is a very, very productive one.

So, with that, I thank you for the opportunity to have spoken to you today, and certainly available to answer any questions.

MR. ALLISON: Thank you, Tom. So we've heard from both Exchanges about the importance of accountability levels outside the spot month. The proposed rule instead calls for limits. And I know Bill McCoy has been looking at this issue including some legal analysis. So, Bill, can I call on you to talk about what you've been doing for FIA on that?

MR. McCOY: Yes. Thanks, Jim. FIA is obviously, with its members, many of which include commercial market participants, but its intermediaries have many commercial market participants, their clients. We could echo the comments Erik and Tom have said, because we think that position accountability in the non-spot months has proven to be really an effective and flexible tool, in terms of monitoring and preventing excessive speculation. And the two exchanges have had a long history in the success and how they've administered it.

And so of course in discussing this, and the question ultimately about our Federal regime, before addressing, first an obvious point that we thought we'd make, is that the Commission, obviously, can first conserve resources and proceed as it's studying what impact of a position limit regime is, should it decide not to impose limits in the non-spot months, for various energy contracts, by delegating to the DCMs, the authority, to have their own position accountability regime as they have had, and to allow that to continue.

Now obviously that would only be applicable with respect to the products on exchanges and such, so the real question is, what about the Commission's authority to adopt a position accountability regime as opposed to the hard position limits in the non-spot months? So we've been giving it some thought through a group of us at FIA, and we would think of that, there are a number of provisions that the Commission can rely on, for its authority to establish a position accountability regime.

And I would start by saying, it all -- it's at the scoring a general theme that these provisions support the proposition that Congress having authorized the Commission with the authority to impose hard position limits, in order to deter and to diminish excess speculation, suggests that clearly that the Commission has authority to establish a less restrictive regime, where it thinks the hard limits are not necessarily, not appropriate, and therefore a less restrictive regime of position accountability levels. In light of the fact of the other part of the mandate, that the Commission consider the impact of any of these regimes on liquidity and the price discovery function.

So, these provisions, I'll start with Section 4a(a)(1), which is obviously the key provision, in which the Commission can determine that the position limits, they can make the determination under the provision that the position limits outside the spot months are not necessary.

And in doing so, as I'll combine with the other provisions, reach the conclusion that in order to prevent excessive speculation outside the spot month, it could implement a Federal -- or a combined Federal and Exchange Administered Position Accountability Regime.

The Commission could rely on its authority under 4a(a)(7), to exempt the non-spot month positions from hard position limits, while implementing the authority, which I'll speak of, regarding an accountability regime. Third, under Section 4a(a)(2), Congress has directed the Commission to establish limits on the amount of positions as appropriate, other than bona fide hedging positions, that may be helped by a person.

Well the Commission can, with discretion, well the provision provides the Commission with the discretion, to establish the most appropriate methodology to limit the amount of positions that a person may hold, so Congress repeated this authority in 4a(a)(3): "The Commission shall, as appropriate, set limits for the spot month, each other month, and the aggregate number of positions."

So, at FIA we believe that the accountability levels are another means to prevent excessive speculation, and manage positions that may constitute disorderly trading or market abuses, and that the discretion that the Commission has to do so, where it deems that the need for hard limits are not necessary, would support its ability to do so.

Once the Commission implements a Federal or Exchange Administered Position, Accountability Regime, it has the statutory and regulatory authority to direct market participants to reduce its positions if they should pose a threat of excessive speculation. And I think here the key is Section 8a(5) of the Commodities Exchange Act, where the Commission has its general rulemaking authority to make and promulgate rules which, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the Chapter.

So the authority to direct market participants to reduce positions above accountability levels, can be deemed to be reasonably necessary to effectuate the Commission's authority to prevent excessive speculation, under Section 4a(a)(1), and to administer a position accountability regime.

So this discretion granted by 8a(5), combined with the other provisions, would, I believe, be supportive of a view that the Commission can reach, that to the extent that hard limits are not necessary in the non-spot month, and Congress has granted it, this tool which in position limits which is more rigid than the position accountability that the -- that the Commission can, to address the issue of excessive speculation without impairing liquidity, and without disrupting the price discovery function, could adopt a Position Accountability Level Regime as a less restrictive methodology.

MR. ALLISON: Thank you, Bill. And the details I assume will be in FIA's comments in the next 30 days?

MR. McCOY: We are anticipating it.

MR. ALLISON: Thanks. Questions for Erik and Tom? Dena?

MS. WIGGINS: I just had a question for Erik back -- I believe it's on slide 6 -- on the deliverable supply estimate. And obviously, it's in our comments, we've said it many times before that we believe that if there are going to be limits, that should be based off of an updated deliverable supply estimate, so it's just -- regardless of how it's done or whether it's phased in, or how it's updated, we obviously believe it ought to be updated.

But I just had a question on your proposal, and how you would update it, to use the simple diagram that you had up there, of the flow direction. Is that data taken from the FERC 284.12 reports on pipeline capacity?

MR. HAAS: Essentially, yes. We've gotten our data from -- not from FERC, from a third party taken for its data, Bentek, primarily from (inaudible), we recognize that that's interstate pipeline.

MS. WIGGINS: Right.

MR. HAAS: And it is excluding in-state activities, but it's publicly available, it's very complete, it's trusted, it's well-known, it's a standardized number. And is it the actual number of supply? No. But to get the actual number is not something that's easily replicated, and it's going to take a considerable amount of non-public data.

MS. WIGGINS: So it strikes me this would be a somewhat conservative number?

MR. HAAS: Yes. I mean -- you can look

in the example, if you could take supply, the actual supply of gas, even the local areas, and it's going to be greater than the pipeline capacity, so what we feel that this is, again, the amount of gas that's -- the best way to estimate the amount of gas that's readily available for delivery -- We are -- we have to meet the rules as to how we can estimate the deliverable supply.

So, the supply -- this is a hypothetical example but it is realistic -- the supply is the supply, that's closer to the real number, but again, you can't take delivery of -- in this example, 1,200. You can only take delivery of 600. So we wouldn't want to base our limit off of an amount that's not deliverable.

MS. WIGGINS: Right. Thank you.

MR. ALLISON: Rob?

MR. CREAMER: Thank you. I just wanted to make a point. You know, obviously I represent the Principal Trading community, and largely the position limits really don't affect our business. I feel like we've solved many of the issues. It's really concerning to hear from our perspective the impacts to the commercial and end user community. I'm looking at the data that you resented in the last session. There were, I believe, 83 participants who would be at 100 percent kind of level of the position limits.

Is there any effective way to model the impact of the market? I know we would say, quality markets would degrade, but how would you approach that to determine what the impact would be, you know, to the overall community?

MR. HAAS: I think one example would be, or one way to witness it would be changes in liquidity, a lack of convergence and contracts. And if you start making participants exit the market it gets less liquid. Prices get more volatile, and then we start to -- the future's contracts starts to move away from the cash price. When that happens, we'll be back here explaining what's going on? Why are the futures markets not lining up, and why are they so volatile?

MR. CREAMER: That's what I would

expect. I just -- I wonder if there's any way to look at it. I mean, it seems like a difficult challenge here. I feel like it's not right if we're going to see that number of participants in one contract that are going to be violating a level. But I don't know how you actually quantify the impact. It would seem like we've got to look at the overall kind of downstream and impact of firms like ours.

MR. LASALA: Yeah, again to follow Erik's point, I think you have to look at the bid ask, what changes there. To some extent some of those parties are going to get exemptions. Others aren't. So I don't think you can take it in its totality, that everyone is going to go out. But to the extent that some of them would be seeking exemptions for some of the things that will no longer be applicable. Again, you have that same problem. So it's going to be something that would have to be looked at very carefully.

COMMISSIONER WETJEN: Rob, is it just because of the positions that you're not really impacted? The positions you have as a firm, that you're not really impacted by the rule? Or is it for other reasons?

MR. CREAMER: I think when we first talked about position limits with respect to my firm, originally we were looking at it and felt like they were very restrictive on a month by month level. And I think once we got to the point where the positions were netted across term structures, across curves, it really alleviated a lot of our concerns. So I think that that solved much of the issues.

We are a firm -- as a market maker, we are largely neutral in the way that we trade. We don't have speculative positions. We hedge all of our activity in one way, shape or form.

MR. ALLISON: Now Herbert.

MR. THORNHILL JR: Thank you. I had a question for Erik. Erik, I know you were in conference. I wanted to ask you a question. It goes to deliverable supply of the power markets and the setting of measuring of the deliverable supply and the setting of the speculative position limits. And I felt that your presentation was good. Obviously now factors that are considered in determining deliverable supply include load, they include generation. Those are all relevant. I thought your point about including transmission in and out of a zone where a contract is traded is also very instructive as well.

I was wondering, even if there are additional factors that could be considered as well. So for example, if you had a contract that acted as a proxy for trading in other -- or power flow in another area and the fact that that contract might be, as you pointed out, interconnected. And I thought that was a very good point. It's kind of a subtle point, but it's a very important one. Whether that should be considered as well in setting the speculative position.

MR. HAAS: The short answer is, it's not considered, given the way the appendix C dictates how we can set limits. We don't have flexibility in the rules to consider that. I agree, it should be considered. You want to have the best estimate as possible. We don't set those restrictions on ourselves. We're abiding by the requirements. It's pretty much a strict requirement. You have to do a three year historical period. You have to quantify it. That's another kind of difficult thing with transmission, is how do you actually quantify transmission of power, things like that? And honestly, if it's not exact and we don't meet that exact obligation, our supply estimate, our position limits get rejected. There isn't a lot of flexibility.

MR. THORNHILL JR: [Inaudible due to simultaneous dialogue] --

MR. HAAS: I'm sorry. I say there isn't a lot of flexibility with what we can do.

MR. THORNHILL JR: But you do see maybe other factors as being indicators of how the speculative position and limits might be set for other contracts. Maybe other factors beyond in the power space, generation, load, transmission in and out of a zone, there could be other factors that could -- that should affect speculative position limits.

MR. HAAS: Absolutely, we agree. I agree 100 percent.

MR. THORNHILL JR: Tom, do you have a view on that?

MR. LASALA: I think it would be similar. I think I'd have to take those on a case by case basis, yep.

MR. THORNHILL JR: Yeah, I think that's right. I think that you have to look at each contract, each zone, how it interrelates with other zones and so forth in order to come up with a view. But just wanted to make the general point that I think that there are a lot of very valid factors that are considered in setting speculative position limits. But perhaps there are even additional ones that are relevant as well.

MR. HAAS: Respond to that really quickly. Again, that kind of gets to our overall point that the energy markets are different than agricultural commodities, which the guidelines for estimating deliverable supply are based off of. So kind of those rules are written with agricultural commodities in mind and not so much the transmission of electricity. So it's hard to shoehorn these into those requirements.

MR. LASALA: And just to further the point though, is I think power and electricity is very unique. Very unique from agriculturals and I'd say further more unique than if you were talking about what the deliverable supply and what limits could be in some of the other markets. Like, for example, New York Harbor heating oil and RBOB, they're different. And I think it's a theme that resonates across so many different areas around the rule making.

MR. ALLISON: I see lots of flags up, and I'm trying to recognize people in the order in which I've recognized the flag going up. So I will get to you eventually, although Mark may have to beat me over the head once in a while. Tyson.

MR. SLOCUM: Thank you. So my question

is for both Tom and Erik. So is it fair to characterize from both of your presentations that you both have concluded that the CFTC proposed position limits would be detrimental to the market? Is that fair to conclude?

MR. LASALA: Yes, I think that some of the restrictions on what is today recognizable and I'd consider viable hedging strategies, if those were not provided for, I think the net effect is a negative. Negative on the orderliness, the price convergence, liquidity in the markets. So I think that it potentially brings you to a less effective place. And furthermore, noting that even in the presence of a federal limit structure, the exchanges still have to do that accountability to satisfy their other core principal obligations. I have to look at those concentrations.

So it's not -- while federally you can say that there are no collisions, no one's harmed, no one's over a limit in natural gas or no one's over the limit in crude oil, what I'm saying is that I fail if I don't exercise in tandem with that structure, the accountability program that I operate today. I have to do it. So I'm not quite convinced holistically what the value added is by the structure.

MR. SLOCUM: So now both CME and ICE are in effect market participants as well, right? You are for profit entities that earn revenues and profits off of service fees and selling data and so forth. So I'm interested to know not the characterization of what your -- in your presentations where you talked about the greater market impact. What is the impact of the CFTC position limit on your business models? On ICE and CME as for profit businesses?

