

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

AGRICULTURAL ADVISORY COMMITTEE MEETING

Washington, D.C.
Thursday, May 19, 2011

1 PARTICIPANTS:

2 CFTC Commissioners:

3 MICHAEL V. DUNN

4 BART CHILTON

5 GARY GENSLER

6 SCOTT O'MALIA

7 JILL SOMMERS

8 AAC Members:

9 HAYDEN WANDS
American Bakers Association10 DIANA PRESTON
American Bankers Association11 JORDAN LEA
American Cotton Shippers Association12 KELLI LUDLUM
American Farm Bureau Federation13 RYAN WESTON
American Sugar Alliance14 JASON UNGAR
Commodity Markets Council15 CHRISTINE COCHRAN
Commodity Markets Council16 MARK SCANLAN
Independent Community Bankers of America17 DANA J. PETERSON
National Association of Wheat Growers18
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1 PARTICIPANTS (CONT'D):

2 KEVIN NATZ
National Council of Farmer Cooperatives

3 DOUG SOMBKE
4 National Farmers Union

5 TODD KEMP
National Grain and Feed Association

6 EDGAR HICKS
7 National Grange

8 RYAN CRYAN
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12 BOB DINEEN
13 Renewable Fuels Association

14 FRED CLARK
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1 P R O C E E D I N G S

2 (9:06 a.m.)

3 CHAIRMAN DUNN: Good morning, ladies and
4 gentlemen. Let me just check and make sure our
5 colleague, Commissioner Chilton is onboard with us
6 in our Kent City office. Bart, are you there?

7 COMMISSIONER CHILTON: I am here, Mr.
8 Chairman. Thank you.

9 CHAIRMAN DUNN: Great. All right.
10 Today is -- we're doing our 35th meeting of the
11 Commodity Futures Agricultural Advisory Committee,
12 and I want to sincerely thank all the members of
13 the advisory committee for participating in this.
14 And also supplying us with the questions or the
15 subject matter because we polled you to ask you
16 what's important and you sent back and said these
17 are the items that are important with us.

18 The Ag Advisory Committee provides a
19 forum for building a base of knowledge at the
20 Commission on issues that matter to the
21 agricultural community. This is particularly
22 important at a time like this when the Commission

1 is tasked with writing dozens of regulations to
2 implement the Dodd-Frank Act. The Commission is
3 acutely aware of the far-reaching impact that
4 these regulations may have but we depend upon
5 those who will be impacted by our rules to provide
6 us with their thoughts and concerns in order to be
7 certain that the Commission's regulations do not
8 have unintended consequences.

9 Now that the Commission has essentially
10 finished the process of the proposed rules and has
11 received many comments from the public, this is an
12 ideal time to convene the Committee to discuss
13 some of the concerns that have been raised in
14 comment letters. Hopefully, the Agricultural
15 Advisory Committee also serves an important role
16 in making the Commission's work less opaque and
17 more accessible to the various components of the
18 trading industry and to the public at-large.

19 As I've stated on a number of occasions,
20 the Commission's process for proposing regulations
21 pursuant to Dodd-Frank have been more open than
22 any that I've ever been involved with and I

1 commend Chairman Gensler for his leadership in
2 this regard. It is my hope that today's meeting
3 will provide the public with further information
4 as to what the Commission is doing and why and
5 then we will have a meaningful dialogue regarding
6 both the Commission's proposals and the
7 Committee's concerns.

8 Thank you to everyone who is in
9 attendance, to my fellow commissioners, to
10 advisory committee members and commission staff
11 and the public. I especially want to thank the
12 panelists today who are each a valued member of
13 the Commission staff. As you all know, we have a
14 full-time job overseeing commodity trading over
15 the years and we have the additional privilege of
16 writing dozens of new regulations and implementing
17 the Dodd-Frank Act.

18 Today we'll hear a presentation from the
19 CFTC staff in four topic areas. This is based
20 upon current events and things that have been
21 ongoing with the Ag Advisory Committee and
22 requests by the membership of the Agricultural

1 Advisory Committee. First, an update on the
2 agricultural commodity markets in general,
3 focusing on the impacts of the recent floorings
4 and issues of convergence. Second is a
5 presentation on the Commission's proposed rule
6 regarding position limits and hedge exemptions.
7 Third is a presentation on the Commission's
8 proposed rule regarding swap dealer definition and
9 user exemption. And fourth, the presentation on
10 the Commission's proposed rule regarding margin
11 requirements. After each presentation the
12 Agricultural Advisory Committee members will have
13 an opportunity to ask questions and discuss the
14 issues raised in the presentation and the proposed
15 rule.

16 Again, I want to thank all of you for
17 participating in this important meeting and I'll
18 ask my fellow commissioners if they have any
19 opening statements.

20 COMMISSIONER GENSLER: Good morning.
21 Thank you, Commissioner Dunn for chairing today's
22 meeting of the Agricultural Advisory Committee and

1 for your leadership. Though there will be many
2 opportunities to thank and congratulate
3 Commissioner Dunn for his more than six years of
4 service at the CFTC and 25 years of service at the
5 Federal Government, I just want to take this
6 opportunity. It will probably be one of many.
7 You'll be here a while, Mike.

8 I want to take this opportunity to
9 publicly acknowledge Commissioner Dunn. Mike is a
10 trusted colleague for all of us and works
11 incredibly hard in service to the American public
12 and the CFTC. His significant and thoughtful
13 contributions have strengthened all of our efforts
14 at the Commission to promote transparency and
15 lower risk in the derivatives markets to protect
16 the American public. I'm honored to have worked
17 with Mike and to call Mike my friend.

18 I also join Commissioner Dunn in
19 thanking my fellow commissioners and the expert
20 panelists and staff who have joined us today.
21 This Agricultural Advisory Committee has been a
22 terrific source of input and advice as we've moved

1 through our rulemaking, but even on our normal
2 business. This meeting comes, of course, at a
3 crucial time as we're rule writing with regard to
4 implementing Dodd- Frank, and at this point we
5 have substantially completed, as Mike said, the
6 proposal phase of our rulemaking. And since the
7 president signed the act last July, the Commission
8 has promulgated rules covering all the areas of
9 the act for a swap regulation with the exception
10 of the Volcker rule. And we do have a testing and
11 supervision rule we will be putting out.

12 With the substantial completion of the
13 proposal phase of the rulemaking, the public now
14 has the entire mosaic and it will allow you all to
15 give sort of comments with all these rules and how
16 they interplay. I'm particularly interested in
17 the views of this panel on the entire mosaic. I
18 know that we're going to be chatting about a
19 couple of topics but particularly how it
20 implements the agricultural derivatives markets.
21 There are two specific topics that are just
22 agricultural-focused, like the definition of

1 agricultural commodities and also how we treat
2 agricultural swaps, but there are other important
3 rulemakings that are much broader and have
4 implications for the agricultural markets, some of
5 which we'll be talking about, like the position
6 limits and hedge exemptions, the swap dealer
7 definition. I would put in also the forward
8 exemption as it was put in the product definition
9 area. The end-user exception I know is going to
10 be discussed and the margin requirements for
11 uncleared swaps. Again, I'd like to thank
12 Commissioner Dunn and my fellow commissioners, as
13 well as this committee's members. And I look
14 forward to today's full discussion.

15 CHAIRMAN DUNN: Thank you, Mr. Chairman.
16 Commissioner Sommers.

17 COMMISSIONER SOMMERS: Thank you,
18 Commissioner Dunn. Good morning.

19 As I think most all of you know,
20 Commissioner Dunn's term expires in June and the
21 White House has nominated his replacement. So
22 today at this Agricultural Advisory Committee

1 meeting, whether or not he ends up chairing
2 another one or not, I feel that it's appropriate
3 to echo the chairman's thanks to Commissioner Dunn
4 for his leadership, especially on the issues
5 important to the agricultural community and for
6 this advisory committee. I seek his advice on
7 many issues, but certainly these issues
8 particularly I will miss his advice and counsel.

9 I think that the group and the groups
10 represented around this table are the groups that
11 have traditionally been the ones advising the CFTC
12 on issues since the creation of this commission.
13 And while we were riding new rules implementing
14 Dodd-Frank and taking over responsibility for an
15 entire new marketplace, we have many people that
16 come in to speak to us every day that tell us
17 they've never been to the CFTC, they don't know
18 much about how we function, but they have a number
19 of issues with the proposals that we've done over
20 the past nine months. I am particularly heartened
21 today to see that some of the most important
22 issues that we are tackling in implementing Dodd-

1 Frank are on the agenda today and we're getting
2 the advice from our traditional constituency about
3 how these proposals will affect you and your
4 businesses.

5 So thank you, Commissioner Dunn, for a
6 great agenda and I really look forward to hearing
7 from all the panelists around the room and want to
8 say again thank you to Commissioner Dunn for his
9 leadership.

10 CHAIRMAN DUNN: Thank you, Commissioner
11 Sommers. Commissioner Chilton.

12 COMMISSIONER CHILTON: Thanks, Mr.
13 Chairman. I'll be brief but also echo my
14 colleagues' thanks to you. You've done a great
15 job at all of these Ag Advisory Commission
16 Committee meetings, Mike, and your staff has done
17 great. They're always well put together. Jason,
18 Nicole, and Bob did a great job on this one, too.
19 And thank you for doing it. I know it's often a
20 thankless chore.

21 A couple of years ago, April 22, 2008,
22 we had one of these and it was right when prices

1 started to become somewhat disconnected from
2 supply and demand. April 22, 2008. And it was
3 shortly after that that a lot of members of
4 Congress raised concerns about excessive
5 speculation. As we recall, in July, Senator Reed
6 offered a bill to deal with excessive speculation,
7 defeated on a cloture motion. Later that year the
8 House actually passed the bill with bipartisan
9 support to deal with excessive speculation. And,
10 you know, here we are again in 2009. Congress
11 passed Dodd-Frank, told us that we needed to put
12 these limits in place. And that's sort of a
13 drastic measure. We had the ability to put limits
14 in place back in 2008.

15 There's a Miranda Lambert song, a
16 country song now that talks about taking sort of
17 drastic measures. And I view it as sort of a
18 drastic measure when Congress has to tell the
19 regulators you will do something. And I'm a
20 little concerned that we -- I mean, I'm very
21 concerned that we haven't put position limits in
22 place. I'm a little concerned that some in

1 Congress -- and we've received letters in the last
2 couple of weeks, maybe over 100 congressmen and
3 senators telling us to implement position limits
4 now -- I'm a little concerned that we'll also be
5 faced with a drastic measure of Congress telling
6 us specifically how to implement position limits.
7 It won't have all the bells and whistles on it if
8 we get told how to do it in statute. It won't
9 have sort of the texture and granular nature that
10 I think we need on any rule that's so important.
11 So I really hope that we go forward.

12 I've talked about it again and again and
13 I know I'm like a broken record, particularly to
14 my colleagues on this. But we could do spot-month
15 position limits right now. We have them in the
16 Ags. We need them in Metals. We need them in
17 Energy. And I just continually get concerned that
18 as we're trying to be deliberative, which I
19 appreciate, we're also not moving fast enough on
20 putting them in place when Congress gave us this
21 deadline. So I think we need to get 'er done.
22 And I'm also interested in listening to the

1 Committee members tell us about the ag legacy
2 limits. If they should stay the same, if they
3 should change. And I know this isn't on the
4 agenda and we're not going to probably have enough
5 time to get to it, but I've been contacted by a
6 lot in the ag community and a couple this week,
7 raising some concerns about something that a lot
8 of us have talked about, particularly Commissioner
9 O'Malia, and that's the cheetah traders, the
10 high-frequency traders, and their impact on
11 markets. And there's lots -- there's an open book
12 on where we are on these things, but people
13 continue to raise concerns about they're having an
14 inordinate impact at times, at certain times in
15 markets.

16 So if people have thoughts on that I'd
17 appreciate it also. But thank you very much,
18 Commissioner Dunn. Again, I appreciate all your
19 work.

20 CHAIRMAN DUNN: Thank you, Commissioner
21 Chilton. Commissioner O'Malia.

22 COMMISSIONER O'MALIA: Let me be the

1 last word on the commissioner at least to echo my
2 thanks and appreciation for chairman of this
3 subcommittee and Commissioner Dunn's hard work and
4 leadership. He is my hall mate just down the hall
5 and I rely on his counsel frequently, especially
6 on these issues and other issues regarding the
7 Commission. So I can't express how much I
8 appreciate your support, your guidance, and your
9 counsel working here and your years of service to
10 this nation which we should all be grateful.

11 I'd like to thank you for hosting
12 today's meeting of the Agricultural Advisory
13 Committee. I look forward to the staff
14 presentations and a healthy discussion on each of
15 the areas that you recommended. And I appreciate
16 the chairman's desire to just open this up for
17 what the Ag Advisory Committee would like to talk
18 about. I don't ever think it's a bad idea to take
19 the time and stop and reassess where we're going
20 in order to make sure we are still moving in the
21 right direction, especially if we don't have a
22 roadmap.

1 A few weeks ago, the CFTC and the SEC
2 held a joint staff roundtable to discuss the
3 implementation process. We heard from all of the
4 members and participants. Very thoughtful
5 comments. And it was abundantly clear to me that
6 all the market participants are ready and willing
7 to comply with the rules but their capacity to do
8 so depends largely on the Commission's sharing its
9 implementation strategy.

10 I heard the same message over and over
11 again at this roundtable. Market participants
12 need an implementation strategy to make necessary
13 investments, hiring decisions, and reorganizations
14 in their companies to comply with the rules.
15 Despite the roundtable, the Commission has yet to
16 commit to drafting a comprehensive schedule for
17 sequencing of final rulemakings or an
18 implementation plan. I think it's time we
19 answered the call and let everyone know what we
20 intend to do and how we intend to do it. I will
21 continue to recommend the commissioner release a
22 comprehensive schedule on the sequencing of the

1 final rulemaking and a proposed implementation
2 plan in the federal register. After we receive
3 public comment, then we should release a final
4 schedule to the public. I believe this small
5 effort on the Commission's part will bring
6 transparency to the rulemaking process.

7 I'd also like to take this opportunity
8 to request of the full commission chairman to hold
9 a staff roundtable to discuss the swap dealer
10 proposal. I have publicly stated that I believe
11 the definition is too broad and the exceptions are
12 too narrow. The Commitment letter seemed to
13 support this as well. I appreciate a recent
14 effort to tackle individual sag, actually for the
15 second time, complicated issue. My compliments to
16 the chairman for taking the opportunity and our
17 pause to have that meeting. Next week?

18 CHAIRMAN DUNN: I think it's June 3rd.

19 COMMISSIONER O'MALIA: June 3rd?
20 Another great opportunity to get participants to
21 discuss the ramifications of these rules. And I
22 greatly appreciate that.

1 This is -- the swap dealer rulemaking is
2 an extremely important rulemaking as it relates to
3 who is and who is not subject to capital margin
4 rules which we'll discuss here among others. I
5 believe that a roundtable is necessary to hear
6 from the public and those entities that believe
7 they will be subject to regulation under the new
8 dealer rule.

9 Now, Chairman Dunn, a year and a half
10 ago I attended my first Agricultural Advisory
11 Committee meeting. It was my second or third week
12 on the job, my first public appearances, and I was
13 terrified we were taking on the easy topic of the
14 convergence in the wheat contract, which I had
15 very little knowledge of at the time. I was
16 impressed by the body of work that this committee
17 produced to uncover the fundamental flaws in the
18 wheat contract and offered a range of options.
19 Again, I'm pleased to have you chosen to focus on
20 the needs of the agriculture community, a group
21 that truly embodies end-users and who pose the
22 least amount of systemic risk but could pay a very

1 high price as a result of the proposed reforms
2 mandated under Dodd-Frank. I appreciate your
3 willingness to organize this forum to discuss
4 these important topics, and I look forward to our
5 presentations from staff and the discussion of the
6 members. Thank you again.

7 CHAIRMAN DUNN: Thank you, Commissioner
8 O'Malia for all the kind words I've gotten on my
9 advice and counsel. Let me remind everyone I get
10 that back fourfold, so I appreciate my fellow
11 commissioners.

12 If I could get the Advisory Committee to
13 introduce themselves and who they represent. And
14 Kevin, if I could start with you, please.

15 MR. NATZ: Kevin Natz with the National
16 Council Farmer Cooperatives.

17 MR. SOMBKE: Doug Sombke with National
18 Farmers Union.

19 MR. KEMP: Todd Kemp with the National
20 Grain and Feed Association and I'm sitting in this
21 morning for Matt Bruns, who is our regular
22 contributor to the Ag Advisory Committee.

1 MR. HICKS: Edgar Hicks, Nebraska
2 Grange. National Grange. I represent Nebraska.

3 MR. CRYAN: Roger Cryan with the
4 National Milk Producers Federation.

5 MR. DIERKS: Neil Dierks. I'm the
6 National Pork Producers Council staff.

7 MR. DINEEN: Bob Dineen with the
8 Renewable Fuels Association.

9 MR. CLARK: Fred Clark on behalf of the
10 U.S. Rice Producers Association.

11 MR. LANGLEY: Reece Langley, USA Rice
12 Federation.

13 MR. BOONE: Robbie Boone, Farm Credit
14 Council.

15 MS. PETERSON: Dana Peterson, National
16 Association of Wheat Growers.

17 MR. SCANLAN: Mark Scanlan, the
18 Independent Community Bankers of America.

19 MR. COCHRAN: Christine Cochran with the
20 Commodity Markets Council. But Jason Ungar will
21 be representing us once he arrives.

22 MR. LEA: I'm Jordan Lea. I'm

1 representing American Cotton Shippers.

2 MS. PRESTON: Diana Preston with the
3 American Bankers Association.

4 MR. WANDS: Hayden Wands with the
5 American Bakers Association.

6 CHAIRMAN DUNN: Thank you very much.
7 Let me introduce a couple of folks that are here
8 in our audience. Representing ranking member
9 Collin Peterson from the House Agricultural
10 Committee, Sharon Josephson. If you would stand
11 up, please.

12 And from the Senate Agricultural
13 Committee, Russ Bayhem. Am I saying that right,
14 Russ?

15 MR. BAYHEM: Yeah.

16 CHAIRMAN DUNN: Who is a new legislative
17 fellow on the Senate Agricultural Committee. So
18 everybody, keep your eye on him. And then Sharon
19 as well.

20 Is there anybody else here from the Hill
21 that I missed?

22 We also have representatives from the

1 various exchanges. And if they'd like to rise and
2 identify themselves. David, if I could start with
3 you. Anyone else from the exchanges here? Fine.

4 Let's then begin with our first panel.
5 And this is kind of an overview that we're going
6 to be getting on what's going on and a little
7 tie-up of some of the past business we've had on
8 convergence. And if I can please get Dave Amato,
9 who is the director of Agricultural Contracts,
10 Market Surveillance branch. Please give your
11 presentation, David.

12 MR. AMATO: Thank you, Commissioner
13 Dunn. As Commissioner Dunn just mentioned, I've
14 been asked to talk about current ag issues. We're
15 going to talk a little bit about prices, a little
16 bit about the flood, and finally, convergence.

17 I'd like to thank the AAC for this
18 opportunity to speak to you. And just to
19 reiterate what everyone has said about
20 Commissioner Dunn, thank you for all you've done.
21 You've been a great advocate for the ag community
22 and especially on the convergence issue. I think

1 a lot of headway was made because of your efforts.
2 So it's much appreciated.

3 To begin, this first chart is -- I'll
4 look at mostly the grains and we also have cotton
5 on this chart. Basically, nearby prices are
6 strong across the board for all these different
7 commodities. However, besides cotton and corn
8 which have had recent record highs hit, we're very
9 far away from the levels that we saw in 2008.
10 However, there's a lot of fundamentals that play,
11 a lot of weather issues. The flood issue.
12 There's a lot of impact on the market coming up,
13 especially this summer, that could have a big
14 impact on prices. And most of the fundamentals
15 are bullish right now. We also have this very low
16 interest rate environment and a weak dollar, which
17 many economists will say will have an impact on
18 commodity prices.

19 Just to highlight the corn, which hit a
20 nearby high back on April 11th, we're looking at
21 15-year lows for the ending stocks. Stocks use
22 ratio is also at a 15-year low. The ending stocks

1 translate to about a 20-day supply of old crop
2 corn when we start the new crop year for the
3 2011-2012 year. Cotton, also a very similar type
4 of fundamentals. We have the lowest ending stocks
5 since 1960. India, the second largest producer,
6 has put a restriction on exports of cotton. And
7 China, the largest producer, importer, and textile
8 manufacturer in the world, is forecast to import
9 about 40 percent more cotton than last year, and
10 it's expected about half of that to come from the
11 United States.

12 So we're not anywhere near where we've
13 been in 2008 in terms of the ag community in
14 general, but we definitely have bullish
15 fundamentals. And with some of the weather and
16 flood situations, things could definitely get even
17 more bullish.

18 Taking a look at the next graphic, this
19 is a look at corn historic volatility. This is
20 only the historic volatility in the month of
21 April. And historic volatility is a measure of
22 how much prices have changed during the month.

1 It's computed as an annualized standard deviation
2 of the percentage change in daily price. April,
3 actually if you look at all the months, April is
4 below the mean volatility of all the months.
5 July, if we had put that up, would be the most
6 volatile and that seems very intuitive because

7 it's a weather -- summer weather month and it's of
8 big importance in terms of the growing season.

9 There's been a general upswing in
10 volatility over time while at the same time we've
11 seen absolute price levels rise considerably.
12 This graph goes all the way back to the '80s.
13 Obviously, in the '80s and '90s, early '90s, we
14 had prices in the \$2.00-\$2.50 range, and if we go
15 all the way up to recent times today you're seeing
16 prices close to almost \$8.00. So prices have
17 risen considerably, and also price limits have
18 been raised considerably over time. In the '90s
19 we had 10 cent limits. That was raised to 12
20 cents. Then in 2002, we raised it to -- or I
21 should say the Board of Trade raised it to 20
22 cents. And then 30 cents in 2008.

