UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

AGRICULTURAL ADVISORY COMMITTEE MEETING

Washington, D.C.

Tuesday, December 9, 2014

PARTICIPANTS:

Opening Statements:

AAC CHAIR DR. RANDALL FORTENBERY

CFTC CHAIRMAN & AAC SPONSOR TIMOTHY MASSAD

CFTC COMMISSIONER SHARON BOWEN

CFTC COMMISSIONER J. CHRISTOPHER GIANCARLO

CFTC COMMISSIONER MARK WETJEN

The State of the Agricultural Economy:

TOM VILSACK, Secretary, US Department of Agriculture

Panel No. 1: Implications of the Agricultural Economy for CFTC and DCMs:

DAVID LEHMAN, Managing Director, Commodity Research and Product Development CME Group

GREG KUSERK, Deputy Director, Product Review, Division of Market Oversight, Commodity Futures Trading Commission

Panel No. 2: Position Limits, Deliverable Supply, and Bona Fide Hedging:

CHRISTA LACHENMAYR, Economist, Division of Market Oversight, Commodity Futures Trading Commission

STEPHEN SHERROD, Senior Economist, Division of Market Oversight, Commodity Futures Trading Commission

OTHER PARTICIPANTS:

JOHN ANDERSON, American Farm Bureau Federation

PARTICIPANTS (CONT'D):

MJ ANDERSON, National Grain and Feed Association

ROBBIE BOONE, Farm Credit Council

BEN BOROUGHS, North American Millers' Association

MIKE BROWN, National Chicken Council

ZACK CLARK, National Farmers Union

GEOFF COOPER, Renewable Fuels Association

SCOTT CORDES, National Council of Farmer Cooperatives

BRYAN DIERLAM, Cargill, on behalf of the International Swaps and Derivatives Association, Inc.

ED ELFMANN, American Bankers Association

CURT FRIESEN, National Corn Growers Association

ED GALLAGHER, National Milk Producers Federation

HARRY HILD, Division of Market Oversight, Commodity Futures Trading Commission

CLAYTON HOUGH, International Dairy Foods Association

DUDLEY HOSKINS, National Association of State Departments of Agriculture

TOM KADLEC, ADM, on behalf of the Futures Industry Association

BRENDAN KALB, AQR, on behalf of the Managed Funds Association

PARTICIPANTS (CONT'D):

CHELSIE KEYS, National Pork Producers Council

LANCE KOTSCHWAR, Gavilon, on behalf of the Commodity Markets Council

JOE KOVANDA, National Cattlemen's Beef Association

KENT LANCLOS, USDA Risk Management Agency

RON LEE, National Cotton Council

ED LUTTRELL, National Grange

BOB MACK, R-CALF

BILL MAY, American Cotton Shippers

DORIS MOLD, American Agri-Women

PAUL PENNER, National Association of Wheat Growers

JAMES RADINTZ, USDA FSA Loans

PAUL RINIKER, National Farmers Organization

MARK SCANLAN, Independent Community Bankers Association

TOM SMITH, Division Swap Dealer and Intermediary Oversight, Commodity Futures Trading Commission

STEPHEN STRONG, North American Export Grain Association

STEVE WELLMAN, American Soybean Association

RYAN WESTON, American Sugar Alliance

TREVOR WHITE, National Sorghum Producers

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P R O C E E D I N G S

(10:00 a.m.)

DR. FORTENBERY: Good morning. I'd like to call the 32nd -- 37th, I'm sorry, meeting of the Agricultural Advisory Committee to session. My name is Randy Fortenbery. I'm serving as the Chairman of the committee. To all of you who have been on the committee in the past, welcome back. Thanks for attending. For all the new members, welcome as well and we're very glad you're participating. We have a pretty full agenda today.

A couple of quick housekeeping items. One, please remember to either mute or turn your cell phones off. I say that not for you, but to remind myself to do that. Also, when you decide to speak during the discussion, please push the button in the center of your microphone and then when you're not talking, please don't push that button and that'll keep everything orderly. As we go through the discussion, if you can sort of signal me that you would like to speak while someone else is speaking, I'll try to keep track of that and we'll keep it a little bit orderly. But, please, everybody participate in the discussion and anything that you think is important to comment on, please do so. We're very fortunate this morning to have all four sitting Commissioners with us. So to my right, Chairman Massad, to my left, Commissioner Giancarlo, and then Commissioner Wetjen, and Commissioner Bowen off to the right side of the table. So I think what we'll do this morning is start with some comments from the commissioners and I'll turn it over to the Chairman.

CHAIRMAN MASSAD: Thank you, Randy. Good morning to everyone. Thank you for coming. We really appreciate it. The secretary is on his way, but we'll go ahead and get started. Let me begin by thanking the CFTC staff who've worked very hard to put this together, in particular, Christa and Cory and others. I really appreciate the dedication of all of our professional staff. And let me also thank Randy for continuing to serve as committee chair. I was quite pleased when he agreed to do that. And I'm grateful to him for flying all the way from Lewiston, Idaho to get here and we appreciate his extensive knowledge and ability to keep us running on time.

You know, much of what we do here at the CFTC can seem removed from everyday life. Most Americans don't participate directly in the markets we oversee. But as all of you know, the Agency's origins are in agriculture. An industry that is as basic and important to the lives of American families as perhaps any other or more than any other. Futures on agricultural commodities have been traded in the U.S. since the 19th Century and have been regulated at the federal level since the 1920's. And today, agricultural derivatives remain fundamentally important even though they may just be one piece of the markets that we oversee. The ability of participants in the agriculture sector to hedge commercial exposure is critical to having a successful agricultural industry and to putting food on the table for all of us.

Now, the way I think of the CFTC's job in overseeing these markets is not simply to help participants be able to hedge effectively. We should be helping these markets thrive and in turn helping the agricultural economy thrive. And I know that strengthening the ag economy, fostering investment and new opportunities in the ag economy are important to all of you and to our special guest, Secretary Vilsack. Our ability to oversee these markets successfully requires listening to market participants and that's why we're having this meeting today. It is helpful to hear your thoughts on what we are or what we should be doing.

Now, I know traveling to Washington two weeks before the holidays, which is a very busy time, is not always easy. But I know I speak for all the commissioners in saying that your presence and your participation on this committee are much appreciated. I joined the Commission about six weeks ago -- six months ago, excuse me, as did

Commissioners Bowen and Giancarlo. And the three of us have also benefited from Commissioner Wetjen whose experience helped us as we got up to speed. I'm very, very pleased that all of us could be here today. We've all been listening and learning from market participants like you. And in the last six months, we have focused on moving forward with important reforms to promote greater transparency, but also we've made it a priority to address areas where our rules may not be working as well as they should, particularly as that pertains to end-users whether they be farmers, ranchers, manufacturers, or other businesses. Our goal is not to create unnecessary burdens on commercial end-users, but to build a reliable orderly framework for oversight in which vibrant markets can thrive. And we've taken a number of steps in the last few months to that end as you may have read. Some of these actions I know are especially important to the agricultural industry such as our proposed change to the rules on residual interest and our changes to certain recordkeeping requirements. We've also addressed other issues such as contracts with volumetric optionality, making sure publically-owned utilities can access the energy swap markets effectively, and making sure end-users can use their treasury affiliates for swap transactions and still benefit from the congressional end- user exemptions.

Today, we will discuss a few topics particularly important to the agricultural markets. And we've decided upon that agenda in consultation with you. We'll first discuss how the current agricultural economy is impacting CFTC regulated markets. And then discuss how to best calculate deliverable supply for commodities, a topic that is critically important to establishing position limits. We'll also spend a little more time discussing what the Agency has been doing lately and what we should consider having this committee discuss in the future. So thank you again for being here and contributing your ideas. I look forward to a productive discussion.

DR. FORTENBERY: Thank you. Commissioner Wetjen, any comments?

COMMISSIONER WETJEN: Thank you, Randy. Thank you, Chairman Massad. And welcome everyone back to the CFTC. It's been, I guess it's been just over a year since this group was last convened, so it's a pleasure to see everyone again today. I was going to make some remarks about the Secretary, but maybe I'll wait on that until after he arrives. But let me just say for now it's obviously a real honor to have him here with us today. He continues in a strong tradition of having secretaries of agriculture from the great State of Iowa, my home state. And carries on a very good tradition in that respect, so we're eager to hear what his report is on the state of the ag economy.

I have some semblance of my own small report. I was back in my home state a couple of weeks ago and spent some time with some market participants back there, but also did some other visits. And one of them was visiting the World

Food Prize and the leader of that organization former Ambassador Quinn. I spent a good amount of time with him talking about the history of that organization, of course, its founder, Norman Borlaug, who I'm sure is someone that a lot of people in this room know a great deal about. But that's someone whose name I had heard before but, frankly, wasn't familiar with as much of his history as perhaps I should have been. And I see the Secretary coming in now. But I raise it because, again, it's a reminder to me that what we do here has a great impact on what's happening in the cash markets and the real physical markets for a number of different physical commodities, but perhaps most importantly, ag. And these markets are in service to the physical ones and so it's very, very important that our policies here make sense, that they're workable, and so it's important that we continue having this discussion about what it means with respect to physical -- or excuse me, bona fide hedging. And that's something that we've been spending some time on already, but continue to work through and try and craft a reasonable definition and conception of what that means to make sure again that these markets are in service to the physical ones and remain an effective place for ag producers and others to hedge.

Mr. Secretary, welcome. Great to see you again. And with that, I'll turn it back over to Randy.

DR. FORTENBERY: Thank you. Commissioner Bowen.

