COMMODITY MARKETS OVERSIGHT COALITION

An Alliance of Commodity Derivatives End-Users and Consumers

Testimony of Sean O. Cota

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Before the

U.S. Senate Committee on Agriculture, Nutrition and Forestry

Public Hearing

"Regulatory Issues Impacting End-Users and Market Liquidity"

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Chairman Roberts, Ranking Member Stabenow and members of the Committee, thank you for the opportunity to testify on the impact of Commodity Futures Trading Commission's (CFTC) regulations on derivatives end-users. My name is Sean Cota and I am delivering testimony on behalf of the Commodity Markets Oversight Coalition (CMOC). Along with other leaders in the energy, transportation, agricultural and manufacturing sectors, I helped to establish the CMOC in August of 2007.[1] Since then, the CMOC has been an advocate for secure, transparent and accountable commodity futures, options and swaps markets. We appreciate the committee's commitment to working with derivatives end-users as it moves forward with CFTC reauthorization.

Background

The CMOC is a non-partisan alliance of industry groups and other organizations that represent commodity-dependent American businesses, end-users and consumers. Our core members are the end-users who transact business in these physical commodities, and seek to

[1] Originally founded as the Energy Markets Oversight Coalition, it changed its name to the Commodity Markets Oversight Coalition in early 2009.

make sure these markets service us - the customers for whom they were created. Our members rely on functional, transparent and competitive commodity derivatives markets as a hedging and price discovery tool. As a coalition we favor policies that promote market stability and confidence; prevent fraud, manipulation and excessive speculation; and, in general, preserve the interests of bona fide hedgers and American consumers.

I first testified before the United States Senate eight years ago as President and co-owner of a family-owned and operated energy company that distributes home heating fuels, motor fuels and biofuels throughout greater Vermont. One of my main roles at the family company was the management of its hedging operations. Hedging is extremely important to heating oil and propane marketers. In addition to broader volatility factors including the price of oil and natural gas, they are exposed to seasonal fluctuations and spikes in demand associated with extended periods of extreme cold and other types of inclement weather. Our industry hedges in order to better protect our business and consumers from risks associated with these commodities and to offer the most stable and affordable prices possible.

Perspectives on Dodd-Frank

Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 (or simply, the Dodd-Frank Act) in order to address the opacity and dysfunction in the derivatives markets that both caused the financial meltdown and the unprecedented (and unwarranted) spike in commodity markets. While the law is imperfect, Title VII of the Dodd-Frank Act represents a significant victory for consumers and small businesses, especially for those that hedge. We encourage the Congress to use CFTC reauthorization to build upon key reforms that have led to more competitive, transparent and functional markets and increased confidence among market participants and commodity-dependent businesses.

Title VII of the Dodd-Frank Act expanded the CFTC's jurisdiction from just the futures markets to the more than $700 trillion or more (notional value) over-the-counter swaps markets.[2] By comparison the total World Stock Market Cap is only $63 Trillion.[3] It also completely restored CFTC oversight to so-called "exempt commodities" such as energy and metals. These reforms have had a profoundly positive impact on end-users. Since the enactment of the Dodd-Frank Act, the markets have become more stable, transparent and competitive. Some commodities have seen a decline in volatility of 40 percent or more since 2010. This has bolstered the confidence of market participants, including those I represent.

Thanks to the Commission's implementation and enforcement of vital new trading rules and cooperation with exchanges, self-regulatory organizations and overseas counterparts, the CFTC is now the "cop on the beat" policing fraud, manipulation and abusive trading practices. Consider for example that penalties imposed by the CFTC have increased from $100 million to $1.8 billion over the last five years. CFTC Chairman Massad recently announced that the agency has obtained $2.5 billion in sanctions year-to-date in 2015, which is ten times its current annual budget."[4] This should be considered as Congress weighs the requested funding increase for the Commission, which our Coalition fully supports and is discussed later in this testimony.

