HEARING TO REVIEW TRADING IN ENERGY MARKETS

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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HEARING TO REVIEW TRADING IN ENERGY MARKETS

TUESDAY, JUNE 24, 2008

HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The Committee met, pursuant to call, at 2:40 p.m., in Room 1300, Longworth House Office Building, Hon. Collin C. Peterson [Chairman of the Committee] presiding.

Present: Representatives Peterson, Holden, Etheridge, Boswell, Baca, Scott, Marshall, Herseth Sandlin, Cuellar, Salazar, Ellsworth, Boyda, Space, Gillibrand, Kagen, Pomeroy, Barrow, Lampson, Donnelly, Mahoney, Childers, Goodlatte, Lucas, Moran, Graves, Rogers, Neugebauer, Boustany, Kuhl, Conaway, Fortenberry, Schmidt, Smith, and Latta.

Staff Present: Christy Birdsong, Adam Durand, Alejandra Gonzalez-Arias, Scott Kuschmider, Clark Ogilvie, Kristin Sosanie, Kevin Kramp, Josh Maxwell, and Jamie Weyer.

OPENING STATEMENT OF HON. COLLIN C. PETERSON, A REPRESENTATIVE IN CONGRESS FROM MINNESOTA

The CHAIRMAN. The Committee will come to order. I want to welcome Members of the Committee to today's hearing. And I appreciate everyone's patience and flexibility to accommodate the Committee moving this important hearing forward by a day.

I would also like to extend a welcome to Mr. Walt Lukken, the Acting Chairman of the CFTC, who is appearing again today. He met with us last week. We appreciate your being here. And Jill Sommers, one of the Commissioners, is also with us. Welcome.

The Agriculture Committee, as everyone knows, has legislative jurisdiction over CFTC and the futures markets, and we intend to examine the issue of energy market trading thoughtfully and carefully. Chairman Lukken and his colleagues at the CFTC are getting used to seeing a lot of different hearing rooms in the House and Senate to explain possible manipulation or excessive speculation in energy trading, specifically the crude oil market.

Ever since a commodity trader in New York made the first trade of $100 barrel of oil in the first week of January for no other reason than to say that he could be the first one to do it, 2008 has come to symbolize one record after another in crude oil futures. Summer has just begun, and we aren't even halfway through the year, and the historic $100 oil trade already seems like a distant memory.

We don't need to talk to too many of our constituents before we hear about how high energy costs are hurting everyone's pocketbook and really changing how people are living their lives. Our Committee knows this firsthand because one of the great untold stories of the farm bill from the big city papers was that farm incomes were soaring. But, no one mentioned how high oil prices were making input costs higher than ever, squeezing the bottom line of our agricultural producers. And farmers and ranchers often cannot pass these costs on down the line the way wholesalers, retailers and other businesses can.

Despite the rhetoric coming from all sides, there is no silver bullet solution to high energy costs. In my personal opinion, our problems are both supply and demand related. We need to do whatever we can to encourage production here in America. I am for domestic drilling. I am for coal. I am for nuclear. I am for renewable, solar, wind, greater conservation, whatever it takes to get us off of foreign oil. Not everybody agrees with me on that, but my position has been clear for a long time, and that was before we started seeing triple-digit oil prices.

There is a growing chorus of voices who believe that a flood of speculative money in energy futures prices is driving prices upward. It is true that a greater number of well-capitalized investors have entered the commodities futures markets seeking greater returns than they may have traditionally found in cash or securities. It is also true that these institutional investors are playing a larger role in futures markets.

Speculators have always played a vital role in the commodity markets, taking on price risks that producers and consumers are seeking to avoid. But, apparently to some people too much speculation means that the markets are no longer functioning as they were intended. These critics have taken aim at the West Texas Intermediate crude oil contract in particular. Under current law, U.S. traders can execute transactions on this contract on both the New York—the NYMEX, a CFTC-regulated exchange, and on London's ICE Exchange, which is regulated by the United Kingdom's Financial Services Authority. CFTC, however, has information on positions of traders on NYMEX that they don't have on traders on ICE. The idea that we have a dual system with differing rules for the same essential commodity delivered inside our country is not easily explained to our constituents.

One of CFTC's primary responsibilities is to ensure that commodities markets operate free from fraud and manipulation. Chairman Lukken is here today to answer questions about the crude oil market from supply and demand factors, to market transparency, to possible manipulation. I hope Chairman Lukken will also shed some light on CFTC's latest proposal to ensure similar disclosure requirements, position limits and accountability levels for U.S. energy commodities traded on foreign markets, like ICE's WTI crude oil contract, and how that might affect prices.

My friend and colleague Bob Etheridge has been a strong leader on CFTC issues as Chairman of the General Farm Commodities and Risk Management Subcommittee. He has introduced a bill to codify CFTC's latest proposal on foreign boards of trade as well as to provide a much-needed increase in CFTC's staff level, which is at a 33 year low despite a six fold increase in trading volumes since 2000. We had intended to mark that bill up in Committee today and even amend it to strengthen its provisions and have it apply to other commodities, not just energy. Because of the multiple legislative proposals that have been introduced, we will use this hearing and subsequent hearings, in July, to examine speculation in energy markets thoughtfully and carefully and to separate the facts from rhetoric. And I look forward to Mr. Etheridge taking the lead in drafting legislation to address the role of speculators in the energy markets here and abroad.

And I just will say to people that right now, we are looking at probably the Wednesday after we come back from the Fourth of July recess to have a full Committee hearing where I would intend to bring all of the bills that have been introduced on this subject into the Committee, and to bring all of the experts on all the different sides into the Committee. We will focus on the actual legislation that has been introduced and go through each one of them and get both sides, or the six sides or whatever there are, on each piece of legislation so this Committee can understand what each bill does, who is for it, who is against it, who has information that they think we should know about it. I don't know how long that process is going to take.

I don't know how many more bills are going to be introduced before then, probably a few, but we will operate in a methodical manner. We will go through this and take whatever time it takes to understand all of this with the idea at the end of the day to have a product out of this Committee that we can have a consensus on, and I would hope a bipartisan consensus, to move us in the direction that we think is the right thing for this country.

So that is our intention. And you know this is going to be a high priority for this Committee now that the farm bill is done. And I look forward to working with everybody through that process.

[The prepared statement of Mr. Peterson follows:]

PREPARED STATEMENT OF HON. COLLIN C. PETERSON, A REPRESENTATIVE IN CONGRESS FROM MINNESOTA

I want to welcome Members of the Committee to today's hearing. I appreciate everyone's patience and flexibility to accommodate the Committee moving this important hearing forward by a day. I would also like to extend a welcome to Mr. Walter Lukken, the acting Chairman of the Commodity Futures Trading Commission for appearing today. The Agriculture Committee has legislative jurisdiction over CFTC and futures markets, and we intend to examine the issue of energy market trading thoughtfully and carefully.

Chairman Lukken and his colleagues at CFTC are getting used to seeing a lot of different hearing rooms in the House and Senate to explain possible manipulation or excessive speculation in energy trading, specifically the crude oil market. Ever since a commodities trader in New York made the first trade of $100 barrel of oil in the first week of January for no other reason than to say he could be the first one to do it, 2008 has come to symbolize one record after another in crude oil futures. Summer has just begun, we aren't even halfway through the year, and that historic $100 oil trade already seems like a distant memory.

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Despite the rhetoric coming from all sides, there is no silver bullet solution to high energy costs. In my personal opinion, our problems are both supply and demand related. We need to do whatever we can to encourage production in America. I am for domestic drilling, I am for coal, I am for nuclear, I am for renewable, solar, wind, greater conservation, whatever it takes to get us off of foreign oil.

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There is a growing chorus of voices who believe a flood of speculative money in energy futures markets is driving prices upward. It is true that a greater number of well-capitalized investors have entered commodities futures markets, seeking greater returns than they have traditionally found in cash and securities. It is also true that these institutional investors are playing a larger role in futures markets. Speculators have always played a vital role in commodities markets, taking on the price risk that producers and consumers are seeking to avoid. But apparently to some people, too much speculation means that the markets are no longer functioning as they were intended.

These critics have taken aim at the West Texas Intermediate crude oil contract in particular. Under current law, U.S. traders can execute transactions on this contract on both the New York Mercantile Exchange, a CFTC-regulated exchange, and on London's InterContinental Exchange, an exchange regulated by the United Kingdom's Financial Services Authority. CFTC, however, has information on the positions of traders on NYMEX that they don't have on the traders on ICE. The idea that we have a dual system with differing rules for the same essential commodity delivered inside our country is not easily explained to our constituents.

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I look forward to today's testimony and questions and would now yield to my friend and Ranking Member of this Committee, Mr. Goodlatte, for an opening statement.

The CHAIRMAN. So I look forward to the testimony today. I look forward to the questions and would yield to the gentleman from Virginia, my good friend and Ranking Member, Mr. Goodlatte, who we intend to have engage with us on this issue just like we did on the farm bill and hopefully come out with a similar outcome.

OPENING STATEMENT OF HON. BOB GOODLATTE, A REPRESENTATIVE IN CONGRESS FROM VIRGINIA

Mr. GOODLATTE. Well, thank you, Mr. Chairman, and I do thank you for holding this hearing today. I welcome the opportunity to examine speculation in the futures markets and its effect on high energy prices.

Concern over excessive speculation and manipulation which challenges the role of our futures markets to discover accurate market prices is a concern that has survived the transition from my chairmanship to yours. When I was Chairman, the Committee spent quite a bit of time exercising our oversight authority by examining the underlying market fundamentals of supply and demand and bringing to light the enforcement efforts of the CFTC.

Recently the Commodity Futures Trading Commission announced several initiatives utilizing their existing authority which allow them to gather data from areas of the market that we previously had very little information about. These new efforts will bring greater transparency, and I look forward to hearing more about the implementation of these new initiatives.

I understand that the market is constantly evolving, and I applaud your efforts, Mr. Chairman, and the efforts of Mr. Etheridge and Mr. Moran to make sure the CFTC has everything it needs to evolve with the market.

There are many factors contributing to the high prices of energy, and I urge caution in blaming only speculators. Speculators add liquidity to the markets and play a critical role in the market system that benefits traditional users of the market. Imposing artificial limits on speculation could cause speculators to dump their positions and create unintended consequences that could be devastating to everyone.

While this Congress continues to only discuss high energy prices, our constituents across the country are getting hit hard in the pocketbooks with $4 a gallon gasoline, higher electricity prices, higher natural gas prices, *et cetera*. I agree with you, Mr. Chairman, that the Congress should be taking an "all of the above" approach to addressing this problem. We need to increase the supply of domestic sources of energy of all kinds, oil, natural gas, clean-burning coal, nuclear power, various new technologies. And we need to incentivize greater conservation as well.

It is unfortunate that this Committee does not have jurisdiction over all of those issues, because I believe in a strong bipartisan way we would indeed be taking the lead on increasing energy supplies for our country and addressing this problem. It seems, however, that the Majority's plan outside of this Committee to move towards energy independence includes limiting domestic energy production and imposing new government mandates that will prove to be costly and burdensome to the American people.

Congress should be working this week to act on the many proposals that contain energy supply solutions. We must diversify our energy supplies by accessing our domestic sources of oil in Alaska, the Rockies and offshore; continuing the development of alternative fuels, clean-coal technologies; and encouraging the production of more nuclear sites which provide CO_2 emission free energy.

The work we have scheduled today in Subcommittee and throughout the week on the House floor will not do much to address the energy concerns of our country. It is important that we get to the bottom of the issue that is before us today. And so again I thank you for holding the hearing, and I look forward to hearing from our witness.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank the gentleman.

The gentleman from Kansas.

OPENING STATEMENT OF HON. JERRY MORAN, A REPRESENTATIVE IN CONGRESS FROM KANSAS

Mr. MORAN. Mr. Chairman, thank you. I will make only a brief statement. It is good to be back in the Agriculture Committee room, and I appreciate the sentiments expressed by both you and the Ranking Member, the gentleman from Virginia, as you described this issue. It does seem to be receiving significant and perhaps unnecessary attention, and from my perspective, there are a lot more things that we could be doing as a Congress to try to decrease the price and slow the increased cost of energy in this country. This is a component, but we ought not use it as a scapegoat to avoid dealing with other more direct and substantial issues in regard to our country's energy policy. I appreciate very much the sentiments expressed by you and Mr. Goodlatte in that regard.

I look forward to working with you and my Chairman, Mr. Etheridge, as we continue to pursue the adequate oversight role at CFTC and make certain that the markets adequately protect consumers and investors in the United States and around the world. It is a very important industry in our country, worthy of our attention, and I appreciate our Committee utilizing its jurisdiction to provide additional oversight and understanding of the issues we will hear of today.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank the gentleman.

I now recognize the gentleman from Virginia for an announcement.

Mr. GOODLATTE. Mr. Chairman, thank you. I am proud and pleased to announce the appointment of Mr. Boustany as the Ranking Member of the Subcommittee on Department Operations, Oversight, Nutrition, and Forestry, a Subcommittee that I once served as the Ranking Member on and chaired, and I hope that this will be a good opportunity for him and the Committee.

Mr. Boustany represents Louisiana's Seventh District and has served on the Agriculture Committee since his first term in Congress. He was an active participant in the drafting of the 2007 Farm Bill and has been committed to southwest Louisiana's recovery effort from Hurricane Katrina.

His professional background as a physician and strong interest in health care policy make him particularly well suited for the role of Ranking Member of the Subcommittee. As a cardiovascular surgeon with over 20 years of experience, he brings a unique perspective to the evaluation of nutrition programs and other important issues within the Subcommittee's jurisdiction. He has always been a pleasure to work with, and I am sure my colleagues will agree that we look forward to working with him in this new role. Congratulations.

Mr. BOUSTANY. Mr. Chairman, I just want to say I appreciate this vote of confidence from the Ranking Member on our side, and I look forward to working with you, our Ranking Member and the entire Committee on the issues before us. Thank you.

The CHAIRMAN. I thank the gentleman, and congratulations.

I now would like to recognize the newest Member of the Committee who has just arrived and was elected by a special election in the First District of Mississippi, and has been appointed to the

Agriculture Committee. We are very pleased to have him with us. He represents an agriculture district that is probably most famous for being the district that was the district of Mr. Jamie Whitten for, what, 50 some years.

Mr. CHILDERS. Fifty-three.

The CHAIRMAN. Are you going to last 53 years?

Mr. CHILDERS. Probably not.

The CHAIRMAN. But anyway, we are very pleased to have him with us in the Congress and, more importantly, to have him as a Member of the Agriculture Committee. And I will be happy to recognize the gentleman if he would have anything that you would like to share with us about your district; or if not, that is okay, too.

Mr. CHILDERS. Thank you, Mr. Chairman. I am just happy to be here. Thank you.

The CHAIRMAN. Thank you very much. And let's welcome Mr. Childers to the Committee.

I see that he learned from Mr. Whitten and others that—back in the old days that freshmen were not supposed to say anything until their third term. A long tradition in the South, right?

Mr. CHILDERS. Yes.

The CHAIRMAN. The Chair would request that other Members submit their opening statements for the record so the witness may begin his testimony and we ensure that there is ample time for questions.

[The prepared statements of Mr. Salazar and Mr. Kagen follow:]

PREPARED STATEMENT OF HON. JOHN T. SALAZAR, A REPRESENTATIVE IN CONGRESS FROM COLORADO

Good afternoon. I would like to thank Chairman Peterson and Ranking Member Goodlatte for holding this important and timely hearing.

I also want to thank the Commodity Futures Trading Commission (CFTC) Acting Chairman, Walter Lukken, for coming to testify before us today.

I am anxious to hear from Mr. Lukken regarding CFTC's efforts to maintain reasonable costs during these changing market conditions.

With the plight of our current economy, it is vital that we ensure that our nation's futures markets operate as fairly as possible.