COMMISSIONER BOWEN: Yes, thank you. Good morning everyone. I am happy to be here at this meeting of the Commission's Agricultural Advisory Committee. Farmers and ranchers have been at the very heart of our commodities markets since its inception. We need to make sure that our rules and regulations remain responsive to their concerns. I look forward to hearing the views about the issues facing small farmers and ranchers and I hope my staff and I can be a resource to this community.

I also welcome the chance to discuss position limits, which is a key rule on the Commission's docket. I support the effort to reopen the comment period on this rule. And I look forward to hearing the views of stakeholders and how we can best enhance this rule. That said, it's been over a year since we reproposed this rule and it is incumbent upon us to release the final rule soon. Thank you.

DR. FORTENBERY: Commissioner Giancarlo.

COMMISSIONER GIANCARLO: Thank you, Randy. This Committee serves as a sounding board for the CFTC's original constituency, agriculture. Our official seal features the image of a field plow. It's a reminder that the well-being of America's agriculture must remain foremost as we put forward regulation. The importance of the ag community and ag commodity futures is reinforced by the service of this committee. And I commend Chairman Massad for its sponsorship, which gives matters before the committee their rightful permanence. It's also highlighted by the attendance today of Secretary Vilsack, and I look forward to his comments.

Earlier this year, the UN Food and Agriculture Organization issued a report called The State of Food Insecurity in the World. It makes fascinating reading. Approximately 800 million people around the world today are undernourished. That is roughly one in nine of the world's 7.2 billion people. It's a staggering shortfall. Now, consider that the Census Bureau estimates that there will be another two billion people on earth in the next 30 years. How will all these people be fed? Clearly, American agriculture will play a big part in feeding the globe just as the U.S. is emerging as a self-sufficient producer and major supplier of energy to global markets thanks to American ingenuity and entrepreneurship. So also, the U.S. Is an enormous producer and supplier of food to the world thanks to the hard work and intelligence of the American farmer.

American agriculture and energy

producers will respond to the rising global demand with the vital support of U.S. financial and derivative markets regulated by this Commission. Efficient and well-regulated markets will remain essential to American food production. They will facilitate return on capital for investment in equipment and technology necessary to serve the world's growing appetite. In short, America's farmers supported by America's derivative markets stand ready, willing, and able to feed the world's growing population. Yet, while these global trends are playing out, America's farming community is itself undergoing transition. Fewer and fewer Americans are becoming farmers. Approximately two percent of the U.S. population is engaged in farming necessary to feed all the rest of us. It's a challenging endeavor that involves long hours, hard work, and thin profit margins. Regulation must not increase those challenges.

Today we will discuss the CFTC's proposed position limits. They should be carefully considered and examined and, if necessary, reexamined. We will review deliverable supply numbers for ag products, some of which were calculated years ago. I'm interested to know if the data remains relevant. Congress told the CFTC to impose position limits to curb excessive speculation. Yet, the vast majority of farmers, ranchers, and other agriculture participants are not wanton speculators, let alone excessive speculators. They should be wholly excluded from the new CFTC position limits regime. They should not be second- guessed on whether hedges they use in their farm production satisfy regulators' concept of bona fide hedges. What do we know about hedging ag production? If we replace farmers' commercial risk management decisions with Washington's risk management assumptions, we're all in for a lot of trouble.

In closing, we must always ensure that the rules we write are smart, efficient, and do no harm. When it comes to ag futures markets, our actions could have a larger impact than we realize. Feeding the globe, not just next month, but 30 years from now, it's a hungry world and getting hungrier. Thank goodness for the American farmer and efficient U.S. markets. Thank you, Randy.

DR. FORTENBERY: Thank you. At this point, I'm going to turn it back to Chairman Massad, also the sponsor of our committee by the way, to have him introduce our first speaker this morning, Chairman.

CHAIRMAN MASSAD: Thank you, Randy. I'm very pleased to introduce our honored guest, Secretary Tom Vilsack. As you all know, throughout his career as a governor of Iowa, and now a secretary, he has been a tremendous leader. He's always focused on trying to do things to improve the lives of Americans. And I know he's particularly focused these days on how to strengthen the agricultural economy, how to strengthen rural communities, how to get more investment into that agricultural economy in those communities, how to foster innovation. And that's why I'm particularly excited that he's here and excited to potentially have opportunities to work together because as I was saying earlier, I think of our job as not only regulating these markets so as to achieve transparency and integrity, but also to help them help the futures options and swaps markets, particularly as they pertain to agricultural commodities, continue to thrive, which should in turn, help strengthen the agricultural economy. So I'm hopeful that we can collaborate and coordinate in the future. And again, I'm very, very honored that he could be with us today, Secretary Vilsack.

MR. VILSACK: Mr. Chairman, thank you very much. And to the Commission, thank you for reconstituting this Agricultural Advisory Committee and thanks to the members and to the Committee for your willingness to serve in this important role. I must say that I'm always a bit puzzled when I'm asked to speak about the state of the agricultural economy because I often want to ask the question, which agricultural economy would you like me to talk about? Do you want me to talk about the agricultural economy that impacts roughly 200,000 producers in this country that produce 85 percent of what we grow and raise? Or do you want me to talk about the bulk and majority of American producers in this country who are finding it more difficult each and every year to be able to profit simply from farming, which requires them to seek off farm income for themselves and their family and the efforts by the United States Department of Agriculture to provide those opportunities. Or do you want me to talk about the global impact of agriculture generally and the opportunities that exist in the future? Let me touch on all three very briefly and then I'll hopefully have time for questions. And I apologize to the Chair and the Commission, the President's speaking to senior executive service personnel at a function that is a command performance and so I may have to leave just a few minutes early for that.

Let me speak first and foremost about

the extraordinary work of production agriculture in this country that indeed produces for every single farmer enough food not only for their farmer and family, but also for 150 people around the world. For most commodities, we've seen a very strong and solid agricultural market the last several years. Despite the challenges in the livestock industry, we have seen a rebound recently and we have seen increased interest on the part of export opportunities in terms of our livestock industry. And with the resumption of the Farm Bill disaster programs, we've seen 465,000 checks sent out to producers across the country for disasters that they had to struggle through in 2011, '12, and '13, pumping an additional $4.2 billion into the ag economy this year. Record income overall in American agriculture and record exports in the last five years. In fact, last year we reached a record in overall ag exports at $152 billion, and a record ag surplus. In other words, we sell a lot more to the world than we purchase from the world at $43 billion.

We expect and anticipate another strong year this year. The current projections are slightly below the record level of last year, but that was also the prediction at this point last year, so I'm confident that if we continue to press our trade advantage that we'll continue to see strong exports, which should support commodity markets and should support those producers who are involved in production agriculture. They represent the bulk of what we produce. If you want to take to a finer point, 33,000 farming operations produce 50 percent of what we produce in this country. There are roughly 2.1 million farmers by the definition that we use at USDA, which is anyone who sells or produces more than $1,000 worth of product value. That's obviously a pretty liberal definition of farmer. But 1.3 million of those people are what we refer to as residential farmers. These are folks who have a small acreage. They produce something, perhaps they sell it at farmer's market. They are not making a great deal of money from their farming operation. In fact, many of them operate it at a loss. But they don't need the farm income.

Roughly 700,000 producers are in the middle. They produce less than 250 to $300,000 worth of product. They are the ones that consistently struggle each and every year. And what we have attempted to do for those individuals is to create new alternative market opportunities. So production agriculture focused primarily on the export opportunities that exist and the high value opportunities that exist in our economy. For medium-sized producers who are struggling, we are looking at ways in which we can create local and regional markets in which producers can directly negotiate with their customer. It may be a farmer's market. It may be a food hub. It may be a farm to school effort. About 200,000 producers today are participating in that direct to consumer sales opportunity. It's roughly a $7 billion industry and it's the fastest growing aspect of agriculture. The future for that market is good and solid as well. The reality is that there is a lot of upside potential, particularly in the farm-to-school market, which is a multi- billion dollar opportunity. Roughly 10 percent of the food that's sold to schools today is locally and regionally produced. So there's a tremendous amount of upside potential there. We've seen a rapid increase in farmer's markets and food hubs. So I'm confident that we're going to continue to create market opportunities for those small to medium-sized producers.

Our ability to continue to help production agriculture will depend in part on our capacity to continue to engage the world in trading relationships. That's why it's extraordinarily important in 2015 that Congress sees its way to provide the President with the trade production authority, trade promotion authority, and that we conclude at least the negotiations with reference to the Transpacific Partnership. This is a trade agreement that impacts 40 percent of gross domestic product globally, a third of all world trade. And it is the place where there is going to be a substantial expansion of middle class consumers who will be interested in American high value products.

To give you a sense of this, there are roughly 525 million middle-class consumers in the countries that are engaged in the TPP discussions. It is expected by the year 2030 that that number will exceed 2 billion. So there is a tremendous opportunity for us with the TPP. The negotiations are continuing. They are focused from an ag perspective on expanded market access, particularly in the Japanese market. The negotiations have not been easy in part because we don't have trade promotion authority. It's hard for those we're negotiating with to understand our capacity to deliver on a trade agreement if there is the risk or the possibility that Congress could seek to amend or modify the agreement. But I'm confident that we will eventually get trade promotion authority and I'm very confident that agriculture will benefit from a strong and progressive and high standards agreement that we'll be able to negotiate through a Transpacific Partnership.

We are also engaged in negotiations with the EU. Were those negotiations to conclude, we would have the largest trade agreement in the history of mankind. It would open up an opportunity for us to shrink the gap that currently exists between EU imports into the United States and U.S. exports to the EU market. It's an opportunity, an upside market opportunity, but there are significant and serious issues engaged in that trade negotiation, not the least of which is the stance on biotechnology, the stance on geographic indicators, and some of the beef and livestock issues, which are difficult. So trade promotion and trade for production agriculture, local and regional market opportunities for the small to mid-sized operator, that is the focus.

