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COMMODITY FUTURES TRADING COMMISSION

# AGRICULTURAL ADVISORY COMMITTEE

## 28TH MEETING

Wednesday, July 19, 2000

1:35 p.m.

Commodity Futures Trading Commission
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# A G E N D A

P R O C E E D I N G S

WELCOMING REMARKS

COMMISSIONER SPEARS: First let me thank all of you for coming. I recognize that participating in these meetings represents a significant commitment of time, effort and expense for all concerned. On behalf of myself, my fellow commissioners and staff, please be assured that we truly appreciate your efforts.

Today's Agricultural Advisory Committee meeting takes place at a pivotal point in marketplace evolution. New markets, the trading system, new technology are bringing profound changes to financial and commodity markets around the world. Exchanges, market users, regulators and legislators are all struggling to keep pace with the rapid-fire developments.

Financial markets have been the principal focus of ongoing change and have received the lion's share of attention but ag markets are also feeling the effects. Agriculture is affected directly; for example, through the emergence of electronic trading systems for ag products. It is also affected indirectly since changes in exchange structures and systems will affect agriculture as well.

Our first agenda item today will be a presentation by Greg Kuserk of the CFTC's Division of Economic Analysis on the Commission's response to the evolving marketplace embodied in the recently published regulatory reinvention proposal intended to simplify and modernize federal regulation of futures and options markets. Please note that the comment period in this proposal remains open and a transcript of the relevant portions of today's meeting will be included in the public record.

Our second agenda item will be presentations by representatives from each of the U.S. exchanges that list agriculture products. Their presentations will include their views concerning the Commission's proposal, their response to competitive challenges, such as innovative changes to their corporate structure.

Following these two presentations we'll have a general discussion of each of the foregoing issues, the potential impact on agriculture futures contracts and markets in general.

A third agenda item today will be presentations by staff members from both the Senate and House Ag Committees concerning Congress's response to the changing marketplace, as embodied in their committees' respective versions of CFTC reauthorization legislation.

Finally, we will hear presentations on recent private sector developments on ag risk marketing and management tools. Representatives from several innovative electronic trading systems will describe new cash markets, potential futures markets, as well, in various ag commodities.

Before we get started I'd like to pause for a few introductions. I'd first like to recognize each of my fellow commissioners and ask them for individual statements if they have some.

To start with, I'd like to recognize Chairman Rainer. Chairman Rainer, as you all know, has been chairman of the agency now for approximately about a year and it's been due to his leadership and efforts that we've come as far as we have during the past year on reg reinvention.

So with that, I'll introduce Chairman Rainer.

CHAIRMAN RAINER: Thank you very much, Commissioner Spears.

I'd like to welcome everyone here today and thank you for your time. We have just an excellent group of people today and I think we're going to get a lot out of this meeting. I'm really excited about it.

I'd like to place this in a little bit of context of what's been going on with this proposal. On June 22 we published in the federal Register the proposed rules for regulatory reform. That was followed on June 27 and June 28 with two public meetings, which were comprised of five panels for a total of 23 different witnesses. We had 24 presentations. One person decided to do it twice.

That included an overview panel of five people who were generally considered very senior people in the industry who'd been around a long time. We had a panel on exchanges, a panel from the over-the-counter swaps industry, and the next day we had a panel on intermediaries, followed by a panel of clearing houses and clearing systems.

And today is an important day because it's in that context we're interested in presenting and hearing from views about how the agriculture commodities may fit into this proposal.

As you're probably aware, at the moment the proposal carves out agriculture from a couple of important elements of the plan, namely rule changes, terms and conditions of contracts, and agriculture commodities are currently in the proposal limited to the RFE status, if you know what that means, and not able to go to the DTF status, which is a lighter form of regulation for certain conditions.

And so it's in that vein that we're interested in this discussion as to what the various views might be and I'm looking forward to--I understand there will be additional--at least one additional meeting on your part to discuss these matters.

So with that, I'll turn it back to Commissioner Spears and thank him and his staff for the efforts of organizing this group. I think around the table and looking in the audience, we have a number of serious players on matters and we're very appreciative of your here. Thank you.

COMMISSIONER SPEARS: Thank you, Chairman.

I'd also like to recognize my fellow commissioners and I'll ask them if they have anything they'd like to add.

Commissioner Barbara Holum?

COMMISSIONER HOLUM: Thank you, Commissioner Spears. I would simply echo the words of the chairman and

Commissioner Spears in welcoming all of you this morning and thanking you for your participation, not only today but over the past many months on this important subject and I look forward to the proceedings of this afternoon. Thank you.

COMMISSIONER SPEARS: Thank you, Barbara.

Commissioner James Newsome.

COMMISSIONER NEWSOME: Thank you, Commissioner Spears.

I, too, would like to take this opportunity to thank you for taking time away from your businesses and your organizations to be here to give us advice on agricultural issues that are currently and will be before the Commission.

I know that we have a strong agricultural roots at the Commission, not only with our history but also with the people that are serving on the Commission now. We certainly are very interested in your thoughts and what's important to you.

I think we're at a very critical time in terms of the Commission, not only our regulatory reform issue that we're going to discuss parts of today, but also with the Commodity Exchange Act reauthorization that Congress is apparently discussing. I know that many of you have been very involved in that process. It's not only important but it's been a very busy time with the Commission as we work with constituency groups such as you and with members of Congress, as well.

I know that not only myself but other members of the Commission and staff have been meeting with many of you and your organizations over the last several months to try and develop opinions and get you to provide input to us and I want to thank you for that because it's very important and very critical not only at this point but as we drafted language and have gotten to the point where we are now.

I believe certainly we're headed in a very positive direction, not only in terms of market participants but for products, as well. And I think as we go forward, to me, the key word is flexibility--flexibility to change, flexibility to embrace new technology, flexibility to participate with new market participants and with new products.

Again I appreciate all of you taking time to be here and I look forward to the discussion.

COMMISSIONER SPEARS: Thank you, Jim.

Commissioner Tom Erickson.

COMMISSIONER ERICKSON: Thank you, David.

I too would like to welcome everyone today and very much appreciate your participation in these processes and proceedings. It's very important to the Commission and I think also for our record to be able to have the ability to hear from you directly and also in greater detail in written comments. I know for a number of you we'll be hearing a full presentation really for the first time and I'm anxious to hear from you your reactions to the final proposal. Thank you very much again for coming.

COMMISSIONER SPEARS: Thank you, Tom.

At this point in time I'd like to go around the table and have each of the members of Advisory Committee and those guests who are sitting at the table, as well, introduce themselves and tell us what organization you're with.

So with that, I'll start on my immediate left.

MR. ACKERMAN: Good afternoon. I'm Ken Ackerman. I'm the administrator of the Risk Management Agency of USDA and I'm very glad to be here.

I would want to just say I congratulate the Commission. I've read the documentation from the meeting this morning and I think it's a very formidable piece of work and has a lot of insight and it challenges some very core principles--I guess I can usee that phrase--on how regulation in this field should go forward. I congratulate you on it and look forward to the discussion.

MR. MARTIN: I'm Gary Martin from the North American Export Grain Association. I'm pleased to be here and continue to look at your work as something that's very positive.

MR. KUSERK: I'm Greg Kuserk. I'm an economist with the Division of Economic Analysis at the Commodity Futures Trading Commission.

MR. HORSAGER: Kent Horsager, president and CEO of the Minneapolis Grain Exchange.

MR. FICHTEL: Mark Fichtel, president and CEO of the New York Board of Trade.

MR. BRAUDE: Mike Braude, president and CEO of the Kansas City Board of Trade.

MS. MUEDEKING: Christina Muedeking, National Pork Producers Council.

MR. WHITE: Robert White representing the National Grain.

MR. KERWIN: Rick Kerwin representing the National Grain Trade Council.

MR. KUBECKA: Bill Kubecka. I represent the National Grain Sorghum Producers Association.

MR. DODDS: Bill Dodds representing the National Grain and Feed Association.

MR. McLENDON: I'm Bob McLendon. I'm a farmer from Georgia. I'm president of the National Cotton Council.

MR. DIERLAM: I'm Bryan Dierlam representing the National Cattlemen's Beef Association.

MS. GATTIS: I'm Tara Gattis. I'm with Independent Community Bankers of America.

MR. METZ: I'm Bob Metz. I represent the American Soybean Association.

MS. THATCHER: I'm Mary Kay Thatcher with the Farm Bureau.

MR. GILLEN: I'm Neal Gillen. I'm executive vice president of the American Cotton Shippers Association.

MR. BLANCHFIELD: I'm John Blanchfield, director of agricultural banking at the American Bankers Association.

COMMISSIONER SPEARS: Thank you. Again I thank each of you for attending the meeting. I think we have a couple of additional folks who'll be joining us a few minutes late due to travel, as well as due to other meetings on the Hill. They'll be joining us around 2:00.

I'd like to take just a brief moment and recognize a couple of special guests in the audience. One guest is Dan Amstutz, who's been a long-time member of this advisory committee. Dan, thank you for coming. We appreciate it.

Second, I'd like to recognize Jonah Bowles, who is a guest who was asked to attend from the Virginia Farm Bureau. Thank you, Jonah, we appreciate your coming.

Finally, before we get started with the first agenda item, I'd like to take just a moment and thank my staff who helped to put this meeting together, especially Jennifer Roe, Alan Ott and Don Heitman. I also want to thank those people from the support staff, administrative services, for doing the room. One never recognizes the amount of effort involved in this type of meeting together until you get involved in doing it--moving tables and chairs. So thank every one for participating in getting the room together for us.

With that, let's go ahead and get started. I'd like to ask Greg Kuserk to do a brief overview of the

Commission's regulatory reinvention proposal and following that we'll have a discussion and presentation by the presidents and representatives from the U.S. exchanges and then a general discussion.

So Greg?

CFTC REGULATORY REINVENTION PROPOSAL

MR. KUSERK: Thank you, Commissioner Spears.

What I'd like to do here is give you an overview of the regulatory reform that the Commission is proposing for the futures and options markets. I think many of you are familiar from other briefings we've had prior to releasing the proposed rules; many of the items are the same but there are some important differences that have come up as we put together the proposals.

The proposals were published on June 22 in the Federal Register. There were four proposals that were issued that day. The first deals with the regulatory structure of exchanges, including the approval of rules and rule amendments. The second dealt with the regulation of intermediaries. A third dealt with regulation of clearing organizations and a fourth dealt with legal certainty for over-the-counter derivative instruments.

The presentation I'd like to give you here today deals basically with the first proposal that dealt with the structure for exchanges. In the vernacular of the Commission we use the term multilateral transaction execution facilities. The reason I want to deal mainly with this area is because this is probably where folks in the agricultural markets will see the most impact on your day-to-day dealings with these markets.

The first thing I'd like to touch on are the regulatory goals that we have in these proposals. The first thing that we tried to do is to replace one-size-fits-all rules with core principles. The idea here would be to give exchanges more flexibility in trying to set up the regulatory structures that apply to their exchanges. So whereas in the past, the Commission has had more prescriptive-type rules that spelled out exactly how things had to be done on exchanges, what we've tried to do is replace these with core principles where exchanges would be left more on their own to determine how they were going to meet the principles. In addition, the Commission would publish guidelines which would give guidance to the exchanges on how they should go about meeting these core principles.

The second goal of the proposal was to develop a more flexible structure for the futures and options derivatives markets. In this regard we're proposing to have three regulatory tiers. We refer to these as recognized futures exchanges, derivatives transaction facilities and exempt multilateral transaction facilities.

The idea here would be that we'd have different tiers that would apply to different types of exchanges, depending upon the types of commodities that would be traded on the exchanges and the types of market participants that would be in these markets. The general idea is that the less susceptible a commodity might be to manipulation or the more sophisticated the parties who are participating in the markets, the lower the level of regulatory oversight by this agency would be.

Now with respect to the agricultural markets, what we get into is determining where different types of commodities might trade. If we look at the exempt MTEF level, in general, ag commodities would be excluded from being able to trade in this type of market. Specifically, the types of commodities that would trade in this type of market would be financial-type commodities, including such commodities as debt obligations, foreign currencies, interest rates, exempt securities, measures of credit quality, things like that.

In addition, commodities that are defined by occurrences or contingencies that are beyond the control of the counterparties would be eligible to trade in these markets. Such things as weather derivatives would be eligible for this type of market. In addition, there would also be cash-settled contracts that are based on economic or commercial indexes, such as measures of CPI, bankruptcy rates, commercial occupancy rates in a city--things like that would also be eligible.

In addition, exempt MTEFs, to trade on exempt MTEFs you would have to be an eligible participant and in general, this would follow the guidelines that we have in the current Part 35 of our rules, so typically large institutional traders.

When we get to the next level, which is the DTF or derivative transaction facility, basically we're looking at two different types of exchanges that would operate at this level. One would be for exchanges that are trading MTEF commodities, so basically that list I just went through with financial-type instruments and cash-settled indexes, things like that.

In addition, it would be possible on a case-by-case basis for various commodities to be traded on a DTF and on a case-by-case basis, the Commission would look at the surveillance history of the exchange; they would look at the type of commodity that's being traded and what additional regulatory undertakings the exchange would take on to trade these types of commodities.

The second type of exchange that would operate at the DTF level would be commercial-only markets. However, I'd point out that enumerated ag commodities would be excluded from this category. Enumerated ag commodities, if you're not familiar with what those are, those are things like wheat and corn and cotton and soybeans, your major type commodities. Agricultural commodities that aren't enumerated are things such as coffee, sugar, cocoa, fruits and vegetables and shrimp, for instance. So commodities like that would be eligible to trade on a commercial-only market. However, the ones that are enumerated, we've carved out and they would not be eligible to trade on this type of market.

And as far as the commercial-only, again that would be defined as the typically large institutions who are involved in the underlying commodities, also. So there would be that requirement on those exchanges, too.

When we get to the RFE level, the recognized futures exchanges, basically that's basically what you're looking at today when you see the exchanges in the U.S. They trade any type of commodity. Anyone's allowed to trade in those markets, so you have retail customers being in those markets, whereas the other ones are more restricted as to who can trade on those markets.

The other part of our proposal deals with listing of new products. As far as listing new products, the Commission already has rules in place where exchanges are able to self-certify that the contracts are not inconsistent with the Commission's rules or with the act and in that case are able to start trading those contracts immediately without receiving prior approval from the Commission.

Alternatively, the exchanges will still be able to come into if they wish and ask the Commission to approve their contracts, which would be done under our fast track approval system.

In addition, for exchanges that are operating at the RFE level, there is a requirement in the core principles that the contracts not be readily susceptible to manipulation. And as guidance for what this means, we would use our current guideline 1 as guidance to the exchanges on how a contract should be designed so that they wouldn't be subject to manipulation.

With respect to new rules and rule amendments on RFEs, again we provide alternative procedures. Exchanges would be able to self-certify that the rules or the rule amendments weren't inconsistent with the Commission's regulations or the act. Or they could come in and ask for fast track review and approval of the rules or amendments.

With respect to amendments to terms and conditions for the enumerated commodities, however, they would not be eligible for self-certification and would have to go through the current approval process that the Commission uses for these types of changes.

Now if we look at the rules, new contract rules and rule amendment approvals for DTFs, again we have alternative procedures. In this case we don't have a certification procedure; we simply require notice to the Commission of the new rules, contracts or rule amendments. And for the most part we would have to receive that notice before the rule went into effect but we wouldn't approve it and basically I think we require it a day before the rule would actually go into effect or the contract was listed for trading.

In addition, these exchanges could still come in and receive fast track approval for these contracts or rules.

Again I would note here that on the DTFs, this would not apply to the enumerated commodities again because in general, they're excluded from this level of trading.

The next slide is probably difficult for you to see but it's in your packet. It's basically just a summary of what I've just gone through. It lists the enumerated commodities as they're listed in the act and then some examples of nonenumerated commodities and then just the different procedures that you would go through in adopting new contracts or rule changes.

As far as issues for agriculture, as you look forward to commenting on these proposals, the one thing would be to consider the rule change procedures for RFEs as they apply to agriculture. The question there would be does it make sense to you to have this carve-out for the enumerated commodities with respect to the rule change procedures for RFEs or should they be included along with the other commodities that would be eligible to trade at that level?

The second thing would be to look at the DTF level and the restrictions on commercial DTFs with respect to agriculture so that if you're an enumerated commodity, even if it's a commercial-only exchange, the enumerated commodity still wouldn't be eligible to trade at that level.

There's also the question as to whether final rules versus proposed rules are going into effect at the end of the comment period.

The other thing to consider is that as these new rules go into effect, we will gain additional experience with how these exchanges operate and at that point I think we will continue to review the effect on agriculture and where agriculture might fit into this scheme.

As far as the process, the rules were proposed on June 22 and the comment period ends on August 7, 2000, so roughly three weeks, I think.

As far as getting the rules, I think some are out on the table out there. You can also find them at our website. If you look under Federal Register notices on the web page you'll be able to find these rules there. So thank you.

COMMISSIONER SPEARS: Thank you, Greg.

I'd like just to recognize that we've had three new members join the group since the meeting started. First I want to welcome Jim Bair from North American Millers Association, Wayne Hammond, National Wheat Growers Association, and then Todd Vanhoose from the Farm Credit Council. Thank you guys for coming.

Because the first two agenda items are so closely tied together, I would suggest that we proceed directly now to the presentations by the exchange representatives, then have a general discussion that would include everyone's perspectives regarding how agriculture fits into the new regulatory reinvention proposal.

There's no question in my mind that farmers and futures exchanges need each other. Farmers depend on exchanges for price discovery and hedging while the exchanges rely upon agriculture for a very important customer base.

I want to say a special thanks to those exchange representatives who are able to be here today. We've been joined by Mike Ryan, second vice president of the Chicago Board of Trade. Thank you for coming, Mike.

What we're going to do now is hear a brief presentation from each of the exchange representatives. I felt it was important for this advisory committee to have the opportunity to interface with these representatives from the U.S. exchanges that deal with agriculture products and to hear first-hand some of the challenges that they're going through at their exchanges as they evolve and develop and deal with the new corporate structure issues, as well as technology and foreign competition.

So first I'd like to start with Mike Braude. Mike is the president and CEO of the Kansas City Board of Trade and is the dean, I think, of all the futures exchange presidents. As most of you know, Mike's been at the Kansas

City Board of Trade roughly 17 years. He has led that exchange through tremendous prosperity and growth and Mike will be retiring, I think, effective August 1?

