

A Successful Regulatory Model

Prepared for:

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By:

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Former OTC Dealers



BEAR
STEARNS



LEHMAN BROTHERS

Thomas J. Saal...26 years experience

2008 – Present	Hencorp Futures, LC	o Senior Vice President - Energy
2003 – 2008	Commercial Brokerage Corp., LLC	o Vice President
1997 – 2003	Pioneer Futures, Inc.	o Vice President
1991 – 1997	Merrill Lynch Futures Inc.	o Senior Financial Consultant o Series 3 Licensed:CFTC & NFA
1986 – 1991	Florida Power and Light Company	o Fuels Analyst/Rate Analyst
1984 – 1986	Texas State Comptroller	o Economist
1983	Natomas North America	o Financial Analyst
1983	M.A., Economics, University of Houston	
1976	B.A., Economics & Mathematics, Southern Illinois University	

Disclaimer

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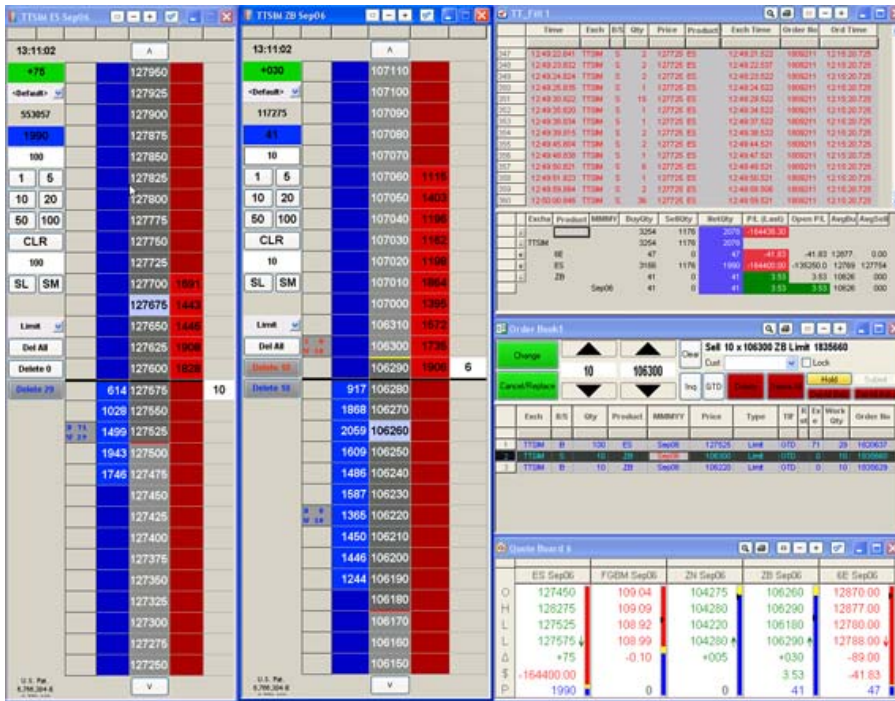
Suggested Reforms

- What should be done?
 - CFTC should regulate all energy forward pricing swap contracts...extending its regulatory model to the OTC energy market
 - CFTC should use the current regulatory model on all participants without any discrimination
 - CFTC should impose hard limits on the number of contracts held by each participant
- Why?
 - Minimize counterparty risk...avoided costs
 - Potentially lower transaction costs

Purpose of a Regulated Futures Market

Price Transparency

Risk Management



Regulatory History of the US Futures Industry

1922

Grain Futures Act

- First federal regulation of futures markets
- Created the Grain Futures Administration (Department of Agriculture)

1936

Commodity Exchange Act

- Provided framework for federal regulation of all commodity and futures trading activities
- Required all futures and commodity options to be traded on organized exchanges
- Created the Commodity Exchange Authority (Department of Agriculture)

1974

Commodity Futures Trading Commission Act

- Formed the Commodity Futures Trading Commission (CFTC) and the National Futures Association (NFA)
- Created a comprehensive regulatory framework for commodity and futures trading
- Provided legal protection futures market users and the public from:
 - **Fraud**
 - **Manipulation**
 - **Abusive practices**

