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On behalf of the
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of New Jersey (FMA)

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Honorable Chairman Garrett, Ranking Member Waters and distinguished members of the subcommittee, thank you for the invitation to testify today. I appreciate the opportunity to provide some insight into Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act and why it needs to proceed without delay to address the needs of bona-fide end-users and consumers.

I. Introduction

My name is Eric DeGesero and I'm the Executive Vice President of the Fuel Merchants Association of New Jersey. Founded in 1933, FMA represents small businessmen and women who distribute heating oil, gasoline and diesel fuel in the state. Our members distribute heating oil to residential, commercial and industrial customers and distribute branded and unbranded gasoline and diesel fuel to service stations they own, and to service stations they supply, as well as to state and local governments and commercial fleets.

I am submitting this testimony on behalf of the Petroleum Marketers Association of America ("PMAA"). PMAA is a national federation of 48 state and regional trade associations representing over 8,000 independent petroleum marketing companies. These companies own 60,000 convenience store/gasoline stations and supply motor fuels, including gasoline and diesel fuel, to an additional 40,000 stores. PMAA members also sell at retail 90 percent of the home heating oil consumed in the United States.

Joining PMAA in these comments is the New England Fuel Institute ("NEFI"). NEFI is a member of PMAA and an independent trade association representing approximately 1,200 home heating businesses including heating oil, kerosene and propane dealers and related services companies, most of which are small, multi-generational family owned- and operated-businesses. Many PMAA and NEFI members also market lubricants, jet fuels and racing fuels, as well as renewable fuels such as biofuels and other alternative energy products.

We first want to commend the CFTC for its dedication to moving forward with prudent futures and swaps market rules and regulations which will bring greater transparency and fairness for all commodity market participants. Bona-fide end users of commodities, many of which are my members, feel that the futures and swaps markets are not serving the best interests for what they were created for – bona-fide end users to manage risk and price discovery. Therefore, we strongly support Title VII because it promotes the free exchange of commodity futures on open, well-regulated and transparent exchanges.

II. Why Title VII?

Title VII is important because it:

1. Brings across the board transparency and clearing requirements.
2. Limits excessive speculation on energy trades.
3. Enhances prohibitions and prosecution of fraud, manipulation and abusive trading practices.
4. Promotes greater consumer protections.

Mr. Chairman, it's imperative that the CFTC move forward with Title VII's rules and regulations to provide certainty to end users and market makers which will allow them to adjust their business models accordingly. PMAA, NEFI and FMA member companies have endured years of wild price swings due to excessive speculation which has increased hedging costs and have hurt the ability for them to provide stable commodity prices to their customers. Title VII will return oversight and order to the futures market and bring stable, open and competitive markets that serve the needs of bona fide hedgers over speculative traders.

While the rules may not be perfect, they are a welcome start in overturning a law implemented in 2000 which watered down oversight and exempted Wall Street from position limits and other requirements that ensure transparency and competition and prevent fraud, manipulation and excessive speculation. A combination of deregulation at the CFTC coupled with passage of the Commodity Futures Modernization Act (CFMA) of 2000 and insufficient CFTC funding allowed for trading activity to move to under-regulated off-shore trading platforms, free from speculative position limits. Before passage of the CFMA, commercial hedgers comprised about 60-90 percent of the open interest for commodities. Today, 60-90 percent is purely speculative/financial trading. This level of speculation is excessive and undermines risk mitigation and price discovery mechanisms, exacerbates market volatility and unhinges markets from supply and demand fundamentals. For the first time, Dodd-Frank requires all swaps, whether cleared or uncleared, to be reported to swap data repositories. This is an important step to help the CFTC capture the trillions of dollars traded in the opaque swaps market.