MR. LASALA: I'm a regulator. I'm not frankly focused on the bottom line of --

MR. SLOCUM: But your -- but CME is.

MR. LASALA: I wouldn't call myself -- well, I wouldn't call ourselves a market participant. My primary responsibility to that for profit organization is to in fact ensure that everyone in the markets that we operate is operating effectively, has integrity above all. I gave you examples where we held people from maintaining positions. Where we reduced people from maintaining positions. You might say I'm turning that business away. That's what I have to do to ensure the orderly of the market -- orderliness of the market. And I think in the most holistic circumstance, that comes back as a benefit to the market that will hopefully benefit users of CME group markets on the most holistic level. So I'm not concerned about executing my regulatory authority to effect what I think is a proper regulatory outcome.

MR. ALLISON: Vince, you had a --

MR. JOHNSON: Part of it we've got -- another question I had, I haven't really hard a lot about this is --

MR. ALLISON: Vince, your mic's not on.

MR. JOHNSON: Oh, it's on. Can you hear me now? Now in part I had a conversation -- I wanted to see if Tom agrees, and I don't know, Steve or Vince may answer. But part of the historical perspective of the exchange is the dialogue that occurs. And when you're looking at the -- and this is kind of in support of the accountability levels, when you have certain market disruptions, whether it's Hurricane Sandy or a refinery out or something like that, part of it is -- and you have to take on additional positions, I know for BP who's been in the practice of having the communications with the exchange in advance and being proactive to have that conversation, to say this is going on.

We want to let you know what's going on in the marketplace. And I don't know if Tom agrees with that. We had those conversations. But I wanted to see for Steve or Vince if there was a federal limit -- or a federal structure that was put in place and there was an accountability for the non-spot month limits. Do you envision -- how would you envision the Commission overseeing that from a dialogue perspective, from the marketplace communicating with the Commission? For more this is around normal circumstances when something arises.

MR. SHERROD: You know Vince, the exchanges have affected the accountability rules in place that they administer and the vision market oversight oversees rule enforcement review program, their administration, their rules. The surveillance department also works at this -- at the exchange level, whether it's ICE or the CME with the surveillance staff and the division market oversight. If we added a federal limit, as Tom mentioned, it's not mutually exclusive. So the exchange could continue to administer an accountability program with the trigger level much lower than the federal limit. So does that get to your question?

MR. JOHNSON: Yeah, I mean, that was one part. So if I understand correctly, the exchange could still I guess have that -- you could still have those conversations with the exchange, specifically for referring to, again, like a market disruption or something else abnormal into the marketplace.

MR. SHERROD: Absolutely.

MR. LASALA: Vince may put it another way. I don't think that the federal structure would trump the exchange's obligations and still monitoring its markets, having those kind of dialogues. That has to occur. I do think that there is an opportunity in a collaborative, cooperative way with the agency to get to an accountability structure where exchanges are still monitoring their markets independent where there is crossover that the agency is the one that possibly sees the positions across multiple venues where there could be collaboration.

I frankly -- we've had -- that has occurred in the past without a federal structure. We've had specific engagements where there have been cross market circumstances. So it is not a concept that foreign or people are immune to. I think that there is a possibility to tighten that up in more of a formalized way. And again, some of that probably -- the foundation for my statement goes back to some of the points that

Bill McCoy made on the agency's potential ability to enact such a structure. But I think if we could, we likely leverage the resources that the exchange is already committing to this. And I'd like to think it to a better place.

MR. ALLISON: Thank you. Sharon?

MS. BROWN-HRUSKA: You kind of -- the last point really brings home a lot of memories 'cause I do remember sometimes sitting on the phone with the exchanges when we'd have a major market move to discuss levels of -- sizes of positions. And I'm sure the current Commissioners are also -- have or will experience that same collaboration. And it's very positive I think. And so I would say that there is a couple of observations I had, and that is the question which is probably the most concerning is this sort of unified observation that we're seeing some degradation of liquidity and sort of speculative activity in the back months of some of the contracts. And wanting to, as a sort of practical matter, understand how that's affecting the quality of the markets and hedgers' ability to put on their hedges.

And I was reminded of a study that sort of -- that was done by the CFTC a few years ago. It was of the crude oil market. I remember Mike Haig -- Dr. Mike Haig as being one of the economists in the CFTC division, I guess chief economist's office that worked on that. And I recall that they found as index traders and managed money increased their activity in the crude oil markets, they were increasingly utilizing the back month contracts. And they actually found that this had a positive impact on the markets. That there was lower bid ask spreads. The prices would become more co-integrated and the liquidity had in fact increased. So that the price discovery function was performing better. And I wondered if there was any sort of interest in -- at the CFTC in sort of pursuing sort of a -- take another look at the markets and how they're performing and whether there's certain things that we could take away from this sort of evolving market structure and how it may be impacting the participation of speculators and other generally folks that we regard as bringing important and valuable liquidity to the markets.

MR. MCGONAGLE: Well, this -- Vince McGonagle. I appreciate the suggestion. We'll certainly carry that back and talk to our chief economist and see, as they think of macro issues and questions this morning surrounding degradation in the market are certainly important. Policy issues I think that the Commission considers separate from discussions around the position limits regime. So I think that is an important point and I appreciate it.

MR. ALLISON: Russ:

MR. WASSON: Thank you. Listening to the conversation this morning I couldn't help but think of the physician's creed. And that is -- perhaps it would be appropriate for the Commission to adopt it, that is, first do no harm. And from the point of view of end users, which electric cooperatives are, I just want to make the observation that it's dangerous to think in absolutes. And I'll give you an example of what I'm talking about.

You know, the EPA has produced a proposal called the Clean Power Plan, which whether you agree with it or not, whether you agree with the timing of it or not, is going to have a profound impact on the electric utility industry because if we have to replace all the coal plants that the utility industry uses, in order to keep the lights on, we're going to have to shift to natural gas generation. Then the question of pipeline capacity is going to become paramount.

So the Commission is going to have to be flexible in dealing with those kinds of things that we know are coming. It's a question of time and a question of magnitude. But we suspect that they are coming. And the industry as it exists today is not going to be the industry that we're going to be facing 5 years, 10 years from now.

MR. ALLISON: Michael, is yours quick?

MR. COSGROVE: Yes. For Steve and Vince, in 2009 John Arnold testified -- or came in and spoke at a Commission proceeding. And he brought some evidence of the -- sort of the bias of small speculators in the market. And over a ten year period found that out of 520 samples, the small speculator, the non-reportable positions were short once. And I was curious to know first of all -- I'll ask my question, then I'm going to throw in an anecdotal and be done here.

My question is, has the Commission sort of taken a look at that or updated that? I'm curious to know if by removing speculative capacity from the market with position limits, that will introduce either a bullish or bearish bias in any of these markets. And then finally my anecdote is that over 35 plus years, it's been my experience that the small speculators or the small participants in the market don't write options. They buy them. They don't go short. They go long. And it's the large speculators that have had the capacity to actually provide some buffering in the market when we were seeing extreme volatility.

So John Arnold's observation was entirely consistent with my experience. And I'm wondering if there's been any examination of the data in the intervening period by the Commission that would give an indication of whether any bias will be introduced as a result of the reduction of speculative capacity in large traders.

MR. SHERROD: I think I heard a couple of different questions there. With respect to the non- reportable positions, so for crude oil, for example, it would be a trader that has a position of fewer than 350 contracts. And roughly speaking, in that market it's usually 10 percent or less of the long open interest, 10 percent or less of the short open interest that's in the non-reportable category.

So I'm not aware that we've done any particular analysis about the role of those small traders, because they're well below any of the proposed limits. None of the proposals would impact those non-reportable traders with respect to position limits. So we haven't proposed to aggregate or group them together in any form or fashion.

MR. COSGROVE: So to clarify, my question was not whether the imposition of any regulations were being contemplated with that group. But rather that by reducing the speculative capacity for large traders, the resultant impact, which I would assume to be the increase in sort of the impact of the non-reportable interest. Whether that had been analyzed at all or considered.

MR. SHERROD: I think what we tried to show earlier today when we showed table 11 from the proposal and the revised table 11A, is summary statistical information that we can reveal to the public, right. We don't reveal any individual trader's positions. And what that data showed basically for the single and all-month limits, is very few traders for natural gas approach the levels of those proposed single and all-month limits.

Anecdotally, and that's all we have, the non- reportable traders are not in the spot months. So to the extent very few traders would be impacted by the non-spot month limits, that would be the inference to draw that there wouldn't be a significant pull down of liquidity by those traders.

MR. ALLISON: Let me turn to Dr. Sandor and we'll make this the last question.

MR. SANDOR: Yeah, question first on those 83 or so exemptions, how many were in power? I think that was the number.

MR. LASALA: In the summary that I supplied, none of them. They were -- my numbers were all focused on the core products. So none of them were power. They were just the core -- four core energies. There are definitely exemptions in power in the deck. They would have been somewhere incorporated in the additional 140 exemptions on my slide number 8. There were 154 exemptions in total, 85 unique entities. But the bullet below it, additionally there were other exemptions, 140 other energy and power. I can't give you the demographic there. But there certainly were some.

MR. SANDOR: I just want to follow up with the colleague on the Advisory Committee who mentioned the EPA pending regulations. But not so much from generation or natural gas. I worry about transmission capacity. For 17 years I served on the board of directors of American Electric Power. And we built about 70 miles of transmission from Virginia to West Virginia, which took 17 years to build that capacity, 16 years of regulatory approvals and 11 months to build it.

And with the shift that's going on in American power and with the fact that transmission is not treated like natural gas, the Commission might want to be in a closer dialogue with FERC and other people because one could conceive of a situation of brownouts and things like this. And I worry about the American consumer and how can FERC and the Commission work together to see how the construction of transmission can be better integrated into the financial markets.

MR. ALLISON: There are many open issues. However, we are beyond the appointed time. We will reconvene promptly at 2:00 because the next panel is the little issue of bona fide hedging and 90 minutes is not nearly enough time to cover that. So we need to be right on time at 2:00, and we are adjourned for lunch.

(Recess)

MR. ALLISON: We're back. Third panel, Steve Sherrod is with us again, also Ron Oppenheimer and Joe Nicosia. Bios are in the package. I'm asked to make one announcement. So when you're speaking, make sure your microphone is turned on. You might also consider bending it down or moving your -- moving closer to it. I think the current reporter is capturing everything properly for the transcript, but sometimes it's been difficult to hear within the room.

Second, the printed agenda says we end at 3:30. I've been advised that we can treat that as an accountability level, not a position (inaudible) since we have demonstrated the ability to run a bit longer than the announced time, we'll certainly not run past 4:00. But that may run a little past the 3:30 printed on the piece of paper. Without further ado, let me turn it over to our panel Steve?

MR. SHERROD: Thanks. Good afternoon. Again, the usual disclaimer applies. These views are my own and may not necessarily reflect the views of other staff or the Commission. I'll provide some historical perspective on the definition of the term "bona fide hedging." I will also highlight certain aspects of the proposed definition of bona fide hedging in the Commission's December 2013 notice of proposed rule making.

There's a long history to the definition of bona fide hedging, both in the Commodity Exchange Act and in the regulation. Prior to 1974, the term bona fide hedging was defined in Section 4a(3) of the Commodity Exchange Act. For example, in 1940 that section defined bona fide hedging with some enumerated hedges, and it included unsold anticipated agricultural production.

The Commission's predecessor had implementing rules that mirrored the statutory definition. For example, Congress amended this Commodity Exchange Act in 1956, and the Commission's predecessor undertook a rule making to add a bona fide hedging exemption for unfilled anticipated requirements. And these two specific anticipatory hedges continue to be in the statutory definition of bona fide hedging until Section 404 of the Commodity Futures Trading Commission Act of 1974 repealed the statutory definition and authorized the newly formed Commission to define bona fide hedging solely by regulation.

In response to that 1974 legislation and before the new Commission began, the Commission's predecessor simply codified the previous statutory definition into Regulation 1.3(z) with only minor deviations from the statutory language. The Commission undertook a series of meetings and public comments and after extensive public comment, in 1977 the Commission adopted a revised definition of bona fide hedging that largely forms the basis of the current definition of bona fide hedging.

That definition in Regulation 1.3(z) is organized into three paragraphs, or you can think of it as three different concepts. The first paragraph is a general definition of bona fide hedging. It's very broad. The second paragraph retained the statutory enumerated lists of bona fide hedges, and it broadened that list. And I know at that time there was an existing Regulation 1.48, that's still in existence, that provides a procedure for traders to apply for hedges of unfilled anticipated requirements or unsold anticipated production. That was previously recognized by the statutory definition.