The last thing I would say without going into specifics, which perhaps the questions we'll get into, is that it is important for us to be focused on high value additional opportunities, market opportunities, for agricultural products. It is not going to be enough in the future for us to rely solely on exports and solely on local and regional food systems. It will be necessary for us to look for creative ways to use agricultural products to produce other materials and items within the economy. It's what I refer to as the bioeconomy. Most often we think of it in terms of fuel and energy and the use of crops and crop residue and woody biomass, et cetera, to produce fuel and energy. Certainly a critical component of this, but it's now expanded significantly beyond fuel and energy. It now relates to chemicals and polymers and other fabrics and fibers, all of which open up enormous manufacturing opportunities, particularly for rural areas.

In order to maximize that opportunity, it's going to be necessary for us to continue to invest in infrastructure, continue to attract credit and capital to rural America. Candidly, we simply will not have sufficient resources within the USDA to make the investments necessary, so we've got to figure out ways in which we can leverage our resources. Last July we held a conference here in Washington, the Rural Opportunity Investment Conference, where we invited 600 participants, investment bankers, commercial bankers, venture capitalists, pension plans, and others to begin the process of educating them about the deals that do exist in rural America. From that conference, we received a commitment from CoBank to invest up to $10 billion in infrastructure in rural America, and the Farm Credit System put together a $150 million equity fund that will help small businesses with equity funding. We hope to be able to expand the number of those kinds of funds in 2015.

So we're looking for ways in which we can use agricultural products in creative and innovative ways through partnerships and leverage. We believe that there is an unlimited opportunity to redefine the rural economy, to create new opportunities for income for producers with waste product and crop residue and unproductive land. We think there's an opportunity to create the jobs that will support those mid-sized operators and their families with additional income. We believe we can also then make the case to young people to want to be in the agricultural business, to want to return to their small communities. And there are a substantial number of these young people we want to welcome back, particularly returning veterans. Many of them come from these rural areas and we are engaged in an aggressive effort at USDA to assist returning veterans to become beginning farmers.

And so I think the future for ag is bright. I think there's solid opportunities for us to expand production opportunities with a solid income already. I think there are tremendous new opportunities to use what we grow and what we raise in rural America in more creative ways, which I think will strengthen the agricultural economy and the rural economy. Mr. Chairman, I'm happy to answer questions. I will tell you that I am a generalist among all these experts here and specialists. If you start asking me about swaps and things of that nature, you're going to get the blank stare. But I'm happy to talk about the rural economy. I'm happy to talk about what USDA is doing and other specific questions about the ag economy.

DR. FORTENBERY: Thank you, Mr. Secretary. Do we have any questions while he has some time for us?

COMMISSIONER WETJEN: Randy, I have a quick question.

DR. FORTENBERY: Sure.

COMMISSIONER WETJEN: Great to see you again, Mr. Secretary. You'd mentioned creating new opportunities both for the younger generations as well as veterans. To what degree has the cost of land proven a challenge in those efforts and what specifically has the Department done to try and deal with that challenge?

MR. VILSACK: When the commodity prices were particularly high, it had a tendency to increase both the value of land and the rental costs of access to land. As we have seen a moderating of commodity prices, we have not necessarily seen a corresponding moderating of land values or rental values. We would anticipate and expect that there will be some adjustment to rental rates over time if these commodity prices remain where they are today, which will make it a little bit easier.

We've done a couple of things in terms of access to land. We are engaged right now in consolidating some of our lab resources that we have that do research at USDA. And these lab resources are surrounded by thousands of acres of land, oftentimes. And as we close labs and consolidate labs, the law requires us to turn these lands over to the land grant university that we may be associated with, with reference to the lab. We have now begun a process of asking those land grant universities to make that land more readily available to beginning farmers so that they have access, better access, more reasonable access to land.

You know, candidly, the discussion about land and future generations often results in a conversation in farm country about estate taxes, which I think, frankly, is the wrong conversation. The reality is that hardly anybody pays estate tax. And there a multitude of ways in which smart operators can avoid the payment of estate tax. The problem is the income tax. And the reason it's a problem is that a lot of land is owned now by older farmers and farm families and those who have survived a farm member. In fact, there are three times the number of farmers over the age of 65 than there are under the age of 35, so there's going to be a significant land transfer here over the course of the next couple of generations. And the reality is that we don't have any incentive in the tax code today that encourages someone like myself. My wife and I own roughly 600 acres in Iowa. When we purchased this farm and got this farm, we purchased it at a place when it was relatively low value. It has appreciated since we've owned it nine times. Now, I could sell it tomorrow and pay a substantial amount of tax. Or I could wait to die and my wife could die and our sons could inherit this property and sell it the next day and not pay a penny in income tax because of stepped-up basis.

There is no incentive in the tax code today for me to even consider the possibility of selling it to a beginning farmer, selling it to a returning veteran. So I've been encouraging members of Congress to think about this particular issue in a different way apart from sort of the tired and old conversation about the estate tax, which really is not really the burden. It really isn't. The burden is that there is no incentive right now for me or people like me, absent landowners, to even consider the possibility of selling to a young farmer or beginning farmer. If there could be a way in which that farmer could absorb our basis, transfer a basis or there was a way in which we could be incented so at the end of the day we end up with a little more money in our pocket than we would have if we didn't sell it or if we sold it to someone whose been around for a while, there might be more opportunity for access to land.

The last thing I would say is that we are focused on trying to encourage small producers to start small and build over time, which is the history of many farming operations. And so we have created within the farm credit system a Microloan program, which has been quite popular since we instituted it. Over 8,000 loans have already been made. And this allows people to start small. To use up to $50,000 in credit to purchase a piece of equipment, to rent a piece of land, to buy the supplies to start small. Now, it obviously is not going to be the kind of thing that's going to enable somebody to buy 100 acres or 1,000 acres, but it is a way in which they can get into the business. And then through a series of other steps that we've taken to make crop insurance more readily available and less expensive and other risk management tools, we are trying to find ways in which we can encourage more folks to consider starting small and then building over time. So whether it's using our own land, encouraging other federal agencies to consider renting and leasing land, or providing land to beginning farmers, or creating new market opportunities, new credit opportunities, or advocating for changes in tax laws, we are engaged in a broad array of steps to try to help beginning farmers get rooted.

DR. FORTENBERY: I think we might have time for one more question. Does anybody from the committee have a question or a comment?

MR. VILSACK: I was told this was a -- yeah, there we go, there's somebody in the --

DR. FORTENBERY: Yes, sir.

MR. PENNER: Yes, thank you, Chairman. Thank you for meeting with us, Mr. Secretary. We appreciate the comments you have made. One question I have as a wheat grower, as well a leader of an organization that does work with wheat exports, you know, U.S. wheat is part of one of the arms that helps with export trade. With the TPP agreements, at what point do you decide whether to conclude the agreement outside of Japan's insistence on maintaining the sacred commodities that they want to have as an exception? Is there a point where you would go ahead with an agreement with the other countries or would you continue to try to negotiate with Japan?

MR. VILSACK: Well, I think the goal here is to have a solid agreement. And the reality is that it would be difficult to obtain the necessary congressional approval if we don't have a solid high standard agreement. I think we are confident that continued negotiations will lead to an opportunity to have greater market access in Japan in some of these commodities that have been at issue. You know, candidly, you know, I think progress has been made on a couple of key issues with reference to the Japanese, which is indicated to me anyway and I think to Ambassador Froman who I was with yesterday that there is still a pathway to a solid high standards agreement that includes Japan. And the reality is I think other members of the TPP negotiations, particularly those Asian members, are quite interested in having Japan be part of this.

Now, here's why this is important. It's not as if this negotiation is happening in a vacuum or by itself. There are two other forces at play here that we need to be conscious of in the U.S. One is that there are contingent negotiations, one-off agreements between individual countries or small groups of countries. In fact, there are roughly 250 of these smaller trade agreements. The U.S. is only a party to 14 of them. So if we are able to fashion a TPP agreement, take advantage of this huge market opportunity, that's not going to prevent other countries from reaching agreements individually that will make it much more difficult for us to be competitive in those markets.

Secondly, and perhaps even more worrisome, is that China is trying to encourage Asian countries to disregard TPP and focus on an agreement that China would help to fashion. Well, this is an agreement that would not take into consideration the multitude of issues that we're trying to address with a high standards agreement, and it would obviously not create the kind of opportunities that we're looking for from a U.S. Perspective. So we don't want to cede this opportunity to China. We don't want to be left out of agreements that will clearly take place if we can't conclude TPP. So I think we have to continue to be vigilant, especially with the Japanese.

Now, having said that, we still have one other participant in this agreement who has not stepped up as much as they ought to have given what's at stake, and that's our Canadian friends. They have refused up to this point to even enter into negotiations. Candidly, I think it's ill-advised and it's unfortunate. And it may very well be that if that attitude persists, that you could find an agreement that does exclude a country. But I don't believe at the end of the day it will be Japan.

DR. FORTENBERY: Mr. Secretary, thank you very much for spending some time with us this morning. We certainly appreciate it. I understand you have other commitments, but --

MR. VILSACK: Well, I apologize for this and I look forward to future opportunities. I would certainly welcome the opportunity to come back when it's convenient and appropriate from time to time.

CHAIRMAN MASSAD: And let me just add my thanks also and I look forward to continuing to work together. Hopefully, there will be many opportunities where we can coordinate and collaborate. Thank you.

MR. VILSACK: Thank you.