<u>Commodity futures markets were established as a tool for true physical hedgers to manage risk – they weren't set up strictly for investment banks to dominate the marketplace</u>. This is a subject we believe gets lost in the discussion from both parties. Hedge funds, sovereign wealth funds and other institutional investors continue to heavily invest in derivatives contracts for crude oil and refined petroleum products, and enjoy little or no controls, such as tough limits on speculative positions. Investment-only speculators that engage in a "buy and hold strategy" serve no purpose in the commodity markets other than to diminish its role as a tool for managing risk and discovering a fair market price for physical hedgers such as petroleum marketers, airlines and farmers. Without sufficient oversight and aggregate position limits from Title VII, commodity end-users such as petroleum marketers, airlines, farmers and trucking companies will continue to be held to the whims of Wall Street speculators.

<u>Legitimate physical commodity hedgers should be protected from these regulations.</u> PMAA, NEFI and FMA members believe that the CFTC struck the right balance between distinguishing commodity end-users and those in the market purely to speculate. This is not to say that we are opposed to speculation. We need speculation in the marketplace for physical end-users to manage risk, but excessive speculation distorts the market and creates tremendous volatility.

To mitigate highly leveraged speculative commodity bets and promote stability in the futures market, Title VII requires over-the-counter (OTC) commodity trades to be cleared through a central clearing house. For instance, if a large investment bank is purely in the market to leverage its commodity futures holdings, then it should be held to mandatory clearing and margin requirements to ensure that it has the cash up front to back up its trade. We wholeheartedly agree that centralized clearing will bring transparency and fairness to the market. Efforts to derail the clearing requirement through legislative and/or regulatory action will maintain the status quo and continue to handcuff the U.S. financial system.

III. The High Cost of Oil and Refined Products Hurt Petroleum Marketers

The effect of excessive speculation on small business petroleum marketers is a problem with far reaching consequences. In recent years, gasoline and heating oil retailers saw profit margins from fuel sales fall to their lowest point in decades as oil prices surged. Petroleum marketers do not benefit from high crude oil or gasoline prices. Because they operate in such a competitive environment, the higher prices climb, the further margins are squeezed. Thus, rising gasoline prices not only hurt motorists, but petroleum marketers as well. Of the 160,000 U.S. retail gasoline locations, 99 percent are owned by independent businesses, not the major oil companies. The major integrated oil companies have essentially removed themselves from the retail gasoline business because they see that the retail environment is not very profitable for gasoline sales.

In order to remain competitive, retail station owners offer the lowest price for motor fuels so that they generate enough customer traffic inside the store where station owners can make a modest profit by offering drink and food items. Because petroleum marketers and station owners must pay for the inventory they sell, their lines of credit approach their limit due to the high costs of gasoline, heating oil and diesel when crude prices go up. This creates a credit crisis with marketers' banks, which creates liquidity problems and may force petroleum marketers and station owners to close up shop.

IV. Excessive Speculation Causes Volatility and Price Spikes at the Pump

Large purchases of crude oil futures contracts by speculators have created an additional paper demand for oil which drives up the prices of oil for future delivery. This has the same effect that additional demand for contracts for the delivery of a physical barrel today drives up the price for oil on the spot market. Basically, a futures contract bought by a speculator has the same effect on demand for a barrel that results from the purchase of a futures contract by a petroleum marketer. The very definition of cash-settled contracts as "look-alikes" means that what occurs in the financially-settled swaps markets directly affects what occurs in the physical market.

In recent years, excessive speculation on oil futures exchanges has driven prices at the pump. In April 2011, Goldman Sachs warned clients to lock-in trading profits before oil and other markets reversed suggesting speculators were boosting crude prices as much as $27 a barrel which translates in upwards of 40-60 cents-per-gallon at the pump. Goldman noted that every one million barrels of oil held by speculators contributed to an 8-10 cent rise in oil price. This comment came as the CFTC found that speculators made up more than 70 percent of the open interest of positions held overnight in crude oil futures, whereas, physical end users, made up less than 30 percent. Additionally, the CFTC reported in July 2011 that almost 95 percent of U.S. crude oil futures volume was generated by day trading.