MR. BRAUDE: November 1.

COMMISSIONER SPEARS: November 1. So with that, I'd like to introduce Mike and thank you for being here.

PRESENTATIONS BY U.S. EXCHANGE REPRESENTATIVES

MR. BRAUDE: Thank you very much, Commissioner Spears. Obviously we appreciate being here.

Let me say first of all that the Kansas City Board of Trade views the CFTC's regulatory reinvention proposal with somewhat mixed emotions. At this time we certainly see definite pros to it and some cons to it but let me hasten to say that I think you're dealing with those cons and in the present form, I don't think they're that serious.

On the pro side, we definitely believe that it makes U.S. exchanges better able to react to threats from both the over-the-counter markets and foreign competition.

Second, we feel that it gives U.S. exchanges more flexibility in creating markets for different types of users. We believe that U.S. markets will be able to react more quickly and easily.

The potential cons we see, and again I think you are addressing them, is that it would be possible that it would create untried and untested market competitors to establish exchanges and, in the same sense, it would be possible that it could cause market fragmentation and reduce existing market liquidity.

Specifically regarding agricultural commodities, we feel at this time futures in enumerated ag commodities, specifically in our case wheat, absolutely should only be allowed to trade on a regulated futures exchange. We feel this is necessary to ensure the liquidity, the oversight necessary for a healthy agricultural economy. We feel that freedom to farm makes these protections even more important, given the ongoing educational process required to get farmers up to speed with prudent risk management.

Commissioner Spears also asked me to say a few words about where we in Kansas City stand regarding electronic trading. For the past two years we have been working toward formulating an electronic trading strategy. Up to now we feel that we've truly been best served by waiting to see how the industry developed. We continue to stay informed about trends and initiatives that are under way within the industry and we've researched various concepts and options available. We're in the final stages of formulating a plan for the best and most cost-effective system that will allow us the opportunity to effectively compete in the electronic marketplace.

We understand that whatever system we implement must be open, allowing for the ease of connectivity by all FCMs and independent software vendors or ISVs. Because there are a large number of ISV firms that have written user interfaces, we plan to focus primarily on our core competency, which has always been and will continue to be providing an efficient, well regulated market.

To do this, we feel like we need to utilize a system that can be easily interfaced by the FCM and IVS communities with the least amount of programming and cost while still maintaining a level of functionality that, at a minimum, meets our customers' needs. Doing so, the ISVs and firms build or buy the user interface that best meets their needs and we're free to improve existing products, develop new products, increase performance and the functionality of our system.

With regard to acquiring electronic systems, we have three basic business models for acquiring an electronic trading platform. First, we could build a system ourselves basically from scratch. The second alternative is to pay a service provider and either list our contracts on their system or run it locally. Either situation, we're liable for fees, either at a fixed rate or on a per-transaction basis.

The third alternative would be to exchange services with someone who has the technology by providing what we have, clearing and regulatory functions on their behalf, in exchange for the use of their technology.

Each of these strategies has pros and cons and we're evaluating alternatives in all three of these areas to determine what is the best alternative for the Kansas City Board of Trade and its members.

With respect to demutualization, I would point out to you that in a sense, we've been the only exchange that's been demutualized for 40 years. We are a for-profit corporation. In fact, we paid a dividend the last three years. We are not a publicly held for-profit corporation and to go that step, which we're not at the present time contemplating, would require change in our by-laws.

Commissioner Spears, we thank you for the opportunity to appear. On a personal note, this, after 17 years, as you mentioned, this will probably be my last time at the CFTC. I've always appreciated the great cooperation that I've received from you and the chairman and all your fellow commissioners. I'm confident that Bob Peterson, who most of you know, will enjoy an equally constructive relationship with this committee and with the Commission. Thank you.

COMMISSIONER SPEARS: Thank you, Mike. You'll be missed.

I'd next like to turn to Mark Fichtel, president and CEO of the New York Board of Trade. That's the parent company of the Coffee, Sugar and Cocoa Exchange or Cotton Exchange.

Prior to his appointment, I think in March?

MR. FICHTEL: March 30.

COMMISSIONER SPEARS: March 30, he served as senior executive vice president, Office of the Chairman, American Stock Exchange. So Mark, I'd ask you to share where you are at your exchange and some of the challenges you face.

MR. FICHTEL: Thank you, Commissioner Spears, and I'd like to thank the other commissioners for this additional opportunity to do a reprise of the last performance a few weeks ago. I am going to add some additional comments per Commissioner Spears' request.

The NYBOT, as we indicated last time, supports the CFTC's proposed regulatory framework and we believe that it provides greatly needed regulatory relief for exchanges without sacrificing market integrity, transparency and oversight. It shows a shift in the thinking of the CFTC that we think is to be welcomed.

Exchanges need regulatory relief so that we can adapt to a changing and increasingly competitive marketplace. Flexibility is going to allow us to minimize our costs and maintain our attractiveness to investors who provide the liquidity necessary for efficient markets.

Now currently, CFTC rules and staff reviews tend to be descriptive. For example, they describe what systems must be used and how an exchange's rules should be worded. The new framework, the CFTC would set performance standards or core principles, 15 in the RFE, seven in the DTFs, and give an exchange greater flexibility to develop the necessary rules and procedures and systems to comply with those standards, and this strikes, we think, a good balance between self-regulatory responsibilities and federal regulatory responsibilities.

The New York Board of Trade, however, does have some recommendations to improve the proposed regulatory framework, which will be provided in detail with written comments which we will be submitting to the CFTC. Today I would like to focus on two issues with regard to the proposal that are important to our exchange's agricultural markets--coffee, sugar, cocoa, cotton and orange juice.

First is the eligibility for DTF status. We welcome the opportunity to be able to convert existing markets or to create new markets under the DTF regulatory regime. Again this scheme will give us greater flexibility for our markets to contain costs and to develop innovative approaches to meet the needs of the market users.

We're also pleased that the CFTC is willing to consider on a case-by-case basis granting DTF status to the nonenumerated agricultural commodities, such as our world sugar contract, on the basis of surveillance history and other characteristics of relevant contracts.

However, as Greg noted earlier, the proposal would not allow agricultural commodities enumerated in Section 1(a)(3) of the act to trade on a DTF. We believe that each agricultural commodity should be allowed, on a case-by-case basis, to decide whether it would like to seek DTF status. This would allow the CFTC to determine, based on the circumstances of the particular agricultural market, whether DTF status is appropriate. Without this flexibility, we are concerned that the opportunity that might be possible for these various agricultural markets would be lost.

The second thing I'd like to address is the contract rule review for enumerated agricultural markets. We would like to recommend that terms and conditions for contracts based on agricultural products enumerated in Section 1(a)(3) of the act not be subject to prior CFTC approval. If an exchange meets certain market surveillance, trade monitoring and other criteria, such an exchange should be able to list new contracts and to amend existing contracts without CFTC approval.

By such action, the CFTC would not lose oversight authority. Among other things, it has power under Section 8(a)(7) of the act to alter or supplement any exchange rule to the extent found necessary or appropriate.

When designing or modifying a contract, our exchange's goal has been and will continue to be to develop a product that is consistent with cash marketing practices and one that can be used effectively by a wide range of market users and these are absolutely necessary ingredients for success of the exchange. We can consult with potential market users and conduct extensive market research before we attempt to implement any change and we would continue to do so. We look at cash market practices, the interests and needs of market users, pricing patterns, deliverable quantity and historical information on production and consumption.

All new product initiatives must receive the approval of our board of directors, who are comprised of experienced world leaders in trading commodities, as well as public directors. But even more importantly, they must first receive the approval of our contract committees, which are made up of specialists in the area.

Just a brief word on electronics. I came to the New York Board of Trade specifically to bring technology to the process. We hope to have an electronic order entry and trade reporting system floorwide by the end of this year or beginning of next year. We already have an alliance with E-speed, the Cantor Financial Futures Exchange, if and when we decide to trade any or all of our products purely on a screen.

With regard to demutualization, I'm going to emphasize that these are my thoughts, since we have not brought them to the board yet. I want everybody to understand these are not the New York Board of Trade's comments.

That's a second reason that I came to the New York Board of Trade. I firmly believe that all exchanges, and I applaud you, by the way, for already being there. In this environment, all current exchanges will have to be demutualized and they will have to be for-profit. They'll have to have a corporate structure. I've watched amazing folks at two of our current competitors and all of our new competitors are in that structure. I think that any exchange that operates under the old structures is going to be at a severe competitive disadvantage.

However, I think even more importantly for the agricultural commodities that we trade, their shift in strategy will be positive. I believe that we will always have to focus on keeping all the participants in our markets happy. That includes trades, FCMs, specs and locals and if we lose the loyalty of any of those, we're going to hurt the business.

Secondly, we must have an attractive and stable business in terms of those who are participating in order to protect investors.

Third, as part of this demutualization effort, we would always maintain our contract committees. This is a fundamental integral part of the way we operate.

Fourthly, the CFTC will still be there, regardless of whether we demutualize or not. And whether or not some of these changes that are proposed go through, if a producer group feels that they are disadvantaged, they can always appeal and no market is going to tell its regulator that it's not going to listen to the regulator's concerns that have been brought to the fore.

And finally, an era of choice is upon us. Any commodity that feels that it is not being treated fairly by its market might have hesitated a few years ago to move its markets. I suspect that that's going to be a lot less of an impediment as we go forward. And that's another reason why there should be less fear about looser regulation. Thank you very much.

COMMISSIONER SPEARS: Thank you very much.

I'd like to introduce next Kent Horsager. Kent is the president and CEO of the Minneapolis Grain Exchange. If Mike was the dean, Kent is the newest member. I think you've been there 30 days. Welcome and we're interested in hearing your comments, as well.

MR. HORSAGER: Thank you very much, Commissioner Spears. It is a pleasure to be here with this group and representing the Minneapolis Grain Exchange today.

First of all, let me say that the Minneapolis Grain Exchange is pleased that the Commission has recognized that the rapidly changing technologies, evolving market reality and economic competition require a new regulatory framework. A new regulatory process is necessary in this trading environment. Therefore, in general we're extremely supportive of the Commission's proposed rules.

The MGE applauds the effort put forth by the Commission to streamline the regulatory process. The proposal provides for three separate tiers. The exchange concludes that it will at least initially receive limited benefits because our current product line is primarily commodities which are agriculture-based in the enumerated list. The exchange therefore will have no opportunity to avail themselves, again initially, at least, of any flexibility to choose another regulatory tier other than of the recognized futures exchanges.

The current proposal will likely then incent platform and product innovation in other marketplaces, across other regulatory tiers, and this is to choose regulatory changes. Thus, the concern would be that it's arbitrarily depriving the agricultural industry of the benefits of progress and developments which are being made in the area of trade and risk management tools being offered.

In this light, I have five specific points of interest that I think the core principle posture may not be as apparent. First of all, the exchange believes that it is in the best interest of the agriculture community and the exchanges to permit the enumerated agricultural commodities listed in the Commodity Exchange Act should be traded on a recognized derivatives transaction facility; that is, DTF.

The exchange believes that the four primary objectives of the CEA--ensuring market and price integrity, protecting the market against manipulation, protecting financial integrity and protecting the customers from abusive trading or sales practices--can be adequately met and it would indeed be in the interest of the exchange operating under any format to meet that.

Secondly, the exchange would not be in favor of any proposal to permit only commercial or institutional traders to trade the enumerated contracts or commodities on a DTF. Restricting noninstitutional traders of these commodities to an RFE while permitting institutions to operate in the environment of the DTF would create two playing fields and two potential pricing mechanisms.

Third, the noninstitutional traders may represent a small percentage of some of the commodities being traded by an RFE but nonetheless they can trade through futures commission merchants or FCMs. Even though some of the FCMs have adjusted capital that is less than $20 million, they're still extremely valuable and contribute greatly to effective marketplaces.

The proposed adjusted net capital requirement should probably be eliminated or reduced since the minimum requirement does not automatically improve financial integrity of a DTF market. Furthermore, there are much more effective ways to measure financial integrity in the marketplace than adjusted net capital and it seems arbitrary and possibly inefficient.

Fourthly, the exchange is pleased to see that the futures exchanges would continue to be able to launch new contracts by certification. This is a process that the exchange employed just recently when we introduced our cottonseed contract within the last two months. However, the exchange is concerned about the proposed process for changing contract terms and terms and conditions of enumerated commodities.

The proposed rules, as is currently the situation, require agricultural group commodity rule changes to be submitted for review and approval. The exchange respectfully requests that the Commission alter the proposed rules to permit changes to the terms and conditions of agricultural commodities by certification. Permitting certification on rule changes and conditions of agricultural commodities would, in fact, benefit the agriculture community as well as other industries by being able to respond to market users in the conditions that they face.

It seems also illogical that an RFE can launch a new contract by utilizing certification essentially overnight and yet take 45 days or longer to receive the appropriate approvals.

And then fifthly, the exchange noted that the proposal requires products trading under the RFE, DTF or MTEF market to be separated in terms of physical environment and locations. The exchange just hopes that the CFTC will utilize a very practical approach when interpreting this requirement.

And then lastly, I was asked to comment a little bit on our demutualization or organizational structure and with respect to that, the exchange's mission is to provide price discovery in risk transfer services. It is committed to being a customer-centric and user-friendly exchange as we go forward. Therefore, the board has considered this. However, at this time it has no plans to demutualize or reorganize. Thank you.

COMMISSIONER SPEARS: Thank you, Kent.

I'd next like to recognize and welcome Jim McNulty. Jim is the president and CEO of the Chicago Mercantile Exchange. Jim, thank you for being here.

MR. McNULTY: Thank you, Commissioner Spears. I'm delighted to be with you here today and to give testimony on the CFTC regulatory reinvention, CME's demutualization plan and how these developments are likely to affect our agricultural markets at the CME.

First I would like to express my gratitude to Chairman Rainer, Commissioner Spears, other commissioners and the staff for the incredible amount of work that went into working through all of the complex issues in the CEA reauthorization. I think that this work helps us assure that our futures markets will remain relevant on a global basis for the foreseeable future. This work and these changes we see as crucial to our future and it is greatly appreciated.

Innovation is key. It's key to the CME's success and it's also key, we think, to the ag members' success. Our clients expect the CME to innovate in order to provide the highest levels of liquidity, transparency and credit-worthy clearing and settlement of your products, and all of this at a reasonable cost.

102 years ago we were the Butter and Egg Board. Sixty years ago we began livestock trading. And next week we will launch e-mini electronic trading on lean logs. In the near future we think that farmers will be able to hedge from the field using web technology in our Globex electronic trading system. This is how far and how fast we think technology will bring us.

We see three major drivers in terms of innovation. The three drivers are globalization, technology and deregulation. They're all linked. If you think about where technology has taken us, it took 65 years for 30 percent of the U.S. population to use airlines and to drive cars. It took 45 years for 30 percent of the U.S. population to use electricity. It took 20 years for 30 percent of the U.S. population to use computers and it has only taken seven years for 30 percent of the U.S. population to do transactions on the Internet.

Internet technology is changing the pace of the way people do business in a rate that is almost unimaginable and unthinkable by major corporations. That will affect everybody in this room going forward.

It also leads us to globalization. In talking with the major players in the futures industry around the world, it's very clear now that they expect that the front ends of the futures industry will essentially be merged, not necessarily because exchanges merge but because you'll be able to see every price from every exchange around the world electronically on ISVs and various platforms. So that will greatly contribute to globalization.

And finally, deregulation. We're beginning to find a level of deregulation around the world that's creating much more even playing fields and we think this will also increase the amount of business and liquidity on the exchanges.

So how is the CME responding to this rapidly changing environment? One of the most important things we thought we could do was to go into the demutualization process. That program began over a year ago and June 7 of this year we had a vote which was 98.3 percent in favor of demutualization. I might add that in the 102 years of CME history, that was the most unanimous vote we had ever had. In fact, one of the gentlemen sitting at this table called me and said the only time he had seen that was in Cuba and wondered how that took place.

Why would we demutualize? I think number one, we needed to shift the emphasis of the exchange from members to customers, to shareholders, and to other stakeholders. Couldn't be so single-line driven. It had to be broadly driven.

We had to streamline our decision-making process. I think the day I arrived five plus months ago, we had 214 committees. We need to streamline them.

We also have a board of 38 people. Now to put that in perspective, Daimler-Chrysler that has probably 100 times as many people employed as the CME only has a board of 18 people. So we need great streamlining of our processes.

And we also think it provides us with an interesting currency and the ability to access capital markets by going through this demutualization. And it unbundles equity from our members.

That led us, of course, to a business plan and the business plan really had two major focuses. One was intense customer focus and the other was shareholder value. What does intense customer focus mean? And I think that some of the people in this room could find it interesting. It means that we need to go out to our end users to understand their business, to understand their needs, and then to make sure that we regulate our markets with the goal of fairness and transparency and cost-efficiency. This is one of the thing that we are absolutely dedicated to. It also means having the right kind of access, the right kind of rules and the right kind of technology to be a first-class modern exchange.

Second, shareholder value. As we demutualize, it'll be extremely important for us to have a return on invested capital that is greater than our cost of capital. In other words, we need to give our shareholders a fair risk-adjusted return. It gives us a great metric system because now we know that we're focussed on our end users and we're also focussed on getting the right returns for our shareholders and it helps us make better judgments about how to go out and meet our clients and the public.

That led us to a plan, because we also need to create growth opportunities. The plan is based on retail, institutional, and B2B environments. If you look at how many people were trading stocks electronically in 1995, there were approximately 400,000 to 500,000 people trading stocks electronically. Today there are 15 million people trading stocks electronically.

And if you look at the futures industry, in 1995 there were about 400,000 to 500,000 retail customers; today there's probably a similar number. It probably hasn't increased too much. We think that's partly because we haven't had exactly the right environment or the right platform.

What does the retail client want? They want a "wizywig" environment--a what-you-see-is-what-you-get environment where they can look at a price on a screen, hit a mouse button, click on that price and within one second get a ping back and then, within another second, find out that they've executed. This is what all exchanges will be doing within the next five years, in my opinion.

Finally, in the institutional arena, what institutions want is much better capital efficiency and they want to make sure that they can keep their costs down. That's something that we can do through rules and also constantly upgrading the capabilities of our clearinghouse on the technology side.

