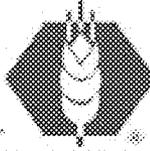


**From:** Todd Kemp <tkemp@ngfa.org>  
**Sent:** Monday, October 11, 2010 1:42 PM  
**To:** OTCDefinitions <OTCDefinitions@CFTC.gov>; EndUser <EndUser@CFTC.gov>; AgSwaps <AgSwaps@CFTC.gov>; PosLimits <PosLimits@CFTC.gov>  
**Subject:** NGFA Comments on Dodd-Frank Act  
**Attach:** cftc pre-proposal stmt 10-10.docx

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Please see the attached pre-proposal comments from the National Grain and Feed Association on several issues to be addressed during the CFTC's rulemakings to implement the Dodd-Frank Act.

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## National Grain and Feed Association

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October 11, 2010

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

Dear Mr. Secretary:

The National Grain and Feed Association (NGFA) appreciates the opportunity to provide pre-proposal comments on issues facing the Commodity Futures Trading Commission (CFTC) as it works to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act. More detailed comments on the subjects discussed herein will be submitted by the NGFA as CFTC proposals are published. However, it is our hope that this input can assist the Commission as it develops new regulations that will provide appropriate oversight to U.S. futures and derivatives markets without overly constricting new-product development and capital formation.

The NGFA is the national non-profit trade association representing more than 1,000 companies that operate an estimated 7,000 facilities nationwide in the grain, feed and processing industry. Member firms range from quite small to very large, both privately owned and cooperative, and handle or process in excess of 70% of all U.S. grains and oilseeds annually. Companies include grain elevators, feed mills, flour mills, oilseed processors, biofuels producers/co-product merchandisers, futures commission merchants and brokers, and related commercial businesses.

A common thread for NGFA-member firms is that they rely on efficient futures markets to provide price discovery and risk management for their commercial businesses. In particular, consistent and predictable convergence of cash and futures values is of primary importance to the NGFA. A number of rulemakings being undertaken by the CFTC will directly or indirectly impact the risk management instruments used by the NGFA's member companies. With that in mind the NGFA offers the following pre-proposal comments to the Commission.

### **Speculative Position Limits**

The Dodd-Frank Act requires that CFTC establish speculative position limits for all commodities, including agricultural commodities. Such limits already are in place for the enumerated agricultural commodities (corn, wheat, soybeans, livestock, cotton), albeit established through a different regulatory process. Position limits are extremely important in agricultural markets, which must function effectively for traditional commercial hedgers. Especially in today's marketplace, with index funds and other investment vehicles seeking enhanced returns, maintaining appropriate position limits is of paramount importance.

The method currently in place for establishing position limits has functioned well – exchanges may propose revisions to limits, subject to review by industry and the public and approval by the CFTC. Historically, the NGFA has been generally supportive of occasional requests by exchanges to increase position limits. However, futures price volatility in recent years and vastly increased participation by nontraditional participants has altered the situation and, at times, threatened the viability of exchanged-traded futures for commercial grain hedgers. The rapid escalation of agricultural futures prices during 2008, and a resulting disconnect of cash and futures values, dramatically increased risks for grain purchasers/hedgers and caused extreme financial stress due to massive margining requirements.

Today, conditions exist that could presage a repeat of those conditions. With investment capital now seeking enhanced returns and many advisors recommending commodities as an investment vehicle, it appears the stage is set for another investment-fueled spike in futures prices – an increase we fear will be largely unrelated to market fundamentals and could again result in extreme financial stresses. If this happens, grain buyers may be forced to limit their grain purchases from U.S. agricultural producers, as occurred in 2008.

For these reasons, the NGFA believes it would be imprudent of CFTC to change current speculative position limits for the enumerated agricultural commodities. We strongly urge the CFTC to use proper functioning of futures markets for traditional commercial users – i.e., convergence of cash and futures – as the primary consideration in establishing position limits. We also urge the CFTC to review corporate linkage issues through which speculative firms might technically comply with position limits through separate entities while coordinating positions that would circumvent the intent of the rule.

### **Bona Fide Hedge Definition**

Closely related to the issue of establishing speculative position limits is administration by CFTC of the *bona fide* hedge definition. The Dodd-Frank Act contains a very specific definition of a *bona fide* hedge, virtually identical to the definition used by the Commission. Although leaving authority for the definition with the Commission would have been the preferable course by Congress, the NGFA generally supports the Dodd-Frank definition as appropriate.

Clearly, the law's intent is that bona fide hedgers are those commercial firms hedging legitimate commercial risk directly related to purchases/sales or changes in value of physical commodities. We do not perceive that the intent of Congress in Dodd-Frank is in any way intended to alter the way CFTC defines *bona fide* hedgers, as applied to entities that are proven to be in the cash commodity trade as buyers or sellers. In that vein, the NGFA believes that CFTC should use its authority to grant hedge exemptions to financial institutions, index funds, hedge funds or other nontraditional participants in agricultural futures markets extremely sparingly and only if it can be demonstrated clearly that such exemptions will not harm contract performance for traditional hedgers.

