

# COMMODITY MARKETS OVERSIGHT COALITION

March 25, 2010

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

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

Dear Chairman Lincoln and Ranking Member Chambliss:

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

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

### *Commodity Markets are in Need of Reform*

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

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

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

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

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

### *A Call to Leadership and Reform*

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

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

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

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

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

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

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

Sincerely,

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

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Letter to Senators Lincoln and Chambliss  
March 25, 2010

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

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