Testimony of

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to the

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Thank you Chairman Boswell, Ranking Minority Member Moran, and other members of the Subcommittee. I appreciate the opportunity to appear today and to submit written testimony on the application of the Cantor Futures Exchange, L.P. ("Cantor Exchange") to the Commodity Futures Trading Commission ("CFTC") for designation as a contract market, and to discuss the public utility, transparency, and risk management benefits of Cantor Exchange's proposed movie box office futures contracts. Cantor Exchange's futures contracts are designed to bring risk management, transparency and financial flexibility to a wide range of participants in the film industry, similar to the role of regulated futures markets in agriculture, energy products, financial instruments, and other sectors of the marketplace.

Introduction to Cantor Fitzgerald and the Cantor Exchange

I am here today in my capacity as the President of the Cantor Futures Exchange. Our parent company is Cantor Fitzgerald, which began as an investment banking and brokerage business in 1945. Following the loss of 658 of its 960 New York-based employees in the 9/11 World Trade Center attacks, Cantor rebuilt to become one of the leading and most widely-respected global financial services firms, recognized for its leadership in serving institutional clients in the fixed income and equity markets and for capital markets investment banking. Driven to succeed in order to help the families of its employees who perished on September 11, Cantor provided over $180 million to the families over five years, including healthcare benefits for ten years for the families that needed it. In addition, to commemorate those who were lost, Cantor and its affiliates forego all their revenues each September 11, donating the full amount to charities that help wounded veterans, children with medical and special needs, and other worthy causes. Turning a tragic day into something positive and uplifting, these annual Charity Days to date have generated over $50 million for charitable organizations. Over the past eighteen months, as the financial markets experienced substantial turmoil, Cantor has added hundreds of new jobs, continuing its expansion and growth during a most difficult time in the global capital markets.

Cantor Fitzgerald is one of 18 primary dealers authorized to trade U.S. government securities with the Federal Reserve Bank of New York. Cantor Fitzgerald has been a major participant in the futures markets and has itself sponsored futures exchanges in the past. Indeed, Cantor Fitzgerald has been involved in operating futures exchanges since 1998. Cantor Exchange's affiliation with Cantor Fitzgerald underscores Cantor Exchange's capability and expertise to professionally operate, finance and monitor a well-run, efficient, federally regulated futures exchange.

Cantor Exchange's Movie Box Office Futures Contract

Cantor Exchange has submitted an application to the CFTC to establish a futures market for contracts linked to the domestic box office receipts ("DBOR") of upcoming film releases. These contracts will be cash-settled at a value that is directly indexed to the dollar value of movie tickets sold in the US and Canada that consumers purchase over a period of approximately four weeks.

The goal of Cantor Exchange has always been to assist the motion picture industry by expanding the breadth and depth of financing sources available to the industry. Enlarging the potential sources of film financing will lower the cost of making a film, help create American jobs, and contribute to stabilizing large and small members of the industry alike as they face the challenge of raising financing in the high-risk endeavor of filmmaking.

We believe that a critical element in this effort is a public, transparent, and appropriately regulated futures market. It's important to point out that the film industry consists of many participants. In addition to the major studios, they include mini-majors and other smaller studios, independent producers and distributors, theater owners and investors. I've talked with a great number of them in the past weeks and months, and it's absolutely clear that there is wide and deep support for the ability to hedge theatrical risk and that hedging capability will drive a fundamental improvement in film finance.

Our box office receipt contract is a straightforward hedging vehicle. It is an important design feature of our contract that box office receipts are a real and knowable value, based upon credible marketplace data. DBOR contracts are structurally identical to cash-settled futures contracts on many economic indices that similarly provide for cash payments based on real underlying economic value. In the case of DBOR contracts, settlement is based on the aggregate box office receipts of the underlying film as reported by the distributor of each film and captured by Rentrak Theatrical.