And finally, B2B, which I think is very interesting to the agricultural community. We think that the B2B markets over the next four years could grow to approximately $5 trillion a year in volume. We think that there will be approximately 4,000 markets or what people will call exchanges that open up over the next four years.

All 4,000 of these exchanges are not going to survive. The business plan or the value proposition of these exchanges is that number one, they will bring content, meaning publishing content, which will be very good for creating community. And then from that community they hope to create commerce. Commerce will only be created if you have the right kind of clearing, settlement and credit processes in place. That's what our exchanges already have in place, the exchanges sitting at this table.

So I would contend that one of the things that we can do to help the growth of business is encourage content development and encourage community development, which we already do and will do, I hope, a better job of consistently going forward and then help commerce by helping people with solving some of these clearing and credit problems.

In conclusion, the demutualization at the CME is a catalyst and this catalyst allows us to rebalance the focus of the exchange, which shifts in favor of our end users and users of our ag products. The shareholder value orientation will drive us to create greater efficiencies and product innovation and we expect to attract new types of clients in the electronic world where we intend to make you, the agricultural backbone of this country, beneficiaries. Thank you very much.

COMMISSIONER SPEARS: Thank you very much, Jim.

Next I'd like to introduce Mike Ryan. Mike is the second vice chairman of the Chicago Board of Trade. Mike is an independent trader and a member of the exchange since 1980. He served on the exchange's executive committee and a number of other leadership positions, as well. Mike, welcome.

MR. RYAN: Thank you.

Good afternoon. My name is Mike Ryan. I serve as the second vice chairman on the board of directors. I'm on its executive committee and I'm also chairman of the Strategy Committee. I'd like to thank Commissioner Spears and the CFTC's Agricultural Advisory Committee for the opportunity to appear today to discuss the effects of the CFTC's regulatory framework and CBOT's restructuring initiatives on the CBOT's agricultural markets.

As most of you probably know, CBOT's core agricultural products are futures and options on wheat, corn, oats, soybeans, soybean meal, soybean oil and rough rice. These products account for approximately 25 percent of our transaction volume. The remainder derive from the financial and stock-indexed products.

CBOT's agricultural futures options contracts are utilized by a very diverse group of users, including many who do not participate directly in the markets but use the price discovery information provided by these products for business planning and NBOTC products.

For example, many producers can now hedge directly using exchange-traded futures and options but prefer to forward contract with their local elevator. These forward cash contracts are typically priced basis CBOT futures. CBOT's agricultural futures contracts are also used by the U.S. Department of Agriculture's Risk Management Agency to determine payment levels for crop revenue insurance products. However, few crop insurance companies participate significantly in these markets.

The primary participants in the CBOT agricultural futures and options market include a broad range of U.S. and foreign commercial firms involved in grain merchandising, processing, grain and livestock production and food processing and manufacturing. Important sources of liquidity in the agricultural markets include CBOT members and institutional investors, such as commodity funds and pools.

While in the past, CBOT has had few competitors for its agricultural products, information technology, globalization, the growth of foreign exchanges have combined to create an intensively competitive environment for the entire futures industry. As a result of these competitive pressures, CBOT has engaged in a number of initiatives designed to improve market efficiency and lower costs, including enhancement of electronic order routing, CBOT's open outcry markets, implementation of the Eurex Alliance Electronic System, and restructuring.

In order to enhance liquidity in CBOT's agricultural futures and options markets, CBOT staff constantly monitors contract performance and reaches out to market users to determine how effectively we are meeting risk management and price discovery needs.

Since September of 1999, CBOT has reviewed contract terms from every agricultural contract and implemented changes for all of them except soybean meal. Exchanges which range from redesigned delivery systems for corn and soybeans, enhancing quality, specifications for rough rice futures, were developed in close cooperation with representatives of the producer and other agricultural trade associations.

The same combination of performance monitoring and customer input is used by the CBOT to develop its current proposal to increase the maximum daily price fluctuation limits for the CBOT's agricultural products. Exchanges initiated to enhance worldwide product distribution will provide market users with more continuity and price discovery, improve market access during volatile markets. They were developed based on input from members of the CBOT's agricultural advisory committee, major agricultural clearing firms and the CBOT membership.

While a slight majority of our AAC favored either eliminating or increasing daily limits by 50 percent, some producer groups and members of the National Grain and Feed Association felt current limits should be maintained. Therefore, the CBOT's proposed increase in price limits is a compromise between market participants who prefer no limits and those who believe that daily price limits provide a cooling-off function in volatile markets.

On behalf of the CBOT, I would like to commend the commissioners and staff for their efforts in developing a new regulatory framework. I believe this proposal creates an environment in which the U.S. futures industry may compete effectively in the global derivatives marketplace. Replacing detailed regulations with the core principles that give exchanges the flexibility to decide and design how to meet their regulatory obligations will allow exchanges to better meet the needs of the diverse customer base.

Competition among providers of risk management and price discovery services in the agricultural markets is increasing as a result of advances in information technology, globalization of markets and the regulatory disparity between traditional exchanges and OTC and foreign markets. In short, users of risk management, price discovery services provided by traditional exchanges are demanding increased transparency, greater access and lower costs.

The impact of information technology on the commodity markets is currently most pronounced in the cash markets where on-line exchanges, such as Iceberg, e-markets, Brewster and CyberCrop, to name a few, are attempting to link buyers and sellers of agricultural products and inputs directly. Enhancements in information technology are also lowering the barriers to entry into traditional exchange markets, as evidenced by recently approved contract markets for live cattle, large freight, and a wide array of financial products.

While the CFTC's regulatory reform proposal will enable traditional exchanges to better meet these competitive challenges, reduced costs and regulation will also benefit these new competitors. The regulatory framework will benefit users of risk management and price discovery services directly by allowing service providers to reduce costs and stimulate innovation. New product listings are likely to proliferate in response to the lower regulatory costs, the lower cost structures of electronic trading.

New products specifications may also be influenced by the proposed regulatory structure as providers look for innovative ways to provide users with the tools they demand in the most cost-effective manner.

On June 28 of this year, the Board of Trade membership overwhelmingly voted in favor of implementation of the initial step of the exchange's strategy to restructure as a for-profit, demutualized organization with about 91 percent of the membership voting in favor. This initial step will allow the CBOT to reincorporate as a Delaware nonstock, not-for-profit corporation which will serve to facilitate the CBOT's future restructuring efforts.

The improved restructuring plan has the following features: allocation of shares of stock representing both trading rights and equity member ownership in for-profit

CBOT to the members; option of a streamlined management governance structure of the CBOT with a smaller board of directors and a more efficient decision-making process that would enhance CBOT's ability to respond to the rapidly evolving marketplace; reorganizing the CBOT's electronic trading business as a for-profit company focussed on electronic trading; allocating shares in the electronic trading company to the members; unlocking value in the current membership interests of CBOT, through a potential initial public offering of the stock of the electronic trading company; attracting capital for the electronic trading company and potentially for the for-profit CBOT; and lastly, executing a three-year non-compete cooperative agreement with the electronic trading company, during which time for-profit CBOT could not operate in an electronic trading system within its corporate structure, except for a small order retail execution-type system.

The structure of the exchange is essential for many reasons. Without it, the CBOT may not be able to preserve a viable open outcry exchange capable of competing in the future and, at the same time, capture the growth of electronic trading. Restructuring enables the CBOT to adopt a business model that will allow it to make the decisive moves required to address competitive challenges, built advantageous strategies alliances, lower costs, and serve the customers.

Detailed business plans for the restructured CBOT companies will be developed by the boards of directors and management of the two companies. However, the strategic focus of the two separate companies provides a broad picture of their business objectives and how the agricultural markets may be affected.

With the open outcry company, the focus is expected to be on attaining and enhancing liquidity by investing in supporting technology, capturing and efficiently executing trades while considering changes to trading rules and other measures aimed at retaining and enhancing order flow.

The main reason for becoming a for-profit corporation is to allow the CBOT to be governed by a more modern and developed body of corporate law in Delaware than that provided by the CBOT's current special charter. Restructuring also will allow for a more streamlined corporate governance system that allocates authority from the membership to the board of directors. The reorganized electronic trading company would continue the CBOT's endeavor to build a market leadership position by providing a superior electronic trading platform, initially capitalizing on the CBOT brand and Eurex alliance and providing greater access to a continually expanding global trading community.

These clients will not be required to own seats or any other type of membership interest in order to utilize direly the electronic trading platform. The focus of the electronic trading company will be on creating a cost-competitive trade execution capability and will invest aggressively in technology to maintain and enhance its competitive advantage. This could include new business and revenue sources in the area, such as business-to-business e-commerce and commodity trading, direct retail access, enhancing its capability to other exchanges and geographies.

In summary, I believe the combination of the CFTC's proposed regulatory framework and CBOT's restructuring initiative will allow the exchange to enhance the world's most liquid, accessible and reliable marketplace for a wide array of financial and agricultural products and services. Exchanges will also stimulate innovation and product development and lead to the creation of new trading mechanisms.

The proposed regulatory framework, combined with the conversion of exchange governance structures, will allow risk management products and price discovery services to be provided at a lower cost, directly benefitting users of the services.

Again thank you for the opportunity to appear before your committee today. I'd be happy to answer any questions.

COMMISSIONER SPEARS: Thank you, Mike.

First, I want to thank each of you for coming and attending the meeting and making your presentations. I think this is the first time that I know of that we've had the senior leadership of each of the exchanges in ag products at the Agricultural Advisory Committee meeting and I appreciate your attendance and presentations and look forward to your comments during the discussion period, as well.

I think it's evident to the membership of the Advisory Committee that the U.S. exchanges are going through massive change, not only through their corporate structure, as well as their leadership. I didn't realize till a minute ago that each exchange will either have a new president and CEO either currently in place or will soon be in place within the next short time period. So that's quite a remarkable change.

What I'd like to do next is have a discussion period where we can have a free flow of information and thoughts and views and concerns among the Advisory Committee members where they'll have the opportunity to present some of those thoughts and questions not only to the Commission but it's a unique opportunity for the presidents and leadership of the exchanges to also hear from this Advisory Committee.

So I'm hopeful that not only can they engage in a dialogue, as well as with the commissioners, but you, as well.

As Greg pointed out early on, there are a couple of key issues that are very important to the Commission that we need input on in developing the final rules on the reg reinvention proposal. As Greg highlighted in his comments, the question is how do we treat agricultural contracts as we go through this transition process? Should ag contracts be treated differently than the other contracts?

Also, as noted earlier in the discussion, the new rule proposal has a carve-out so that the enumerated ag commodities can only trade on an RFE platform and would be subject to the current criteria for rule changes, approval for rule changes on terms and conditions of contracts.

A second question that we're very much interested in input from this committee now and as you develop your final comments for the comment period would be should ag commodities trade on a DTF level? Should there be the opportunity and flexibility to go from the RFE to DTF level?

And then how that should deal with, as well, as far as rule changes and terms and conditions on rule changes as far as notification, certification on a DTF level, as opposed to the RFE.

So I'd like at this point in time during the meeting to have a discussion as long as necessary and we'll take a break before we go to the third part of the agenda. I'd like to have an opportunity to open it up for discussion among members of the Advisory Committee--their thoughts, their views, their questions, their concerns with regard to the above issue.

I've also been asked by two members or two groups on the Advisory Committee to make a short statement of their position, so I'll recognize those members if they'd like to submit them, as well. So at this point in time the Commission is open for comments and questions.

Neal, go ahead.

MR. GILLEN: Thank you.

Commissioner Spears, Chairman Rainer, Commissioner Erickson and members of the Advisory Committee, I thank you for the opportunity to present these views as the Congress and the Commission move in unison in the final stages of the process of deregulating commodity markets. While I am of the view that it is the proper direction to take, I share the observation and concerns of many that what is happening may not be fully understood by important participants in the process. Underlying these concerns is the future role of the Commission and the fact that agriculture is not participating in the deregulatory process.

In 1974 the American Cotton Shippers Association was among a handful of advocates, including the National

Grain and Feed Association and the National Farmers Union, who urged the Congress to remove the regulation of the agricultural futures contracts from the Department of Agriculture through the establishment of an independent regulatory agency with authority to regulate all commodity contract markets.

Until that time, the regulatory authority over commodity futures trading was vested in a USDA agency, the Commodity Exchange Administration, and limited to the contract markets trading in agricultural commodities. The unregulated commodities--gold, silver and other precious metals--were self-regulated by the contract markets on which they were traded.

In 1973, Senator Robert J. Dole recommended that the regulatory jurisdiction of the CEA be extended to include trading in all contracts for future delivery, noting that the public desired and required this protection. Further, he observed that should a problem occur in a nonregulated futures market that it would reflect badly on all other futures markets.

America had just ended a regretful period of government price controls, inflationary pressures were unleashed on the marketplace and commodity prices were rising to new plateaus driven by significant increases in the price of oil and other energy products vital to maintaining our productive resources, particularly agriculture.

Further, financial, stock indexes, options or other derivative instruments did not exist. It was around this time that the world's financial powers, the signatories to the Bretton-Woods Agreement, abandoned the concept of fixed currency rates in effect since 1945 and agreed to let market forces determine the value of the various world currencies. Overnight, a significant opportunity emerged for the development of contract markets and off-exchange markets for the trading of the various currencies. By the early 1980s, trading in stock index futures began and soon after, Congress lifted the ban on the trade of agricultural options.

The success of these markets is well documented. Trading volume has expanded well beyond expectations and the contract markets and this agency have kept pace with this exponential expansion through effective self-regulation and prudential oversight.

This important fact is overlooked. The regulation of these markets has been effective, not overly intrusive, and accomplished with minimal resources. Simply stated, the CFTC's regulatory role has provided the trading public the necessary confidence to utilize the markets and has materially assisted in the phenomenal expansion of the U.S. futures industry.

As the Congress and the Commission move from an era of effective regulation to a new era of deregulation or self-regulation, the question comes to mind: are the appropriate safeguards in place to maintain the public's confidence in the financial and futures markets?

Market innovation keyed the phenomenal growth of the U.S. economy and its related markets in the last decade, but tied to this growth is a combination of governance that kept it on track at a controlling rate of acceleration. The agencies participating in this effective governance--the Federal Reserve, Treasury, the SEC and the CFTC--have concluded the markets have come of age and it is time to relax the, albeit limited, restraints.

The report of the President's Working Group could be the most influential document in the history of U.S.

financial markets. Given the leadership of the Working Group, its far-reaching recommendations are being followed with little dissention or dispute. I do not challenge the conclusion of the report or its recommendations. I simply raise the question: why is there an inconsistency in the regulation of the agricultural and nonagricultural commodities?

We understand the need for transparency, the essentiality of price discovery, and the concern that commodities with a finite supply could be manipulated. Every market participant shares these concerns--the producer, merchant, cooperative, processor, and speculative interests. If the contract markets afford adequate participation to the representatives of these interests in the development of rules and regulations and the governance of that market, then the self-regulation of the futures and options trading in this agricultural market should be permitted.

Simply stated, we understand the markets, we are entitled to a meaningful role in market development and governance, and we do not wish to be prohibited from benefitting from any innovative trade practices available to the nonagricultural commodities.

What is the stake of cotton? Permit me to quote from Mr. Robert McLendon's testimony this morning to the House Committee on Agriculture. "The industry and its suppliers, together with the cotton product manufacturing, account for one job of every 13 in the United States. Annual cotton production is valued at more than $5 billion at the farm gate. In addition to the fiber, cottonseed products are used for livestock feed and cottonseed oil is used for food products ranging from margarine to salad dressing.

While cotton's farm gate value is significant, a more meaningful measure of cotton value in the U.S. economy is its retail value. Taken collectively, the business revenue generated by cotton and its products in the U.S. economy is estimated to be in excess of $50 billion annually.

Cotton stands alone, above all other crops, in its creation of jobs and its contribution to the U.S. economy.

The agricultural spot and forward markets are open networks ubiquitous with accurate price data and other information vital to all who function within them. This open network of producers, merchants, cooperatives and processors utilizes transparent market information to serve one another by producing a product, adding value to it, offsetting price risks, protecting the product's value, shipping it for processing or manufacturing, and then creating a product or products which stimulates additional production.

The participants in these networks moving farm products from the field to the consumer adhere to the highest standards by sharing the norms or values of fairness, truth and reciprocity beyond those necessary for ordinary market transactions. That is why the Congress, in 1921, included the forward contract exemption in the Commodity Exchange Act.

The agricultural segment of American business is perhaps the most complex and yet the most efficient and productive in our economy. Americans spend approximately one-fourth of their disposable personal income on food and fiber, the lowest percentage in the world because of the productivity of our nation's farmers and the efficiency of our processing and distribution system. Our efficient and self-sustaining system equals the efficiency of the financial markets, yet it is trapped within a legislative and regulatory framework that precludes its use of the product innovation allowed the nonagricultural commodities.

Why do the Commission and the Congress trust the financial markets to move toward self-regulation yet deny the same privilege to agriculture? The answer lies in the recent failure of the implementation of the pilot program for agricultural trade options. It is assumed that innovation is either too risky for agriculture or agriculture lacks the sophistication to innovate. These assumptions are not only unfounded but they are prejudicial to the interests of agriculture.

Since 1985 when the Commission's Office of General Counsel issued an Interpretative Statement on the forward contract exemption, the trading of agricultural product has been constrained from innovation and limited to merchandizing transactions in a physical commodity in which delivery is delayed or deferred for commercial convenience or necessity.

In the 15 years since the issuance of this opinion, the production, harvesting and distribution practices have undergone considerable improvement through technological change. Except for the advent and significant use of exchange-traded options contracts, there has been little change in the risk management instruments made available to the producers of agricultural commodities. It is patently unfair and unreasonable to continue a policy that denies agricultural producers the innovations in risk management instruments made available to other industrial producers.

Much has transpired in the 79 years since Congress enacted the forward contract exemption. The law of contracts and the court interpretations are uniform throughout the various states, the reputable agricultural buyers are known to the producers, trade rules and practices are well established, arbitration and other legal remedies are readily available to resolve disputes, and accurate spot and futures price information is available on a continuing basis.

Therefore, if ready buyers and sellers agree to terms they are financially capable of undertaking, they should not be restrained from entering into such contracts. Denying producers and merchants the flexibility to enter into such contracts is denying them the right to maximize their opportunities to minimize their risks and maximize the price potential of the market.