1 One final little piece of information on
2 this graph. I took a look at the daily price
3 moves from 2007 to 2011 for the April corn
4 contract. And we had an average dial move of
5 about 8-1/4 cents. So obviously that is -- when
6 you look back at where the price limits were back
7 in the '90s, a 10 cent limit, to have an 8 cent
8 move on average every day just shows you how
9 volatile the corn market has been. That
10 volatility has corresponded with years where we've
11 had bullish fundamentals and high prices.

12 The next graphic takes a look at some of
13 the planting progress and the conditions.
14 Obviously, we've had a tremendous amount of
15 precipitation this spring, especially in the
16 eastern corn belt. And we've also had very, very
17 cool weather. I'm from Chicago and we had
18 absolutely no spring. It's basically been like
19 November for the entire spring. So that's going
20 to have a big impact on the corn crop.

21 If you look at the 63 percent for the
22 completed progress, that doesn't look so bad next

1 to the five-year average of 75 percent. But I
2 broke it out there and you can see. The eastern
3 corn belt is only at 35 percent complete, where
4 the western corn belt is at 85 percent. So we
5 have sort of a dichotomy in the corn belt there.

6 And the other thing I wanted to
7 highlight is the winter wheat. We had very, very
8 poor conditions. The poor to fair conditions is
9 at 45 percent. The five-year average is only
10 eight percent. So that does not bode well in
11 terms of a quality crop. And that's going to be
12 very bullish going forward. We already said that
13 April was extremely volatile in 2011. With the
14 slow planting, and if we get any weather scares --
15 and we always get weather scares during the
16 growing season -- we could see much more
17 volatility going forward.

18 This next graphic is the Mississippi
19 watershed. This view will show you the rivers
20 that flow into the Mississippi. I drew in the red
21 to show you where we had the flood. Obviously,
22 the biggest impact is going to be the Mississippi

1 River down towards the gulf where most of the
2 exports are shipped out. The causes for the flood
3 is we've had high levels of snow cover in the
4 upper Midwest. That led to a high snow melt and
5 runoff. In April, like I said, the rainfall in
6 the northern tier of the corn belt and the Great
7 Plains combined with that snow melt. So we have
8 the combination of rain and snow melt to the
9 tributaries of the Ohio, Missouri, upper
10 Mississippi Rivers, that led to a surge at Cairo,
11 Illinois. Cairo, Illinois is right where that
12 Birds Point levee is on the map there.

13 Between May 2nd and 6th, the Army Corps
14 of Engineers destroyed the levee at Birds Point.
15 This was an attempt to prevent the flooding of
16 Cairo. This is only the second time that the
17 floodway has ever been opened. On May 9th, the
18 Army Corps of Engineers opened the Bonnet Carre
19 spillway to release water from the Mississippi
20 River. This is going to allow water to reach the
21 Gulf of Mexico. And on May 14th, the Army Corps
22 of Engineers opened the Morganza Spillway north of

1 Baton Rouge to allow potentially about three
2 million acres in the Atchafalaya River basin to
3 flood. This is the first time in the history of
4 the country that all three of these flood control
5 devices have been used together, so obviously
6 we're in a very, very serious situation.

7 Taking a look at some of the
8 agricultural impact of this flood, again, this is
9 very, very preliminary. I have a feeling that
10 these numbers will change and probably get worse
11 in a lot of cases. You also have the human
12 element of people's homes being flooded, possible
13 loss of life, and things like that. But this is
14 just focusing on some of the initial agricultural
15 impacts of the flood.

16 Barges are not allowed to move south of
17 Natchez, Mississippi, and no grain vessel loading
18 for a while. Obviously, this could cost tens of
19 millions of dollars per day, so that could have a
20 huge economic impact on the country. The
21 different farm bureaus are estimating two million
22 acres of land in Arkansas, Tennessee, and

1 Mississippi are flooded or under flood threat. In
2 rice, in Arkansas, there are projections that
3 nearly 300,000 acres or about 21 percent of the
4 Arkansas planted acres could be lost. That would
5 be about 10 percent of total U.S. rice acres.
6 Between Arkansas, Louisiana, and Missouri, there's
7 a potential 40 percent reduction from last year's
8 planted rice acreage.

9 We see similar things happening in
10 winter wheat in Arkansas where about 120,000 of
11 550,000 projected planted acres will be abandoned.
12 That's a loss of millions and millions of dollars.
13 Cotton, again preliminary numbers, say 66 million.
14 That's expected to get a lot bigger. And finally,
15 with the closing of barges not being allowed to
16 pass Natchez we're seeing basically the export
17 market being greatly, greatly reduced. So this is
18 going to have a big impact going forward.

19 To take it and look at how that's
20 affecting actual futures contracts, this is a
21 special bulletin that was put out by the CME that
22 talks about these sorts of act of God kind of

1 situations and the contingency plans that are
2 made. Basically, with the flooding that's taking
3 place, load-outs are definitely affected on the
4 Ohio River and the St. Louis area. And so
5 different commercial firms have had to look and
6 negotiate different alternatives besides the
7 normal planned load-out that was expected to take
8 place. So again, not only is it affecting things
9 way down the Mississippi River and affecting
10 exports, it's also having an impact on our futures
11 contracts directly as well.

12 The final topic I'd like to talk about
13 is the convergence issue. Both Chicago's soft red
14 winter, Kansas hard red winter, and the Chicago
15 Board of Trade rough rice contracts have had
16 convergence problems. The standard to which the
17 CFTC holds the exchanges is to see that cash and
18 futures prices come together at the par points
19 upon or near contract expiration. Convergence is
20 core to the mission of the CFTC and it goes to the
21 heart of public confidence and price discovery and
22 risk management functions of future markets. The

1 problems have been more protracted in the soft red
2 winter wheat market, but in both wheat cases we've
3 seen the basis deteriorate as the calendar spreads
4 approach financial full carry.

5 In this scenario it's advantageous to
6 hold a delivery instrument from one contract
7 expiration to the next, earning a small return on
8 the spread. Load-outs are extremely unlikely to
9 occur when futures is above cash. Elevators are
10 hesitant to issue more shipping certificates or
11 warehouse receipts in these full carry markets as
12 they know the grain will not move for months and
13 the commercial firm will lose control of a portion
14 of their elevator space. At this point, the
15 arbitrage link between cash and futures appears to
16 be broken.

17 Why is this an important issue? There
18 are several side effects that happen when you have
19 poor convergence. The main one, futures markets
20 are supposed to, at their essence, be a price
21 discovery mechanism. When you have futures prices
22 that are 80, 100, or even 150 cents over the cash

1 market at par points like we've seen in the past
2 at Kansas City on the Kansas City Board of Trade
3 or at Toledo on the CBOT, price discovery is
4 obviously very weak. We look to the futures for
5 price discovery but at times the futures price at
6 both exchanges had seemed to be decoupled from the
7 physical cash market.

8 The second point is the hedge
9 effectiveness. Hedge effectiveness is hampered
10 when the basis loses its predictability and
11 producers are dealing with a very volatile basis
12 that becomes much more difficult for them to
13 hedge.

14 The third point, which is a very big
15 deal obviously to market surveillance at the CFTC,
16 is the potential for market manipulation. When
17 you have contracts that are not performing or not
18 sending out the right price signals it can lead to
19 actions that can appear economic and that puts the
20 market surveillance staff in situations where
21 investigations have to take place.

22 The fourth point would be the forward

1 contracting. A volatile basis and poor
2 convergence make some elevators not willing to
3 forward contract. WE did several interviews in
4 Kansas back in July of last year and talked to
5 some banks and different credit agencies. And
6 that ties into the fifth point, an agricultural
7 lending crunch. The volatile basis has forced
8 some banks to lend less and/or require more
9 collateral.

10 And finally, something that the USDA
11 deals with is the crop insurance program. When
12 you have the USDA using futures prices to
13 calculate estimated producer revenue and futures
14 are well above cash, it's an overstatement of the
15 projected revenue that a farmer is actually going
16 to be receiving. So again, that makes that
17 program much less effective.

18 In short, this is a huge issue for the
19 ag community, and that's why the CFTC has invested
20 so much time and effort to address the problem.

21 And what has been done to address the
22 problem is the following slide. Over a two and a

1 half year period, the CFTC has worked with the
2 CBOT through the Ag Advisory Committee and its
3 subcommittee on convergence. And the CFTC has
4 approved the following changes: In July of 2009,
5 we saw an expansion of the delivery territory,
6 quality specifications, and harvest premium
7 storage rate. In July of 2010, we saw the
8 variable storage mechanism for the CBOT take
9 effect. And basically, what the VSR does is it
10 triggers a higher storage rate when the spread
11 between the near and next to expire contract is
12 greater than 80 percent of financial full carry.
13 It also triggers a decrease in storage costs when
14 the spread is less than 50 percent. Currently,
15 the storage rate is 20 cents per bushel.

16 Kansas City also has had contract
17 changes proposed, and they will go into effect in
18 September of this year. The CFTC also worked
19 extensively with the Kansas City Board of Trade
20 and their Wheat Contract Committee last summer.
21 There was work being done with the Ag Advisory
22 Committee. There were numerous staff visits by

1 market surveillance working with the exchanges.
2 And there were also several commissioner visits
3 from the CFTC and even a chairman visit back in
4 July of 2010.

5 But as I said, the KCBOT has submitted
6 these contract changes which include increasing
7 the base storage rate 30 percent to six cents,
8 instituting a harvest premium storage rate of nine
9 cents, requiring monthly payment of storage,
10 establishing a power protein level of 11 percent,
11 and tightening the specifications on vomitoxin.

12 While these changes represent a
13 significant increase in the storage rates and will
14 likely result in improvement in cash futures
15 convergence, the CFTC will continue to monitor the
16 situation carefully to discern whether additional
17 changes are necessary. It's obviously much, much
18 too early to judge what kind of impact this will
19 have but I think these moves should have an impact
20 and should help to improve the contract.

21 And finally, the rice contract, which
22 hasn't gotten as much attention as the two wheats,

1 but we see a contract change being instituted in
2 September. Currently, the discounts in premiums
3 are based off of futures prices. With the rule
4 change, those discounts and premiums will be based
5 off a USDA five-year loan rate. And this rule
6 change should help to remove some of the
7 uncertainty of delivery values of rice, and in
8 fact, help the contract.

9 The CFTC continues to monitor the base
10 levels and convergence, particularly with respect
11 to the calendar spreads, carrying charges, changes
12 to world supply and demand, changes in absolute
13 and relative levels of participation by the
14 different market segments, whether they
15 commercials, index funds, or managed money. I'd
16 like to reiterate that although the CFTC was
17 assertive in drawing attention to the convergence
18 issue and the need for action, the CFTC did not
19 create or recommend the contract remedy for either
20 exchange. The VSR was designed within the CME
21 product research department and the KCBOT changes
22 were devised by their Wheat Contract Committee.

1 The following graphs give a little bit
2 more detail of what we've been looking at and
3 monitoring over time. What this graph is is the
4 Chicago Board of Trade soft red winter wheat
5 contract. The left side of the Y- axis in blue is
6 the basis on first delivery day and cents per
7 bushel. The right side of the Y-axis in red is
8 the percentage of full carry. As I mentioned
9 before, in general, as the percentage of full
10 carry goes above 80 percent, and especially as it
11 approaches 100 percent of fully carry, we tend to
12 have a weak basis. In these full carry markets,
13 some sorts deliver as futures is above cash, so
14 the futures market is the short's best sale.
15 Under non- full carry scenarios though -- I'm
16 sorry, under non-full carry scenarios these
17 deliveries would cause downward pressure on
18 futures prices. However, in fully carry markets,
19 longs are perfectly willing to take the deliveries
20 as their costs are being covered and oftentimes a
21 guaranteed profit as well.

22 In these instances, the long is looking

1 at the weak futures market like a financial
2 instrument instead of just grain. The long can
3 earn two to three percent guaranteed return, much
4 better than a short-term treasury and have all of
5 their costs covered. In the case of a market
6 disruption, they have what amounts to a free call
7 on the grain.

8 This graph shows that between 2008 --
9 May of 2008 and May of 2010, the CBOT wheat
10 contract experienced very poor convergence and a
11 weak basis. The basis from July 2010 through the
12 May 2011 contract has showed marked improvement
13 and we've had good to decent convergence in four
14 of the five expirations. And that's since the VSR
15 has gone into effect. September, obviously, you
16 can see September of 2010, is the outlier there.
17 The reason why we tend to have bad convergence in
18 the September contracts and that's the case going
19 back through history, at that time with the corn
20 crop coming online, a lot of elevators drastically
21 drop their bids or make very, very low bids for
22 wheat. And we often see September being the worst

1 month for convergence.

2 We believe that the VSR has helped
3 convergence, but we also had a 40 percent smaller
4 soft red winter wheat crop from the 2010 -- I'm
5 sorry, from 2009 to 2010. So with a much smaller
6 crop it's hard to say how much of the impact is
7 the VSR but we have seen an improvement in the
8 basis. Going forward we're going to obviously
9 need more crop years to fully judge the
10 effectiveness of this VSR. The contracts at both
11 Chicago and Kansas City have tended to converge
12 when we've had either tight markets or more normal
13 supply and demand. The problems have come when
14 we've had these situations of oversupply.
15 Oversupply has led to these convergence problems.
16 An effective contract should be able to work no
17 matter what the fundamentals are, whether we have
18 a tight market or if we have a very large supply.

19 The Kansas City situation is very, very
20 similar, and this set-up on the graph is exactly
21 the same. The left axis is the basis on first
22 delivery day. The record is the percentage of

1 fully carry. In general, like I said, as we go
2 above 80 percent and approach 100 percent, we have
3 the wheat basis. The last nine expirations at
4 Kansas City have had very weak basis and poor
5 convergence. The May that went off the board just
6 recently on the 14th went off at 75 under on first
7 delivery day.

8 The Kansas City rule changes to improve
9 converge go into effect with the September
10 contract. There's a lot of confidence that that
11 will help, but obviously we haven't seen the
12 contract changes go into effect so we're going to
13 need time to evaluate that. It's much too soon to
14 judge.

15 And then the final graph that I have is
16 the same concept, 10-year look at rough rice.
17 Rough rice is a lot more difficult to really get a
18 handle on convergence because cash prices are much
19 harder to come by. It's a much more think market.
20 It's not liquid the way we see the wheats and the
21 corns and the soybeans. However, the same general
22 concept we're seeing, especially over the last

1 year. We're seeing very, very poor convergence.
2 You can see at several of those expirations in the
3 last year or so we've had basis levels \$3 under or
4 \$4 under. And the current May contract that went
5 off the board on the 14th went off the board \$3.50
6 under the future.

7 Currently, we have a very large, poor
8 quality crop and again, as I said, that's what we
9 have observed pretty much across the board of all
10 the grain contracts. When you have large
11 supplies, we've tended to have the poor
12 convergence. It's our hope to have contracts that
13 can work no matter what the supply and demand
14 situation is. Next year's crop is expected to be
15 much smaller due to the flood. The USDA is
16 already showing an expected 17 percent decrease in
17 plantings. With the flood that's probably going
18 to be much, much worse. So we should have a
19 tighter crop situation and the convergence problem
20 will probably go away but that's only because of
21 the fundamentals change, not necessarily because
22 of any contract change.

1 The CFTC has been conducting trader
2 interviews with the rice industry in coordination
3 with market surveillance and product review as a
4 preliminary first step to address the convergence
5 issue. Overall, the work of the AAC and its
6 Convergence Subcommittee have had a positive
7 impact on convergence and I think going forward,
8 especially for the wheats, I think we're going to
9 see continued improvement.

10 And that's all I have. Thank you.

11 CHAIRMAN DUNN: Thank you, David. David
12 is one of the three Davids that I use out of the
13 Chicago office. I call them the Daves, and they
14 have just been invaluable to me during my tenure
15 here. So I appreciate this briefing, but all the
16 work that you've done in the past.

17 I also want to thank you for giving us
18 that quick overview of what's going on in the
19 agricultural sector, but more importantly that
20 very succinct briefing here of convergence and why
21 it is important to us as we see it in the
22 marketplace. And I also want to thank the

1 Agricultural Advisory Committee for working with
2 the Commission and working with the exchanges in
3 coming up to these fixes on convergence. It has
4 been an effort where I have seen the industry as a
5 whole dig in and work together. Although they
6 have some conflicting views on these things,
7 they've done a very, very good job and the
8 exchanges have been very open to their
9 suggestions.

10 With that I will open it up to the Ag
11 Advisory Committee for any comments or questions
12 to David on his briefing.

13 MR. AMATO: Commissioners.

14 CHAIRMAN DUNN: David, you've done your
15 job well.

16 COMMISSIONER GENSLER: I'm just struck
17 nobody's asking about convergence. I just want to
18 associate myself. I think your comments on page
19 eight and nine really got to the heart of why
20 convergence matters. It's really to the
21 confidence as to whether the hedgers can use the
22 product, futures, and have the confidence that

1 it's an open, transparent market that prices their
2 product. And if they wish to they could deliver
3 into the contract if there's this wide lack of
4 convergence. So good work, Dave.

5 MR. AMATO: Thank you.

6 COMMISSIONER GENSLER: I think there's
7 still more work to do on some of the products to
8 get to convergence.

9 MR. AMATO: Yes.

10 CHAIRMAN DUNN: Thank you again. Let's
11 then get panel number two in place. Steve
12 Sherrod, who is the acting director of our Market
13 Surveillance and David Van Wagner, who is chief
14 counsel.

15 MR. RADHAKRISHNAN: I thought I heard
16 Commissioner Chilton. He wanted to say something.

17 CHAIRMAN DUNN: I'm sorry.

18 Mr. CHILTON: Yeah, actually, since you
19 -- thank you, Ananda. And since you're still
20 there, Dave, I was struck by this chart on corn
21 historical volatility in April. You know, it
22 looks -- of 30 years, we had the third highest

1 volatility and I'm curious of two things. One,
2 Dave, is if we looked at that for, you know, wheat
3 and beans and rice, would it look similar? That's
4 the first part of the question. And the second
5 thing is, and I want to make sure I don't put
6 words in your mouth, but what I thought you said
7 in there in the middle was that the longs, and
8 these are folks that have been called
9 massive-passives, that they were looking at wheat
10 like a financial instrument. Maybe this is what
11 people call the financialization of commodities.
12 And so my question is, one, would it look the same
13 for rice, wheat, and beans, this volatility chart?
14 And two, do you think this financialization of
15 commodities that you were talking about correlates
16 with any of this in the more recent times -- the
17 2007 and this year, 2011? I'll just listen there.

18 Thank you very much. Thank you again,
19 Ananda.

20 MR. AMATO: Sure. I would say -- I
21 can't speak to rice because I have not looked at
22 rice. But soybeans would look similar. It has a

1 similar crop year. For wheat, it may not be April
2 but the general trend is for the grains that we
3 have had increased volatility. There's no doubt.
4 And I would imagine rice would be similar but like
5 I said, I have not directly looked at rice.

6 When I was talking about the financial
7 sort of aspect of the wheat as opposed to people
8 thinking of it as grain, I was talking about
9 people who decide to take delivery. So that could
10 be longs of any stripe. It doesn't have to
11 necessarily be what we would define as sort of the
12 index traders. And in fact, those index traders
13 tend to roll. And that's public knowledge. They
14 tend to roll before we get into the delivery
15 period. So these would be either commercials or
16 it could be a speculator taking advantage of this
17 full carry situation.

18 So I hope that answers your question.

19 COMMISSIONER GENSLER: Yeah. Thank you,
20 Dave. I appreciate it. Thanks for your
21 indulgence, Commissioner Dunn.

22 CHAIRMAN DUNN: Sure. Thank you.

1 MR. HICKS: Commissioner Dunn?

2 CHAIRMAN DUNN: Edgar.

3 MR. HICKS: I think part of the reason
4 why we haven't had many comments is this issue of
5 convergence goes to the heart of all the issues
6 that we have to address of volatility. And coming
7 from Nebraska and Kansas, my farmers were somewhat
8 losing confidence in the system, I guess. So if
9 we can't solve the issue of convergence, how are
10 we going to address the issues, you know, the
11 margin requirements and volatility? Because my
12 farmers are starting to think that this, too, is
13 becoming a speculative vehicle. And so, you know,
14 I don't have the answer but it just feels like --
15 I feel less -- I feel less of the ability of the
16 Committee to -- the advisory committee to be of
17 service less this time than I did when I first
18 came last year. So we can't give up but it really
19 is a struggle.

20 And so -- and what I'm really worried
21 about is that as our bankers in rural communities
22 challenge our farmers when we most need the use of

1 the futures market, and so it's kind of hard to
2 have a comment. I appreciate the work you put in
3 it but, you know, how do we address the problem, I
4 guess.

5 CHAIRMAN DUNN: Well, Edgar, I think
6 you've kind of hit the nail on the head. And for
7 you -- Edgar represents the National Grange but
8 he's located in the Omaha area. Is it Omaha or
9 Lincoln?

10 MR. HICKS: It's either one.

11 CHAIRMAN DUNN: Omaha. But we've seen a
12 shift because originally the concern was on the
13 Kansas City Board of Trade wheat contract where we
14 first had the convergence problems. And
15 certainly, what David highlighted here of why it
16 matters to us or the types of things that you're
17 seeing. And now we have had a similar problem in
18 the Kansas City Board of Trade with their wheat
19 contract. And it really has hit home more for
20 produces in your particular area right now. And I
21 can understand that they've probably been a lot
22 more vocal to you than they would when it was on

1 the Chicago contract. But I feel that what this
2 committee has done, what the exchanges have done
3 in being open and frankly the Commission as a
4 whole. I know I've used this as a bully pulpit,
5 my position, as have other commissioners, and I
6 feel that there is genuine support out there to
7 address this problem and get it correct. And this
8 is an ongoing, continuing thing. Long after I'm
9 gone after chair of the Ag Advisory Committee
10 there will be people following up to see whether
11 or not we have found the right solution. And I
12 think it's incumbent upon all of you that are
13 going to still be members long after I'm gone to
14 hold our feet to the fire.

15 The one thing that Dave said in his
16 presentation is these aren't our contracts. They
17 belong to the exchanges. But the exchanges are
18 aware that the only -- that you are the customer
19 base out there and you have the ultimate control
20 of whether or not you're ever going to trade those
21 particular contracts. And you want to have them
22 have the convergence so that it can be utilized

1 for price discovery and risk mitigation. So I
2 appreciate your comments and I think they're right
3 spot on.