2000

Commodity Futures Modernization Act of 2000

- Created the “Enron loophole”
- Certified that products offered by banking institutions would not be regulated as futures contracts
- Allowed single-stock futures

US Futures Industry Structure

Regulated Futures Structure

- Exchanges
- Futures Commission Merchants
- Introducing Brokers
- *Customers*
- Federal Government Oversight



Unregulated OTC Structure

- Financial Counter Party
- *Customer*
- 100% Bilateral



Regulated Futures Markets

Unregulated OTC Markets

Price Discovery

Limited Price Discovery

Trade Transparency

No Transparency / No Reporting

Customer Daily Mark-to-market
Reporting

FCM Monthly Capitalization
Reporting (1FR)

No Counterparty Risk

Unlimited Counterparty Risk*

Standardized Contracts

Customized Contracts

Centralized Exchanges

Bilateral Contracts

Margin: Control Mechanism

IOU

Leverage: Controlled

Leverage: No Control

Strong Regulatory Structure

No Regulatory Oversight

No Defaults On Energy Contracts
– **EVER**

Defaults: Enron, Metallgesellschaft
AG, Bear Stearns, AIG, Lehman
Brothers Holdings

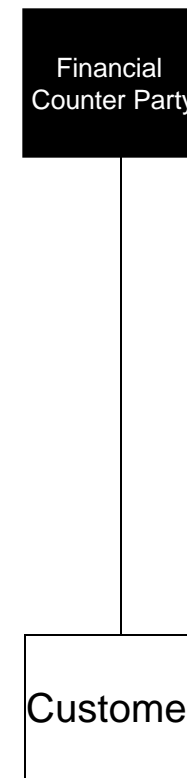
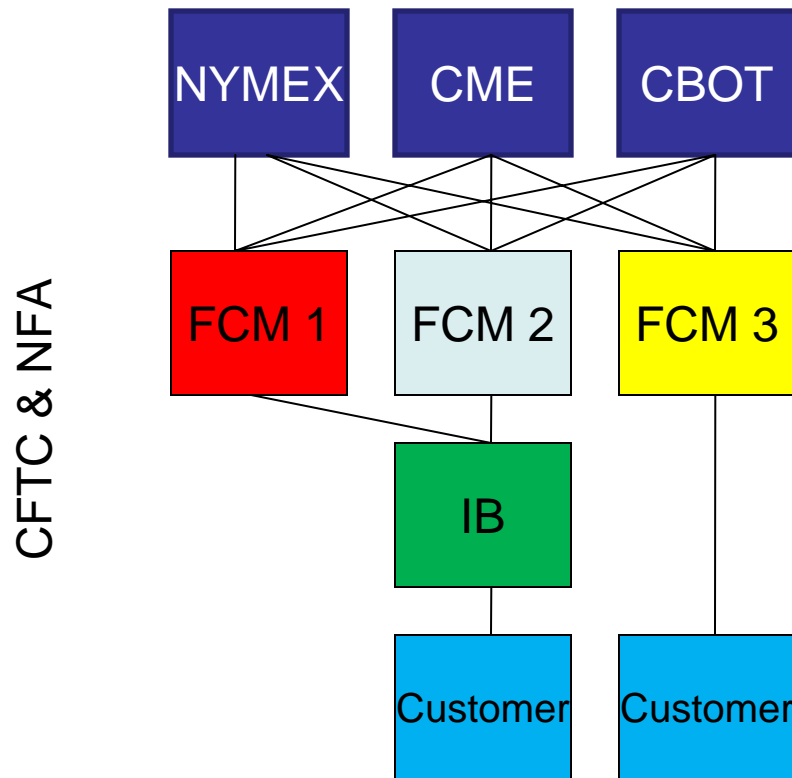
*List Of Noteworthy Credit Failures