By labeling transactions as non-sanctioned trading instruments we are denying agricultural producers the right to innovative risk management alternatives. In doing so, we are failing to consider, in the words of the Commission's 1985 Interpretative Statement, and I quote, "the economic reality of the transaction." The reality is that delivery will be required or not required depending on the specifics of the contract to which the parties, possessing the legal and financial capacity to engage in such transactions, have entered into of their own volition solely for purposes related to their business. This is the standard utilized by the Commission for all commodities other than agricultural commodities.

In its desire to protect agricultural producers, the Commission is instead penalizing producers in denying them the potential of beneficial marketing innovations. Before the Commission and the Congress finish their work on the deregulation of the markets they should reconsider the decision to continue treating agriculture as a market meriting constructive regulations and instead provide U.S. agriculture the same opportunities it allows other segments of our thriving economy. Thank you.

COMMISSIONER SPEARS: Thank you, Neal. We appreciate your comments, Neal. The Commission, as you know, has labored diligently in trying to receive as much input from the agriculture community as possible on these issues as we developed the proposed rules.

As Commissioner Newsome mentioned earlier on, each of us have met with numerous representatives around this table, as well as members of the group. This topic was a discussion at the last Agricultural Advisory Committee meeting we had and that's why I think this process is so important today, is that we can hear the views and comments. As we've discovered, there hasn't always been total agreement on those views but I think it's important that we hear from all the parties as to what their thoughts might be on that.

With that, Bill, I'll turn the comments to you.

MR. DODDS: Commissioner Spears, the National Grain and Feed Association in its structure has a risk management committee and they met as late as yesterday with

15 members from the grain industry. I was unable to attend. I would ask that you permit Kendell Keith, president of the National Grain and Feed, to maybe make a few comments relative to what was discussed on this subject at our meeting yesterday.

COMMISSIONER SPEARS: I appreciate that, Bill.

I might just note for the housekeeping rules that it's important that as we finish speaking into the microphones, turn off the microphone. The system is quirky in that if more than three microphones are on at one point in time, the system shuts down.

So with that, Kendell, I'd welcome your comments.

MR. KEITH: Thank you. I'll try to be brief in the interest of allowing more time for discussion.

We, too, agree that the CFTC deserves commendation for this proposal. We think the concept is sound. It provides regulated markets the choice on how regulated they want to be, based on market need.

At the same time, we see this proposal as incomplete from agriculture's perspective from two standpoints. One, ag markets do have new competition from many sources and we think they need regulatory relief to be able to compete. Secondly, there is a strong need for greater legal certainty for off-exchange forward agricultural contracts, much like the over-the-counter contracts in other markets.

As to the first point, we plan to support permitting exchanges the flexibility to move the agricultural contracts into the less regulated category of DTFs. We believe that with proper exchange self-regulation and good oversight by a well qualified CFTC, that these markets can properly handle this level of new responsibility and there will be broad benefits to the market.

At the same time, we're going to ask the CFTC to restrict the flexibility to a certain extent so as to not permit exchanges to bifurcate markets on the basis of types of traders. That's a concern we've had since the pro-market exemption and that's going to be part of our recommendation to the agency.

We think there are some risks in not moving forward in deregulation. Maintaining status quo for futures markets is going to keep transaction costs high. We think the institutional investors are going to look elsewhere for places to invest portfolio money. We think we will reduce the liquidity, especially in the out-months, and potentially affect, impede multi-year contracts.

We think high transaction fees are going to encourage commercial hedgers to look for alternatives. In particular, as electronic exchanges develop, there's going to be a myriad of alternatives that are easy to use, low-cost, and we think that there's a risk that we will move and migrate off organized exchanges and a long-term threat at least to price transparency in the marketplace. We don't think that's good for anyone concerned here.

Concerning the second issue I talked about, mentioned briefly on cash forward contracts, we do have a written statement where I go into more detail on that but we are quite concerned that the agricultural marketplace be given reasonable freedom to develop contracts to serve farmer needs. We think the environment out there today is certainly not ideal for doing that and a lot of this is driven by the lack of legal clarity.

Cash contracts in our industry are still the number one price risk management tool out there today. We think with the changes in the marketplace, the need to serve end-use customers better and more diverse end-use customers-

-we're going to see more integration, more contracting take place, so it's very important in our view that we decide and more clearly state what is permitted in cash contracting, what is subject to CFTC jurisdiction and also what is not.

One of the experts who testified in an earlier hearing that the CFTC held--I think it was Tom Russo--made a comment that we overuse labels in risk management and I think I agree with that. Labels that we all commonly use, such as options, futures, derivatives, trade options, swaps, cash contracts or any other term can be misleading simply because there are no pure or complete definitions of these terms.

The point that he made was that we need to focus less on labels and more on features and functionality, what the marketplace needs.

In that regard, what are the contract features most important to agriculture? In our view, the farmer needs flexibility today to deal with changing circumstances. Just a couple of examples, and I offer some more in the written comments.

The farmer cash contracts his crop but a hailstorm destroys it before combining. Should the marketplace be given the freedom to establish a value on that failure to deliver prior to the event or are we forever left with the situation where liquidated damages are only allowed to be computed at the time of scheduled delivery?

Another example: is it okay for the elevator to charge an administrative fee in the event that contracts are mutually renegotiated or is this at risk of being labeled an option premium at some stage?

I see a few smiles around the table. I think you understand that there is some legal uncertainty regarding these contract terms. But they are contract terms that are very useful in the cash marketplace.

We think farmers need increasing flexibility, in short, and to provide that flexibility, the cash market buyers need better clarity on what is considered acceptable legally. In our written remarks we do present a proposed legislative solution that would help on legal clarity. It's not the final answer--there may be better ways to deal with it--but we would also urge the CFTC to start working with commercial agriculture interests to achieve more clarity.

Most importantly, we think the CFTC needs to focus less on technical legal considerations or labels and more on the commercial needs of producers and merchandisers and users. Thank you.

COMMISSIONER SPEARS: Thank you, Kendell, and you're certainly welcome to submit your full written statement for the record of the meting, as well. We look forward to any additional comments you might have as far as a comment letter to the Commission within the proposed comment period.

Now I'd like to open it up to additional comments or questions from other members of the Advisory Committee. I know that during various discussions we've had I think a number of the producer groups have also had thoughts about that so I'd welcome, in addition to the agribusiness folks, but also producer groups to comment as to their thoughts or views with regard to the proposal.

Bryan?

MR. DIERLAM: Thank you, Commissioner.

Lemmy Wilson couldn't be here today so I appreciate you allowing me to sit at the table in his place.

I guess I do have a couple of kind of comments and questions, both some directed to the leadership from the exchanges, as well as the Commission staff, any commissioners that can answer the question.

The first one deals with the issue--I'll preface all of this by saying that the National Cattlemen's Beef Association in general is more supportive of less regulation and not more, so any questions that I ask are asked more in the interest of how do we explain some of these things to our membership, as opposed to any opposition, if you will, to anything in the rule, notwithstanding whatever comments we submit.

On the issue of the derivatives, ag commodities moving to the DTF level, there's language in the House bill that passed the House--excuse me--passed the House Ag Committee--that we are supportive of that lays out a framework, if you will, for how agricultural enumerated ag commodities on a registered futures exchange, recognized futures exchange, could move to that DTF level and we are supportive of that.

One of the gentlemen from the exchanges indicated that there was some current concern about market fragmentation and loss of liquidity and we understand that loss of liquidity isn't good for anyone, but neither is an inflexible contract that loses liquidity because it is no longer useful for risk management.

We believe that ag commodities, if they meet the requirements as laid out both in the law and the regulation, should be allowed to move to that level if they meet the requirements and the contract participants meet the requirements that are laid out in the reg. So we are supportive of that.

Another issue is on the--this ties back to the over-the-counter issue. I'll direct this question to the Commission staff.

Will enumerated ag commodities be allowed to be traded under the Part 35 swaps exemption if the contract participants meet all the requirements laid out in the regulation?

MR. KUSERK: I think the current rules allow enumerated commodities to trade as swaps under Part 35, so that would continue--they'd be able to continue to trade that way, yes.

MR. DIERLAM: Just for confirmation, the third point I'd like to direct to the members of the exchanges. This is more about how do we explain this to our members?

On a couple of occasions when we look specifically at the live cattle contract, for a number of years we have proposed a number of changes to that contract which we believe would improve the ability of producers to manage their risk and would improve producer confidence in the market, but due to opposition and other concerns from the members of the exchange, we've been unable to get that done.

At the same time, there's another issue that all facets of the industry have been opposed to and that's on the speculative limits issue. Dozens of letters were submitted when that proposal was sent up here to the Commission earlier this year.

So by prefacing that we do support less regulation and not more, we've got to be able to explain to our members how, on the one hand, will less regulation be good for the industry when, as far as the flexibility to make rule changes with just a self-certification, right now, under the existing process, we've had a difficult time getting the changes we'd like to see made; however, changes that we're opposed to seem to be forced at us.

So the concern is how do we explain to the membership and why should they support this proposal when all they've seen in the past is rule changes being pushed at us that we're opposed to? Under the current system, we have a way to comment, we have a way to discus these things and a way to have an impartial arbiter, if you will, on these rule changes.

So what would be the feedback from the gentlemen representing the exchanges on how we can explain to our membership how this deregulation specifically related to rule changes will benefit them?

COMMISSIONER SPEARS: Thank you, Bryan.

I see that Kent's moved the microphone over in front of Jim since Chicago Merc has the live cattle contract. So Jim, would you feel comfortable in commenting and responding to his questions?

MR. McNULTY: Sure. I don't think I can get to the level of detail that you would like to hear. I'm in my position now for five months and there are still some things that I haven't gotten to yet.

Clearly what we see is there are a number of stakeholders involved. You would be one of the stakeholders. There are clearinghouses. There are members.

There are liquidity providers of different sorts that are involved.

I think getting the right contracts is one of the best things that an exchange can do for the success of the contract, to have the right liquidity and to provide the right risk management solutions.

Clearly with the shareholder value focus and with an intense customer focus approach to life, we should be very interested in getting the right contract specifications. And where we know we're in disagreement with any one group, we should be able to explain what the issues are. And I can pledge to you that that is of interest to me and that we will be able to do that for you and your members.

I can't always say that one stakeholder will win the day, though, because I don't think that would be fair to the other stakeholders.

MR. DIERLAM: The exchanges are facing a new era of competition, electronic trading, exchanges from overseas and outside the country at the same time that the beef industry has changed tremendously since the industry and the futures industry was first regulated.

As the industry has changed, so has price discovery; so has the method in which we market cattle, which in the end, is going to necessitate a change in the manner in which those cattle, those livestock are hedged, which will either be a change of the current contracts or an offering of new types of contracts, and those contrasts are either going to be offered by yourselves or someone who chooses to compete with you.

How do you foresee yourselves making the decisions under this regulatory framework to where you've got a contract that's your bread and butter but it's less and less capable of managing the risks of the industry for which it was designed, entailing a switch to another type of contract that for the folks who are entrenched and have been at the exchanges for a long time see that as competing with their bread and butter, but yet that contract is no longer meeting the needs of the customers.

How will that transition from an old contract that doesn't work anymore and people are using it less and less, how are you going to offer that contract even if you see it as competing with your existing business?

MR. McNULTY: Maybe I can answer that one, as well, at least from the point of view of the CME.

As a for-profit company going forward, it will be extremely important to me not to have a lot of Edsels on our electronic system or any other kind of trading system. I think we need to meet our end users' requirements and we have lots of different kinds of end users, as you know.

But we think one thing is clear, that meeting the end user requirements means you'll have to have an electronic version of the contract and an open outcry version of the contract and our end users will choose which one is the most efficient way for them to hedge or to express their investment opinion.

I think I mentioned earlier that next week we will launch an electronic contract, our first agricultural electronic contract, which will be the e-mini, lean hog contract. It's a 10,000 pound lean hog contract and people will be able to trade that electronically starting at the end of next week.

It gives you a what-you-see-is-what-you-get interface, very similar to the high growth contracts that we've had in the S&P 500 and the NASDQ 100, where this year we have 117 percent increase in volume because our clients are expressing exactly what kind of interface they want.

So we will meet those types of demands and our ears are open, so if you have things that you want to express along those lines, please feel free.

MR. DIERLAM: We have had a good number of meetings with the Live Cattle Committee, so we appreciate all the discussion.

COMMISSIONER SPEARS: Thank you.

Mike?

MR. BRAUDE: Thank you.

Let me point out in clarification that when I was talking about meeting the liquidity and risk management needs of the market, I was specifically referring to our bread and butter, wheat. We've had five straight record years of volume and I think one of the reasons--and I think Kendell would agree with this and I think the wheat-growers--is that we, as we've made changes in our contracts, such as adding Hutchinson as the delivery point, we listened very carefully to the wheat growers and to the grain and feed industry.

So to clarify points I made, I was referring specifically to our contracts.

COMMISSIONER SPEARS: Mark?

MR. FICHTEL: I would just say, and actually I think, Mike, you were the one who brought it up about fragmentation, no matter what the CFTC ends up doing, we're going to see fragmentation in these markets.

I come from the securities industry, as does Jim, and there were people who tried to resist change, and change will result in the short term in fragmentation. What we have to try to do is figure out ways to minimize that. And certainly one of the ways is going to be to create new contracts that supplement other users' needs and make them fungible with the contracts that currently exist so that you don't lose the liquidity totally, but you can move back and forth and hopefully increase the total liquidity.

As new marketplaces develop, though, they're going to have to be regulated by the CFTC in some way, shape or form because I don't think we want to have both fragmentation and unregulated markets, totally unregulated markets, moving into the futures environment.

But I would still come back to the question: when you go back to your members, I think you have to go back to them and ask, why wouldn't you want the opportunity to be able to apply for DTF status? I mean you may start out as an RFE but as it stands right now, it looks as if the CFTC's going to take the view that you are an RFE forever. And it seems to me that you should be asking your members why would they want to be locked into that? Why wouldn't they want the opportunity to raise their hands and say we'd like to be considered for DTF status?

COMMISSIONER SPEARS: Kent, would you like to respond?

MR. HORSAGER: Just very quick. I think I might be the only president of an exchange who spent my formative years shoveling feed into the cattle and then what they make out of the cattle barn after that. It actually is my background, butI don't want to speak specifically to cattle.

In terms of contract development, I think what we're going to see, and I'll speak certainly on behalf of the Minneapolis Grain Exchange but I think we're hearing some of the same comments and that is that exchanges will develop a very clear methodology for interfacing with their user groups. And we're certainly working to make that more apparent so that as these decisions can happen more at the exchange level without the same type of analysis that might have happened here at the Commission in the past, that it's very, very important for the users to understand what that process is.

So that then, when you go back, you'll have basically two things to say. One is here is the process that the exchange set forth for either affirming the specifications or for looking to alter that specifications in the contract. And then secondly, of course, in that process I expect we will see areas or the possibility to specifically comment on that. So I think you'll be able to go back and tell your user group that.

COMMISSIONER SPEARS: Bob?

MR. WHITE: Something that I wonder that hasn't been addressed or made comment on, many of the enumerated grains--we'll say corn for an example--the government has set a price that a farmer receives for corn. However many bushels he can raise, that's fine. If he feels that he needs to cover the risk of loss of that, he insures it. If he wishes to add or enhance his profit, he will future-contract or use the options market. So there's three opportunities for a farmer to profit on his production.

The one key point that I think, and I understand where the cattlemen are coming from and the pork producers, that may not have some of the protections that grain has under the government farm program, for those people it's an opportunity to say let's see what can happen here?

The third thing that we profit from is the market--the futures, the contract options, the opportunities to enhance our income. But we have certain safety things there for us. I understand where they're coming from they may not have those safety nets and I can see where they're concerned about what's going to happen here.

I, as a grain producer, say let's allow some things to happen here and let's see if we can allow this market to function and be more profitable and give me the opportunities to enhance that third position of hedging my production.

So I just wanted to make that point, that I do have some protections and I understand where these other groups are coming from, that they're concerned about their protections. They don't have that level that some of the farm community does have.

COMMISSIONER SPEARS: Ken?

MR. ACKERMAN: Just an observation along these lines and a question for the Commission or Commission staff.

Whenever you have a change in authority in the form of a deregulation or a movement of this nature, you do change expectations and you do change accountability. And as this last colloquy showed, when you go down this road of moving to the exchanges the authority or the ability to make self-governance decisions more quickly and with less hoops that they have to jump through, the responsibility on your shoulders will be much greater and the accountability on your shoulders will be much greater.

That relationship is one which, over time, is going to have to be worked out. There will probably be trials and tests and issues that will come up, during which it will be refined but clearly that shift goes with this change.

It will also mean that the CFTC will have to evolve its role because when things do go wrong, Congress's first phone call will be to members of the Commission. Then members of the Commission will have to relay that to members of the exchanges.

So the relationships clearly are going to change but for the system to work, the exchanges who are receiving the greater flexibility will need to step up and use that well.

One question I do have on this division of the enumerated commodities, the enumerated agriculture commodities versus the others, when you look at it, it does look kind of arbitrary. Yes, as Bob White pointed out, many of the enumerated commodities are the recipient of government programs and fixed prices and so on, but not all-- butter, eggs, potatoes, orange juice. The list is more something of a historical relic.

When you look at the meaningful distinction, it goes to more the concept of some commodities historically have been more prone to manipulation than others, either because they are tangible objects with limited supplies or historically there have been incidents.

In many cases they are not in agriculture. From my experience at the Commission, from my time here, obviously silver was one that took quite a lot of discussion. More recently, probably the one commodity that's gotten the most discussion about price distortion has been gasoline in the Midwest.

I guess my question to the Commission or the Commission staff: why the line around enumerated agriculture commodities?

COMMISSIONER SPEARS: Greg, do you want to go ahead and then I'll try to comment, as well, and other commissioners?

MR. KUSERK: Okay. I think you're right. This is an historical relic. My understanding, this is the list that existed probably from about 1968. These are basically the commodities that were regulated at that time.

But as we've gone forward, I guess we've noted in there that we continue to have regulations, for instance, the ag trade options, which rely on this list. I'd say these are the major agricultural commodities, too, that we're dealing with--things like corn, wheat, soybeans.

And I think in going out and proposing these rules, we've had a lot of comments from people in these industries who are producers, producer groups who deal with these commodities who express some concern about the protections they would receive.