All Americans are affected by the cost of commodities, thereby making it necessary that these prices maintain control through supply and demand.

I am glad that the leadership of the Agriculture Committee brought forth this discussion and thank both the Chairman and Ranking Member for this judicious hearing.

PREPARED STATEMENT OF HON. STEVE KAGEN, A REPRESENTATIVE IN CONGRESS FROM WISCONSIN

Chairman Peterson and Ranking Member Goodlatte, thank you for holding today's hearing to discuss energy trading and the challenges facing the CFTC. I appreciate this opportunity to discuss such an important issue.

Everywhere in Wisconsin, and across the U.S., people are asking for help to cut the cost of gasoline and diesel fuels. People are having a tough time just keeping their heads above water, and are using entire paychecks to pay for their gasoline, just to make it to work, to the grocery store and to the doctor.

There are many things Congress can't do—we can't decrease demand of oil from China and India, we can't immediately increase the decline of the dollar and we can't demand an increased oil supply from the Middle East. We can, however, provide complete and accurate transparency, oversight and provide sufficient resources to the CFTC so that the rules and regulations under which they operate does not contribute to price manipulation, speculation and unduly high energy prices.

I am anxious to hear from Chairman Lukken on the CFTC's recent actions to combat the problems they face due to the overwhelming amount of daily data they must process, the record energy and agricultural commodity prices, international regulation disparities and general insight into whether he believes it to be true that index traders and swap dealers are pumping so much money into futures markets that we don't know the amount of total trading occurring and it is in fact falsely inflating energy prices, thus creating a "bubble."

Thank you very much for the time.

The CHAIRMAN. We welcome to the table Mr. Walter Lukken, the Acting Chairman of the U.S. Commodity Futures Trading Commission in Washington, D.C., somebody that we have come to know and had continuing and more frequent discussions with, and I assume we will have more as time goes on.

So, Mr. Lukken, we appreciate your making the time for us today, and you can begin when you are ready.

STATEMENT OF HON. WALTER LUKKEN, ACTING CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, D.C.; ACCOMPANIED BY JOHN FENTON, DIRECTOR OF SURVEILLANCE, DIVISION OF MARKET OVERSIGHT, COMMODITY FUTURES TRADING COMMISSION

Mr. LUKKEN. Thank you, Chairman Peterson, Ranking Member Goodlatte, and other distinguished Members of the Committee. Thank you for allowing me to testify today. I apologize if this testimony sounds a bit familiar, but I have testified twice this week, once last week, but I believe my testimony today outlines the steps we are taking in order to ensure that these markets are operating efficiently.

During the last few years, the futures markets have changed dramatically in size and complexity, experiencing 500 percent growth in both size of volume and products listed. Today exchanges are technology-driven corporations that trade electronically 24 hours a day all around the globe. Approximately $5 trillion of notional transactions flow through these U.S. exchanges daily. This description alone would make the oversight of these markets a challenge for regulators, but add to it the subprime crisis, record energy and agricultural commodity prices, the influx of financial funds in the futures markets and historic low staffing levels at the CFTC, and it is clear that these are challenging times for this regulator.

Recent substantial increases in the price of crude oil have put considerable strain on U.S. households. These issues are a matter of intense focus at the Commission due to the key roles that the futures markets play in the price discovery of this commodity.

The CFTC recognizes that these markets and their participants have evolved significantly in the last several years. Concerns have been raised recently regarding the role of speculators and index traders in our markets. As prices have escalated, the CFTC has pursued an active agenda to ensure that the commodity futures markets are operating free of distortion. These initiatives fall into five broad categories: One, increasing information and transparency; two, ensuring proper market controls; three, continuing aggressive enforcement efforts; four, improving oversight coordination; and five, seeking increased funding.

The proper oversight of markets requires transparency. Market regulators must receive the necessary information to conduct surveillance of market activity, study long-term financial trends and evaluate policy changes as circumstances evolve. The backbone of the CFTC's Market Surveillance Program is its large trader reporting system. All traders must file daily with the CFTC their futures and options positions in the markets. This information enables the CFTC surveillance economists to oversee all traders of size to ensure that these markets are not being manipulated by participants.

As markets have become electronic and global, the CFTC has been working to expand its data collection to accommodate these trends. On May 29, the CFTC announced an agreement with the U.K. Financial Services Authority to greatly expand the trader data already received from ICE Futures Europe on its linked crude oil contract that settles off the NYMEX crude oil benchmark, including receiving equivalent daily large trader reports on all months traded. This cross-border information sharing is unprecedented among global regulators.

The CFTC has also taken action to improve the transparency of index traders and swap dealers in the energy markets. In late May, the CFTC announced that it will use its special call authorities to gather more detailed data from swap dealers on the amount of index trading in the markets, and to examine whether index traders are being properly classified for regulatory and reporting purposes. These information requests have been sent, and the CFTC expects in the coming weeks to receive detailed information about these index funds and other transactions flowing through swap dealers. After analyzing this data, the CFTC will provide a report to Congress by September 15 regarding the scope of index trading in the energy markets and whether recommendations for improved practices and controls should be implemented.

Beginning last fall and finalized last month with this Committee's leadership, the Commission worked with Congress to enact legislation as part of the farm bill requiring exempt commercial markets that trade linked energy contracts to provide the CFTC with large trader reports and impose position limits and accountability levels on such products. Congress and this agency believe that these authorities were necessary to protect the regulated energy marketplace.

As noted earlier, linkages between contracts is not purely a domestic occurrence, but also happens across international borders. Most energy and agricultural commodities are global commodities operating in a global marketplace, and the U.S. futures markets have been facing the challenges of cross-border trading and regulation for years.

For more than a decade, the CFTC has utilized its mutual recognition process for foreign exchanges that allows U.S. institutions access to those markets by striking the balance between protecting the U.S.-regulated marketplace and acknowledgement that increased globalization for commodity markets requires international cooperation and coordination between governments.

With this balance in mind, last week the CFTC announced modifications to its foreign boards of trade process. After consultation with the British FSA, the CFTC revised the access letter of ICE Futures Europe to require the implementation of position and accountability limits on its linked crude oil contract. The CFTC will also require other foreign exchanges that seek such access to provide the CFTC with large trader reports, as well as to impose position and accountability limits. This combination of enhanced information data and market controls will help the CFTC in its surveillance of the regulated domestic marketplaces while preserving the benefits of its mutual recognition program.

During these turbulent economic times, the environment is ripe for those wanting to illegally manipulate the markets. In late May, the Commission took the extraordinary step of disclosing that in December of 2007 its Division of Enforcement launched a nationwide crude oil investigation into the prices of oil and the practices surrounding crude oil, including the purchase, transportation, storage and trading of crude oil and related derivative products. Strong enforcement at this time is imperative.

Given the size of the CFTC and the enormity of the global marketplace, the CFTC must also engage others in government as we seek to meet our important mission. Two weeks ago the CFTC announced the formation of an interagency task force to evaluate developments in the commodity markets, which includes staff from the CFTC, the Federal Reserve, the Department of Treasury, the SEC, the Department of Energy, and the U.S. Department of Agriculture. We have also invited the FTC and FERC to participate as well, given their expertise in these areas. The task force is intended to bring together the best and brightest minds in government to aid the public and regulatory understanding of the forces behind these come-on WTI prices.

If the CFTC sounds busy, it is, especially given that agency staffing levels are near record low numbers. Since the CFTC opened its doors 33 years ago, the volume on futures exchanges in the United States has increased 8,000 percent, while the CFTC staffing numbers have fallen 12 percent. As the agency embarks on new authorities and initiatives in order to respond to changing market conditions, it is imperative that these be met with adequate resources.

The CFTC is in the midst of implementing its new farm bill authorities, which may require programmatic changes at the agency as well as old-fashioned hard work from a staff that is already under considerable strain. Additionally, the agency staff is racing to implement the new initiatives I have just outlined in my testimony. Recall as well that our employees are full-time regulators charged with overseeing the markets each and every day. Without proper funding, this agency will not be able to sustain this pace much longer.

In summary, the Commission shares this Committee's concern for the condition in the energy markets and the effects of high crude oil prices on all Americans. These are difficult economic times, and the Commission recognizes the need to respond accordingly to ensure that the futures markets are working for all citizens.

Thank you very much, and I would welcome any questions you may have.

[The prepared statement of Mr. Lukken follows:]

PREPARED STATEMENT OF HON. WALTER LUKKEN, ACTING CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, D.C.

Chairman Peterson, Ranking Member Goodlatte, and other distinguished Members, thank you for inviting me to testify before this Committee on the role, responsibilities, and resources of the Commodity Futures Trading Commission (Commission or CFTC).

During the last few years, the futures markets have changed dramatically in size and complexity, experiencing 500 percent growth in both volume and products listed. Once member-owned and dominated by open-outcry trading, today exchanges are technology-driven corporations that primarily trade electronically, 24 hours a day, all around the globe. Approximately $5 trillion of notional transactions flow through these U.S. exchanges and clearing houses daily. This description alone would make the oversight of these markets a challenge for regulators. But add to it the subprime crisis, record energy and agricultural commodity prices, the influx of financial funds in futures, and historic low staffing levels at the CFTC, and it is clear that these are challenging times for this agency.

Recent substantial increases in the price of crude oil and other commodities have had a significant impact on American consumers and have put considerable strain on U.S. households. These issues are a matter of intense focus at the Commission due to the key role that futures markets play in the price discovery process. The CFTC shares the concerns of Americans and Congress, and we are committed to ensuring that our nation's futures markets operate fairly and efficiently, and that the prices of commodities, including crude oil, are determined by the fundamental forces of supply and demand, rather than abusive or manipulative practices.

The CFTC recognizes that these markets and their participants have evolved significantly in the last several years. Concerns have been raised recently regarding the role of speculators and index traders in the commodity markets. As prices have escalated, the CFTC has pursued an active agenda to ensure that the commodity futures markets are operating free of distortion as the agency looks to better understand the implications of these structural market developments. The Commission has undertaken several initiatives directed to enhancing the oversight of the energy and agricultural markets. These initiatives fall into five broad categories: (1) Increasing Information and Transparency, (2) Ensuring Proper Market Controls, (3) Continuing Aggressive Enforcement Efforts, (4) Improving Oversight Coordination, and (5) Seeking Increased Funding.

(1) Enhancing Information and Transparency.

The proper oversight of markets requires transparency. Market regulators must receive the necessary information to conduct surveillance of market activity, study long-term financial trends, and evaluate policy changes as circumstances evolve. The backbone of the CFTC's market surveillance program is the large trader reporting system, through which the CFTC receives daily data showing all large traders' futures and options positions in the markets. This information enables the CFTC's surveillance economists to oversee all traders of size to ensure that no one is attempting to manipulate the futures markets. This amount and detail of trade data collected and analyzed at the CFTC is unprecedented among financial regulatory agencies.

As markets have become electronic and global, the CFTC has been working to expand and enhance its technology and trade data collection to accommodate these trends. Last spring, the CFTC announced a major technology purchase that will modernize our trade practice surveillance system to enhance basic trade surveillance and permit nearly real-time analyses of all trading activity. Investments in technology are critical for the CFTC to sort through the millions of pieces of information generated by these electronic markets daily.

The CFTC is also working to increase the amount and quality of the trader data we receive from the markets. In late May, the CFTC announced an agreement with the U.K. Financial Services Authority (FSA) to expand the trader data received from ICE Futures Europe on its cash-settled light sweet crude oil contract that settles off the NYMEX benchmark crude oil contract. When first listed in 2006, this linkage between the two contracts caused the Commission and its surveillance staff to be concerned that regulators would not be able to observe the entirety of a trader's position in both markets. Once the surveillance issue was identified, the CFTC worked with its foreign counterpart, the FSA, to share large trader data for these linked contracts to ensure that traders were not gaming one market to influence the other. At that time, the CFTC's agreement with the FSA provided the CFTC with weekly trader information, and daily information in the final trading week, to facilitate the ability of the CFTC and FSA to oversee trading in these related contracts.

Building on these efforts, the CFTC and FSA 2 weeks ago announced an expanded information-sharing arrangement, including: (1) providing daily large trader positions in the linked ICE Futures Europe crude oil contract, (2) extending trader information sharing to all contract months, (3) a near-term commitment to improve the identification of market end users to be completed within 2 months, (4) improved formatting so trading information can be seamlessly integrated into the CFTC's surveillance system, and (5) CFTC notification when traders exceed NYMEX position accountability levels. This cross-border information sharing is unprecedented among global regulators.

The CFTC also has taken action to improve the transparency of index traders and swap dealers in the energy markets. There is public concern about the amount of index money flowing into the futures markets. Pensions, endowments, and other long-term investors increasingly are investing a portion of their portfolios in a broad mix of commodities in order to diversify their holdings and reduce volatility and risk. Unlike traditional speculative trading by hedge funds and other managed money, index investors are typically non-leveraged entities utilizing a long-term buy-and-hold strategy. Most of this type of investment comes through major Wall Street swap dealers that sell their clients broad exposure to the commodity markets through an over-the-counter commodity index contract. Swap dealers then are exposed to commodity price risk as a result of aggregating these transactions and must utilize the futures markets to manage their own remaining residual risk. This "netting out" of risk by swap dealers before coming to the futures markets makes it difficult for regulators to determine the total amount of index trading occurring in the energy markets.

As a result, the Commission decided to issue special calls for information about commodity index trading, principally to swap dealers through whom most of this trading takes place in the over-the-counter (OTC) market. Some market commentary has pointed to long-only index trading as part of the reason for the sharp increases in energy prices. Through its large trader reporting system, the Commission has highly accurate information on all swap dealer positions in all regulated U.S. futures markets, including energy futures markets. However, swap dealers' futures positions can represent hedges of very complex "books" of many different types of OTC derivative and cash transactions. Therefore, swap dealers' futures positions do not necessarily correspond accurately with the amount of index trading that is occurring in the OTC market. In order to better understand the extent and possible impact of index trading, the Commission has issued special calls to swap dealers requiring them to provide information on commodity index transactions.

After analyzing this data, the Commission and its staff will provide a report to Congress by September 15, 2008 regarding the scope of commodity index trading in the futures markets and recommendations for improved practices and controls, should they be required.

(2) Ensuring Proper Market Controls.

Last fall, the Commission announced its intention to address the mounting regulatory concerns surrounding exempt commercial markets that trade over-the-counter energy products. The Commission held a public hearing and worked with Congress to enact legislation as part of the farm bill requiring exempt commercial markets that trade contracts linked to regulated U.S. futures contracts to provide the CFTC with large trader reports and impose position and accountability limits on such products. Congress and this agency believed that these authorities were necessary to protect the regulated energy marketplace.

As noted earlier, linkages between contracts are not purely a domestic occurrence but also happen across international borders. Most energy and agricultural commodities are global commodities operating in a global marketplace, and the U.S. futures markets have been facing the challenges of cross-border trading and regulation for many years.

For more than a decade, the CFTC has worked to develop international regulatory networks, to increase international cooperation, and—most importantly—to maintain and improve oversight of U.S. futures markets in the face of increasing globalization. Over the years, the CFTC has developed a mutual recognition process that strikes the balance between the need for U.S. regulators to maintain confidence in the functioning and integrity of our markets, and the acknowledgement that the increased globalization of commodity markets requires international cooperation and coordination.

With this balance in mind, the CFTC last week announced modifications to its foreign boards of trade process. After consultation with the British FSA, the CFTC conditioned ICE Futures Europe's direct access to U.S. customers on implementation of position and accountability limits on its linked crude oil contract. In addition, ICE Futures Europe will adopt hedge exemption requirements similar to those in the U.S. and report any violations of those requirements to the CFTC. The CFTC has amended ICE Futures Europe's direct access letter to reflect this change. The CFTC will also require other foreign exchanges that seek such direct access to provide the CFTC with comparable large trader reports and to impose comparable position and accountability limits for any products linked with U.S. regulated futures contracts. This combination of enhanced information data and additional market controls will help the CFTC in its surveillance of its regulated domestic exchanges while preserving the benefits of a mutual recognition program that has enabled proper global oversight over the last decade.