The third paragraph that the Commission adopted in '77 provided a procedure for traders to apply for non- enumerated exemptions under our new Regulation of 1.47. So in the Commission in 1977, added the term to the broad general definition, anticipatory merchandising. Basically since 1977, for the non-agricultural contracts subject to federal limits, I'm not aware of any applications to the Commission for a non-enumerated exemption for anticipatory merchandising.

So in the Dodd-Frank Act it added Section 4a(c)(2), providing direction to the Commission in defining the term bona fide hedging. Congress used the general definition of bona fide hedging in the Commission's Regulation 1.3(z) as the basis of their statutory direction. However, in drafting that directive, Congress edited CFTC's regulatory definition and those edits appeared at least in part, designed to disallow an intermediary or risk management exemption for a commodity index swap entered into with a counter party who is not active in the physical marketing channel.

And the Commission, beginning as early as 1991, had previously granted those non-enumerated risk management exemptions to a number of financial intermediaries. However, that section, as I mentioned, appears to narrow the bona fide hedging definition with respect to pass through swap offsets. And that's what the Commission has proposed.

The proposed new definition of bona fide hedging would be located in Regulation 150.1, the opening paragraph. The proposed definition would include the incidental tests and the orderly trading requirement down in the current regulation. The incidental test requires a purpose to offset price risks incidental to commercial cash, spot or forward operations, and the orderly trading requirement requires the hedge to be established and liquidated in an orderly manner in accordance with sound commercial practices.

A temporary substitute test required by Section 4a(c)(2)(A)(i) of the Act, would replace the temporary substitute criterion in the current regulation. Congress omitted the word "normally" from the statutory directive and thus requiring a bona fide hedging position in a physical commodity contract to represent a substitute for positions taken or to be taken at a later time in a physical marketing channel.

The proposed new definition would also incorporate the economically appropriate tests of the Act. And again, that economically appropriate tests was in Section 1.3(z)(1) of the regulation. That test requires a hedge to be economically appropriate to the reduction of risks and the conduct and management of commercial enterprise. The change in value requirement also in that provision requires the hedge to arise from the potential change in the value of assets, liabilities or services. And merchandising and anticipatory merchandising is included in that list.

A new hedge would be recognized for pass through swaps. The proposed definition would recognize as bona fide a commodity derivative contract that reduces the risk from a swap executed opposite a counterparty when that counterparty at the time of the transaction would qualify as a bona fide hedging position. And that mirrors the provision in the Act.

In addition to the existing enumerated exemptions in Regulation 1.3(z)(2), the Commission proposed new enumerated bona fide hedging exemptions, including for royalties, service contracts, and unfilled anticipated requirements for resale by a utility. And under the proposal more generally, other positions could be exempted under the provisions of Section 4a(a)(7) of the Act. And I look forward to the discussion and comments from the Advisory Committee today.

MR. ALLISON: Thanks Steve. Ron?

MR. OPPENHEIMER: So thank you Jim, and thank you to the Commissioner and the Chairman for having this meeting today. I think one thing Steve and I absolutely agree upon, and that's that we have to stop meeting like this. This is, as somebody else said, the proposal that keeps on giving.

I'm going to use my time today to talk

mostly about some real life hedging examples that are used in the energy space and would not be granted bona fide hedge treatment under the proposed rule if it were finalized. I know that Steve said that there hasn't been an application for an exemption for anticipatory merchandising in the enumerated Ags. In the energy area, these types of transactions and the ability to hedge them has been going on and accepted, well accepted by the industry.

Before I go to the examples, I want to try to just cover a couple of points. Most of them have been covered this morning, and so I won't spend a lot of time on them. But I think it's important to go back to first principles. In Dodd-Frank, adopting a position limit provision, the focus was on really two primary things. Not speculation, but excessive speculation. And secondly, bringing swaps into a position limit regime, OTC swaps that had not previously been subject to position limits.

Dodd-Frank was never focused on

commercials engaging in hedging activity that was in fact speculation but hiding under the guise of hedging. That's never been the case. But the rule in many respects is focused on limiting the activities of commercials in hedging in the markets. The unintended consequence is significant. If risk reduction by commercials is curtailed or is more difficult, there's more risk in the pricing of commodities and that risk comes with a cost. And the cost is ultimately borne by consumers, and that's not a result that I think we want to countenance.

I want to talk about the economically appropriate test. Steve brought it up. We'll talk about it more during the course of the panel I'm sure. The language of the economically appropriate test has been in the law and regulations for a long time. But there is an interpretation of what the economically appropriate test means in this proposal that's different than that which we had before.

And the interpretation that's in this

proposal suggests that in order to qualify for the economically appropriate test, an entity has to consider all of its exposures in order to quality for the test, when doing a risk reducing transaction. And that says that the entity itself can't take into account exposures on a legal entity basis. They can't take into account exposures on a division basis, a trading desk basis, a trader basis or even on an asset basis. It has to all be lumped together and analysis be done as to whether or not it reduces the risk to the entire enterprise.

There's two real problems with this. The first is that it substitutes a governmentally imposed one size fits all risk management paradigm for that of a company doing its own prudent risk management business in light of its own facts and circumstances. The second problem is that commercial entities would have to build a system to manage risk this way. We have no problem with having risk management systems. We have them in place currently. We don't have this risk management system, and there's a reason. And that is that this form of risk management system doesn't provide what we perceive to be risk management value.

It's an important issue to us. I know Joe has something to say about it. So I'll leave it here. But I want to talk about the enumerated hedges. There are several problems with the enumerated hedges as proposed, and there's an important distinction to be made and that is that, to the extent the CFTC has administered enumerated hedges under the paradigm that Steve just went through, the markets are very different in energy. And I think the first problem with having an enumerated hedges list is that this proposal changes the current 1.3(z) which says, the enumerated hedges or bona fide hedges include but are not limited to the enumerated hedges. The proposal said, these are the only permitted -- the enumerated hedges are the only permitted hedges, and that's a big change.

And there's also a problem with having

such a list. Having such a list in any circumstance is difficult because no one can be expected to understand or anticipate every type of hedge that can be done, that could fit all markets or fit all market participants. And it's true that you can't see it or express it today. It's even more true that we can't see into the future and identify those that will come up going forward.

The second problem is that the enumerated hedges discount the importance of merchandising and anticipatory hedging. And as I said, we think the energy markets are different and have used them continuously throughout the development of the energy markets from the '70s to today. I spent a lot of time talking about anticipatory merchandising at the roundtable in June and I'm not going to do it here.

But it's very important to understand the role of merchandising and not try to pin it into a category of these are merchants doing this, as though they're not other participants in the marketplace. Producers engage in merchandising. Refiners engage in merchandising. Merchandising is a very, very broad concept, and it's an important concept because it connects the two ends of the value chain, production and consumption.

Before I get to two examples, I want to make two more points to level set and make sure we're on the same page. There are two things that sometimes get overlooked when you're talking about hedging and risk management, and that is that the energy market prices transactions on a very routine basis on a floating price as opposed to a fixed price. And the concepts of the enumerated hedges focus much more on fixed price and probably inappropriately.

The second thing is that energy transactions and associated risk management is generally done on a relative basis. I can buy it here, and I can sell it there. Or I can buy it today, and I can sell it another day. And those are very, very important concepts to keep in mind as we look at these two examples.

The first example, and this looks complicated, but it's not, and I will walk you through it and it's important to understand, this situation involves a commodity in one location that's being priced at a level in one area, demonstrating that the commodity is in greater demand in that area than it is in another area. And the commodity we're going to use in this example is gas oil, which is diesel. It's traded on the ICE in Europe as a gas oil contract and in New York Harbor as a ULSD contract. And if you look at the box on the left, you'll see that on the particular date we're going to focus on, January 19th, and I just want to say this is a simplified example, but it's based on real prices. So again, it's simplified. I think Joe will talk about some slightly more complicated situations, but this will help us go through the example.

And if you look, on January 19th, gas oil was trading at about $1.51 in Europe, and diesel was trading at about $1.66 in New York Harbor. In our example on January 19th, an importer would buy physical gas for forward delivery and he'd do it on a floating price basis against the ICE futures. And in this example he hasn't located yet a buyer for the product in New York, but he intends to ship the gasoline to New York and sell it on a floating price basis and capture that differential that we see in the chart on the left.

And the way he does that is he locks in the ULSD gas oil differential, of 15 cents and change, by buying the ICE Feb gas oil futures at $1.51 and selling to NYMEX at $1.66. The short NYMWZ ULSD futures would not quality for bona fide hedging treatment under the proposed rule, even though it's an essential component of the transaction that allows the importer to take the gas oil from Europe where it's in relatively excess supply and bring it to New York where the prices in the market are dictating to it that it ought to be sold and delivered.

Going down the calendar in this example, on January 26th he finds a buyer in New York

Harbor, and he sells it on a floating price basis. At that point he's got a floating price buy and a floating price sale, and the rules would permit it as a bona fide hedge. But for that interim period, which is a week in this example but it could be much longer, in other examples, for that week it's not a bona fide hedge.

Continuing on down, on January 29th, both counterparties to the importer agreed to price the commodity, and they take the indexes that they agreed to use for pricing, and they look at the prices and they establish them as the prices for their physical transactions. So in this case, the importer could buy actual physical gas oil at $1.5268, sell physical in New York at $1.6184 and have revenue from that transaction of 9 cents a gallon.

At the same time, he'd liquidate the futures spread and in this case he'd recognize again on the futures transactions of 6 cents a gallon. The revenue of the two together is about 15 cents, and when you take out the costs that he anticipated, which are shown on the left hand side in the box of about 14.5 cents, yields the expected gain of about three quarters of a cent per gallon. Exactly what he had hoped to accomplish by hedging and moving the product where it was needed.

So even though the price of ULSD dropped by about 40 percent relative to the price of gas oil in Europe, and even though it dropped by 5 cents in absolute terms, through the use of this hedge, the importer was able to preserve the economics of his transaction and move the cargo.

So what's important about this? The one week transaction that I was talking about before where he had an unfixed purchase in Europe and had not yet established his unfixed price sale in New York, should qualify as a bona fide hedge because it meets all of the statutory requirements. Okay, it was a substitute for a transaction to be made at a later time in a physical marketing channel, i.e. the sale of physical product in New York Harbor. It was economically appropriate to the reduction of his risk in that the relative value of the product in New York Harbor could drop before he sold the product on a floating price basis. And it arose from the potential change in value of an asset, the gas oil, that the importer owned after he made the purchase in Europe.

The consumer benefits from this transaction because gas oil was imported to the United States in response to market signals, ultimately reducing the cost of fuel in the US. And the importer would not have entered into this transaction without the ability to have hedged his risk. I'll take a pause to see if there's any questions before I move on to the next example.

MR. SLOCUM: So is the analysis that this would not be covered confirmed by the CFTC? Was it something that you had negotiations or discussions with them? Or is this your internal analysis that it wouldn't comply?

MR. OPPENHEIMER: So the commercial -- after the, I was going to say initial, but after the rule was approved, a position limits rule was approved in December -- or November of 2011, the working group submitted a petition. We felt this might not be included. We read it as not being included and we submitted a petition to the Commission concerning this need to have this as a bona fide hedge.

The petition was never acted upon, but in the recent proposal it was addressed and bona fide hedge treatment was rejected for it. Any other questions?

MR. ALLISON: Okay, Ron -- actually Steve, could you speak to that? Are you willing to speak to that point?

MR. SHERROD: Ron's entirely accurate.

COMMISSIONER WETJEN: Why was it rejected? What's the basis for the rejection of that as a bona fide hedge? Rationale?

MR. SHERROD: You know, the petition is addressed in the preamble in my recollection, as basically that based on the generic fact pattern, we didn't have any, what I will refer to as plus factors that would indicate that we could distinguish someone that buys unfixed price in Europe and re-sells in Europe and uses that as a pretext for an exemption. Versus something that Ron's describing, where a merchant's buying in Europe and they have a practice and pattern of importing into the US, and they perhaps has transportation arrangements in place. And it's the type of exemption that ICE or the CME would have considered those additional details. And in the generic fact pattern we just didn't see that level of detail. So we asked questions about what could make it a bona fide hedge.

MR. OPPENHEIMER: So I'm a little confused because there aren't many more details here that aren't there. Would this be a bona fide hedge? And I don't mean to put you on the spot. I really don't, but if that's answerable.