DR. FORTENBERY: So we're just a few minutes ahead of schedule. Let me ask quickly before we take a break, is there any other discussion or comments for the benefit of the commissioners that any of the committee members would like to engage in to follow-up on Secretary Vilsack's comments? Any of the commissioners have anything they would like to add or?

Okay, so here's what I think we'll do. We're going to go ahead and break a few minutes early. I'll call us back into session in about 15 minutes and we'll begin with our first panel. So enjoy coffee, water, introduce yourselves to each other and we'll be back in 15 minutes.

(Recess)

DR. FORTENBERY: Thank you. I'd like to call the AAC meeting back to order. One other quick note. As we're entering into the discussion, if you have an opportunity to introduce yourself and your organization at least when you first speak, that would be helpful probably to the rest of the committee so everybody knows who's talking and what their affiliation is. What we're going to do this morning is start with our first panel. The panelists are going to be speaking about the implications of the agricultural economy for the CFTC and DCMs. We have two panel speakers this morning. The first is Greg Kuserk who's the Deputy Director of Product Review at the CFTC Division of Market Oversight. And then we have David Lehman, who's the Managing Director of Commodity and Product Development at the CME Group. What I'll ask is that we allow both presenters to present and then we'll open the floor for discussion. And so at this point, I'll turn it over to Mr. Kuserk.

MR. KUSERK: Okay, thank you. I'm just going to get the slides up here a moment. Good morning. I'd like to begin by thanking the Agriculture Advisory Committee and the participants in today's meeting for taking the time to be here today to share your thoughts and views on the agricultural commodity markets. Also, I would just like to clarify that the comments and opinions that I share here today are my own and do not necessarily reflect those of the Commission or other staff. Meetings such as these are important because not only does it give the public the opportunity to comment on issues of importance, but it contributes to a better informed staff of the Commission, which helps us to better carry out our mission.

Listening to the Secretary earlier, I think that we can all agree that agriculture is not a static industry. There are years of good yield and high production followed by lean years. Likewise with demand, there is a constant shifting of needs throughout the world, as well as the development of new production sources and product uses. The impact of these changes on the futures market is that the Commission, as the regulator, and the exchanges, as developers of contracts, must stay current to ensure that contracts being offered to the public remain relevant and safe from a regulatory perspective.

What I'd like to do is spend a little time talking about what we in the Product Review branch do with respect to the agricultural contracts and how the treatment or scrutiny that is given contracts on agricultural commodities differs in some respects than for other commodities. In some ways, there is not much difference in the treatment of a contract on an agricultural commodity and that on any other commodity. Under Core Principle 3 of the Act, contracts listed on the DCM must not be readily susceptible to manipulation. And this core principle must be met on an ongoing basis. From the start, when a contract is listed, staff will perform a review of the contract to determine whether the contract appears to mirror cash market practices. They will look at the availability of deliverable supply at delivery points. They will look at the mix of market participants and they may look at any number of other factors that might come into play with respect to the design of a contract. And staff will talk with market participants in forums such as this or through special roundtables or hearings or public comment periods to gain the public's input on contract design.

For contracts that are already being traded, staff continues to monitor the performance of those contracts. The surveillance group here at the Commission constantly monitors contract performance as that contract goes from one delivery expiration to the next. Through that monitoring, they will note whether the cash prices and futures prices tend to converge from one expiration to the next. They will note whether there are delivery issues from one expiration to the next. If issues arrive, the division staff both product review and surveillance staff monitor the situation carefully in order to gauge whether problems appear to be isolated instances or whether they are more systemic in nature and possibly related to the design of the contract. I would also add that we regularly have conversations with the product development and market regulation staff at the exchanges. And I understand that Dave Lehman is going to share with you some of the analyses that they recently shared with us on their convergence monitoring program.

In terms of what happens when the exchange believes it's necessary to amend a contract, the Act provides different levels of scrutiny depending on the type of commodity underlying the contract, the level of activity in the contract and the complexity of the change being proposed. The figure I have put up maps out the decision tree that is followed when a contract amendment is sent to the Commission. In terms of the type of commodity involved, certain commodities, what we refer to as the enumerated commodities, are afforded a higher level of review than for other commodities. And these enumerated commodities are listed there on the left side of the slide and basically those are outlined in Section 1a(9) of the Act.

So the first question that is asked is whether the amendment is for an enumerated commodity. If not, then the commodity can go forward with a 10-day certification, meaning that the exchange can certify that the amendment is compliant with the Act and Commission regulations and it can go into effect in 10 business days. If the commodity is one of the enumerated commodities, the next question that is asked is whether there is open interest in the contract. If not, again, it can go to a 10-day certification process. If there is open interest, then the question is asked is the amendment material? In making this determination, staff typically asks whether the change would have affected market participants' decisions to enter into the contract or make or take delivery. Also, would the change be expected to change the value of the existing contracts? And would the change cause the contract to no longer be in compliance with one of the core principles?

If the change is determined to be material, then the contract would need to be sent in for formal approval. Under that process, there is a 45-day period in which staff has the opportunity to review the contract for compliance with the core principles. In addition, if staff determined that the contract should not be approved, it could only do so if the contract was found to be inconsistent or appear inconsistent with the Act or Commission regulations. Finally, if the proposed amendment was found to raise novel or complex issues that require additional time or if the application was incomplete, the Commission could extend the period by another 45 days to complete the review.

The approval process would involve the most formal review of contract amendments. In that case, the amendments would be put on the Commission's website and staff would welcome any views of the public. Regardless of whether an amendment is self-certified or approved by the Commission, the exchange is always required to note any substantial opposing views that it may have received from market participants. In addition, all amendments are posted on the Commission's website and because of the continuing obligation for compliance with core principles, we would welcome any feedback on contract performance.

That's a general overview of the amendment review process and I look forward to the discussion to follow. Thank you.

DR. FORTENBERY: Thank you, Greg. Dave Lehman from CME Group.

MR. LEHMAN: One second here while I change slide decks. Here we go. Well, thank you very much, Chairman Massad and the committee, Christa and Cory for inviting CME to participate today. I've been asked to give a little review of how we monitor convergence in our physically delivered contracts. And then I'll also talk a little bit about corn contract review that we are in the process of now where we're reviewing the terms and conditions of our corn futures contract.

So in terms of convergence monitoring, we -- as I said -- monitor convergence at either expiration or first delivery day for all of our physically delivered contracts. And the goal there, obviously, is to assure that cash and futures prices converge during the delivery period. The first step of that process is to collect cash price data and this is somewhat difficult in some markets. In the grain markets, we do have USDA data that the Agricultural Marketing Service collects and publishes on a daily basis. And these are bid prices from consumers, from grain elevators, ethanol plants, to farmers for spot delivery.

This chart is a chart of the September Wheat expiration and so just to give you an idea of the areas that we look at, the different locations. We're looking at the cash price or basis for about 90 days prior to expiration. And in (CBOT) Wheat we have multiple delivery points. We have a primary delivery point in Toledo, Ohio. We also have a delivery point in Chicago. Those are both at par. We have delivery on the Ohio River, which is at par as well, and then delivery on the southern Mississippi River. This chart doesn't have a price for southern Mississippi. But the other prices are charted here. And as you can see, the primary delivery point in Toledo is the gray, kind of light gray line. And it showed essentially a zero basis just after the delivery period began. So the vertical black line in the chart is first delivery day, and that's the day that we look for convergence. Obviously, it could converge throughout the delivery period, but that's what we're looking at.

This chart is Kansas City Wheat. The only other data point we have other than Kansas City terminal wheat prices is for the Gulf, New Orleans Gulf. The Gulf has been very strong in wheat, so that kind of dampens the price, so I've charted just the Kansas City basis with respect to KCHRW futures in this chart. And as you can see on first delivery day that we're right on delivery value.

This is the Corn chart. This is September Corn. The other two charts were September Wheat as well. So these are the latest expirations that we have. Again, we're looking at Chicago. Northern Illinois River is our primary delivery territory from Chicago to Peoria, Illinois on the Illinois Waterway. And so we're looking at the northern Illinois River cash price as reported by USDA. We're also looking at central Illinois, which is obviously a large consumption area, large production and consumption area with the processing that's located there, and then the Gulf as well. And as you can see, strong Gulf prices and that's been the case in all of these key commodities in corn, wheat, and soybeans even into the, you know, the current period through harvest where we've had a really big crop. We're still seeing very strong prices at the Gulf and strong basis values in Chicago. You can see the Chicago basis on first delivery day just maybe four cents, five cents under futures.

This is the November Soybean expiration, so a little more current. Same, you know, process here, same delivery points. The difference in the (CBOT) Soybean delivery territory is it extends all the way to St. Louis on the Illinois Waterway. So we have a few additional points. Southern Illinois, we don't have a price for southern Illinois. It's not reported by USDA, but we are again looking at northern Illinois River as the primary delivery point, Chicago, and again, looking at central Illinois. So soybean basis looks very good as well with a gray line for Chicago showing right at futures value.

So what do we do with this data when we collect these cash bids and then look at the basis on first delivery day for each location and compare that to the historical average? And so historical average for us is three years, the most recent three years of data for the basis on first delivery day. If the value at any of the locations is more than two standard deviations away from that historical average, that triggers in our view a possible convergence issue. And the two standard deviation test is simply...that's a statistical measure of value where two standard deviations isn't deemed to be statistically significantly different than the average.

So we look at mean and standard deviation as I said on first delivery day, each location. We calculate the confidence interval of two standard deviations and then we measure the basis, the current basis compared to that. And if this measurement...if we have an outlier outside the two standard deviation range for two consecutive expirations, then we inform our market regulation department. If it falls outside for three consecutive expirations, then we'll begin reaching out to the marketplace. And, you know, we talk to the marketplace all the time. That's really how we ensure that our contracts are meeting our customers' needs, how we ensure that contract terms and conditions are consistent with the underlying market. So while I say we're talking to the marketplace in this situation where we have some basis weakness, this would be a more formal outreach to the market where we collect some feedback from the marketplace and get their views on what might be going on.