And I would note that we've asked specifically for comments as to whether it does make sense to carve out these enumerated commodities, as we've proposed. It is a proposal and I think that's what we're here today partially to talk about.

So I don't know that it's carved in stone but I think it's a place to start the discussion.

COMMISSIONER SPEARS: I agree.

I appreciate your comments, Ken, as far as the historical perspective but I think it is just a starting point that we looked at as a place we could start and then go from there based on the comments we get from the various producer groups and commodity groups.

Mary Kay?

MS. THATCHER: Dave, I guess to pick up a little on Bryan's comments, although I'm afraid at this point the Farm Bureau isn't quite as supportive of deregulation as the cattlemen.

And I'm really happy, Mr. McNulty, to hear you say we don't want any Edsels on the electronic contracts and Mr.

Horsager says we want to be there and we want to listen to what our user community wants. And I'm not sure I really heard the answer I wanted to hear, so let me give a couple more examples.

If in the past Bryan has had trouble getting the live cattle contract change, certainly our members still have not forgotten the corn-soybean delivery point fiasco. Even more fresh in their minds is the changes in the daily price limits that the Board of Trade has sent through.

I think the answer is what I'm hearing this afternoon is, "Trust us.: And, on the other hand, there's just lots of examples where they say,"But if we just had to do what the exchanges suggested."

And things like the daily price limit, if I was in your shoes and I wanted to match the Eurex, I'd do the same thing you are. But when farmers look at that and see the possibility for a lot higher margin calls and the possibility for not being able to utilize contracts because of that, then to go out to them and say, "You know what? We're going to pull the CFTC out of the regulatory body and we'll give them oversight."

You know, how would I explain to my producers that they ought to trust what the exchanges want to do without having the CFTC there to step in when we come with what I think is probably overwhelming comments, for example, on the daily price limits from the producers' perspective versus from the other perspective on why it's necessary. You know, why would we want to take CFTC out of that regulatory environment?

COMMISSIONER SPEARS: I think both Mark and Mike immediately raised their hand and wanted to comment. So Mark, go ahead.

MR. FICHEL: I'd like to pick up, in answer to Mary Kay's question, I'd like to pick up on what Ken said. There is going to be a period of attitude adjustment or expectational adjustment. And again, coming from the security side, there are a lot of things that get filed with the SEC effective on filing.

The most famous of them most recently was when the New York Stock Exchange put through what appeared to be a significant--in fact, a doubling of their market data rates and Schwab raised its hand in objection to that and the SEC went back to the New York Stock Exchange, that generally doesn't take a real weak-kneed attitude about things, and said, "Gee, we'd really like you to reconsider that and maybe rescind it until we've kind of looked it over." And you couldn't even have blinked your eyes fast enough to see how fast they did that.

So I think the one thing that all the elements of the trade right from the producer on up ought to be thinking about is that while more responsibility is going to fall on the exchanges, the CFTC's going to have a different role in that you're going to have the opportunity if you see something coming down that you don't like, to go right them, and they're going to have to respond real fast to come back to us to say, "We're getting some problems here. Why don't you rethink that?"

And I've got to tell you, I can't think f any of the five of us at the table who are going to have the nerve to turn around to the commissioners of the CFTC or the staff of the CFTC and say, "We really don't think we want to hear from you today." I don't think that's going to happen.

MR. BRAUDE: Mary Kay, let me tell you one way the Kansas City Board of Trade has dealt with your question, and I think it's a good question. That is starting in 1987 and carrying right up to the present day, we have had a wheat producer as a member, an outside director of the Kansas City Board of Trade. And I can assure you when things like delivery issues, price limits and so forth have come up, that person has been very vocal and more often than not, they've carried the water.

So again I would let Kendell or--I don't think anybody's here from the wheat growers--say that has been another very effective tool in giving the producer a voice in the governance of the exchange.

MS. THATCHER: And I wouldn't disagree with that but some exchanges don't have as much interest in agricultural contracts.

MR. BRAUDE: We do because it's 98 percent of our business.

MS. THATCHER: So I have more confidence that my producers might be able to affect what your exchange might be doing without deregulation than others.

MR. BRAUDE: I think if you talk to the Kansas Farm Bureau and the Missouri Farm Bureau, they'll agree with that.

COMMISSIONER SPEARS: Mike, you asked to be recognized, as well. I think that Mary Kay raised the issue that you talked about in your comments regarding price limits so I'd be interested in your response to that, as well as your other comments.

MR. RYAN: I'd first like to make a comment about responsiveness to the customers. I think you raised a good example of why the Board of Trade needed to restructure, dealing with the delivery points and grain contracts, how long it took to get that done. We need to be more responsive to the customers.

We know that no one will have a monopoly on the contracts anymore. Competition is out there. We need to be responsive and listen to what the customers are saying and provide the service to them that they desire and allow us to compete in the globalization of the marketplace that's going on.

As far as the price limits, Dave Lehman, who is an ag economist for the Market and Product Development Department at the exchange, was good enough to come with me today and he is the expert on price limits and he was in on all the meetings and discussions and is much more knowledgeable on that and I'd like to defer that to Dave.

COMMISSIONER SPEARS: Dave, do you feel comfortable taking just a minute to address that issue?

MR. LEHMAN: I think Mr. McNulty really hit it on the head when he responded to the Cattlemen's Beef Association's concerns about their contract terms. There are a number of stakeholders in these contract design issues, obviously. What we have tried to do, and I think it's been echoed with many of the other comments here, is to have a very progressive and active method of reaching out to all of the stakeholders, trying to come up with what we think is a compromise which, in many cases, is the solution that you have to come up with.

Our Ag Advisory Committee was heavily involved, which included all of the producer groups and the Farm Bureau, in discussions on how to address this issue. This is an important strategic initiative for the exchange and I just say that what we came up with, I believe, is a compromise that will allow our markets to provide more continuous price discovery when you most need it, when markets are volatile, and yet still maintain the safeguards of a cooling-off period that our price limits provide. Thank you.

COMMISSIONER SPEARS: Wayne, do you want to make a comment?

MR. HAMMON: Thank you, Commissioner Spears.

I, too, appreciate the opportunity to be here. Bob Bold, who's our member of this panel, couldn't be here today and Terry Dietrich, who was going to fill in for him, had to run to the airport and the pending storm has made airline travel difficult.

I'm Wayne Hammon with the wheat growers and I'd like to echo what Michael said. We have had a tremendous relationship with the Kansas City Board of Trade, as well as a much-improved relationship with the Minneapolis Trade in the last year or so. Wheat contracts make up the bulk of that. We've had a great relationship.

However, our members are greatly concerned about the responsiveness in general of some of the changes. We hear about this responsiveness to customer needs but as was just pointed out by the last speaker, we're not the exchange's only customer.

And as we move into the for-profit atmosphere, my members are becoming even more concerned that they are not the primary customers the exchanges are trying to serve.

So I go back and try to sell them, you know, don't worry; we have a member on the Ag Advisory Panel. We have a wheat grower who serves on the Chicago Board of Trade, very involved in this recent decision. But his views aren't what carried the day.

When I go back and try to tell wheat growers, "Don't worry; we're going to let them do it and the CFTC will step in if there's a problem," they're just generally more comfortable with the CFTC being involved. I can't imagine saying that about any other government agency. Maybe RMA, but definitely not most of the agencies they deal with on a day-to-day basis, but they just are.

It's nothing personal. It's nothing to fear. We can't point to bad examples but more generally it's just a sense that as more and more money is made on agricultural commodities, less and less of that money is being made by the farmer and they're concerned that their role in the exchange's business is going to become smaller and smaller.

That's why we're very supportive of the proposed rules in keeping enumerated commodities separate. We're going to have a chance to talk about that later in the month. I will take this discussion back to my members. We will have a meeting of our policy committee before the end of the month and we'll be able to come up with some more formal comments but as of now, today, my members just aren't [inaudible].

COMMISSIONER SPEARS: Thank you.

Bryan, did you want to go ahead and add something, as well?

MR. DIERLAM: One of the examples that I've used a lot is that currently right now we're in a situation where we are essentially working with a regulated monopoly, if you will, that manages the price discovery of our live cattle contracts. That's where we're at today and we want to get to a situation where there's enough competition out there to where the regulation that kind of keeps things orderly is not needed because then it's the marketplace, if you will, that disciplines bad actors.

But even under a situation of regulated monopoly, on a number of occasions we've had to deal with changes that we think are detrimental and destructive to producer confidence and risk management.

So it's not the end or the beginning that we're worried about. It's what happens in between, when there is essentially an unregulated monopoly that can maybe change a rule with one day's notice to where we don't have--it's kind of late to go to the CFTC. Once you go to the CFTC, it's kind of late to get that unchanged and by the time you get something changed or by the CFTC steps in, perhaps the damage that we were concerned about is done already.

So with that continuum in mind, how can we address that situation under this proposal or if the rule change were to take effect, with rules being able to be made with one day's notice?

COMMISSIONER SPEARS: Jim?

MR. McNULTY: I think if you look through American business history, one of the things that you find is that incentives are one of the most important drivers. And if you see what way things move, it usually has to do with incentives.

If you think about traditional futures exchanges, I think what you can see is that over 100 and some years, many of the exchanges developed incentives which were for the staff to make sure that they created opportunity for the members.

And one of, I think, the benefits of demutualization and I think if I were going back to your members, this would be one of the messages that I would bring, is that once you demutualize and you put a for-profit incentive in place for the exchanges, now the staff has the incentive of creating profit and it's changed the whole focus from very short-term to long-term.

We know at the CME that the only way to stay in business for a long time is to be innovative and to provide the right level of service to our end users. And our members will also be end users but they'll only be one of many end users and we have to find that optimal point in order to make our incentives matter. And I think that's going to be very important for everybody who is a user of our exchange.

COMMISSIONER SPEARS: Bob, would you like to make a comment?

MR. METZ: I'm Bob Metz with the American Soybean Association. I'm also a farmer.

I think the Chicago Board of Trade has been quite good about involving the farm groups, the commodity groups in some of their discussions. There were a lot of discussions on contract limits and while it maybe wasn't exactly what we wanted, we realized we had to make a decision and the Chicago Board of Trade doesn't exist just for farmers. We're a very, very small part of it, but I think we bring legitimacy to the markets.

So we are happy with that. We're a little bit torn between the deregulation. I don't know exactly where the American Soybean Association stands right at this point. That's why we're here today. We realize that there needs to be regulation but yet we're fearful that if we're in such tight regulations, that agriculture might be left behind. We're a bit in a listening mode today.

COMMISSIONER SPEARS: Neal, do you have a comment?

MR. GILLEN: I just want to reiterate the point I made before. I don't think you're going to get the innovation you want on exchange-traded instruments until you allow innovation in the physical markets. Regulatory or the legislative framework precludes that and I think the maximum you can hope for is mini-contracts, which Mr. McNulty described. That is perhaps smaller delivery requirements and different delivery months to give flexibility. Unless you can allow the flexibility in the physical markets, allow the merchant to tailor the product to meet the customer he or she deals with on a face-to-face basis, that is not going to happen.

Most of the innovation that happens on the contract market are ideas that come from the trade. It has no use to the trade, and the trade being the merchants, the cooperatives, the farmers and the processors. They're the ones who come up with the contract documents. There's no wizards sitting in back rooms in exchanges dreaming up contracts because if it has no economic purpose, it's not going to trade. That's the simple fact. It has to have an economic purpose. It has to have some value to participants.

So I view in the cotton industry--and my statement was approved by our executive committee, our committee on futures contracts--and we view our limitations being regulatory and physical markets and until those constraints are lifted, you're going to have the plain old vanilla contracts that you have now.

COMMISSIONER SPEARS: Bob, do you want to make a comment?

MR. McLENDON: Yes. I'm a cotton producer and I'm here today mainly as an observer but I echo what Neal has said about innovations in trading. I was a tractor driver originally. I use the Internet extensively now and I don't guess as long as Ameritrade stays in business, I won't ever call a broker again. And I am concerned about that.

I just want to applaud the Minnesota exchange for trading cottonseed. We, as farmers, have several commodities that aren't traded and I realize they would be traded if there was a market to get the volume with adequate [inaudible], but that's very helpful. I wish all commodities that I grow I could hedge.

The biggest thing that I'm concerned about as a producer is when I hedge that product and deliver it to the market, that that contract or that hedge will be good. I have had a price contract that wasn't good and that's not a good sign.

We, as cotton producers, mainly have price contracts with merchants and we look to those people to be sound financially and when we deliver our cotton if we think we have a price of X cents per pound, we want that to be good.

So at this point we favor regulation because of our concerns. We don't know who we're doing business with, really.

I'm here today as an observer but I encourage you to continue to offer more products. I grow a lot of crops. Peanuts is one. I'd love to be able to hedge that price of peanuts. With cottonseed, it was a need and I thank you and I hope we'll have enough volume to support it. Thank you.

COMMISSIONER SPEARS: Thank you, Bob. I think you have a unique opportunity, the exchanges have; they'll have a new peanut contract. So we'll see who the first exchange is to have a new peanut contract.

Bill, then we'll take one or two more comments and bring this session to a close because we're running out of time.

MR. DODDS: David, let me give a personal reflection. I've been in this industry now for 41 years. Number one, I am a producer. I buy a lot of grain from a lot of other producers. I sell a lot of grain to a lot of consumers.

Like Mike, I've been a member of the Chicago Board of Trade since 1980 and the biggest factor that I see prevalent, even in our own Risk Management Committee at the National Grain and Feed, is fear. Because of the past--and believe me, I go back 40 years and I hear stories that were 80 years ago. I don't quite understand that but why don't we look forward more, rather than look back? Producers in particular carry this fear factor. They fear the Board of Trade. They fear the big grain companies. And, to some extent, the grain companies fear the CFTC. And I think it's all a reflection of history.

So we've just got to get on the bandwagon and open the doors and be outgoing and honest about the future and create a vision and I think we're going to have to loosen up a lot in order to accomplish that.

COMMISSIONER SPEARS: Thank you, Bill.

Certainly I think that as we move forward, I want to bring this session to a close. I want to thank the exchanges for being here and for engaged in this dialogue. I think it's been very healthy.

I'm sorry we're out of time on this topic. I'd like to go on for another hour or so. This has been the meat of the meeting and I think this part has been very helpful to the Commission. We recognize at the Commission that not all of the ag groups are in the position to, as some of you commented, to outline their final position and make their final comments on the proposed reg reinvention, so we look forward to that as the comment period closes, again on August 7.

I understand that there will be additional meetings, as the ag groups have commented, later in the month but it's my hope that this meeting could serve as a springboard and serve as part one to their discussion that they have that would be beneficial to them to hear from the exchanges as they develop their positions. So we look forward to your final comments on that.

I'd also be interested in--I know one group has been pretty quiet and that's the ag bankers. Ag bankers aren't always that quiet. I'd be interested, as we go through the final comment period, that there are some unique opportunities I think for banks in the proposal and I think I'd be interested from the ag perspective what the ag bankers--and I don't necessarily expect to hear your comments today but as the comment period closes I'd be interested in hearing your comments as to the ag banks seeing any unique opportunities for their producers, their members, their customers, as having unique opportunities presented to them in this bill, as well, as far as clearing and FCMs and things. So I welcome those comments in the future.

With that, I'll bring this session to a close. I want to just recognize Chairman Rainer for a couple of closing comments on that. Did you have a question or comment?

CHAIRMAN RAINER: Thank you.

As you can tell, there is some tension here on some of these ideas. This is very helpful, to get everyone's views on the table and on the record.

Ken Ackerman made an interesting point that I would like to attack from a little different direction and that is--and this is said without any prejudgment on my part of where I think this ought to end up; I'm still very open-minded myself and think that there's more debate to be done.

One of the paradoxes that we find ourselves facing is that this approval process, rule approval and formally contract approval, has created ambiguity for the exchanges with respect to how careful they need to be about their image. And part of the hypothesis away from the agriculture product, part of the hypothesis behind the Commission becoming much more aggressive as an oversight body and less important with the approval aspect of regulation is it will force--this is a cousin of Mark Fichtel's example of the New York Stock Exchange--it will force the exchanges to be much more careful about their image with all of their, to use Jim's words, stakeholders than they are now because of Commission involvement.

COMMISSIONER SPEARS: Just finally, I wanted to note for the members's benefit that the issue that Mary Kay brought up earlier as far as price limit fluctuation limits on the Chicago Board of Trade, that comment period is still open. I think it closes on July 24 so if any members of the committee wanted to make comments on that, we'd welcome those comments by next Monday. And thus far I think we've received 129 comments on that issue.

Tom, did you want to add anything?

COMMISSIONER ERICKSON: Just briefly, I guess. We talked a little bit about the interest in the DTF marketplace and I think personally, one of the first questions we need to look at from the agriculture perspective is what are producers in that environment? And I think everybody has maybe their own perspective on that but I'd just like to run down maybe the exchange leaders who are here with us today and just say in a DTF trading environment, would producers be commercial or would they be retail in a DTF marketplace?

MR. BRAUDE: I think they would be commercial.

COMMISSIONER SPEARS: Go ahead. Did you want to say something?

MR. HORSAGER: I would echo that most producers, especially in today's environment, would be commercial.

MR. McNULTY: We would agree with the hat, as well, at the CME.

MR. RYAN: The Board of Trade producers are commercials.

COMMISSIONER SPEARS: Thank you, Tom. Thank you.

With that, we're going to take a short break. I mean a very short break. We're behind schedule so I'd like for us to just take a few minutes. Be back at the table by 4:10 and then we'll get started again. Thank you.

[Recess.]

COMMISSIONER SPEARS: Could we come back to the table? Again if we could go ahead and please get started for the third part of our agenda.

A very important partner to this Advisory Committee has been Congress--I've asked Walt Lukken from Senator Lugar's office, the Senate Ag Committee, and Ryan Weston from Chairman Ewing's office on the House Ag Committee to come down and brief this committee just briefly on the status of legislation on the Hill.

As I commented in my earlier comments, we're all well aware that legislation is moving forward on the Hill regarding reauthorization of the CEA and the CFTC and within that are major changes. So I've asked again Walt and Ryan to make a few comments, Take as much time as you need and we'll go from there. Walt?

LEGISLATIVE UPDATE

MR. LUKKEN: I guess I'll go first.