<u>Company</u>	<u>Bankruptcy Date</u>	<u>Assets (in Billions)</u>
Lehman Brothers Holdings	09-15-2008	\$691
Washington Mutual	09-26-2008	\$328
Worldcom, Inc.	07-21-2002	\$104
General Motors	06-01-2009	\$91
Enron Corporation	12-02-2001	\$63
Conseco, Inc.	12-18-2002	\$61
Chrysler	04-30-2009	\$39
Thomburg Mortgage	05-01-2009	\$36
Pacific Gas and Electric	04-06-2001	\$36
Texaco, Inc.	04-12-1987	\$36
Financial Corporation of America	09-09-1988	\$34
Global Crossing Ltd.	01-28-2002	\$30
UAL Corporation	12-9-2002	\$25
Adelphia Communications	06-25-2002	\$21
MCorp	03-31-1989	\$20
Mirant Corporation	07-14-2003	\$19
First Executive Corporation	05-13-1991	\$15
Gibraltar Financial Corporation	02-08-1990	\$15
Kmart Corporation	01-22-2002	\$15
FINOVA Group, Inc., (The)	03-07-2001	\$14
HomeFed Corporation	10-22-1992	\$14
Southeast Banking Corporation	09-20-1991	\$13
NTL, Inc.	05-08-2002	\$13
Reliance Group Holdings, Inc.	06-12-2001	\$13
Imperial Corporation of America	02-28-1990	\$12
Federal-Mogul Corporation	10-01-2001	\$10
First City Bancorp of Texas	10-31-1992	\$10
First Capital Holdings	05-30-1991	\$9
Baldwin-United	09-26-1983	\$9