DBOR contracts are not a direct investment in film, but rather a cost effective means to hedge the extraordinarily high risk of the movie-going public's willingness to pay between $5 and $15 to watch any single film. Some films, like "Avatar", generate audiences and revenue that not only have strong openings but sustain their financial strength over a protracted period, whereas the audience for films like "Gigli" and others evaporated quickly as consumers shift their preferences to better movies. The transparency offered by a regulated public market and the ability to hedge risk has indisputably been shown to result in reduced capital costs and greater competition, and that is the function and value that we propose to bring to the marketplace.

We believe one of the immediate beneficiaries of our DBOR futures contract will be investors who provided the capital investment to make these films and are locked into multi-year, illiquid investments. Then, we expect the transparent public pricing and commercial potential of DBOR contracts will be recognized by theater owners to help reduce revenue volatility across their business by hedging their exposure to film-release volatility. We believe that every segment of the motion picture industry will ultimately find value in using box office receipt futures to hedge risk and broaden access to less expensive financial resources.

While the Motion Picture Association of America, the MPAA, has raised concerns about our contract's usefulness as a hedging vehicle, it's often been the case in the history of the markets in our country – the oil and aluminum industries are notable examples – that industry participants that initially resisted change came to see the futures market as an instrumental element of their industry's business and financial practices.

Comprehensive Regulatory Review Process

Cantor Exchange has been working with the CFTC on its application to become a designated contract market. For over two years, Cantor has worked diligently with two staff teams of the CFTC to comprehensively demonstrate why box office futures satisfied the CFTC's Core Principles as required by the Commodity Exchange Act, including the ability to adequately prevent market manipulation and enforce equitable access and trading rules. I want to emphasize this point: our proposed exchange has proper and prudent safeguards against trading on inside information consistent with CFTC requirements. Indeed, these issues had been the subject of intense scrutiny by the professional staff of the CFTC and, by all accounts, had been successfully addressed in the application process.

Our application was formally submitted to the CFTC on November 28, 2008. A public comment period on our exchange was held by the CFTC during January 2009 and no comments were received. A second public comment period on the subject of box office receipt contracts was available to the industry in October 2009 when Media Derivatives applied for designation and again no comments were received. The CFTC's review of Cantor Exchange's application is substantially complete and a decision on our application is expected this month.

Despite receiving no comments during either public comment process, we are here today at the first ever Congressional hearing on an exchange application in the history of the CFTC because a segment of the motion picture industry has raised public policy objections at the eleventh hour to any form of futures contract based on domestic box office receipts. We think it is clear that the assertions of the MPAA are groundless.

The law and regulations of the United States are clear and unequivocal about fair trading rules, market surveillance, compliance and enforcement to ensure financial integrity and transparency of futures markets. As an expert agency and regulator of futures markets, the CFTC is well-equipped to consider the public utility and transparency that box office receipt contracts will bring to the motion picture industry. The CFTC has adequate authority to ensure that any proposed futures contract meets the public policy, anti-manipulation, and fair competition requirements of current law. The CFTC does not need further legislation or regulation to make an appropriate determination of this issue.

Since enactment of the Commodity Futures Modernization Act in 2000, the CFTC has designated over ten additional futures exchanges as contract markets, including Trend Exchange (Media Derivatives) on April 16, 2010. The CFTC has also registered at least nine clearinghouses as "derivatives clearing organizations" during that time. Countless new products have been filed with the CFTC since enactment of the CFMA, with the majority "self-certified" by exchanges for immediate trading. None of these innovative exchanges or the products that they self-certified under the watchful eye of the CFTC has been associated with any form of systemic risk or financial stress.

We expect that the creation of futures contracts based on box office receipts could dramatically lower financing costs for motion pictures; we expect that futures contracts could act as an engine for overall growth in the motion picture industry; and we expect that small and independent firms and financial investor partners would benefit considerably by having a hedging vehicle.

