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COMMENT

Minnesota Department of Agriculture

July 10, 2000

RE: Proposed Amendments to CBOT Daily Price Fluctuation Limits

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

Dear Ms. Webb:

I appreciate the opportunity to comment on the Chicago Board of Trade's (CBOT) proposal to increase the maximum daily price limits on its primary commodity futures and options contracts.

First, let me say that the Minnesota Department of Agriculture is a strong supporter of producers using commodity futures and options as a price risk management tool. We are also supportive of producers using cash contracts offered by country elevators and offset by positions in the futures and options markets.

As the third largest soybean and fourth largest corn producing state in the U.S., Minnesota has a strong vested interest in the CBOT corn and soy complex markets. These contracts provide important price discovery and risk management services to Minnesota agriculture. Therefore, any significant changes in the rules and regulations for either of these contracts can have a major impact upon Minnesota agriculture.

The proposed increase in daily price limits and the manual shutdown procedure for limit markets to accommodate trading of CBOT contracts on the existing EUREX electronic trading system will do nothing to improve price discovery and risk management.

The CBOT argues that "...price limits, by their very nature, prevent futures markets from the discovering the market price at times when market participants would most like to have that price information (i.e., after a major news release or other event)". While that may be true in the short run, the current rules do allow for the imposition of expanded limits (at approximately the proposed levels) to allow the market to quickly find its new equilibrium if three or more delivery months close at the limit. Indeed, it is often the case when a major news event occurs that the markets will tend to overreact due to the imperfect information available at that time. Having an overnight "cooling off" period allows traders to better evaluate their information and peg the market to its true equilibrium price. Expanding the existing price limits to substantially higher levels will only result in a greater initial overreaction effect by the market and do nothing to enhance price discovery.

Under the current system, if one or more of the delivery months move the limit, trading (and price discovery) continues in the other delivery months. The current price limit rules only place a limit on how far a price can move and not on trading activity itself. Therefore, if a delivery month moves the limit, a market participant can still potentially execute a trade at that limit price or a price within the limit range. The proposed rule changes would have the CBOT "pull the plug" on trading in all contract months if even one delivery month moves the limit. I don't see how this would improve price discovery at all.

I am also concerned about the impact of the expanded price limits upon the initial margins required for hedging transactions. Expanding the daily price limit would increase the potential daily loss in a hedge account; thus, resulting in increased margin requirements for hedging transactions. This would discourage Minnesota's small farmers and country elevator operators from using CBOT corn and soy complex futures as hedging tools.

Also, the increased daily price limits may result in an increase in the implied volatility in the options markets. This would result in higher option premiums and make it more expensive for Minnesota's small farmers and country elevator operators to use the price insurance offered by the CBOT contracts.

While the proposed expanded limits are proposed only for the CBOT futures and options, I also fear that other smaller exchanges, such as Minnesota's own Minneapolis Grain Exchange (MGE), will be forced to match the CBOT's expanded limits in order to reduce the risk to spread traders. These smaller exchanges rely heavily upon spread trading with CBOT futures in order to transfer speculative volume and liquidity from the larger market. Forcing the MGE to expand its trading limits will create the same adverse impacts upon Minnesota's spring and durum wheat farmers.

While I wholeheartedly support the CBOT's goal of competing in the electronic marketplace, increasing the risk and costs of trading its futures and options in order to accommodate a flawed EUREX trading system is not the correct nor the prudent approach to achieving that goal. The CBOT needs to further study how it can adapt EUREX to its current contract rules and regulations rather than the other way around.

Again, thank you for the opportunity to comment upon this important issue to Minnesota agriculture.

Respectfully yours,

Gene Hugoson
Commissioner