National Grain and Feed Association

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Statement to the
Agricultural Advisory Committee
Committee Futures Trading Commission
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Commissioner Dunn, we appreciate this opportunity to appear before you today, and we thank you for calling this meeting of the Agricultural Advisory Committee to focus on solutions to the CBOT wheat contract's lack of convergence. I thank you for the opportunity to present the National Grain and Feed Association's (NGFA) views today.

I am Matt Bruns, Vice President for Exports of Archer Daniels Midland Company in Decatur, Illinois. In that capacity, I manage ADM's risk management activities on a daily basis. I also serve as Vice Chairman of the NGFA Risk Management Committee and as the NGFA's representative to the Agricultural Advisory Committee.

As you know, the NGFA and its member companies have worked many months for solutions to the lack of convergence in the CBOT wheat contract. Less convergence and less predictability in futures and cash prices has resulted in a less useful hedging tool for our member companies, who are the first purchasers from producers and who hedge their price and inventory risk on regulated exchanges. The NGFA's member firms play a critically important role in helping producers market their crops by offering a variety of cash forward contracts. Unfortunately, the availability of some cash forward contracts has been constrained due to last year's spike in futures prices, which placed huge margining requirements on commercial grain hedgers, and due to the uncertainty created by the contract's lack of convergence.

Over the past two years, we have worked closely with the CME Group for solutions that will re-establish convergence. We support the contract changes made to date by CME, and we agree that additional action is needed to re-establish a reliable relationship between cash and futures values. With respect to the current proposal by CME to implement a Variable Storage Rate on the contract, we are in complete agreement that this contract amendment is the next logical step. We believe that, over a period of time, the Variable Storage Rate will help re-establish convergence.

That is an important point – **the Variable Storage Rate will take some time to work.** We believe it will eventually result in convergence, but it will be a process as the storage rate ratchets up over time. For that reason, we have recommended strongly that it be implemented as soon as possible – ideally, on the December 2009 contract so it can begin the initial process of working immediately. Our industry has struggled for more than two years with the wheat contract's lack of convergence. Waiting until September 2010 to implement the VSR, as proposed by the CME Group, could result in another two years before the change would have its full effect. Our member firms and their farmer-customers who rely on properly functioning futures markets to manage risk and market their crops cannot afford another two-year wait.

A second compelling reason to implement the VSR right away is that, if we don't, the storage rate actually will move in the wrong direction. Under the seasonal storage rate implemented earlier this year, the rate is scheduled to move down from about 8 cents/bushel/month currently to about 5 cents/bushel/month in December. Clearly, that would be a move in the wrong direction. Even if the VSR is implemented this December, it will simply have the effect of keeping the storage rate at its current level – not the ideal, but at least better than letting the rate tick down and further delaying the VSR's effects.

It is important to note that this Advisory Committee's own Subcommittee on Convergence also has recommended that the VSR be implemented in Dec. '09. We have appreciated being part of that subcommittee's discussions, and we hope that the Commission will place a high priority on implementing its expert recommendations.

In the interest of balance, we do recognize that implementing the VSR this December will have impacts on some market participants. However, we believe those impacts would be relatively small compared to the consequences for commercial grain hedgers and producers of essentially putting off a solution for another two years. An examination of open interest for upcoming contract months shows the following:

Dec. '09 Open Interest = 191,218 contracts
March '10 Open Interest = 57,175 contracts
May '10 Open Interest = 9,157 contracts
July '10 Open Interest = 45,029 contracts
Sep '10 Open Interest = 1,401 contracts
Dec' 10 Open Interest = 23,957 contracts

Generally, we agree with the CME Group that significant changes should not be implemented on contract months with high levels of open interest. However, the numbers show that open interest drops dramatically after Dec. '09 and by May '10 is not significantly higher than Sept. '10 open interest. A second factor that supports quick implementation is the fact that spreads are not at full carry for several contracts prior to Sept. '10 – a condition that CME has indicated in the past could make them more comfortable when considering changes on contracts with open interest. We urge the CME and the Commission to take these factors into account when determining the final implementation date.

In this exceptional and urgent situation, we submit that the Commission and the CME Group need to weigh potential impacts on market participants with open positions (who may already have assumed that the VSR is coming) versus the harm that could be inflicted on the wide swath of commercial grain hedgers and producers if convergence is deferred for up to another two years. We believe strongly that the broader public good of implementing the VSR quickly outweighs concerns about potential negative impacts. If Dec. '09 implementation cannot be met, we urge implementation no later than the March '10 contract.

We would view such quick implementation as a one-time, extraordinary action made necessary by the specific circumstances surrounding the CBOT wheat contract. If the VSR were to be considered in the future for corn and soybean contracts, we would anticipate a more traditional approach to amending the contracts.

In order to ensure that the VSR more robustly and quickly encourages convergence, the NGFA also recommends that higher storage rates be implemented when 80 percent of full carry is reached in the market, rather than the 85 percent trigger being proposed by the CME Group.

In conclusion, the NGFA has worked diligently with the CME and CFTC on this important issue, and we continue to support efforts to bring balance and viability to the contract. We stand ready to continue with that support, and we will provide technical and practical assistance in bringing conclusion to this matter as soon as possible.