4 MR. CRYAN: Mr. Commissioner, is it me?
5 Okay. Commissioner Dunn, I also want to thank you
6 for your service. You've been invaluable to the
7 agriculture sector in your sensitivity to our
8 issues in this job and in your previous jobs.

9 On this convergence issue I think it's
10 important to recognize that the Dodd-Frank
11 regulations and requirements put the convergence
12 issue in a whole new light. Under the status quo,
13 the Exchange can do what it wants, and as long as
14 it's not egregious you say go ahead. If we have
15 new regulations that require clearing of all types
16 of -- of a very broad category of transactions,
17 there's going to be a limited number of exchanges
18 and clearing organizations set up to do these
19 things. And a lot of actors are going to be
20 forced into these transactions with these
21 exchanges that you regulate. And all of a sudden
22 allowing second best solutions is no longer

1 acceptable. It's going to be much more your
2 responsibility to define as nearly perfect a
3 solution as you can find in cooperation with the
4 exchanges. And the public and the users become
5 much more significant stakeholders in the actions
6 of the exchange.

7 You know, the flip side of that is, of
8 course, gets into issues of exemptions for
9 end-users and I've talked about this quite a bit.
10 I think that's the next topic. There has to be a
11 balance. We can't have our cake and eat it too.
12 We can't say the exchanges can do it however they
13 want and then force everybody to use the
14 exchanges. The alternative is to let the
15 exchanges do things the way they want to do them
16 but leave people an out. And I think that's very
17 important.

18 Thank you.

19 CHAIRMAN DUNN: Thank you, Roger.

20 MR. KEMP: One quick comment and it ties
21 back into what Edgar was talking about in terms of
22 lenders' reactions and impacts on producers. Our

1 industry has been concerned about a credit crunch
2 coming again. As commodity values stay high,
3 perhaps even go a little bit higher, there is at
4 some point a limit on what agribusiness lenders
5 can provide to their customers to buy the crop to
6 meet margin calls. There are rulemakings under
7 way, both in terms of Dodd-Frank and
8 implementation. And another good example is the
9 daily price limit proposal for CBOT corn. We
10 would sure urge the Commission to look carefully
11 at those issues in light of the agricultural
12 credit situation and in light of -- both points D
13 and E up on the screen are really related.

14 If it gets to the point where elevators
15 are faced with much higher margin calls, much
16 higher financial demands, at some point that eats
17 into their working capital and at some point it
18 will affect their ability to forward contract with
19 producers. That would have the effect of reducing
20 marketing opportunities for producers which is not
21 good certainly for them for our industry or for
22 U.S. Agriculture.

1 So we appreciate the recognition of
2 those facts and encourage the Commission and this
3 committee to keep it in mind.

4 CHAIRMAN DUNN: Thank you, Todd.

5 MR. WANDS: Commissioner Dunn, the ABA
6 also appreciates the comments that Mr. Kemp has
7 stated. Financial margin calls on the bakers have
8 been moving financial assets away from our core
9 businesses to something that we have very little
10 control over. And so we want to echo the comments
11 on -- the Commission take very serious
12 considerations on volatility.

13 And Chairman Chilton, to answer your
14 question, the ABA did a study on volatility and
15 the Chicago Board of Trade wheat on a monthly
16 average. And in 2005, January 2005, the monthly
17 volatility was 22 percent and in January of 2011,
18 the monthly volatility was 45 percent. So it
19 echoed the same as in the corn market.

20 MR. LEA: Mr. Commissioner, thank you
21 again on behalf of the cotton industry for all
22 your help and service and having worked with us at

1 our conventions.

2 Sort of along the lines of what Edgar
3 and Todd were saying, I am actually a cotton
4 merchant and if you could chart -- if David could
5 chart there would probably be no way the
6 volatility and convergence. The two quickly
7 divorce themselves. We've been about 175 percent
8 of volatility or average volatility in cotton over
9 the last year and as we move toward new crop and
10 out of a demand- driven cycle, we're quickly
11 seeing the market become less dependable. And
12 like Edgar said, the producers don't know what to
13 say. And as a merchant, my tagline is, well, it
14 doesn't matter. You know, here's your cash price.
15 It's still a profitable cash price, but
16 unfortunately, from a basis standpoint, it doesn't
17 illustrate convergence. It probably illustrates
18 the opposite of convergence.

19 And as an example of what was just said,
20 last year for me to hedge 1,000 bales of cotton
21 was \$7,500 on initial margin with no maintenance
22 margin required. This year it's a total of

1 \$100,000 just for 1,000 bales. And so if we're
2 looking at potentially a 20 million bale crop of
3 cotton, you can imagine the capital requirements.
4 And what happens, and you heard David mention what
5 a dramatically tight situation we're in with the
6 stocks relative to cotton and the lack of a
7 dependable marketplace, sort of like what Edgar
8 was talking about, the more it's seen as a
9 speculative tool or the lack of convergence is
10 just going to further discourage production
11 regardless of where the market price is because
12 the two become less and less closely associated.

13 CHAIRMAN DUNN: Thank you, Jordan.

14 MS. PETERSON: Mr. Chairman, thank you
15 again for your service and all that you've done
16 for the wheat industry. And thanks again to the
17 staff for being so helpful in this convergence
18 issue.

19 Over the last year and a half since I
20 came to the National Association, there's been a
21 lot of discussion amongst our growers about what
22 should our expectations be in this new market

1 environment. You know, with the convergence
2 issues, with the higher prices, everything is
3 uncertain for growers. And I think my question to
4 you, David, is when you were talking about the
5 changes to the contracts and it's too short of a
6 time to really tell whether they work, what is an
7 adequate amount of time to determine whether
8 they've worked? And when do we start looking at
9 the next level of surveillance?

10 MR. AMATO: I would think -- I would say
11 like for the Chicago Board of Trade, those major
12 changes went into effect last July. So we're
13 almost at a year. Unfortunately, like I mentioned
14 in the presentation, we had a dramatic reduction
15 in the soft red crop. And as I've said, these
16 contracts have worked when we've had small supply.
17 So I would argue that you can't really judge the
18 VSR. We have improved. Is that the VSR or is
19 that a smaller crop? It's probably a little bit
20 of both. I think you have to have a more normal
21 supply and demand year, an averageish kind of year
22 and then we can see if this contract has actually

1 improved. So I think that's the fairest way to
2 judge it.

3 MS. PETERSON: I think we're all looking
4 for a normal year.

5 MR. AMATO: Yes.

6 MS. DUNN: Dana, I agree with you. I
7 just don't know what normal is anymore,
8 unfortunately.

9 The problem you raised is a legitimate
10 problem and something that we've talked about all
11 along on convergence. You can't just flip the
12 light switch and say we're making a change in this
13 particular contract because there are people out
14 there that have financial interests in those
15 contracts. And again, I want to say the exchanges
16 have been very willing to come to the table and to
17 offer proposals to us. And some of the proposals
18 that were offered earlier on, for instance, with
19 the Kansas City Board of Trade, they listened to
20 the folks here. They went back and they adjusted
21 that. The same thing happened with the Kansas
22 City Board of Trade. They made an adjustment and

1 we looked at that through a year's cycle and then
2 we -- that really didn't fix it so they came back
3 with another fix.

4 And it's incumbent upon us to continue
5 to stay on top of this so your constituents out
6 there can look to the futures market for price
7 discovery and risk mitigation. And it's not going
8 to be an easy job. There are more and more
9 externalities that are going into there.

10 Commissioner Chilton talks about what he
11 calls the massive-passive. We also look at high
12 frequency traders. We look at externalities like
13 floods and those types of things. So I don't know
14 what a normal year is anymore. But we will
15 continue to do it. David and his colleagues in
16 our Chicago office are just a wealth of
17 information and will continue to work with any of
18 you. I know a lot of folks have visited the
19 offices and worked with them to get information,
20 and the same holds true for our Kansas City
21 regional office and our New York office, as well.

22 So any other questions or comments?

1 Doug.

2 MR. SOMBKE: Mr. Chairman. David. One
3 question about the weather issues that you
4 indicated in the watershed. I live in the James
5 River Valley area in South Dakota where the Big
6 Red spot is. And I've been at a number of
7 meetings in the last couple of months talking
8 about our disaster issue there and they're telling
9 us this is the fourth year of a 10-year cycle of
10 all this water, so don't expect things to change.
11 Is that going to be a good thing for this
12 convergence or a bad thing? I mean, Commissioner
13 Dunn, you mentioned what is normal anymore.

14 MR. AMATO: Well, like I said in the
15 presentation, I think contracts -- I think
16 everyone, the commissioners would agree and the
17 economists at the CFTC would agree, a good
18 contract works no matter what the supply and
19 demand situation is. I think the problem with the
20 contracts in the past is they've tended to work in
21 average crop years and when we've had tight supply
22 and demand issues it would tend to add the

1 convergence. Whenever we've had oversupplies or
2 big grain crops, we haven't seen convergence.
3 We've seen the exact opposite. We've, in fact,
4 seen divergence and we've seen the approach of
5 first delivery day and we're moving in the
6 opposite direction. So that's clearly a
7 disconnect between the futures and the cash.

8 So to answer your question, I would say
9 if a contract is designed correctly it should work
10 and converge no matter if we have floods,
11 droughts, abundant supply, or virtually no supply.
12 The cash in futures in a well operating contract
13 come together at the power points at first
14 delivery day. And by come together I'm not saying
15 zero because there's obviously differences,
16 delivery costs involved. There sometimes quality
17 differentials between the cash and the futures but
18 we should definitely be seeing a coming together.
19 We shouldn't be seeing this.

20 CHAIRMAN DUNN: Okay.

21 MR. SOMBKE: One other thing, Chairman,
22 I want to also commend you for your past service

1 and I hope this gives you an opportunity to come
2 to South Dakota and hunt pheasants a little more.

3 CHAIRMAN DUNN: I will, Doug, but you
4 know, we do have some in Iowa.

5 Let's go to our second panel now if we
6 could. And this is Position Limits and Hedge
7 Exemptions. And this is two of the things that
8 the advisory committee has already started talking
9 about. And certainly I look for this to be an
10 informative and spirited panel. Steve Sherrod and
11 Dave Van Wagner.

12 I don't any -- because we've got so much
13 pushed into this meeting I don't really have any
14 breaks involved in here so feel free to take a
15 break at any time.

16 MR. LEA: Doug, I've never been to South
17 Dakota.

18 MR. SHERROD: Good morning. I'm happy
19 to be here again to talk about proposed Dodd-Frank
20 rulemaking.

21 The Commission voted on and published
22 for public comment a Notice of Proposed Rulemaking

1 to establish additional federal position limits
2 and make a number of proposed changes to the way
3 the position limit regime would be applied. We
4 received about 12,000 comment letters, so we're
5 busy with a staff currently of about 15 people
6 trying to work to summarize those comment letters.
7 Before the Commission can go to the next step
8 implementing position limits by a vote of the
9 Commission, the staff needs to prepare the summary
10 of the comment letters and then we need to address
11 and recommend approaches for the Commissions to
12 publish in a final rulemaking. So that's a
13 somewhat involved process. We hope to be complete
14 with a summary of comments by the end of this
15 month. We certainly have a lot of people working
16 very diligently on that process.

17 The proposal that we have, I want to
18 contrast it for just a moment to the position
19 accountability regime that exists in some of the
20 exchanges. And what we're proposing basically are
21 bright lines, position limits that would be
22 applied and that speculators would not be able to

1 increase their positions above those levels. In
2 the position accountability regime, the exchange
3 needs a hook, if you will, reached to the
4 nonmembers of the exchange. At the CFTC, our hook
5 is when a trader becomes reportable. So we have
6 reportable positions and that gives us an ability
7 to ask through a special call for additional
8 information from a trader.

9 The exchange, once they have a hook
10 under position accountability, they, too, can ask
11 for additional information on requests to the
12 exchange. In the current proposed rulemaking we
13 have something called position visibility. That
14 essentially is an automatic special call once a
15 trader's position reaches a certain size. At the
16 exchanges, the last part of position
17 accountability is a trader, once they've exceeded
18 or reached the level of position accountability,
19 they've given the automatic consent to the
20 exchange upon order of the exchange to stand still
21 or actually to reduce the position. At the CFTC,
22 for us to use a similar authority we would need to

1 declare an emergency. So that's the first
2 difference between what we proposed, a bright line
3 test, and a position accountability regime.

4 The proposal applies to 28 different
5 core reference contracts. The current futures
6 limits only apply to nine enumerated contracts and
7 they're not aggregated. In this proposal, we
8 would aggregate across futures, foreign boards of
9 trade that offer linked contracts to the U.S.
10 referenced core contract where those foreign
11 boards of trade have direct access to U.S.
12 persons. And we would also include economically
13 equivalent swaps. So the limits in the proposal
14 would apply across a broad range of contracts,
15 whether they're traded on a board of trade,
16 whether they're traded on a swap execution
17 facility, or executed over the counter.

18 We have a number then of aggregation
19 provisions that apply to the different position
20 limits. And this gets a bit complicated in the
21 proposal. As much as we currently have in the
22 federal limits for grains, there's a spot-month

1 limit, there's an individual month limit, and then
2 there's an all-months combined limit for each of
3 these contracts. In a couple of minutes I'll go
4 over some examples and we'll illustrate how these
5 individual month and all month limits would work.
6 And then finally, there are aggregation provisions
7 by owner or controller that are tighter in the
8 proposal than what currently exists in the part
9 150 regulations.

10 So let's look quickly at the way the
11 all-months limits would look in the energy area
12 and then I'll look at an example of a few grain
13 contracts. For the all-months limits, as much as
14 we for a number of years have provided guidance to
15 the exchanges on acceptable practices for

16 complying with core principles, we use a formula
17 approach. And that formula is based upon open
18 interests. It is 10 percent of the first 25,000
19 contracts of open interest and then 2-1/2 percent
20 thereafter. So to get open interest, we need to
21 look at what's the open interest in the core
22 reference contract that trades on the designated

1 contract market. In an example of crude oil, it's
2 what trades on NYMEX in a physical delivery
3 contract. But there are also cassitle (?)
4 contracts that trade on exchanges and there are
5 swaps that settle to those cassitle contracts. So
6 we need to get more information about open
7 interests to set a level for all of the
8 economically-equivalent contracts.

9 What I can do by way of illustration is
10 show what's the open interest in the main
11 contract. In crude oil, for example, it's about
12 three million contracts. For the whole group of
13 contracts that feed into the crude oil contract,
14 it's a little more than 4.7 million contracts.
15 For the proposal that we have, as much as we're
16 thinking about a time period of an annual
17 adjustment, we would use the month-end open
18 interest for each of the 12 months and then
19 average that. So for 2010, in crude oil it was
20 about 4.2 million contracts, just in the contracts
21 that we can currently see, not including the
22 swaps. Applying our formula then we would come up

1 with a limit of about 108,000 contracts in crude
2 oil. So that's the way the math works.

3 And let's look at some of the contracts
4 traded on the Chicago Board of Trade. Corn and
5 soybeans and wheat. The current levels of open
6 interest are high. The open interest in the
7 agricultural contracts tends to be in a single,
8 main physical delivery contract that's traded on
9 the exchange. And there aren't a lot of
10 look-alike contracts other -- that's the
11 difference between the agricultural contracts and
12 the energy contracts, for example.

13 The average open interest in 2010 was
14 about 1.75 million or so contracts. It's a little
15 higher now. But using that 2010 average open
16 interest, we can look at what the levels of the
17 limits would be under the proposal. And this is
18 where we've provided some flexibility for how the
19 Commission might move to a final rule. In the
20 proposed rulemaking for corn, we've said the
21 existing limit in part 150 in all months combined
22 is 22,000 contracts. The Chicago Board of Trade

1 has petitioned the Commission to increase that
2 using the formula and applying it to, I believe,
3 the 2009 calendar year. And that formula would
4 result in 33,000 contracts as an all-months
5 combined limit. If we look at the 2010 level of
6 open interest, the average level of open interest
7 and apply the formula, then the all- months
8 combined limit would be 46,500 contracts.

9 So there are a variety of opinions that
10 have been expressed in the 12,000 comment letters
11 on how we might proceed. I look forward to
12 receiving your guidance on which of these possible
13 paths the Commission should pursue.

14 I'm going to turn to David Van Wagner to
15 talk a little bit about account aggregation.

16 MR. VAN WAGNER: Thanks. Yes, as part
17 of the position limit rulemaking, the proposed reg
18 would also establish requirements about how to
19 aggregate positions under common ownership control
20 for purposes of determining what is a position
21 that's going to be subject to position limits.

22 Conceptually, the aggregation

1 requirement is going to attribute to a particular
2 trader all the positions in which that trader
3 either has an ownership or equity interest of
4 greater than 10 percent or controls trading by
5 some power of attorney or otherwise. I should
6 point out that this basic aggregation requirement
7 is consistent with the way in which -- at least
8 it's a baseline -- is consistent with the way that
9 the Commission currently aggregates positions and
10 our expectations with respect to DCMs or exchanges
11 that have position limits.

12 Where the position aggregation
13 requirements start to vary from the current regs
14 is when it comes essentially to the exemptions
15 from position aggregation. The CFTC's proposal
16 would withdraw the current -- what's been come to
17 be known as the independent account controller
18 exemption -- and replace it with a series of more
19 narrowly focused exemptions to achieve
20 disaggregation.

21 So essentially, part 151, or position
22 limit regime, sets up three basic grounds for

1 disaggregation. The first area where
2 disaggregation is going to be available would be
3 for passive pool investors who have an interest
4 between 10 and 25 percent ownership -- investment
5 interest of between 10 and 25 percent in a pool.
6 Now, keep in mind, you know, otherwise, again,
7 being over 10 percent they would have otherwise
8 presumptively had to aggregate their position with
9 the pool's positions.

10 Anyway, the basic requirement is that
11 the investor in the pool doesn't supervise or
12 control the pool's trading in any way. The pool
13 operator has to have written procedures in place
14 to prevent investors from gaining knowledge of the
15 pool's trading strategies or positions. And also,
16 the pool operator is going to have to apply and
17 receive disaggregation relief from us so that we
18 will essentially evaluate the procedures that they
19 have in place to ensure a Chinese wall around the
20 information that they have. Again, this is only
21 for that band between 10 and 25 percent ownership
22 interest.

1 A second area of disaggregation
2 potential is for FCMs with respect to
3 discretionary accounts. FCMs who have trading
4 programs where the FCM doesn't control the trading
5 or maintains minimum kind of management to control
6 over the trading decisions and the account and
7 they have to be independently-made decisions from
8 the other trading decisions that the FCM is making
9 in his accounts.

10 And then finally --

11 CHAIRMAN DUNN: David, I'm sure everyone
12 knows what an FCM is but just for me, would you --

13 MR. VAN WAGNER: Oh, I'm sorry.

14 CHAIRMAN DUNN: -- would you explain
15 what it is and give me an example?

16 MR. VAN WAGNER: Well, an FCM is a
17 futures commission merchant. And we're
18 essentially talking about the largest investment
19 banks, I guess, to simply it.

20 An example. Do you want a name? Okay.
21 And in any case, and then there's a last category
22 of disaggregation. It's an awkward mouthful.

1 It's the owned nonfinancial entity category. So
2 it's essentially -- it allows an entity to
3 disaggregate the positions of a nonfinancial
4 entity, generally a nonfinancial operating
5 company, in which the investing entity owns a 10
6 percent or greater interest. So then the entity
7 that is seeking an exemption is going to have to
8 demonstrate that the nonfinancial entity, the
9 target of investment, is independently controlled
10 and managed. And then the regs, or proposed regs,
11 set out a list. And it's a nonexclusive list but
12 it's a list of basically sort of indicative of
13 independence. And some of those areas are the
14 entities have no knowledge of each other's trading
15 decisions, the nonfinancial entity has written

16 policies and procedures in place to preclude
17 knowledge of its trading strategies and positions,
18 and then the two entities, the investing entity
19 and then the nonfinancial entity in which the
20 investing entity has an ownership interest have
21 separate employees and risk management systems.

22 I should say, I mean, obviously these

1 are the three basic categories of disaggregation
2 we'll say or at least aggregation exemptions. One
3 thing that's sort of very philosophically
4 different from our current aggregation
5 requirements where the exemptions are essentially
6 self- effectuating and there's really no prior
7 submission or notice to us or any sort of approval
8 by the Commission. With each one of these
9 exemptions there's some level of vetting with the
10 Commission prior to being able to obtain
11 exemptions. So that's it, I guess, in a nutshell
12 for a fairly technical area.

13 MR. AMATO: So I want to talk a little
14 bit about the bona fide hedging exemption
15 proposal. In the Dodd- Frank law, Congress
16 directed the Commission to write a bona fide
17 hedging definition and they left out a word which
18 has in the past allowed the Commission's
19 regulation for bona fide hedging -- that's 1.3Z --
20 to have a third part of it. So 1.3Z3 allowed
21 nonenumerated hedging exemptions. And those
22 exemptions were granted under our commission

1 regulation 1.47. For example, it allowed us to
2 grant swap dealers risk management exemptions
3 without regard to the characterization of the
4 counterparties' positions. Congress narrowed bona
5 fide hedging and directed the Commission to write
6 a new definition.

7 So in the proposal there's a new
8 definition for bona fide hedging. It provides
9 that in general the transactions must represent a
10 substitute for physical market transactions in the
11 case of physical commodity futures contracts. The
12 Commission can retain the existing provisions for
13 financial contracts on things like interest rates
14 and stock index futures, but for physical
15 commodities we can no longer allow a bona fide
16 hedging exemption for any risk management
17 activity. Instead, Congress narrowed that and
18 said to the extent a swap counterparty would have
19 been bona fide if they had approached the futures
20 markets directly, then the counterparty to that
21 transaction can use futures and essentially step
22 into the shoes of who would be their bona fide

1 counterparty. In that way, a swap dealer would be
2 allowed to manage the risk that they acquire by
3 providing risk management tools to bona fide
4 hedgers using swap transactions.