COMMISSIONER SPEARS: Being a Senate man, I always defer to the Senate first.

MR. LUKKEN: I appreciate that.

I guess bringing you up to speed on what we've been up to lately, it's been sort of a whirlwind. Two weeks ago, I guess it was, the Senate passed out of our committee the Commodity Exchange Act reauthorization unanimously. In order to do so, there was some horse-trading going on at the very end.

Primarily you had three areas of reform contained in it. One was the regulatory relief package that the CFTC had proposed to Chairman Lugar, I guess it was back in January that Chairman Rainer had come up to talk to us about it and we've tried to incorporate that into our bill.

Secondly, we dealt with the Shad-Johnson Jurisdictional Accord, trying to repeal that law that's been on the books since '82 so that single stock futures could trade in the United States and develop some sort of regulatory framework around that.

Thirdly, we tried to address the legal certainty question that's been around for the last couple of years and to try to ensure that over-the-counter derivatives can be traded overseas without the legal uncertainty problems that have plagued that market.

There are a couple of problems that sort of face this legislation going forward. We don't have the jurisdictional problems that the House faces, the procedural problems, but we do face some issues in the Senate. When time becomes short at the end of the year, one senator can pretty much hold up the train, so we have to accommodate anybody's concerns with this legislation before we can move forward.

Primarily, the two problems our bill is facing at the moment is Senator Gramm, who has some concerns with the legal certainty aspects as it pertains to the securities laws and secondly, the Shad-Johnson portions of our bill. The SEC and the CFTC continue to work on trying to resolve those problems but until they can, it's unlikely. There are folks in the Senate that are willing to block that bill until they can resolve those.

So we're sort of in a holding pattern, I think, at the moment, trying to resolve those two problems. We have another week of the Senate being in session. We'll be out then for the conventions until after Labor Day and then we have sort of a sprint to the finish line, probably four weeks of legislating. I think there are 30 legislative days left, somewhere around there.

So we're trying to, over the next month, I think try to solve those two problems. If we can, this is something that's likely--if we could solve those two problems, we could probably hopefully get some floor time with a unanimous consent agreement on the time arrangement so that we could, in an afternoon, dispose of this legislation. That's sort of the optimistic view but that's our game plan if things work as planned.

I'll turn it over to Ryan and let him comment further on what he sees as the forecast here.

MR. WESTON: Well, I can't believe the Senate bill only has two problems. I wish we only had two problems.

Thanks for having us down today. I think this is very timely and I know it's a very important issue. Obviously the agriculture section of the bill is the most important to us. Obviously Mr. Ewing has worked it through his subcommittee, Mr. Combest has been very involved, helping us with the staff work and everything else, and we were very happy with what we passed out of committee.

I think the only thing I really wanted to touch on is our bill is very much like Walt's. In the ag portio of the bill we did have many meetings with the exchanges and the ag groups. Mr. Ewing came in himself to try to find some type of consensus.

I realize it's very hard. The markets are changing much more quickly than we ever imagined. I know when we tried to draft a bill in '97 things just moved so remarkably quickly. We want to have the most flexibility we possibly can so that two years, if this bill passes, we're not trying to come back and redraft everything. Hopefully the producer groups and the Commission can work together to provide some innovative features.

What we did in our bill is basically we made the enumerated agricultural commodities only eligible to trade at the most regulated level. Through conversations with ag groups--we had everyone come in--it was determined that the majority of the producer groups wanted some flexibility to be able to possibly move in that second level of regulation.

Very tough decisions to be made. It was not complete consensus but we decided that after rulemaking and public comment, the majority of the groups were able to live with the chance to move into the DTF level of regulation.

We know that that obviously is farther than some groups wanted to go, it's not as far as many in agribusiness wanted to go. We haven't been able to loosen up ag trade options and some other things. We really are at the point in time where the Banking Committee held a subcommittee hearing today and you could hear some members in Banking question, "Why is Ag even looking at these futures issues if only 3 percent are ag?"

So there's already a mindset out there that there's possibly no reason ag should have jurisdiction over these issues. I think people need to be reminded if futures were developed from ag products and through the history, this is where the innovation has occurred. The Commission has a strong record of regulating all futures--financial and agricultural physicals.

That's the approach we've taken. We've tried to be strong. Obviously when we're working with our Commerce and Banking Committees, they're very strong, powerful committees. We feel that you do have the expertise in CFTC. The producer groups have worked hard. The exchanges have worked hard. We want to keep as much of this jurisdiction here as possible but in order to make a large enough arena to have a regulatory body and influence the members of Congress, we really thought we had to move forward some way.

That was really all I wanted to say. We did pass our bill out of committee on voice vote. The House Banking and Commerce Committees are both looking at relevant clearing sections of the bill, Shad-Johnson, which we obviously are working very hard on. And they both have referral until September 6, so they're supposed to be done by then.

However, they only have about five more legislative days to act on the bill because they have to be done by the end of July. Commerce subcommittee under Mike Oxley will mark up tomorrow, tentatively scheduled, and Banking evidently will try to go forward sometime next week. But we still have the battle to go to Rules Committee, whether it's with variations of our bill or three separate bills or however this ends up, and trying to get floor time in August-September will be a very tough process.

We'd really like to thank the Commission for the impetus of putting forward a regulatory relief proposal. It's shown strong leadership and it's been very helpful and we appreciate everyone's input in the process.

MR. LUKKEN: If I could just follow up, Commissioner, as I was listening to the debate with Bryan over here, they kept talking about the enumerated commodities and the differences and why we've drawn a line.

We really, when we started this, and it really dates back to '98. I remember having the Commission along with the Fed and the Treasury Department and Alan Greenspan had made the distinction that there's differences, he thought, between financial futures and agricultural futures, that maybe they should be treated differently, that this one-size-fits-all structure was different. It wasn't just because they were agricultural futures; it was because there were public policies behind those types of products, that there was manipulation involved, that there was a retail segment that some of these financial markets don't necessarily have.

And I think we've tried to follow up that with several roundtables, several discussions with the CFTC to try to really, instead of looking at the products themselves, looking at the policies of why we regulate the products. I think it's been our presumption that once we've figured out those policies that we're going to divide lines based on whether there's a retail segment to the markets or whether there's manipulation involved with these markets.

Then we decided to try to figure out how do you divide those lines? And we could have said--the Commission, I think, has gone the route of maybe defining financial versus ags. We went with a route saying manipulable or nonmanipulable, so there's lots of ways to draw the line but it's a very difficult line to draw.

So we're certainly open to agricultural products advancing into less regulated frameworks in our bill and we allow for that to happen, but they also have to prove that they can't be manipulated, that there doesn't need to be a retail oversight of these products. That's a reason we've drawn those lines like that but hopefully we have a mechanism in our legislation that will allow them to move around if the case can be made in the future.

COMMISSIONER SPEARS: Thank you, Walt and Ryan.

Are there any questions or comments from the members of the Advisory Committee to address to Walt and Ryan regarding legislation?

MR. GILLEN: I have a question actually for both Ryan and Commission staff.

Since the post-World War II era or since the CEA Act was passed 79 years ago, how many instances of manipulation are on the record?

COMMISSIONER SPEARS: I'm not sure if we have any of our staff left.

I can't point, Neal, to the exact number. We'll get our staff to research that and get back to you as to what the number might be. Your point being that there have been very few?

MR. GILLEN: Well, Hunt was alleged to have tried that in the late '70s but little old ladies cashed in their silver when the price got so high and it turns out there wasn't a finite supply. So it was in everyone's hope chest stored away and the market broke.

I was involved, I think, in the only manipulation case involved before the Commission when the Commission first started. Its first case as In Re: Hohenberg. That was an alleged attempted manipulation and the case was dismissed.

The exchanges do a tremendous job and the participants in the market do a tremendous job and all of the large trader reports--I don't think it's a legitimate fear. Certainly we want price discovery and transparency but to give Mr. Greenspan his due, every time I check my 401(k) I say a prayer to him; it remains in good health.

But manipulation is really--it's there but it's not there. Market participants do a tremendous job to preclude that. It's a very transparent process.

MR. LUKKEN: Is that because of regulation or because of the markets themselves? I guess we're--

MR. GILLEN: Walt, it's a combination of all because any commercial on the market, anyone who is in the market certainly wants their position protected from someone taking advantage who's on the other side of that particular contract.

You have reports that are required by the Commission rules and regulations. You have management by the exchange committees, exchange oversight and supervision.

So it's a combination of market participants, the exchanges, the Commission regulations, so you have a very transparent situations.

You could make the argument that manipulation would not necessarily be a problem in and of itself to exclude, to maintain so-called special treatment.

COMMISSIONER SPEARS: Thank you, Neal.

Are there other questions or comments from other members of the committee?

MR. ACKERMAN: I'll ask Walt the question I said I was going to ask. This is a question for Walter or Ryan.

How do you see the two processes working together? We've had our briefing on the Commission's regulatory package and to some extent or to a great extent it covers issues that are also covered in the legislation. The legislation covers issues that are not covered in the regulation.

How do you see the two processes working together? Are there inconsistencies between them? Are they generally consistent? How do they work together?

MR. WESTON: I can just say from the House perspective obviously it's very important, I think, that the processes do continue to work together in tandem. The Commission can do a lot to help in regulatory relief for the futures markets and modernization. However, there are just areas that are outside the statutory authority to be dealt with down here. We really have to have a comprehensive bill go forward.

I think that it puts a solid stamp of congressional approval upon what the Commission has done. I think it gives it more legitimacy if it passes through the

Congress. In no way to disregard what has been done here, it's just really important to keep moving forward as fast as possible and continue that credibility.

Congress is very happy with the work that is accomplished down here. We have great faith that the agency will do what it needs to do.

And as far as regulation and what's happened with manipulation in the past, we can look at that but I think what is more important is how has the regulation evolved to be more efficient? Can it be more efficient?

I realize there's been less and less reporting of fraudulent activity. The reparations program has had less cases brought before it. So evidently, the markets continually improve upon how efficient they are and there must be good fairness there.

MR. LUKKEN: I think for us, we've tried to from the get-go work with the CFTC on starting from the same conceptual viewpoint. I remember the meeting that we had with Chairman Rainer, stating is there any down sides for these two trains sort of leaving at the same time? Is one going to maybe thwart the efforts of the other? We weren't sure but what came out of that meeting was that it's important that we both continue to plow on.

We sort of started from the same place and we may have drifted slightly. I think in the details there may be some differences but I don't think anything that can't be resolved in the end. I think we were trying to do the same things and our document is largely based on theirs.

So hopefully, like Ryan said, we want a congressional stamp of approval to this that gives them some leeway to do what they're trying to do, but I don't think it's anything that can't be worked out in the end.

COMMISSIONER SPEARS: I want to thank both you, Ryan, and Walt for coming down here. I know your busy schedules and we're behind schedule as far as keeping you guys waiting, so I apologize for that. Again this Commission enjoys a tremendous relationship with both your offices and the committees and we appreciate that, as well as the members of the Advisory Committee. Thank you very much.

Next we'll go to the next part of the agenda. I thought it might be beneficial to the committee to have an opportunity to hear and engage in discussion with some of the new businesses out there that are engaged in providing new innovations in ag risk management tools and ag risk management marketing.

So I've invited a number of companies to come to the Advisory Committee and provide some briefings to us and then we'll have an opportunity to maybe engage in a Q&A with them if committee members would like to do so.

While they're getting set up I might just note that I invited four different groups to come. Three of the groups were able to come. The fourth group, Rooster.com, was unable to be here today due to travel and pervious commitments on their part. They expressed their interest in being here, would like to do so in the future, and they apologized for not being able to be here to brief the committee.

But we were fortunate to have three groups. I've decided to go ahead and recognize them in alphabetical order as to their organization, not any particular order other than that.

The first group is CyberCrop. With us we have Ron Weineinger, who's vice president of marketing. In the interest of time I'm not going to go through the bio of each of these guys because I'd be more interested in hearing what they have to say, but their bios are included in your packets so you have an opportunity to have more information about the individuals themselves.

Again I want to thank all participants for being here and in the interest of time, I'll go ahead and turn it over to you, Ron. Thank you very much.

RECENT INNOVATIONS IN AGRICULTURAL
RISK MANAGEMENT AND MARKETING

MR. WINEINGER: Thank you, Commissioner Spears. We appreciate the opportunity to spend a few minutes with you and to talk about what's going on in e-commerce in agriculture, particularly in marketing and in risk management.

So what I'll try to do is to be very brief but I want to share with you a little bit about what our company is doing but really to start with an overview of what's happening in total in e-commerce and what kinds of opportunities that presents as an industry.

I'm also pleased to be able to share this tim with some colleagues in the industry from e-markets and from ICEcorp, both who are doing very innovative things and I think are also great competitors, so I appreciate the chance to be with them today.

I wanted to start off by talking a little bit about the size of business-to-business e-commerce and the projections for where it's going from today and then bring that back to agriculture and what it means in the industry.

In total, business-to-business e-commerce is projected to be close to $1 trillion within the next two years. By 2002 it's expected to reach almost $850 billion in total transactions.

In agriculture, depending on the source that you look at, and we have our own estimates factored in here, but we expect that by 2005 there will be about $70 billion in agricultural transactions at the grower level. The 1997 Census of Agriculture suggests that total grower level transactions, either sales, when you combine sales and purchases at the grower level, is about $400 billion. So that means that about one in every six dollars that the producer brings in or sends out is going to be over the Internet by the year 2005. So that's a pretty rapid adoption, as was mentioned earlier, of the Internet for conducting commerce.

The question that always comes up is is there really access out there from producers to be able to utilize this new technology? And we think the answer is clearly yes. If you look at the percentage of computer ownership, in this case, if you use 500-acre corn growers or larger, corn growers as a proxy for the entire industry, about two-thirds of producers have a computer today.

Then if you ask the question what percentage of those folks have Internet access, 44 percent of 500-acre or greater corn growers have Internet access. So two-thirds of the folks that have computer also have Internet access and it's doubling about every year or close to doubling about every year, so that access is growing dramatically.

The question then that has to be posed is should we feel good about that? Is that good access? Is that a good amount of access for America's farmers and ranchers or is it not? And we believe that it is. If you compare that 44 percent of corn growers that have access to the Internet with consumer households, you find that they're about a third ahead of consumer households in total, that 44 percent leading the 33 percent of households with Internet access. So we think that that provides the basis for a very rapid uptake in commerce to be conducted over the Internet over the next few years.

What are we doing at CyberCrop.com and how does it fit into the whole e-commerce picture in agriculture? Our vision is really to work collaboratively with the institutions and with the companies in the business to help improve the profitability of the commercial producer of food and fiber. That's what we're all about. But we know that those growers don't exist in a vacuum and that the counterparty to any transaction has to see a benefit, as well, so we're also very committed to providing e-commerce solutions to the partners of the grower as we try to find a way to conduct transactions and I'll tell you a little bit more about specifically what we do. But we're all about creating a win-win situation in the marketplace for both the seller as well as the buyer of cash commodities.

The term disintermediation gets used a lot when it when it comes to business-to-business e-commerce and particularly in agriculture, that gets applied on the input side very frequently. That's definitely not what CyberCrop.com is about. We are a collaborator. We're trying to work with each of the current players in a transaction, both counterparties, and we want to create a win-win situation for those involved in e-commerce.

Essentially today CyberCrop.com has two basic products. The first is an innovative on-line cash grain exchange. So for producers of corn, soybeans, wheat and grain sorghum, they and the grain buyer that they do business with can complete a full, legally binding contract over the Internet. No need to go to the telephone after finding that buyer or that seller. The full, legally binding contract can be completed right on the Internet.

This tool emulates the phone and paper system that's in place today. And the reason we developed that was we knew that there were several things that we couldn't do. One was to use an auction to be able to trade grain. Grain is not traded at auction. It's not traded by listing it in a catalogue. There's a very specific bid-offer-execute kind of market mechanism that's utilized on a cash basis, so we developed a proprietary piece of software to be able to emulate that current system on the Internet, which drives a number of efficiencies that I'll talk about here in a few minutes.

We also are not an instrument for trading futures. No futures are planned to be traded at the moment. We may eventually end up trying to originate orders for futures instruments but we definitely are focussed clearly on cash grains.

Today the on-line cash grain exchange is available to producers in Kansas and Nebraska. This is only limited by really where the supply chain partners, whether they're elevators, processors, feedlots, feed mills, flour mills, are located and we've focussed initially on trying to get folks on board, placing bids in Kansas and Nebraska. By August we will have expanded to Indiana, Illinois, Iowa and Minnesota and by October we'll be available throughout the entire corn belt. So that's been basically the roll-out strategy that we've implemented so far.

We are a truly independent, neutral website. Those terms get kicked around a lot but we define that as being an organization that is not closely controlled or even held by large agribusinesses with other interests in the industry. We're very independent in terms of our ownership structure and I'll talk about what that ownership looks like in a few minutes.

The other thing I would bring to your attention is there's a great article in the July 17 issue of Forbes Magazine that lists a number of websites that are kind of picked out, I guess, as those most likely to succeed by industry, so I would recommend that to your attention, as well.

The other product that we offer is what we call a portal. It's really the news, weather, market data, analysis and commentary that's provided to really both the grower, as well as the grain buyer to utilize. And these tools are effective in providing some of the context and some of the decision-making tools for the producer to make better decisions about marketing the crop.

This is actionable unique content. We've taken a different tack than many sites in that we've gone out and hired our own editorial staff to be able to provide that kind of proprietary content that we think is usable.

In the future you can expect us to continue to add innovative services and products for this core set of corn, soybean, wheat and grain sorghum producers, as well as some Enterprise Software solutions for the supply chain partners who work with those producers. So again we're trying to collaborate with those folks in the industry.

What are the benefits then from the growers' perspective? The key benefit is that the grower will now see more marketing alternatives than ever before. Most growers tell us that when they are in the market to sell grain, they will call for one or two grain bids, typically from local buyers.

This system allows for price discovery on a scale heretofore not seen because on a single page you'll be able to see literally dozens of bids from grain buyers in whatever area the grower chooses. In other words, I'm from Marion, Kansas; I set up my market monitor, my grain exchange, to look at a 100-mile radius around my home town. And there are today 40 wheat bids in that 100-mile radius that I can review.

So suddenly you've gone from a marketplace of one to two bids that are typically reviewed to literally dozens of bids that can be looked at by the producer.