We did not expect, however, the inaccurate, over-reaching and extraordinary claims of gambling, manipulation, and commercial damage made by the six largest studios' trade association, the MPAA, on March 23. Through its unfounded and insupportable assertions, the MPAA essentially has impugned all futures trading, attacking the practices of the energy, aluminum, agricultural products and other industries as equivalent to gambling and marketplace manipulation.

Cantor Exchange appreciates the opportunity to address these assertions with the Subcommittee. The primary purpose of my testimony today is to reinforce to the Members of this Subcommittee the sound and sensible answers that were presented to CFTC staff over the last two years. In so doing, our hope is that the Subcommittee recognizes the careful, thorough and considerable effort that both Cantor Exchange and the CFTC have put forward to ensure that Cantor Exchange and the DBOR contracts meet the letter and the spirit of the Commodity Exchange Act and, just as importantly, represent a positive innovation for the motion picture industry.

Economic Purpose of Box Office Contracts

The motion picture industry is undergoing radical transition brought about by changes in film distribution technology, the Internet, and the ongoing financial crisis. All of these factors have combined to partially destabilize this very important American industry. The number of motion pictures produced in 2009 dropped dramatically by 12%, the first decline since 2003. Bank financing for films has all but ceased, over ten independent film companies either ceased doing business or consolidated their operations over the last 24 months, and the number of jobs lost by the film industry is estimated to be in the thousands.

A public market for futures contracts based on domestic box office receipts will not by itself reverse these trends. However, DBOR contracts will provide a fully transparent and highly regulated marketplace where the risks of film investing can be shared and financing costs can be lowered.

There are currently no mechanisms for firms in the motion picture industry to hedge risk associated with new film releases and, accordingly, there are no open and transparent markets for such transactions. A panoply of banks, institutional investors, and individuals place capital into various film financing vehicles and are exposed to unhedged box office risk. Other participants in the industry including distributors, theater owners and film studios themselves also have substantial un-hedged exposure to a film's box office performance.

Investing in film production and distribution is extremely risky. Motion picture finance has failed to find a sustainable investor base due to the great uncertainty of film performance at the box office. Particularly in times of economic uncertainty, the high variability and risk of returns means that identifying sources of film financing quickly becomes difficult.

The ability to finance films and manage the risks associated with film finance varies greatly. The major studios may be least affected by financial stress. Owned by large corporations, they benefit when fewer films are produced and there is less competition for movie goers, and they have the greatest leverage in negotiating revenue splits with theater owners.

Weakest among the risk bearers include the financial investor who places capital in a multi-year film fund, the small theater owner who commits screens to major studios based solely on representations of those studios, and the production company that has little control over the marketing and distribution of its film. We submit that these commercial interests, combined with non-MPAA studios, represent a large enough and significant hedge community to meet the requirements for economic purpose under the Commodity Exchange Act.

In addition to the extensive support for futures contracts we have identified amongst this section of the industry, there also is support by some of the larger players in the motion picture industry. Michael Burns, the Vice Chairman of Lionsgate, one of the leading independent film studios with a major presence in producing and distributing motion pictures, submitted a letter on April 16 to the House Committee on Agriculture in support of DBOR futures. Mr. Burns indicated that the regulated futures market proposed by Cantor Exchange "would allow a diverse group of motion picture industry participants, including studios, film distributors, theater owners, investors and other financial intermediaries within the motion picture industry to manage their risk and exposure to new film releases." Mr. Burns added "We believe a market in domestic box office receipts would substantially widen the number and breadth of financing sources available to the motion picture industry by lowering the risk inherent in such financing." We also understand that despite the National Association of Theater Owners signing various letters of objection, individual theater owners representing almost 20% of all theaters in America wished to see DBOR futures made available and not restricted as a result of any regulatory or legislative action.