Identifying Counter Party Risk

Regulated Futures Structure

Unregulated OTC Structure

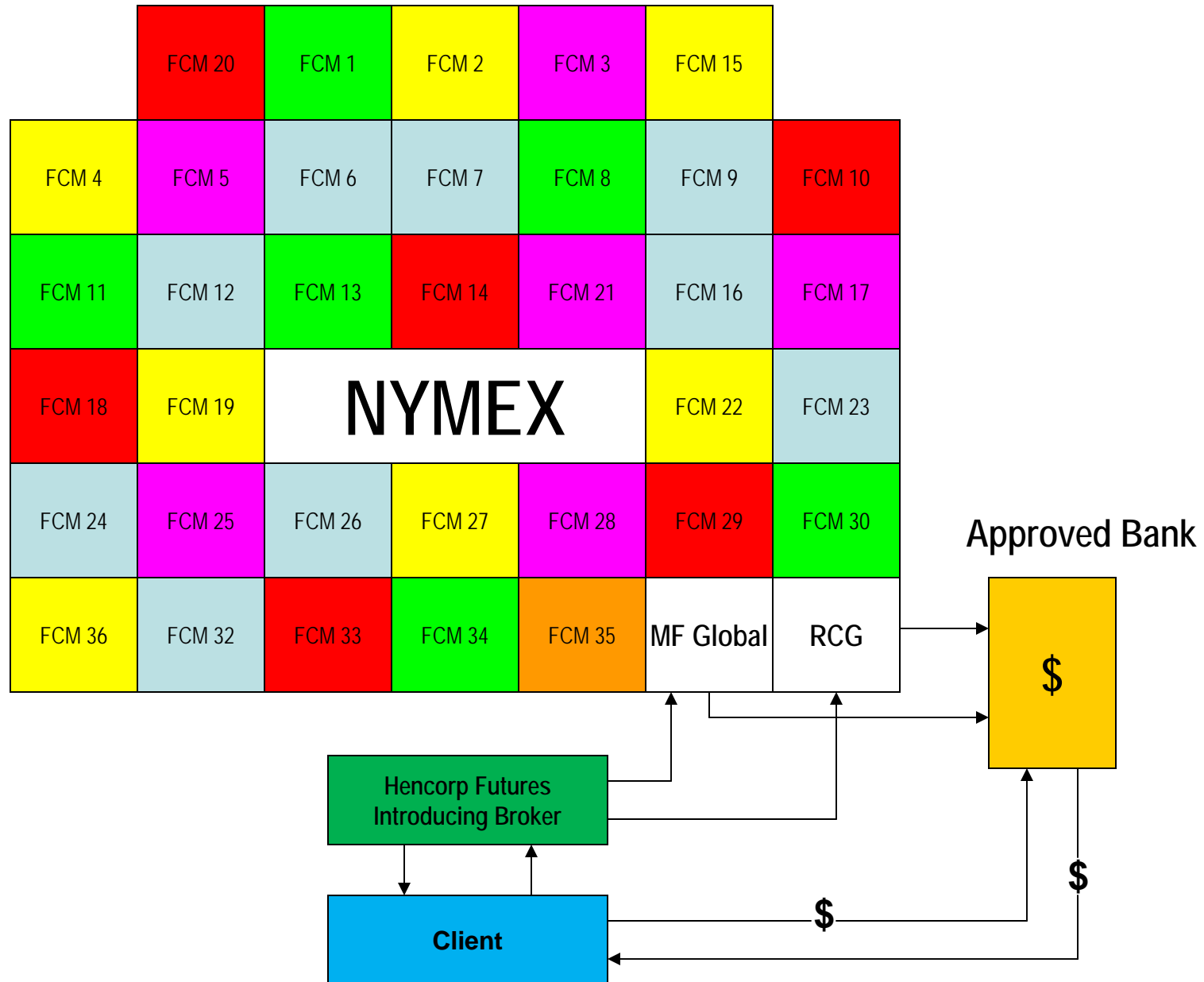


Regulatory Protection from potential abuses

- Fraud
- Manipulation
- Abusive practices

No Regulatory Protection from potential abuses

Minimizing Counter Party Credit Risk...How it works...