MR. SHERROD: It's an open comment period and we certainly hear what you're saying. You've provided a fact pattern. And in other places where we have Commission application procedures, someone would indicate, for example, here is the last three years of my production. Here's what I anticipate in the next year and provide that additional level of information that would give us comfort in being able to recognize, you know, unsold, it just made production as a bona fide hedge.

So we're certainly willing to listen to everything you have to say.

MR. OPPENHEIMER: Appreciate that. Moving to the next hedge, unless there are other questions. This is the winter storage transaction okay, and this one has an interesting history too. The winter storage transaction was recognized as a bona fide hedge in the rule that was approved by the Commission in 2011. And in the proposal in 2000 -- I'm losing my dates now, 2013, it's no longer recognized as a bona fide hedge. And it's another circumstance where we think it's entirely appropriate.

And what we've got here is a natural gas supplier who in April of 2013 leases storage in order to store gas an provide it during the winter season of 2015-2016. And again, this is based on actual prices. It's still in some respects got some rounding and it's representative. It's not an actual example, and as you'll see, from a timing perspective, it can't be an actual example.

But assume that the supplier leased the storage and his expected cost for storage is 38 cents per MMBTU. Okay, again, looking at the green on the left hand chart. But in June of 2013 the market conditions are such that he is able to lock in a profit associated with that storage by using the futures markets. He can buy October 2015 gas on the market for $4.299 per MMBTU. And he can sell gas which would come out of storage in January of '16 for $4.69 per MMBTU.

So what does he do? He enters into that transaction on the futures markets. He buys October natural gas futures. He sells January natural gas futures, and he locks in that differential. Again, the important note is here that neither the October nor the January futures contracts would qualify for bona fide hedge treatment under the proposed rule.

So again following this one down the line and we pass where we are today chronologically, and so we don't have real numbers to assign to this one. But in September 2015, when natural gas is actually -- the physical market is active, supplier's going to buy the gas that he'll use to fill his storage in October of 2015. And when he does so, he'll liquidate his October natural gas futures contract.

And in December 2015, when he needs to supply local utilities or whomever his customers are with the natural gas, he'll sell the gas to be withdrawn from storage and liquidate the January natural gas futures contracts. Whoops, wrong button, sorry.

Okay, again, why should this storage transaction be given bona fide hedge treatment? Well, the reason is, it satisfies the statutory standards established by Congress. It was a substitute for transactions to be made at a later time in a physical marketing channel, i.e. the purchase of natural gas to fill storage and a sale to withdraw from storage. It was economically appropriate to the reduction of the supplier's risk, i.e. that it will be able to recover the cost of its storage obligation and separately that it can profit from its business of supplying gas in winter. And it arose from the potential change in value of an asset, the natural gas storage, that the supplier owned and the gas itself that he anticipated owning.

Again consumers benefit from this transaction because it assures that gas will be in storage as you enter the winter heating season in '15-'16. And the supplier wouldn't have entered into the transaction to commit to storage without the ability to hedge its risk. It's very important to note that in this example, like many others, there are always two sides to it. In this one the storage hedge is equally applicable to the storage operator, the pipeline who owns the storage facility, the metal in the ground. And he wants to hedge the value of that storage that he has not yet leased. If the prices move against him, he won't lease that storage, but the futures markets allow him to lock in the value of his asset by hedging in the futures markets.

Do we want to entertain questions on this one Jim before I wrap up?

MR. CAMPBELL: I guess I've got a question. This concerns me because the storage example is a physical asset. It's a lot like a generator. I own steel in the ground generation. At some point in time when the price signals tell me to, I'm going to buy my gas and sell my power. What changed between the CFTC's first interpretation that this was a bona fide hedge and the later interpretation that it wasn't? I don't know whether that's for Steve, Vince or you Ron.

MR. SHERROD: Staff re-reviewed it. The original proposal was very broad. It would have provided, for example, that a storage bin that could have held corn or wheat or soybeans, someone could have claimed a bona fide hedge in any of those at their election with no requirement necessarily to have shown a pattern of having been a merchant in those. So what the Commission did in its proposal was ask again, just like on the other issue, a series of questions about what would make this a bona fide transaction. What could be shown further? And it's the type of thing again that would be in an application to an exchange, showing specific detail about a past commercial practice that was expected to continue.

MR. ALLISON: So are there questions about what does the example mean? Or are all the rest of the questions about why we believe the example represents an unwise decision? Questions about what the example means I think would be in order now, but let's hear -- I think we've got more examples.

MS. SHARMA FRANK: Ron, one question about part C. Gas utilities either own their storage or they give up their capacity contracts to asset managers who either own their own storage or somebody else owns independent storage. Or they're contracting the pipelines, which are regulated the equivalent of storage. Does changing the ownership in C affect your example in terms of its classification as a bona fide hedge?

MR. OPPENHEIMER: No, not at all. And what I was trying to point out with the note at the bottom is that it really does apply to all sides of that equation when they hold that risk.

MS. SHARMA FRANK: So in that case I'll note for the record, this is a bread and butter transaction that gas utilities regulated by the 50 states rely on to manage commercial risk. That's very concerning, and I appreciate you bringing it up.

MR. ALLISON: Vicki, is your question about what does the example mean or is --

MS. SHARP: Well, it's actually about -- ask for Ron about how Steve's comment that this would be handled through an application process, how would that work in the context of a commercial transaction?

MR. OPPENHEIMER: That's a complicated question, and let me try it this way. If the rule passed as drafted, there is, as I said, a change from the initial list of enumerated transaction being an included but not limited to list. And so no flexibility to say well, it may not be on the list, but it's still within the definition because it fits in that phrase. And so that's a problem.

There is no Rule 1.47 process in this proposal, so there is no ability to apply for a non-enumerated exemption that way. There is 4a(a)(7) which is a broad provision that allows the Commission to basically exempt anything from the position limit rule and one might have to go that way. It's a fairly unsatisfying resolution for a couple of reasons. First of all, we've been talking about this particular example now for I guess three years. The petition is three years old, hard to believe. But to have a final rule come out that doesn't address it and leave you to using a 4a(a)(7) process, would be somewhat disconcerting.

It took nine months up until the date that the other position limit was supposed to go into effect, and the petition hadn't been ruled upon. So the industry was really in a state of concern and confusion that it might not ultimately be granted. And the last concern is, you know, again, this is pretty plain vanilla. And so maybe it can be addressed swiftly or whatever. But it's a real problem if the non-plain vanilla that's not addressed in an advance list comes up in a commercial context, and one then has to apply in a 4a(a)(7) context. And in the meantime the economics or the counterparties or other parts of the opportunity disappear. That would be a problem.

I just want to respond a little bit to what Steve said about the reason it was rejected being that a farmer might have storage that has the possibility of being used for a bunch of different commodities. And so that was a concern that the farmer might use that as an opportunity to speculate in a number of commodities. Natural gas storage to my knowledge is only usable for natural gas. And so that kind of fear of the flexibility shouldn't really be a reason to reject this kind of a transaction in natural gas. I don't think it's a reason to reject it in the agricultural context either. Maybe Joe will address how it's used there. But that really doesn't seem like a good rationale to exclude it in the natural gas context.

I do want to just wrap up here. These are two of many examples that the Commercial Energy Working Group has put forward. They're complicated. They're simplified for these purposes, but they're complicated. They're a lot to absorb. We've heard that this rule is likely to get finalized by the end of the year. We hope that we can use the full year to engage in a real dialogue and get into the economics of some of these transactions so that they're really fully understood. Because it's a big issue for us.

I see there's a question, but let me just -- I got one more thing to say. And that is to go back to saying that we really want to be given the latitude to manage our risks prudently because not allowing us to do that increases costs into the system, and those costs are borne by consumers. So thank you.

MR. ALLISON: Mr. Chairman.

CHAIRMAN MASSAD: Thanks Jim. Thanks Ron for the presentation. At the risk of maybe making -- oversimplifying this, let me just understand whether -- how much of this is really related when you say that the staff didn't accept this and it would have been accepted otherwise? As I understand it today, obviously the transaction might just fall underneath whatever the limit is, in which case you wouldn't need an exception. If you needed an exception, you would go to the exchange. You would present various facts about your business and Tom is -- I don't if Tom is still here or Erik. But I assume you guys ask about kind of past practice and the business and things like -- the kind of context, right?

MR. LASALA: Absolutely.

CHAIRMAN MASSAD: Right, and I take it when it's presented to you Steve -- when it's presented to you in the context of rule making, none of that context is part of it. Is that correct? I mean, I thought you referred to it, well, when it's presented to us as something generic without that context, that's what we're ruling on. Is that accurate?

MR. SHERROD: I think that's fair.

CHAIRMAN MASSAD: And if I understood Ron, what you're saying is, yeah, okay, that's well and good. But you don't have a good process in the rule for dealing with things that aren't generically okay if you will. I mean, in other words, without all this context, without evidence of past practice, without evidence of who the business is, and you're saying you need a process for that.

MR. OPPENHEIMER: A process would help, but I think it works even without a process. And the point is that, as drafted, the enumerated hedges would exclude it. If it were permitted as an enumerated hedge, that still doesn't give somebody the opportunity to use it for speculation. There are records that are kept.

You have to certify on a 204 form that you are actually using it for hedging purposes, and you do that under penalties of perjury. And the Commission has special call authority, as was identified this morning. So if it's misused, that can be reviewed after the fact with the Commission's authority.

CHAIRMAN MASSAD: Right. Got it, thanks.

MR. ALLISON: Ron, does that complete your presentation? Thanks. And I know there are many questions. But let's let Joe get his examples out, and try to take up the whole set at once.

MR. NICOSIA: Okay, thank you. First of all I would like Commissioners Giancarlo as well as Chairman and the other commissioners for inviting me here today to participate in this important meeting. And although the focus is mostly on the energy issues, as an employee of Louis Dreyfus I've traded primarily agricultural commodities for 34 years, but our firm is involved in energy trading in many different locations as well as products.

But all commercial commodity traders today, whether they be Ag or energy, have the same concerns about the Commission's position limit rule, and particularly as it relates to bona fide hedging. The original intent of Congress had the direction for the Commission to expand its position limits regime to curb excessive speculation, not to curb hedging.

Under the Commission's proposed rule, the practice of hedging would be curbed. There is no public benefit to the curbing of bona fide hedging. Merchants accept and manage several different types of risks in the supply chain that allow for higher producer prices and lower consumer prices. Examples of these risks are absolute price risk, otherwise known as flat price risk, relative price risk, which is basis or unfixed risk, as well as calendar spread risk, time risk, location, quality risk, execution and logistics risk, credit, counterparty risk, default risk, weather risk, sovereign risk, government policy risk.

It's important to recognize that all of these above risks directly impact the commercial operations of a merchant and ultimately affect the value of the merchant's commercial enterprises. It also ultimately affects the price that merchants pay or receive for their product. In each and every one of the transactions, the above identified risks are not the same, and thus the merchant must be able to make a decision on how not only to price these risks in a commercial transaction, but more importantly, how to manage these risks.

For instance, in negotiating a forward contract with a potential counterparty, the merchant must take into considerations all of these above risks so will make the most appropriate decision on if, when and how to utilize exchange traded futures in order to hedge the multiple risks that are present. Each of these risks ultimately affect price risk. Meaning the price to the seller of the raw commodity and the price to the consumer.

In other words, hedging any or all of these risks directly affect and our hedging price risk. The Commission is taking a very narrow view of risk. By taking such a narrow view, the Commission is focusing solely on absolute risk, and absolute risk with a counterparty, and is not considering the multiple risks that exist in a commercial operation or enterprise.

Commercial producers, merchants and end users have provided numerous examples to the Commission over the last three comment periods and have explained how detrimental it would be to constrain the market participants in bona fide hedging. By narrowly defining bona fide hedging, the traditional hedger will be compromised and thus will not be able to effectively manage its risks or the risks of its customers. If this happens, risk premiums will be going wider throughout the business channel, which will also be passed along to end consumers.

Bid offer spreads will widen, credit

risks will widen and liquidity will be reduced. As a result again, the consumer will bear the brunt. To highlight several of these issues, first I would like to mention about the economic appropriate test. The Commission has imposed a new test for identifying bona fide hedges where the concept of gross versus net hedging has been addressed in the proposed rule.

Merchants should be able to hedge inventory or purchase their sales contracts in a manner that reduces its risks. Some commercial transactions may be hedged, while others may not. Every transaction does not have a one to one offset or an equal risk exposure. Many merchants operate globally and manage their risks and associated with these global risks over merchandising projects in many different countries, qualities, times and locations.

