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COMMENT

February 2, 2000

Jean A. Webb, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
21st Street, NW
Washington, DC 20581

Dear Ms. Webb:

I am writing this letter in response to notice RIN 3038ZA05 printed in the Federal Register on January 24 regarding the proposal from the Chicago Mercantile Exchange to increase speculative position limits for the live cattle contract.

I have been an observer and active participant in the live cattle futures contract for over 25 years, the last 13 as a registered commodity broker. I have recently formed my own consulting firm that serves users of the live cattle contract. During the last 25 years I have had the opportunity to work with a number of users of the futures contract, including commercials, speculators, and fund managers. My experience would lead me to the conclusion that the portion of the request to allow an increase in the non-spot position limits from 2,400 to 3,200 contracts would be a move that would not hurt the workings of the market and could allow for more participation. *However, my observations of the workings of the live cattle contract are that any increase from the current 600 contract position limit in the spot month (300 in the last 5 days) could be very detrimental to the effective use of the contract as a risk transference tool.* I am strongly opposed to any consideration of increasing current spot month speculative position limits, and in fact would favor a move back to the levels seen prior to June 1998 of 300 (200 in the last 5 days) until the CME shows a willingness to take the steps necessary to assure an adequate supply of truly deliverable animals.

From the earliest writings of economists regarding the need for futures markets, through the current economic justification criteria used by the CFTC, the message has been clear that the markets have to provide a viable risk transference mechanism for commercial users. Basis must be predictable within reasonable variation, and the true deliverable supply must be large enough to pose a meaningful threat of delivery and to prevent any potential distortions to the market.

Under the current contract specifications for live cattle deliveries, and within the framework of cattle feeding industry structure and practices, true deliverable supplies of live cattle fall far short of that suggested by the CME analysis. While no one enjoys making deliveries of a live animal, the true deliverable supply must be large enough to discourage potential attempts by a small group of speculators to distort the market for their own gains at the expense of other market participants. Thus, I believe that the CME must address the following issues affecting deliverable supplies before there can be any consideration of increasing spot month speculative position limits:

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1. Live Weight Limits. When the short files a delivery intention he has no idea whether the long who gets assigned the certificate will take the cattle on a live or carcass basis. He must be sure that he has cattle that will meet the specifications of either delivery method. However, in regards to weight limitations, there is a major disparity. Under the carcass delivery alternative there are no discounts for carcasses weighing between 600 and 900 pounds. A "market based grid" determines any discounts to be applied to animals outside that range. Realistically, the market rarely if ever discounts carcasses weighing up to 950 pounds. However, under a live delivery no individual animal weighing over 1350 pounds is deliverable. Using a 63% yield, a 1350 pound live animal would yield an 850 pound carcass, well within the weight range acceptable for carcass deliveries at par.

The upper weight limit on live deliveries is especially restrictive in northern plains cattle feeding areas such as Nebraska and Iowa where grain is cheaper and animals tend to be fed to heavier weights. Yet, some of the best quality animals are fed in these areas and are not available as true deliverable supplies by this restriction. Using an assumed 63% yield, live animals weighing up to 1430 pounds should be deliverable at par, with similar "market based grid" discounts applied to live deliveries over that weight as they are to carcass deliveries. With carcasses up to 950 pounds showing no discounts in the market based grid, a 63% yield would equate to a live weight of 1500 pounds – 150 pounds over the current contract limitation -- being defined by the live market as acceptable weight.

2. Heifer Delivery. Heifers are not deliverable under the current live cattle contract specification, yet they represent nearly 35% of the total fed cattle supply. In the cash market heifers receive no discounts, and at times even trade at a slight premium to their steer mates. The CME has seemed very reluctant to even truly address the issue of heifer deliveries. Unfortunately, this has aroused suspicion in the commercial community that the CME may want to put a cap on deliverable supplies. When the refusal to address the heifer delivery issue is viewed concurrently with the request to increase spot month speculative position limits, a questionable image problem arises in the minds of the commercial users of the contract.

3. Other Limitations. The CME's own analysis would conclude that there is a physical capacity to the number of deliveries that can be processed during a delivery period. That capacity is well below the number of deliveries it could take to realistically have an impact on basis under current spot month speculative position limits, let alone any increase in limits. This capacity limitation applies both to the physical facilities to deliver cattle, as well as the difficulty in the transfer of accurate and timely delivery records and settlements by the USDA and CME.

It is not clear what participants in the live cattle futures market are driving the request from the CME for increased spot month speculative position limits. Clearly, opposition to such a move has been strongly voiced by the cattle industry. The Kansas Livestock Association (KLA), Texas Cattle Feeders Association (TCFA), and the National Cattlemens Beef Association (NCBA) all have policy statements opposed to increasing spot month speculative position limits. The majority of fund managers have established trading rules included in their disclosure documents requiring them to have futures positions liquidated prior to first notice day, so they have no interest in changing spot month speculative position limits.

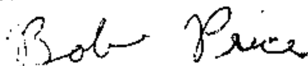
I have heard comments from some individual speculators that because the hedger is granted trading limit exemptions, the speculative limits should be increased to "level the playing field". The true hedger is neither long nor short the market and does not stand to gain from price movement up or down. The hedger is only concerned that basis be predictable. Hedgers that require positions in excess of specula-

tive limits must file reports detailing the history of their cash positions and can be asked with little notice to document their current cash positions. Speculators, on the other hand, have a vested interest in prices moving up or down, and will use any leverage at their disposal to attempt to move prices in the direction by which they can reap the most profit. *Unfortunately, history has shown us many examples of speculative manipulations of the futures markets that were inconsistent with movements in the underlying cash markets, with the live cattle futures market being no exception.*

To summarize, while I see little potential problems in increasing the non spot month speculative position limits in line with the CME request, I am strongly opposed to any increase in the spot month speculative position limits. I do not know one cattle feeder who likes to make cattle deliveries. However, the threat of deliveries is the critical component to basis convergence, and basis convergence is critical to the success of using the futures contract as an effective risk transference vehicle. Until the CME shows a willingness to take steps necessary to increase the true deliverable supply of cattle I urge the CFTC to take a stance against increasing spot month position limits in the live cattle futures contract.

I appreciate the opportunity to respond to this proposal, and I stand ready to further discuss my views with any interested party.

Sincerely,



Bob Price
President
North America Risk Management Services, Inc.