The amended direct access letter also formalizes the recently announced information-sharing agreement between the CFTC and the FSA by requiring ICE Futures Europe to provide the CFTC with detailed market information, equivalent to U.S. standards for market surveillance, as a condition of receiving direct access to U.S. customers. The CFTC will incorporate this new data into the CFTC's Commitments of Traders Report, which is a weekly report categorizing traders and positions.

The Commission's staff intends to apply these new direct access conditions to any future requests by foreign exchanges for direct access to U.S. customers, where the exchange in question lists a contract that settles against contracts listed on any U.S. exchange. These revisions to the foreign boards of trade program will provide the CFTC with additional oversight tools to monitor linked contracts. This combination of enhanced trading data and additional market controls will help the CFTC in its surveillance of regulated domestic exchanges, while preserving the benefits of our international mutual recognition program, which has permitted cross-border oversight of global markets over the last decade.

(3) Continuing Aggressive Enforcement Efforts.

During these turbulent market conditions for crude oil, the environment is ripe for those wanting to illegally manipulate the markets and, as a result, the Commission has stepped up its already aggressive enforcement presence. In late May, the Commission took the extraordinary step of disclosing that in December 2007, its Division of Enforcement launched a nationwide crude oil investigation into practices surrounding the purchase, transportation, storage, and trading of crude oil and related derivatives contracts. Although the Commission conducts its enforcement investigations in full confidentiality, today's unprecedented market conditions and the desire to maintain public confidence justified disclosing the existence of this investigation.

Since December 2002 to the present time, the Commission has filed a total of 39 enforcement actions charging a total of 64 defendants with violations involving the energy markets. The agency has assessed almost half a billion dollars in civil monetary penalties in settlement of these enforcement actions. The Commission also has achieved great success in this area by working cooperatively with the Department of Justice on over 35 criminal actions concerning energy market misconduct. Strong enforcement is imperative during this time.

(4) Improving Oversight Coordination.

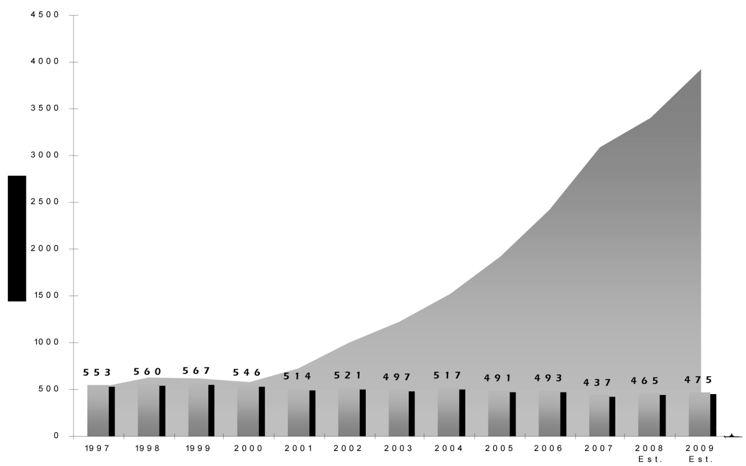
Given the CFTC's size and the enormity of the global marketplace, the CFTC must engage others in government as we seek to meet our important mission. Last week, the CFTC announced the formation of a CFTC-led interagency task force to evaluate developments in the commodity markets. The task force-which includes staff representatives from the CFTC, Federal Reserve, Department of the Treasury, Securities and Exchange Commission, Department of Energy, and Department of Agriculture—is examining investor practices, fundamental supply and demand factors, and the role of speculators and index traders in the commodity markets. It is intended to bring together the best and brightest minds in government to aid public and regulatory understanding of the forces that are affecting the functioning of these markets. We convened the first meeting last week and will strive to complete this work quickly and make public the results.

The CFTC also recently hosted its second international enforcement conference—a 2 day event focusing on global trading in the energy markets with senior enforcement officials from ten countries. Our goal was to enhance the ability of the CFTC and its fellow regulators to detect and deter misconduct affecting commodity prices in the energy sector, and I am confident that it was a success that will bear the fruit of coordinated international enforcement for manipulation.

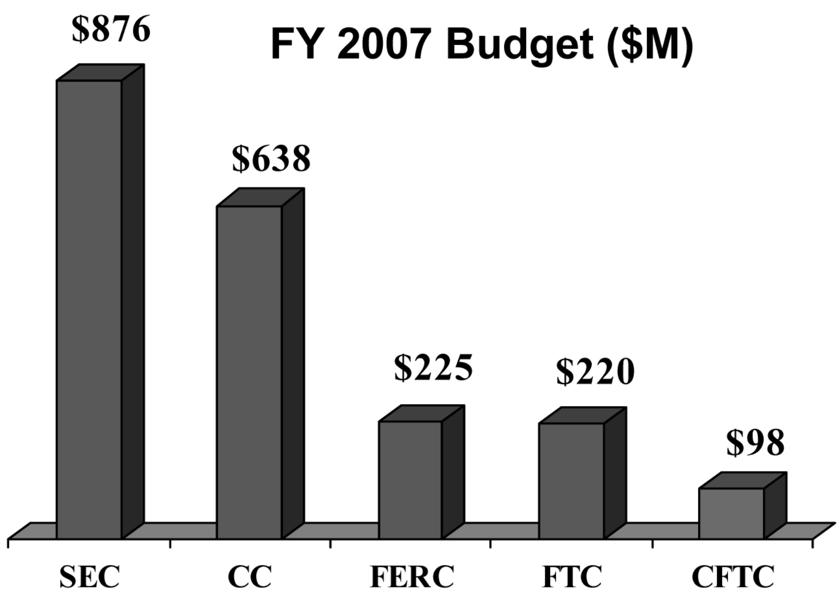
(5) Seeking Increased Funding.

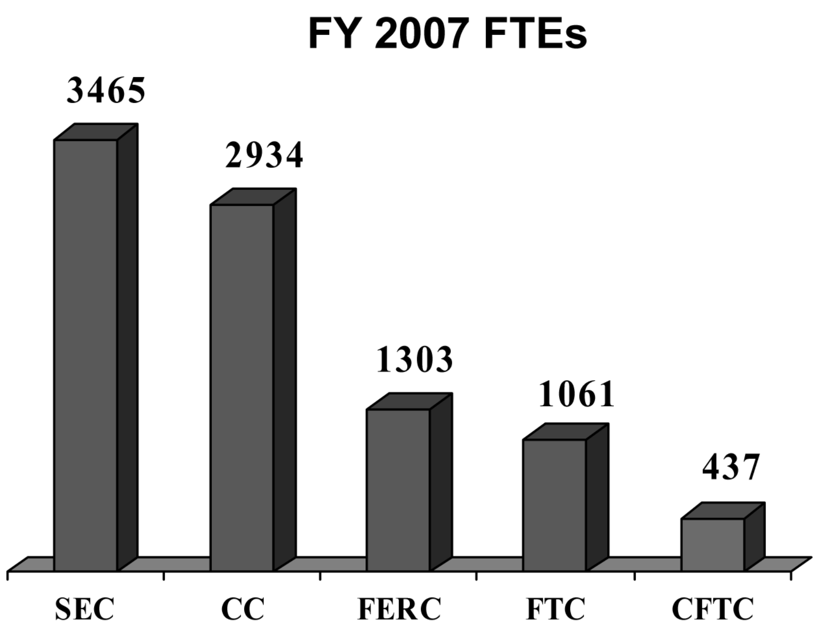
If the CFTC sounds busy, it is—especially given that the agency's staffing levels are near record low numbers. Since the CFTC opened its doors 33 years ago, the volume on futures exchanges has grown 8,000 percent while the CFTC's staffing numbers have fallen 12 percent. The following chart shows the exponential growth in contract volume, compared to CFTC staff numbers.

Growth in Volume of Futures & Option Contracts Traded & CFTC Staffing Levels



The CFTC's resources simply have not kept pace with the growth of the markets and the growth of similar financial regulators. As you can see, the CFTC lags other comparable agencies in funding levels by substantial margins. This agency's lack of funding over the course of many years has had a negative impact on our staffing situation, rendering it unsustainable for the long run.





The CFTC is a small agency doing an extraordinary job under difficult circumstances. The dedicated and skilled individuals at the CFTC are working tirelessly to ensure the integrity of the markets. However, as the agency embarks on new authorities and initiatives in order to respond to changing market conditions, it is imperative that the CFTC receive additional funding.

The CFTC is in the midst of implementing its new farm bill authorities, which require many programmatic changes and plain old hard work from a staff that is already under significant strain. Additionally, the agency's staff is racing to implement the many recent agency initiatives I outlined earlier in my testimony. Recall as well that our employees are also full-time regulators, charged with overseeing these markets each and every day, upholding the agency mission to safeguard the futures markets. Given our staffing numbers, the agency is working beyond its steady state capacity and is unable to sustain the current situation for much longer without being forced to make Hobson's choices about which critical projects should be completed and which ones will be delayed. And while we welcome discussions of any appropriate and necessary legislative or agency changes, our agency is clearly unable to accommodate additional tasks at our current resource and personnel level.

On Tuesday, June 17, I testified at a joint hearing of the Senate Appropriations and Agriculture Committees to support the Commission's request for additional appropriations from Congress. In making this request, the Commission was mindful of the need to maintain fiscal restraint in appropriations and the competing needs of other parts of the Federal Government. However, we believe that the proposed funding level of $157,000,000 is the appropriate level of resources required to fulfill our immediate responsibilities. The increase will restore staffing to a level last sustained almost 2 decades ago when market volume, innovation, and complexity were significantly less than today and when the agency did not yet have to face the expanded workload brought on by globalization of the marketplace and the emergence and widespread use of derivatives and hedge funds. This of course means the Commission is now doing much more with less and continues to deliver a good return on investment for the American taxpayer. The Commission's ratio of workload to resources has always been lean compared to other financial regulators. But we have reached our limit and cannot uphold our mission without immediate additional resources.

In summary, I want to thank the Committee for inviting me to testify today. The Commission shares the Committee's concern for current conditions in the energy markets and for the effects of high crude oil and gas prices on American consumers, workers, and businesses. These are difficult times in the futures markets, and the Commission recognizes the need to respond accordingly. As I stated in my earlier testimony—and it bears repeating given the challenges of the last several weeks—I am deeply proud of our highly skilled and productive staff. This small Federal agency is working hard to protect the public and the market users from manipulation, fraud, and abusive practices in order to ensure that the futures markets are working properly.

Thank you for the opportunity to appear before you today on behalf of the CFTC. I would be happy to answer any questions you may have.

The CHAIRMAN. I thank you, Commissioner, and again appreciate you being us.

As we always do, we are going to recognize people by seniority as either for the people that were here when the Committee started, and then as people come in.

First of all, in the—as I understand it, the Agriculture Appropriations Subcommittee has authorized more money. Could you tell us what action has been taken here in the House concerning how much more money, and people, they have allocated at this point?

Mr. LUKKEN. The President's budget mark for the CFTC was $130 million. The House Agriculture Subcommittee for Appropriations recently gave us $135 million. As a result of their efforts, we have asked on top of the $130 for an additional $27 million, $21 million to increase our staffing levels by roughly 100 FTEs to get us up to historic levels of where we need to be. Second, the implementation of the farm bill requires us to regulate new markets, known as exempt commercial markets. This Committee helped enact this provision that will require additional staff as well. And, so we have asked for an additional $6 million on top of the $21 million for a total of $27 million.

The CHAIRMAN. So the $21 million gives you another 100 people?

Mr. LUKKEN. Roughly about 100, correct.

The CHAIRMAN. And what is $130; that is your existing budget?

Mr. LUKKEN. $130 million was the President's mark. Our current budget is about $112 million.

The CHAIRMAN. So that increase from $112 to $130, what did that buy?

Mr. LUKKEN. We are also updating technology, so a lot of that has to do deal with trying to improve the surveillance system that we are doing. So a lot of that was dedicated towards technology, but I believe that got us up to 475 FTEs.

The CHAIRMAN. So it bought you some additional——

Mr. LUKKEN. Absolutely. And FTEs are not equivalent to people, so we might be above that, but certainly it is more people.

The CHAIRMAN. Well, we applaud the agreement that you have put together, and I think you are moving in the right direction. I would just say that given what has transpired around here in the last week or so, and how this thing is ginning up, we also applaud the fact that you are going to have some kind of report back to us by the 15th of September. But I am not sure we have until the 15th of September. So I don't know if there is any way to speed that up, and I am not putting you on the spot here, but, probably stating something obvious that you already know, that we may not have until the 15th, because I understand the intention is for us to go out of session by the 26th of September and not be back for a lame duck this year. So there is going to be a lot of pressure for us to move sooner rather than later. So the sooner you can get us information, the better.

And in spite of the work that you have done, we still have people saying to us—I just had some people in just a little bit ago—"Anybody that is doing business in the United States should be regulated by the CFTC on the same basis." I think there are a number of bills that move us in this direction and so forth. So, my question is if, say we did that, that we moved to bring in all of the exempt commercial market and the over-the-counter and all of this under the regulation, with the same margin requirements and transparency and all that stuff, what in your estimation would happen at that point if we did that? Would a bunch of money come out of the market? If so, how much? Do you have any kind of crystal ball as to what would happen if we did that?

Mr. LUKKEN. I think from the CFTC's perspective we want to ensure that we are getting the best data from the entirety of the marketplace that we can. The goal is transparency, and that is the goal that we have tried to achieve through our mutual recognition program. So what we are getting from the London markets currently under this new agreement will be equivalent to what we are receiving from NYMEX, so that we are able to put this data into our systems seamlessly and see the entirety of the marketplace.

On top of that, we have announced last week that we put foreign boards of trade under limits that are equivalent to what NYMEX is putting on their markets. If we somehow required these businesses to come in and register in the United States, my worry is that they would decide not to do that, and the leverage that we have currently in order to see these markets would disappear.

We have to recognize that these are global markets, that the New York Stock Exchange is now married to LIFFE and to Euronext in Europe, and that we have to as regulators get together and engage each other to ensure that we raise standards globally. We have chosen to follow that path, not to say that everybody has to come to the United States and abide by our rules, but let's try to get people to raise their standards internationally so we can recognize this global environment. And I think it has been very effective, and I think we are going to start seeing that with the London markets as well once this information starts to flow in.

The CHAIRMAN. Thank you, Commissioner.

The gentleman from Virginia Mr. Goodlatte.

Mr. GOODLATTE. Well, thank you, Mr. Chairman.

Mr. Lukken, welcome. We are pleased to have you with us today. And I want to follow up on the questions asked by the Chairman about the CFTC's regulatory relationship with ICE Futures Europe. Can you explain a little more about why a foreign government can regulate an American exchange?

Mr. LUKKEN. Well, the exchange that the foreign government is regulating is the foreign exchange. The foreign exchange was previously named the International Petroleum Exchange—it had been in existence for 25 years in London trading primarily the Brent contract. They were bought by an American holding company, ICE, located in Atlanta, but their Board is a completely separate Board. Their Chairman, Sir Robert Reid, was here yesterday testifying from London.

And so certainly they want access to U.S. customers as a foreign board of trade, like our U.S. exchanges want access from foreign institutions trading on them. So we have taken the tack that it is important to recognize this is principally regulated, as it has been for 25 years in London, but we would condition that with important information, information sharing, limits, and all the things that we go through to ensure that they are a comparable regulator. And we are comfortable that they are.

Mr. GOODLATTE. What types of information or data sets do you get from NYMEX that you do not get from ICE Futures Europe?