5 So that's a little bit of why the bona
6 fide hedging definition changes and would be -- if
7 I have a minute, Commissioner, I'd like to touch
8 on basically a little bit of the information we
9 currently obtained so that the members can give us
10 an idea about what else we might need to obtain.

11 Currently, we obtain information every
12 day through the Commission's large trader
13 reporting position. I mentioned earlier that's
14 our hook. Once a trader is reportable, the
15 futures commission merchant that carries their
16 account reports the position each and every day to
17 the CFTC. We obtain a trade capture report from
18 each of our exchanges that lists the transactions
19 during the day by what they call accounts.

20 So for an example, an executing broker
21 has an account in the electronic system that may
22 have orders from many different customers but at

1 least we get a trade capture report that says
2 these are the transactions that occurred for a
3 particular executing broker within the executing
4 broker's omnibus account.

5 And then finally, we can get access to
6 the orders that are input during the day, and
7 that's an enormous number of messages in these
8 electronic systems -- the bids and the offers.
9 And currently, quite frankly, we don't have the
10 resources to receive and process an order book on
11 a day in and day out basis, but we can inquire on
12 specific time periods and drill down and determine
13 what's the nature of the orders that are being
14 entered.

15 Under the broader proposals under
16 Dodd-Frank, and to facilitate both surveillance of
17 the swaps markets in setting and enforcing
18 position limits, the Commission has a swaps
19 position reporting rule that's out as a notice.
20 The comment period is closed and the staff has
21 summarized the comments. And the staff is busy
22 trying to finalize a recommendation to present to

1 the commissioners which essentially would create a
2 large trader reporting system for swaps as
3 reported to the Commission by swap dealers.

4 Down the road we'll get intraday
5 transaction information from swap execution
6 facilities, and down the road we will get
7 information from Swap Data Repositories that would
8 be comprehensive on commodity swaps. We would
9 receive either a lifecycle set of information from
10 a Swap Data Repository or perhaps just a snapshot
11 if it's an end- user exemption transaction. But
12 those are some of the other rules that will help
13 us increase the richness of the dataset so that we
14 can conduct surveillance in the full market for
15 commodities both in futures and in swaps.

16 And I would be happy to answer any
17 questions.

18 CHAIRMAN DUNN: I would open it up to
19 the Ag Advisory Committee. Remind you that
20 although we've already received over 12,000
21 comments on this particular subject matter,
22 everything that you say here today will also be

1 taken into account as part of the comments. So
2 you're going to get -- you get another bite of the
3 apple here. Also, because we are in the
4 rulemaking process, if you would address your
5 questions to the staff and not necessarily to the
6 commissioners, because we can't give you that give
7 and take as much as we might like to.

8 So with that I will open it up to the
9 Commission or committee for --

10 COMMISSIONER O'MALIA: Oh, Mr. Chairman,
11 I have a question regarding the bona fide hedge
12 requirements. Maybe this might form some
13 questions as well.

14 Steve, can you -- what impact will the
15 change in the bona fide hedge rule have on the
16 positions that we see today? You mentioned in
17 some of your earlier slides this is what the open
18 interest and the rules -- how that would play out.
19 Does that include changes in the bona fide hedge
20 definition?

21 MR. SHERROD: Interesting question. I
22 have to think about it for a minute.

1 There are a number of changes in the way
2 that we would approach bona fide hedging. Much as
3 David mentioned, there are a number of changes in
4 the way we would approach aggregation. So for
5 setting the position limits we would use all open
6 interest regardless of whether a particular
7 trader's position was speculative or bona fide
8 hedging. In our exiting large trader reporting
9 system, the reporting system doesn't tell us
10 whether a particular trader's position is hedging
11 or speculative. It just tells us here are the
12 number of contracts open at the close of trading.

13 So under the existing rules in part 150,
14 we have traders, for example, that are holding
15 positions relying upon a self-executing bona fide
16 hedging exemption. In wheat, for example, we have
17 them file a monthly form that identifies the types
18 of positions in the cash market that are being
19 hedged, whether it's actual inventory of grain or
20 a fixed price purchase or a fixed price sale
21 contract. That information comes in once a month
22 from the commercials.

1 In the proposal, we would increase the
2 frequency of that collection. And so it would be
3 an additional burden to report more frequently on
4 the cash market positions that are being hedged.
5 That proposal, you know, I think about it in terms
6 of a bona fide hedger in the range of the three
7 different options that I laid out in the slide and
8 the additional options that were asked in the
9 questions about setting the level of the position
10 limits.

11 So a hedger, if we retained the existing
12 limits, would have an additional burden. If, for
13 example, the Commission were to adopt the formula
14 approach and substantially increase the position
15 limits from those that exist under part 150, then
16 a number of hedgers might no longer be over the
17 limit and they would have no reporting
18 requirement. So I hesitate to give a simple
19 answer because the proposed rule has a lot of
20 flexibility about how the Commission might
21 proceed.

22 COMMISSIONER O'MALIA: The bona fide

1 hedge changes are in the position limit proposal,
2 correct? And they require a rulemaking to be
3 effectuated?

4 MR. SHERROD: Congress directed the
5 Commission in Dodd-Frank to write a rule so the
6 existing bona fide hedging definition in 1.3Z is
7 in effect, 1.3Z3. 1.3Z3 would be the part of the
8 existing definition that would go away for
9 physical commodities. And that's the one that
10 allows us to have a bona fide hedge if it doesn't
11 represent a transaction be made in the physical
12 marketing channel but is more of an intermediary's
13 risk management trying to get flat on their
14 exposure as they provide liquidity to both
15 speculators and hedgers in perhaps the swap or
16 over-the-counter markets.

17 COMMISSIONER SOMMERS: On this same
18 subject, could you walk us through how the
19 reporting requirements might change for a swap
20 dealer who currently qualifies under 1.3Z3? Under
21 the new definition, how would they report with
22 regard to that look-through?

1 MR. SHERROD: So a swap dealer currently
2 that has applied under 1.47 has indicated their
3 needs for risk management and the staff under that
4 regulation gets 30 days to review it if it's an
5 initial application or 10 days if it's a change.
6 And the swap dealer then would need to keep
7 records under the current provisions. The
8 additional provisions, the swap dealer needs to
9 keep records about the representations of their
10 counterparties that have said they are bona fide.
11 And only those counterparties who are bona fide
12 will sort of count in this risk management regime.

13 So, for example, if a swap dealer has
14 100 contracts equivalent on the long side as their
15 exposure because there is a grain elevator that
16 wanted to short 100 contracts equivalent in a
17 swap, then the swap dealer, to the extent they
18 have that 100 contract long position with that
19 bona fide counterparty, can approach the futures
20 markets and go short 100 and rely upon a bona fide
21 hedging exemption. If that counterparty were a
22 speculator, then the swap dealer cannot exceed the

1 limit based on that speculator as a counterparty.
2 So they will have to identify in their books and
3 records the representations of their swap
4 counterparties at the times the swaps are entered
5 into, not on an ongoing basis but at the times the
6 swaps are entered into. And then the swap dealer
7 would need to make that available to us for
8 inspection if we wanted to review the details of
9 their counterparties.

10 COMMISSIONER SOMMERS: Okay, so they
11 don't report that to us? They're just required to
12 keep it?

13 MR. SHERROD: They wouldn't report the
14 details, no. Unless we asked for it. So there's
15 no -- there's no registration requirement, if you
16 will. The counterparty that's the bona fide
17 hedger to the swap transaction doesn't have to
18 file kind of a registration statement nor get a
19 registration number or anything on that side.

20 CHAIRMAN DUNN: With that we will now
21 open it up to the Committee. Roger.

22 MR. CRYAN: I like that approach. I

1 want to make one additional small comment about
2 cash settle contracts. There are some cash settle
3 contracts now that have scale down requirements on
4 the position limits which have no purpose, no
5 point. And I'd like to make sure that all those
6 things be considered as you're developing
7 individual position limits that you not put
8 one-size-fits-all things in where they don't fit.
9 And scale down requirements for cash settled
10 contracts is kind of pointless and actually to
11 quote Mayor Daley, it doesn't create disorder, it
12 preserves disorder. So, thank you.

13 CHAIRMAN DUNN: Todd.

14 MR. KEMP: A couple things. And I'll
15 address first the bona fide hedge exemption.

16 We actually told Congress we would have
17 preferred if they left it with CFTC to make that
18 determination. We think you all have done a good
19 job over the years. But having said that, we do
20 like the change in the definition that came out of
21 the legislation. We like the fact that a swap
22 dealer will only qualify for a hedge exemption to

1 the extent that the counterparty otherwise would
2 be a bona fide hedger. We think that the previous
3 -- the current risk management exemption basically
4 has been an open back door to futures markets in
5 an unlimited fashion for swap dealers and their
6 counterparties. In many cases those were
7 investors, funds, the massive-passives. We think
8 it's appropriate to put the brakes on just a
9 little bit and that it's a reasonable limitation.
10 I think that will aid in performance of some of
11 the enumerated ag contracts that have had some
12 challenges with convergence in recent years.

13 In terms of the -- in terms of the
14 position limits, we've, in our comment letter to
15 the Commission, we've supported retaining the
16 legacy limits that you all have proposed. We
17 think the current limits are appropriate for the
18 enumerated ad commodities. There are a lot of
19 moving parts right now with Dodd-Frank
20 implementation with changes to contracts in
21 Chicago and Kansas City. We think it would be
22 prudent to let those changes take effect. Let's

1 get the lay of the land and see how that all
2 shakes out before we look at increasing position
3 limits at least on the enumerated ag commodities.
4 And again, we think that will help in performance
5 of particularly the wheat contracts where we've
6 had some challenges.

7 CHAIRMAN DUNN: Thank you, Todd.
8 Others?

9 MR. WANDS: Steve and Dave, a terrific
10 presentation. Just a clarification.

11 It's been our contention that the index
12 funds have caused a dramatic increase in
13 volatility, especially in the smaller ag markets,
14 specifically the wheat contracts. So while I
15 didn't hear exactly you say index funds, where do
16 they fall in your bona fide hedging definition --
17 and then will you also be looking at the --
18 lifting those hedge exemptions or denying those
19 hedge exemptions that have been granted in the
20 past?

21 MR. SHERROD: So the first question is
22 is an index fund a bona fide hedger, and the

1 answer is no. So an index fund would be treated
2 as a speculator. And whether they approach the
3 futures markets directly or were opposite a swap
4 dealer, in neither case would there be a bona fide
5 that would pass to anyone. They would live within
6 the speculative position limits.

7 MR. WANDS: And in the exemptions that
8 have been granted in the past, would those be
9 lifted as well?

10 MR. SHERROD: In terms of the swap
11 dealers that have been granted an exemption under
12 1.47, the general approach that I think we should
13 recommend to the Commission and I think it makes a
14 bit of sense, the swap dealers have generally very
15 large -- some of them do -- very large books of
16 business. There are long side exposure and short
17 side exposure. The terms of the swaps may not
18 match and they hedge or manage the risk under the
19 existing regulations by plugging that imbalance
20 with futures contracts. So I think the way it
21 makes sense to phase out of the existing 1.47
22 exemptions is to grandfather the existing swaps.

1 And as those swaps age off the books, they would
2 not count anymore in their need for risk
3 management. They would not transfer over to bona
4 fide hedging.

5 So if, for example, a swap dealer had a
6 long exposure on a swaps that would last two
7 years, they could continue to manage that risk
8 with short futures for two years. Once that
9 existing book of business rolls off, the swap
10 dealer would be under the new provisions and would
11 no longer be able to use that risk management
12 provision. With the size of the positions that
13 are on in the swaps markets, I think it would be
14 disruptive to say to someone with a very large
15 futures position that is managing risk that you
16 need to get out and you need to somehow negotiate
17 your way out of lots of swaps if you want to
18 reduce your risk. So I think that's the only kind
19 of viable way to proceed without disrupting the
20 existing book of business.

21 COMMISSIONER CHILTON: Mr. Chairman, I'm
22 sorry, with respect to --

1 CHAIRMAN DUNN: Bart.

2 COMMISSIONER CHILTON: I can wait for a
3 moment, Mike.

4 CHAIRMAN DUNN: Okay. Thank you.
5 Jason.

6 MR. UNGAR: I'm sorry about that,
7 Commissioner Chilton.

8 With respect to maintaining the legacy
9 limits, which just for everybody's information
10 were set back in 2005 based on 2004 open interest
11 data, these markets have seen -- and the entire
12 futures markets have seen a tremendous increase in
13 volume. And I know that it has been the
14 contention of some of those who submitted comments
15 that some of this is, in fact, fictitious volume
16 that has come about through some have called them
17 the massive-passives.

18 The fact is though that this is, as most
19 of the, I believe, arguments against the massive
20 passives are simply anecdotal, when anybody
21 actually looks at the facts, and this has been
22 done routinely by many, many academics and

1 professional economists, you can very easily
2 discern. For instance, if you look at the COT
3 data, the fact is that commercial short
4 open-interest has increased in the ag markets
5 anywhere from 1-1/2 to 2-1/2 times more rapidly
6 than speculative long open interests. So the fact
7 is that long interest is meeting a growing and
8 robust demand from commercial shorts. And I think
9 those who have been in these markets for a very
10 long period can remember a time when there was
11 insufficient long speculative liquidity and that
12 commercial hedgers had to sort of go begging to
13 find liquidity.

14 So we, CMC believes that not only that
15 the limit should be set using the same formula
16 that's been proposed, I believe, quite wisely for
17 the other markets, that being the open-interest
18 formula, and should always rely on the previous
19 years and it should be done systematically. I
20 think that the process of increasing limits should
21 be reformed, that it should not be a petition
22 process so that there is some level of consistency

1 and predictability to these markets. And
2 therefore, I don't think that the ag should be in
3 any way, or the so-called nonexempt market should
4 be in any way differentiated from the other
5 markets and that this should be a reliable
6 process.

7 Further, also keep in mind that if we
8 were to keep the legacy limits, we are now
9 introducing an entire new player into these --
10 under these limits and those are the swaps. And
11 there are those who claim that there is not huge
12 agricultural interest in the swap markets but I
13 think that the fact is that a lot of the index
14 funds do have holdings and have been providing, I
15 think, very useful long speculative liquidity to
16 commercial hedgers. And that will now be brought
17 under limits. So the fact is that a large amount
18 of open-interest will now be -- that was
19 heretofore relied on the hedge exemption and was
20 not under limits -- will now be brought under new
21 limits. And I think that the open-interest
22 formula is a very rational, reasonable way and

1 again should be consistently applied across
2 markets and that the evidence or the hard facts
3 bear this out.

4 Thank you.

5 CHAIRMAN DUNN: Thank you, Jason. Bart,
6 you had a question?

7 COMMISSIONER CHILTON: Yeah, I was going
8 to follow up with Steve on the previous question,
9 although since that was talked about there I'll
10 just say very briefly I actually agree that we
11 need to update these legacy limits. I disagree
12 with about everything else you just said with
13 regard to massive-passives.

14 Here's what I know. There are so many
15 different economists who say different things on
16 this. And so when you say look at the facts, it's
17 whose facts do you want to look at? If you want
18 to look at the ones that say the massive-passives
19 are having an impact, go to CFTC.gov. Go to my
20 speeches and testimony. I put about 10 different
21 sites on there and some remarks I gave to FIA.
22 But you can find them on your side, too. They're

1 all over the map. You know, nobody I think is
2 suggesting that we don't need speculators and that
3 they're not important to these markets. And
4 nobody is saying that massive-passives are bad.
5 It's just whether or not they're having an
6 unintended impact on the market and we should put
7 some legitimate sideboards. Nobody is talking
8 about getting them out of the markets.

9 But my question, Mr. Sherrod, Steve, was
10 about the hedge exemptions. How would you
11 recommend to the Commission that we define who has
12 an underlying interest in the physical commodity?
13 You know, if there's a swaps dealer who has some
14 small interest in a home heating oil or something,
15 you know, would they be able to qualify -- I know
16 this is theoretical -- under the exemption? I
17 mean, one of the concerns I have is that, you
18 know, the exchanges have a view that they want
19 traded. I understand that. It's a business.
20 They want volume. But from our perspective, it
21 gets to the point where -- when Dave was talking
22 earlier about the financialization of some of the

1 commodities -- that's my phraseology -- but that,
2 you know, some of the financial players get in and
3 are using these markets as whatever. A hedge
4 against the dollar. Or some other hedging
5 strategy that's beyond what has been done perhaps
6 in the past.

7 So how would we define that? How would
8 you recommend to the Commission, Steve, that we
9 look at the specifics of a bona fide hedger? Do
10 they have to have some quantification of an
11 underlying interest in the physical commodity?

12 MR. SHERROD: So that's -- it's a
13 two-part answer. The first part is for decades
14 the Commission has recognized as bona fide hedging
15 anyone holding cash market positions. And anyone
16 that has entered into fixed price purchase and
17 fixed price sales contracts. And under the
18 current regime that's automatic recognition. You
19 don't need to file. You don't need to preapprove
20 with any of the Commission staff that you're
21 holding cash inventories. You don't need to
22 preapprove that your fixed price purchase or sales

1 contracts are okay. And under our existing
2 definition and 1.3Z, if you're cross hedging, you
3 don't have to file that either. That is if your
4 expected price fluctuations in the cash commodity
5 that you hold are related to the price
6 fluctuations in the futures that you will use to
7 hedge then, that's a provision that's currently in
8 our 1.3Z bona fide hedging definition.

9 There are certain types of positions
10 that need preapproval under the current rules and
11 also under the proposed rules. And those would be
12 anticipated transactions. So if, for example, a
13 producer of a product uses as an input a physical
14 commodity and they have anticipated needs for the
15 next year under our current rules, we require that
16 anticipatory hedger to file their annual needs
17 over the last three years and to project their
18 needs over the next year. And then the staff
19 would review their information and approve the
20 anticipatory hedge exemption.

21 There's a similar provision in this
22 proposal. And to go back to the example that --

1 the hypothetical that you posed, if a swap dealer,
2 in fact, had a heating oil business and an
3 affiliate, the heating oil business to the extent
4 they're buying heating oil or they're engaged in
5 fixed price purchase or sales contracts, they're a
6 bona fide hedger. Just because someone is engaged
7 in speculation doesn't mean they can't get the
8 bona fide hedging. And that goes back to the data
9 difficulties that we currently have. So someone
10 that's both engaged in speculation and hedging, we
11 get the positions every day and we have an
12 interest in having that hedger to the extent
13 they're over the limits provide us additional
14 information about the extent of their actual bona
15 fide hedging needs, whether it's cash or forward
16 fixed-price contracts.

17 So I hope that's responsive,
18 Commissioner Chilton.

19 COMMISSIONER CHILTON: Yes. Thank you.
20 And sorry to interrupt. I was just following up
21 on the other question. Thank you, Steve.

22 CHAIRMAN DUNN: Other members of the --

1 Jordan?

2 MR. LEA: Two things. One, my initial
3 reaction to your grandfathering in would be very
4 positive. I think it's a good idea and a way to
5 handle that. But secondly, going sort of the
6 massive-passive thing, I know you all heard a lot
7 about how we feel about massive-passives and what
8 happened in cotton in 2008 and how it sort of laid
9 waste to the industry. And the flipside, we're
10 facing a liquidity crisis in cotton. We're
11 looking at increased consumption, increased
12 production, and decreasing volumes in a horribly
13 illiquid market. Yesterday I tried to hedge 1,000
14 bales of cotton. Coincidentally, not the same I
15 was talking about earlier, and it took me -- it
16 took a one percent move in the market for me to
17 execute 10 contracts in the open -- that's just
18 unacceptable, ridiculous, whatever.

19 We would welcome the liquidity the
20 massive- passives provide but the only tools -- we
21 feel like the tools are almost there or
22 potentially there, and that would be surveillance,

1 enforcement, and transparency. In 2008, if we had
2 known -- if we could have seen the open-interest,
3 if we knew anything about the open-interest, it
4 would have been an entirely different situation.
5 But unfortunately, now we are in a situation where
6 we know nothing about the open-interest. And with
7 the new phenomenon of exchange for swap, the ETFs,
8 again, we're willing to participate and play as
9 commercial hedgers with that. We welcome the
10 liquidity at this point. It's the devil we know,
11 the massive-passives. The ETFs. But we just need
12 some sort of -- we need confidence that, one,
13 there's transparency. We need the transparency
14 and open-interest. But we also need confidence
15 that there's enforcement and surveillance.

16 It broke my heart to see on the Wall
17 Street Journal a few months ago that the \$16
18 million required for surveillance program was
19 going to be unavailable because we felt like as
20 merchants that was probably the most valuable tool
21 that the CFTC was in the process of offering us so
22 we could know more about the securities of our

1 markets.

2 CHAIRMAN DUNN: Any other comments or
3 questions?

4 MR. HICKS: Steve, you mentioned omnibus
5 accounts. The FCM that's carrying the omnibus
6 accounts, are they -- do you have access? Can you
7 see? Is there a transparency where you can see
8 the breakdown of what the FCM is carrying on those
9 omnibus accounts?

10 MR. SHERROD: So the breakdown is in two
11 different ways. The first breakdown is the FCM
12 reports every day the end of the day positions for
13 reportable traders. So we can see at the FCM
14 level the large positions that are reported each
15 and every day. Where it's a little more difficult
16 for us is the transactions that are completed.
17 When the FCM uses a single account, an omnibus
18 account, and executes orders, much as the 10
19 contracts for your firm and maybe contracts for
20 many other firms through a single account in the
21 trading system, then those are orders. And in
22 order to look at the order level detail, that's a

1 set of information that we have to get by
2 inquiring to the FCM to find the identity of the
3 individual order levels.

4 MR. HICKS: You will only do that if
5 there's a cost. I mean, if you have a reason to
6 do that. I mean, it isn't a random thing that you
7 would do it, right?

8 MR. SHERROD: That's correct. That's
9 correct. Now, a number of firms that approach the
10 electronic trading platforms directly, so they're
11 direct market access participants, they had their
12 own accounts and then we know for those very large
13 and very fast transaction accounts we can get the
14 identity of those accounts directly and see in the
15 daily trade capture report what they've done each
16 and every day. It's the smaller customers that
17 execute through FCMS through orders that we can't
18 see unless it's an inquiry back to the FCM.