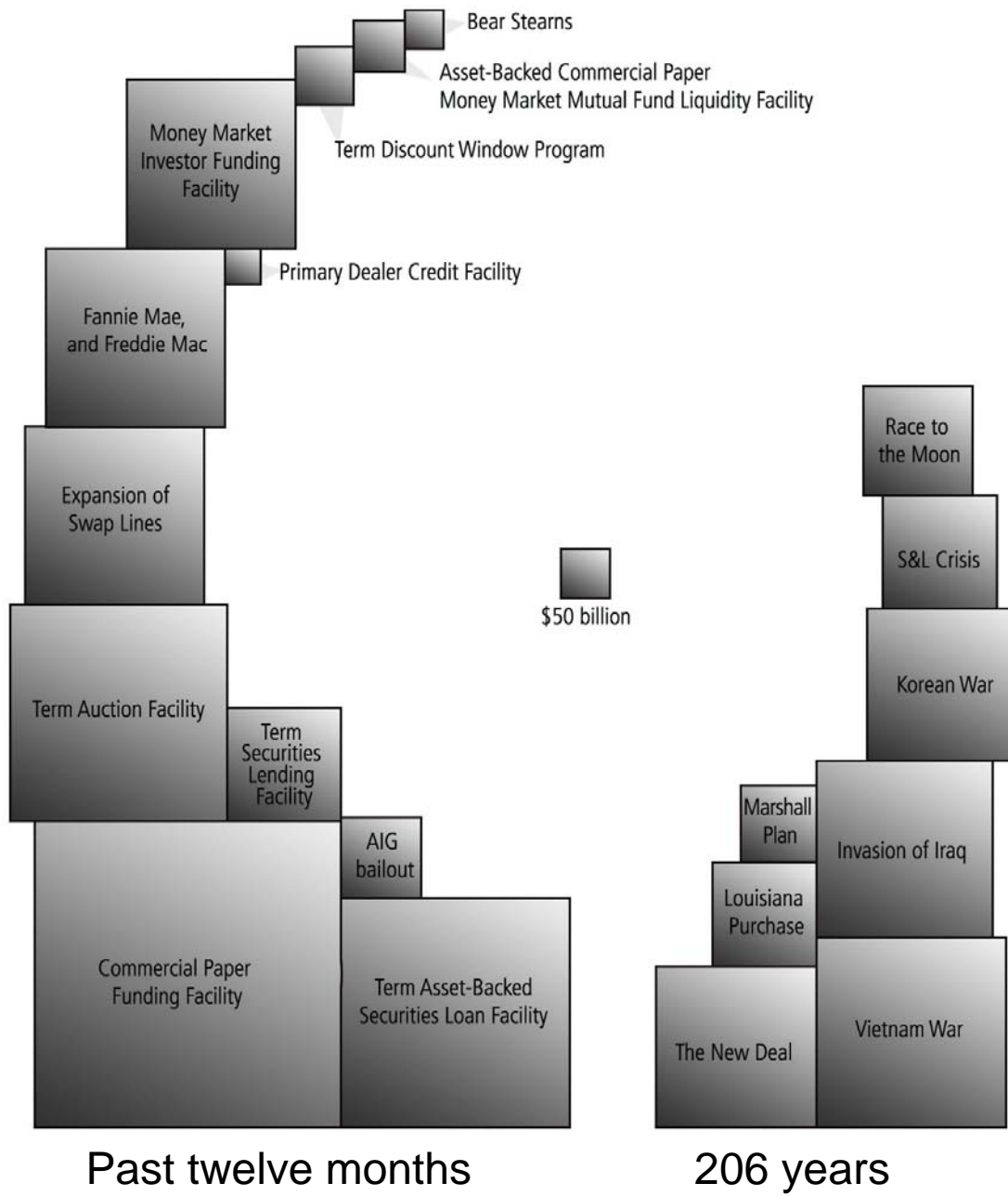


44 NYMEX Clearing Members

1. ADM Investor Services, Inc.
2. Advantage Futures, LLC
3. AIG Clearing Corp.
4. Bank of America Securities, LLC
5. Barclays Capital, Inc.
6. BNP Paribas Commodity Futures, Inc.
7. BP Corporation North America, Inc.
8. Citigroup Global Markets Inc.
9. Credit Suisse Securities (USA) LLC
10. Deutsche Bank Securities, Inc.
11. Enskilda Futures Limited
12. FC Stone, LLC
13. Fortis Clearing Americas LLC
14. George E. Warren Corporation
15. GETCO, LLC
16. Goldman, Sachs & Co.
17. HSBC Securities (USA), Inc.
18. J.P. Morgan Clearing Corporation
19. J.P. Morgan Futures, Inc.
20. Jump Trading LLC
21. Macquarie Futures USA Inc.
22. MBF Clearing Corp.
23. Merrill Lynch, Pierce, Fenner & Smith Inc.
24. MF Global Inc.
25. Mizuho Securities USA, Inc.
26. Morgan Stanley & Co., Inc.
27. NEWEDGE USA, LLC
28. Penson GHCO
29. Phibro, LLC
30. Prudential Bache Commodities, LLC
31. Rand Financial Services Inc.
32. RBC Capital Markets Corporation
33. RBS Securities Inc.
34. R.J. O'Brien & Associates, LLC
35. Rosenthal Collins Group, LLC
36. SMW Trading Company, Inc.
37. Sterling Commodities Corporation
38. Term Commodities, Inc.
39. Triland USA, Inc.
40. Timber Hill LLC
41. Tradelink LLC
42. Triland USA inc.
43. UBS Securities, LLC
44. Vision Financial Markets LLC

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Transaction Costs

Regulated

Futures Markets

- 100% Cost Transparency

Unregulated

OTC Markets

- Limited Cost Transparency

Cost per MMBTU

• Brokerage Fees	\$0.003000
• Exchange Fees	\$0.000290
• NFA	\$0.000002
• TOTAL	\$0.003292