Mr. LUKKEN. I think under the current agreement it is going to be the same.

Mr. GOODLATTE. And how do you get that information from them, or how will you get that from them?

Mr. LUKKEN. I believe this goes through the FSA that—but then they forward it on seamlessly to us under this agreement.

Mr. GOODLATTE. And can you explain the advantages of trading the identical contract on ICE Futures Europe *versus* on NYMEX?

Mr. LUKKEN. Well, I think competition is always healthy for those in the markets, and so it has brought down prices for commercial hedgers in the field. I think the advantages originally were the electronic platform *versus* an open outcry. That has changed dramatically since NYMEX went electronic, and actually NYMEX is gaining back market share. And you don't hear about that very often, but actually the London market is losing market share currently. So we haven't seen a wholesale shift of participants overseas. We actually have seen business coming back to the United States recently.

Mr. GOODLATTE. Would you say that trades on ICE Futures Europe are less transparent than trades on NYMEX?

Mr. LUKKEN. I think now we are going to get the data, we are going to put it into our Commitment of Trader Reports. We are going to treat this equivalent to how we treat NYMEX data.

Mr. GOODLATTE. And how quickly will that happen?

Mr. LUKKEN. We are trying to get the end-user information included within the next 2 months. That was stated when the agreement was announced. After the end-user information is included, and after some technological operation changes, it will be included, but by the end of summer.

Mr. GOODLATTE. And what enforcement activity can you engage in against ICE Futures Europe traders?

Mr. LUKKEN. Our section 9(a) authority is expansive covering manipulation in interstate commerce, so we certainly can go after activity by U.S. participants anywhere if it is affecting our marketplace.

Mr. GOODLATTE. And have you?

Mr. LUKKEN. Yes. We certainly have worked internationally to go after this type of activity. Most people talk about the Sumitomo crisis, remember back, the copper trading happening elsewhere. That is a good example of our manipulation authorities being used overseas.

Mr. GOODLATTE. Let me ask you about the "Enron loophole." How would you define that?

Mr. LUKKEN. Well, the "Enron loophole," as this Committee did fix as part of the farm bill, was really trying to ensure that exchanges weren't developing elsewhere that served a price discovery function. We want to make sure that if people are using these markets to discover prices in interstate commerce, that we have the proper controls in place, large trader reports and position limits, and that is what this Committee did. It is going to be very effective once we implement it.

Mr. GOODLATTE. Are you satisfied that the new authority that was put into the farm bill, which virtually everybody on this Committee supported, is sufficient to close the so-called Enron loophole?

Mr. LUKKEN. Absolutely.

Mr. GOODLATTE. Do you think there is any additional authority that you would need to identify and eliminate the type of activity that is defined by this loophole?

Mr. LUKKEN. No, sir.

Mr. GOODLATTE. So you would say that effectively with the implementation of those rules changes, the Enron loophole has been closed?

Mr. LUKKEN. Certainly, but as regulators, as conditions evolve, we are always trying to keep an open eye out for things we need more, but currently, no, we think we will have enough authority.

Mr. GOODLATTE. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Pennsylvania Mr. Holden.

Mr. HOLDEN. Mr. Lukken, how much does trading in one market such as NYMEX or the London Exchange or any over-the-counter market have an effect on trading in other markets?

Mr. LUKKEN. Well, it depends on if those markets are linked. So, for example, when this became a concern in 2006 is when the London market began to link directly to the NYMEX contract. And so that when that occurs, we have concerns, because you can influence the ultimate price of the NYMEX market. That is also why we address the linkage in exempt commercial markets as part of the farm bill. The key is when they are linked to each other.

Mr. HOLDEN. Do you believe that some markets are being manipulated through the use of other markets?

Mr. LUKKEN. We have not seen evidence that one market is being systematically used to manipulate the price of any commodity, but we are always looking out for that. We are the policemen of the markets. You can't prevent all crime, but when you do, you go at it aggressively, and that is what we have tried to do. And so I can't rule it out completely, but certainly that is something we have not seen systematically happening.

Mr. HOLDEN. There have been many statements at other Congressional hearings and in the media that a specific dollar amount or a specific percentage of the price of crude oil is due to speculation. Has the Commission examined these claims or asked the proponents upon what these figures are based?

Mr. LUKKEN. We have reached out with our economic staff to look at these issues on a daily basis to find out what data they are using. Are they using our data? Are they using other economic models to come up with these numbers? And to date we have not had anybody come back to us with hard economic evidence of where they get their prices.

Mr. HOLDEN. So the information you receive is not showing correlation?

Mr. LUKKEN. No, but we welcome information, if somebody has data that explains why prices should be lower, that is something we want to know about so we can factor that into our decisions.

Mr. HOLDEN. Thank you, Mr. Chairman.

The CHAIRMAN. I thank the gentleman.

The gentleman from Kansas Mr. Moran.

Mr. MORAN. Mr. Chairman, thank you.

Mr. Lukken, thank you for joining us. You are a very in-demand figure on Capitol Hill these days. And I am thinking about, I remember your first appearance before this Committee or Subcommittee, and you have matured over the period of time that I have known you in our respective positions, and I appreciate your expertise.

Speculation that oil prices will rise rather than fall has dropped dramatically since—I am reading from an article—has dropped dramatically since we crossed the $100 mark. The net long position on the New York Mercantile Exchange fell from 113,337 contracts on March 11th to 25,246 by June 10th. So nearly as many traders are now shorting oil as are going long. More. Purely financial speculators need not play futures at all. They can simply buy or short the exchange-traded U.S. Oil Fund, which tracks the price of West Texas crude. *The Wall Street Journal* reports that short interest in that fund is up 140 percent since January, outnumbering long bets by 2 to 1. Speculators, in other words, are increasingly leaning towards betting the price of oil will go down, not up. Is that an accurate portrayal of the markets?

Mr. LUKKEN. Well, certainly in the economic data we look at, there are: traditional speculators, which are the hedge funds; the people that are in and out of the markets every day; and then, what is also being lumped in with those hedge fund-type speculators, are swap dealers. So, if you look at just the traditional speculators, they are pretty flat in the market, and have been so since the price run-up began in January 2007, at about four percent net long. So, there are about as many positions on the long side that would benefit from the markets going up, as on the short side that would benefit going down.

Now, if you look at just the swap dealers, these are the people who bring the index trading into the marketplace; they enter into contracts with different clients, net up that risk, and come to the futures market to manage that risk. They also are even less long—they are almost on the zero line as many longs as short.

So again, we haven't seen support for the theory that everybody is on the buy side of this market, and that is driving up prices. The evidence is, we have not seen that, we will continue to look at it, but currently you are correct.

Mr. MORAN. Which would—I assume a reasonable conclusion from that would be that speculation is not driving up the underlying price of the commodity. Is that a fair conclusion from——

Mr. LUKKEN. That is one inference you can draw, sure.

Mr. MORAN. And then in regard to index funds, they exit the market prior to contract termination because the funds don't take delivery of the commodity. If index funds had the ability to move the market, wouldn't any run-up in price in the back-month contracts be accompanied with a price drop in the front-month when the index funds exit their position by shorting the market? So you are in for a short period of time. If you can drive up the price while you are in, you would drive the price down when you get out?

Mr. LUKKEN. I think that is a good point to make. The index traders, they in essence have a buy and hold strategy in the commodity markets. They never get into the delivery month, so they are not affecting actual physical delivery of crude oil in any way. But what they do is they hold positions, and then each month, to roll into the later contract month, they sell. They sell in the front-month, which we would think would have a downward pressure, price pressure, in those months, and they buy in the later months. So we have not seen that when they are selling prices that go down or stay down in those markets as expiration of the contract occurs.

So again, we are looking for the smoking gun in regards to these index traders. We haven't seen it yet, but that is a very good point to make. Once they get in the market, there is offsetting buying and selling occurring by these index traders.

Mr. MORAN. Mr. Chairman, Chairman Lukken, at the Subcommittee hearing that Mr. Etheridge held a few weeks ago, my concern was about convergence or lack of convergence. Any developments in your analysis since you last testified before us about the cash price converging; has anything changed?

Mr. LUKKEN. Well Commissioner Mike Dunn, who chairs our ag advisory committee, was in Chicago this week working with the exchanges on developing ideas to help improve convergence. He is holding an Agricultural Advisory Committee at the end of July to talk about ideas on how to improve convergence on agricultural products, so I look forward to hearing what Mike has to say. But we are working hard to find improvements in that area.

Mr. MORAN. Thank you, Mr. Chairman, for the opportunity to question Mr. Lukken.

The CHAIRMAN. I thank the gentleman.

The gentleman from North Carolina Mr. Etheridge.

Mr. ETHERIDGE. Thank you, Mr. Chairman.

Chairman Lukken, thank you for being here today.

As you know, I have introduced legislation that—you touched on it, and each Member has—will help give the CFTC the resources and the authority that it needs to help you ensure that, as you said, "Manipulation and excessive speculation are not occurring in the energy markets." And I hear every day from constituents, as I am sure every other Member on this panel does, who are struggling to make ends meet while gas prices and diesel fuel prices are skyrocketing. This Sunday at my church, one of my constituents told me he is going out of business because he can't continue at the current rate to drive his truck and put fuel in; it is taking half of it. And Congress and the CFTC must ensure—I think this is critical—that investors are not able to artificially increase the price of oil while hardworking families are suffering. I think you agree with that.

With that said, I want to ask you a question about the bill that I introduced which deals with foreign boards of trade popularly known as the London loophole. You touched on it earlier. As you know, the bill deals only with energy commodities delivered in the United States. I was planning on amending that bill's provision to apply to any contract traded on a designated contract market or other registered entity in the United States, because if there is a problem with the WTI being traded overseas, I think we ought to address it. I certainly would like to. But I also want to make sure that we are addressing any potential future problem that might occur if one day these foreign markets start trading in contracts linked to corn farmers and corn futures, wheat contracts, or even ethanol, which I understand that they haven't figured out whether that is going to be an agricultural commodity or an energy commodity.

Do you believe such an expansion to cover other commodities is prudent given the potential for growth in these markets?

Mr. LUKKEN. I do. I think, especially, in the physical commodities. I think that it is most important to concentrate on the energy and agricultural commodities. I would have to think, though, on whether it makes sense on the financial side.

There are lots of linked contracts that our markets link to as well. For example, the largest contract traded in Chicago is the CME Eurodollar market that is linked to an overseas index, so we want to be sure that we are not causing retaliation from others as a result of some of these ideas. But I think it makes a lot of sense when you are dealing principally with agricultural and energy commodities.

Mr. ETHERIDGE. I would appreciate if you do a bit of thinking and work with your staff and get back to us on that. It seems to me that we have three kinds of participants in the futures market. We have the *bona fide* hedger you talked about earlier, who either plans to take delivery on the futures contract or buy and sell the underlying commodity so that they have need to hedge against the price changes. And I don't think anyone thinks they are driving the market. You touched on that earlier.

Then there are the pure speculators, and by that I mean there are people who do not qualify for hedge exemption, so they are bound by the exchange's speculation limits. People are concerned about their activity. But that is not the focus of my question.

I am interested in those speculators who do obtain hedge exemptions, although they are not hedging against ownership of the underlying commodity. Just so you will be prepared, I plan to submit a question in writing seeking details about the position of these traders in the NYMEX WTI crude oil markets over time, because some people charge that this is a loophole and a departure from the spirit and the intent of the CEA.

But for now, please explain the history of the hedge exemption and how the hedge exemptions arise.

Mr. LUKKEN. Well, this is something that dates back to the early 1990s. The policy was put into place about 1991 at the CFTC by the Commission, but it even predates that. In the 1986 reauthorization of the CFTC, Congress strongly urged the CFTC to revisit its exemptions to include this type of an exemption for risk management, looking at the growth of the this sort of aggregation that occurs through swap dealers.

So this is something under the strong urging of Congress—in the legislative history of that Act—they asked the Commission to look into this, and the Commission did. They had a Financial Products Advisory Committee that looked into the issue, held public hearings, discussed this, and ultimately came to the conclusion that swap dealers deserved an exemption under the hedge exemption rules. And the reason they did this, and, of course, we are revisiting this and whether this is right or wrong, but the reason they did this is swap dealers were going to clients, lots of them commercial clients, that could come directly to the markets and receive exemptions, but they are aggregating these positions. They were also aggregating other positions, such as index traders, and then were coming to the market, and they needed to offset the risk that offering these clients risk-management products—they needed a venue to offset that risk. And the futures markets, as you know, are price discovery markets, but they are also risk-management markets, and so this was seen as a way for these entities to manage risk.

Currently we are reviewing that policy. We are going to get data from the swap dealers to figure this out, whether it still makes sense, and whether there are people evading limits. But something I think is important to remember, we don't want to cut off a venue for institutions like banks to manage risk. We are looking at the Bear Stearns crisis currently where they didn't have a regulated venue for credit default swaps and other products. It is important to make sure that they have an avenue to a very transparent market where prices are set.

So we have to look at those, balancing those two ideas, making sure that proper controls are in place, that people aren't evading purposely position limits, but also ensuring that they can manage risk in a very transparent, regulated avenue.

Mr. ETHERIDGE. Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. I thank the gentleman.

The gentleman from Texas Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. Chairman, thank you for being here.

Would you say that the discovery price for oil today—are you comfortable that whatever oil closed at today on the markets, if it is closed yet, is the price of oil?

Mr. LUKKEN. Well, our economists work closely with the data, the fundamental data that they receive from EIA and other sources around the world to make sure that markets are reflecting supply and demand. But we also have the issue of making sure that any one participant is not, or collectively with others are not, driving artificially the prices of oil and other commodities. Our trained economists have been doing this for 30 years. They are comfortable that this is the price of crude oil in the markets.

Mr. NEUGEBAUER. And why do they say that crude oil is $130 a barrel? Why do they think that is a legitimate price for oil? What do they think causes that?

Mr. LUKKEN. Well, there are several factors to consider. We are at flat production, world production, in oil. That has been the case now for the last 3 years. Certainly, demand in the non-OECD countries; China and India in particular has been growing much more than the demand has been shrinking in the developed countries. Those factors on top of a decrease in the value of the dollar over time have played a role into the current prices. I can't explain every up and down in the market every day, but certainly I think our belief is that these are reflecting powerful fundamental forces.

Mr. NEUGEBAUER. I don't want to put words in your mouth, but I want to repeat what I think I heard you say. What I heard you say is your economists say the world is not producing enough crude oil, and the demand is increasing at a faster rate than the production. It is a supply and demand issue here, and that relatively for those things to happen, for that to change, you either have to reduce the demand, or we have to increase the supply; is that correct?

Mr. LUKKEN. That is absolutely correct, but also our job is to ensure that speculators are not driving this. So even if a small chance that it may be happening, it is worth overturning every rock to ensure it is not occurring, and that is what we are trying to do. That is why we are asking for the additional information, the additional transparency to ensure that it is fundamentals that are driving these prices.

Mr. NEUGEBAUER. I think you brought up another issue, and one which we discussed, and that is that the oil is traded in dollars, and the dollar has dropped pretty significantly over the last 2 or 3 years. And really the rest of the world is not paying $130 a barrel, but in many cases considerably less depending on the currency. And so basically, if the dollar were stronger, oil would actually be a much lesser price; is that correct?

Mr. LUKKEN. Our economists believe it is a factor.

Mr. NEUGEBAUER. And some people say that if you were to wave your magic wand and take all of these unregulated markets, put it under your umbrella, that oil would drop $30, $40, $50 a barrel. Do you believe that is true?

Mr. LUKKEN. I don't think there is a silver bullet here. I wish there was. But certainly there are steps we can take, measures we can put into place to ensure that somebody is not trying to game the system to the disadvantage of consumers. But I am not certain that anything that we do will end up affecting the price of crude oil.