If a majority of those that we contact feel that there are concerns with contract performance, then we would initiate a more formal survey or review industry meeting and reach out to a wider cross-section of the market. And if we see it go away after two expirations, then, you know, that issue we're deeming to be a temporary dislocation of supply and demand or some other fundamental event.

As I mentioned, the corn contract review is underway right now. And this is a standard procedure that we employ at CME Group to, as I said, ensure that our contracts are meeting our customers' needs, ensure that the terms and conditions are consistent with the underlying market. We do this periodically for all of our contracts. And the way we conduct this is we form a focus group of 10 to 20 market participants, a cross-section of buy side, sell side, a few market makers or proprietary trading firms, investors in the market. We hold individual calls or meetings with each of those focus group members and go through a set of questions about the contract terms. The (CBOT) Corn contract I think we have 15 questions that we're asking. So everything from the grade, deliverable grade and differentials for non-par delivery grades, location differentials, contract months. In this review, we asked also whether the contracts should be pricing in metric tons rather than in bushels. We're the only marketplace in the world that uses bushels. But as you can imagine, that feedback came back pretty strongly keep it in bushels. That's the market here in the U.S. and that's what the contract is based on.

But anyway, we'll do these one-on-one meetings and then synthesize that feedback, summarize it, and then hold a meeting, call everyone to a joint meeting where we discuss this feedback. We don't attribute the feedback to any individual firm. It's all obtained on a confidential basis. And we discuss in a group setting then the feedback that we've heard and areas where we think there might be a need for a contract adjustment.

So in the case of the corn contract as mentioned, it was comprised of commercials, brokers, proprietary trading firms, hedge funds, index funds. The individual calls were held in August through November. The focus group meeting was held on November 19 in Chicago. The overall kind of feedback from the focus group is that this contract is working very well. It's an extremely liquid contract. Be very careful about any adjustments you make because we kind of view this as the gold standard, if you will, of agricultural contracts. However, there were recommendations for some adjustments in contract specifications and we're continuing to review that feedback and continuing to consider whether adjustments should be made.

So that's the end of my presentation. And I also look forward to questions from the committee. Thank you.

DR. FORTENBERY: Thank you, Dave. Before I open it up for discussion from the group on the floor, we do have a couple of committee members that have connected with us by telephone. So let me first ask if anybody on the phone has a question or a comment for Greg or Dave?

MR. COOPER: No questions.

DR. FORTENBERY: Okay, thank you. So let's open it up to general discussion on the floor. Any committee members or commissioners questions or comments? Go ahead, sorry.

MR. RINIKER: Do I hold this down while I talk, or...?

DR. FORTENBERY: Push it once and it's on. Push it once and it's off.

MR. RINIKER: Okay, Paul Riniker with the National Farmers Organization. I've got a question on the corn. The basis in our area, which is northeast Iowa, when the corn started going in reverse after the 2012 drought back up the river, how could we be pulled out of the market on a 90 cent basis drop, I believe, in one day? In two days, I believe, we were like a plus basis at the time, probably a buck ten and almost in two days' time it was almost a $2 drop just from some corn coming back up the river into Dubuque, Iowa. How is the basis regulated? It seems like the buyers were kind of setting the basis at the time, you know, of the corn. That's the question I have. Who regulates the basis?

MR. LEHMAN: Well, I'll start on that. Obviously, our contract reflects the flat price, the price of corn in Chicago and on the northern Illinois River, Chicago and Burns Harbor. The basis is a component of the market that you can't manage with our contract. We recognize that's a separate risk. And so I don't know that the basis is regulated. It's a cash price essentially. And I'll let Greg comment on that. But we have looked at listing basis contracts -- so a separate contract that would reflect the basis in a certain location. We tried three of these that were relevant to the ethanol industry in western Iowa and eastern Nebraska. This has been four or five years ago and the contracts simply weren't traded. So the basis is a part of the market that is discovered between sellers and buyers and really something that we recognize as a source of risk that can't be managed in our contract.

MR. KUSERK: Yeah, and I would add,

right, that the basis isn't something that, you know, anybody in particular determines or that we would regulate. I mean, it's a function of the price discovered in the futures market versus prices discovered in local cash markets. And I think some of the slides that Dave showed he's basically, you know, looking at bases at different locations. But what you might see is at certain locations because, you know, issues really related more to the cash market might be out of line, you know, with other bases that you would see. And I guess with, you know, for us it would be, you know, it would be an issue if you -- over time -- you see problems over and over again at certain, you know, at certain points, particularly if it's certain delivery points that might suggest that there's a problem. But, you know, at any one point in time, you know, it could be a problem or an issue that's related to conditions at that local cash market, you know, versus more broadly at, you know, at other cash markets.

DR. FORTENBERY: Ed, did you have a

question?

MR. GALLAGHER: Yes, I do. Thank you. My name is Ed Gallagher. I'm representing the National Milk Producers Federation. I am employed by Dairy Farmers of America who is their largest dairy cooperative member and for Dairy Farmers of America, I am the President of their Risk Management Division. I've got a question. It's not on corn basis. It's more for helping me better understand some things for our discussion later in the day on position limits. And so my question is when you're thinking about having a new contract or you're proposing a new futures contract, what's the process that you go through now both the CME and then the CFTC to determine what the position limits for the new contract would be and how does deliverable supply enter into that process of determining the position limit?

MR. LEHMAN: Well, I think it's outlined in the attachment that was sent out, the Appendix C guideline on new product design and that an exchange must ensure that a new product has a sufficient deliverable supply to achieve convergence. So really how we look at it, and I think there's a guideline on what a position limit must be in a new contract as well. I believe it's 1,000 or 1,500 contract, something like that in a single month or all months combined. But the deliverable supply question is obviously more relevant to a spot month position limit and we look at -- what we want to ensure -- is that the delivery territory for a new contract or any contract for that matter, is located in the commercial flow, the predominant flow of the commodity that's marketed in that underlying physical market.

A new contract that's relatively new for CME is our ethanol futures contract. It's a physically delivered contract. There aren't many new physically delivered contracts being launched these days. But in that case, Chicago was one of the mandated markets where ethanol was mandated in the fuel blends to meet EPA requirements and so there was a significant flow of ethanol from plants in the Midwest area into Chicago via rail. And so that's how we constructed the delivery mechanism for that contract. It's ethanol that's delivered to Chicago. It's in 29,000 gallon units because that's what a rail car, you know, handles. And we feel that's a predominant flow in the underlying market.

In the grain contracts, they were redesigned in the late nineties as the underlying markets changed from terminal storage markets to more on-farm storage and more flow markets. That's when the Illinois Waterway delivery system was adopted. And what we did there is we looked for the kind of predominant cash market at the origin of production. Some suggested the Gulf, New Orleans Gulf, which is our main export point. But that is at the destination and is limited in its flexibility for how a producer might use that. So we preferred to design the contract with origin delivery and the Illinois Waterway, Illinois River area was the most active cash market that we could find that was homogenous and had enough capacity in terms of loading barges and receiving grain into those facilities.

MR. KUSERK: Yeah, so I would add, yeah, as Dave mentioned, the guidelines we have on the deliverable supply are in Appendix C to our Part 38 regulations. But, yeah, generally, I mean, I think, you know, and we'll talk about this, I guess, more this afternoon about, you know, deliverable supply and how you go about calculating it. But, you know, basically we're looking, you know, at the delivery points in terms of what's more or less freely available. So it's not just, you know, just storage capacity or capacity of pipelines and transportations, but, you know, there's guidance there on, you know, how you consider a commodity. It may be tied up in long-term supply contracts and things like that.

So anyway, but, I mean, we would review when the exchange comes in. You know, they would give us, you know, their analysis of deliverable supplies. And we would look at that and try to, you know, ascertain whether, you know, the assumptions and things that they've made are reasonable. And we would look at our, you know, our own, you know, figures, you know, whatever information we could collect. You know, that would look at deliverable supplies in areas and try to come to a conclusion as to whether the analysis that they've done is reasonable or not.

DR. FORTENBERY: Curtis.

MR. FRIESEN: I'm a --

DR. FORTENBERY: Could you push your button, please, on your microphone?

MR. FRIESEN: It's pushed. There we go. It just didn't light up. I am a small producer. Our group's the National Corn Growers, but I'm a small producer from Nebraska, a corn and soybean farmer. And I know the convergence issue came up probably because of what happened in wheat quite a few years ago. And as a hedger, I watched that with a lot of interest because I use the CME to hedge almost all of my production. So from that aspect, when I look at the long timeframe you're going to take to study a problem with convergence if something happens and I'm hedging in a certain month, if it happens in wheat, I mean, to me that's a disaster. Then I can no longer trust the CME to be a true reflection of price and I would no longer be able to use that as a hedging tool. So I'm a little concerned about the long timeframe before you act or do anything. But maybe you've got policy in place now that that won't happen. I'm sure that's what you're trying to address. But do you feel you've addressed that situation totally?

MR. LEHMAN: Well, in wheat you mentioned the convergence issues that occurred in that market and I believe we do have a change in contract specifications that addressed that issue. In that contract we've implemented a variable storage rate structure so that we measure the nearby spread relative to financial full carry and if that spread trades at 80 percent or above financial full carry during the observation period, then the storage rate is adjusted for the next expiration. So this is something that acts very quickly and when we implemented it we had, I think, about five consecutive increases in storage rates until the market sort of self-corrected. And then those storage rates came right back down almost consecutively as well. So we're now back at the same storage rate in the wheat contract that we have in corn and soybeans.

