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Speech

"Green CAT" Markets
You Gotta Show Some Guts

Speech of CFTC Commissioner Bart Chilton before the Chicago Climate Exchange & Chicago Climate Futures Exchange, Sixth Annual Meeting, Chicago, Illinois

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Introduction

Good morning. Thank you for that introduction Richard. There are a few people in the futures industry who are true leaders. Richard Sandor is one of them. Shortly after I was confirmed by the Senate, I went to hear Richard—one of Time Magazine's "Heroes of the Environment"—speak at George Washington University. He talked a little about his time at Berkeley, about derivatives and financial futures, about how the CCX came to exist from very early on, about his global work on environmental markets, and his visits to China and to Peking University. He spoke about how the futures markets can be a force for environmental good. Needless to say, I'm big fan.

Green CAT Markets

The philosopher Henry David Thoreau—not known for his investment advice—once said that "Goodness is the only investment that never fails." Well, "Green CAT" markets—that is green cap and trade markets—are going to be good markets *and* good investments for our nation and the world.

A testament to that goodness is the diversity of membership here today—the diversity in this room. Folks representing entities from aerospace, agriculture and automotive; chemicals, and commercial interiors; electric and ethanol interests; financial, food and forest firms; manufacturing, mining, municipalities and other state and local governments; technology and transportation interests, and even healthcare and academia. Also critical to making this market concept work are the offset providers and aggregators, liquidity providers, and market makers, who help make these markets function while also contributing to the goal of greenhouse gas reduction.

Black & White Cookie

I know we all care about the environment. For some of you, that is your primary reason for being a member here. I commend you. But, after all, there is also an economic purpose to this endeavor. Not many years ago, however, making the business case that good environmental stewardship also made good economic sense was tough. Not today. Nope, now business and environmental stewardship go together. It reminds of the Seinfeld "Dinner Party" episode where Jerry says to Elaine, "The thing about eating the Black and White cookie, Elaine, is you want to get some black and some white in each bite. Nothing mixes better than vanilla and chocolate . . . . If people would only look to the cookie," he says, "…all our problems would be solved." Today, good business and good environmental polices go together—like the Black and White cookie. More and more people are seeing that we can turn what might have been considered economic drains into gains with great benefits. Good environmental stewardship is now seen as a business driver that can fuel the economic engine of our democracy.

You are all part of "the most important thing that we have never done." That is, we have never had a market like the one that is being created, the one that you are a part of now on a voluntary basis. We have never had such pressing need—and yes, the opportunity—to use those markets for so much good. Just last Friday, CCFE established a new record for daily volume. Total open interest on the CCFE is up 143 percent in 2009. CCX also recently had its largest trading day in history.

If we take a quick trip in the Wayback Machine to the origins of these markets in the 1990's, it is obvious that the global market for carbon emissions has grown tremendously. In 2002, the World Bank estimated the volume of carbon emissions traded globally at 32 million metric tons with a value of approximately $100 million. For 2008, these values were 4.8 billion metric tons, and a total dollar value of $126 billion. What does all that mean? It means that the market value of global carbon trades has experienced an average annual growth rate of about 329 percent since 2002! That is a cumulative increase of 126,000 percent! That's not conjecture, it is a hard number fact that this trading has gone from $100 million to $126 billion.

Taking this a step further, we observe generally that in developed markets, futures trading is conservatively 10 times the size of the cash market for many commodities and can even be as great as 30 times that of the cash market for certain financial products. Even with the conservative assumption of 10 times the cash market, this would imply we are looking forward to a $2 trillion dollar futures market!

In terms of volume, a $2 trillion market would be the equivalent of anywhere from 60 to 180 million contracts. To give you an idea of the magnitude of this, in 2008, Light Sweet Crude Oil traded on NYMEX saw a volume of about 135 million contracts. Natural Gas experienced an annual volume of almost 39 million contracts, and all metals combined on NYMEX, about 53 million. So, we are talking about a really incredible potential for emission markets.