Congress also required that the CFTC impose speculative position limits across all commodities in the futures and swaps markets. This provision was supported by CMOC

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[2] Source: Testimony of CFTC Commissioner Timothy Massad before the U.S. House of Representatives, Committee on Appropriations, February 11, 2015.
[3] Source: http://www.aei.org/publication/global-stock-rally-world-market-cap-reached-record-high-in-november-and-is-back-above-pre-recession-pre-crisis-level
[4] Source: CFTC

members and other like-minded end-user groups and commodity-dependent industries as a prophylactic measure to help minimize wild price swings in the price of commodities and, importantly, to prevent market manipulation. We understand that Commissioners are currently negotiating the details of a final rule and we look forward to reviewing it. While many groups representing bona fide hedgers and commodity-dependent industries have some concerns about the specifics of the proposed rule, nearly all of them are supportive of meaningful limits on speculative trades. We hope the concerns of commercial end-users can be adequately addressed and that the CFTC can move forward with the rule in the coming months.

Please note, however, that our Coalition strongly opposes the "conditional spot month limit" included in the December 2013 proposed rule. We understand that many in Congress, both Republicans and Democrats, share our concerns regarding this proposal. The conditional spot month limit would allow a trader to hold a cash-settled position in a given commodity that is up to five times the spot month limit, or 125 percent of deliverable supply. We have submitted comments to the CFTC in strong opposition to this proposal as it could increase price volatility and open the door to manipulation in the cash-settled markets. This would jeopardize market convergence, increase hedging costs and result in market uncertainty for commodity-dependent businesses and consumers.

We are also concerned with a suggestion that the CFTC cede its authority to set speculative position limits and issue bona fide hedge exemptions to the commodity exchanges. While exchanges play an important role in providing a safe and secure platform for transactions between market participants, we must remember that most are publically-traded, for-profit entities. As such, they benefit from higher trading volumes and a large number of market participants and therefore have an incentive to make positon limits voluntary (or at the least very high) and to allow for broad hedge exemptions that may include purely speculative trades. This proposal runs contrary to the intent of Congress, which is that the CFTC – not the exchanges or self-regulatory organizations – be tasked with the responsibility to set position limit levels and define who should be eligible for bona fide hedge exemptions. Congress should watch developments closely and take action as necessary to ensure that this intent is preserved.

CFTC Reauthorization

As the Committee moves forward with new legislation to renew the CFTC's authorizing statute (the Commodity Exchange Act), the CMOC recommends the following:

- Provide Greater Protections for Customer Funds. Several of my peers in the downstream petroleum industry were victims of the collapse of MF Global - their accounts were frozen and in some cases their market positions were jeopardized. As the committee is well aware, the agriculture sector was particularly affected by this crisis. The CFTC and the exchanges should be commended for their efforts to strengthen consumer protections and prevent a repeat of "MF Global." The committee should support these efforts by including robust customer protections in CFTC reauthorization.

- Reinforce Congressional Intent Regarding End-users. In enacting the Dodd-Frank Act, Congress did not intend for many of its rules and regulations to adversely impact bona fide end-users of commodity derivatives. The committee would be justified in reinforcing this Congressional intent in the CFTC reauthorization bill. However, the CMOC cautions against inadvertently creating new loopholes or regulatory exclusions that might benefit financial institutions and other large market participants by weakening exemptions meant only for bona fide hedgers, or by allowing them to trade overseas without comparable oversight.

- Study into High-Frequency Trading and Autonomous Computerized Trading. In response to the "Flash Crash" and other events in the securities and futures markets, Congress should require a broad study into the role of new trading technologies and practices, including and especially those that utilize automated (and increasingly autonomous) computerized trading programs. This study must include an examination of the cyber-security and national security implications of such technologies and activities, their impact on the commodity markets (including market volatility), and whether or not they could (intentionally or unintentionally) disrupt or manipulate futures and swaps markets.

- Increase Penalties for Fraud and Manipulation. The previous reauthorization in 2008 strengthened antifraud provisions and increased civil monetary penalties for manipulation from $500,000 to $1 million per violation. As a matter of course, these penalties have become insignificant when compared to the overall profits of large market participants and have become part of the "cost of doing business." The committee should take a "zero tolerance" approach to such behavior. We urge you to include in reauthorization an increase in fines and penalties for fraud, manipulation and other severe violations.