Mr. NEUGEBAUER. And so really what your job is going to be is to determine if the markets are transparent, number one, and second, that there is not anybody gaming the system. And so if you answer those two questions, then the current price of oil is the current price of oil. Is that——

Mr. LUKKEN. I certainly think that transparency and sunshine are healthy for markets. That, what we are trying to do is to ensure that everybody is being seen and treated fairly no matter where the point of entry into the central marketplace. And, that is why we have addressed the foreign boards of trade issue, why we have addressed the exempt commercial market issue with the help of this Committee, and why we are looking into the swaps issue to get more information. We want to make sure that no one is trying to evade limits or controls in place, and we are taking steps to do that.

Mr. NEUGEBAUER. Thank you. I yield back.

The CHAIRMAN. The gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you very much, Mr. Chairman.

Welcome back again, Mr. Lukken.

I would like to get to about a couple of points, but before I do, I would like to address the ICE situation very quickly, get your response to a few things that I want to clear up and make sure the record is clear.

First of all, you would agree that ICE Futures of Europe, while owned by ICE in Atlanta, is indeed a completely autonomous company with its own Board and has been regulated by the Financial Services Authority for over 25 years?

Mr. LUKKEN. Yes, it is.

Mr. SCOTT. Okay. And would you also agree that it is—is it not true that the WTI volumes did not rise on ICE Futures Europe and London but actually decreased slightly as prices skyrocketed upward?

Mr. LUKKEN. That is correct.

Mr. SCOTT. All right. And when we look at market share, that ICE has 15 percent market share, and if you look at the open interests and options and positions combined, which is generally accepted as the true price driver for the contract; NYMEX holds 85 percent of this market. Wouldn't this indicate that this does not represent a flight of speculation to the London market or a pace driver as the prices increase significantly?

Mr. LUKKEN. We have not seen a flight to London as a result of the price increase.

Mr. SCOTT. And also, if ICE adheres to the new regulations that you propose and the Financial Services Authority agrees, will ICE effectively be playing by the same rules as the United States NYMEX?

Mr. LUKKEN. In regards to large share reports and position limits, yes.

Mr. SCOTT. And is any further regulation needed on that point?

Mr. LUKKEN. In our view, to surveil the markets to prevent manipulation, no.

Mr. SCOTT. All right. Thank you.

Now, let me just go, generally—I appreciate that. I wanted to clear those points up for ICE.

Let me go to this. Recently, as a matter of fact, on Sunday, they had this meeting in Jeddah, Saudi Arabia. And at that meeting, the Saudis agreed to go ahead and increase their output up to really, right now, first 300,000 in May, and then now another 200,000 barrels per day, so their output is 9.7 billion barrels a day.

Now, the issue becomes, what is causing this price volatility? We say it is a problem of demand, supply and demand. And they made a point of saying that—and I want to get your opinion on it—that they blame billions of dollars of investment in oil as a hedge against the weakening dollar.

And given the fact that the world's oil market is traded in our currency, the dollar, which is weakening, what role is that playing in this price volatility?

Mr. LUKKEN. Obviously, the dollar is not something the CFTC normally gets involved in talking about, the policies surrounding a weak or strong dollar. But our economists certainly consider it a factor in the price of crude oil currently.

Mr. SCOTT. Okay.

Now, finally, you asked for additional resources, particularly in personnel and funding, so that you could complete your mission. I think we have worked on that. We also have crafted some solution for many of these issues with CFMA reauthorization which is contained in this farm bill.

So, in your opinion, do you think it may be more prudent to wait for the new regulatory authority given to you in the farm bill that we just passed, along with the additional resources we have given you through our appropriations, to take effect before we move with more regulations?

Mr. LUKKEN. I do. I mean, I think this is something that, in a bipartisan way, that Congress came to enact as part of the farm bill. Let's allow it to come into law and to implement it before we start revoking it or repealing it. I just think that it should be implemented after the enormous amount of work that went into it, the thoughtful work that went into it, to ensure that these markets are working correctly.

Mr. SCOTT. Now, finally, my time is up, but how—and you are approaching, and we want to get transparency—how, very specifically, do you plan to achieve greater transparency and regulation?

Mr. LUKKEN. Well, on the foreign boards of trade issue, we are now going to get better data from ICE London and be able to put that into our Commitment of Trader Reports, hopefully, soon.

Also, we're looking into the swap dealer market to find out what that business is doing, and hopefully bring greater transparency to some of these transactions as well.

So I think, again, transparency is imperative to well-functioning markets, and those two steps are going to take our efforts along that way.

Mr. SCOTT. Thank you, Mr. Lukken.

The CHAIRMAN. I thank the gentleman.

The gentleman from Louisiana, Mr. Boustany.

Mr. BOUSTANY. Thank you, Mr. Chairman.

First, let me applaud you, Chairman Lukken, for your vigorously leadership in creating this interagency task force. This is very welcome news, and we look forward to hearing further what the findings are going to be.

Also, I want to applaud you on implementing the mutual recognition program. I think it is a very important step.

Given the very tight supply and demand equation, which we all acknowledge, and the fact that Venezuelan production is undergoing degradation, and Mexican production is undergoing degradation, we are seeing a shift toward heavy oil from light crude, clearly we all recognize this tight supply-demand problem.

Does that amplify the volume of trading and the degree of speculation that occurs in the market?

Mr. LUKKEN. I think it certainly amplifies potential volatility of the market. So, any little bit of information with these tight conditions can have significant price swings, which we have seen in recent days.

So I am not sure whether we have seen any additional speculative interest. Over a long period of time, we have obviously seen more speculators. I think, over the last 3 years, it has been about two percent more traditional speculators in the markets, which is growth but not significant growth.

Swap dealers have grown considerably, about seven percent during that last 3 year period of time.

So, yes, I think there is a lot. During this price run-up, people are looking to manage risk and speculate. But that also could be very healthy in bringing the right information to the market, so that liquidity is an important function of our markets and helps to make sure they are efficient.

Mr. BOUSTANY. You have mentioned that in answers to previous questions, as well, and also focused on the transparency side. I guess I am concerned that if we try to implement regulations and arbitrary caps on these markets, could we drive business outside of U.S. jurisdiction, which, if you couple that with the weak dollar and also the potential that we are hearing about to shift oil transactions from dollars to potentially Euros, that could be devastating for the U.S., could it not be?

Mr. LUKKEN. Absolutely. And these markets, as you know, are electronic markets, they can go anywhere; most likely, to developed countries such as the U.K. I mean, we certainly know that there is a market there that would be willing to take our benchmark away from us. Hong Kong and others around the world would be willing to list any of these contracts electronically.

So I think it is a better tack to ensure that we engage: others around the world, make sure the standards are proper and the highest around the world, ensure that we are getting the right information and have the right controls in place, so that no one is able to manipulate prices.

Mr. BOUSTANY. I guess I am concerned, because I have read that Dubai is looking at two potential electronic trading venues, which is more diversification in this “globalized” market. But if that were coupled with a shift from dollars to Euros for transactions, and possibly even other currencies, this could really add tremendous complexity to what your job is going to be. But, clearly, I think it would be detrimental for U.S. interests in the long run.

Do we have a clear-cut—well, maybe that is the wrong adjective. Do we have an agreed-upon definition of "excessive speculation?"

Mr. LUKKEN. The Commodity Exchange Act mentions "excessive speculation" in the preface of wanting us to put speculative limits onto certain contracts, but has no defined concept in the Act.

Mr. BOUSTANY. Okay. So that is still somewhat of an arbitrary distinction that is codified?

Mr. LUKKEN. Correct.

Mr. BOUSTANY. Okay.

And one final question. With regard to the Enron loophole—and, clearly, we took steps in the farm bill—how long do you think it will take to implement what was codified in the farm bill?

Mr. LUKKEN. We are working as fast as we can, but I think we were given 180 days in order to come out with the first proposed rulemaking in that area. And so we are going to meet those deadlines.

Mr. BOUSTANY. I thank you.

And I yield back. That is all I have.

The CHAIRMAN. The gentleman from Georgia, Mr. Marshall.

Mr. MARSHALL. Thank you, Mr. Chairman. Thank you for holding this hearing. Also, thank you for putting off the markup and planning to move this thing a little bit more cautiously down the line. I think we are playing with something that is terribly important to our markets, to ag, to the consumer, and we don't want to mess it up.

Mr. Lukken, glad you are here. You, in your testimony, described the deal that has now been struck that would require additional information from ICE Futures and consequently make the information the CFTC is receiving from ICE Future comparable to what the CFTC receives from NYMEX. Consequently, you kind of feel that CFTC has what it needs in order to properly supervise the activities of ICE Futures.

I am curious as to how that deal came about. Was it FSA insisting upon the deal?

Mr. LUKKEN. Absolutely not. It was the CFTC trying to work with the FSA to reach this agreement.

Mr. MARSHALL. Well, I guess I am kind of curious to know whether or not the agreement was actually reached with ICE Futures Europe.

Mr. LUKKEN. It was. It was. This is something we worked with both parties to reach an agreement on.

Mr. MARSHALL. Well, why would FSA even have been involved, actually? It seems to me that the question was whether or not ICE Futures was going to agree to regulations, that it didn't have to, since it was a European-based or British-based entity, and that you would have worked directly with ICE to get ICE to agree that ICE Futures would be subjected to this. And then, in your testimony, you described it as an announcement made by CFTC and FSA.

Mr. LUKKEN. I think I described it as a consultation with the FSA, and that is probably the proper term; that we worked with ICE to reach the agreement, because these were linked contracts with U.S. markets. But we, as we always have to do, is ensure that the foreign regulators, who are the primary regulators of these markets, understand why we are doing it. And that is what we worked with them to understand.

And so, they have the ability—this will be a rule change on ICE. FSA will have to review that rule change. We wanted to make sure they were properly informed and consulted on the issue, so that they understand why the CFTC was asking for this additional requirement.

Mr. MARSHALL. Are you saying that you had to have FSA involvement in order to accomplish the objective, or you wanted to have FSA involvement?

Mr. LUKKEN. Well, our No Action letter does not require that we involve FSA.

Mr. MARSHALL. I understand that. But the way you got ICE to agree was by talking about the No Action letter and saying, "Hey, look, under the circumstances, we are going to have to"——

Mr. LUKKEN. Correct. That is correct.

Mr. MARSHALL. Okay. It just seems to me that it would be wonderful if we could somehow manage to develop a better working relationship with all of the regulators around the globe, and a good start would be our British counterparts. And I applaud you for heading in that direction by involving FSA as much as possible.

But, just for the record, it seems to me that CFTC worked with ICE Futures to accomplish this. And that is principally what happened. It wasn't that FSA concluded all of a sudden that this is information that needed to be provided. It is that the CFTC decided that this is information that needed to be provided, and you worked with ICE to get that done.

Mr. LUKKEN. That is absolutely correct. But then we also worked with our foreign counterparts to ensure they understood what was going on.

Mr. MARSHALL. Okay.

The Chairman has already mentioned this September 15th date for you to report back the results of your investigation is troublesome for us. Is it possible for, say, staff from the Agriculture Committee to be assigned to be involved with your staff, as you go through the process here, so that we can get feedback earlier on how this is evolving, what direction does it seem to be headed in?

Mr. LUKKEN. We will certainly consult with this Committee, as we start to make progress. The reason the target date is September 15th is that we are not going to start getting the data until late July from these organizations.

And, again, these are multi-billion dollar books that are not in standardized futures terms, but in individually negotiated contracts that we will have to convert into contracts that we understand. So this is going to take a bit of work from a staff that is already pretty strained, trying to get our arms around all these initiatives.

The hope is that it can be completed by September 15th. If we can do it earlier, we will. But, certainly, it is a good idea to consult with the Committee staff early on.

Mr. MARSHALL. As you know, there are a number of credible folks out there that are arguing that the run-up is partially due to these index funds. We have talked a lot about that.

It would be very helpful to me if you or somebody on your staff could perhaps share with the Committee itself something in writing which, in layman's terms, describes why this is wrong-headed.

You know, the idea that a lot of money that wasn't in a market comes into that market and yet doesn't cause an increase in prices in that market is a little odd. I mean, it is just not intuitively obvious. And if you could, in a very simple, straightforward, anybody-can-understand-it way, provide us with a description of why that is the case, as your staff and you seem to be contending, it would be enormously helpful to all of us.

Thank you, Mr. Chairman. I am beyond my time.

The CHAIRMAN. I thank the gentleman.

The gentleman from New York, Mr. Kuhl.

Mr. KUHL. Thank you, Mr. Chairman. Once again, I would like to also thank you for holding this hearing and join with Mr. Marshall and other Members who say that your wisdom in putting off the markup on some of these bills is great and is to be complimented. Because I think it will allow us to really cover the issue completely in a couple of weeks, as things become more apparent.

And thank you, Chairman Lukken, for being here.

I just want to clarify, I guess for probably about the fourth time, what I thought I heard you say, because it is not what I am hearing from people back home. And that is that I thought I heard you say that speculators are not a reason for the increase of the price of oil. Was that what I heard you say?

Mr. LUKKEN. That, yes, our economists that look at this feel that the fundamentals of supply and demand are the principal reason behind the price.

Mr. KUHL. How do you explain—how do you suggest I explain to people back home when they say, "Oh, it is those speculators making millions upon millions of dollars that are driving up the price of oil." How would you explain it from your position and knowledge as a regulator?

Mr. LUKKEN. Well, I think speculators, as this Committee knows, provide a healthy mix of participants in the market to ensure there is a buyer for every seller and a seller for every buyer. That has been the case for the 150 years that these markets have been around.

Our job has been, always has been, to put proper controls in place on speculators. So that is what we are trying to ensure, that there are proper controls, to ensure there is not too much speculation in the market, and that the commercials are getting the prices they need to manage risk.

And so, that is the exercise that we have been undergoing over the last year; first, dealing with exempt commercial markets, most recently with foreign boards of trade. Now we are turning to swap dealers and whether there is anybody evading limits there.

So we are taking steps to ensure that markets are not being overrun by speculative interests. But, to date, we have not seen evidence of that. As my chart shows, these people are flat in the market. They are not all on the long side of the market, betting it will go up. So it is difficult to say there is a smoking gun there. But we continue to look.

Mr. KUHL. Okay.

And just for my own curiosity, when you look at speculators and their activity as a regulator, what would stand out, from what you are able to observe, that would indicate to you that there was a speculator trying to game the system?

I mean, you have had that experience in the past, I am sure. It is not necessarily in the energy commodities but in other areas. How do they do that?

Mr. LUKKEN. Well, typically, they hold a large controlling position in a market, particularly in the delivery month. When there is a threat of delivery of the physical product and they are holding a large position—and they may also be holding a large position elsewhere. They may benefit from driving down prices or driving up prices.

And so, famously we saw this with Amaranth, where they tried to push down prices, using the futures markets as the mechanism to push down prices, but they held a large position in the over-the-counter market that would profit as a result of their action. So they may have lost money in one market, a small amount of money, but they made a lot of money elsewhere.

And so we have tried, through the efforts of this Committee, to ensure we are seeing all of those different pieces, whether it is exempt markets, whether it is foreign markets, whether it is the regulated marketplace, to ensure somebody is not gaming one of those markets off of each other.

Mr. KUHL. And you also mentioned that your economists had looked at the influence, if you will, of the declining dollar over the years. And I am curious as to whether or not you are able to quantify that in any way. Can you say that over a set period of time, say, the last 2 years, that the dollar has lost ten percent of its purchasing power and, as a result thereof, the price of oil has gone up ten percent on the other side? And how do you figure that into the mix of looking at speculators?

Mr. LUKKEN. We can provide you with some different figures on this. I will ask our economists whether they have been able to quantify it. But it is significant.

Mr. KUHL. Okay.

And last, I am not familiar with swap transactions or swap traders. Can you tell me a little bit about that?