The merchant is uniquely positioned to decide which risks that it wants to take and to what degree they need to be hedged. All positions are not equal, and they are not able to be offset, and a gross hedging approach is the most appropriate one to pursue. As far as unfixed price commitments, Ron - I think Ron's example just opened the door to one of the problems - one of the major problems that we have, which is unfixed price commitments.

The Commission has failed to recognize the hedging needs of unfixed price contracts, or otherwise known as basis contracts as a bona fide hedge. The business of merchandising is conducted substantially in this form of basis contracts, and merchants must be allowed to utilize hedging strategies, including calendar spread hedging, to manage this risk. It should be noted that one of the main reasons for hedging is to turn flat price risk into relative risk.

It is by taking flat price risk and offsetting that with a futures position, that we create exactly unfixed or basis positions, the same positions that the Commission does not want to recognize as a bona fide hedge. Although the basis risk is generally less volatile than flat price risk, it is not always the case. Basis and unfixed positions still maintain risk, and they still must be allowed to be hedged, managed and recognized.

Unfixed positions, and I think this is a very important point, unfixed positions being not recognized but fixed price sales with offsetting futures positions being recognized. A fixed price transaction with an offsetting future becomes an unfixed position or a basis position. Yet only one of them is being recognized. Unfixed contracts exist for several reasons. One is to minimize the transaction risk from the time that the original transaction is made in order to where it gets hedged. Instead of exposing both parties to the possibility of variances in prices, in order to establish the second leg to their hedge, an unfixed contract allows both parties to establish the relationship and move forward in a more orderly manner.

But almost more importantly, another one of the things and reasons for unfixed purchases, is that it provides for a much greater security with regards to counterparty risk, credit risk and default risk. By allowing to stay unfixed until a closer period for the final execution of that contract, we are able to minimize price variance that could take place.

If these contracts were not allowed to be recognized, the Commission would be forcing commercial enterprises to move more towards a fixed price regime with offsetting hedges in the commodity market. Now I would ask the Commission to imagine the position today here amongst those around the table and especially in the energy market, if that were the case of what we've just experienced.

Today we find ourselves with the crude oil market dropping over $50 a barrel. If today we were to look at our outstanding positions, we would see that on paper all of us being hedged would have a P&L statement that would show that we are completely covered. However, by forcing us into fixed price positions with offsetting hedges, that wholeness that we would have would be totally dependent upon the credit worthiness of our counterparties.

Today we would find ourselves in a situation where the majority of our contracts would have over a $50 variance against today's open market position. Therefore the ability in the future, and as we saw earlier, these contracts can extend for a long period of time, for several years, for months, would have counterparty risk on their books where your own solvency would be totally dependent on your counterparty's ability to be able to execute those contracts and be able to fulfill what would be some extreme mark to market differentiations.

Therefore, to recognize unfixed transactions in the marketplace is not only right, it is essential to protect market participants, banks, consumers and producers. Another issue to highlight will be the issue of anticipatory merchandising. The Commission has omitted the concept of anticipated merchandising from the proposed rule in spite of the statute which Congress clearly intended to include.

Merchandising activity promotes market convergence, which is a crucial aspect of the price discovery function in the commodity markets. Allowing a full scope of hedging activity by merchants will promote more efficient marketplaces, transparent marketplaces and which ultimately serves the public good by providing a more reasonable price. Commodity cross hedging, cross commodity hedging, while the Commission recognizes commodity hedges as an enumerated hedging transaction in the proposed rule, they apply a new quantitative test that is being imposed. We believe a more reasonable test is appropriate.

I would be happy to go into any of these issues in more depth as we move forward and answer any questions that the Chairman or the commissioners or any of the staff might have, and I appreciate the opportunity to be here. Thank you.

MR. ALLISON: Joe, let me start with one quick question. You've often used the word "basis contract." So in the natural gas business, the word basis contract has a very precise meaning. It is literally the difference in price for natural gas between two locations. My sense was you were using basis more broadly than that.

MR. NICOSIA: Yeah, basis is also the same thing as unfixed. It can be used as premiums. Sometimes it's used as on call. But it's a relationship between the price and the futures.

MR. ALLISON: So thank you. I just wanted to get that clarification out there. Questions for any of the speakers? Mr. Chairman, do you still have your flag up?

MR. BRANDENBURG: Thank you. Ron and Joe, you've done an excellent job of giving some examples. I just wanted to make sure that I understood them. As a producer, as a coal producer, so a single commodity producer, we market our coal to various different jurisdictions and various different markets. Some of those markets buy it on a fixed price basis, long-term fixed price contracts. Some of those markets buy those on an index basis. In order to move our product from one location to another we often have to make very large capital investments in infrastructure. So what I understand Ron from your example, is that if I'm selling to -- if I've made a five year commitment, capital commitment or a throughput commitment for infrastructure, I would not be able to hedge those transactions into a market that buys on an indexed basis. I would not be able to sell those short contracts, have a short indexed exposure and be able to protect that and claim that as an exemption.

MR. OPPENHEIMER: So if I understand your example, you would take production you haven't yet pulled out of the ground and your forward exposure would be unfixed price forward exposed.

MR. BRANDENBURG: So I would have several exposures, as Joe mentioned. I would have

-- I would not yet have a counterparty buying my product. That counterparty would buy it -- in that particular market would buy it on an indexed basis 'cause that's the way that market works. And I would have a large capital exposure for an investment that I had made that I needed to guarantee the throughput for.

MR. OPPENHEIMER: Right. So there are a couple of ways that has to be addressed, and it's funny that I'm answering these questions and not Steve. But let me take a crack at a few of them, and Steve can correct me where I get it wrong. You have a couple of different things there. As a producer, you have the ability to use what's called the unsold anticipated production hedge. And that would allow you to take certain futures positions as substitutes for the forward sale and treat those as exempt positions.

But what you also said is that you've built some infrastructure, and it's another important point that's in the working group comments. It was in the working group petition as well. And that is that the ability to hedge the value of that asset, steel or whatever it is, and Lael I think brought up the issue of a generator, in capital projects very often you won't get financing unless you have some hedge on the expected value of whatever the project is. Your capital project or the building of a generation facility.

Those hedges would not be recognized as bona fide hedges under the proposal either.

MR. NICOSIA: I think one other thing too, when you were starting to talk about having transactions in the future, whether they're index based but they're unfixed to where things are. I want to back up to one thing on Ron's opening statement on this example. And Steve, would the Commission's view of a bona fide hedge on Ron's first example have been changed if instead of buying it on an unfixed basis out of Europe, he'd have bought it fixed price and hedged it? Would you have then had a different answer of whether the rest of the transaction was a bona fide hedge?

MR. SHERROD: I like it when you ask questions you know the answer to. So when someone buys something, they have inventory or forward fixed purchase and that's the classic hedge.

MR. NICOSIA: So the answer is yes to this then. So there -- that goes back to this unfixed issue that I think is critically important that we have to deal with. And that it wasn't the transaction in and of itself that was a bona fide hedge or not bona fide hedge. It was simply the form of the first transaction that was making it qualify for a bona fide hedge or not. And yet those two transactions, one with a fixed price and a hedge and the other in the unfixed position, are the exact same position. And yet one would qualify for a bona fide hedge and one would not.

MR. ALLISON: Russ?

MR. WASSON: Thank you Jim. I would like to give you all a different perspective on this, and let me just preference what I say by the fact that I'm a CPA, not an attorney. But electric cooperatives, there are approximately 900 electric cooperatives that serve areas from 300 miles north of the Arctic Circle to Key West and from Hawaii to Maine. We are private corporations, but unlike traditional corporations, which must balance the interests of shareholders and customers, electric cooperatives’ owners are our customers.

And so everything that we do that incurs an increased cost, flows through to them. So in let's say September of 2010 we filed 73 comment letters or participated with others in filing 73 comment letters with the Commission. We view those as a hedge against the regulatory risk that the Commission is going to increase our cost. And the reason we're so concerned about that is because in that area I just mentioned, the median average household income -- or median average, the average household income is $68,000, 12 percent below the national average of $77,000.

So when something happens to increase our cost and it flows through directly to our members, it has a dramatic impact on them. I know if I told you your cost for electricity was going to go up by 10 percent, most of you wouldn't think anything about it. But for some of my members, that's a tragedy. So we are acutely aware of trying to protect them from increases in the cost of electricity. We are all end users. We don't hedge -- I'm sorry, we don't trade, we don't speculate. We are hedging our commercial risk, and by commercial risk, I mean operating risk. The risk of keeping the lights on, and the risk of protecting our members from upward price pressure primarily from fuels. But also from increased administrative cost that may come about by the Commission's actions.

And I will say this in all due respect. We do not believe that Congress intended for the Commission to substitute their judgment for the reason business judgment of commercial end users who are trying to hedge their commercial risk. The passage of Dodd-Frank didn't change the physics of the electric business. And furthermore, we're using the same contracts that we use to hedge our commercial risk, that we've used since 1930s, '40s and '50s. Our business has not changed.

I don't know anyone with any electric utility that can even enumerate all the thousands upon thousands of ways that electric utilities have to hedge their operational risk. And the idea that the Commission could create a bona fide hedge that would cover all those, is impossible in our opinion.

And so we -- in our comment letters we ask for an exemption under the statutory authority in 4a(a)(7). We ask for an exemption -- an entity based exemption, and barring that, we ask for a transaction based exemption. But I don't think that end users who are trying to hedge their operational commercial risk, should be second guessed or subject to being second guessed by the Commission, when all we're trying to do is keep the lights on. And actually, I mentioned this at lunch, we're not in the electric business. We're in the business of providing modern civilization.

That's out business. And those of you who have been without power, you know what I'm talking about.

So that's really all I've got to say.

MR. ALLISON: Lots of flags up, so I'm going to try to take you in the order in which I've seen them come up. So Herbert?

MR. THORNHILL JR: Thanks very much for the time. One of the things I wanted to focus on is what Joe brought up about cross commodity hedging. And I like the fact that you brought up a lot of really real world examples because unless you have those real world examples, you really won't know how the proposed rules really will affect commerce on a day to day basis.

And in the power space, it's a very common way to hedge your power length, by using natural gas, futures options and so forth. It's tried and true, whether you're a competitive power producer or you're a utility. It's a tried and true way of hedging your risk. And it's been done for decades. It's been accepted on the accounting level. It's been accepted by the exchanges. I don't think it's been challenged legally in the past.

However, if we get to the cross commodity hedging issue that Joe raised, you find out that there's a new mathematical correlation there. It's zero point eight. And suddenly because of a mathematical correlation, what would happen is, this tried and true method of hedging would disappear because, since you're going to be measuring that in the spot price period of time, the correlation between natural gas and power may not be zero point eight. It's very volatile, especially in the spot area where quite frankly prices are volatile and change day to day.

But it doesn't only affect power, which is obviously essential, as you pointed out Russ. It affects many people. It affects everyone in this room, every business and so forth. The price of power is very important, and the ability to hedge risk associated with power is important.

But this zero point eight correlation

also affects some other energy commodities that affect every one of us in this room. Let's take fuel oil, which is usually hedged with -- oftentimes hedged I should say, with the crude oil contract. That correlation in the spot period just doesn't make the zero point eight test.

So I think it's excellent that Joe raised his point about the mathematical correlation. I think it's something that should be examined. I think, based on what I've been told by accountants, it's based on not an accounting rule, but an accounting practice that's not used in every case. I understand it's related to cash flow accounting. Whereas there are other accounting standards that are equally viable, used on a day to day basis, where they use more of a substantial relationship test to see if it's viable from an accounting standpoint.

They just really look at whether there's a meaningful commercial relationship between the underlying commodity being hedged and the futures contract that's being chosen to hedge the risk.

But I do think that the zero point eight correlation is something that is worthy of more examination. And I think that the ability of people here to offer more examples to the Commission of the impact of using that kind of a correlation, the impact it's going to have on commercial activity, is a very useful process to go through.

MR. ALLISON: Let me exercise the Chair's privilege to inject one technical comment on Bill and Herbert's comment. If you are thinking about risk in the sense of standard deviation, then for any correlation other than zero, there exists a scale of the hedge such that the portfolio of the exposure plus the hedge, has lower risk than the exposure by itself. Any correlation. Zero point eight is completely arbitrary. And Dena, I think you were next.