Make no mistake, these carbon markets can be the world's largest commodity markets in a few short years.

Good Company—Waxman-Markey Legislation

There is that old saying that it is not what happens to you in life, but how you react to it that sets your course. Well, we are on a good course. That course, by the way, is being spearheaded by the leader of the free world: Barack Obama. So, you are all in good company.

It was candidate Obama who, just before the election, said that if he was elected the green economy and addressing global warming would be his number one priority. He hasn't wavered in that mission. In fact, he has pushed Congress to move forward with a Green CAT bill. As you know, that legislation was passed by the Energy and Commerce Committee in the U.S. House of Representatives before Memorial Day, and is scheduled to come before the full House before the August break. President Obama says he wants the bill to become law by the end of the year.

Passing the new law won't be easy. As the President has said, "Politics is a contact sport." There are plenty of opponents to these Green CAT markets. Some say now, given our fragile economy, is the wrong time to move forward on any legislation that might put increased pressure on business. Some think these Green CAT markets will be fraught will fraud, abuse or manipulation and we should simply put a tax on carbon emissions. By the way, that is one reason why the CFTC recently expanded an advisory committee, which I'm pleased to chair. The Energy and Environmental Markets Advisory Committee, or EEMAC, is seeking to do something all-too-often not done in government. We are trying to get ahead of the curve to ensure that we are ready for these new mandatory markets.

Some opponents of the Green CAT bill say it will cost households as much as $3,100 per year and called the plan a "massive national energy tax." But according to factcheck.org, "…the $3,100 figure is a misrepresentation of both Obama's proposal and the study from which the number is derived." Even the conservative Heritage Foundation estimates the price tag at less than half of that—$1,500 per year. Some have estimated the costs at about $800 a year per household, while the Environmental Protection Agency (EPA) suggests the cost between $98 and $140 per year.

The Green CAT bill that passed the Committee—H.R. 2454, the Waxman-Markey legislation—would cap emissions at 17 percent below 2005 levels by 2020. That's a sharper initial reduction than the 14 percent cut originally proposed by candidate Obama. Important language in the bill is that it contains a provision for the government to sell 15 percent of the allowances. The proceeds of the auction would go toward off-setting the increased energy bills of low to moderate-income families. Eventually, the bill would auction 100 percent of the allowances and cap emissions at 83 percent below 2005 levels by 2050.

While the President wants the bill completed by the end of the year, there are lots of hurdles to clear, including other House committees, the House floor—then, of course, the Senate. But this effort, the effort you and President Obama are involved in, is a good thing. And you, who I have called Progress Pioneers, are at the forefront. There is a saying that change is made by those who participate. That is certainly true for climate change. Your involvement kind of reminds me of that great Springsteen song, "Leap of Faith." Bruce sings, "It takes a leap of faith to get things going. It takes a leap of faith, you got to show some guts." Well, you have all shown some guts by being the first to get involved in these voluntary markets and I commend you.

While I'm sure you don't object to being commended, being commended only goes so far. The Waxman–Markey Green CAT bill, if passed, would preempt state-run trading schemes, like the RGGI or Western Climate Initiative for a period of seven years. Those who hold RGGI or CCAR allowances would be compensated with allowances from the federal program. Regulated facilities that have already purchased credits under RGGI or other state programs would be able to exchange them for federal credits "sufficient to compensate for the cost of obtaining and holding such state allowances," in an amount determined by the average auction price in the year in which the allowance was issued.

Given all these moving parts, that negotiations are still far from over, and that the legislation is constantly evolving, it is still possible that early action taken by members of CCX will be rewarded to an even greater degree.