19 MR. CLARK: Mr. Chairman, I apologize
20 for being later earlier this morning. I just want
21 to let you know and I want to commend you as well
22 for all the good work you've done on this

1 committee and on the Commission generally. And I
2 really want to commend all the commissioners. I
3 mean, I think with respect to agriculture, you
4 know, since it's sort of the origin of the futures
5 market, I think all of us feel like, of course,
6 the people in this room around this table, of
7 course, feel like agriculture is special. And we
8 all understand at the same time the way these
9 markets have grown, you know, around that sort of
10 core. And we appreciate the fact that everyone at
11 the Commission, particularly the commissioners, go
12 out of their way, I think, to acknowledge and
13 recognize how these markets are still different
14 and special in many respects. I just want to
15 acknowledge that and thank you for it.

16 And with regard to Dodd-Frank -- and I
17 do have a question -- but with regard to
18 Dodd-Frank, I just want to say -- I want to
19 commend everybody at the Commission, the
20 commissioners and the staff, because, you know,
21 Congress heaped a huge amount of work -- I know I
22 don't need to tell you -- on the Commission in

1 this regard. And since they've done that I know
2 you've had everybody around this table, everybody
3 in the audience, people in the press, people in
4 the industry, people at the other end of the
5 street, all telling you you should drive faster,
6 you should go slower, you should take our foot off
7 the accelerator and put it on the brake, put the
8 car in reverse. And you have an unenviable job.
9 So I just want -- I know you're all working very
10 hard and you've been given some impossible
11 deadlines.

12 CHAIRMAN DUNN: I know you're going to
13 want something now, Fred.

14 MR. CLARK: No, actually I just have a
15 pretty simple question. And that is with regard
16 to position limits -- and I'm asking because I'm
17 either ignorant or I've half forgotten -- does the
18 rule with the 12,000 comments include the position
19 limits across the spectrum of commodities? Not
20 just agriculture but also energies and everything
21 else? And is there any -- and can you inform us
22 all as to what expected timing is when you might

1 do a final rule? And then also whether it's your
2 intention, if you can say, to do a single rule
3 that covers all those commodities? Or I know
4 there's been a lot of people in other places
5 suggesting maybe some should be early harvested as
6 opposed to others. I'm just curious if you can
7 comment on sort of that set of issues and timing.

8 MR. SHERROD: So the good news for staff
9 is the 12,000 comment letters cover all 28
10 physical commodities. So it's not 12,000 just on
11 agriculture.

12 But the bad news is before we can move
13 forward we, under the Administrative Procedures
14 Act, need to consider each and every comment
15 letter, summarize them, and then consider how
16 we're going to respond to those comment letters.
17 We are driving to try to finish that first step of
18 reviewing and summarizing the comment letters by
19 the end of this month, in May. And then we have
20 the difficult task of trying to formulate
21 responses, which ideas that we want to try to
22 incorporate, which ideas that we don't think we

1 should incorporate, and formulate recommendations
2 for the commissioners and begin the process of
3 discussing with the commissioners the different
4 comment letters, the staff's views of the comment
5 letters, and get the input from the commissioners.
6 So how long that would take, I really can't
7 forecast.

8 The third part of the question is
9 whether different pieces of the rule could be
10 voted on separately. I think the answer, legally
11 David, is yes. Whether the commissioners want to
12 take that approach, again, I can't answer.

13 COMMISSIONER GENSLER: Commissioner
14 Dunn, I don't know if I'm allowed -- am I allowed
15 to answer any point?

16 CHAIRMAN DUNN: Yes.

17 COMMISSIONER GENSLER: There's another
18 role that's very related to this that we -- I want
19 to say we probably proposed in the fall -- we
20 didn't get 12,000 comments but Steve could tell us
21 -- called large trader reporting. And that's so
22 that we -- the Commission could be more informed

1 but ultimately the public could be more informed
2 on data. And so I could maybe ask Steve Sherrod
3 the same question. How many comments do we have
4 and what sort of timing? Because the large trader
5 reporting might be more ripe in a sense because it
6 was proposed earlier, fewer comments, and it's
7 about just getting data.

8 MR. SHERROD: So you're asking me a
9 number question and I don't remember the answer
10 but it's not thousands, it's more like dozens of
11 comment letters on the swaps position reporting
12 rulemaking. Staffs review the comments. We're
13 ready to begin the process of briefing the
14 commissioners on our recommendation. And then it
15 would be up to you, as the chair, to schedule when
16 it might be considered.

17 COMMISSIONER GENSLER: I was just
18 noting, I mean, there's proposals we've made.
19 There's every bit a reason that you've focused on
20 other things like running your business and so
21 forth but this large trader reporting role is
22 something we might also be able to move in a more

1 timely fashion and start to get data.

2 CHAIRMAN DUNN: The amount of
3 information since my tenure here, the Commission
4 has tried to be more transparent with the data
5 that we have. The Commitment of traders has
6 evolved over time. I think at one time we were
7 contemplating changing it and one of the questions
8 that we asked was should we keep the commitment to
9 trade report. And I think David said he got a
10 reply that said it's the only thing you guys do
11 right. Why would you get rid of that? But all of
12 that information has spawned many of those reports
13 that Commissioner Chilton talked about. And there
14 are reports that have been sent to us as part of
15 the comment on position limits. And so if you

16 want to find those on both sides of the issue,
17 those are on the website under those comments.

18 Let me recognize Christine from the CMC.

19 MS. COCHRAN: Excuse me. I'm sorry.
20 Jason, I don't mean to take over the microphone,
21 but I had a couple of questions that I wanted to
22 get some clarification on. And the first one was

1 on this anticipatory hedge exemption that you were
2 talking about. Just so that I'm clear, that,
3 however, would not apply to commercial
4 merchandising firms. So those types of firms that
5 take those types of positions, they would be
6 classified as speculative. Correct?

7 MR. SHERROD: To the extent that a
8 merchandiser would not have a fixed price purchase
9 or sales contract, that's correct. They would be
10 speculative. That's consistent with the existing
11 approach.

12 MS. COCHRAN: Okay. The other question
13 that I had related to -- relates to if you're a
14 commercial firm, you're going to be required to
15 track. And again, I apologize. This may be
16 somewhat repetitive but I just want to make sure
17 I'm very clear on it. You are going to be
18 required to trace your sale or purchase agreement
19 in the cash market to your position in the futures
20 market and report that on a daily basis. Correct?

21 MR. SHERROD: Not on a one-to-one basis.
22 So a commercial firm that, for example, has an

1 inventory of wheat, they'll report their total
2 inventory of wheat for the day. To the extent
3 they're over a position limit they'll report that
4 because they need to avail themselves -- to be
5 over the position limit means you have to have a
6 very large amount of wheat indeed because these
7 limit levels are rather large. So it's going to
8 be a large commercial firm reporting on their
9 current inventory position and as well, if it's
10 applicable, their fixed price purchase and sales
11 contracts as a daily matter. Right?

12 MS. COCHRAN: All right. Thank you.

13 COMMISSIONER GENSLER: Steve, is that
14 only if somebody is actually over the number? I
15 mean, so for the thousands of farmers that won't
16 be anywhere near these numbers, they don't have
17 any -- they don't have to track anything, do they?

18 MR. SHERROD: Well, they have to track a
19 lot of things but none of those have to do with
20 the futures market.

21 COMMISSIONER GENSLER: Yeah, but nothing
22 to do with us.

1 CHAIRMAN DUNN: Other questions or
2 comments from the Committee?

3 MR. WANDS: Commissioner Dunn, I have
4 just one more question.

5 I want to get -- and I don't want to
6 beat the drum here to death but on the index
7 funds, let's say a year ago a pension fund decided
8 to invest in a commodity fund, Goldman Sachs, just
9 to name one, commodity fund. And they elect to
10 stay in that commodity fund for a period of years.
11 So how would -- would they be phased out of this
12 eventually if, you know, they're going to treat
13 this like an asset class and they're going to stay
14 in commodities as they broaden their portfolio or,
15 you know, spread their risk out over their
16 portfolio, how is that going to change? Or is
17 this structure going to change that?

18 MR. SHERROD: So let me try to kind of
19 parse through that. There are two different
20 answers depending upon whether the pension fund is
21 entered into a swap with a swap dealer that has a
22 risk management exemption currently. In that

1 case, the swap dealer would be able to retain
2 their hedge exemption until the swap expires. In
3 the second case, a pension fund or other
4 speculator investing in a commodity pool that
5 invests or takes positions in futures contracts,
6 the commodity pool would be a speculator and they
7 would be subject to the limits. So as their
8 existing positions in futures expired, they would
9 need to get down to whatever the applicable
10 position limit was.

11 COMMISSIONER GENSLER: Jordan, can I ask
12 you a question about the cotton market just
13 because we're here? You mentioned the lack of
14 liquidity or less liquid certainly than wheat and
15 corn and so forth. Do you have a sense of why
16 that is? I mean, of course, it's a smaller market
17 but beyond just being a smaller market than the
18 oil markets or the wheat markets, why do you think
19 it is?

20 MR. LEA: It's a variety of concerns and
21 I was -- every time somebody says something, of
22 course, I want to pipe in but it's not my arena.

1 But going back to the first presentation, the
2 increase in volatility has probably led to an
3 increase in anxiety and I am sitting next to a
4 banker but banks -- there's a lack of financing.
5 There's a lack of -- there's a general lack of
6 participation, especially by the merchandising and
7 the cooperative community. I don't want to drag
8 Kevin unwillingly into this conversation but
9 because the marketplace has changed so
10 dramatically since 2008. We have a new exchange.
11 The ICE that we work with. It's no longer the old
12 exchange that we owned and operated ourselves. So
13 it's a different set of rules. It's more the
14 anxiety -- and I'm not criticizing the ICE. I
15 think they've done a good job this year of
16 managing a very volatile cotton market but their
17 rules -- it's not a CFTC situation as much as it
18 is an ICE situation. There's just a lot of
19 anxiety about a merchant's ability to establish,
20 or a co-op's ability to establish and maintain a
21 hedge.

22 We feel like the actual withdrawal of

1 commercial hedgers is the primary lack of
2 liquidity and when you couple our
3 non-participation, what you've seen is an increase
4 in volatility because of the lack of liquidity.
5 For example, I spoke with the guys in our -- the
6 representatives in our office here. I was talking
7 to Jim Newsome about it yesterday, about people
8 that want to participate in cotton from a

9 speculative standpoint within their limits but
10 don't because of the lack of liquidity. In other
11 words, they can't establish and maintain positions
12 because the market is so illiquid and reacts. So,
13 I mean, so volatile. I mean, well, so much in
14 either direction.

15 Honestly, I wake up every morning and
16 recheck the market and I know it's going to be
17 three cents -- it's going to move three cents. I
18 just don't know which way or why. And again, the
19 problem there is probably not fundamental. It's a
20 lack of liquidity issue. But it's apprehension
21 over participating based on, like I said, an
22 unavailability of funds, who's participating, and

1 what happened in March of 2008. For example, in
2 March of 2008, we had about 110,000 bales in my
3 firm and 807 short futures. Now I've got probably
4 60 short futures and about a 30,000 bale position.
5 And it's all because of, again, the expense of
6 hedging and apprehension over my ability to manage
7 risk.

8 COMMISSIONER CHILTON: Mr. Chairman?

9 CHAIRMAN DUNN: Yes.

10 COMMISSIONER CHILTON: I wanted to ask
11 Jordan a follow-up question on that. I don't have
12 any data but it seems to me, based upon the
13 notices that we've been getting, that we probably
14 had more limit ups and limit downs in cotton,
15 certainly than in recent years. And when I looked
16 at the first part of the year, the end of January
17 and the beginning of February, it was mainly limit
18 ups then. And of the, I think it was 14 -- it may
19 be 13 but I think it was 14, 11 of those limit ups
20 were occurring before trading even opened in New
21 York. So it was the overnight markets. And my
22 question, Jordan, is whether or not you think that

1 overnight trading where maybe it's the Chinese
2 coming and, look, you know, it's great to have
3 people in our markets, but I'm just curious when
4 there's light liquidity in these overnight hours,
5 whether or not even a relatively small trade
6 occurring when there's not a lot of people trading
7 can move the markets that way and if that is a
8 concern. Should -- some people suggested that
9 maybe the overnight hours be reduced to some
10 extent. I'm just curious your thoughts on that.

11 MR. LEA: My thoughts personally would
12 be yes, that is an issue and a problem. We met
13 last week here in Washington, I guess a week ago
14 today with the ICE. And the ICE, at our request,
15 provided us with some very useful information
16 regarding nighttime trading and when volumes were
17 being done. And I don't have it with me but about
18 60 percent of the volumes being done during our
19 traditional hours, which is sort of 10:30 Eastern
20 to 2:30, they, you know, we've had various
21 proposals to stay open when the Chinese markets
22 are open and close again. I would say the

1 American Cotton Shippers as a policy would like to
2 probably see less trading hours, primarily not so
3 much as a lifestyle issue because my company
4 doesn't -- we're not represented in Asia by
5 futures traders but most firms are. So managing
6 that is not a problem. It's just to concentrate
7 liquidity and create efficiency in the
8 marketplace. And we don't all agree that that
9 would solve that problem but it's obviously common
10 sense and our opinion would tell you that if more
11 business was being done in less hours like it used
12 to be, then we probably would see a more efficient
13 marketplace.

14 In those situations you mention this
15 year, again, ICE was very helpful. We went back
16 and looked and on a couple of those 14 occasions
17 you mentioned, it was literally like nine
18 contracts that locked the market limit up. And we
19 have a new provision now that when the market --
20 the options market, you know, if the markets limit
21 up, we can use derivatives or options to get out
22 of our position but if options are double limit

1 up, then the market closes. And there was a three
2 contract order that when the market was about 150
3 points from limit up on one particular day, a
4 three contract order forced the market limit up
5 and closed the market. Obviously, that makes our
6 situation as commercial hedgers very difficult.
7 So long story short, you asked me what time it is
8 and I'm trying to explain how to make a watch, but
9 yes, we think that -- my opinion would be that
10 less trading hours or the trading hours aren't
11 part of the problem. It's very thin at night and
12 less trading hours would be beneficial to the
13 efficiency of the marketplace.

14 COMMISSIONER CHILTON: Thanks.

15 MR. WESTON: Thank you very much and I
16 apologize also for being a little late. We had
17 our annual --

18 CHAIRMAN DUNN: You're excused, Ryan.

19 MR. WESTON: We had our little world
20 sugar dinner last night in New York and I
21 appreciate your staff being so helpful keeping me
22 filled in on what was going on. And I'm sorry I

1 missed the surveillance portion. I was very
2 interested in that.

3 But I would like to bring up -- it was
4 actually very good because I was talking to all of
5 our traders and everyone else last night that is
6 in this and our industry has become much more
7 vertically integrated so we're going all the way
8 from the field hedging on the futures market.
9 People are more interested in what will be
10 happening with the swaps market.

11 And I would like to say where we've got
12 the 11 world contract and the 16 domestics, we
13 haven't had a lot of problems but we're a lot
14 smaller on the domestic side, obviously. Much
15 like cotton. So we are following this closely,
16 and if there's going to be any changes between how
17 the world market is regulated versus the domestic
18 market, and there's probably been more glitches
19 right now in the world market, not many, but it is
20 something I think our traders are watching, our
21 people in charge of hedging are paying attention
22 to. And I hopefully plan on talking to ICE a

1 little bit about those in the future. But I do
2 appreciate the workload and appreciate, you know,
3 I guess I've got great respect for what you are
4 dealing with, much like Fred said. But we will
5 try to stay as involved as possible as you go
6 forward because I think now with our end-users
7 trying to figure out who the bona fide hedgers are
8 going to be, our companies are a little interested
9 -- are interesting in the fact that they grow it
10 at the beginning and then are selling it all the
11 way through the end process. So we actually hedge
12 probably a couple different ways depending on what
13 the product is, if it's the raw sugar or the
14 refined sugar at the very end.

15 I appreciate your time. Thank you.

16 CHAIRMAN DUNN: Commissioner Sommers.

17 COMMISSIONER SOMMERS: Thank you, Mr.
18 Chairman. I have one other question with regard
19 to the proposed limits. And the charts that we
20 have in the packet are with regard to the all
21 months. And I'm wondering if under our proposal
22 the changes -- are we also proposing changes to

1 spot-month limit based on deliverable supply? So
2 is deliverable supply now different than it was
3 when we set that or the exchanges, either one, set
4 spot-month limits? And if we believe that
5 spot-month limits will go up at the same kind of
6 levels that we're seeing here, the levels that are
7 based on open-interest?

8 MR. SHERROD: For the 28 commodities
9 that we have, the spot-month limits, the exchanges
10 essentially set those limits. Under the proposal,
11 once a year the exchanges would provide data and a
12 recommended spot-month limit that the Commission,
13 if we validate the exchanges' information, the
14 Commission then would adopt that spot-month limit
15 for the following year as the outerbound. Each of
16 the DCMs, the designated contract markets, could
17 set a limit on their exchange at that level or
18 lower. So if the exchange had a concern that the
19 deliverable supply was shrinking during the year,
20 they could set and administer a lower level. And
21 that's currently the case in our part 150 limits
22 where the exchange can petition to make them

1 bigger but they have the leeway to set a lower
2 spot month limit.

3 The formula that we proposed is
4 generally consistent with the current guidance to
5 the exchanges. We've certainly received comments
6 on the specifics of how the deliverable supply
7 should be estimated and how we should then take 25
8 percent of that to set the limit. There are some
9 comments regarding whether to the extent supplies
10 that are in storage that are subject to long-term
11 contracts should be considered part of the
12 deliverable supply. And so the staff is reviewing
13 those comments and we're going to try to make a
14 good recommendation to you as a commissioner.

15 COMMISSIONER SOMMERS: Thank you.

16 MR. HICKS: Jordan, I want to tell you
17 that the comments you made about the risk and
18 exposure and the lack of liquidity. When we were
19 sold a bill of goods on overnight trading, you
20 know, we needed to have -- to be able to trade the
21 crop reports before the Japanese. We needed to
22 have access to trading the news and the liquidity.

1 This was all supposed to help us and even the
2 NGFA, we support these things. But in the end,
3 I've come to the conclusion that it really doesn't
4 work in the best interests of the people around
5 this table who we represent because it helps the
6 speculation, it helps the volume, but it really
7 doesn't help the user.

8 We support, you know, when I was at
9 Cargill, we supported all of these concepts
10 because it was supposed to help. And in helping
11 us as commercials, it is also supposed to help the
12 farmer and the user and the cooperatives and that
13 extension piece. But somehow it creates the
14 revenue for the exchanges and the FCMs but it
15 really isn't serving -- it really isn't serving
16 us, I don't think, as users. I think if you
17 polled everyone that it represents, we wouldn't be
18 advocates for overnight trading anymore.

19 As the NGFA, I mean, you're outleading
20 grain organizations. You know, we were advocates
21 for this, just like we were advocates for the
22 Staggers Act and deregulation. But somehow this

1 whole process changes and the voice of the little
2 guy in this process gets drowned out by the
3 money-making opportunities we have for volume and
4 electronic trading. We won't get rid of
5 electronic trading because of the revenue it
6 generates. But it isn't in the best -- the farmer
7 hasn't generated any more additional need for
8 electronic trading. But the users on the
9 commercial side of the business, the spec side of
10 the business. I just think that's the issue. I
11 think that the volatility is connected to the
12 ability to trade more often and the user doesn't
13 -- the small guy doesn't get a chance to use this
14 process. I don't know, I guess --

15 MR. LEA: Edgar, I would absolutely
16 agree with you. I mean, we buy cotton during the
17 day. Because cotton is now consumed in Asia, we
18 sell cotton at night. We liked the idea initially
19 but it, unfortunately for my farm and I think in
20 general for the marketplace, it's probably been a
21 failure. It has created volumes but it also
22 inevitably has created illiquidity and

1 inefficiency in our marketplace to a degree to
2 which it's ultimately the farmer who is impugned
3 the most in the process. And oddly enough, about
4 two months ago, I guess actually it was in January
5 we started an initial series of conference calls
6 with the ICE as the Cotton Committee and
7 interestingly enough, they wanted to talk about
8 expanding hours. One of the purposes of the call
9 was contracting them.

10 MR. HICKS: Commissioner Dunn, it just
11 seems like, you know, this table, the issues that
12 we'd address, we're at odds with the exchanges a
13 lot of times. And it just seems like we're
14 automatically -- you ask us to come, we come here.
15 But how do we implement the voice that the
16 majority of us -- the ideas that we have? We just
17 somehow are at odds with the policies. Well, you
18 know where I'm going with this.

19 CHAIRMAN DUNN: I understand, Edgar.

20 COMMISSIONER O'MALIA: Steve, can I ask
21 a question on your last -- on slide five you
22 talked about trade capture reports, order book

1 data. What's it going to take for us to develop
2 an intraday surveillance system? How much time
3 and how much cost? And then how does that relate
4 to implementation of the standing up of Swap Data
5 Repositories?

6 MR. SHERROD: You ask the impossible.

7 COMMISSIONER O'MALIA: You had a
8 throw-away line that we didn't have the resources
9 so I'm trying to figure out what -- how much is it
10 going to take.

11 MR. SHERROD: So our head of technology,
12 John Rogers, would probably have the better handle
13 and estimate on it. John and his staff have been
14 working for quite a while to try to scope out the
15 storage devices that would be necessary to even
16 store the high electronic message traffic from the
17 order book. If we were to be able to store it,
18 that's great. But we have to be able to get the
19 data somehow. So that means a substantial
20 transmission capacity to us. Once we obtain the
21 data in the order book we have the same problems
22 with order book data that we have with trade

1 capture report that we as staff addressed with the
2 Commission in the ownership control and reporting
3 rulemaking to try to understand the codes -- the
4 short codes, the account codes -- that are used in
5 the systems to be able to tie the activity back to
6 particular traders or operator IDs as the CME
7 would use tag ID. And the scope of that I really
8 don't have the numbers but it's in the many
9 millions of dollars for the technology capacity,
10 both for transmission and storage and it's
11 likewise a significant number of staff to be able
12 to manage that process and a significant number of
13 staff to have effective programs to extract from
14 the great degree of data some usable information.
15 So I don't have specifics for you.