Mr. LUKKEN. Well, if you are a commercial business, let's say you are a refinery or United Airlines. You have risk on the price of crude oil and gasoline and fuel oil and other things, and you may go to a Wall Street institution to help you manage that risk. And they could get into the risk-management markets, both the futures markets and the physical markets even, to help you manage the risk in those markets. So it is a very customized product, tailored to the needs of a different client.

And what those swap dealers do at the end of the day is they combine all of these clients together and, through their risk-management systems, come up with a net figure that they need to come on to the regulated markets in order to manage.

So the regulated markets provide a standardized way for them to come and manage risk on a regulated exchange. And it has proven to be very helpful over the years to help those institutions do that.

Mr. KUHL. Okay. I think I understand it a little better now.

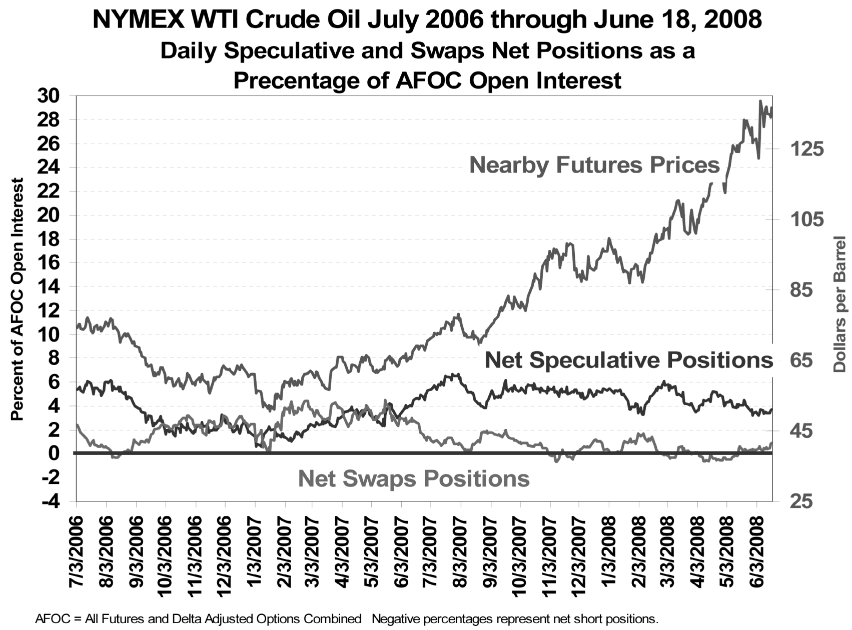
Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. I thank the gentleman.

We are finally using some of our technology here. You can see this on the screen, Mr. Lukken.

And maybe you could comment on this chart. I am not even sure where this came from. But this has been shown to me before, where it shows the net swaps position really haven't changed, that the net speculative positions—it looks like it kind of tracks the price until it gets to about October of 2007, and then there is a divergence that happens from then on, where the speculative positions stay the same and the price goes way up.

Is this an accurate chart? And maybe this comes from your information; I am not sure.



Mr. LUKKEN. This is our information.

And the net speculative positions, again, these are the traditional speculators that everybody thinks of speculators in the markets, those day traders and hedge funds that are in the markets.

The net swaps position, again, are these swap dealers that are managing the risks of different clients in our markets. That is, swap dealers are the institutions that bring index funds, the pension funds, the endowments. They bring those into the marketplace.

So as you can see, swap dealers have obviously a lot of short positions that they are also bringing to the marketplace, as well as the long index money. So we have seen them virtually flat the market over the last year or so during this price run-up. That seems a bit counterintuitive to what we would expect. We would think that if they were pushing up prices they would be very long in the market.

Again, with net speculative positions, they are also relative flat. They are averaging about four percent net long over the same period of time.

So, again, we are trying to figure out whether this data points to a smoking gun by any participant type. And it really has not shown that any one of these participants seems to be driving the markets higher.

The CHAIRMAN. If people will indulge me 1 more minute here.

What about this information that people keep putting out that we have, like, $260 billion more money in the market than we had 5 years ago? You know, and they are blaming these swaps and whatever for that, pension funds. But these charts don't seem to indicate that. Where is that $250 billion? Where did that come from?

Mr. LUKKEN. Well, there are not very accurate figures in regards to the amount of money coming into index funds. Index funds are primarily an over-the-counter contract. They are not traded into the futures markets directly. And I think a lot of the $260 billion figure that has been quoted, much of that is just the appreciation of the commodities themselves. It is not necessarily new money coming into the marketplace.

So a lot of that is coming directly to swap dealers. Swap dealers are entering into these transactions, selling their Goldman Sachs commodity index to different individual pension funds and entities, endowments out there. But then Goldman Sachs turns around with a variety of other client businesses and comes to our markets. And you could see, based on the swap position data, they are bringing a lot of short positions to the market, most likely commercial businesses.

So commercial businesses, although they have shrunk as a percentage in the futures markets over a period of time, some of them may be coming through swap dealers now, because they are given certain client services that they get through swap dealers that they may not get through directly investing in the futures market.

So this is all something that we are going to get better information in the coming weeks from swap dealers, so that we can make informed decisions on what controls, if any, need to be put onto that type of business.

The CHAIRMAN. Thank you.

The gentleman from Georgia, Mr. Barrow.

Mr. BARROW. I have no questions, Mr. Chairman.

The CHAIRMAN. All right.

Mr. Donnelly from Indiana.

Mr. DONNELLY. Thank you, Mr. Chairman.

Thank you, Mr. Lukken, for being here, and I appreciate your presence.

Let me ask you this: What do you believe would be the impact on the price of oil and gas if you increased the margin requirement to 35 percent?

Mr. LUKKEN. Well, margin in the futures market is used to manage the price risk for the clearinghouse, so clearinghouses in futures markets set a margin to ensure that one default by any trader will not take down the clearinghouse. It has been very effective over the 150 years that margins have been used for this.

I am not certain that raising margins would have the effect that people would like it to have, which is driving down prices. It certainly would be a cost of doing business, may drive businesses overseas to London markets and unregulated markets. I think that is dangerous.

Certainly, the other thing is that they think it will drive index trading out of the market as a result of this. Well, these pension funds have a dollar for every investment in the futures markets, so they have the ability to meet these margin calls. So I am not sure it actually would have the effect of driving them out of the markets.

Mr. DONNELLY. How about requiring the ability to take physical possession?

Mr. LUKKEN. Well, speculators are necessary for the markets. I think if you had the provision that only those that were commercial businesses in the market, it would be a one-sided teeter-totter. I mean, there would be no one on the other side of the transaction to be the buyer of every seller or the seller of every buyer. So we have to have healthy speculation in the markets in order for these markets to work.

But, yes, we have controls in place, especially during expiration, to ensure that speculators are getting out of the markets at the end, when they need to be out of the markets, to ensure that the price discovery function is working.

Mr. DONNELLY. Well, let me ask you this: Has the mix of people with these contracts gone much more heavily toward the speculative side over the last 5 years?

Mr. LUKKEN. It certainly has.

Mr. DONNELLY. And doesn't that have a dramatic effect on the price? Or do you feel it has no effect?

Mr. LUKKEN. Well, that is something we are studying. The traditional speculators, over the last 3 years—I have the data for that—they have increased from about 34 percent of the market to 36 percent.

The swap dealers are being lumped by some in with the traditional speculators. Again, we don't know how much of that swap business is commercial business or speculative business or index trading. So that is something we will have to determine to find out what exactly is the mix in our markets currently.

Mr. DONNELLY. Well, do you think—and bear with me, because I am not an expert on this like you are. However, do you think that when a Southwest Airlines or another organization comes in to hedge their costs, by actually being in a market that has a number of speculators looking to get out in the next few months thereafter, does that not make it much more difficult and more costly?

Mr. LUKKEN. Well, if there are not speculators bringing liquidity, it does make it difficult for them to get out of positions. And Southwest famously locked into the price of oil, I believe, through a swap dealer in order to lock in those prices, who then came into our markets to help manage that risk. United Airlines does the same with Morgan Stanley.

So there are lots of commercial businesses that are using swap dealers to manage risk. We are going to get better information so we can make better-informed decisions in the future.

Mr. DONNELLY. And I have talked to some folks who I would call expert on this who have indicated that—people involved in airlines and others, who have indicated that they felt that at least $40 a barrel was attributable to the increase in the speculative dealers increasing so dramatically into the market.

Would you disagree with that?

Mr. LUKKEN. Well, there are lots of views, obviously, about where the price should be, some above the current price; I hear from those folks on occasion. We certainly hear about the ones that believe it should be lower.

So our job is to ensure that the markets are reflecting fundamentals of supply and demand. So I can't say that I know what the correct price is. I let the markets do that. But our job is to ensure the markets are trying to do the best they can to function to reflect current market prices. And that is why we are taking these additional steps, to ensure of that.

Mr. DONNELLY. And if I could ask you one more question—and I sure appreciate your pointed answers. Am I wrong in saying that, in the last month or so, the tracking has indicated supply, on almost a daily basis, has exceeded demand?

Mr. LUKKEN. Well, I would certainly—again, I am not an oil analyst expert, but these are certainly tight, tight fundamentals. So we do have some good news on occasion, which is helpful. But certainly these tight markets have kept it in the range of the $130.

Mr. DONNELLY. Well, you mentioned that you focus on supply and demand. And am I wrong in saying that supply has exceeded demand on almost a daily basis recently and, at the same time, we have seen the price increase go up?

Mr. LUKKEN. I do have our Chief Surveillance Economist that might be able to give a little more data on what he is seeing directly in the markets.

Mr. FENTON. Well, I think we have not seen supply going up more than demand. U.S. crude oil stocks have actually gone down in recent weeks.

Mr. DONNELLY. Demand usage drops and supply increases. So what you are telling me is your experience is that you have seen demand actually outstrip supply recently?

Mr. FENTON. Stocks are going down, which is an indication—crude oil stocks are going down in the United States. It is true that, for the first time, there seems to be an effect in demand of higher prices, in particular in gasoline consumption.

Mr. DONNELLY. Has there been a drop in demand?

Mr. FENTON. There has been.

Mr. DONNELLY. And have supplies dropped, as well?

Mr. FENTON. U.S. crude oil stocks have dropped.

Mr. DONNELLY. Thank you very much.

The CHAIRMAN. I thank the gentleman.

The gentleman from Texas, Mr. Conaway.

Mr. CONAWAY. Thank you, Mr. Chairman.

Mr. Lukken, the December 2007 investigation that you started, is that the report that will come in September, or is that something else?

Mr. LUKKEN. This is an enforcement investigation, so this is looking into allegations of manipulation that are occurring in the markets.

Mr. CONAWAY. Okay. And that investigation is proceeding the way you hoped it would?

Mr. LUKKEN. Absolutely.

Mr. CONAWAY. Okay. We looked forward to that hard information or, actually, facts, because an awful lot of the talk show hosts and the talking heads simply make stuff up and then act like it is the real deal. I mean, if I told you that redheaded chickens were the reason—my colleague asked what to say to his folks back home that make erroneous statements. And the first thing to tell them, "You are making a wrong statement."

Here in America, we sometimes think we are the absolute center of the universe, with all of our regulatory changes. The recent dustup in the *London Times, Financial Times*, about this proposed regulation that we would require ICE Futures Europe to do some things unilaterally, and that some guy named—Economic Minister Ed Balls has some sort of a clause that, "Use of the Balls clause"—this is in an article in yesterday's *Financial Times*—"Use of the Balls clause would be a nuclear option. But it is time for the FSA and the U.K. Government to remind the U.S. Senate—and, by extension, us—that they know the launch codes."

What is your reaction to their being miffed at our considering additional regulations?

Mr. LUKKEN. I think it is imperative for us to try to engage our foreign counterparts. I think this recognizes how global these markets currently are.

And so, for us, the FSA is a strong partner of the CFTC. We talk to them almost daily about these markets, what is going on with them, about what is going on not only in ICE but also the LIFFE exchange, another important futures market based in London.

And so, for us, we have to engage. We can't turn away from foreign regulators and require everybody to come to the United States to register. There are certain things and requirements that are important that we have to get from different foreign counterparts that may be trading products linked to the U.S. products, but there could be retribution, as you are noting.

If we start down this line and start requiring everybody to come to register in the United States, our exchanges will have the same put on them elsewhere around the world. And our exchanges are trying to break into those different countries around the world.

So I think it is a dangerous road to go down. It is better to try to engage foreign regulators to raise foreign standards.

Mr. CONAWAY. Okay.

Help me with the math. You said that the growth in speculators was up two percent. That is two percent in the number of people doing it, the positions?

Mr. LUKKEN. That is market share, market share of types of participants.

Mr. CONAWAY. Okay. And the swaps were then a seven percent increase in market share? Okay. Thank you.

Our Chairman said earlier that we might not have time to gather facts before we pull the trigger, or something similar to that;

ready, aim, fire. I am hoping that his deliberate approach in July will act as a cooling agent on some of the hot-headed folks perhaps on the other side of the building, that we could, in fact, gather facts and understand what we are doing before we pull the trigger on some wide-sweeping regulation that we don't know what impact that it does have.

I yield back.

The CHAIRMAN. I thank the gentleman.

The gentlelady from Kansas, Mrs. Boyda.

Mrs. BOYDA. Thank you very much, Mr. Chairman.

And thank you for your testimony today.

You have been in front of me before, and I have said I am really trying to get my head around all of this. So I am going to ask you some questions, and we will see where this goes.

And I appreciate very much that we are having this conversation today. When one person sits in front of me, I am going, "Wow, that is interesting. There is one person."

And so we have a number of credible sources that are saying oil is X number of dollars, $30, $40, you pick what they are saying.

Could I ask you to do your level best to move into a chair right next to yours and act like you were they for a moment and tell me what they would say?

Mr. LUKKEN. I think there is an instinctual feel about what is going on in the markets, that it has to be something other than supply and demand. And I understand that. I am sympathetic with that.

Mrs. BOYDA. Are these people who don't understand your job, then?

Mr. LUKKEN. Well, some of them are in our markets, but a variety of them come from other fields, but aren't specific to the futures markets.

And they are different animals; I mean, I think that is important to point out. In the securities markets, there can be a win-win when somebody buys and sells a stock. Both the buyer and the winner or the buyer and the seller can profit as a result of that transaction. In the futures markets, they are zero-sum gains. For every dollar that is gained, there is a dollar that is lost at the end of the day.

In the long run that makes sure that the right information is getting into the market. If you are wrong, you are not going to be in the business very long. That is why it is important to understand that it is not necessarily only buy pressure that is going to lead to higher prices.

Mrs. BOYDA. Let me just ask another question. When I look at these swap positions down here, from what I understand with China and India just growing and their energy usage growing in really just exponential ways, if we were just talking about a market-driven scenario here, supply and demand and the perfect market, my hunch would be that the price would continue to go up.

And so you have some huge positions here that are swaps, and they are betting that they are going to go down. Which, again, would say to me intuitively, if this is just a market position, then do we see plug-in hybrids taking over? Are we going to have electric cars, hydrogen vehicles soon, while these contracts are still taking place?

So we don't have any short-term solution to a real energy crisis. And so, in my mind, demand is going to go up and—do you see where I am going with this?

Certainly, demand is going to go up worldwide. We don't see any real quick fix to say we are going to have production go up that fast. So if I were a betting woman, if we are just working in a—then I would say, "Boy, I bet demand is going to go up." Half of the people who have the biggest positions in here say that it is going to go down, and I have to wonder if they know something that I don't know.

Mr. LUKKEN. Well, certainly, demand destruction is beginning to happen in some of these markets. We are seeing, for example, in the United States, people changing behaviors in order to——

Mrs. BOYDA. But we don't see any of those really. I think we all agree that there probably isn't going to be any real short-term dynamic change in the market.

