COMMENT

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NATIONAL CATTLEMEN'S BEEF ASSOCIATION

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November 13, 2002

Jean A. Webb
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: Chicago Mercantile Exchange (CME): Proposed Amendments to the Spot Month Speculative Position Limits for the Live Cattle Futures Contract

Secretary Webb,

The National Cattlemen's Beef Association (NCBA) appreciates the opportunity to comment on an issue that has been before the Commodity Futures Trading Commission (CFTC) on previous occasions (see CFTC Public Comment File 97-002 and CFTC Public Comment File 00-002). Unlike the two previous proposals, the CME is now contemplating a reduction in speculative limits on the Live Cattle Futures contracts.

Section 5 of the Commodity Exchange Act (CEA) states that the purpose of the CEA is "to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions; to protect all market participants from fraudulent or other abusive sales practices of misuse of customer asset; and to promote responsible innovation and fair competition among boards of trade, other markets, and market participants."

The CFTC has the duty to monitor many aspects of the markets under its regulation. One area clearly articulated in the CEA is speculation. The role of the speculator is absolutely essential to the functioning of a futures market. Nonetheless, Section 6a of the CEA states that "excessive speculation" causing "sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity is an undue and unnecessary burden on interstate commerce." To diminish, eliminate, or prevent such a burden, it is the duty of the CFTC to "proclaim and fix such limits on the amounts of trading which may be done or position which may be held by any purpose under contracts of sale of such commodity for future delivery."

The National Cattlemen's Beef Association and many others have previously commented on modifications to speculative limits on the live cattle contract. We call your attention to the public comments regarding the live cattle contract submitted to the CFTC in 1997 and 2000. In 1997, there was unanimous opposition to increasing the speculative limits from 300 to 600. Not one comment supported the CME proposal in 1997 to increase speculative limits. Nonetheless, over these objections, the CME request was granted and speculative limits were increased from 300 to 600. In 2000, the CME contemplated increasing the speculative limits from 600 to 900. Again, there was unanimous opposition to this proposed increase. Not one comment was submitted to the CFTC in support of the CME proposed increase. In fact, half of the comments in 2000 argued in support of a reduction back to 300 contracts—the speculative limit in place prior to 1997. In light of solid opposition and no support for the proposal, the CME dropped its request to go to 900. Since 1997, the speculative limit on the live cattle contract has been at 600. The CME proposal currently before the CFTC would reduce the speculative limit to the pre-1997 level of 300 contracts during the delivery month.

Observing the actions of the CME leads us to believe that the CME has realized what many users of the live cattle contract have long recognized. Speculative limits must be established at appropriate levels relative to deliverable supply of cattle. An imbalance will lead to a contract that is not reliable as a risk management tool and will also create a climate where manipulation and price distortions could occur. The current proposal by the CME is a 180 degree change in their opinion in just over two years. We believe that the CME has carefully evaluated the specifications, contract terms, and speculative limits of its live cattle contract and now believes a downward adjustment in speculative limits in warranted. After evaluating the evidence that the CME has provided to justify this proposal, the CFTC should grant the reduction in speculative limits from 600 to 300.

The CFTC is ultimately the judge of deliverable supply. However, on previous occasions, many industry participants have pointed out to varying degrees tremendous concerns about the inadequacy of deliverable supply for the live cattle contract. The CFTC has been a recipient of this information during previous comment periods. The CME has had the benefit of this information as well as any internal evaluations they have conducted. If the CME held today the same opinion about deliverable supply as they did in 1997 and 2000, then this pending request would not have been submitted. This proposal from the CME marks a significant change in opinion by the Exchange on the availability of deliverable supply. The CFTC should pay deference to the position of the CME in evaluating this proposal. To ascertain deliverable supply, the CFTC should evaluate if there have been times that the premium of futures over cash should have stimulated deliveries but deliveries did not occur in the volume that the economics suggested? When economics determines that deliveries should be taking place, then deliveries should equal the deliverable supply. Deliveries have not been anywhere near the existing speculative limits. This imbalance could lead to market and pricing distortions—which the CEA is designed to prevent. The proposed action by the CME will reduce this imbalance and thus reduce risk of price distortions.

NCBA agrees that changing the rules on currently trading contracts should be held to a minimum—changes of this sort should be the exception and not the rule. NCBA argues that this is that exception. The reduction in speculative limits is meant to reduce the risk of price distortions and market manipulation and to protect the integrity of the contract and market participants. The CFTC should weigh this change to existing contracts against the damage that could be inflicted on market participants should pricing distortion, manipulation or malfeasance occur. The CME would not have proposed this change if there was no evidence to support it. The fact that the CME is proposing this change on contracts currently trading should say something about the exchange's concern about deliverable supply and their concern about price distortions. Additionally, modifications to existing contracts have occurred in the past. In fact, the 2000 CME proposal to increase speculative limits to 900 would have changed the speculative limits on contracts already trading at the time.

Some have argued that the contract should be designed in a manner that favors one side of the market over the other. The contract should pick and choose no one. The CFTC, CME, contract specifications, and market participants should not choose which side of the market is advantaged or favored by a contract. Instead, the CME has the responsibility to list contracts for trade that are based on industry norms with a delivery process that is trouble-free and fair to all. The position that participants take in the market should be based upon their unique business needs and upon their views of the direction of the market—not on their ability to use outdated specifications, antiquated rules, and market power to push the market in their own preferred direction.

Many have stated that this change will have a negative impact on producers by eliminating the futures premium that exists in today market. The argument NCBA presents is not for a strong basis or a weak basis, but for an economically functional basis. A contract that has terms consistent with cattle prevalent in today's industry combined with a functional delivery system will establish a basis that works for all. A futures market with contract terms which create a bias for higher futures markets relative to the cash market gives producers false hope of higher cash prices to come. This creates an incentive to defer marketings which leads to heavier cattle weights—the very problem the Federal Register notice articulates as being a cause of declining deliverable supply. Additionally, an unpredictable basis results in less effective risk management. When parties cannot adequately manage the risk they face in the marketplace, risk premiums will often be factored into the price that those parties are willing to pay or be paid for commodities. Factoring in a risk premium due to unpredictable basis volatility could result in lower prices for producers, both hedgers and non-hedgers alike.

The CME is required to list for trade contracts that are not subject to manipulation or price distortions. The CFTC regulates these futures contracts. One key component used to measure risk of manipulation is the speculative limit placed on the contract relative to the deliverable supply of the commodity being traded. With this in mind, a determination must be made on an appropriate level of speculative limits for the live cattle contract relative to the deliverable supplies of live cattle. Arguments presented in opposition to the proposal that do not address the central and fundamental question of deliverable supplies are secondary. The CFTC must address this central question in evaluating the proposal and the comments submitted in support or opposition to the change. Section 6a of the Commodity Exchange Act specifically authorizes the CFTC to established speculative limits as appropriate. If the current deliverable supplies do not justify a 600 contract speculative limit, then the limit must be reduced. That is the position of the CME, the position of the NCBA and the position held by many market participants over the past 6 years.

The National Cattlemen's Beef Association appreciates the opportunity to comment on this important issue. We stand ready to work with you and the CME to improve the contract and increase the utility of the contract for risk management and price discovery. We will continue to work to implement the policy that our members establish that improves risk management and reduces the risk of market manipulation, price distortions and illegal activities.

Please contact NCBA if we can provide additional information or answer any questions regarding this or any other matter.

Sincerely,

Wythe Willey

Wythe Willey
NCBA President