16 COMMISSIONER O'MALIA: Mr. Commissioner,
17 I was going to add one more thing based on what
18 Edgar said.

19 Edgar, one thing I would say about
20 electronic trading, when we eliminate electronic
21 -- when we eliminated our open outcry in
22 market-making, and Mr. Chairman, we eliminated,

1 you know, efficiency and liquidity in the
2 process -- and I might rue the day that I made
3 this part of the public record, but at this point,
4 and I don't know if it's through Dodd-Frank or
5 not, we would probably welcome the entrance in a
6 large way or a somewhat large way of algorithmic
7 or high volume traders. I know what happened in
8 cocoa and sugar this year and we don't like that.
9 We had entered conversations with ICE last week,
10 it seems like they have some circuit breaker ideas
11 that might be effective. But we need the volume
12 back. So inasmuch as I said I might hate saying
13 it, at this point because the exchange -- the
14 locals aren't coming back to the exchanges, we
15 need locals. And if it comes in the form of
16 (inaudible) we'd probably welcome it. And we
17 think farmers might realize a benefit as a result.

18 CHAIRMAN DUNN: Doug stepped away but
19 one of the comments that they had sent in from the
20 National Farmers Union and said they'd like us to
21 address was that -- it says -- the statement is
22 the CFTC should hold emergency meetings as

1 prescribed by Dodd-Frank early and often to ensure
2 that position limits are effective and meaningful.

3 Steve, are there plans to hold emergency
4 meetings? What are the folks in DMO going to do?
5 Is there a notification process to the Commission
6 that you think we should be having meetings on
7 this? How will that take effect?

8 MR. SHERROD: So I don't -- I don't
9 think -- I'll turn to David here but there are
10 very specific statutory requirements for
11 emergencies. And I don't think the conditions for
12 emergencies are currently in play. We do have
13 emergency authority under 87 but they are very
14 specifically prescribed circumstances where time
15 is of the essence actually and in certain ways it
16 seems sort of odd to have planned emergency
17 meetings but nonetheless, I mean, so I think the
18 circumstances this person is probably talking
19 about are potentially sort of structural problems
20 which I think are sort of meetings like this on an
21 ongoing basis are more helpful towards. But 87
22 actions, there's not actually a public meeting

1 requirement around them and there are very
2 specific sort of prescribed conditions.

3 But I can actually -- if there's an
4 implication of a Dodd-Frank provision I'm going to
5 have to take a look at that because I'm not
6 particularly familiar with what might be referred
7 to there.

8 COMMISSIONER O'MALIA: If you would, I
9 would appreciate that.

10 MR. SHERROD: Sure thing.

11 COMMISSIONER O'MALIA: Also, is there an
12 opportunity for folks, be it the AAC or even their
13 constituents that they represent to request an
14 emergency meeting from the Commission?

15 MR. SHERROD: To request an emergency
16 meeting? There are certainly -- not that I'm
17 aware of. There are certainly procedures around
18 petitioning us to force reg changes which might
19 force rule changes at the exchanges. There is
20 certainly that. But forcing emergency actions,
21 not that I'm aware of.

22 CHAIRMAN DUNN: Thank you. If we could

1 get the next panel to step up, please, if there
2 are no more questions.

3 And while the next panel is coming up --
4 it's Mark Fajfar and Lee Ann Duffy -- I would ask
5 the chairman to comment on a couple of things that
6 we also got questions on, and this was from the
7 CMC. They ask about the implementation timeline
8 and sequence of rulemaking and then international
9 harmonization effort and something that was
10 brought up at this last panel. So if the chairman
11 could quickly go over where we are on those two
12 issues.

13 COMMISSIONER GENSLER: A lot to cover
14 while Lee Ann and Mark are at the table. But on
15 implementation, the Dodd- Frank Act gives both the
16 SEC and CFTC latitude on setting effective dates.
17 It's not 100 percent latitude because it, of
18 course, has to be logical and so forth. We've had
19 some public roundtables and we've asked all of you
20 and the broad public to comment on effective
21 dates. And staff put out -- I guess it was about
22 three or four Fridays ago -- a list of concepts on

1 how -- I think there were 12 or 13 concepts in a
2 four-page document on thinking about
3 implementation.

4 But if we were successful over the
5 course of the rest of 2011 finalizing rules, just
6 because we finalized a rule in July of this year
7 or September of this year, October of this year,
8 does not mean that it would go effective in that
9 order. The order of effective dates could be
10 different. And in fact, I think you should all
11 anticipate it will be. If we can, for instance,
12 if after this discussion today, if we were able to
13 move forward and finalize rules on the definition
14 of agriculture commodity, you know, that that
15 doesn't need to wait.

16 The first concept in this 13 or 12
17 concepts was that it's lower cost to the public if
18 we phase implementation, if we don't have sort of
19 a big bang and everything has to be done on the
20 same day, the same month that it be phased. And
21 some of the concepts that it would be terrific to
22 get your feedback on and the staff concepts was

1 that the large infrastructures, meaning the
2 clearinghouses, the trading facilities, where
3 they're called swap execution facilities and
4 designated contract markets, and the data
5 repositories, that they have to get their
6 rulebooks in place before any market participants
7 really have to have what's called transaction
8 compliance.

9 And though just about all of you and
10 your members will be end-users -- I don't know
11 that there's anybody here that -- I know there's a
12 little bit of this debate about farm co-ops, but
13 let me just assume that you're all going to be
14 end-users for a moment and jump over that issue
15 for one or two moments. So there's not a clearing
16 requirement that would necessarily affect any of
17 your members but if the clearinghouses' rules were
18 finalized, if we were able to finalize them this
19 summer or early in the fall, then there would be a
20 period of time that the clearinghouses would have.
21 We have to come together on how much time but the
22 clearinghouses would have some time before they'd

1 have to comply with those new risk management
2 standards of the clearinghouse. The staff
3 concepts, just threw out an example and that's all
4 it was, it said could they possibly be open for
5 business and have their new rulebooks by December
6 31st of this year, of 2011. That was in those
7 concepts.

8 But even if that were the case, the
9 clearing mandate would follow afterwards. That
10 the clearing mandate, which would actually affect
11 financial entities, not your membership but
12 financial entities would follow later. And that's
13 sort of a concept. And so position limits is one
14 that we just discussed. If we were able to
15 finalize the large trader reporting rule it would
16 certainly be the hope of just the chairman -- I
17 can't speak for the commissioners -- that we could
18 finalize large trader reporting in the near term,
19 in the summer, so that we can start collecting
20 data. Obviously, if we have 12,000 comments on
21 position limits that might take a little while
22 longer.

1 But even in the proposed position limit
2 rule there was contemplating some phasing that the
3 position limit rule would be finalized, whether
4 it's this summer or early in the fall, you know,
5 whenever that's finalized. There's phasing even
6 contemplated in that position limit rule that we
7 need data. That that data needs to come in. What
8 we proposed, there had to be an order by the
9 Commission before the actual rule went into place.

10 So there's probably 20 more questions
11 that could come on phasing but we also opened a
12 public comment file on implementation phasing. We
13 opened that, I guess it was in April that please
14 send in thoughts. I think that comment file, and
15 it's just on our website, is open and I know it
16 will be open into June. On most of our rules, not
17 all of them but most of our rules we also reopened
18 the comment file for 30 days. That runs till June
19 3rd. As you see the whole mosaic it would be
20 really helpful to get feedback.

21 I don't know, Commissioner Dunn, if that
22 answers that first question. And the other one is

1 international harmonization. The staff here and
2 the commissioners have been working very well and
3 I think closely with regulators around the globe.
4 And Commissioner Sommers chairs our -- it's
5 another committee like this but a Global Markets
6 Advisory Committee. And Jackie Mesa gets all of
7 us when she can to travel overseas. Where it
8 stands is Japan moved actually before us, a month
9 or so before with a law last year. Europe is very
10 close. The European Parliament is considering a
11 law and it might take that up and vote on it in
12 the next few weeks. Canada already has its
13 authority so its regulators are starting to look
14 at implementing this.

15 There is a commitment amongst 20
16 nations. It's called the Group of 20 that was
17 made in September of 2009 to move forward on
18 derivatives regulation and have it in place by the
19 end of 2012. To have it effective by the end of
20 2012. I can't speak for all 20 of those nations
21 but I would say I remain reasonably optimistic
22 that Europe and the U.S. will be largely aligned.

1 We're different cultures, different political
2 systems. There will be differences. We will be
3 able to recognize their regulation to the extent
4 it's comparable and consistent. That doesn't mean
5 it has to be identical but it has to have some,
6 you know, consistency. That might be by topic
7 area and so forth. So there's a lot of work still
8 to be done and it's not just by the CFTC. It's,
9 of course, by the Treasury and the Federal Reserve
10 and the SEC and others as well trying to promote
11 harmonization.

12 Thank you, Mr. Chairman.

13 CHAIRMAN DUNN: Thank you.

14 MR. UNGAR: Mr. Chairman, if I could
15 just make one comment about phasing. I think it's
16 -- CMC certainly believes it's a great idea and
17 obviously preferable to instituting everything at
18 once. But I encourage you to keep in mind when
19 you're phasing these in the implications of
20 instituting, for instance, one part of a proposal
21 that it may have on current market participants.
22 For instance, doing away with the hedge exemption,

1 the swap hedge exemption before you raise limits
2 and the ags would be, I think, extremely
3 prejudicial to some of us. So I'm sure that you
4 have that in mind but we'd encourage you to, you
5 know, keep an open dialogue with regard to those
6 limits.

7 COMMISSIONER GENSLER: And I would
8 encourage you and others to please note those for
9 us. I mean, the one that you've raised is quite
10 clear. At least I can't speak for other
11 commissioners. To me they're sort of -- they have
12 a mutuality. Capital and margin is an example.
13 Again, not related to you, this group. But if --
14 when in doubt please note it in a comment letter.
15 Let us know so that we don't inadvertently miss
16 that mutuality of something.

17 CHAIRMAN DUNN: It was an elaborate sham
18 to tease these things out of you, Mr. Chairman, so
19 I can make my schedule for the rest of the summer.

20 With that if we'll turn to our third
21 panel. And we're going to be running overtime. I
22 apologize in advance. I ask my fellow

1 commissioners to please check your schedules, see
2 if you can stay. I am committed to be here as
3 long as we can and I apologize to members of the
4 Ag Advisory Commission. But your questions have
5 certainly warranted us being here taking this
6 extra time. So let's go with the swap dealer
7 definition and user exemptions.

8 Mark.

9 MR. FAJFAR: Good morning. We'll go
10 quickly through our presentations and get directly
11 to your questions and comments.

12 The rulemaking on the swap dealer
13 definition was a joint rulemaking with the SEC.
14 It was proposed in December. We got about 200
15 comments in meetings, including many from the
16 agricultural community. And as the chairman just
17 said, we've extended the comment period. Like
18 Steve said, we're reviewing the comments and then
19 we'll go to a final rulemaking when the Commission
20 is ready to do so.

21 The definition of swap dealer largely
22 follows the definition in the statute that sets

1 out four sort of ways of being a swap dealer or
2 holding yourself out as a swap dealer, making a
3 market, being commonly known as a swap dealer or
4 regularly entering into swaps as an ordinary
5 course of business. In the rule proposal, we
6 tried to think of looking at those factors and the
7 comments from the public. What are some of the
8 characteristics that distinguish swap dealers?
9 And what the proposal said were ideas such as
10 accommodating demand, facilitating other parties'
11 interests in entering into swaps, proposing terms,
12 engaging in the activities that are thought of for
13 swap dealers. And this is obviously an area where
14 we've had a lot of comment on whether these
15 particularly are the right characteristics, how
16 they should be interpreted, whether there are any
17 others. So that's what we're doing now, reviewing
18 those comments.

19 The statute also has an exemption for a
20 person who engages in a de minimis quantity of
21 swap dealing. So in the proposal we tried to
22 think of what would be a level that one could say

1 is de minimis, very small, an area that wouldn't
2 require -- somebody could engage in swap dealing
3 but not register as a swap dealer. So we set out
4 the four thresholds that you see on the slide.
5 And this area, also we've had a lot of comment in
6 this area about whether these are the right sort
7 of factors to look at or where the numbers should
8 be set. So we're going through those comments and
9 analyzing them.

10 There is also in the statute an
11 exclusion for swaps that are in connection with
12 originating alone and this is for insured
13 depository institutions, banks. And generally in
14 the proposal we've said that this would apply to
15 swaps that are connected to the financial terms of
16 the loan. An interest rate swap connected to a
17 loan would be a classic example. And in this area
18 we've had a lot of comments and we're looking at
19 this both from the perspective of the bank and the
20 borrower and how this exclusion would affect the
21 swap market overall. We're considering all of
22 those factors.

1 Generally, another thing that the
2 proposal went into was, especially for the persons
3 who are not explicitly holding themselves out as a
4 swap dealer, we're trying to think of how do you
5 identify what a swap dealer is. And what we
6 propose is to look at a person and say are you
7 fulfilling the role of a swap dealer? Are you
8 accommodating demand? Are you connecting people
9 to the swap market? And again, this is an area
10 where we've had a lot of comment and extensive
11 meetings. One of the real issues that we've had
12 to face and deal with is that this is a definition
13 that applies across all different types of swap
14 markets and we've had to sort of balance the idea
15 of trying to provide guidance that's specific to a
16 type of market versus having a rule that's fair
17 and applies, has a level playing field across the
18 board.

19 We've also -- the rule proposal also
20 provides -- proposed some indicators of what it
21 means to be commonly known as a swap dealer, you
22 know, contacting people to solicit their interest

1 in swaps, developing new types of swaps. These
2 are the kind of things that we would be looking at
3 -- propose to look at to determine if somebody's
4 commonly known as a swap dealer.

5 And the next topic in the rule proposal
6 was how you actually go about being designated.
7 How would the process work? And generally, what
8 we proposed was that people would look at their
9 own activities and decide whether they fall within
10 the definition. And then they would register.
11 And also important in the agriculture market, we
12 recognize that many companies use swaps for a very
13 wide variety of different purposes within the same
14 company. And so only a part of their usage of
15 swaps could be related to their swap-dealing
16 business. And then in that case you would
17 designate that part of your swap activities as
18 being the dealer and that part would register as
19 the dealer. And your other swap activities would
20 not be considered swap dealing. So there's a
21 process we proposed for the company to come in and
22 make an application to do that.

1 And lastly, obviously, we note that the
2 rule proposal did talk about how the rule on --
3 the swap dealer would interact with agricultural
4 swaps. In particular, we have a rule proposal out
5 on swaps and agricultural commodities and we asked
6 and we've received comment on a variety of
7 different topics on how the swap dealer definition
8 should be applied in the agricultural market. As
9 somebody said this morning, the agricultural swap
10 market is developed first in some ways and has
11 unique aspects that aren't part of other swap
12 markets. And as I said before, the real thing
13 that we're looking at in terms of the comments is
14 how do you balance wanting to provide specific
15 guidance for specific areas and be sensitive to
16 considerations over part of the market without
17 then having a balkanization of different rules for
18 different markets that wouldn't -- couldn't be
19 applied fairly across the board. So those are the
20 two interests that we're balancing.

21 CHAIRMAN DUNN: Thank you, Mark. Lee
22 Ann.

1 MS. DUFFY: The Commission approved
2 rulemaking for the end-user exception to mandatory
3 clearing of swaps in December. The initial
4 comment period closed in February and the comment
5 period --

6 CHAIRMAN DUNN: Lee Ann, could you move
7 your mic closer?

8 MS. DUFFY: I'm sorry.

9 CHAIRMAN DUNN: Or could they ramp up
10 the volume a little bit in there? Thank you.

11 MS. DUFFY: The comment period closed in
12 February but it's been extended until June 3rd.
13 We've received over 1,300 comments to date and we
14 continue to take meetings with commenters.

15 The general clearing mandate in
16 Dodd-Frank is section 2H1, which makes it unlawful
17 for any person to engage in a swap unless that
18 person submits the swap for clearing to a
19 derivatives clearing organization if such swap is
20 required to be cleared. However, 2H7 provides the
21 end-user clearing exception, which says that if
22 one party to the swap is not a financial entity,

1 is using the swap to hedge or mitigate commercial
2 risk, and a notice is provided to either a Swap
3 Data Repository or the Commission regarding how it
4 generally meets its financial obligations
5 associated with entering into non-cleared swaps,
6 it can avail itself of the end-user clearing
7 exception.

8 Credit risk generally is handled
9 differently for cleared and non-cleared swaps. As
10 proposed by the Commission, the end-user exception
11 requires 10 disclosures about how a counterparty
12 meets credit risk. An end-user must answer five
13 questions about how it meets its financial
14 obligations with respect to uncleared swaps. The
15 questions are whether there is a written credit
16 support agreement, whether it meets its financial
17 obligations by pledging or segregating assets,
18 whether there is a third-party guarantee, whether
19 the end-user relies on its own resources or
20 whether other means of meeting credit risk are
21 involved. The end-user must also identify itself,
22 you know, who they are, whether they are a

1 financial entity, whether they're a captive
2 finance affiliate, and if there is an SEC filer
3 involved, whether the entering into of the swap
4 has been approved by a committee -- an appropriate
5 committee of the board or an equivalent
6 institutional organization.

7 There is also a tenth question, whether
8 the swap is being used to hedge or mitigate
9 commercial risk. Not all swaps are eligible for
10 the end-user exception. Only swaps used to hedge
11 or mitigate commercial risk qualify. The
12 Commission provided guidance on the definition.
13 Swaps that are eligible for hedge accounting
14 treatment or swaps that qualify for the hedge
15 exemption from position limits or swaps that
16 reduce risks relating to an end-user's assets,
17 liabilities, or services qualify as hedging or
18 mitigating commercial risk. The Commission also
19 provided guidance about which swaps would not
20 qualify for the end- user exception. Swaps used
21 for speculation, investing, or trading don't
22 qualify. And swaps used to hedge another swap,

1 unless the first swap is used as a hedge, also
2 don't qualify.

3 The definition of hedging or mitigating
4 commercial risk in the end-user proposal is
5 virtually the same as the definition proposed in
6 connection with major swap participants. The
7 Commission proposes to determine whether a swap
8 hedges or mitigates commercial risk by analyzing
9 the facts and circumstances at the time the swap
10 is entered into, taking into account the person's
11 overall hedging and risk mitigation strategies.
12 In general, the proposed definition of hedging or
13 mitigating commercial risk would not encompass any
14 swap position that is held for a purpose that is
15 in the nature of speculation, investing, or
16 trading.

17 Dodd-Frank directs the Commission to
18 consider whether to exempt small banks, savings
19 associations, or farm credit system institutions
20 and credit unions from the definition of financial
21 entity as used in the end-user exception.
22 Financial entities, as defined in Dodd-Frank, may

1 not use the end-user exception. The exemption
2 being considered by the Commission would allow
3 small financial institutions to elect to use the
4 clearing exception. The Commission has requested
5 comments from the public on the question of
6 whether small financial institutions should be
7 exempt and staff is reviewing the comments
8 received.

9 Dodd-Frank requires notice to the
10 Commission of how the end-user generally meets its
11 financial obligations associated with entering
12 into non-cleared swaps. The proposed rule states
13 that the notice is to be provided through a Swap
14 Data Repository if one is available. The
15 Commission has proposed a check-the-box approach
16 to providing notification. At the time a swap is
17 executed, information regarding the methods used
18 to mitigate counterparty credit risk or the
19 financial obligation notice and other pertinent
20 facts are provided to the Swap Data Repository
21 along with information about the swap itself
22 that's provided to the SDR. The Commission's

1 oversight and enforcement effort for end-users
2 will depend upon the information that is submitted
3 this way to the SDR.

4 COMMISSIONER GENSLER: Commissioner Dunn
5 asked if I could just -- until he returns, chair
6 for a few moments. Why don't we open it up to
7 questions for Mark and Lee Ann.

8 Commissioner O'Malia.

9 COMMISSIONER O'MALIA: I have -- Lee
10 Ann, on page four we have the five questions for
11 end-users. In the margin rule the prudential
12 regulator doesn't take -- doesn't seem to be able
13 to take noncash collateral. Will we ask a
14 question whether you're able to post noncash
15 collateral to another bank and then to get cash to
16 meet, to satisfy the prudential regulator, is that
17 nuance captured in these questions?

18 MS. DUFFY: No.

19 COMMISSIONER O'MALIA: All right. Thank
20 you.

21 COMMISSIONER GENSLER: I just ask -- on
22 all of these, this is, if I remember, and this is

1 just a proposal and the rule could change, but
2 this was a check-the-box sort of thing. Congress
3 said that to be a commercial end-user you had to
4 be nonfinancial. You had to be secondly hedging
5 your mitigating risk. But thirdly, you have to
6 say how you're managing your risk. Is that right?

7 MS. DUFFY: Yes.

8 COMMISSIONER GENSLER: And so on the
9 third one it was just we have this form that you'd
10 have to -- the end-users would sort of check the
11 boxes.

12 MS. DUFFY: Yes.

13 COMMISSIONER GENSLER: We don't plan to
14 do more or less than that from our proposal. Is
15 that right?

16 MS. DUFFY: Well, we asked for comment
17 on --

18 COMMISSIONER GENSLER: Oh, yeah, we
19 asked for comment but I'm saying that if the
20 proposal were the final, we're not asking for
21 reporting to us or record-keeping to us. It's
22 just a form and the end-users check the

1 appropriate boxes on the form. Is that right?

2 MS. DUFFY: Yes.

3 MR. UNGAR: Okay. CMC has several
4 comments on this and would ask for some
5 clarifications. I think they all fall under the
6 general umbrella of what Christine mentioned
7 before about the possibility that some of the
8 hedge exemptions may be, in fact, as proposed, too
9 narrow going along with her initial comment about,
10 and I think dissatisfaction with the fact that
11 non-processors of food products would be, you
12 know, deemed speculative and not be allowed to be
13 -- to fall under the margin. I'm sorry, under the
14 hedge exemption. But if you could just please
15 clarify what you mean in the footnote 23 of the
16 end-user exemption. It's our understanding that
17 the Commission will not deem swap positions used
18 to hedge trading positions in the physical markets
19 as hedging commercial risk. Is that correct?