Shape Shifters—Regulatory Reform

There is one final area I wanted to mention. We read about regulatory reform in the newspapers. What I want to make clear is that we need it and need it now—especially as we look to Green CAT markets. As part of the Waxman-Markey legislation, there are important regulatory reforms that would be put in place at the CFTC—amendments to the Commodity Exchange Act to provide greater transparency of dark markets, that is regulation of certain over-the-counter trading that could have an impact on price discovery. The CFTC would place position limits to avoid undue speculation that could result in manipulation.

We all saw what happened last year with crude oil and gasoline prices. They went through the roof. Long passive investors flooded to these markets. I think they had an impact on raising the prices to $147 a barrel for crude oil. Unfortunately, we don't have all the rules and regulations that we need in place to ensure that there is no excessive speculation in these markets. Don't get me wrong, we need speculators. Speculation shouldn't be a four letter word. I understand that. I'm also not suggesting that speculators were the single cause of the large run-up. Certain fundamentals also played a role. But when consumers pay more for any commodity than they should, it is my job as a regulator to try and stop it. While some solid efforts have been made, nothing has been approved to give us new tools since last year. All of this as we are once again seeing oil and gas prices moving up fast. Oil settled over $70 yesterday, and we have seen a 60 percent increase in crude oil prices this year. Retail gasoline prices here in Chicago have risen from $1.86 on January 5 of this year to $2.92 on June 8—that's an 56 percent increase in just six months. That, with a ten-year high in supply and a ten-year low in demand. If, as a regulator, I wasn't concerned about those dynamics, then I should be fired.

Thankfully, the Waxman-Markey bill, with the amendment by Congressman Bart Stupak that was inserted into the legislation, will address many of these issues. There are other efforts to try and address these problems. The House Agriculture Committee passed a bill earlier this year with bipartisan support. That legislation, which I support, would provide many new authorities. But we need to be on top of things and always looking around the corner for the shape shifters.

Let me give you an example of what I mean by the shape shifters. Several years ago, the CFTC was faced with a plethora of fraud cases involving something called “forex”—foreign currency transactions. You’ve probably seen advertisements for this kind of thing on late night television—how to make a lot of money with virtually no risk trading Eurodollars or yen or whatever the “currency de jour” is. And the classic maxim, “if it sounds too good to be true, it probably is,” certainly applies to forex trading. Thousands of unsuspecting individuals across the United States were being scammed by fraudulent bucket shop operators—guys who would simply take their money, promising sky-high profits, and then disappear with the cash. These were often “affinity fraud” cases—the low-life types perpetrating the scams would target members of an affiliated group: a church, an ethnic community, even people with a certain type of disability. Kind of makes you sick to think about it.

The problem from the regulatory side occurred when, because of a glitch in our statute, certain courts told us we could no longer bring these fraud cases. Congress tried to fix the problem in 2000, and yet again, we ran into legal challenges in federal courts. The fraud continued, and finally, in the summer of 2008, Congress changed the law to provide the CFTC with clear authority to bring forex fraud cases. But here’s the kicker: Congress fixed the law with regard to “forex” only, that is, our fraud authority doesn’t apply to any other commodities using similar type contracts. I had urged an expanded fraud authority. So the same bottom feeders who got away with cheating customers in forex contracts simply shifted shapes and switched to other commodities, like gold or silver. They don’t care what they’re allegedly “selling” (no actual commodity ever changes hands anyway—it’s all a farce). Because the law was narrowly written, the fraud continues, just in different flavors. It’s a current debate, and one that I believe deserves to be addressed by amending the law to include a broad commodity fix for this type of off-exchange trading. American consumers need and deserve to know that we’re protecting their interests—whether on regulated exchanges or in illegal off-exchange trading—that’s our job.

So, we need new authorities to protect consumers and markets. We need them in general, but we certainly will require such changes as we are about to oversee the largest commodity markets on the planet.

Conclusion

I’m inspired by your attendance here today. I thank Richard for the invitation to join you and wish you a good day. Like Bruce sings, you’ve shown some guts. To me, each of you represents the optimism we need to overcome this global challenge.

Thank you.