I understand your concern about the time -- you know, of us taking say two consecutive expirations of a basis abnormality, if you will. Is that too long? Maybe it is, but we want to make sure that we're not reacting to a short-term supply demand situation that really isn't something that a contract design change could address. It is more, you know, as I said, a market condition that's being reflected and our feedback that we collect from the marketplace is always to be very cautious in making contract changes. Do no harm, if you will. These contracts are used by many and we appreciate your, you know, your use of the corn and wheat contracts to hedge your business. But we want to be sure that we're not reacting to something that is really not a contract design issue, but a fundamental market issue.

CHAIRMAN MASSAD: Can I also add the following to Curtis' question? I think it might be helpful to remember there's the contract design process, which David has done a great job explaining. There's also market surveillance. And maybe Greg, or if Harry's still here or, yeah, maybe you could talk about, I mean, if we saw a significant difference even in one delivery period, we're not going to wait around for another one in terms of looking into that. Harry, do you want to talk about that a little bit?

MR. HILD: Yeah, very briefly. I don't want to expand too much beyond the scope of the meeting here. But, yes, there is definitely a different function and it's the surveillance function. I'm Harry Hild. I'm with the Division of Market Oversight and I lead the group of analysts charged with surveillance on the agricultural markets. So there's definitely different mechanisms that we do use, we can use. And it's a very, very different function. We get rather specific with the information that we do request and ask when we're in the moment of an expiration. And I don't want to get too specific on that, but I'm sure that there are participants here. We've talked to a lot of your participants, your traders, and it's definitely very situation-specific. So there are definitely tools and processes that we can follow in the surveillance function.

DR. FORTENBERY: Other questions or comments for Greg or Dave or -- here we go.

MR. GALLAGHER: Yeah, I'd like to, if you don't mind, while we have these two experts here, I'd like to continue to ask them a couple more questions on deliverable supply since that's going to be a big topic of our conversation. So in your discussion about new contracts, you mentioned deliverable supply. You didn't really talk about the significance of deliverable supply and setting position limits. We're going to later talk about a formulaic process of determining position limits based on deliverable supply. And so in existing contracts, not necessarily new contracts, how often do you, the CME, how often do you review deliverable supply? When you do that, does it play a role in consideration of changing position limits? And then how often do you change position limits for different contracts based on anything?

MR. LEHMAN: Well, the position limits in the grain, the legacy grain contracts as they're referred to or the enumerated contracts are federal limits. They're CFTC limits and so they don't get changed very often. It requires a petition process by the exchange to change those limits and that then involves typically an industry comment period and so those limits in the spot month rarely change. Outside of the spot month, same process, requires a petition to CFTC by the exchange to request a change and then a pretty lengthy review and comment period. So those non-spot month limits have been updated. I believe the last time was in 2012, and this was based on analysis of both the Commission and the exchanges did on the level of open interest. And that's a different kind of formula approach. But I think, Ed, you're really talking about spot month limits more so than the single month limits.

In terms of monitoring deliverable supply, we monitor that constantly. We update our own estimates annually. But we look at flows on a monthly basis and so the deliverable supply for corn, for example, is based on stocks in Chicago and Burns Harbor, which are terminal markets with large storage capacity. So we look at those stocks. We actually report that data weekly on our website. It's called the stocks of grain, weekly stocks of grain report. So the market can monitor deliverable supply from that report. But probably more importantly is what flows through the shipping stations on the Illinois River and that's data that the USDA's Agricultural Marketing Service publishes, collects and publishes. And as

I said, we look at that monthly and look at it for the month prior to the delivery month and we believe that's an accurate, you know, reflection of what could be delivered against the contract.

Those are conservative, very conservative numbers because we're not measuring any of the stocks held in areas tributary to the delivery point. So, you know, grain elevators that are 25 miles to 50 miles from the delivery points typically are where the flow comes from. Now, those may be counted on the river because we're counting the flows that are actually shipped on the river. But there's plenty of grain in storage that doesn't come to the river. It may go to a processing plant. It may go to a livestock feeding operation that we aren't counting even though it's what we would consider to be tributary to the delivery points.

And in the livestock contracts, we look at, you know, slaughter cattle marketed. In the dairy contracts, its USDA publishes a Class III milk price that is a national price, and so that data is reported to USDA under mandatory reporting rules, and the prices are. The supplies we collect again from USDA data. So it's pretty much all public data. The one exception might be in soybean oil. One of the reports that USDA had published was discontinued due to budget constraints. There was a little gap there. That was picked up then by the National Oilseed Processors Association. And now I believe the USDA has restarted that report on its own. So we look at this all the time. It's part of our, you know, our continual monitoring of contract performance. And we have databases of this data that we maintain at the exchange.

DR. FORTENBERY: Yeah, Chelsie.

MS. KEYS: Hi, this is Chelsie Keys with the National Pork Producers Council, and I have a question for Mr. Lehman. I believe it was in August of this year the CME Group had proposed some changes to the lean hog contract. And they included lengthening the averaging period and adding additional calendar months in which contracts would be available. And there were comments submitted by industry participants on that proposal. I just wonder if you could share where the CME is in the process of reviewing comments, making the changes, sort of status.

MR. LEHMAN: Yeah, thank you, Chelsie. That's correct. This was another one of our standard contract review processes that we conducted for the lean hog contract. This is a little different contract than most agricultural contracts. It settles to an index or it's financially settled. We have two contracts that are financially settled, the lean hog index contract as well as the feeder cattle contract. And the data that again is used to create this index, we create it at CME. Our staff actually calculate the index. But the data comes from USDA from mandatory reporting by packers to USDA. There was some concern about the volatility of the index, if you will. It's a two-day average of this data that is reported by packers to USDA. And as you noted, there were some suggestions that we linked in that averaging period to three, four, five, some even ten days.

We heard very, kind of inconsistent feedback in the industry meeting that we held to review the one-on-one feedback that we collected. So we decided to do a more in-depth study of the effect of changing that index averaging period. And that study, I've seen a preliminary report, but not the final. The final report we'll have by the end of this month. We actually asked Kansas State University to do that study for us and the results are kind of surprising in that expanding the averaging period really isn't what causes a change in volatility of the index. It's more the pattern of volatility as you lead into an expiration whether volatility is increasing or declining. So as I said, those are preliminary results. And we should have a final decision, if not toward the end of this month, early next year.

The other issues that we looked at, you mentioned contract months. There's some interest in listing every month, expiration month, of the calendar. The feedback there was that that likely would not be successful, that to develop liquidity, enough liquidity to make those months efficient for a hedger would be very difficult. We have a contract month that was added in this product, the May expiration several years ago, and it still suffers from very, very poor liquidity. So we don't think that would really help the contract. What we have heard though is that perhaps listing additional option contracts on those off months, what we call serial options, that would be options on the index rather than options on the future, would be something that there's interest in. So we're exploring that further.

DR. FORTENBERY: Go ahead, Mark.

COMMISSIONER WETJEN: Thanks, Randy. I have a question. In some ways it might be more of an academic one, but since we have all this expertise in the room, I wanted to see if anyone had any reaction to this. It just seems like there is special sensitivity to basis risk. I've heard a couple of producers now point to that. And so I'm just kind of wondering...why has it been the case that over history there hasn't been more of an OTC market in the ag space? And is there anything about our policies here at the CFTC that have stood in the way of that? In other words, if you've got some lender or some other financial institution with the wherewithal to do it, why haven't we seen more, I suppose, bespoke contracts made directly to producers so that they can eliminate this basis risk that they are always going to have when trading in a standardized futures product at the CME or CBOT. I'm just kind of curious why that's been so.

MR. LEHMAN: Well, I'll start off and I'm sure there are many in the room that probably have a better answer to that question, Commissioner Wetjen, than I would. But as I mentioned, we did list basis swaps for, I believe, three or five regions of the corn belt that were kind of concentrated around the ethanol processing industry in, I believe, in 2009 is when those were listed. We applied to CFTC. That was prior to Dodd-Frank. And to list an agricultural swap we had to go through a petition process and we went through that and got approval to list those. And, you know, we were very careful about how we described the regions that the basis would represent so that it had sufficient transactions so that the prices that would be used to settle that would be reflective of the market and we used DTN prices.

And so this is one difference that I think is clear between the agricultural markets and the energy markets is there really aren't -- USDA is such a well-known and trusted source of market information, the market really looks to their data as the, you know, the best source of data for where cash markets are, where supply and demands are. But those are bid prices. They're one side of the market. In other markets, in energy markets, there are companies that do assessments. They look at bids. They look at offers. They look at transactions and come up with an assessment of the market. And that simply doesn't take place in the agricultural markets. It may be beginning to take place, but I think that was probably the reason for the failure of those contracts is the market perhaps didn't really trust the, you know, the indexes that were being created based on these bid prices. Again, I'd kind of open that up for others in the room here who may trade in those markets and have observations on that as well.

COMMISSIONER GIANCARLO: Just a follow-up to that. In that program and that product that didn't take off, were there committed market makers to that or might that have been a product design missing ingredient?

MR. LEHMAN: That's a very good point, Commissioner Giancarlo. We did not have committed market makers in those products. And that's something that we do in nearly every new product that we list we do want to have market makers that are there willing to make a two-sided market. These are pretty niche markets when you get into a basis in western Iowa or eastern Nebraska. Where you might think it makes more sense is trading a basis contract on the New Orleans Gulf between Chicago and New Orleans, which is the primary export point or the Pacific Northwest, which is also a major export point. But again, we just haven't gotten the market support to move ahead with those kinds of products. We have big commercial firms that are very active in those markets. They do trade those markets on a paper. They trade paper in many of these markets. But again, they aren't cleared markets, you know, they haven't gotten to the scale, I guess, or haven't experienced the kind of counterparty risk that would motivate central counterparty clearing.