It also in the future will provide a way for the grower to look at the premium and discount schedules, as well as the differences in freight associated with going to each of those grain buyers. By the first of September we'll be out with an additional feature that allows the grower to put all of those grain bids basically into a formula to adjust it for freight, to adjust it for the individual buyer's premium and discount schedule, allowing them to see essentially a net-to-farm bid price. So they'll be able to rank, top to bottom, what's the best cash bid available to them on any given day. That's a feature that growers have become very excited about and we kind of call it the "holy cow" feature back in our shop and we think it'll be very valuable to the grower.

The other key pieces of the site or key benefits for the grower are, number one, it's free. The buyer pays a nominal transaction fee to utilize this site; it's free to the grower. And finally, we've mentioned just briefly the customized market information, analysis and commentary that's provided.

Our supply chain partners are buyers of grain. They have substantial benefits, as well, we believe. First of all, it allows them to utilize the Internet to make more profitable decisions. It provides a way to gain access to producers over a much broader geography than they typically do today. That drives volume. That drives bushels originated through those assets, which, in turn, drives profitability.

It also reduces transaction costs because now one merchandiser spends a whole lot less time on the phone, their time is more productive, they're able to originate more bushels with less time.

They also have the opportunity then to conduct those transactions 24 hours a day by posting their bids on the site. And eventually those bids will be able to be linked to Project A. Currently it has to be a static bid after the market closes but eventually those will be linked to Project A for overnight trading.

I mentioned briefly that we're an independent neutral site. We don't have associations with other major players in the industry. CyberCrop.com's lead investor is Internet Capital Group or ICG. ICG is arguably the leading business-to-business e-commerce developer in the industry today. They have over 60 companies at the moment engaged in different industries and their objective is to really become the General Electric of this century, if you will, with their business-to-business holdings in that they want to participate in the top 50 vertical marketplaces with different companies.

We kind of call ICG our accelerated execution partner, meaning that we're able to learn from other companies in other industries and apply that knowledge to our company and to agriculture and hopefully provide products and services to growers and supply chain partners in a much faster and more effective way.

I wanted to take you on a very brief tour of the site. I've only got four slides here to show you what's available today on CyberCrop.com. These slides are a few weeks old, I might add, and there are some prices on here which are not live prices. So when you see $5.39 corn, those of you who still have old crop corn, please don't head for the door to try to price that grain.

This is the home page for CyberCrop.com. I mentioned those two products. Essentially on the top right is a snapshot of the cash grain exchange and I'll show you more about the cash grain exchange in just a second.

Surrounding that then is, from top left going to the bottom, is first of all, our market information that we provide, as well as our ag news and then a good component of weather, as well, and a package of weather that we're pretty proud of.

Some of that content includes a three-day forecast that includes a section on wind speed, particularly important for spring purposes, as well as a number of other agriculturally sensitive indices. Maps of Brazil, Argentina, Asia, and Australia. Many of the growers that we worked with on our producer consultant panel, which was about 15 growers who designed this site, they were very interested in international weather maps because of the effect that that has on U.S. prices.

We also have a number of pieces of data that are simply not available, to my knowledge, anywhere else, including historical local basis charts. And our markets editor, Bryce Knorr, who's arguably the most read markets editor by producers in the U.S. over the last five to ten years, produces market recommendations and analysis that most people have to pay for. The Brocks or the Allendales would charge a fee for essentially what we're giving away on the site.

And then finally, we produce a show called CyberCrop.com Week in Review, which is a wrap-up of both the ag news, as well as the market news from that week, and that's available in slide show form with audio. So at the end of each week, at the grower's or the supply chain partner's discretion, they can view that slide show with audio that's available on the site.

I mentioned our editorial staff. That editorial staff is led by Andy Markwart, who's formerly with The Furrow Magazine and was with Illinois Prairie Farmer before that, as well as FFA New Horizons. Bryce Knorr was the lead editor for Farm Futures Magazine and then was the markets and management editor for Farm Progress Magazine, which includes holdings like Waltz's Farmer Nebraska, Farmer Kansas, Illinois Prairie Farmer, all of the state publications.

And then finally, Dean Houghton was previously with The Furrow but has history, as well, with Successful Farming and Farm Journal. Those folks we brought in-house because we wanted them very focussed on providing unique and actionable--key word "actionable"--content for the site.

Let me turn to the cash grain exchange. This is the first page of what we call the market monitor of the cash grain exchange. What the producer would see when he or she turns to this page is the top chart, which reviews what's happening in the futures markets, with the contracts across the top and the data in rows down the left side. So they can get a quick look at what's happening in the futures markets.

The bottom chart then--this one is clearly abbreviated because there are many bids that are available on a local cash basis but that bottom chart then would present all of the cash bids in the area selected by that grower and they can select a 10-mile to a 1,000-mile radius of bids to review.

So this would present, by delivery period, what cash bids are available in the marketplace at any point in time.

To proceed toward a transaction, the grower would simply move the cursor across one of the prices that they see in the delivery month that they're interested in. When they click on that, they move to a page that we call bid details, which outlines more of the specifics of the contract. This would include everything from the commodity to the price to the basis, weights and grades information, minimum quantities for delivery. All of that information is presented.

A couple of other features that the grower has then at their discretion is to view the terms and conditions of that contract and they can also look at the premium and discount schedule of that particular buyer.

Then, if the grower is still interested in proceeding with that transaction, they would enter in in the box that's kind of middle center on the screen the number of bushels they're interested in selling. In this case in this example, the minimum quantity was 500 bushels but let's assume that if you wanted to sell in 5,000-bushel lots, you would enter 5,000 bushels. You would also have to enter in your trading password.

There's a double security feature here, meaning that you have two different passwords, one that allows you to move forward with the transaction. That's simply so that your five-year-old or your evil uncle can't trade everything you have in the bin for 10 cents a bushel. That second password allows you to keep that protected.

The grower then has a couple of choices. They can accept that bid as flat or accept it basis and then deliver that grain at some point in the future with the basis floating with the futures markets.

The other feature that I wanted to mention back here is one of the key questions that producers asked us was if I'm going to be delivering grain to a location or a buyer that I've not done business with before, what confidence do I have that they're credit-worthy? Defaults are very, very rare, of course, but it's a concern from the producers' standpoint. So we provide them actually with a way to check the credit of buyers, two different options for conducting a credit check on buyers so they have greater confidence in delivering to that buying organization.

Once they accept the bid here as either flat or basis, there's actually a screen which I haven't presented which is a trade confirmation screen. It's a double accept so that the producer has to really say "Yes, I want to do this" twice before they're locked into a legally binding contract.

Then finally, once they do that second accept and in that second accept, by the way, there's a 45-second time period in which they have to do that or it kicks them back to the market monitor. Since the market's always changing and these are priced off the futures markets, it will kick them back to the beginning again if they don't accept that within 45 seconds.

Assuming they did, they would end up here with a contract confirmation showing that they've entered into a legally binding contract over the Internet for delivery in a certain period of tim and of so many bushels, with all of the other terms and conditions of that contract presented.

The contracts are not sent out by mail. They're not sent out by e-mail. E-mail is not considered generally secure and we're trying to save the expense of a hard copy contract. So the contract is actually held on the site behind a contract confirmation number that the buyer and seller know about that specific contract and they can access that contract through that number, print it out if they choose to do so. But otherwise, the contracts are actually held on the site.

That's a very quick review of what the site can do. I've presented only the producer side of this. I'd love to show you the supply chain partner side but in the interest of time, I suspect I had not better do that, but it's equally intriguing, I think, from the supply chain partner's standpoint. Thank you.

COMMISSIONER SPEARS: Thank you very much, Ron. I appreciate that.

My staff has told me it takes two or three minutes for each group to boot up their computers so with that, we have a couple of minutes here just to engage in a couple of questions or comments that you might have for Ron and CyberCrop. Then if the committee as a whole would like to address questions to the entire group later on, we can do that, as well.

So are there any questions at this point in time for Ron and CyberCrop? John?

MR. BLANCHFIELD: Earlier in this meeting Commissioner Spears put me on the spot--what did the ag bankers think? Usually we don't think a lot but we do think about getting paid when we lend money to buyers and sellers.

You mentioned several things that intrigue me. One is the legally binding contract that I'm not sure how that works. And then how do you have certainty if you're--and I'll ask this of each of the dot.com guys--how do you have certainty that the buyer indeed exists or that the seller indeed exists?

MR. WINEINGER: From the buyer's standpoint, those are folks who we have visited with and know very well and they are well established legal entities. So we have an authentication process actually for both buyer and seller on the site.

So the last thing that we want to do is to create an exchange where there's little integrity, so it's definitely in our interest to make sure that those folks can deliver on those contracts.

Now having said that, we don't provide a guarantee, just as there's no guarantee in the marketplace today. But for certain, we have an authentication process that works both ways, for both buyer and seller.

MR. BLANCHFIELD: Do you handle the money? Or once the contract is executed, you don't know them? How does that work?

MR. WINEINGER: Great question. No, we never handle the money. That settlement takes place just as it does today. We're the market-maker. We put buyer and seller together but we do not get in the middle of the funds being transacted.

COMMISSIONER SPEARS: One quick question, Ron, from my standpoint. Right now you're strictly a cash market. Do you see--and I'll ask the same question of all the dot.com companies--do you see yourself evolving into more than a cash market in the future, in futures and options, or how do you see that?

MR. WINEINGER: We think that we need to continually provide tools to that core corn, soybean, wheat, grain sorghum producer that they're going to be able to use to be more profitable. So to be able to provide at least through an order entry system some way to give them futures instruments, that's definitely on our white board back at the office.

COMMISSIONER SPEARS: Jim?

MR. BLAIR: When were you founded and what kind of trade volume have you experienced since then?

MR. WINEINGER: We started with financing from ICG last September and we launched the content portion of the site in February and then the cash grain exchange in May. And at some point in the future we'll release all of the volumes but we want to do that on a timely basis, so I won't do that at this point. But we are getting good and consistent activity on the site.

COMMISSIONER SPEARS: Thank you, Ron. I may ask you to come back later on if there are questions as a whole for the group.

Next I'd like to recognize and thank Scott Cavey, who's vice president from e-markets, for coming and again, Scott, I won't go through your bio in the interest of time.

MR. CAVEY: Very good. Thank you, Commissioner Spears, for the invitation to us to come and share our thoughts on e-commerce.

Ron kind of went through the industry as a whole and again in the interest of time, rather than doing that, I'll just kind of jump into what e-markets is, what we do and what we have done in the past.

E-markets is a provider of on-line solutions, on-line tools for the agrifood industry. And as we look at the agrifood industry, that is an industry that is about a $500 billion industry. There's continual efficiency pressure within that industry but we look at it from a production-to-processing mindset.

We do B2B transactions and last year we hosted $500 million in transactions over our pipes. We have industry relationships and right now our strong relationships with Dow Ager Sciences, Cropland, Land O'Lakes, Cropland Seed Division, National Pork Producers Council. We just finished development of a national swine production financial database. And we've just entered into alliances with Iowa Farm Bureau and some other groups that are working on beta testing in the industry.

We also have domain expertise of over 100 years of experience in agriculture from seed, feed, fertilizer and grain trade business.

We were founded in 1996, located in Ames, Iowa. The first Internet application was actually launched, developed and launched in 1997. We have over 60 employees and again over $500 million in transactions over our pipes in 1999. 400 of that was in contracting, 120 of that in input ordering.

This last year we had $1.4 million in revenue. We have over 14,000 registered users, 1,000 elevators posting on net market and 1,500 ag retailers. With the expansion of

Land O'Lakes business it'll increase to about 3,000 by this fall.

We offer a suite of on-line tools that enable attribute-specific exchange production contracting certification, input ordering, inventory management and price risk management. And what I'll do is go through each of those applications and how they work.

Something that's a little different, I think, in our spiel, if you will, is we're extremely committed to the fact that the infrastructure in agriculture is extremely efficient. It's not a system that the web is going to immediately disintermediate, as Ron said. Until Scott can beam you corn, the existing system really is quite efficient. You don't trade on one-cent margins in the grain industry without it being extremely efficient.

So we're working on back office tools. We're working on tools that increase the efficiency of the transfer of information, increase the efficiency of the communication of the information back and forth between trading entities and trading partners. So we do become imbedded in the process.

Our primary customer focus are ag retailers, elevators, grain handlers, people that are moving the grain from point to point. The farmer is an absolute customer of ours and the applications we develop are applications that are highly beneficial to the farmer because it's applications that come from the trading partner from which they're going to do business.

The different systems which are running or starting to run, an exchange--production contracting, ag order, which is a crop input ordering system, decision rules for contracts. We have a pilot program with AOSCA going on right now for process certification and grain certification oriented at specific identity-preserved grains.

Ag Risk, which is a portfolio analysis program, which we've had great interest from both banking community and farming community. It's a probability risk analysis system that lets farmers look at different options for opportunities for pricing their grain and lets them determine probabilities for price risk on each of those options.

In the future we'll have a financing alliance which works on clearing and trading trades, document transfers and trade guarantees, and also a logistics alliance.

I'll go through very quickly each of these different elements and give you a feel for what's going on.

Production contracting is essentially where we started. In 1997 e-markets built DuPont Quality Grains Production Contracting system, which was turned into a program called Oscar. We actually started with--two of the cofounders of the company were former pioneer Seed employees and broke off and developed Oscar on behalf of DuPont Quality Grains.

We have taken that system and applied it to other life sciences companies. The screen you see right now is Dow Ager Sciences screen. And we've done over 1.5 million acres just last year alone on production contracting.

A quote from The Economist that when DuPont had difficulty finding growers in its market for high-oil corn, they came to e-markets and we developed production contracting.

What the Internet does, in our opinion, is it enables the communication to occur much faster. It enables the transfer of information--inventory, seed ordering and contract application. In the first three hours on this system, DuPont contracted as much grain as they did in the previous four months with their typical paper and pencil system.

So we think that's really the advantage of the Internet--the speed of information transfer, the speed of communication between parties.

Net order was introduced in August of '98. Net order is a system which allows customers to sell their products over the Internet, to inventory their products, to manage the flow of products. It becomes, in essence, a virtual sales force.

Cropland is one of those applications for us. They did over $100 million in product sales last year to 1,500 different outlets in the Midwest where they essentially turned the product inventory and ordering process over to the Internet. It didn't matter whether it was their own sales rep that was inputting it, it was a customer that was inputting it. At this point they haven't gone to the farmer level but as I show you next, that's the next application, called Ag Order, which then will let the farmer do the ordering through their ag retailer back to communicating with the manufacturer and origin supplier.

It allows elevators, ag retailers, to bundle products together so now instead of just a seed ordering system, it can be a seed and a fertilizer and a feed ordering system. They can couple together production contracting where they will bundle the seed, fertilizer, crop protection products with a production contract or with a bid offer exchange product. That, in essence, creates that virtual sales force for the ag retailer in the marketplace.

Decision rules for contracts are essentially a forward pricing mechanism and it's a forward pricing tool. It is not a contract. It is a decision rule for contracting. It allows grain handlers, grain processors and elevators to set pricing mechanisms for their customers. It uses traditional exchanges and exchange information but it applies some simple algorithms to tracking and capturing the values on the exchanges each day.

It's in operation right now in over 240 elevators and this has been live for about four months and we've had over 500,000 bushels contracted through the system.

Just some examples of what some of these programs are. We have two that are jump simple average programs. One's just a straight market average. A producer decides that they want to buy a product over a certain specified time frame, certain amount of bushels, and it equally prices increments on each of those dates. Very simple market average, something that could be done easily on a Excel spreadsheet until you start dealing with multiples of customers with multiples of start-stop dates, with multiples of different criteria for their delivery. That's when it becomes a real burden.

We also have a seasonal market index, which essentially lets you weight-average that price to different time frames in the contract period.

We have three offer programs; I'll give you examples of a couple of them. One just follows a predetermined trigger level on a volatility index and any time the volatility index is over your trigger level, it prices grain on a proportionate amount.

Another one falls off of the moving average and looks at moving averages and any time the market is above the moving average, it prices a determined amount of grain.

The other rides the peak, rides the market up to a peak and as soon as it establishes a peak, it prices down for a certain amount of time to a predetermined stop limit, then rides the peak back, rides the rally back up and prices from the peak down again.

Net Market is an application that's essentially an information base for producers. It was started in 1999 and enabled farmers to view grain bids from elevators. We had all these elevators that were utilizing production contracting and net order and we didn't have a way really for them to communicate their prices to the marketplace. Since June of '99 we've had over 1,000 elevators at any one time posting bids on the Net Market application. It's not a transaction system. It is truly a free service to both elevator and farmers where they can communicate their bids. They can search for all of the elevators within a predescribed amount of miles, up to 75 miles from their own zip code, and they can keep track of those elevators with a set screen, a personalized screen that lets them look at all the bids that they're interested in from all the customers or all the buyers in their marketplace.

So it allowed customers of the elevator to view bids in the marketplace, to watch the market and to track what opportunities were in their marketplace on one-shot-click, a lot of what Ron was talking about, the advantage of their program.

This is just a geographical map of the elevators and ag retailers that have been using the system in Net Market over the past year, primarily an Upper Midwest and northern Plains application at this time.

A lot of comments and questions about exchange. We have an exchange that's in the beta test stage right now but a lot of what we learned from Net Market was that there are some different dynamics in commodity grains versus attribute specifics.

There's a need in the marketplace, in our opinion, for processors to get specific grain. There's also a need from the farmers' side to be able to explain and describe what they really have in their bin. All farmers don't grow the same product quality. They don't grow the same attributes that everybody else does, yet they get lumped into number 2,number 3, number 4. They get lumped into a very broad grade status.

Our exchange is going to address the specific attributes of the product. There's over 80 different attributes from nutritional composition to physical characteristics to hybrid characteristics that they can designate and create markets in the cash market for those specific attribute grains.

We believe the age of the choice board, as Mercer Management Consulting stated, is really the future in agriculture. It allows the users to become product makers. It allows suppliers to become price-makers. It allows individuals within the supply chain to start defining what they're looking for in the marketplace and start capturing the appropriate value for what they're manufacturing, what they're creating in the marketplace.

Differentiation in our mind is simply not about maximizing price, minimizing purchase price; it's about adding value. It's about adding value in terms of quality. It's about adding value in terms of custom product specifications, cutting back office costs, increasing your speed and efficiency, delivery timing and asset utilization.