With respect to price discovery, the MPAA asserts in its March 23 letter that DBOR contracts would not serve this public purpose; however, the MPAA subsequently submitted another letter on April 8 in conjunction with other film industry associations which explicitly recognizes that commercial transactions are affected by the pricing of film revenue contracts. Specifically, the April 8 letter stated that "[m]any prices for downstream licenses and other sources of revenue are driven in part by box office gross".

Transparency of information can only be a positive for any market. For eight years, Cantor Fitzgerald's virtual entertainment marketplace, the Hollywood Stock Exchange ("HSX"), has found that its hundreds of thousands of participants have not negatively impacted the virtual market domiciled on HSX.

In contrast to unfounded claims by the MPAA, and because of the many economic interests and legitimate hedgers that have directly or indirectly expressed support for the existence of a market in box office futures, we submit that this market should be allowed and encouraged to exist.

Box Office Contracts Have Safeguards Against the Risk of Manipulation

Cantor Exchange and its DBOR contracts will be monitored and policed like any other CFTC regulated market. To support its own compliance efforts, Cantor Exchange has engaged the National Futures Association ("NFA"), the industry-wide self-regulatory organization for the U.S. futures industry, to provide the exchange with self-regulatory services to monitor trading and protect against market manipulation and other abuses. NFA has demonstrated its ability to safeguard and protect the public interest in markets as broad and diverse as carbon futures markets and the foreign exchange markets.

The final settlement value of a DBOR contract represents the movie ticket purchases of millions of American consumers over a period of approximately four weeks. These purchases are reported by movie theaters, tabulated by Rentrak Theatrical, and published by studios. Therefore any effort to manipulate the DBOR contract's final settlement value would require tens of thousands of ticket sales to be under or over reported. It is hard to accept that such a large scale reporting gap could go undetected by all these commercial entities. For example, studios compare pop corn and soda sales to ticket sales as a check against under reporting. Even if such a fraud was attempted using box office futures, the beneficiaries of any such manipulation of the final settlement value would be quickly detected by Cantor Exchange, the NFA, and the CFTC. As Lionsgate's Mr. Burns indicated in his letter to the Committee, "Lionsgate is comfortable that the market for futures on box office receipts can be adequately policed regarding material non-public information and attempted market manipulation. The Cantor Exchange, under the CFTC's rules, will restrict trading by those with material non-public information relating to film releases."

Manipulation is often associated with trading on material, non-public information. Clearly, certain institutions that may have an economic interest in hedging with DBOR contracts will have access to material non-public information relating to the underlying film title. This is not different from the situation in other public markets where trading activity is walled off from those who have material non-public information.

Currently, the entertainment industry has no such barriers and has expressed concern about how such barriers might impact their operations. Cantor Exchange would like to emphasize three key points on this issue: (1) information barriers will not be required unless an entity is actively using the market; (2) having knowledge of the artistic content or prior viewing of a film does not constitute material non-public information; and (3) Cantor Exchange will work to assist any firm that wishes to prohibit its employees from trading. For example, Cantor Exchange does not permit trading by any employee of a FINRA or CFTC regulated entity unless that employee has the written permission of his employer's compliance department.

Commercial Value of DBOR Contracts

As I noted, the financing and distribution of motion pictures is undergoing a period of enormous technical and financial change. Studios largely control the distribution of films and are uniquely able to fund the large advertising budgets so crucial to a film's box office success. Recently studios have abandoned many of their boutique divisions that distributed independent film, focusing instead on blockbusters.

However, digital distribution of motion pictures will make it easier for movie theaters to show smaller independent films. The missing element for independent film makers and distributors is a means to evaluate the commercial potential of their film and secure financing against that potential. This is exactly the role that a futures market based on box office receipts can play.

The financing of motion pictures is now coming from many new sources including corporate sponsors who may back individual film projects as part of their brand marketing. As the sources of film financing become more fragmented, the need for a regulated and transparent futures market increases.