DR. FORTENBERY: We'll take one more question from MJ and then we'll need to move on.

MR. MJ ANDERSON: MJ Anderson. I represent National Grain and Feed Association and I'm employed by the Andersons out of Maumee, Ohio. I just wanted to address that question, Commissioner Wetjen. My firm in particular and many of the firms I'm here representing will make a market in basis for producers today through 2016. I'll lock-in just the basis with you. If you wanted to lock-in the flat price, we would lock-in the flat price. And that gets into some of the stuff we're going to talk in this afternoon, about what is a bona fide hedge and why I am able to offer that to producers here.

DR. FORTENBERY: Okay, thank you to Greg and Dave. We're going to move on on the agenda. Our next topic this morning is going to be talking about residual interest implementation. And to get it started, we're just going to have a few comments from Tom Smith, who's the Deputy Director of Division Swap Dealer in Intermediary Oversight. And welcome, Tom. Thank you.

MR. SMITH: Okay, thank you. Again, I'll just do a very brief explanation of the residual interest so that we can then move on with the discussion.

Last November, the Commission finalized several rule amendments intended to enhance protections afforded to customers and to the funds customers deposit with FCMs to margin their accounts. One of the amendments, the so-called "residual interest requirement," requires FCMs to maintain a sufficient amount of their own capital or residual interest in segregated accounts to cover any futures customers' accounts that are under margined. Operationally, an FCM is required to identify customer futures accounts that are undermargined and compute the total amounts of the under margin amounts as of the close of business each day. The FCM also is required to ensure that it maintains its own capital or residual interest in the customers' segregated accounts in an amount sufficient to cover the aggregate under margin amount of the customers by the residual interest deadline. The residual interest deadline is defined under the rule as the time of the next business day of the daily settlement cycles of the derivative clearing organizations that clear the respective futures positions.

In adopting the rule, the Commission

established a phased-in compliance period. First, the compliance date for FCMs and market participants was set at November 14, 2014, one year after publication of the final rules. Second, the rule provides that the residual interest deadline for futures shall be 6:00 p.m. Eastern time on the next business day pending the publication of a report by Commission staff addressing the practicability for both FCMs and market participants of moving the 6:00 p.m. Eastern time deadline to the time of the DCO's daily settlement cycle or some other point in time.

The rule requires staff to seek public comments and to hold a public roundtable regarding specific issues to be covered by the report and the report is required to be published for public comment by May 16, 2016. Lastly, the rule provides that absent Commission action after the publication of the report, the residual interest deadline will change on December 31, 2018 from 6:00 p.m. eastern time to the time of the DCO's daily settlement cycles.

Subsequent to the issuance of the final rule, staff of the Division of Swap Dealer and Intermediary Oversight issued an interpretation in response to request for guidance from FCMs and market participants. This interpretation effectively provides that an FCM may credit customers' accounts upon the FCM's initiation of an ACH withdrawal from the customers' bank account provided that the customer has granted the FCM authority to initiate ACH withdrawals. The interpretation provides that an FCM is not required to wait until the ACH transaction clears the FCM's segregated bank account before recording a credit to the customers' trading account. The interpretation is consistent with the Division's previously issued and long-standing review regarding the recording of checks deposited by customers upon the receipt of the check by the FCM.

The Commission also has proposed amendments to the residual interest requirement.

The proposal was published on November 14, 2014 in the Federal Register for public comment and would amend the residual interest requirement to provide that the residual interest deadline will only be changed through a formal Commission rulemaking after the publication of the staff report. Accordingly, if adopted as final, the residual interest deadline would remain 6:00 p.m. eastern time pending Commission action via a rulemaking. The proposal will not alter the requirement for staff to host a public roundtable or issue a report by May 16. The comment period on the proposed amendment closes on January 13, 2015.

DR. FORTENBERY: Thank you. Comments, questions, discussion? Yes, sir.

MR. FRIESEN: I was at the committee meeting the last time we met about a year ago and I guess I'll just reiterate the same comments I made then. I'll go back to my example. I'm a small producer, roughly 1,000, 1,100 acres, which would be an average-sized farmer. And currently with the farm program the way it is and crop insurance products out there, if I'm willing to use the futures market to do a lot of hedging in the cycles that we're in, I can sometimes be hedging two, three years out if I see an opportunity out there. And this helps provide that safety net we've been asking for.

But what you've done now by including a bona fide hedger in this, I don't think we've ever caused a problem with a bankruptcy of an FCM or anything like that. And we're a small hedger, but at the same time, I probably could have, I would say 200,000 to 400,000 bushels of coverage out there, which is a substantial amount. But my FCM now wants to ask me for an ACH for direct access to my checking account and I'm not going to grant it. I will quit using futures positions. I will find some other way to hedge my grain. You've driven me out of the market if you continue to do this. I still think the trade plus two, I can move money in that amount of time. Sometimes I'm out of cell contact or whatever. They've had trouble reaching me, but I will not grant them access to my checking account. It just gives someone an opportunity to steal more money from me then in the future, and I won't let that happen. I'll find a different way to hedge.

So I guess the impact to the small bona fide hedger, whether he's a producer like me, or an end-user, a bona fide end-user, any costs you incur on them gets passed down to me. So in the end, I would hope that you look at true hedgers differently than you do the speculative market. And I have nothing against speculators. I appreciate it when they drive the market too high. I appreciate it when they drive it too low. I'll take advantage of either one. So it's not as though I want them punished or anything, but I think they should be treated differently than a bona fide hedger. Thank you.

MR. SMITH: I understand your point. And I think though we have to take into consideration what the statute provides. And the statute does provide that a futures commission merchant can't use the funds of one customer to margin or guarantee positions of any other person but that customer. So if there is an under margined account at the FCM, they need to cover that in one way or the other. They need to either use their own capital, which is what is sort of required by this rule, or try to call and receive margin funds from the under margined customer. As you know, that's sort of the intent of this rule as well.

DR. FORTENBERY: Excuse me, Tom, I think Scott and then we'll come to you. Go ahead.

MR. CORDES: Thank you. Scott Cordes, I'm here with the National Council of Farmer Cooperatives. I'm employed by CHS, and probably more importantly for this discussion is, I head up our futures commission merchant, CHS Hedging. I want to commend the Commission and thank you for taking some steps to make some amendments to the rule. The way it was originally written headed towards a T-plus-1 was going to be a real problem for the industry. We were looking at it with our customers whether it's farmers, ranchers, or local cooperatives that are mainly hedgers, we're going to have to prefund their margin accounts, and that was going to be a real problem. Probably addresses a little bit to the gentleman to my left about, you know, where's that money, where that access is, and you want to have some say in that to make sure that your funds are good.

The proposal to change the T-plus-1, we're living in that environment today. I would tell you so far it's going pretty well. It's probably something we can live with. I would like to see some more results when we get a major market move. Most of our hedgers recently since it's been implemented, the markets have been going down or sideways. I'd like to see what happens when we go from $5 corn to $7 corn to see what stress we put on our systems, et cetera. But currently, where we are today, is working, but I think we still need some time to bear this out. I know we've taken the approaches, our firm, that we have to deal with a lot of folks that still deal with checks, ACHs. We know we probably are going to put some more capital in our balance sheet to handle some of that. We'll work through that. We figure that's part of our mission of who owns us to go through. But certainly this is a topic that's going to need to see some further review as we go, but I want to commend the Commission at least for taking a positive step. And let's take a time-out here and not push towards T-plus-0 so quickly.

DR. FORTENBERY: Tom.

MR. KADLEC: Thank you. Tom Kadlec representing the Futures Industry Association, and my day job is I'm the President of ADM Investor Services. I echo Scott's comments and appreciate the dialog with the Commission on a multitude of issues. The ACH interpretation, I have worked with Tom Smith and it is a good solution. We have very high standards in terms of the way we communicate with hedgers and it's very well-documented. That's part of the CFTC dialog. We are working through the challenges of T-plus-1 and I'm very interested in being a part of the

CFTC study on this. It's imperative that we calculate the costs and the effects on all of our customers.

I would ask Tom, and we had the benefit of talking a little bit in the dialog, what additional tools should we contemplate, could we use, to move money efficiently through the system to meet the current standards that have been passed? If you have ideas, I think we should continue to look and explore for things like ACHs, whatever they may be. And I also think we should work with ACHs with the banking associations to better document. There's a claw back provision, for example in ACHs, that I get concerned about as an FCM. How can we mitigate that effect? But anyway, thank you for having this meeting.

MR. SMITH: Yeah, I think we'd be very interested in continuing looking at what other alternatives there are for customers to finance their futures positions and, you know, again we're trying to address risks that can build up if any particular customers are under margined, we want that customer to be called for margin and we don't want other customers to be exposed to that customer's potential shortfall.

DR. FORTENBERY: Scott, let me just check-in real quick with our phone participants and see if there's a question from there. Okay, Scott, go ahead.

MR. CORDES: Just a follow-up and you talked about protecting customers' monies and if I had my comptroller here she could explain it better. But there's a provision in the rule right now or how it's implemented that we also have customers with excess funds. They would like those back as quickly as possible. I think today if we send that out inter-day it counts against us on some calculation. And I don't quite know exactly how it all works, but I just want to bring it up as something that needs to be reviewed. So we talk about protecting customers. We've got to think about it in both directions. We've got to be able to send the money back to the people it belonged to, yet not say we got to hold that up for a day because it's going to impact us on a regulatory item.