MS. WIGGINS: Thank you. Thanks Jim. Russ confessed to being a CPA. I will confess to being a recovering FERC lawyer, so I'm much more accustomed to being at the other end of

DC than I am to being at this end of DC. But because of that, I've spent a lot of time dealing and addressing issues in the physical market. And I think that part of what we need to keep in mind here is that the actions that this Commission takes can have an impact in the physical market.

And last winter, for example, we heard in the gas industry a lot of hue and cry over the spot market price of natural gas. Now that was the spot price. It was up in the Northeast. As everybody remembers, it was very cold for an extended period of time. Spot market prices went up pretty high.

Our response to that as natural gas producers and suppliers, was to say to people, please make your arrangements in advance. Go out commercially and make some arrangements so you're not trying to go into the spot market on the day that it's two degrees below zero in February. What I find troublesome now is to hear Ron, as confirmed by Arushi, saying that one of the, what I understand to be fairly standard ways that a generator or a utility could go out and hedge and try to do some of what we've been advising people to do on that storage slide up there, would not necessarily be deemed a bona fide hedge.

And I find that troublesome. And we put comments in the record previously that we think the list of bona fide hedges ought to be expanded and at a very minimum, there ought to be some fairly fast process for someone to get some clarification as to what kind of transaction this is and whatever this is. Whether it would be deemed a bona fide hedge, because as others have said, these decisions need to be made and they -- I understand that there is a process for a regulated body to make a decision. But it needs to have some book ends on it so that people just aren't out there struggling and flailing around trying to figure out what to do.

So as the Commission decides how to address this, I would just ask that you keep that in mind, that we are trying to help. We do understand you've got a regulatory job to do. But we really want our customers to be able to engage in appropriate behavior to hedge their risks.

MR. ALLISON: Lael?

MR. CAMPBELL: Thank you. I'm chomping at the bit here, because I have a really good follow-up to that, with an example. It's the point I wanted to make and I wanted to steal Russ's quote because it was funny and we had a great conversation at lunch up on the ninth floor. And Russ said, "We're not in the business of delivering electricity. We're in the business of delivering modern civilization."

And so much of the focus since last year's polar vortex and some of the issues we've had with in the physical gas and electricity infrastructure last year, have really turned the focus onto reliability. And to your point, generators will often secure their long-term gas contracts at an unfixed price, to make sure that they have that gas available to them and that gas is going to be delivered to them.

So they're securing gas at an unfixed

price to secure supply. And this really gets back to Joe's point about the unfixed issue. Now my understanding is that you are allowed to hedge -- bona fide hedge treatment for unfilled anticipatory fuel requirements. But if your requirements are filled, that doesn't necessarily qualify for bona fide hedge treatment.

So I'm a generator. I'm concerned about reliability. FERC's told me I have to be concerned about reliability. I procure gas on a long-term basis at an unfixed price. All of a sudden when I go in and the market tells me now is the right time to go ahead and fix that price, I can't do that on a bona fide hedge basis. I am exposed to price risk. I have purchased my gas long-term. Market's going to go up and down. I would love to be able to manage that price risk if I could when I think the price is right and fix it for the time period. But my understanding is that under the current rules, I can't do that as a generator because I've already procured my gas. I have a filled fuel requirement, even though it's unfixed.

So again, this unfixed issue doesn't just impact merchants. It impacts us as well, and the ability to fixed unfixed price exposure should certainly be deemed as something that's economically appropriate to managing risk.

MR. ALLISON: Ben?

MR. JACKSON: Thanks Jim. Russ, you're going to be famous here today with some of the comments that you've made. And building on that civilization, modern civilization example, from the vantage point with ICE, I look after markets that range from the US energy markets to enumerated agricultural markets to also non-enumerated agricultural markets. And what would modern civilization be without products like chocolate and coffee?

Those are also some of the products that trade on our exchange. And these rules, the issues that I'm hearing around the table here, that are relevant for energy market participants, are the exact same issues that agricultural market participants are also arguing. It's going to impact their ability to hedge and mitigate their price risk.

Just in the last comment period, ICE futures US submitted two different comment letters on these particular rules, talking about anticipated merchandising. The limitation on anticipated production and consumption down to 12 months. Allowing the ability to only hedge flat price risk. We submitted comment letters that were co-signed by over 50 different commercial market participants in our markets. In our enumerated commodities as well as our non-enumerated commodities.

So these issues are not unique to energy. It is shared by people that are manufacturing the clothing on our back and the food that we eat each day. Ron's examples that he went through are almost identical to the examples that sugar manufacturers, producers and refiners have. Same with coffee. We had the opportunity as well yesterday to bring a representative subset of those 50 commercial entities that signed that, a major coffee roaster, a major chocolate manufacturer, producers, merchandisers, to walk through these exact same issues.

The other thing I'd highlight is, when you look at what are these rules at the end of the day? You're trying to apply rules that today are in place for the enumerated agricultural commodities, across non-enumerated Ags and across the energy sector. As though that's the model for convergence and the model for liquidity and open interest out the curve.

And I'd highlight for the record a couple of slides that Erik presented earlier, where he showed open interest in our enumerated agricultural commodity, namely cotton. And how it's primarily concentrated in the front couple of months, compared to our energy contracts, where open interest goes far out the curve. And thinking about a lot of the concerns that our commercial market participants are bringing around liquidity outside of those front months, brings deep concern to me on what the impact of these could be on liquidity going out the curve for our market participants.

Our energy markets are a model for convergence, which at the end of the day, enables our users to hedge their price risk and mitigate their price risk. And Russ, to another comment you made earlier, is actually the exact same comment I made on a panel back in June on do no harm.

MR. ALLISON: Arushi?

MS. SHARMA FRANK: Mr. Chairman, you made a point earlier in your discussion on Ron's comment with Steve that at some point in this rulemaking there has been a question by staff as to whether a fact pattern that's been presented on a bona fide hedge is sufficiently non-generic in order for staff to be able to make a reasoned determination on its status. And that was something in the discussion where you talked about, well, in 2011 a certain fact pattern was in fact considered appropriate for the hedge exemption and then in the other proposal, staff's view changed.

So, trying to watershed, and given the fact that we don't have a lot of time left, one of the reasons that we are all here is so that we can provide the commission well-articulated comments in this open comment period about what else staff needs to see in order to help resolve some of the problems that we've talked about today, especially on this last panel with the number and the nature of the types of transactions that we believe do not fit within the bona fide hedge exemption.

Looking at it from the perspective of someone who represents gas utilities, I agree with everybody here who has spoken that there isn't a good way for me to develop a panoply of non-generic examples of what might be a bona fide hedge. And so my question for staff, I guess, Steve, maybe you could answer this, is, what do you expect from us as a follow on to what we've made today in comments? Do you expect that we could or should be putting forth a series of examples that could appropriately capture what we think should be covered by this rulemaking? Or do you think we should be suggesting to you an appropriate alternative procedural mechanism, whether it's the 4a(a)(7) exemption route or something else as a way for us to move forward?

Because, I think we all agree, at least on the basic notion, that there are some things that this rulemaking at this time does not cover that probably should be covered, and the question is, what do we need to do to get there?

MR. SHERROD: I think you're doing it. You're providing oral input for the record, you provided comment letters. We appreciate those. We're carefully reviewing those, as the Chairman has said many times, and continue. We have 30 more days in the comment period. We suggested it at last summer's staff roundtable that maybe one way forward on non-enumerated is to have the exchange process that Tom LaSala and I think it was Tim Berry from CME Group and ICE suggested they may be amenable to that.

So, we're open to any sort of

suggestion, any comment, we're going to carefully consider all the many substantial comments that have been received and that we expect in the next comment period.

MR. ALLISON: Sue?

MS. KELLY: Thank you. I just want to associate myself with Russ's remarks and that he and I have been joined at the hip since the passage of the Act and all those comment letters that he's joined in, we have as well. Again, trying to reduce our regulatory risk. But we have found out the hard way that even when the commission intends to protect us, sometimes the doctrine of unintended consequences can come into play and we probably are the poster child for collateral civilian casualties when that occurs.

We extremely very much appreciate the relief that the commission has granted us to kind of take back some of the worst impacts of Dodd-Frank regulatory regime on us, but as you can imagine, it's made us a little gun shy. And so when I sit here today and I hear that, you know, transactions that I know my members use to try and reduce risk of prices to be able to provide electric service to our entities, you know, our members, who own us -- we are units of state and local government. You know, why we have to be, frankly, here at the CFTC seeking this type of exemption for that kind of hedge, I mean, it just makes no sense to me.

So, the words that I would like to latch on to -- and what Russ said was "entity-based exemptions" -- is there any reason why not-for-profit, city and state owned utilities that, you know, are owned by their customers have to be here for this regime? Why is it -- why are they concerned about excessive speculation on our part?

So, I would just like to put in a plea here that maybe we could somehow make being a special entity into a good thing instead of a bad thing. So, I just urge you to think about trying to figure out if there's classes of market participants that you might be able to, kind of, let our people go, have some kind of relaxed regulatory regime, or whatever it is, I hope you will think about this in your next go around on this issue and I will stop there. Thank you very much.

MR. ALLISON: I don't see any volunteers to respond to that, Sue. Paul?

MR. HUGHES: Thanks. I want to perhaps -- I love the comments we've heard -- maybe change the direction just a hair based on something that we heard earlier from Joe, and it had to do with kind of the enterprise-wide approach to hedging. This is -- sometimes we call it the gross versus net, and viewing our overall view of risk across the enterprise, and for a company like mine, a southern company, we have multiple subsidiaries. We have four regulated utilities, one non-regulated utility, but each one of those regulated utilities where we hedge our natural gas on behalf of our customer base, every single one of those hedges fall under a PSC oversight and each state has their own set of rules, their own set of circumstances, and their own governance to how we hedge.

Now, the one thing that they all do is they all review, transaction by transaction, every one of those transactions for prudency. And so, trying to somehow combine four separate hedging programs into one and view that as an enterprise is problematic at best, and then if I throw in my unregulated utility then we have additional issues.

And just from an operational standpoint and a feasibility standpoint, it's -- I'm not sure how, exactly, we get there to manage that.

I will say, I do appreciate what the staff did and they included some language when it came to PSC regulations or PUC regulations and they included some language in the regs or in the proposal that talks about where PUC directs or encourages hedging and I appreciate that, but not all PUCs and PSCs work like that.

A lot of PUCs say, hey, we're going to come back and do a prudency review of all your costs. We expect you to do what is in the best interest of your customers regardless, if that means hedging, then we expect you to be hedging the best interest of your customers, and we'll come back and we'll review that for prudency.

That doesn't necessarily mean that they're going to encourage us to hedge or discourage us from hedging. Some may provide us specific limits. Some may have more of a prescriptive program. But what we see in our companies, we have a very diverse set of public service organizations that we work with and they all look at things differently. And so to combine those together in an enterprise manner is very difficult to work with.

And so, the language, while it's appreciated by the PSC, I would say it's problematic and I think some wording tweaks, I think, in the spirit of what you're trying to do, I think we can get there and I'm optimistic that will happen.

Secondly, and I won't go into this

because I know I could cause an uproar, we'd all start jumping up and down, but just so that it's on the record, right now, position limit rule would include trade options. It can't include trade options. We cannot have trade options in the position limit rule. To try to include the calculations, trying to figure out how that would work, is almost impossible.

You know, we're reporting trade options this week, but to somehow translate that into equivalent contracts, I would be looking to staff to tell me how to do it and I don't think staff could tell me how to do it either.

I think everybody probably is on the same page on that. If anybody wants to talk about that further, I could talk about it for days, but I do think it pushes the line between -- it gets into our construct of having to be reliability -- (inaudible) versus (inaudible) decisions. I think there's lots of things that causes problems in that regard, but I just want that on the record.

The other thing, just maybe to pull back a little bit, I think it's important that we recognize -- we started, everybody's talked about it, we've been doing position limits for a long time now. I think the order of the rules and the order that they're implemented matters because I think the market has changed since 2010 and when we started this.

Where I look at today is -- just give you an example, so if I go back to January, I manage the risk operations group for Southern Company, so in January we had some folks in our company come say, hey, Paul, I want to sit down and let's see if we can figure out -- we have this risk, we want to figure out if there's a way to hedge around a specific facility.

We sat down, we looked at it, and we came up with a plan. In the past, this is a risk that we could have hedged. We could have gone out to the marketplace. Now, I'll admit, we operate in some areas where it's not necessarily oceans of liquidity. And NYMEX Henry Hub is an ocean of liquidity. Perhaps PJM West, was mentioned on the previous presentation, that's an ocean of liquidity.