Mr. LUKKEN. But we are seeing, for example, with China's recent announcement that it is going to stop subsidizing gas, potentially raising up to 20 percent the price of gasoline in China, that is going to have real effect on people, whether they drive and consume energy in China. Others may follow suit.

So we are going to see—supply is difficult. It takes a longer-term view. But on the demand side, I think you are going to see some demand destruction going up.

Mrs. BOYDA. Can I just ask one other question too? When you say you get the speculators out of the market when it gets close to the delivery date, what does that mean?

Mr. LUKKEN. Well, speculators, at the end, when the futures price becomes the current price they have to get out of the marketplace.

Mrs. BOYDA. And do you know that these are speculators only? Do they identify themselves as speculators?

Mr. LUKKEN. They identify themselves. And they have to get down to certain positions at the end to ensure that they are not controlling a large enough futures contract that could manipulate the market.

Mrs. BOYDA. Let me just ask one more question then.

Mr. LUKKEN. Sure.

Mrs. BOYDA. It seems like these swap positions are pretty huge; they are big. And yet you say that—and I am really just trying to understand—but you say, we want to make sure that there isn't anything that could, in fact, sway the market.

Why would these swap positions, which represent huge, huge monied interests, why would they not be able to affect the market?

Mr. LUKKEN. Well, typically they are aggregating a lot of clients. So instead of the entire group of customers going to the futures market individually, they can combine all of their positions with one entity and have them manage the risk in the futures market. That is what swap positions do: they have people who are long, they have people who are short, and they combine all of these at the end of the day and manage their risk in our markets.

What we are doing is unwinding all of these to find out if there is any individual client of these swap dealers that may cause us concern, that they are moving markets, evading limits, all the things that we look out for. This is something we are going to get back to this Committee with as quickly as possible.

Mrs. BOYDA. All right. Thank you.

The CHAIRMAN. I thank the gentlelady.

The gentleman from Nebraska, Mr. Fortenberry.

Mr. FORTENBERRY. Thank you, Mr. Chairman, for holding this hearing.

And thank you, Chairman Lukken, for appearing today.

Let's go back again to the essential question. On Monday, a hedge fund manager and oil company advisor testified on Capitol Hill that it was his perspective that the increased regulation would drop the price of a barrel of oil to $65–$70 in about 30 days.

With that said, this is not meant to be a challenge to you, but I want to unpack precisely what you are saying, because it seems to me you are saying two things. One is, you do believe that the futures markets are an accurate indicator of underlying fundamentals. And yet, at the same time, you have pointed to the fact that there has been an enormous increase in speculative activity, that speculators actually hold a higher percent of overall market activity. It was very important to act on closing the Enron loophole. You are concerned about transparency, particularly in the swap markets.

So that indicates that, again, there is a reasonableness of concern that speculative activity, or the acceleration of speculative activity at the moment, leaves the question as to whether it is a driver of price, creating an artificial price beyond the underlying fundamentals.

I would like you to respond to that.

Mr. LUKKEN. We do not have any direct evidence that speculators or index money seems to be moving these markets.

And the way we look at this—and the data is very good with the agricultural markets—we look at a variety of different agricultural products that have large institutional money coming into them. And so this is corn, soybeans, hogs, cattle, all of them.

The largest, percentage-wise, of the markets that have institutional index fund money in them are cattle and hogs, around over 40 percent. And so you would think, theoretically, that they would have the highest prices of all, as a result of this institutional money. Until recently, it has actually been negative. It is in positive territory now, but they are certainly some of the weaker commodities that we have seen with all this institutional money.

If it is correlated, you would think we would see higher prices. We see other markets with no institutional money, such as the Minneapolis Grain Exchange and wheat. So no index trading is going into those markets. Again, huge price run-ups in those markets, without any of this buy-side pressure that is being talked about. And so, why is that occurring?

Of late, for the last 3 months, we have actually seen a decrease in index money in the agricultural markets. It is flat or slightly decreasing over the last 3 months during price rises for commodities.

So, again, we are looking for a smoking gun. We have not found it. That doesn't mean we shouldn't continue to look, to try to get better data, to try to see if there is some correlation here. But, to date, we haven't found the evidence.

Mr. FORTENBERRY. I had looked into this question a number of weeks back, when we began to experience the significant spikes. And the economists, the analysts back then were saying $10–$40 is the effect of speculation in these markets.

And, again, let's go back to the testimony of this hedge fund manager who said increased regulation would drop it back to $65–$70 in 30 days. Now, there is concern there that this might push activity overseas, and we have talked a lot about that.

But let's tick through the types of regulation that this person would be referring to and look at the possible effects.

Mr. LUKKEN. Well, I think he is talking about banning institutional investment, so prohibiting pension funds and others from investing any of their money into the markets. I think that is a bad idea. I don't think we should limit the free flow of capital in a market system. I think there are ways that we could try to manage that money and develop best practices. That is something that we are thinking about. That is why we are trying to get better data in this area.

But to take drastic steps with the hope that this would drop prices in half, it is intoxicating, I agree. I mean, boy, if I were a consumer, I would love to hear that, that there are steps that we could take to drop prices in half. But I think we need to be measured, I think we need to be careful. Because, once these markets go, they may never come back.

Mr. FORTENBERRY. All right.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank the gentleman.

The gentleman from Ohio, Mr. Space.

Mr. SPACE. Thank you, Mr. Chairman.

Did I hear you or your associate correctly, that the supply of oil has been outpacing demand in recent history, the last 30 days?

Mr. LUKKEN. Supply has been dropping, the U.S. supply. I think we have had a drop below the 5 year average. It is much below the 5 year average of U.S. stocks.

Mr. SPACE. In response to a question that my colleague from Indiana asked, is supply being outpaced by demand right now, or is it *vice versa?* In the last 30 days, has supply been outpacing demand?

Mr. LUKKEN. Well, supply has been dropping. We had some drop-off in demand in the U.S. as well, and it is very difficult to measure. But, certainly, we have had indications that supplies are below the 5 year average.

Mr. SPACE. Okay. Maybe I misunderstood it, but I thought the response was that supply has been outpacing demand, at least over the last 30 days. Did I misunderstand that?

Mr. LUKKEN. You mean that supply has been increasing?

Mr. SPACE. Yes. Right.

Mr. LUKKEN. No, it has been decreasing.

Mr. SPACE. All right.

Speculation, from my understanding, at least, of your testimony, proper speculation is a necessary ingredient within the marketplace, right?

So when we talk about speculation, there are two kinds, as I, again, understand it: appropriate proper speculation or improper excessive speculation, which would be more attuned to manipulation. Is that correct?

Mr. LUKKEN. Well, manipulation and speculation are different concepts. Manipulation is one person or maybe a couple of people trying to intentionally move the market for profit without risk.

Mr. SPACE. Right. The example you used—I can't remember the specifics—seemed to be describing manipulation, as opposed to speculation.

Mr. LUKKEN. Right. And it is typically a short-term occurrence. You just need it to happen for a day in order to profit, and then you gain your profits.

I think what people are concerned about with speculation is, is there is an asset bubble occurring in a different commodity as a result of the types of participants in the markets.

Our tools have typically been used to prevent manipulation, not necessarily managing types of participants in our market, but this is something we are trying to get our arms around.

Mr. SPACE. Well, how would you define—speculation is different from manipulation. Perhaps even improper speculation is different from manipulation of the market. How would you define—I mean, I know that you indicated the that there has been no standard or definition—but how would you define "excessive speculation?"

Mr. LUKKEN. Well, I think "excessive speculation" is when the markets aren't functioning properly, that we see distortions in prices. And so, currently, I think our economists feel that the fundamentals seem to be explaining the markets.

But, certainly, at some point, I think you are right, I mean, excessive speculation can lead to markets not functioning correctly. But, to date, we have no evidence that that is occurring.

Mr. SPACE. That excessive speculation is occurring, or that, if it is, it is affecting market price?

Mr. LUKKEN. That is correct.

Mr. SPACE. The oversight and the enforcement and other goals that you outline in your testimony, will that provide meaningful control or prohibition against excessive speculation—not manipulation, but speculation?

Mr. LUKKEN. Which ones?

Mr. SPACE. Well, the oversight that you point to or the greater enforcement, will that provide a meaningful counter against, again, not manipulation, but excessive speculation?

Mr. LUKKEN. Well, certainly, trying to coordinate with others in government will help us to try to get a better understanding of this. So, in regards to what is going on in the foreign markets, that has an effect on speculators. And what we are studying now with the list of government entities that I laid out is trying to figure out whether these new participant types, like index funds and swap dealers, are having some structural effect on our markets.

Mr. SPACE. If they are having a structural effect, can we effectively regulate or eliminate them, in your opinion, and not put ourselves at a disadvantage in the international economy?

Mr. LUKKEN. Well, that is something that we would be striving to do. Certainly, we are going to look at all the tools that we have, once we get the data, and make a determination of what is happening. Certainly, that is going to be our first priority. If we need additional tools we will ask Congress for them.

Mr. SPACE. Thank you.

I have nothing further.

The CHAIRMAN. I thank the gentleman.

The gentleman from Wisconsin, Mr. Kagen.

Mr. KAGEN. Thank you, Mr. Chairman, for holding this very important meeting.

And thank you, Commissioner, for being here today. We have limited time, and I know you have limited time, but I want to express my gratitude for your public service.

Mr. LUKKEN. Thank you.

Mr. KAGEN. So I only have a few questions for you.

Mr. LUKKEN. Good.

Mr. KAGEN. The first one is a simple one. Do you believe in the free markets, free and transparent markets?

Mr. LUKKEN. I do, absolutely.

Mr. KAGEN. That is good. Do you believe that the Arabian kingdom and OPEC believe in free markets?

Mr. LUKKEN. I can't comment on that.

Mr. KAGEN. Well, isn't it a fact that Saudi Arabia and other members of OPEC manipulate not just the price but the supply of oil?

Mr. LUKKEN. Cartels are not free market organizations.

Mr. KAGEN. So we are really confronting a manipulative, government-sponsored, speculative oil marketplace, aren't we? Something you can't control anything about.

Mr. LUKKEN. I do not disagree.

Mr. KAGEN. So rather than being a Commissioner of a very powerful CFTC, you are like the sign in my neighborhood that says "Neighborhood Watch," which means that the neighbor is going to watch somebody rob me without doing anything.

So, in your recent past on the CFTC, how many people have you discovered were cheating the system? How many people have you caught cheating? And what sort of dollar amounts and fines have you levied?

Mr. LUKKEN. Well, over the last 5 years, in just the energy area in particular, we have had about 40 entities we have caught trying to manipulate or game the energy markets for about half a billion dollars' worth of fines.

Mr. KAGEN. Half a billion dollars.

Mr. LUKKEN. $440 million.

Mr. KAGEN. Does that $440 million go back to your Commission so you can hire more people, or do we have to tax people? Where does that money go?

Mr. LUKKEN. I wish it did. No, it goes to the General Fund at the Treasury.

Mr. KAGEN. All right. So we are working hard to get some of that money you found from cheaters from your Neighborhood Watch activities back into your Commission so you can beef up your policing activity.

Is it possible for anyone to cheat the system? And if so, if you were one of these market speculators, what would you recommend you and I do together to game the system to make money?

Mr. LUKKEN. We cannot prohibit people from cheating the system. There are going to be fraudsters, no matter where we try to close loopholes. We do the best we can to police them, and I think we do a very effective job at that.

But we also have to ensure that the regulated marketplace, the price discovery marketplace, is protected. And there are lots of different things that might be available to influence that, whether it is foreign exchanges, exempt markets, even the over-the-counter market where we can get information on a need-to-know basis through our rules.

So we are always trying to ensure that we have good information to make informed decisions and then to go aggressively after these people when they break the law.

Mr. KAGEN. Well, I appreciate that, and I appreciate the fact of you finding the cheaters whenever you can. But it is kind of like policing our border. We, in the Arizona region, may have caught 300,000 or 400,000 people trying to enter the United States illegally, but that doesn't tell us how many people slipped through.

Do you have any "guesstimate" about what dollar amount you are missing in fines because of cheaters you are not catching?

Mr. LUKKEN. I don't. But we could use more enforcement policemen on this job. If we do get additional funding a lot of those individuals will be going to our Enforcement Department, to ensure that we are litigating these people out of the business.

Mr. KAGEN. You have also mentioned earlier in your testimony that you do believe that we are seeing a supply and demand marketplace within the commodities exchange. Is that true?

Mr. LUKKEN. Correct.

Mr. KAGEN. So forget about the fact that it is a controlled marketplace with regard to OPEC and other countries, such as Iran, Mexico, and Venezuela, that may regulate and manipulate the supply of oil. Forget about the manipulation. Within what you are doing, you think there is an open marketplace, and you think that supplies of oil are adequate; is that true?

Mr. LUKKEN. I wouldn't say they are adequate, but certainly supply and demand factors are being reflected properly in our marketplace.

Mr. KAGEN. Because there is another government agency that would disagree with that. The Energy Information Agency has stated that, in January of this year, 335,000 barrels a day of diesel were exported by American companies because we had too much.

So, in the early part of 2008, when demand was going down, we were exporting diesel fuel, and yet prices went up. Can you explain that?

Mr. LUKKEN. Well, diesel fuel is a fuel that Europeans primarily use in their cars, but also China, as they build different entities and houses and whatever they are building, they use this in the heavy equipment that they use to operate their machines.

So the rest of the world is very demanding of diesel, and that is the reason that we were exporting it to those nations.

Mr. KAGEN. The other reason for the increasing surge in oil prices—and I use that word with every meaning that surrounds it—has to be the decline in the value of our purchasing power of the United States dollar.

Is it true that the dollar has lost 38 percent of its value *versus* the Euro in the last year? As an economist, would you agree with that?

Mr. LUKKEN. I am not sure on the exact figure, but it certainly has lost value over the last several years.

Mr. KAGEN. So, really, when we talk about the surge in oil prices, we really have to talk about all commodities, everything that we need to survive, whether it is food, shelter, clothing, whether it is paying for rent, electricity, everything that American citizens, the people I represent in Wisconsin, the price of everything has gone up. It is not just about oil, is it? It is about the fact that your purchasing power of the dollar has fallen down.

And wouldn't you agree, as an economist, that that is in large part because of this Administration's economic policy of borrow and spend and borrow and spend without paying their bills?

Mr. LUKKEN. Well, certainly, the dollar is a factor.

Mr. KAGEN. I see. So you wouldn't want to comment about the Administration's economic policy.

Mr. LUKKEN. That is above my pay grade.

Mr. KAGEN. All right. Well, maybe, with more funding for your CFTC, we could increase your pay grade to answer that type of question.

[Laughter.]

Mr. KAGEN. I see my time has expired, but I thank you for your openness and your honesty. And I look forward to beefing up your patrol, so you are no longer the Neighborhood Watch.

The CHAIRMAN. I thank the gentleman.

The gentleman from Florida Mr. Mahoney.

Mr. MAHONEY. Thank you, Mr. Chairman, for being here. And one of the problems with being the most junior Member on the Committee is you get to go last, and everybody takes your good questions.

Mrs. GILLIBRAND. You are not last.

Mr. MAHONEY. Almost.

A couple things. I wanted to really focus in on, first of all, this—we are talking about excessive speculation and the fact that in a year's time we have gone from $70 to almost $140 a barrel. That is pretty excessive. And we have talked about and I have heard other Members trying to justify drilling by demand *versus* supply. And I am a Blue Dog Democrat, so I am all concerned about fiscal responsibility, and obviously there has been a devaluation of the dollar, and all that is factoring into it. But you don't run the exchanges. Your job is to make sure that the people running them and the people participating in them are doing the right things.

Mr. LUKKEN. Correct.

