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National Grain and Feed Association

April 27, 1998

Ms. Jean Webb
Secretary to the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N. W.
Washington, D. C. 20581

COMMENT

Dear Ms. Webb:

This statement of the National Grain and Feed Association responds to the "Concept Release": **Regulation of Noncompetitive Transactions Executed on or Subject to the Rules of a Contract Market**, as published in the Federal Register, Vol. 63, No. 16, January 26, 1998.

The National Grain and Feed Association (NGFA) is comprised of 1,000 member companies involved in the cash grain handling, marketing, processing and futures industry. Our company members include country elevators, feeding operations, processors, exporters and related businesses that are the primary users of grain and oilseed futures and options markets for commodity pricing and hedging.

This "concept release" addresses a number of topics, but NGFA's primary interest is with the potential regulatory changes being considered for the exchanges of futures for physicals, or EFPs and the consideration of permitting off-exchange block transactions. Our comments are intended only to be directed at how this "concept release" might affect the regulatory treatment of futures markets for physical commodities. Our members are mostly involved in the cash grain merchandising activities, and are heavy users of exchange-traded options and futures for hedging purposes. Cash grain merchandising companies are also frequent users of EFPs to reduce risks.

Rather than accepting additional basis risk by liquidating futures in an open exchange market, the EFP provides a convenient vehicle for fixing the basis with certainty. This is a business tool that our industry has strong interest in preserving intact, with no change in regulatory treatment.

For the grains contracts, the present handling of EFPs appears to work well. While the focus of this rule seems less directed at the grains and oilseeds contracts than other markets (with the possible exception of the consideration of off-exchange block trade execution), we have concern that many of the questions being raised could lead to more extensive, unnecessary and unwarranted regulation by the CFTC in all markets. For the physical commodities, we believe additional oversight is absolutely unnecessary, would only add to cost and offer no concomitant benefits. We urge the CFTC to be extremely cautious in suggesting the addition of more regulatory burdens applied to all markets to solve problems which do not exist. The regulation of EFPs in agricultural commodities is an area where the exchanges have a long history of success, based upon exchange rules, strong technical market knowledge and the application of reasonable judgments. We perceive scant opportunity to enhance the current regulatory structure of EFPs in the grains/oilseeds contracts by more CFTC involvement, and believe there are other areas where CFTC resources could be used more productively.

With respect to the CFTC's consideration of permitting block trading off exchange, we have serious concerns about the impact of such change on price transparency, public price discovery, liquidity and vitality in the markets. Such a change would appear most counterproductive in accomplishing the objectives of a public exchange that is being regulated to protect public interest and offer a reasonably level playing field among all participants. NGFA is opposed to this concept on these grounds.

Below are listed our responses to only those questions contained in the "concept release" which we believe are most applicable to our interests and views.

Questions:

2. Should other types of noncompetitive transactions, such as EFS transactions or block trades, be permitted to be executed on or subject to the rules of a contract market and, if so, what standards should apply to these transactions?

Response: Noncompetitive block transactions conducted off-exchange is a concern of our industry. Such practices threaten market liquidity and the transparency of a public, competitive pricing vehicle. The concept also raises legitimate questions concerning the equitable treatment of large and small market users.

In general, we would suggest that EFS transactions be treated as EFPs, i.e., permitting the exchanges to determine the circumstances in which an EFS is appropriate.

4. How should the "strong price correlation" standard articulated in the EFP Report be implemented?

Response: We believe the current standard set by CBOT requiring "reasonable correlation" continues to be the proper and correct approach. Defining a precise standard for acceptable correlation raises other, more difficult issues, such as on what basis is

correlation measured (how many years, which cash price series, etc.) and would eliminate the judgments that can give due consideration to other factors. For example, the unavailability of any “better” alternative than the existing exchange product, even though correlation may not be as high as desirable, could be a justifiable business rationale. Market users are in the best position to judge such situations with oversight by the exchange.

5. Should the Commission require contract markets to adopt a minimum statistical correlation coefficient to be used in assessing the acceptability of a particular cash commodity for use as the cash leg of an EFP?

Response: No. See response to question 4. In addition to the concerns expressed in question 4, high quality cash price data that truly represent actual transactions (not just bids or quotes) increasingly are difficult to assemble for long time periods. Reasonable economic and/or physical substitutability may be as relevant as price correlation estimates.

7. What is the appropriate type and scope of guidance contract markets should be required to provide to the general public concerning the acceptability of particular commodities as the cash leg of an EFP?

Response: For the grain industry, the acceptability of EFP transactions by the exchanges is well-understood. We see little to be gained by requiring more publicity or education on this topic by the exchanges. If the exchanges begin experiencing abuses or what it considers questionable EFPs, at that stage, the exchange should publicize its general guidelines and use clearing members to distribute information to the hedging community.

8. What is the appropriate scope of the separate parties requirement?

Response: The “separate parties requirement” (which defines minimal parameters for the independence of businesses) should be left to the exchange to determine.

9. Should the Commission address string trades as that practice is described in the EFP Report and, if so, how?

Response: We see no purpose for the CFTC to address “string trades” or to suggest to the exchanges that they be handled any differently than they currently are. String trades have been common in the grain industry for many years and provide liquidity in the cash marketplace. An efficient handling of the EFPs for such transactions is needed and the exchanges are managing this appropriately.

10. What criteria are appropriate for judging whether the futures leg of an EFP is bona fide?

Response: On request, the exchange should have the right to review business documents relating to the underlying cash market exchange to determine that the transaction is consistent with the nature of the customer's business.

11. What criteria are appropriate for judging whether the cash leg of an EFP is bona fide?

Response: Ownership transfer of a similar amount of a similar commodity in the cash marketplace (in the judgment of the exchange) within an acceptable time frame.

14. Should the Commission require both the futures and cash legs of an EFP to be priced within the daily range of their current respective markets, should it require only one leg of an EFP to be priced within its daily range, or should it impose no restrictions on the price of either leg of an EFP?

Response: No. There are legitimate business reasons for pricing EFPs within or outside daily ranges for prices. Provided the exchange can selectively request documentation to judge the consistency of the transaction with the underlying business, review is adequate. We urge the CFTC to not take any regulatory action in this area.

15. Should the Commission require contract markets to obtain documentation regarding the business purpose underlying the pricing of an EFP?

Response: No. The grain exchanges selectively request this information already.

16. Are the current reporting and recordkeeping requirements relating to EFPs adequate?

Response: Yes.

17. What should be the form and content of disclosure concerning EFPs?

Response: When exchange staff request documentation, cash contracts or confirmations should be made available.

20. *Should the Commission explicitly require Commission registrants to obtain customer consent before executing an EFP on the customer's behalf?*

Response: No. We are uncertain why this matter is even being raised. This is not a problem area. Mechanics of executing EFPs is smooth and efficient and in no need of regulatory oversight or mandated communications between FCMs and customers.

23. *Should the Commission require contract markets to publicize information about bids and offers, as well as consummated EFP transactions?*

Response: No. This question does not make sense when applied to physical commodity markets. There is no bidding system for EFPs and there is no price risk. Thus, there is no such data to collect. If this question is directed at commodity markets, it demonstrates a serious lack of understanding at the CFTC of the structure, use and purpose of the EFPs.

Thank you for the opportunity to comment on this "concept release."

Sincerely yours,



Diana Klemme

Chair

Risk Management Committee