We operate in some areas where I would say, historically, I would describe more so as large ponds of liquidity. There may not be a super amount of depth there, but there's been enough to where I can offset my risk.

Well, this January when I'm looking to go offset risks in the past I would have been able to do it, there's no more players out there. Those ponds have dried up. And I think you can't necessarily attribute that to one specific rule, and I think to do so would be unfair, but I do think if you look at the order of the rules, and it's just kind of the way it happened, I think if we ignore the fact -- I think Dodd-Frank has had an impact on the markets and we can't ignore that.

I heard the guy from ICE this morning say that, hey, they're actually seeing people leave, they're seeing less liquidity in the electricity markets, I'm seeing less liquidity in the OTC market. And we're struggling. And so, from a big picture perspective, I worry that we, as a hedger -- and that's what I am -- the transactions we go out and hedge, they're not that complicated. I'm probably closer to what Russ's group does than probably a lot of other folks. We keep it pretty simple.

But all the sudden, we've got a whole lot of complexity we've got to deal with from a regulatory standpoint, and while I feel like we may have driven out maybe some of the swap dealers out of this market, for various reasons, now all the sudden I feel like we've got a whole bunch of hedgers. And what I really would like to see is, find me a way to get some more liquidity. I need some more people out there that can help offset my risk, because right now I'm sitting in a mud puddle that I used to could go hedge and now it's dried up and that's where I'm afraid that the burden of excessive speculation that we're trying to relieve, has now become a burden of illiquidity on the hedgers, and that's my biggest concern.

MR. ALLISON: Commissioner Giancarlo.

COMMISSIONER GIANCARLO: Paul, thank you for that. I just wanted to ask you, you made the point about trade options and even though that wasn't on our agenda, I do want to ask, I think you said everybody here agrees, but I'd just like to test that out. Does anybody want to push back on that? Or is there anybody that would like to address trade options and its applicability for position limits?

MS. SHARMA FRANK: So, one quick note about the impracticability of doing this. In the natural gas world, one of the ways that we're seeing more and more commodity option contracts built is physical delivery agreements off of the NYMEX futures without necessarily referencing the NYMEX Henry Hub as the actual contract on which the price is based off of once that option settles.

So, we're looking at a situation where you have a group of stand-alone commodity trade options settling in the physical delivery of natural gas at different points around the country or one utility doing it for different points on a system, and they don't necessarily all tie back to the same reference contract. And if they do, they tie back at a point in time that's very hard for a utility to figure out where and how all of it fits together and a lot of these contracts are also very open-ended, I mean, they're 10-year contracts, 15-year contracts, and the whole notion of the commodity option in the utility world is to hedge price risk and to hedge risk related to deliverability of supply.

So, asking a utility to go through the monitoring and the other various very detailed record keeping reporting type requirements related with those positions, and compliance with basic position limits rules that are effectively impossible, for example, taking delivery into the spot month, which basically is the underlying characteristic of that type of gas trade option, effectively renders the trade option a useless tool that they could not use if they were subject to position limits and that takes out a good chunk, 50 percent chunk, of what the utility can do to manage price risk for its consumers.

So, the bottom line here, what I'm saying, is that by applying position limits to commodity trade options, you'd effectively be requiring natural gas end user consumers, retail, commercial, and actual customers to pay more for gas in constrained times of the years because utilities could not use those contracts in the way that they imagined in order to hedge those price risks.

MR. ALLISON: Commissioner Wetjen.

COMMISSIONER WETJEN: Thanks, Jim. Just to follow up with Paul. These ponds of liquidity that you referred to, it sounds like they might be in what you also refer to as the OTC space? So, just a point of clarification, OTC, because, as we've seen here at the meeting, these terms mean different things depending on what the context is, but when you say OTC, are you also including some of the electricity or power markets like RTOs and ISOs? Or are you referring specifically to, you know, bilateral swap contract marketplace?

MR. HUGHES: Truthfully, both. And my specific example would be more of a bilateral type market, but one of the reasons I was going to go to a bilateral type market is there wasn't enough liquidity in these areas on an exchange to do a transaction there, and that's just kind of the way it has been. But what I -- the situation we have now is where I used to maybe have eight or ten counterparties that were out there that I could call on and reliably expect to be there. Some of those counterparties have just left. Some of them have kind of left the marketplace, some of them got completely out of the business. Some of them have moved overseas.

So, it's overall liquidity problem, but I think it highlights perhaps, that electricity is still based on regional markets and I don't -- you know, just because we're not in an RTO, I don't think that the rules should be -- have any bias against that.

COMMISSIONER WETJEN: Right, but the --

just another point of clarification, the RTOs and the ISOs, those are essentially bilateral markets as well, correct?

I mean, there's not a central counterparty involved, there's no clearing, correct?

MR. HUGHES: Well, I think I'm probably not the best person to be an expert on the RTO/ISOs, but I would tell you that a lot of those agreements are actually -- you may not know who is on the other side of that. You bid in to a market that's administered by the RTO/ISO.

COMMISSIONER WETJEN: Okay.

MR. HUGHES: Lael maybe can follow up on me on that.

COMMISSIONER WETJEN: I guess, you know, one comment I would make is that I don't know -- I don't mean this to be received as a defensive statement or anything on the part of the CFTC, but the fact is, we just have almost completed now implementing an entirely new regime, so -- and we're seeing this in the international context too in thinking about -- in trying to analyze why global market participants and swaps want to be part of the U.S. market structure or not, and I do think a lot of this comes down to perceptions about legal and compliance risk.

And the reason I was asking this bilateral question is I'm not intimately familiar with the RTO and ISO markets. We had a nice time talking about them yesterday. But I imagine there's probably some increased compliance risks there. I don't know exactly what FERC has done over recent years, but certainly on the enforcement spectrum they've become, I think it might be fair to say, fairly active or perhaps more active than they were a number of years ago.

So, I just wonder to what degree that factors in, and in light of the fact we are all implementing statutes, you know, what can or should be done about it?

MR. HUGHES: Yeah, I think maybe the last comment, and this comment maybe goes back to the order of the way things happen, if you go back a few years ago and there was an RTO/ISO exemption that was put together for that group of electricity markets, at that time, I still remember discussions among trade associations, people in this room, well, we don't really have to worry about that because our transactions, they'll never be classified as a swap. I think had that been known at the time, there probably would have been a much more concerted effort -- group effort to say, hey, perhaps we all should be on board with this same type of exemption on the energy space because, you know, regulated utilities in particular, it's a unique commodity and it's a unique business, and it doesn't -- we don't exercise options based on price signals all the time. Sometimes we do it simply because it's cold outside, even if it's out of the money.

So, you bring up great points. I think they're worth more consideration.

MR. ALLISON: Tyson, you've been waiting patiently.

MR. SLOCUM: Thank you so much. So, you

know, my organization, we receive funding from 350,000 individual households across America, so the issue of bona fide hedging is very important to the folks that help pay my salary, and so we are extremely sympathetic to some of the specific examples that I've seen here where what appear to be legitimate hedging operations might be limited or prohibited under a rule, and Public Citizen is interested in making sure that legitimate hedging strategies can be utilized, that regulation doesn't go too far.

But we have to remember that the reason that Congress addressed this, right, we're not talking about this issue in a vacuum, the lines between hedging and speculation had become intentionally blurred. We had almost every major Wall Street bank jumping in to acquire or lease energy assets to complement or expand their speculative activity that harmed consumers. We had issues where entities that everyone would assume was simply hedging their risk, a company like Chevron, that the only reason we know that they were engaging in hyper speculative activities is because one of their PR people accidently sent a detailed spreadsheet, right, in July 2001 to reporters that show that they were making massive profits speculating in oil markets so that we need to understand that we've got to preserve the ability of legitimate hedgers, but when I hear some comments that we don't want the CFTC second guessing some of this -- we need the CFTC to be looking at it. Congress directed the CFTC to look at this because of widespread abuses that resulted in billions of dollars in thefts from consumers.

You know, I was very proud to work with Natural Rural Electric Cooperatives when Glenn English was its CEO. Glenn English and I worked together during the California electricity crisis when we were chasing Enron around, and he was firmly committed to understanding the role that strong regulation over derivatives markets was essential in protecting consumers and so, again, I look forward to working with folks on these issues, but we just need some historical perspective on why Congress addressed this in the first place.

MR. ALLISON: Robert?

MR. CREAMER: First of all, I just want to express to everyone who's given comments here that as a principle trading organization, I've really absorbed an enormous amount and have learned a lot from the conversation.

We are market makers in some of these very liquid contracts and we are also very active in some areas, OTC and what we would call pond markets. I think the reality is for principle trading firms, our business is supported by a handful of individuals, it's our capital, we serve as market makers, we are trying to provide liquidity. It is not economical for us to participate in markets in which there is no hedging activity.

When people don't show up into the markets and we're just casting bid and offers all day long and no one's there, we lose interest, it's not viable for us to do it, so whatever effects the commercial hedgers and folks from entering the market, is going to have the impact of taking people out from actually hedging, and it's not going to provide incentives or the reasons for folks to step in and provide resources to support markets there.

So, I just wanted to throw that out. It builds on itself.

MR. ALLISON: Vince, are you seeking to be recognized? Robert, did you finish?

MR. CREAMER: Yes, I'm finished. Thank you.

MR. ALLISON: Vince?

MR. JOHNSON: I was thinking, a quick question in a different direction, in conversations that we've had with commissioners and staff, we've been told on several occasions, with regard to hedging, and in light of the great examples that Joe and Ron brought up about the complexities, about a -- coming back with a bright line test on how to determine someone is hedging, coming back to your term, whether someone's hedging or whether someone is speculating.

And I guess my question -- I'm just throwing it out to the room just to see if that is kind of still the thinking -- it seems to me very difficult to draw up a bright line test and I know we had a conversation with the Chairman one time and I think we went back in our shop and worked on it for a long time, and just found it very difficult. And in light of the conversations I was just seeing if there are any other additional comments or thoughts around that.

MR. HUGHES: I think it's easy after the fact to determine if you're hedging or not. It's the before the fact that I think that the Commission is having an issue with. But it's easy to prove that you've hedged. You can always show what you're offsetting.

MR. JOHNSON: Yeah, but it is the aspect of prior (inaudible) to a transaction whether or not that was a hedge or not.

MR. HUGHES: So, are you a speculator until you are proven a hedger?

MR. JOHNSON: I would say you're a hedger until you're proven a speculator.

MR. HUGHES: I like that better.

MR. ALLISON: Robert?

MR. BRANDENBURG: Yes, I think that brings us back to what seems to be one of the fundamental points that we've been discussing today, which is, first of all, what is a speculator? Why is a speculator bad in the market? It seems to be that there's a lot of defensive conversation around speculation in the market.

We as hedgers, we have said multiple times today, we need to have speculators in the market to have an orderly market. What we are interested in making sure happens is that we have an orderly market and that we don't have market manipulations. That it's not that we don't want speculators, we need speculators. Thank you.

MR. ALLISON: Bryan?

MR. DURKIN: I would just like to compliment Commissioner Giancarlo for bringing this all together, a lot of enlightening commentary and reaffirmation of a multitude of comments that have come from many of us around this table, a reaffirmation that this proposal needs to be given reconsideration, so we appreciate the opening of the comment period to allow for further commentary to be placed in that regard.

Let it not be lost that, you know, today, we confirm that there's a very strong regime in place through the CFTC as well as the SROs for maintaining and supporting position limits at the spot month level. That regime has been in place for many, many, many, many decades and for some of us that have been in this business for three decades, at least, I think the market system itself working in conjunction with the CFTC has worked very well.

There is a solution that can be addressed to try to move things along and that is to refine where we are with spot month limits, give greater consideration to what both SROs have pointed out in two terms of their rigorous monitoring of accountability and implying accountability regimes for non-spot contract months, allow the exchanges to continue to have the flexibility and the end users associated with the hedge regime that's been in place -- hedge exemption regime that's been in place today.

You've heard a lot of concrete examples being presented that, you know, from users around this table that rely very heavily on the sustenance and liquidity associated with these markets that we all represent, saying to you today that if these examples of what we have always viewed as commercially reasonable examples of hedging go away, there's going to be very negative consequences to the efficacy and the efficiency of these markets.

So, you know, I certainly hope that the Commission is taking all of this feedback into consideration and we welcome the opportunity to once again reaffirm these points during the comment period.

MR. ALLISON: Sharon?