Mr. MAHONEY. And in your testimony you kept on talking about these agreements with ICE. The first question I have is that if I were a sovereign fund, and I thought I came up with a strategy for trading oil futures, how many different places on this planet could I go to and purchase a futures contract?

Mr. LUKKEN. There are lots of futures exchanges around the world. Certainly in the western world there are multiple futures exchanges.

Mr. MAHONEY. So there are a lot of places that I could go to, and I don't even to have to trade directly, I could go through a dealer, right?

Mr. LUKKEN. Yes.

Mr. MAHONEY. My question to you, you are touting this agreement with ICE as a way to start to get your arms around who these traders are. When you take a look at the entire globe, what percentage of trades do you have visibility on in terms of who is making these trades and who is behind these trades?

Mr. LUKKEN. Roughly I think the U.S. has about 43 percent market share in the global-traded futures contracts.

Mr. MAHONEY. So you are seeing 43 percent of the entire pie. So if I am somebody and I am sitting back, and one of the things that is very interesting is we have gone from, what did you call it, a shout system where people would have to go down and bid. Now we have this global exchange, so somebody sitting in Dubai or somebody sitting in Los Angeles with a large amount of money, with access to these global information systems could have a system whereby they are basically arbitraging the various exchange rates around the globe; is that not correct?

Mr. LUKKEN. I think that is correct. I would like to point out, though, that any time it links back to a U.S. product, though, we have this surveillance system in place to try to get all that information. So if they are trading the Bund contract, the German long-term bond contract, in Germany, that is really not of interest of the CFTC. It is of interest of the BaFin in Germany that they oversee their markets. And the same with the London currency markets and other markets they may oversee. But if it has a linkage back to our markets, that is when our new process kicks into place, and we get the information, and they must obey U.S. position limits in order to get access to U.S. customers.

Mr. MAHONEY. It seems to me that up—getting back to fundamentals, we have had this huge influx of capital. Obviously people are buying contracts at higher and higher rates. This chart everybody looks at is interesting, but basically it is balancing out the longs *versus* shorts, which really doesn't get back to excessive speculation in terms of people trying to game the system. And we are trying to manage this, and you are trying to manage this, and you don't have the tools or the authority to really have transparency in the market; is that correct?

Mr. LUKKEN. I think we do of the things where there is a public interest. I mean, I don't want to have to be overseeing the Japanese yen commodity regulator.

Mr. MAHONEY. I am talking about things like corn, things like oil. You are trying to figure out how to be able to see who is doing the trades and are behind the trades, but you only see 40 percent of that today, correct?

Mr. LUKKEN. Of those types of contracts we see 100 percent of the on-exchange activity. The crude oil markets, the New York and London, we are going to see all that. The agricultural markets are primarily here, so we see all of that. The ECM markets, the exempt commercial markets, where natural gas is traded as well as New York, due to the leadership of this Committee, we are now going to see that data as well.

Mr. MAHONEY. And when you see the data, the transparency, what are you looking at? Are you looking at who the dealers are who are doing these transactions? Or are you actually seeing who the people who are who are actually placing the orders?

Mr. LUKKEN. Of the people who are coming onto our markets directly, we are seeing the end-users, no matter if they go through a middleman or not. The swap dealers, we are going to ask for that information even though their clients are not trading futures positions. We are going to break that out so we understand what positions to bring greater transparency to those types of dealers.

Mr. MAHONEY. And is it possible that—last question. Is it possible that a big sovereign fund could take advantage of the world market and the arbitrage opportunities and, given the volume that is out there on any given day, could be a force in the market?

Mr. LUKKEN. In our markets we track this. There is one small sovereign wealth fund that is currently in our market, so not a very sizeable position. It is something we are going to ask for additional data from the swap dealers to see if swap dealers may be bringing sovereign wealth money into the marketplace through these Wall Street firms. We will have better data on that in the coming weeks.

Mr. MAHONEY. And just to finish, all I just have to say is that when I take a look at the data, and I take a look at the supply and demand, and I take a look at all the economic indicators, it is very obvious, common sense tells you that there is something going on in the marketplace. And it seems to me that the challenge that you have is we have gone to a digital global situation, and trying to have oversight and enforcement is difficult. And I also hear you say that you feel like you are understaffed and undermanned to be able to take on this challenge; that you are not only worried about these oil markets, but all these other commodities, foreign and other things. And I hear the plea for more resources because of the greater challenge and the more sophistication of the markets; is that not correct?

Mr. LUKKEN. Absolutely. We didn't even get into the corn market today. We need to make sure they are properly functioning as well. So, we need bodies.

Mr. MAHONEY. I thank you very much. The sophistication of global markets, whether it be the stock exchanges or commodity, has just changed the game so dramatically in terms of strategies, how people trade. And the other thing is that people are working very hard to try to conceal trades and trading strategies, and you are trying to figure out how to "unconceal" them. So it is a very, very difficult job.

Thank you very much, Mr. Chairman.

The CHAIRMAN. I thank the gentleman.

And the gentlelady from New York is recognized, and she is commended for her patience.

Mrs. GILLIBRAND. Thank you.

Thank you, Mr. Chairman, and thank you so much for coming here and tolerating our many questions.

The reason why you may sense some confusion from the Members on this Committee is that we as Congress Members have been having testimony over the last several weeks on this. And there was a hearing in front of the Energy and Commerce Subcommittee on Oversight and Investigations on June 23rd on energy market speculation. And the testimony in that hearing was very specific.

Fadel Gheit from Oppenheimer says the reason why he thinks there is increased price is due to speculation, and he says there has been no unexpected changes in the oil industry fundamentals in the last 12 months before which crude prices were below $65 a barrel. In fact, the market expected more demand growth in that time than has actually occurred. So his conclusion is that world oil production is economic at the price of $65, so the cause must be speculation.

He wants a raise in the margin requirements, 50 percent. He wants to set trading volume limits by commercials in relation to physical needs. He wants to require full disclosure by investment banks of oil-trading results and bar investment banks and other financial traders from owning energy assets.

Another one of the witnesses was Edward Krapels from the Energy Security Analysis. He had similar conclusions. He wanted greater disclosure for IPE and ICE, impose position limits and reduce leverage available.

Roger Diwan from PFC Energy also had similar conclusions.

And one of the witnesses Mr. Masters, I thought, had an interesting way to describe it. He says there is supply-demand and demand, and there is physical demand, which is the consumption that we talk about in America. And in America what I read in the paper is that consumption has actually gone down because people are very—especially folks in my district—very concerned about the high price of gasoline, and they really can't afford to do all the things they would normally do. So consumption has actually gone down.

And then the second demand is the paper demand, which is what we are talking about today, the speculation in the markets, and that is when you have the influx of enormous amounts of capital over the last several years.

So I would like you to comment on how their conclusions can be so opposite to yours, because you are saying it is just supply and demand. But again, consumption is going down, particularly in America. And we have read in the paper that Saudi Arabia has now reached agreements that they will increase supply for us. So please give us your thoughts.

Mr. LUKKEN. Certainly, I testified yesterday as well at this hearing, so I was able to hear from all the analysts that were a part of that hearing.

For us, we look at this very carefully, the data, and what is going on in these markets. In regards to supply, certainly we have seen in Saudi Arabia's announcement, my understanding—and Chairman Newsome today testified on this on the Senate side—that this is a heavy type of crude oil that is not easily refined and may not have the benefit and market impact that some would have expected it to have.

So on the supply factors—and we are seeing demand decrease here in the United States, but the oil analysts that we talk to tend to look at the undeveloped countries and the demand that is still continuing to grow in other places such as China and India. So, if we start to see demand destruction as well there, that may have an impact on some of this.

Again, we are looking, everybody is looking, for a simple solution to all this, and I wish we had it. But we are going to put the proper controls in place of all this type of money to ensure that excess speculation is not driving prices. We have taken steps to do that——

Mrs. GILLIBRAND. But can you address the different kinds of demand, because, again, this is paper demand. They are not taking ownership of this oil—I mean, they are not taking delivery of the oil. So when you are talking about demand, yes, there are a lot of people in the market today because they are going to make money. They know the price of oil is going to go up, so they are going to continue to try to make money. But that is not the same as consumption. So can you differentiate when you talk about demand? Because it is confusing.

Mr. LUKKEN. Right. And demand is probably a wrong term in the futures markets, because there is demand on the short side and demand on the long side, and so people are trying to find what the right price is. And every short position is trying to get the right price, because every time the price goes up, they lose money because of that, and *vice versa* with the longs. And so there is an incentive, there is no bias on the long side for speculating.

I think that is important. The reason a lot of people don't like speculators is because they make money coming and going, when the markets are going up and when the markets are going down. But they provide the liquidity, the shock absorber, to allow those markets to function. So we are trying to find the right balance in all of that. But we have not seen this sort of this buy-side-only demand that was discussed yesterday, and I think this chart tries to describe this.

Ms. GILLIBRAND. But do you see any—in the vast volumes of money that is in the market now, do you see risk in the ability of a sovereign wealth fund, for example, to give the potential to foreign authorities to actually manipulate our market, and if you do, what would that manipulation look like?

Mr. LUKKEN. Well, typically manipulation is when you have too large of a position given the underlying supply of the commodity, and that you can move markets around as a result of that. And so we have a telescoping system in place that brings positions down for traders in our markets to ensure that they can at the end of the expiration of the contract—that they cannot manipulate the markets.

So we would treat sovereign wealth funds like we treat any participant, whether you are commercial or speculative. We make sure they get out of the market so they don't control prices. If they are in our market as a commercial participant in our markets, we would expect them to behave as commercials. We would try to get the information we need from them to ensure they are behaving properly.

Mrs. GILLIBRAND. Thank you for your testimony.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank the gentlelady.

I am going to give Mr. Goodlatte an opportunity if he wants to close, but is—getting back to this chart, is there any money going into the oil markets that is not on this chart?

Mr. LUKKEN. The commercial participants, that is the largest category. And they would likely be on the short side because they are trying to lock in prices and typically are on the short side of the market. This is probably also reflective of the speculative positions, because speculators are taking the opposite sides of those trades. So they are not in this, but we could put that on there for you.

The CHAIRMAN. I was confused when you were explaining—and I get all mixed up on these different terms, but are there speculators and swaps that you don't know about that are not on this chart?

Mr. LUKKEN. Well, swap, the swaps positions——

The CHAIRMAN. Business is going on in this commodity that you have had no idea about, and so you can't put it on here.

Mr. LUKKEN. Well, these are futures positions. So the net speculative positions are speculators in the futures markets. The swap dealers' positions are futures positions that they are managing their risk in our markets. But we are not looking at the second layer under swap dealers, which are all their clients' positions.

The CHAIRMAN. That is what I was getting at, because not all of this position is hedged in your market.

Mr. LUKKEN. Right. And that is the data——

The CHAIRMAN. We don't know what that is. That is what I was getting at, correct?

Mr. LUKKEN. Correct.

The CHAIRMAN. Do you have any idea how much that is?

Mr. LUKKEN. No. But——

The CHAIRMAN. Does anybody know how much it is? Nobody knows?

Mr. LUKKEN. Well, nobody knows currently. People are guessing what the amount of index trading is coming into the energy markets. There are ways to try to extrapolate from what is happening in the agriculture markets to get to the energy estimates. But right now, no, we currently don't know.

The CHAIRMAN. So this is what you are trying to find out by September 15?

Mr. LUKKEN. We will be finding that out over the next month.

The CHAIRMAN. How are you going to find that out?

Mr. LUKKEN. We have used our special call authorities, which is section 1805 of our regulations. We can ask for additional information from any participant in our markets, and so we have asked the major swap dealers, Goldman Sachs, JPMorgan, Morgan Stanley and others, to give us access to, report to us on what is happening in their underlying books.

The CHAIRMAN. And they are cooperating?

Mr. LUKKEN. Absolutely.

The CHAIRMAN. Well, I think it would be good if you can put those commercial positions on here. And then if there is some way that you could—I don't know if you can do this, but if you can give us a chart that shows how much of this increase in these funds came from just the increase in the underlying commodities, the increase in price, because, like wheat is three and a half times what it used to be. I don't know how it is for all the other different commodities, but I am sure they are all considerably more.

Is there some way to put that on a chart so we can get some idea if you are saying $260 billion, some of it is just an increase in price of commodities?

Mr. LUKKEN. We can certainly do it for agricultural commodities right now. Once we get this data from the swap dealers, we will be able to do that as well for energy.

The CHAIRMAN. Good. I think that is important information that we need to have. And people—I make this mistake—they get mixed up between regulation and transparency and just information. And I am one of those that believes that if you can get all this stuff out in the public, and the public has access to it, and they can get to it every day, and it is all transparent, that is the best thing you can do.

We have done that now hopefully in the livestock market in the farm bill by requiring USDA to set up a database that the average farmer out there in Minnesota or Iowa can go out in the morning and see what happened all over the country the day before. We think that will do more to give us the right outcome than anything else we can do.

So the more we can get all this information pinned down, if you can help us do that, because there is a lot of misinformation out there. There are a lot of people looking for an easy—I just had the airline executives in, and they bought into this idea that you have to regulate everything, and then everything is going to be fine. And in the conversation, apparently they are using the swaps market, which is going to be maybe in question if we do that.

So it is—I don't know. We have a lot to learn. I have a lot to learn. I think the Committee does. And, again, what I want to have happen here at the end of the day is that we get the right outcome for the country and for these markets. So thank you for being here.

Mr. Goodlatte.

Mr. GOODLATTE. Thank you, Mr. Chairman.

Mr. Chairman, some of the concerns we have heard expressed here today and heard in the testimony yesterday in the Energy and Commerce Committee relates to the thought that speculators can get into these energy futures trading markets too cheaply, that somehow this is contributing to the excessive price that we are seeing or what some people see in the price of a barrel of oil. Do you agree with that?

Mr. LUKKEN. No. I mean, I think they are referring to margin, and somehow margin is leading to excessive speculation. Margin, again, is a different concept in the securities markets. It is not a down payment on buying a stock. It is not a down payment on buying oil. This is really what we are doing in these markets is managing price risk. We not buying the ultimate barrel of oil.

And so margin, if you raise it is going to force these people elsewhere potentially and——

Mr. GOODLATTE. When you say "elsewhere," do you mean into other speculative markets or into other energy markets that would be outside the jurisdiction of your regulatory authority?

Mr. LUKKEN. It certainly could move to London. It certainly could move to other electronic exchanges around the world. It certainly could move into the over-the-counter market, and, again, if we limit the over-the-counter market's ability to manage risk on-exchange, that could create systemic problems with unmanaged, unhedged, over-the-counter risk. So I think it is better and more appropriate to try to keep this within in the regulated marketplace as best we can with controls, with transparency, as the Chairman mentioned, is enormously helpful. So I think there are things we can do, steps we can make to ensure speculation is not overriding these markets.

Mr. GOODLATTE. Do you have authority to change those margins without——

Mr. LUKKEN. We have emergency authority. It is very broad. We have never exercised it to increase margins in the history of the agency. We have only used our emergency authorities two or three times in our past, normally during an active manipulation, during the Hunt silver crisis and other times, but certainly not to try to influence prices.

Mr. GOODLATTE. Thank you, Mr. Chairman.

The CHAIRMAN. I thank the gentleman, and I thank all of the Committee Members, and, Mr. Lukken, you especially for putting up with us for the last 2½ hours, and I am sure we are going to have more discussions in the future. And if you can—the more information you can get us and the other Members on the other Committees, if you can get them to pay attention, the better off everybody is going to be. So thank you very much.

Mr. LUKKEN. Thank you.

The CHAIRMAN. I forgot. We have to adjourn. Under the rules of the Committee, the record of today's hearing will remain open for 10 days to receive additional material, supplementary written responses from the witness to any question posed by a Member to the panel.

And this hearing of the Committee on Agriculture is hereby adjourned.

[Whereupon, at 4:53 p.m., the Committee was adjourned.]

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