That's the inefficiency that's created in this marketplace right now. it isn't the movement of grain. It isn't necessarily the pricing structure of grain. It's in what it takes to get product from point A to point B and the requirements of those transactions.

Our management team is led by Dave Abbott. Dave is a 26-year veteran and former president and CEO of Purina Mills and has been with the company since December of '99.

Again just a recap. '97 we launched production contracting. In 1998, crop input ordering. 1999, the grain bid exchange. Again that's not a product exchange. That's the Net Market where parties can exchange their bid offerings into the marketplace.

Forward grain contracting, our DRC application in 2000. Attribute exchange is in a beta test right now. Grain certification, we started the pilot phase with AOSCA on grain certification. Ag Order will be fully implemented on August 15. And financial services are coming in the latter half of the year, the latter quarter, along with logistical services.

That's e-markets and what we've done, w here we've been, who we are and we welcome any questions or comments.

COMMISSIONER SPEARS: Thank you, Scott. I think we'll take some time to provide some questions while the other group is booting up their computer, as well.

John, did you have the same question for e-markets as you did for--

MR. BLANCHFIELD: Yes. Again the customers that are finding buyers or buyers that are finding sellers, again, and it's not just the bankers, it's the ag finance community; certainty is part of the equation. How do you guarantee that there's a real buyer and a real seller?

MR. CAVEY: Right now in the beta of our exchange, which is really the only application we have where there isn't a personal interaction, on DRCs, the elevator manager and the seller of that program are physically talking with people. So the DRC application is really cutting back office costs and increasing the communication. So there's a personal relationship. You know who you're dealing with in all the products we have, except for the exchange.

And in the exchange there are two levels of notification. You know who the party is. You can research who the party is before you ever accept the bid or offer from the other party.

COMMISSIONER SPEARS: Bob?

MR. WHITE: One comment. I've been using the Internet for purchases of grain and so forth here around the community while this particular grain item has done very well. I just come home, type on the Internet the company name, boom, it comes up. You can talk to them without having to listen to a bunch of garbage, number one. Number two, you can do it on your time, not on some time when you don't want to. I find it very handy on the purchasing end and I really find it very handy. I've not experienced selling yet.

MR. CAVEY: Just a quick comment to that. In the net order application, 30 percent of the volume that is transacted or ordered, committed to in that plication has been done between 8 p.m. and 2 a.m. in the morning and we have had trades as late as 2 a.m.

COMMISSIONER SPEARS: Are you monitoring those trades at that point in time?

MR. CAVEY: That's the nice thing about a computer. They're up all the time.

COMMISSIONER SPEARS: Thank you very much, Scott.

MR. CAVEY: Thank you.

COMMISSIONER SPEARS: Brett, are you just about ready?

MR. JOHNSON: We're all set to go. I'm going to get you guys out of here on time. This is Ed Keating. I am Brett Johnson. We both founded ICE.

I'd like to thank CyberCrop and e-markets for doing all the dirty work. They gave you a very good overview of what on-line trading is and that's something that Ed and I quite honestly aren't that equipped to do as far as all the nice Power Points. We're a couple of farm kids trying to scratch a living out of a dirt field. We're University of Kansas graduates, so that gives us a little bit of a disadvantage in agriculture but we're trying to get by here.

What we're going to do here over the next 10 minutes is give you a live walk-through of what ICE is. ICE is an on-line grain exchange and some of you out there have already seen this. We are dialed into the Internet right now. I apologize for the resolution but trust me, there are live bids and offers up here.

Ed, if you will, hit the ICE home. I want to take them back to our main entry screen. We've been operational since October 11 of '99. Since that time we've had about 343 million bushels--actually, there's the number--posted to the exchange. This is a B2B exchange, so this is from the commercial elevators, local coops, all the way to the end users.

Since our launch we've traded approximately 60,000 million bushels through this exchange. By the end of the month we are rolling out our producer interface, which will allow these same customers on ICE to communicate with their growers and much in the same manner of CyberCrop and e-markets, making their jobs easier and making their company more efficient.

So without going into a lot of detail about what the home page is, Ed, if you'll click on the grain and feed, we're going to walk through real quickly what it's all about. We are in the offer section here.

Ed, scroll on down and let's show them what we've got. These range from everything from wheat meds to number 2 yellow corn. As we continue on down, we'll be in the bid section. These are companies wanting to buy product. You'll notice there's no company name associated to any of these bids or offers. We have number 2 soft. Go ahead and stop for a minute, Ed. This is Ogden, Utah. His bid is 243. You'll also see basis bids.

You might be asking yourself, okay, well, how am I going to be able to trade on this if I don't know who the other party is? We've implemented this section here where you click on the traders' link and it will bring up a list of all the companies registered to use ICE. As this loads you'll be able to see the companies and exclude the ones that you don't want to trade with.

Now, they won't be notified. They'll just be simply excluded any time they click on your bid or offer. This gives them the ability to securely trade--it gives you the ability to secure trade without getting stuck with somebody you don't want to do business with.

These companies are listed in alphabetical order. The ones in blue have a website; you can click on it and it will take you to their site.

If I don't want to trade with--let's just pick somebody--Co-Ag, simply put a checkmark next to their name, scroll down to the bottom and hit "save exclusions." Now I know that I can trade with everybody on ICE without dealing with them.

There's another feature we've incorporated to allow these companies to communicate directly to companies that they want to trade with. We're going to walk you through how to enter a bid.

Since we're live on the site, we're going to put a bid out there and quickly pull it. We've done about 150 of these demos over the past year and a half now and we've had one screw-up where we actually booked somebody in a demo, so we're trying to be real careful.

Ed's going to go ahead and do the order entry screen. This is buy or sell; he'll choose buy. He's choosing the commodity, now the subclass. He'll then enter his quantity. And what we've done with this is we've standardized most of the entry field so that this can eventually dump into their back office accounting systems.

The idea behind that is we want contract entry to be our gold mine. We want that to be the standard so that once we capture that, we can show them efficiencies in the back office. And there's a lot of things you can do once you get those contracts into Agriss or Grossman or DBC or whatever they're using so that it can further make their job more easy and more efficient. But to do that you have to standardize this screen and this screen was developed by ourselves, traders from around the industry. We sat down, had a forum. Cargill, Continental Grain Traders, ex-Continental Grain Traders, Schooler, all implemented parts of their order entry screens into this.

Ed's clicking on the calendar for shipment period. You'll notice it's filling in. You can also choose, once he's done with that, the pricing basis. The location is a free-form field. They can put anything in there they want. They can put in their SIFF. They can put in there Kansas City for beyond. They can put in there group 3s. Whatever they want to put in there is up to them.

Delivery mode--we can choose between truck, rail and barge and vessel.

He's now down into the remarks, grades, and terms. After he's selected his payment information and his trade rules, he can put up to 4,000 characters worth of specs, details. We're working with some companies about putting in forenographics, aveliographs so that flour millers can look at this and see exactly what the wheat that they're bidding on specs out at.

Go ahead, Ed, and choose the trade duration. This is how long we want our bid to remain on ICE. We can leave it out there good till cancelled. He's chosen other, in which case he can set an expiration on this bid. And he's chosen the 22nd. He'll preview the trade.

As we scroll down through, this is what the sellers will see when they click on our bid. Now remember we've excluded Co-Ag so when they click on this bid, they're going to see the detail but they won't have the ability to counter this.

Now he has four options down here at the bottom. He can make changes, he can cancel it, or he can activate it, in which case--don't do it just yet, Ed--if you activate it, it posts it out to the general exchange, which we saw, anonymously.

The feature that we've incorporated that allows these companies to be more direct with their buying intentions or selling intentions is called IDI, ICE correct interchange. Go ahead and click that. This is going to bring up that same list of trading companies that we saw a minute ago but instead of excluding the ones that we don't want to trade with, we're going to click on the ones we want that bid to go to. It will send them an anonymous e-mail from ICEcorp and it will tell them, "The following is being bid to you" and it will outline the details of our bid. They'll have the ability to click a link in that e-mail and come back directly to ICE and counter that bid, in which case we'll be notified instantly.

Let's go ahead and send this to our good friends at Seaboard. Seaboard and Farmland are strategic partners, by the way. Seaboard Corporation is right here. We can click on as many companies as we want to but we're just going to click on those two locations. Click "sends bids" and from right here at the CFTC hearing room we're able to generate our buying intentions to a multitude of different users.

Now I've got my e-mail open, which is a dangerous thing to do in front of people. As soon as this bid goes, I'll get a confirmation. The sellers or the potential sellers will also receive that e-mail.

Now we also track contracts on-line but remember, we're working on integrating into the back office. We don't want to recreate or reinvent the wheel here when it comes to contracting. These are not binding contracts on ICE. We are allowing the users of ICE to use their current systems and we have successfully integrated into Agriss. We're working on going into the other popular accounting systems so that they can take control of these contracts.

The same philosophy is being utilized on our producer interface. And without showing you any more details on to B2B side, which is histories, your portfolio, you have the ability to go in and accept counters, whether or not they're close to your bid, you can still accept the trade. You can change your bid price at any time. That's the only facet--Ed's little beeper is going off. That's the bid being sent to him. He has a two-way e-mail pager. He has the ability to counter back directly from his belt. It's our goal to lower the handicap of the agriculture industry.

This is our history file. We can go in and reactivate old bids, old offers without having to fill out those order entry screens each time, again making it more easy for the users.

Ed, if you go ahead and click down here, it might be hard to see it but we're going to take you into the ICE producer interface. I'd like to ask Ron and Scott to leave the room. This has yet to be seen by anybody outside of ICE.

This basically allows our customers, our elevators, our end users, to communicate bids to their producers. It's an elevator-centric approach, a little bit different than what Scott and Ron are talking about, which is more producer-centric, which is fine. I think we're going to all weed out over time which is the best approach. Like Ron said, the competition is good for all of us. It drives us. It keeps us going. We're going to find out here in the next couple of years which approach works best and it may be a hybrid of the two.

This is me, Acme Elevator it says up there at the top, and this is a bid that I have out to my producers. Go ahead and click that, Ed.

As the producers receive these e-mails of this bid--log-in as Brett--this is a beta version, so we can't communicate live but this is where the counters will come back. As we send out those bids, as the producers counter back, I can see the details, if they've set an expiration on their offer. He clicked on "detail." It tells me a little bit more about the offer. I can accept it, I can decline it, I can put comments in there.

Go ahead and accept that offer, Ed. It's for 175,000 bushels. Go ahead and say, "Okay." Okay, confirmations went to both of us. This is not anonymous, by the way. This is a fully open exchange for me and my producers. It doesn't expose my producers to other elevators. It gives me the ability to manage my grower base without exposing them.

Close that window if you will there, Ed, after you decline that offer. Go ahead and close that.

You'll see now our balance declined by the amount we just accepted. So it allows me as the buyer to make sure that I don't get overbooked. I can send out bids at night, basis or flat price, put expirations on them and know that I'm not going to walk in in the morning and see that I've bought 5 million bushels when I was bidding for five.

Again you can go back at any time, click on your accept or decline and change any aspect of that.

Entering a bid is just like it is on ICE. You fill out the form, you submit the bid, you click on the producers you want that bid to go to. You can go into your history folder, reactivate old bids. This same model--we're working with Farmland to allow them to tender out offers or tender out bids for acreage. So if they have a particular program for white wheat that they want next year, they tender out X amount of acres that they're going to need for that. The coops then, in turn, send that out to their producers and get feedback instantly as to who's wiling to participate.

So there's a lot of functionality to this. Inputs, fertilizer, diesel fuel, all that can be offered out in the same manner. The whole idea is to make it more efficient and tied into that back office.

That was a real quick overview. Do you guys have questions on either one?

COMMISSIONER SPEARS: I think they're all speechless.

Do any of the members that are left have questions about this?

MR. JOHNSON: We always get to speak before lunch, after lunch or before golf, so we're used to these crowds.

COMMISSIONER SPEARS: I apologize to all three of the presenters for the lateness of the hour. Our discussion earlier went over what we anticipated, so I apologize. A number of the members had to leave to catch planes due to the weather and things, so I apologize.

This is something I think that the group needed to hear as far as the new innovations, technology out there. Certainly I find it very rewarding and very beneficial for my part. I think it's something that the committee members in the future might want to see additional talk, additional discussion about these issues and maybe invite you guys back in the future as you further develop your tools. I promise to put you on a little more of an earlier time slot than the last time slot of the day.

Are there any questions or comments?

MR. BAIR: Brett, you mentioned, or an earlier speaker, I guess the first speaker from CyberCrop mentioned having confidence with who you're transacting with. What kind of a security you have in that respect like bonding or licensing kinds of things?

MR. JOHNSON: We do the same thing that most everybody else does. We screen. Most of the buyers are not the problem. It's more on the producer end that we're worried about. But we do have the screening. We also allow, with our exclusion process, for if you're not comfortable for any reason that we've accepted them as a trader, you can still go ahead and exclude them from your business.

So we're trying to do everything we can but you really can't do ag other than that without changing the way trade actually happens. You exclude people today over the phone by just not calling them. We've tried to incorporate that into our process on line.

MR. ACKERMAN: Is that something all of you have, the ability to exclude a counterparty?

MR. WINEINGER: Yes, we do provide that feature, as well.

MR. CAVEY: Again our exchange part is in beta right now so you know today exactly who your buyer is because that's who's generating the bid. They have a defined audience that they're working with.

There's a real fine issue in exclusion in that the power of the Internet also lets you identify new markets and if you know nothing about the new market, that's why it's new, because you know nothing about it. Yet there still is that need for the exclusion, so my bias is that the approach that most companies are going to take is you'll have both options. You have the option to exclude but you've got to have the option for the openness, as well. Otherwise, you can't find any market. You deal with [inaudible].

COMMISSIONER SPEARS: Bob?

MR. WHITE: Question on the buyers. Do they have grain-handlers permits and in case--Ohio has an indemnity. What happens if a buyer, you sell and you don't get a check? Does the indemnity follow that in any way to receive the funds from the loss of the grain by the buyer? I mean the check from the buyer. Have you ever experienced that? Or how does that work?

MR. CAVEY: I'd probably pass experience over to Brett from the experience standpoint. We have incorporated into our system a grain-handling certificate field where you have to have a warehouse license or certification in order to be a buyer.

MR. JOHNSON: We've had one occasion where a trade actually busted. It wasn't because of funds. It was more--and that's one of the reasons we don't make our contracts binding yet. We're waiting for the industry to say, "Okay, we're ready. Let's take that step."

So what we've done is we've incorporated the trade rules to apply, no different than if we pick up the phone and trade. We had a busted trade because instead of putting 21 cents over the live futures, they put $21 over and it was instantly booked. Both parties agreed that it was a mistake and being gentlemen, which I've had and Ed, your experience in grain trading is much greater than mine but I think the percent of default is less than half a percent. I can't say I've ever had it happen where someone hasn't paid. They may be a little slow but that's something that can be remedied with the trade rules.

MR. KEATING: That's one of the reasons Brett mentioned that we made these contracts initially not binding so that people could get experience with using the new system, but eventually we'll turn it over where it is a legally binding contract when the industry's ready for it but when we rolled it out back in October, people said, "Hey, we need to get comfortable with this."

But I would say this. We had a few contract disputes and people were treating them like binding contracts and they're not saying they're not binding.

They're not making artificial bids and offers just for the purpose of trading on line.

So eventually it'll all come together, but everybody's got to get their feet wet.

MR. JOHNSON: It's much more of an issue on the B2B side. I think producers--it's a little easier to implement binding contracts. I think it's necessary on the futures side. B2B, you can't go to Cargill and ADM and tell them, "By god, this is a binding contract and you're going to trade on it, like it or not." You've got to let the industry develop this and that's been our approach. Tell us what you want. We'll be the facility to promote this kind of transaction.

MR. KEATING: Actually, the truth be known, within the industry I traded at Continental for 10 years and I can count practically on two hands the number of contracts that we actually--we would send a contract, the counterparty would never sign it and they would send a contract, we would never sign it. So those things--I guess the trade rules address those issues but there's a small, small amount of problems that exist even in that environment.

MR. WINEINGER: Quickly, at the producer level we do tell the grower in the bid details page where that buyer has a grain buyer's license, where they have a warehouse license, so that's listed in those details.

And I think these guys are right. At the grower level it's not quite as difficult to get a binding contract. At least we haven't seen objections to it. In fact, enthusiasm for it.

MR. ACKERMAN: On all of your systems [inaudible] major crops and you're going beyond that into vegetables and a broad variety of commodities [inaudible]?

MR. JOHNSON: Well, there's already a lot of penetration in those markets. We at first started off by thinking that if you had a tool that you could trade any commodity [inaudible]. But rather than spread ourselves thin and say we're going to trade everything we can on ICE, we decided to focus on grain and feed vertically, execute that plan, rather than spread ourselves out. We're pretty limited. [Inaudible] money, so it wasn't our area of expertise. Grain traders--we don't know fruit. We don't know cattle. We know grain trading and we felt that this was [inaudible].

MR. KEATING: I should say, though, that we've--probably weekly we get called on different commodities that we never thought we'd trade on ICE, like dairy quality fuzzy and things like this. Some of the stuff, I don't even have any idea what it is. But we get someone obscurely. Some of these California feed grain markets say they want to trade this, that, or the other. Certainly the system works for whatever people want. If somebody searching for it, then they can trade it.

MR. WINEINGER: Yes, it's a very short step really into other commodities but probably not the high value products like fruits and vegetables but certainly value-enhanced or specialty crops--that's a pretty easy one to add. Just for the entry it's number 2 yellow corn; it could be Iowa corn easily enough.

So from a producer to first handler perspective, I think those are definitely coming.

COMMISSIONER SPEARS: I want to thank each of the companies for coming and making your presentations. In the interest of time, I apologize. I think some of the members will stick around afterwards and visit with you individually if they'd like to.

Speaking as a Kansas farm boy, you guys have done Kansas proud. You really have. It's amazing what two Kansas farm boys can do from your perspective.

I want to thank you guys again. I want to thank all the members for coming. Again I apologize for the lateness of the hour. Typically we get done early, not late. We'll try to do better in the future.

But I think it's been a good meeting. I think the discussion we had earlier was very beneficial to the Commission and I want to thank all of you for coming. Thank you.

[Whereupon, at 5:32 p.m., the meeting was adjourned.]