Further, we believe a rulemaking on position limits and the bona fide hedging definition offers an opportunity to reexamine the CFTC's current swaps exemption. Essentially, the swaps exemption provides unlimited access to futures markets for swap dealers, an indirect route to futures markets that allows investment capital to evade speculative position limits. The NGFA believes strongly that this exemption has contributed significantly to futures volatility and lack of convergence in agricultural future markets.

Consistent with the NGFA submission to CFTC on June 16, 2009, in response to CFTC's March 24, 2009, "Concept Release on Whether to Eliminate the Bona Fide Hedge Exemption for Certain Swap Dealers and Create a New Limited Risk Management Exemption From Speculative Positions Limits" (copy attached), the NGFA urges that CFTC "look through" swap transactions and allow hedge

exemptions to be granted only for that portion of swap dealers' business where the swap dealers' counterparties are entities that otherwise would have qualified for a hedge exemption. All other swap dealer business should be subject to speculative position limits. We believe this adjustment to the swaps exemption would result in more appropriate levels of investment participation in agricultural futures and greatly enhanced futures contract performance for traditional hedgers.

### **End-User Exemption**

In the Dodd-Frank law, Congress clearly intended to establish a commercial end-user exemption from many of the requirements that will face OTC derivatives users. While the construction of the exemption in the law may be somewhat ambiguous, that intent was made clear in letters and floor statements by Congressional leaders. The NGFA believes that such an exemption for commercial end-users is not only merited, but also highly needed. We submit that CFTC should issue a clear and concise statement establishing the end-user exemption for similar kinds of commercial participants as described above in the *bona fide* hedge discussion. We do not believe Congress intended to burden these commercial end-users or their customers with the increased costs and regulatory burdens of exchange-clearing, margining, and capital requirements.

It is problematic that the end-user exemption in Dodd-Frank may not appear to extend to the counterparty of the commercial end-user in an OTC swap transaction. Increasing the regulatory requirements of the counterparty certainly will result in those costs being factored into total costs of the transaction, thereby increasing costs to the commercial end-user – and likely achieving little or no added protections in the marketplace. The NGFA suggests that CFTC consider extending the end-user exemption to counterparties like swap dealers in instances where the dealer is doing business with a commercial end-user. In essence, this would be a “look through” process similar to that discussed in the *bona fide* hedge section above. Such an action would help keep costs at a reasonable level for commercial end-users and their customers to the benefit of the entire U.S. economy.

### **Agricultural Swaps**

The NGFA will submit more extensive comments concerning agricultural swaps in response to the series of questions posed in CFTC's Advance Notice of Proposed Rulemaking (ANPR) published on September 28, 2010. In general, we offer the following preliminary input:

- 1) The regulatory structure under which agricultural swaps function should be the same as for other types of swaps. Like other swaps, ag swaps will be subject to extensive capital and margin requirements, business conduct standards, and reporting, recordkeeping, and documentation requirements. We believe these provisions of Dodd-Frank will provide more-than-sufficient safeguards to the market and to swap participants. Piling on additional requirements for ag swaps would put such instruments and those who use them at a competitive disadvantage and amount to regulatory overkill. Generally, participants in swap transactions are larger, knowledgeable and sophisticated parties that do not need additional regulatory protections.
- 2) As detailed above, a robust and clearly defined commercial end-user exemption for ag swaps from clearing, capital, and margining requirements will need to be stated by the CFTC.

### **Swap Dealer Definition**

In the Dodd-Frank Act, a “swap dealer” is specifically defined as a market participant meeting one or more of four conditions. One of those conditions is that the person or firm “...regularly enters into swaps with counterparties as an ordinary course of business for its own account;”.

In general, the NGFA believes that swaps are not widely utilized among grain, feed and processing firms in the course of their commercial business – we will provide more detail on the extent of swap use in response to the ag swaps ANPR. The vast majority of risk management activity among commercial firms in the grain, feed and processing industry involves buying or selling futures contracts on a regulated futures exchange.

However, some firms may enter into swap agreements from time to time as an alternative risk management vehicle to hedge their physical commodity risk. Such occasional activity should not subject a firm to being defined as a swap dealer and incurring the regulatory requirements and costs that come with it. Certainly, these firms that utilize swaps only occasionally are not considered by themselves or their customers to be swap dealers. The NGFA suggests that CFTC exempt occasional swap participants from the swap dealer definition. Alternatively, some *de minimis* usage of swaps could be established that would exclude participants from the definition.

The NGFA looks forward to continuing discussions with the Commission on provisions of Dodd-Frank that impact our industry. We appreciate the opportunity to provide this input as rulemakings proceed.

Sincerely,

A handwritten signature in black ink that reads "Matt Bruns". The signature is written in a cursive, flowing style.

Matt Bruns  
Chair, Risk Management Committee