20 MR. FAJFAR: We've received comment on
21 that concept from a lot of different people on
22 what the distinction between hedging and

1 speculating in trading is. And we've received
2 multiple comments on each side going into
3 different industries. So we're going through
4 those on what that distinction would be and how it
5 would work in practice. This applies both for the
6 hedge exception and the major swap participant
7 test. So there's a lot of different
8 considerations. I couldn't characterize how
9 that's going to come out.

10 MR. UNGAR: We certainly appreciate that
11 that's a very -- the distinction between hedging
12 and speculating is a very difficult one to make.
13 And I would just encourage, or I think that many
14 of the largest speculators, and this goes back to
15 an older comment, you know, just because there may
16 be some small exposure to say heating oil in one
17 part of the business, that may represent only a
18 very small portion of the actual trading that's
19 going on. To me that seems -- and I understand
20 it's a huge devotion of resources, but in order to
21 make these, particularly for the CMC membership
22 and to ensure the hedging, that none of this --

1 none of the Dodd-Frank really messes up the
2 hedging ability either on the swap or the futures
3 side, would encourage you to as much as possible
4 draw those distinctions as clearly as possible
5 because to me it seems that the greater risk is in
6 the very large speculators who were, you know,
7 claiming hedge exemptions under the existing laws
8 just because of very small commercial exposure,
9 whereas, for instance, in the case that Christine
10 brought up before, you know, nonprocessors who I
11 think have a very viable argument that they are
12 hedging commercial risk would not be considered
13 hedgers.

14 CHAIRMAN DUNN: Mark, I believe it was
15 in the end-user proposal, proposed rule, there is
16 a question asked of whether the exemption should
17 apply to swaps just with the origination of loan
18 or at any time during the life of the loan. And
19 our position was that you should apply at any time
20 during the life of the loan because the swap would
21 still be used for the same financial transaction.
22 And I mention that just because I see it on page

1 six of the presentation.

2 MR. FAJFAR: We definitely -- we see
3 that comment from different people.

4 MS. PRESTON: Mark, this is American
5 Bankers and we have similar concerns about the
6 lending exception. And certainly in the
7 agricultural context it's very difficult to
8 determine for the producers what their needs are
9 going to be over the life of a multi-term loan.
10 You look at things like crop rotation. You can't
11 predict that five years in advance always. You
12 can't predict the weather conditions. So these
13 are types of things that are very important to us
14 as we look at loans to agricultural producers.

15 CHAIRMAN DUNN: Robbie.

16 MR. BOONE: Yes. Commissioner Dunn,
17 since this is the first time I've spoken today I
18 want to echo the sentiment expressed by others
19 around this group about your service before the
20 CFTC. I've only been at Farm Credit for a couple
21 of years but I know your long-standing public
22 service also included a time at Farm Credit

1 System. And thank you for that as well.

2 And also I guess what Fred indicated as
3 well with respect to Dodd-Frank, regardless of
4 your individual views and their varied -- I
5 appreciate all the commissioners public service
6 because it's been a lot of work I know by all the
7 folks that are in this room and at this table,
8 staff included. Thank you for having these items
9 -- the end-user exception swap dealer definition
10 being considered today. I guess we've filed
11 extensive comment letters on both and we'll let
12 that largely stand.

13 I did want to quickly note, however,
14 about just our latest earnings came out the end of
15 March, at least the first quarter. And as many of
16 you know, the system continues to perform quite
17 well. The overall notional value of our
18 derivatives contracts are now down to about 41
19 billion, but an interesting thing is that, you
20 know, you get down. The notional value sounds,
21 you know, rather spectacular but when you get down
22 to the exposure net of collateral, which is sort

1 of the all-important, sky is falling-type
2 situation, that's 204 million. Which, if you take
3 that to our total loan level, not total assets but
4 total loans now in the system are \$177.5 billion.
5 If you take that 204 million, I mean, that's in
6 basis points, that's 11 or 12 basis points for the
7 -- and again, that's just loan volume, not --
8 total assets are actually tens of billions higher
9 than that.

10 But when you start, you know, we would
11 argue, I guess, when you start talking about
12 things like interconnectivity, systemic risk, you
13 know, we would at least hope the Commission will
14 understand it's sort of an uphill climb to sort of
15 at least as far as the Farm Credit system is
16 concerned, that there would be, you know,
17 implicating the system into that sort of risk
18 structure, you know, we think would be quite a
19 reach. But at the end of the day, you know, and
20 again this is laid out in our comment letters, you
21 know, if the system is treated, you know,
22 differently here, we do think there is going to be

1 some meaningful impact as far as, you know,
2 increased lending costs to our farmer-rancher,
3 rural American borrowers. So again, I'll leave it
4 at that. But thank you all for having this on the
5 agenda today.

6 CHAIRMAN DUNN: Thank you, Robbie.
7 Others? Kevin.

8 MR. NATZ: Thank you, Chairman Dunn. I
9 appreciate you having the meeting today. I don't
10 have a question. I guess I have a big question
11 but I won't ask that today.

12 But I would like to pick up on some of
13 the others' comments in the room. Earlier today I
14 heard a lot of concerns about increased
15 volatility, increased margin costs, and liquidity
16 issues. And these would be three major reasons
17 why our membership, the co-ops, have started using
18 the over-the-counter market. For example, margin
19 costs this year, if you have limit-up in wheat and
20 corn and soybeans in one day you might be talking
21 to your banker that night. However, co-ops have
22 been able to alleviate some of those stresses by

1 entering into swaps. And that has freed up
2 working capital. And by freeing up that working
3 capital, they're allowed to continue the forward
4 contract with farmers. This happened in 2008 and
5 it's happening today. Without the ability to
6 enter into the swaps, it would be more difficult
7 to continue to enter into forward contracts with
8 the local elevator when prices are high and when
9 farmers want to engage in those contracts. As you
10 know, our concern has been being swept in as a
11 swap dealer and we're working through some of
12 those issues.

13 Another issue I looked at -- we made
14 some comments on the end-user rule and we did have
15 a few questions and it had to do -- I'm going to
16 assume that co-ops are end-users and they enter
17 into swaps with customers from time to time. And
18 how end-user to end-user transactions will be
19 handled as far as some of the data reporting, some
20 of the financial reporting. And looking at those
21 issues, I think it's going to take some time to
22 work through all of this, even for end-users to

1 figure out exactly what they need to do at the end
2 of the day. So we appreciate your comments about
3 phasing some of the rules in. And understanding
4 that agriculture tends to be a high volume, low
5 margin industry, just keeping in mind as all these
6 rules are being layered on and all the reporting
7 requirements, etcetera, etcetera, are being put
8 together, keeping in mind that at the end of the
9 day that's going to end up as a large aggregate
10 cost and it'll trickle on down to producers
11 eventually.

12 I want to recognize your staff and the
13 commissioners for being very engaged with us in
14 this process. We appreciate that. We appreciate
15 the commissioners' comments back in January
16 highlighting some of our concerns, and we look
17 forward to working with you and your staff moving
18 forward as the bill -- the act is implemented.
19 Thank you.

20 CHAIRMAN DUNN: Kevin, it strikes me
21 hearing from you and hearing from the
22 representative of the three financial institutions

1 that there is a lot that the industry needs to do
2 on their own of getting prepared for this. And we
3 would encourage you to be having those types of
4 meetings and talking, you know, with the financial
5 institutions if there are certain types of lines
6 of credits or other guarantees that may be out
7 there, that you begin working with those.

8 Mr. Chairman, I'm going to offer up your
9 staff, the CFTC staff to help attend those
10 meetings as we go forward. It's all part of the
11 implementation aspect of what kind of instruments
12 are going to be needed out there. Where are we
13 going with that? And I think it would be prudent
14 if we could get that type of assistance.

15 COMMISSIONER GENSLER: I think the staff
16 always stands ready to take meetings with the
17 public. I don't know, particularly as it relates
18 to what we're trying to accomplish, but I also
19 leave them sort of on their own if they have to
20 deny a meeting because they can't travel somewhere
21 and they've got to get their work done on these 50
22 or so rules, too. So hopefully you were chatting

1 about here in Washington.

2 CHAIRMAN DUNN: Or videoconferences.

3 Todd.

4 MR. KEMP: Just a quick comment. One of
5 the things we like about Dodd-Frank is that we
6 think it probably opens up some new opportunities
7 for risk management tools, particularly to be
8 offered to producers. The old ag trade option
9 regime which never worked falls away. Those kinds
10 of instruments will be easier for agribusiness
11 firms to structure now to offer to producers.
12 Under the swap dealer definition rulemaking,
13 however, we have very similar concerns as you've
14 heard from the co-ops. If a country elevator out
15 in the middle of Kansas or out in the middle of
16 Iowa is viewed as a swap dealer, defined as a swap
17 dealer, those kinds of new tools are probably not
18 going to be developed. I don't think any of our
19 members, to the extent they can avoid it, wants to
20 be a swap dealer, nor believes they're a swap
21 dealer.

22 So we would suggest that as the

1 Commission continues in its rulemaking process,
2 keep in mind the kind of business function that
3 these agribusiness firms perform, not just co-ops
4 but also privately held companies. We've got
5 about 1,000 members. About half of those are
6 co-op; about half of those are private. Organized
7 a little differently but perform the same function
8 in helping producers with their marketing and risk
9 management plans. So we hope that there will be a
10 common sense way of resolving the swap dealer
11 definition issue.

12 MR. DIERKS: Commissioner Dunn, thank
13 you. And again, I'll join the chorus of thanking
14 you for your service and everything you've done.
15 And hope you've got your corn in. Thanks to the
16 commissioners also.

17 From an NPPC perspective, one thing I'll
18 just put forth and it relates to what was just
19 talked about, but as we look at our membership,
20 the potential-- and I would just ask the
21 commissioners as they deliberate this on this
22 issue about the definition of a dealer, things in

1 this order, that we see the greatest risk from our
2 membership of who is going to be impacted as a
3 smaller producer. Our larger producers have the
4 wherewithal, have the sophistication to deal with
5 whatever. If you do get in a situation as was
6 just put forth either by a local co-op or local ag
7 dealer, or in our case we have co-ops that market
8 hogs, that really don't do a lot of this type of
9 work. But if they get drawn into the definition
10 they'll step back.

11 The ramification is the reason they do
12 it is they're offering it to service small
13 producers that can't really justify the risk
14 management or the cost of getting the risk
15 management by getting into working with a normal
16 dealer or broker or whatever. So I just ask that
17 as we go through this that we -- that you
18 deliberate and recognize that as this comes
19 forward there could be ramifications on this
20 definition of the dealer that could have
21 ramifications to the smaller producer looking for
22 risk management also.

1 CHAIRMAN DUNN: Thank you, Neil.

2 MR. CRYAN: Kevin and Todd and Neil all
3 saved me a lot of time because I second everything
4 they said. That pretty much summarizes where we
5 stand on this. The first thing is the co-op. I
6 want to emphasize that. The co-op is the farmer
7 and the farmer is the co-op. I really hope it's a
8 no-brainer that the relationship between the co-op
9 and their members shouldn't be considered a swap
10 dealer relationship.

11 Beyond that, similar analogous
12 relationships exist between small -- all kinds of
13 processors and farmers. They provide risk
14 management opportunities because of direct
15 relationships that are directly involved with
16 marketing their milk, even if a marketer of a
17 farmer's product facilitates a swap with a third
18 party, I would hope that there is a lot of leeway
19 for that without chasing them off. Without
20 chasing off those folks by threatening to regulate
21 them as swap dealers because I agree with all
22 three of these gentlemen, that that kind of

1 paperwork and regulation is going to chase off a
2 lot of opportunities for the small farmers of the
3 small scale that don't exist otherwise.

4 And I also want to reiterate my
5 appreciation for the Commission's work, and
6 especially for reopening the comment period. Now
7 that we have a chance to see everything that's
8 very much appreciated. So thank you. And thank
9 you for having this hearing -- this meeting.

10 CHAIRMAN DUNN: Any other?

11 MS. PRESTON: I also want to recognize
12 the Commission and thank you for providing this
13 opportunity to talk. And I also would like to
14 compliment your staff on their professionalism and
15 responsiveness. When I have called with questions
16 I've been very impressed. So kudos to the staff.

17 I wanted to also point out in the small
18 -- the end-user -- I wanted to ask for
19 clarification on the small bank exemption. And as
20 I'm reading this it says that you will include one
21 in the final read or you're anticipating including
22 one. And I just wanted to ask for clarification

1 on that.

2 MS. DUFFY: The Commission is directed
3 in the statute to consider whether an exception is
4 appropriate. We've received comments and we are
5 reviewing the comments.

6 MS. PRESTON: Okay, so it's still at the
7 consideration phase. There's been no decision on
8 including it or not. Is that fair to say?

9 MS. DUFFY: No, there hasn't been a
10 decision yet.

11 CHAIRMAN DUNN: Other questions or
12 comments on this panel?

13 COMMISSIONER O'MALIA: Mr. Chairman. I
14 have -- Mark, I have two questions. And this is
15 kind of a combination for both Mark and Lee Ann.

16 Do we provide a clear guidance on
17 end-user to end-user transactions? Do we say that
18 these are clearly outside the swap dealer
19 definition or how do we -- do we provide
20 sufficient clarity on that?

21 And the second one, the chairman
22 mentioned large trader -- are you working with the

1 large trader team? Because it references swap
2 dealer. Who is a swap dealer if we put out a
3 large trader definition and reporting requirement
4 but have yet to do the swap dealer definition?
5 How do we -- how are you working with the teams
6 and how will we -- how will all of these people
7 deal with that going forward?

8 MR. FAJFAR: On the first question, I
9 think we received a lot of comments and these
10 weren't simplistic, you know, easy to read. They
11 were very detailed comments and I think there were
12 a lot of things in the proposal that need to be
13 clarified.

14 On the point of what's the status of
15 end-user to end-user trade, I don't think that was
16 directly addressed in the proposal because the
17 proposal talks about who is a swap dealer and
18 identifying swap dealers out of the many market
19 participants. And I think one thing that could
20 certainly be clarified is that if you're not
21 pulled out and identified as a swap dealer or a
22 major swap participant then you're not in that

1 status and you're not covered by those
2 requirements. That can certainly be more clear.

3 And then in terms of the -- how will
4 this rulemaking interact with the other teams.
5 That's sort of exactly why this process takes some
6 time of working through. Like I said, of all the
7 different -- looking at it from all the different
8 angles and making sure each one is covered. So
9 these are all issues that we're considering how
10 the swap dealer definition will then interact with
11 the other definitions.

12 CHAIRMAN DUNN: Thank you. Any other --
13 Bart, did you have any questions?

14 COMMISSIONER CHILTON: No, thank you,
15 Mr. Chairman.

16 CHAIRMAN DUNN: If not, Mark, Lee Ann,
17 thank you both. We appreciate that. And we, as
18 usual, have saved the best for last. Ananda has
19 been sitting there but certainly the thing that I
20 think is on a lot of people's mind because I've
21 heard it mentioned over and over again and that's
22 the margin aspect. So when you're ready, Mr.

1 Director.

2 MR. RADHAKRISHNAN: Thank you,
3 Commissioner Dunn. I would ask somebody to pull
4 up my slideshow. While that's being done, just on
5 a personal note, it is very gratifying to hear all
6 of the great accolades that have been provided to
7 Commissioner Dunn, and I would echo them. I would
8 also make a plea to Commissioner Dunn that he
9 would consider staying with us as long as he can.
10 Not as long as he wants but as long as he can
11 because I think certainly speaking for the staff,
12 we would benefit from the wisdom and the guidance
13 that you provided to the staff since you've come
14 to the Commission.

15 CHAIRMAN DUNN: Ananda, my wife is
16 watching the streaming out in Iowa and you just
17 got on her bad list.

18 COMMISSIONER O'MALIA: Did you say your
19 wife is screaming out in Iowa?

20 CHAIRMAN DUNN: Streaming. She may be
21 screaming.

22 MR. RADHAKRISHNAN: So what I wanted to

1 do today, members of the Commission and members of
2 the committee, is to give you a summary of the
3 proposal making that the Commission issued with
4 respect to margin requirements for unclear swaps.
5 And this proposal was published in the Federal
6 Register Thursday, the 28th of April. It is page
7 23732 of volume 76 of the Federal Register. And
8 the comment period ends on the 11th of July, 2011
9 to coincide with the end of the comment period for
10 the Commission's proposed rule on capital
11 requirements on swap dealers and major swap
12 participants.

13 So to get to the authority, the statute
14 requires the Commission to impose both initial and
15 variation margin requirements on all swaps that
16 are not cleared by a derivatives clearing
17 organization that's registered with the
18 Commission. And this requirement is directed at
19 those entities that are swap dealers and major
20 swap participants for which there is not a
21 prudential regulator. So, for example, the
22 Commission's requirement -- the Commission's

1 eventual requirements will not apply to bank
2 holding companies, for example. That has been
3 addressed by a concurrent proposal-making, but all
4 of the prudential regulators have also issued --
5 and this is in accordance with the provisions of
6 the Dodd-Frank Act. So if an entity is a swap
7 dealer but it is also a prudential regulator, then
8 they are subject to the requirements of the
9 prudential regulators. And for those who are not
10 also prudentially regulated, they're subject to
11 the requirements of the CFTC.

12 As the proposal making indicate, we have
13 strived to be as comparable to the requirements of
14 the prudential regulators. It's just one little
15 difference that -- well, two differences that we
16 made. And I'll highlight that. And also, the
17 other provision in the statute is that the
18 Commissioner is directed to permit the use of
19 non-cash collateral as a deterrence to be
20 consistent with preserving the financial integrity
21 of the markets trading swaps. And also the
22 stability of the U.S. financial system.

1 So at the outset, let me indicated --
2 because I'm sure this will be of interest to you
3 -- that this proposal- making would not impose
4 margin requirements on commercial end-users, which
5 have been defined under the proposals as
6 non-financial entities. And as Chairman Gensler's
7 point about, you know, let's work on the
8 assumption that the entities that you represent
9 will fall under this category. So if you fall
10 under this category of commercial end-users, then
11 I will direct you to page 23736 of the Federal
12 Register release. It's not here but basically all
13 you are required to do is to -- well, all that the
14 swap dealer and MSP would be required to do is to
15 make sure that there are credit support
16 arrangements between them and commercial end-uses.
17 And basically, the parties will be free to set,
18 you know, initial end-margin requirements and
19 variation requirements as dictated by the credit
20 support agreement.

21 So basically, you've been required to
22 have -- the swap dealer and MSP would be required

1 to have a credit support agreement or an
2 arrangement to governing the swap relationship and
3 a credit support arrangement. And margin
4 requirements, if any, would be those that are
5 dictated by the credit support arrangement.

6 So let's go to the requirements. There
7 will be requirements between swap dealers and
8 MSPs. And in the proposed rulemaking, the
9 Commission calls them covered swap entities. So a
10 covered swap entity is a swap dealer, MSP, and
11 other swap dealers and MSPs. And here the rules
12 would require the payment and collection of both
13 initial and variation margin for each transaction.

14 With respect to trades between swap
15 dealers or covered swap entities and financial
16 entity end-users, the rules would require that the
17 swap dealer and MSP collect but not pay initial
18 and variation margins for each trade subject in
19 certain circumstances to permissible thresholds.

20 And then as I pointed out for trades
21 between covered swap entities and nonfinancial
22 entities, it would basically require the existence

1 of a credit support arrangement with
2 counterparties and for the counterparties to abide
3 by those arrangements.

4 Another important point of the proposal
5 is that the rules would not apply retroactively.
6 They would apply to uncleared swaps entered into
7 after the effective date of the regulations. So
8 whenever the Commission proposes for the final
9 rule to be effective, these will apply to swaps
10 entered after the effective date.

11 Let's go ahead and talk about the
12 calculation of initial margin. Initial margin
13 will be calculated using a model that is approved
14 by the Commission and is also used by a
15 derivatives clearing organization or DCO that is
16 registered with the Commission in a clear, related
17 swap. Sorry, clear swaps. Or is used by an
18 entity that is subject to oversight by a
19 prudential regulator. Model has been approved by
20 the prudential regulator. Or that's made
21 available for licensing to any market participant.

22 If no such model is available, then the

1 initial margin would be calculated by selecting a
2 comparable cleared swap or futures contract and
3 applying a multiplier that is set forth in the
4 rule. And in all instances, all initial margins
5 must cover 99 percent of 10-day price. With
6 respect to variation margin, variation margin will
7 be calculated to cover the current exposure
8 arising from changes in the market value of a swap
9 since the trade was executed or the previous time
10 the position was market to market. And the
11 proposals previously proposed for swap dealers and
12 swap participants will require that documentation
13 include an agreement on the methods, the
14 procedures, the rules and inputs for determining
15 the value of each swap at any time from the
16 execution of the swap to the termination,
17 maturity, or expiration of a swap.

18 Let's talk about the forms of margin.
19 The covered swap entities would be required to
20 accept only certain specified assets as initial or
21 variation margin from other SDs or MSPs offering
22 financial entities. And appropriate haircuts are

1 specified in the proposed rule. I direct you to
2 page -- sorry, 23738 of the third Register release
3 and the forms of initial margin are specified
4 there.

5 CHAIRMAN DUNN: Ananda, do you have the
6 number of that Federal Register or at least the
7 date so that people --

8 MR. RADHAKRISHNAN: Oh, yeah. So it is
9 76 FR 23732. So volume 76 of the Federal
10 Register, starting on page -- I guess it's 23,732.
11 And the date is the 28th of April.

12 So the forms of initial margin appear
13 starting on page 23738. Basically, it's cash
14 denominated in U.S. Dollars or the currency in
15 which the payment obligation under the swap is
16 required to be settled. And this cash has to be
17 immediately available cash, which means in the
18 United States it's got to be in a bank deposit
19 account. Any obligation which is a direct
20 obligation of or fully guaranteed as to principal
21 and interest by the United States or an agency of
22 the United States, and any senior debt obligation

1 of Fannie Mae, Freddie Mac, Farmer Mac, the
2 Federal Agricultural Corporation, or any
3 obligation that is an insured obligation at that
4 time is defined in the Farm Credit System Bank.
5 And those are the limited forms of collateral but
6 we do ask questions as to whether we should expand
7 the forms of collateral. And the schedule of
8 haircuts appears on page 23739 of the Federal
9 Register.