CFTC Funding

The CFTC is no longer a small "backwater" agency that regulates niche financial markets. As mentioned, it now regulates financial markets with a notional value that is many hundreds of trillions of dollars in size, are utilized by commodity-dependent business to hedge and to "discover" prices for essential commodities and that, as evidenced by recent events, affect the lives of every single American. The CFTC must do all of this despite limited resources, an unprecedented expansion of its responsibilities under the Dodd-Frank Act, constantly evolving markets, and ever-changing trading practices and technologies. Congress must therefore provide the CFTC with the $322 million requested for Fiscal Year 2016. These funds are necessary to conduct market surveillance, develop initiatives to guard against cyber-attacks and cyber-terrorism, and to protect market participants and the broader public from fraud, manipulation and excessive speculation.

Conclusion

Five years ago, Congress passed a new law empowering the CFTC to ensure transparency and provide greater security and integrity to markets that our businesses depend on for hedging and price discovery and that affect the lives of every American. This law and related regulatory initiatives are not without their flaws, including concerns that bona fide hedgers may be inadvertently captured by rules and regulations meant for large market participants such as financial institutions. We believe the CFTC has the existing authority to remedy these concerns and if not, Congress would be right to address them in forthcoming reauthorization. However, at the same time, it is essential that the spirit and intent of the original law be upheld if not strengthened. We look forward to assisting Congress in this regard as the process moves forward.

Thank you again for the opportunity to appear before you today. I would be happy to answer any questions you might have and look forward to providing further input as the Congress continues the process of CFTC reauthorization.

APPENDIX I – ENDORSING ORGANIZATIONS

Airlines for America
American Trucking Associations
Colorado-Wyoming Petroleum Marketer Association
Connecticut Energy Marketers Association
Florida Petroleum Marketers Association
Fuel Merchants Association of New Jersey
Gasoline & Automotive Service Dealers of America
Institute for Agriculture and Trade Policy
Louisiana Oil Marketers & Convenience Store Association
Maine Energy Marketers Association
Massachusetts Energy Marketers Association
Montana Petroleum Marketers & Convenience Store Association
National Association of Oil & Energy Service Professionals
National Association of Shell Marketers
National Family Farm Coalition
National Farmers Union
National Latino Farmers & Ranchers Trade Association
New England Fuel Institute
New Mexico Petroleum Marketers Association
New York Oil Heating Association
North Dakota Petroleum Marketers Association
North Dakota Propane Gas Association
North Dakota Retail Association
Oil Heat Council of New Hampshire
Oil Heat Institute of Long Island
Oil Heat Institute of Rhode Island
Organization for Competitive Markets
Petroleum Marketers & Convenience Store Association Kansas
Petroleum Marketers & Convenience Stores of Iowa
Petroleum Marketers Association of America
Public Citizen
Rancher-Cattlemen Action Legal Fund (R-CALF) USA
Vermont Fuel Dealers Association
West Virginia Oil Marketers and Grocers Association

APPENDIX II – BIOGRAPHY

Sean Cota has nearly 40 years of experience in the downstream petroleum industry including more than 17 years as President of one of the most successful retail home heating and motor fuel businesses in northern New England. Cota has previously served as a member of the CFTC's Energy and Environmental Markets Advisory Committee. He is a member and past-Chairman of the Petroleum Marketers Association of America (PMAA) and New England Fuel Institute (NEFI), which together represent marketers that serve more than 8 million households, and who own or distribute to over 100,000 convenience stores or gasoline stations. He has served as a board member and First Vice Chairman of the National Oilheat Research Alliance (NORA) and National Association for Oilheat Research & Education (NAORE). Mr. Cota is a founding member of the Commodity Markets Oversight Coalition (background can be found in the introduction to this testimony). He has been interviewed or quoted in various media, including CNBC, CBS Evening News with Katie Couric, 60 Minutes, MSNBC, Platt's, WUSA-TV, USA Today/Gannett Media, Bloomberg News, The Financial Times, Reuters, ABC News, Oil Price Information Service (OPIS), The Wall Street Journal and various publications in the oil, gas, biofuels and home energy industries. Prior to this hearing Cota has testified on derivatives market oversight before the United States Senate three times, the House of Representatives twice and the Commodities Futures Trading Commission four times.

Mr. Cota is a graduate of Kimball Union Academy and Wilkes University, where he received a Bachelor of Science in Business with a concentration in marketing. He is a native of Bellows Falls, Vermont where he raised his two children, both now attending college. Mr. Cota retired from his family business in 2011 and is now an independent consultant for the industry that he has served and fought for all of his life.