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National Grain and Feed Association

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January 21, 2008

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

COMMENT

RE: Revision of Federal Speculative Position Limits

Dear Mr. Secretary:

This letter transmits the position of the National Grain and Feed Association (NGFA) on the Commodity Futures Trading Commission (CFTC) proposal to increase federal speculative position limits, published November 21, 2007 in the *Federal Register.*

The NGFA is the national trade association representing the grain, feed and processing industry. About 900 companies nationwide comprise the NGFA's membership, including grain elevators, feed manufacturers, grain and oilseed processing companies, futures commission merchants, introducing brokers, biofuels producers and marketers, flour millers, integrated animal operations and related commercial businesses. We estimate these companies operate upwards of 6,000 facilities nationwide. The NGFA's member firms are traditional hedgers who rely on efficient and predictable performance of U.S. futures markets and contracts to manage inventory and price risk and to assist their farmer-customers to market their production.

Speculative Position Limits

We appreciate the opportunity to provide comments to the CFTC on this matter. However, before offering specific responses, we first want to make the agency aware of how serious the business outlook is for many in our industry, and the ripple effect that current poor market performance is having on many businesses in our industry.

The lack of convergence between cash and futures markets during the delivery period, in conjunction with rapidly rising commodity values, has created huge borrowing needs and financial risks and exposure for the grain buying industry. At the same time that the predictability of convergence, hedging and pricing efficiency all have declined in performance, the requirements to finance traditional short hedges and grain purchases in an uptrend market are now at several multiples of normal borrowing needs. As banks have begun to question hedging performance in futures positions, borrowing lines have been stretched to the limit or beyond. Banks are beginning to restrict financing to some companies. Elevators and other grain buyers have been forced by market conditions to liquidate inventories. Cash basis levels are widening in reflection of much higher financing costs that now are being forced into the system – if, indeed, financing remains available at all. In some cases companies have eliminated deferred cash bids altogether.

If commodity prices continue to rise and market performance does not improve, our industry is facing the potential of a real crisis situation. Just in the last few weeks, there have been reports of cash grain firms that cannot obtain adequate financing attempting to sell physical assets. There is a genuine risk of "fire sales" if grain elevators run out of margin money. We are talking about grain elevators that do not speculate in futures price movement, but simply hedge purchases from farmers as prudent operators.

While we recognize that the CFTC is not responsible for the overall economic health of an industry, we submit that the agency does have influence over some fundamental factors that influence hedging performance. We strongly urge the CFTC to consider the serious impact on convergence and hedging efficiency that its decisions likely could have. We submit that both the overall confidence in the market and the livelihood and business structure of the cash grain industry are at stake.

For these reasons, the NGFA believes it is inappropriate to increase federal speculative position limits at this time. We respectfully request that the CFTC hold this proposal in abeyance for the next six to twelve months to allow commercial grain hedgers time to adjust to market disruptions currently roiling the industry. Further, the NGFA recommends that specific analysis be done on potential impacts of spec limit increases, especially related to futures volatility and impacts on cash/futures convergence (see below). The NGFA will continue to work with the CME Group to identify ways to enhance convergence and restore hedging reliability.

Risk Management Exemption for Index and Pension Funds

We also are aware that the CFTC is considering institutionalizing the criteria for granting hedge exemptions to certain funds. We will offer separate comments on that proposal, but we would like to offer some preliminary thinking. We understand that the agency wants to be consistent and eliminate bureaucracy, but we also believe that the poor market performance we are experiencing is influenced by new investors targeting agriculture with the aid of the hedge exemption.

Regardless of the type of fund and its stated purpose, the original invested equity moving into funds is always invested as speculative money. When that money moves into the hands of a fund, whether traded actively or passively, we understand the CFTC's position that the stake in futures can be viewed as a hedge – a hedge of the invested capital by the middleman. However, it does not negate the fact that the original money and purpose for that money was, indeed, speculative.

There is, apparently, a virtually endless supply of such investment capital, and that capital already is dominating the agricultural futures markets today. There are agricultural markets where the entire U.S. crop is traded almost on a daily basis, and such volumes are having a negative impact on performance and adding unnecessarily to volatility, which does impact both pricing and hedging performance of markets. The ultimate value of hedging is to allow grain to move from producers to ultimate consumption at a lower risk and maximum efficiency, thereby creating better returns for producers and lower prices for consumers. Recent dramatic increases in volatility and growing investment by large, nontraditional market participants have dramatically raised the risk and cost of moving grain through the system.

Because of borrowing limitations, many companies – large and small – are significantly reducing bids, or eliminating bids altogether, on deferred grain purchases. If this trend continues, it defeats the fundamental purpose of futures coupled with the cash forward exclusion to provide producers access to deferred cash sales to manage price risks.

With this in mind, we recommend that CFTC reconsider the stance it has taken with the hedge exemption for funds, with the understanding that agricultural futures markets were established with an economic purpose to serve as efficient, central public pricing and hedging vehicles for grain and oilseeds. That purpose is not being fulfilled as well as it should be under today's conditions, and the current broadened definition of hedging has contributed to this situation.

Recommendations for Analysis

The six-month to twelve-month period recommended above would provide a valuable opportunity for industry, the exchanges, and the CFTC to collaborate on needed analysis that could lead to a greater understanding of the potential impacts of higher speculative position limits. This waiting period also would allow time for the development of alternative risk management and financing tools, as well as time for the industry to become familiar with them. We believe that the market can and will develop such tools, but it takes additional time. In addition, waiting would allow time for implementation of changes to existing exchange-traded contracts (e.g., pending changes to the CBOT wheat contract, potential revisions to the CBOT corn and soybean contracts) and to evaluate their impacts.

The NGFA suggests that analysis needs to be done on the following questions before re-opening consideration of spec limit increases:

1) What would be the impacts of increased speculative position limits on futures volatility in agricultural futures markets?

2) What would be the impacts of increased speculative position limits on cash/futures convergence in agricultural futures markets?

3) What would be the impacts of increased speculative position limits on capital needs of the grain, feed and processing industry?

4) Are there other regulatory changes or contract changes that should be considered to enhance cash/futures convergence and improve hedging efficiency?

5) Are there other risk management tools available now or potentially in development to help traditional hedgers manage their risks? For example, might the concept of exchange-cleared swaps be effectively implemented for grains and oilseeds?

In conclusion, we urge the CFTC to give all stakeholders – commercial grain hedgers, exchanges, and other market participants – a period of time to adjust to major change in the marketplace before considering an increase in spec limits. While it may be a positive sign for the overall health of U.S. agriculture that investment capital views the sector as a "buy," serious damage will be done if future capital inflows are not handled properly. As noted above, there is the potential for serious financial exposure to grain handling companies, and the market simply isn't ready to efficiently absorb more investment capital today. Answers to the questions posted above are critical to managing this process correctly and avoiding major damage to commercial grain hedgers.

The NGFA deeply appreciates its strong working relationship with the CFTC and the role the Commission plays in oversight of futures markets. We look forward to working with the CFTC, the exchanges and others to help ensure that agricultural futures markets remain an effective tool for commercial grain hedgers.

Sincerely,

Rod Clark

Rod Clark
Chair, Risk Management Committee