V. Position Limits

It is unfortunate that the U.S. District Court vacated the new position limits rule, albeit on narrow grounds, and sent it back to the CFTC for further consideration. However, the District Court did not question the CFTC's authority to address excessive speculation. The court merely concluded that the statute was ambiguous on the question of whether the agency must set speculative position limits and that the agency failed to address this ambiguity. We believe the court's reasoning is flawed and that the Congressional mandate to impose position limits was unambiguous for a number of compelling reasons, not the least of which is that Congress required position limits to be imposed "within 180 days" for energy and "within 270 days" for agricultural commodities, and that a study be conducted and presented to Congress on the final rule's effect on markets.

There is more than adequate evidence that excessive speculation has been disruptive to commodity markets. More than 100 studies, reports and analyses on such findings have been published by academic institutions, central banks, market experts and governmental organizations (online at http://bit.ly/ListStdys).

The CFTC final position limits rule would have capped spot month holdings of the NYMEX Sweet Light Crude, NYMEX Gasoline Blend stock, NYMEX Heating Oil, and NYMEX Hub Natural Gas at 25 percent of deliverable supply. The all-months combined position limit regime would not be implemented until the CFTC had collected a year's worth of swaps data. While we believe the position limits final rule should have capped speculative oil trades at lower levels, we agreed that it was a necessary first step in tackling the futures/swaps market which has grown exponentially over the last 10 years.

Finally, it's unfortunate that the partisan tone has only amplified regarding position limits. As recently as the 110th Congress, nearly 70 House Republicans voted to approve legislation (H.R.6604) that would have established across-the-board position limits and even provided the CFTC with 100 new employees to carry out the its mission. Of these Republicans, 44 still serve in the House of Representatives.

VI. The CFTC Must Enforce Cross-Border Regulations

Derivatives transactions conducted by off-shore affiliates of U.S.-based firms can have a direct and immediate impact on American businesses and consumers and the stability of the economy. Some areas of cross-border application authority are clearer than others. For instance, transactions with overseas affiliates that are guaranteed by a U.S. entity clearly must be subject to Dodd-Frank given that what happens offshore could potentially put the American taxpayer at risk, especially when a U.S. bank's foreign affiliate has direct access to the Federal Reserve's discount window and FDIC backing. Furthermore, failure to conduct prudent regulation and oversight of said transactions can open the door to regulatory arbitrage and encourage firms to relocate U.S. jobs and business operations overseas.

Congress gave the CFTC enough discretion to go after off-shore affiliates. In order to fulfill its mission to protect U.S. market participants and to ensure market stability and confidence, it is essential that the Commission move forward with its proposed cross-border guidance documents. The approach set forth in these documents will provide certainty to regulated entities; allow foreign regulators additional time to finalize new swaps market rules; and permit CFTC Commissioners to continue their multilateral negotiations with their overseas counterparts on jurisdictional issues, regulatory harmonization, data sharing agreements and cross-border enforcement. If the CFTC isn't able to effectively regulate U.S. bank foreign affiliates that engage in swap transactions, then Title VII of Dodd-Frank will effectively be gutted thereby impacting implementation of dealer oversight, the clearing mandate and real-time reporting.

VII. The CFTC Needs Adequate Funding

Given that the over-the-counter (OTC) derivatives market has grown exponentially over the last 10 years, a small down payment for the CFTC to ensure that these markets are reflective of supply and demand fundamentals is critical. Currently, the U.S. OTC market totals $300 trillion with another $300 trillion traded world-wide. The CFTC's $205 million budget is inadequate to provide comprehensive oversight especially since the agency is operating below early 1990s funding levels when the OTC market was in its infant stages.

<u>PMAA and NEFI support a $308 million appropriation for future fiscal years and oppose any number that falls short of meeting this request.</u>

VIII. Conclusion

It's critical that regulators get the futures/swaps market under control for the benefit of the physical end-user and consumer. Therefore, we urge this subcommittee to allow the CFTC to do its job and implement pending rulemakings without further delay. Reliable futures markets are crucial to the entire petroleum industry and consumers. Again, I want to thank the Subcommittee for the opportunity to testify today. I will be happy to answer any questions that you may have at this time.