MS. BROWN-HRUSKA: Yeah, I think that's well said. I mean, I guess I was thinking, you know, in Tyson's cry for historical context and institutional memory, I mean, I think there is a lot of that here and part of the problem is that we've -- I think in some sense we've overreacted in an effort to deal with those sort of anecdotal incidences of excessive speculation or, I guess, largesse by banks, we've kind of pushed back and taken such a highly prescriptive approach, certainly when we discuss bona fide hedging that that's a perfect example where the Commission has taken it upon itself to define specific hedges, which makes it very difficult for the end user and intermediary community as well, to do business as usual, because you've got the cart before the horse, you've got to sort of get approval for a certain unique or innovative hedging that you want to undertake. By the time you can get Steve's sign off or the staff's sign off, you've -- the opportunity has passed.

And that kind of prescriptive model is not a good model, I think, for government to adopt. So, I guess I would say that I know it's hard to back away from the enumerated hedges and the exemptive process, but it would be nice if there were a mechanism for almost along the lines of certification that the exchanges have to try to -- when we talk about a process that allows firms and end users to sort of put forth what they intend to do and continue to do so without getting proactive approval by the Commission.

MR. ALLISON: I think we've got time for two more comments, so, Russ and then Lael and --

MR. WASSON: I just want to echo everything Arushi said with respect to trade options from the electric point of view, we agree with everything she said. We also do not believe that transactions that are physically settled can or should be considered swaps. And we've made that comment many times.

And I also want to go back to something you said under the enumerated hedge exemption with respect to entities that are regulated by public service commissions because electric cooperatives are regulated in a handful of states by public service commissions but we are governed by our democratically elected boards, primarily, and so if you want to cover utilities in that exemption, you're going to have to expand it to include not for profit utilities like electric cooperatives and municipal utilities are governed as well because our boards set our rates and they govern us typically.

MR. ALLISON: Lael, I think we'll give you the last word.

MR. CAMPBELL: Oh, wow. It's an honor. Thank you. I'm sure that probably won't be true. But anyway, I just wanted to follow up on something Sharon said, I wanted to make this point, but this started out as about being about excessive speculation and somehow we found ourselves to a point now where it's actual hedging activities are what's under the microscope, not excessive speculation, and I just kind of wanted to also follow up on a point that Tyson made in that same regard is that, you know, you mentioned widespread abuse. Well, you know, widespread abuse may have come under the anti-manipulation rules, maybe even been excessive speculation, but I don't think there's ever been an example of widespread abuse of the bona fide hedging rules.

And just think about that. Is this about speculation or is this about -- you know, I mean, it seems like the hedgers are who are under attack here and is that really where we should be focusing our efforts?

MR. ALLISON: Mister --

COMMISSIONER WETJEN: Sorry, I wasn't trying to have the last word, but I did have a question. Because I remember at the open meeting where we considered the last proposal we talked about this, the process by which we would consider other examples of bona fide hedging that weren't enumerated. And I think, Steve, you and I actually had an exchange about that at the meeting. But just remind me, we asked a number of questions about that process in the release. So, just remind me where things stand in the proposal and give me a flavor, again, for the kinds of questions we asked. It's been some time now since we've done that.

And just before you respond, Steve, I mean, I think it's become even more clear here at the meeting. I don't know how practical it's going to be for the CFTC itself -- people here in this building -- or the other offices, I suppose, to be the ones on an ad hoc basis reviewing example after example that comes in about a particular kind of hedge. I don't know that we're particularly well equipped to do that, but I'm not sure that's really what was envisioned, in any case, in the release.

MR. SHERROD: I'm going to let the proposal stand for itself. We did have a conversation in the public meeting and I think the clearest statement that staff has made was at last summer's roundtable where we encouraged through a question some alternative process for allowing non-enumerated bona fide hedges.

MR. ALLISON: Mr. Commissioner, I might suggest we ask our panelists if they have any closing comments. We had a lot of comments from the table, but no questions, so we might ask Ron and Joe if they've got any closing comments.

MR. NICOSIA: If I could just maybe try to highlight one thing and -- you know, the Commission's job is complex and there are reasons for certain decisions that are made as they try to address, whether it be excessive speculation or ability to try to get around some of the issues of what is a bona fide hedge and/or who is a bona fide hedger. What I would encourage is that the Commission not take such a narrow view in defining bona fide hedge that it affects bona fide hedgers.

Part of the story here is to also be able to identify people who want to use bona fide hedges who are not bona fide hedgers. So, don't close the loop so tight that you remove real risk reduction normal activity of the bona fide hedger just to eliminate the inability to try to define who is a bona fide hedger.

MR. OPPENHEIMER: So, thanks, Jim, I wasn't quite prepared for this. Maybe I'll say one thing similar to what Joe said and it's in response to Commissioner Wetjen and that is that whatever the process is for non-enumerated hedges, we've had a lot of discussion over the many years of things that should go into the list of enumerated hedges if it's to be and I don't want that to get lost that we focus on how do we get to the ones that haven't even been part of the discussion. All of the ones that have been part of the discussion should be addressed in whatever final rule comes out so that the universe of what's outside of that is limited.

The other thing, just as a general comment I would make, to tie in a few things that were said today, nobody cares more about well-regulated markets than the people sitting around this table. We're the users of the markets. Okay, if there is excessive speculation that affects pricing, it affects nobody more than it affects us.

So, regardless of whether it's the exchanges performing a self-regulatory function or the Commission's very important function in this space, we really support good regulation and well run markets because we want efficient pricing mechanisms to do our business. And so, that's the basic principle, but we're also very, very committed to continuing to work with the Commission and the staff to get this right, because that's the goal here.

COMMISSIONER GIANCARLO: Thank you very much. I'm now going to close the committee discussion and ask my fellow commissioners to say a few closing remarks starting with Chairman Massad.

CHAIRMAN MASSAD: Thanks, Chris. Let me first thank Ron and Joe for your participation in this last panel, and of course, Steve, as well. And let me thank Jim for chairing this. And I want to thank all of you for being here. And in particular I want to thank Chris for all his hard work in putting this together.

You know, our advisory committees are extremely important, as I was saying earlier, and what we do is each of us essentially takes one and runs with it. And these are just very useful forums for us to hear views of market participants and I appreciate again all of Chris's work in reconstituting the committee, getting all of you to serve on it and putting together the agenda. And thanks also to his staff.

It's been very helpful to have the input. We are listening. We do take all this in and of course the comment period now is reopened for further written comments. And we've gotten a lot to date, and we are trying to work through all those.

You know, no one is trying to attack bona fide hedgers. No one is trying to drive speculators out of the market. We are trying to carry out our statutory responsibility, which is, Congress has directed us to implement position limits to address the risk of excessive speculation. And there were some comments made earlier about, well, can't you detect that without the limits, and, you know, in theory as, I guess, Professor Pirrong was suggesting, I suppose you can. It was kind of a theoretical economist answer from someone who probably doesn't know what my budget is or how much it costs to do surveillance.

But, you know, we are -- and with respect to the data that we get, as was discussed here, our data does not come in -- our COT report, as we discussed earlier, does not categorize people by whether they are hedging or speculating. It does have categories of commercial and so forth, but I don't think anyone is suggesting that we go back to 1981 where we actually did try to ask people what they were doing. I'm not, frankly, sure how that worked other than Boy Scout's honor. But maybe within kind of -- ask them more questions, I don't know.

But in any event, you know, I guess the other element of why can't you just detect this after the fact, you often can, obviously, you can detect someone like the Hunt Brothers or Amaranth after the fact, it's just that Congress has directed us to say, let's try to prevent the harm.

We don't want to end up with that kind of a situation where we have a bankrupt party, perhaps, that no one can recover from and we have the damage already done.

So, that's what we're trying to do, but we are very committed to making sure these markets still work for participants. That, in my mind, is our job, it is part of our job to make sure these markets work for participants, not just to address risk to our economy or to consumers or to financial stability.

And making -- you know, the importance of making sure that people can still engage in bona fide hedging is obviously a core piece of that and that's why all the comments are very helpful, the importance of trying to maintain liquidity -- and increased liquidity -- is very important, but as you all know, liquidity is also something that's influenced by a lot of different factors and there are probably those today who think that despite what happened in the crisis, we shouldn't raise capital levels on banks because it might affect liquidity. Well, you know, we are trying to balance costs and benefits here.

But the comments today were extremely helpful. I think we're taking in all that you've suggested. There were some comments made on deliverable supply and looking at, you know, our guidance there and the fact that these markets differ, we recognize, you know, that different products have different market characteristics. There were comments made on whether you're looking at the enterprise as a whole or whether the business units, we understand that, and we very much do want to benefit from the experience of the exchanges today and I really appreciate Tom and Eric being here. And, again, the idea of relying somehow on the exchanges' experience with respect to non-enumerated hedges, as Steve pointed out, that was mentioned earlier, it was mentioned again today.

So, I just want to say thanks again. It's very valuable to have you all here. We are listening and I think all of us, you know, are simply trying to do the best we can to carry out what we perceive as our statutory responsibilities here and to continue to make sure these markets work for participants.

COMMISSIONER WETJEN: Thanks, Chris, and thanks, Mr. Chairman. I would like to echo some of what the Chairman said. You know, it's been a windy road that has gotten us to where we are today as it relates to this rulemaking, but the Chairman put it very eloquently, we didn't really have a choice here. I think the best read of the statute -- and we haven't talked about -- we haven't done much legal analysis of the statute in terms of whether we are mandated to impose these limits or not -- the agency impose federal limits, but I do think the best reading and reasoning applied to the statute is that it is a mandate.

There are other arguments as to why it

might not be, but I think the best reading is that it is a mandate.

I alluded to this a year and a half ago when we did the re-proposal, I was a Senate aide when Dodd-Frank was passed and those most intimately involved in drafting the provisions that ultimately became the Revised Commodity Exchange Act and included the language on position limits, I can assure you, I don't think they were giving us an option when they were drafting that language.

So, that's why I've always felt comfortable that we have to do this job, and just as the Chairman said, we have to do it responsibly. There are other competing interests that we have to balance and other statutory mandates we have to take into account when we implement this, but it's something that we have to do. But we just have to do it well and I think we're probably going to stand a better chance of doing that in light of this discussion and other public forums we've had.

So, it's been very, very beneficial and I also appreciate everyone's participation and their comments today. Thank you very much.

COMMISSIONER BOWEN: I also want to echo thanks for the time -- Chris, it really shows how much work went into today, so I really do appreciate that.

I've had the opportunity to meet many of you who are in the room today and I want to thank you for coming in and sharing your thoughts, even though the comment period is still open, my door also is still open. So, if you think there's a perspective that I have not heard before, I really do encourage you to just knock on my door and come by at any time. Thank you so much.

COMMISSIONER GIANCARLO: Thank you, Sharon. And I want to say a few specific thanks here before we close. To division directors and staff members from the CFTC, Steve Sherrod and Vince McGonagle. They're truly dedicated public servants that are really working hard to get this right and their doors always remain open and their minds remain open to a lot of these concerns, and so we thank you. And to our other panelists who shared such important data and insights today, it was very, very helpful, Tom and others, thank you very much. To all of you on the committee who took time away from your day jobs to come here to Washington to brave the snow and the weather, and good luck getting back to wherever you're going, but thank you very much. We were actually lucky, it could have been a lot worse, so thank you.

And to my fellow commissioners who devoted precious time today -- you can see them taking notes, listening intently, the four of us -- I'm not sure what will emerge, but I can assure you that whatever emerges will be the result of a lot of give and take amongst the four of us, a lot of thoughtful consultation and professionalism amongst this commission, and I'm very proud to be a member of it, I'm proud to be working with them to try to get the best position limits proposal that we can put forward and I'm sure it will be.

To Jim, a masterful job in managing

this. It's said to be like herding cats, but not at all. This was as smooth as silk, Jim, so well done. You're very skillful at that.

And I really want to thank Ajay Sutaria, who many of you got to know in this process. All the compliments that came along for how well this was put together all go to Ajay who did so much work in talking with all of you and putting this together. So, my greatest thanks to him. And to other members of the CFTC staff and personnel organizing this room, organizing all the arrangements for today, they really are a great bunch of professionals, did a great job.

And with that, I thank you all very, very much for a very professional, robust, expansive, and insightful day. Thank you very much.

(Whereupon, at 3:59 p.m., the PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Carleton J. Anderson, III, notary public in and for the District of Columbia, do hereby certify that the forgoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not 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.

(Signature and Seal on File)

Notary Public, in and for the District of Columbia

My Commission Expires: March 31, 2017