Hollywood studios have hedged their film making risk for many years, for example, by buying insurance against bad weather during outdoor filming. In spite of its glitz and glamour, the motion picture industry is relatively opaque. We suspect that the MPAA is primarily concerned that a transparent market in film revenues will detract from its influence and control of market information, hence its disingenuous claims that futures trading has no commercial value.

We also recognize that the MPAA's concern seems to be a kneejerk reaction to change, just as companies in the oil, aluminum and other industries initially opposed the establishment of futures markets, but now find them to be useful and customary aspects of their industry's commercial practices.

There is no question that a public market for DBOR contracts will shine a brighter light on the motion picture industry. Allowing a greater number of market participants to signal their expectations about the market by allocating their capital will result in a more accurate assessment of value. We believe this greater transparency could benefit many participants in the industry. For example, purchasers of downstream licenses pay prices based on box office receipts or based on expected box office receipts if contracted in advance. DBOR contract pricing could constructively benefit those negotiations by providing new information to the downstream counterparty that currently has to rely on less public and less transparent sources.

Conclusion

Enlarging the potential sources of film financing will lower the cost of making a film, help create American jobs, and contribute to stabilizing large and small members of the industry alike as they face the challenge of raising financing in the high-risk endeavor of film making. A marketplace that enables film makers to raise capital at a known price will reduce risk and increase the likelihood of bringing their product to market.

The MPAA asserts that its objection to DBOR contracts is based on its belief that those contracts will not provide a genuine market for hedging risk or contribute to price discovery. As my testimony has shown, these critiques are misguided.

It is ironic that while transparency in financial markets is widely endorsed in legislation and Congress is promoting regulated futures exchanges and centralized clearing, the MPAA's objections would result in less transparency, increased counterparty credit risk, and fewer financing options.

Since the early stages of our process to establish the Cantor Exchange, we have actively sought out the input of a wide range of individuals and entities throughout the motion picture industry. Many of those we have reached out to have expressed interest in the concept of DBOR futures contracts. We have received considerable useful feedback and have continued to refine our business plans and strategy.

An April 8, 2010 press release by the Futures Industry Association, the leading trade organization for the futures industry, urged that the potential introduction of film revenue contracts should be "applauded rather than criticized".

We encourage the Subcommittee to ensure that the CFTC continues its diligent work to review and allow transactions to be executed and cleared in regulated and transparent venues. The legislation is already in place to allow Cantor Exchange to operate a futures market in DBOR contracts in accordance with the Commodity Exchange Act, and its application should be approved promptly.

Greater transparency, reduced counterparty risk, and broader participation are precisely the benefits that Congress, economists and others have cited in recommending improvements in the financial markets. During the financial crisis of 2008-2009, most agree that the futures markets performed their function properly. We urge the Subcommittee to support creation of this new, constructive, federally regulated futures market that will enhance the motion picture industry's transparency, market integrity, and ability to effectively manage commercial risk.

We believe our application for contract market designation and for approval of the futures contracts based on box office receipts is clearly in the public interest. Our innovative proposed futures contracts on box office receipts offer many in the motion picture industry the ability to hedge their commercial risks and will be used for price discovery purposes. Although not all interests in the motion picture industry may be inclined to trade box office contracts for these purposes, others stand to benefit greatly from their availability. This has often been the case at the time a new class of futures contracts was introduced.

Prohibiting futures on motion pictures by changes to the Commodity Exchange Act or by new laws or regulations could deny this critical industry a tool available to manage capital and allocate risk more effectively. While all forms of financial innovation should be carefully assessed to determine their value to the marketplace and the public interest, we are extremely confident that the current Commodity Exchange Act and CFTC regulations fully and adequately address all the issues that have been raised by certain groups within the motion picture industry for the Subcommittee's consideration.

On behalf of Cantor Exchange, thank you for this opportunity to discuss how our proposed futures contracts will bring new levels of risk management, transparency and financial flexibility to the motion picture industry.

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