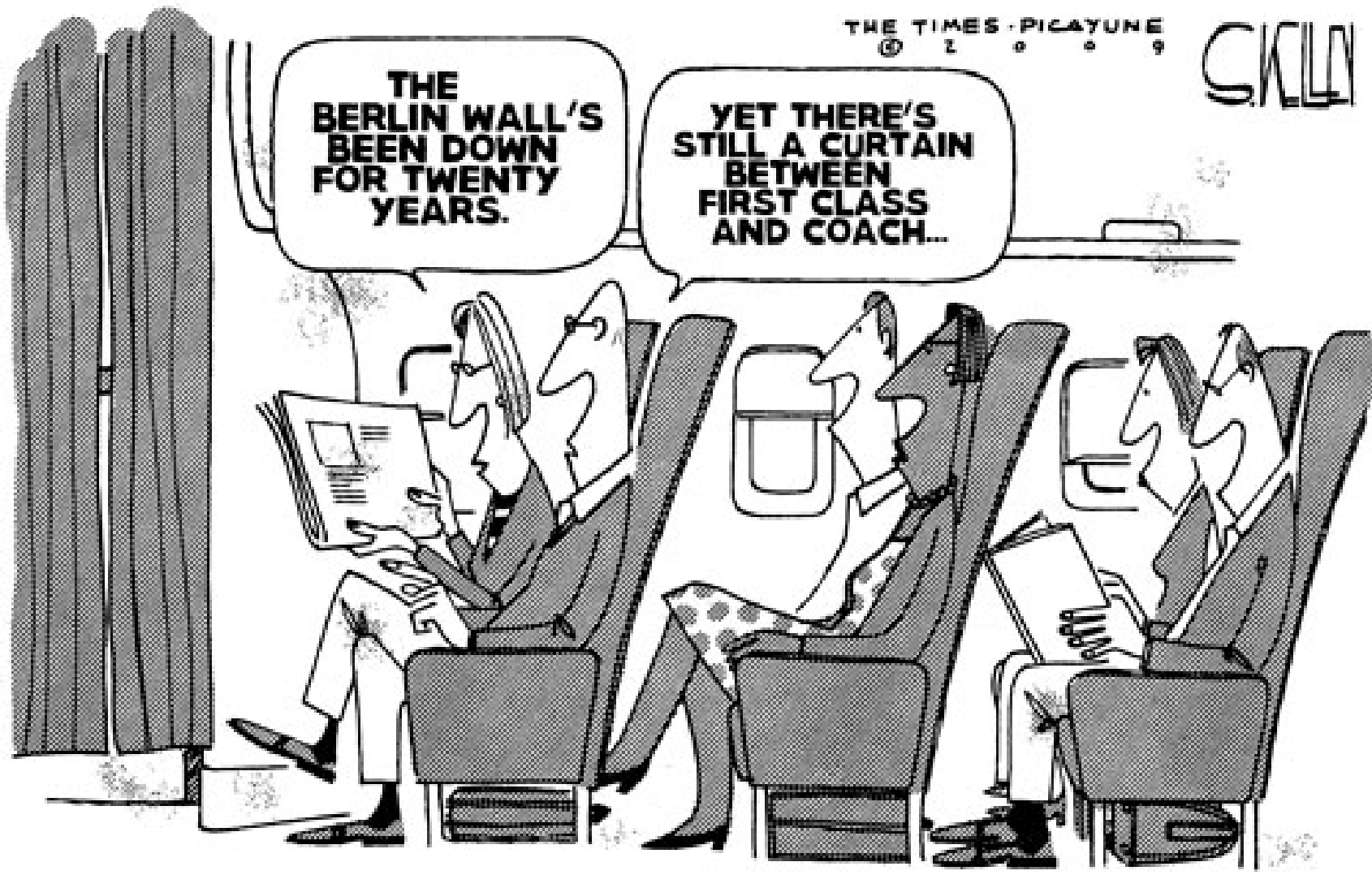
- Bid and Ask Spread
- Added Convenience Markup

\$\$\$\$\$\$



THE
BERLIN WALL'S
BEEN DOWN
FOR TWENTY
YEARS.

YET THERE'S
STILL A CURTAIN
BETWEEN
FIRST CLASS
AND COACH...



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