10 Now, let's talk about location of the
11 collateral. Collateral for trades between covered
12 swap entities and other covered swap entities
13 would be required to be held at third-party
14 custodians and cannot be rehypothecated. And
15 covered swap entities would be required to offer
16 non-covered swap entities, the opportunity to
17 have any initial margin segregated.

18 So that is the end of my presentation.
19 It is a broad summary. I would urge all parties
20 who are interested to please look at the proposal
21 as it appears in the Federal Register. And if you
22 have any comments, please do submit your comments

1 on or before the deadline which is the 11th of
2 July, 2011. Thank you.

3 COMMISSIONER GENSLER: Ananda, I know
4 that you said this but just to reconfirm, so for
5 nonfinancial end-users, they're not covered by our
6 margin proposal as proposed.

7 MR. RADHAKRISHNAN: Correct.

8 COMMISSIONER GENSLER: And then
9 secondly, the dealer is not required to have
10 margin with them. The only thing is the two can
11 negotiate just as they do today, negotiate
12 whatever their credit support arrangements are.

13 MR. RADHAKRISHNAN: That's correct.

14 COMMISSIONER GENSLER: And thirdly, if
15 they have whatever arrangements they do, we
16 explicitly say that the dealer can -- as the
17 statute says, accept noncash collateral.

18 MR. RADHAKRISHNAN: Correct.

19 COMMISSIONER GENSLER: Of course, I
20 mean, it's still subject to their negotiation.

21 MR. RADHAKRISHNAN: Correct.

22 CHAIRMAN DUNN: Questions? Comments

1 from the Ag Advisory Committee?

2 MR. SCANLAN: Thank you, Mike. I would
3 also be remiss if I didn't say thanks to you,
4 Mike, for your efforts here at CFTC and over your
5 long history of serving American Agriculture. So
6 thank you.

7 Just a couple of comments. One of the
8 things that I've seen in a number of the proposed
9 rules is the assertion that off-comments -- excuse
10 me -- that over-the- counter swaps are inherently
11 more risky than exchange- traded swaps. And I
12 would simply say that I think that's painting with
13 too broad of a brush. A lot of the over-the-
14 counter swaps that, for example, our banks use are
15 simply customized based on the notational value of
16 the loan or they may not fit the model that the
17 exchange is using. And from my understanding, the
18 exchanges don't simply accept the low risk swaps;
19 they accept, you know, they accept swaps based on
20 the volume of business that they're doing. And so
21 a lot of the swaps that some of the community bank
22 would want to do with the mid-term or mid-level

1 swap dealers, they would like to be able to move
2 to the exchange traded platform but they're unable
3 to do so.

4 So I just raise that as a point because
5 in the proposal where it says that these -- the
6 capital could not be rehypothecated. From what
7 we've been told that could cause serious problems
8 for the ability of community banks to use
9 over-the-counter swaps because it could force a
10 number of the mid-level swap dealers out of
11 business. And therefore -- and those are the ones
12 that the community banks use. So the community
13 banks and their borrowers would therefore not have
14 a source to go to in order to engage in these
15 over-the-counter customized swaps. So we're going
16 to commenting on that but I just want to mention
17 it because it's a serious concern that I think
18 could affect our industry and our industry's
19 ability to serve farmers and ranchers.

20 CHAIRMAN DUNN: Thank you, Mark.
21 Robbie.

22 MR. BOONE: Just a quick, I guess,

1 process standpoint. Ananda, I appreciate your
2 comments about the prudential regulator who also
3 have sort of their own process. And we're
4 working, Farm Credit Systems is sort of aiming its
5 -- I'm expecting we're going to have a comment
6 letter. But I will say as I sit there, we're
7 trying to figure out whether or not we, you know,
8 either need to copy you all or answer your own
9 sort of margin proposed rule just from the
10 standpoint that there may be situations where
11 given, you know, how these contracts are entered
12 into, that we may find ourselves in a situation
13 where your rule is also relevant. But we're sort
14 of trying to work through all that now. So.

15 MR. RADHAKRISHNAN: Well, I will just
16 say that we worked very closely with all of the
17 prudential regulators and the SEC throughout the
18 process -- staff did throughout the process. And
19 this was directed by the statute. And, you know,
20 so there were drafts sent back and forth between
21 staff.

22 Certainly, we would welcome comment

1 letters and, you know, I think it could -- from a
2 staff perspective it could only be beneficial if
3 you were directing a comment to one of the
4 prudential regulators if you felt you could copy
5 us on it because that could inform staff thinking
6 and maybe the Commission thinking as well.

7 MR. BOONE: Yeah, I would just --
8 obviously, the Farm Credit Administration is our
9 prudential regulator and so that's -- with that in
10 mind we're focused to that. Thank you.

11 COMMISSIONER GENSLER: But Robbie, I
12 would say -- and we do this as best we can also on
13 rules that the SEC has something similar. The
14 staffs here are, as best they can, sort of in
15 consultation with the other staffs and as
16 commissioners. So we are talking to the Farm
17 Credit, your regulator, as well as the bank
18 regulator. So since Congress has asked us to the
19 maximum extent practical I think it says or a
20 maximum extent, it's some words like that. We're
21 trying to stay consistent on these margin and
22 capital rules. To the extent you have comments to

1 them, we'll be -- you can feel free to go cc the
2 CFTC. But even if you didn't, I think we would be
3 looking at it.

4 MR. BOONE: Right. Thank you. That's
5 helpful.

6 CHAIRMAN DUNN: Other? Diana.

7 MS. PRESTON: Another process question.
8 First of all, I really appreciate you extending
9 the timeline to dovetail with the capital
10 proposal. It's very helpful.

11 As we obviously are focused on the
12 prudential regulator margin proposal and then
13 obviously incorporating in our analysis the CFTC's
14 proposal, I wonder if you would give consideration
15 or probably will be asking to give consideration
16 to also have time to include in our analysis the
17 SEC's anticipated proposal.

18 Now, I know it's hard to say long in
19 advance of the deadline, you know, hey, we'd like
20 some time. But I think it's become clear as we
21 look at the prudential proposal, and obviously
22 there are parts of it that nicely dovetail with

1 one another. We're all anticipating also the
2 SEC's proposals. So hard to comment in the
3 abstract.

4 COMMISSIONER GENSLER: Diana, I can't
5 speak for the Commission but I can speak for
6 myself. I think we could wait and wait and wait
7 but we also had a real financial crisis in 2008.
8 And we're supposed to try to move thoughtfully and
9 also lower regulatory uncertainty. So the SEC
10 will move forward on on important part of the
11 market related to single-name credit default swaps
12 and narrow- based credit default swaps and
13 securities based swaps and so forth. As Chairman
14 Shapiro has pointed out, you know, probably five,
15 six, seven percent of the swaps marketplace.

16 So I don't know the answer to your
17 question but to say, you know, please also
18 understand what we're trying to do is lower
19 regulatory uncertainty, finish our rules over the
20 course of 2011. I do think that they -- the SEC
21 has been doing an excellent job but they have
22 about twice the number of rules to do as we do.

1 And hopefully they'll move forward close to this
2 but -- and if it were out in June or July that
3 would be helpful for all of us but I can't speak
4 for them.

5 MS. PRESTON: And I just wanted to add,
6 I appreciate what you're saying about how much the
7 marketplace is under the CFTC's jurisdiction, but
8 there will be at least some part of the
9 marketplace that is the mixed swap that will be
10 subject to joint or whatever you want to deem it
11 jurisdiction. So that's something --

12 COMMISSIONER GENSLER: Do you think
13 there will be many mixed swaps?

14 MS. PRESTON: That's an excellent
15 question.

16 CHAIRMAN DUNN: Kevin?

17 MR. NATZ: Thank you. I have one
18 question just because I have no idea what the
19 answer is and I think you can shed some light on
20 this for me today. Some of our co-ops enter into
21 commodity swaps with banks and I believe those
22 banks at some point have to take those trading

1 desks and, I guess, push them out. Will those
2 entities be under the capital and margin
3 requirements under CFTC rules? Or will they be
4 under the other prudential regulator rules?

5 MR. RADHAKRISHNAN: If they're not
6 subject to regulation by prudential regulator and
7 they're registered with the CFTC, then they'll be
8 subject to CFTC rules. Now, of course, if they're
9 also -- the other issue is whether they also have
10 to register as a security-based swap dealer, in
11 which case they're subject to the SEC's rules. So
12 the key is are you subject to regulation by
13 prudential regulator.

14 COMMISSIONER GENSLER: Kevin, I think
15 that you raise a very good point. I think that it
16 will be some time but the physical commodity
17 dealing, whether it's energy dealing, agricultural
18 dealing, as I understand it as the lawyers have
19 explained it to me, we ultimately have to be
20 pushed out from the banks to an affiliate within
21 their bank holding company. And thus, the capital
22 margin would be under the CFTC for the commodity

1 swaps. Ananda is correct. If it were credit
2 default swaps it might be the SEC. So I think
3 there would be some consistency and it would come
4 under the margin rules as we finalize them
5 ultimately if it's a non-bank affiliate of a bank
6 holding company.

7 Now, capital -- capital rules, of
8 course, because it's part of a whole bank holding
9 company it's a little bit different. Does that
10 answer your question?

11 MR. NATZ: I think so. And it's of
12 interest because I believe the other proposal
13 treats end-users different than your proposal
14 does.

15 CHAIRMAN DUNN: Other questions?

16 MR. HICKS: One question. Is there any
17 spillover from unclear swaps to list of contracts?
18 Is there anything that's going to happen that
19 might implicate or have impact on list of
20 contracts margins?

21 MR. RADHAKRISHNAN: I don't see it. I
22 mean, we do make references to, you know, you've

1 got to look -- in terms of initial margin, you've
2 got to make a reference to what a DCO does and so
3 on. Are you concerned about the other way around?

4 MR. HICKS: Well, I just, you know, now
5 we have -- I guess what I'm thinking about is now
6 the exchanges are, you know, most of them, maybe
7 all of them are for-profit now. And I'm just
8 wondering how this is going to -- how does this
9 connect to the little guy, I guess, the smaller
10 player who probably isn't -- who may not use
11 uncleared swaps. I just wonder about how that --

12 MR. RADHAKRISHNAN: Well, usually, you
13 know, the exchanges set margin for the cleared
14 products. And, you know, they're always trying to
15 cover volatility with a certain amount of
16 statistical confidence and, you know, they send --
17 they change it, they send it to us, we take a look
18 at them. And, you know, I am sensitive to some of
19 the comments that were expressed, which is that in
20 times of volatility it does become expensive to
21 maintain the futures contract. On the flipside,
22 we've got to be careful because we want to make

1 sure that exchanges behave responsible. So there
2 is a lot of volatility and if people don't raise
3 margins, then that triggers a question for us.
4 Like, why aren't you doing it? You know, why are
5 you so comfortable not raising margins if you see
6 extreme volatility? So I do see the tension there
7 if that's what you're talking about.

8 But I think to my mind I don't know
9 whether -- to me it would seem that the margin for
10 uncleared swaps may be influenced by what happens
11 in the cleared world. In fact, it's sort of --
12 one of the proposals sort of ties it in that if
13 you don't have a model, you know, the alternative,
14 what we call -- what the Commission calls the
15 alternative approach is to make a reference to
16 margin in the cleared environment and then add a
17 multiplier. So it's the other way around.

18 MR. HICKS: You know, the most
19 significant thing I heard today was, you know,
20 when Jordan was giving the example of what's
21 happened to his industry, and as a student of the
22 commodity market the whole existence of why we're

1 here was created for the purpose of the way the
2 Board of Trade -- all this thing was set up was to
3 service those guys, you know. And now it almost
4 seems like they're the insignificant piece of
5 this. It's the size of which we've come to trade,
6 you know, the funds, you know, I mean, the focus
7 that we put on the money side of it because that's
8 where the money is generated now. And I just

9 think about like when I came into the industry it
10 was like you wanted to work for a commercial. You
11 know, those were the guys. And now it just seems
12 like they're the insignificant pieces of this pie
13 now.

14 MR. RADHAKRISHNAN: Well, I think
15 Commissioner Dunn had a good point when, I think,
16 Commissioner Dunn, you said it was imperative for
17 the exchanges and the users to have a frank
18 dialogue and staff could be a participant in that
19 because it seems to me that what I think you're
20 suggesting is the market is not of use anymore.
21 Is that what --

22 MR. HICKS: I just think there's an

1 imbalance now. I mean, from where I was when I
2 came into the industry and where we are now, and
3 the positions and the attitudes I have about the
4 market have completely changed now. I never would
5 have thought I would be an advocate for position
6 limits because I never thought the market would be
7 that -- I never thought anything would be larger
8 than the Cargills and the ADMs and Bunkies of the
9 world. And I'm speaking about grain,
10 specifically. And they seem like the small
11 potatoes in this whole process now. And it's just
12 amazing the amount of money -- when I came into
13 the industry in the '70s, the amount of money. I
14 never would have dreamed that we would have had
15 this type of participation. And the global aspect
16 of it.

17 MR. LEA: Well, to further some of what
18 Eddie was saying, I mean, we do appreciate the
19 opportunities this sort of presents because we do
20 need, in addition to liquidity and efficiency, all
21 these different tools give, I think, us
22 opportunities to manage risk. And I would agree

1 with you wholeheartedly. As volatility goes up,
2 margin requirements should go up. I mean, the
3 clearinghouse has to remain financially viable.
4 And that's why we like the idea of some of these
5 margin ideas on swaps.

6 An additional comment, Edgar, just in
7 case, I'd have to say what you're saying, you're
8 not thinking it. It's basically fact. And the
9 conversation in a conference call we had with the
10 ICE again in January, they told us we weren't
11 their most important constituent, that the ETFs
12 were.

13 MR. HICKS: See, in my mind, that
14 defeats the whole purpose of why we have a futures
15 market.

16 MR. LEA: I couldn't agree with you
17 more.

18 CHAIRMAN DUNN: Any other comments from
19 the AG Advisory Committee? How about from the
20 commissioners? And I'll start with the chairman.

21 COMMISSIONER GENSLER: Well, I had a
22 question, but before I say the question, what

1 Jordan and Edgar just talked about is a challenge
2 for those of us who serve on the Commission.
3 Markets, since they were started, had hedgers and
4 speculators meeting in a marketplace. If you
5 wanted to lock in your price at harvest time,
6 which is the reason why the futures market
7 started, there was somebody on the other side that
8 was often a speculator on the other side of that
9 market, even 100 years ago. But now, as Edgar
10 says, the ratio shifts. In some of these markets,
11 the vast majority of the market are financial
12 participants rather than producer-merchants. You
13 know, what does that mean? We promote
14 transparent, open, competitive markets. We are
15 not a price-setting agency. It's about making
16 sure the markets are open and competitive and free
17 of fraud and manipulation and there's integrity.
18 But it's, I mean, this discussion probably will go
19 on for years but any advice you have will be very
20 helpful.

21 I want to just ask a question about the
22 agricultural commodity definition. It wasn't a

1 rule but just because we might move on that in the
2 next month or two and some of you -- I think there
3 was only 20 to 30 comment letters on it, but if
4 there was anything, you know, on anybody's mind,
5 that we hear that. And also there was a rule that
6 Congress said that they can't do agricultural
7 swaps unless we do a rule saying that you can do
8 agricultural swaps. And largely I might have this
9 a little off but what we said is yes, you can do
10 agricultural swaps in accordance with the rest of
11 Dodd-Frank. So those two -- the definition of
12 agriculture commodity and in essence the how
13 agricultural swaps will be treated are two
14 proposals that I don't want to assume anything but
15 if there was anything you want us to hear it would
16 be great to hear.

17 MR. UNGAR: Well, I would just be
18 echoing the CMC's comment letter that we believe
19 that all swaps should be treated consistently and
20 that there shouldn't be a distinction necessarily
21 on ag swaps.

22 MR. KEMP: We would agree with that. We

1 felt that both of those proposals were well done.

2 CHAIRMAN DUNN: Thank you, Todd. Any
3 others? Any final comments, Mr. Chairman?

4 COMMISSIONER GENSLER: Just mostly to
5 thank you again. I mean, I don't think you're
6 going anywhere anytime soon. I'm sorry that your
7 wonderful wife is watching me say this but Brooke
8 is going to, you know, get me. But your
9 leadership of this committee and the counsel that
10 you've given all of us and continue to give us on
11 the issues that are related to the core of our
12 market, because we started as an agricultural -- I
13 mean, over in the Department of Agriculture in the
14 1930s, we started just overseeing grain market.
15 But though it is a smaller percentage of what we
16 oversee, it is a big part of our culture and how
17 we look at markets. And Mike brings that
18 perspective which has been terrific.

19 CHAIRMAN DUNN: Jill, any final
20 comments?

21 COMMISSIONER SOMMERS: Just to say thank
22 you to all the participants here today. I think

1 that certainly your perspective on all of these
2 issues is very helpful to us. So thank you.

3 MR. HICKS: Mr. Commissioner, I would
4 like to take a shot at you but I guess I really
5 can't. Everybody's been so complimentary. But --

6 COMMISSIONER O'MALIA: We can wait for
7 that. We'll have more opportunities.

8 MR. HICKS: I really do appreciate, you
9 know. But I guess my question is, you know, given
10 the service that you've given and the time, who's
11 going to replace you? I mean, what's going to
12 happen to, you know, I mean, we could always come
13 to you because we knew your background in
14 agriculture. So who's replacing you? You know,
15 who's replacing, you know, where's the Ag Advisory
16 Committee in all this process and who's going to
17 give that leadership now that you're leaving?

18 CHAIRMAN DUNN: Edgar, that's up to the
19 president and the members of the Senate on a
20 confirmation and whoever the chairman appoints as
21 my successor on the Agricultural Advisory
22 Committee. The official designee on here has

1 actually -- we've already passed that mantle and
2 Jason Gizzarelli who is on my staff is now the
3 official designee from the commission on the Ag
4 Advisory Committee. But my fellow commissioners
5 are all going to be listening and I do appreciate,
6 Edgar, over the times that you and I have talked
7 and you have brought to me special concerns that
8 you have from your constituents.

9 So, Bart, do you have any comments?

10 COMMISSIONER CHILTON: Just briefly,
11 Mike. I wanted to -- not that the exchanges need
12 to be defended. They've got enough lobbyists of
13 themselves to do a great job, but you know, look,
14 it's a balancing act for us to try to figure this
15 stuff out. But that's our job. That's what we're
16 supposed to do sort of 24/7, 365.

17 You know, ICE, for example, they're
18 concerned about HFTs and about the speculative
19 interest. They want to deal with that but they've
20 only got 10 percent of their market are HFTs. And
21 you know, we have to remember these markets, the
22 regulated futures exchanges, they work very well

1 in this economic calamity. You know, we've got
2 this big Dodd-Frank bill but the main part of that
3 is really dealing with OTC land. And Mark, you
4 talked about the bankers and how, you know, swaps
5 aren't dangerous. And certainly, I'm not
6 suggesting they are but, you know, credit default
7 swaps were pretty dangerous. They helped propel
8 AIG down and others. So it's getting a hold of
9 this new animal, the OTC land for us, for folks
10 who haven't dealt with it. And I think that's why
11 some of the proposals that have been out there
12 didn't hit the market exactly. It was a learning
13 curve for us and that, you know, when people see
14 proposals originally that scares some folks.

15 But this interim process that we're
16 going through, not only in this meeting but
17 through the comment period, that's really what,
18 you know, how regulators -- how regulations are
19 come up with. That's how they're devised. And so
20 it's very helpful and, you know, it's our job to
21 seek the balance. And I think we're going to do
22 that. We may not do it exactly in the time period

1 that all of us would like. I want limits now.
2 That doesn't look like it's going to happen. I'm
3 disappointed. But I understand that we're going
4 to have to get there on all of these things and
5 due course.

6 So I thank all the members and thank
7 Commissioner Dunn, Chairman Dunn, and thank
8 commissioner -- my other colleagues. And
9 particularly thank Chairman Gensler for his
10 leadership on all these important issues and
11 keeping the trains running as close to as
12 possible, Gary, on time. Thank you.

13 CHAIRMAN DUNN: Commissioner O'Malia.

14 COMMISSIONER O'MALIA: Let me thank you
15 for putting together a very high value meeting.
16 The staff presentations were excellent in type,
17 the comments were well thought out, and obviously,
18 we had the benefit of reviewing our rules and I
19 found a lot of value in this. So this was a very
20 worthwhile endeavor here and a great meeting.
21 Thank you.

22 CHAIRMAN DUNN: Well, thank you all. I

1 was remiss in not recognizing my predecessor on
2 the Ag Advisory Committee and Gary's predecessor
3 as the chairman of the commission. Jim, would you
4 stand up so we can all recognize Jim Newsome.

5 And I'm sure there were people who
6 thought when Jim Newsome stepped down, well, gee,
7 we're never going to find somebody to fill his
8 boots on the Ag Advisory Committee. Someone will
9 take my place. But it has been a real pleasure
10 and honor to work with the Advisory Committee.
11 Many of you I've known for years. Some for
12 decades. We've worked together and I appreciate
13 your counsel and your willingness to come here and
14 give your perspective to the commission. It does
15 help us as we make our decisions to get your
16 input. I appreciate it. But I really appreciate
17 my fellow commissioners. This has been a delight
18 for me to serve as the chair of the Ag Advisory
19 Committee simply because I've got such wonderful
20 people to work with. And what makes them so good
21 is their staff and the commission staff. So I
22 thank everybody. And with that we're adjourned.

1 (Whereupon, at 12:54 p.m., the
2 PROCEEDINGS were adjourned.)

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DISTRICT OF COLUMBIA

I, Stephen K. Garland, notary public in
and for the District of Columbia, do hereby certify

that the forgoing PROCEEDING was duly recorded and
thereafter reduced to print under my direction;
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under penalty of perjury; that said transcript is a
true record of the testimony given by witnesses;
that I am neither counsel for, related to, nor
employed by any of the parties to the action in
which this proceeding was called; and, furthermore,
that I am not a relative or employee of any
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nor financially or otherwise interested in the
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