MR. SMITH: I believe the issue you're referring to is there is a requirement that before funds are returned to customers each day that the firm must do its daily segregation calculation. That needs to be done by 12:00 noon, demonstrate that they are in compliance that not only do they have enough funds to meet any under margined customers, but they actually have sufficient funds in segregation to meet all of its obligations to every single customer. That's one of the key protections of customer funds. It's not only, you know, you...basically every FCM needs to have enough funds in the account at all points in time to pay back every customer if they all walk in the door at one point. So I think that's the issue there. The intent is that we want to make sure that there is sufficient funds at the firm before withdrawals are made.

DR. FORTENBERY: Other questions or comments? Okay, Tom, thank you very much for your time. We have a few minutes before lunch so I'm going to do something, we probably should have done at the beginning, but we were a little bit time constrained early on, and that is to have everyone introduce themselves and the organization they're with and then we'll break for lunch. So are the folks still on the phone?

MR. COOPER: Yes. This is Geoff Cooper with Renewable Fuels Association.

DR. FORTENBERY: Thank you, Geoff. Doris, you want to start with us?

MS. MOLD: I'm Doris Mold. I represent American Agri-Women and I have my own consulting business and I'm a dairy farmer in addition.

MR. ELFMANN: Ed Elfmann with American Bankers Association.

MR. MAY: Bill May with the American Cotton Shippers Association representing cotton merchants in the U.S.

MR. J. ANDERSON: John Anderson with the American Farm Bureau Federation.

MR. WELLMAN: Steve Wellman with the

American Soybean Association, farmer from Nebraska.

MR. KOTSCHWAR: Lance Kotschwar representing the Commodity Markets Council.

MR. BOONE: Robbie Boone representing the Farm Credit Council Farm Credit System.

MR. KADLEC: Tom Kadlec, Futures Industry Association representing them and President of ADM Investor Services.

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

MR. HOUGH: Clay Hough, International Dairy Foods Association.

MR. DIERLAM: My name is Bryan Dierlam. I work with Cargill and I'm here today representing the International Swaps and Derivatives Association.

MR. KALB: Brendan Kalb representing the Managed Funds Association.

MR. STRONG: Steve Strong representing NAEGA. My day job is with Bunge and maybe some of the people that have some basis gyration questions, we can get together at lunch.

MR. BOROUGHS: Ben Boroughs with the North American Millers Association.

MR. LUTTRELL: Ed Luttrell with the National Grange.

MR. PENNER: Paul Penner, farmer from Kansas, President of the National Association of Wheat Growers.

MR. KOVANDA: Joe Kovanda representing National Cattlemans Beef Association, Vice-President Bartlett Cattle Company, Division of Bartlett Grain.

MR. LEE: Ron Lee representing the National Cotton Council. I'm a cotton farmer and ginner in Georgia.

MR. CORDES: Scott Cordes representing the National Council Farmer Cooperatives and I'm also President of CHS Hedging.

MR. FRIESEN: Curt Friesen from Nebraska, producer representing National Corn Growers.

MR. RINIKER: Paul Riniker, National

Farmers Organization, a cattle farmer, and I raise corn in northeast Iowa.

MR. CLARK: Zack Clark with National Farmers Union.

MR. MJ ANDERSON: MJ Anderson with the Andersons, representing National Grain & Feed Association.

MR. GALLAGHER: Ed Gallagher representing the National Milk Producers Federation, and I'm the President of DFA Risk Management.

MS. KEYS: Chelsie Keys representing the National Pork Producers Council.

MR. WHITE: Trevor White representing the National Sorghum Producers.

MR. RADINTZ: Jim Radintz, USDA Farm Loan Programs.

MR. LANCLOS: Kent Lanclos, USDA Risk Management Agency.

DR. FORTENBERY: Thank you very much. I'm Randy Fortenbery from Washington State University. For the committee members we will be having lunch up on the ninth floor. Your white badge is your ticket to get on the elevator. There'll be some security folks that'll escort us up to the ninth floor. For everyone else who's interested, we'll be reconvening at 1:15. So at this point we'll take a break for lunch. Thank you.

(Recess)

DR. FORTENBERY: Okay, I'm going to go ahead and call the meeting back to order as we kind of find our seats. This afternoon we're going to take up the topic of position limits. So we have a panel of two speakers, Christa Lachenmayr, who's with the Division of Market Oversight with CFTC, and Steve Sherrod, who's a Senior Economist with the same group. So as this morning, let's let them both make their formal remarks and then we'll open it for discussion and questions. So with that, Christa.

MS. LACHENMAYR: Thanks, Randy, Chairman, and Commissioners. And I'd also like to thank the Committee members. Can you hear me?

Okay. I'd also like to thank the Committee members. I know that some of you have traveled a great distance to be here today and we really appreciate that. Before I start, I'd like to offer the standard disclaimer that the views discussed in the presentation are my own and do not necessarily reflect those of the Commission or its staff. So we thought it would be worthwhile to set up the discussion for deliverable supply by briefly summarizing how the term is defined by the Commission and its significance. And then the Commission's last public and in-depth experience with calculating deliverable supplies.

The most concise summary of the significance of deliverable supplies that I've come across is from a Federal Register -- sorry, I guess I speak at a frequency that is not well heard. Okay, the most concise summary of the significance of deliverable supplies that I've come across is from the Federal Register Notice issued November of 1997, after the Commission notified the Chicago Board of Trade that it needed to amend the terms of its corn and soybeans futures contracts. At that time, we said, "[T]he Commission believes that in order to meet the statutory requirements of tending to prevent or diminish price manipulation, market congestion, or the abnormal movement of a commodity in interstate commerce, a futures contract should have a deliverable supply that for all delivery months on the contract is sufficiently large and available to market participants that futures deliveries, or the credible threat thereof, can assure appropriate convergence of cash and futures prices.

So there are two things that I'd like to highlight from that quote, which relate to the presentations from this morning about convergence and contract design. As this group in particular knows, most short positions do not result in actual physical delivery but it's the potential for arbitrage -- buying cash and selling futures -- that bring those markets together and that is the critical link between the two markets. So at a very basic level when we're talking about deliverable supply, if we don't have an adequate amount, then that potential for arbitrage, or that credible threat of delivery, doesn't exist or, at the very least, it's compromised.

Secondly, I'll give a little more detail about this in the next slide, that for any futures contract settled by physical delivery, the terms and conditions as a whole inform the levels of deliverable supply, the quantity, the quality, the other specifications. And that level needs to be sufficient to ensure compliance with Core Principle 3, that a DCM shall not list a contract that is susceptible for manipulation. And that goes back to Greg's presentation of this morning. So as Greg also talked about, and Dave Lehman, the Commission's guidance for DCMs for calculating deliverable supply is located in Appendix C to Part 38. We distributed that as a part of the info packet and the questions in advance of the meeting. It's also posted on the website for more information.

So not to be confused with supply, generally, deliverable supply is the quantity of a commodity that could potentially be made available for sale on a spot basis at current price levels at the contracts' delivery points. There are a number of qualifiers that you see on the slide, which I won't go into detail about because you'll notice that they are also remarkably similar to the items that we review when we're looking at contracts for compliance with Core Principles 3 and 5. But I'd like to highlight two of those qualifiers.

First, that the commodity can be reasonably expected to be readily available to short traders and saleable by long traders and also the clause that says barring abnormal movement in interstate commerce. The first qualifier relates to long standing Commission policy to exclude the amount of the commodity committed for long-term supply agreements in the calculation of deliverable supplies, which goes to the "readily available" part. The second qualifier relates to the exclusion of quantities of the commodity that are not economically obtainable or deliverable at prevailing price levels. So that also goes to the "abnormal movement of interstate commerce."

I'd like to point out that the guidance in the calculation of deliverable supplies is located in the Appendix under the heading for contracts settled by physical delivery, but we also look at deliverable supplies when reviewing cash settled contracts. And then also there's no commodity-specific guidance in the Appendix C.

So finally, I'll just note that I have a lot of other supplemental materials from both the rulemaking and then also the 1996-98 review of deliverable supplies for corn and soybeans, but we can get into those if necessary and they're available for your information. Thank you.

MR. SHERROD: Thanks, Randy. Under the Commission's December 12, 2013, Position Limit Notice of Proposed Rulemaking, an exchange listing a core referenced futures contract must supply the

Commission with an estimate of deliverable supply. The exchange must describe the methodology it used and they have to include any statistical data supporting the estimate. An exchange may use the guidance regarding deliverable supply in Appendix C of Part 38 that Christa's discussed, but they don't have to. The Commission proposed to verify whether an exchange's estimate of deliverable supply is reasonable, and if so, to use that estimate to reset the levels of spot month limits. If not, the Commission could rely on its own estimate of deliverable supply. The CME Group provided estimates of deliverable supply to the Commission and the Commission proposed that as an alternative in setting the initial spot month limits under the proposal. The exchanges would be required under the proposal to submit an estimate of deliverable supply to the Commission at least every two years. And I look forward to getting the committee's input on the proposal.

DR. FORTENBERY: Okay, we're going to open it up for discussion. Maybe what I'll ask this afternoon is if you think about it, you can turn your name tag upright so I can try to keep better track of the order and who would like to participate. I have trouble seeing some of the lights and some of the lights don't work. Let me first start, I think he has a time constraint, so let me see if Geoff is on from the Renewable Fuels Association, see if he has any questions or comments first. Okay, I guess not. So we'll open it to the floor. Discussion, questions, comments? Yeah, MJ.

MR. MJ ANDERSON: MJ with National Grain and Feed. Maybe kind of a broad statement and we can discuss from there. But to our members what is really critical is the convergence of the cash and futures. We believe that all the exchanges have a vested interest in making their contract successful and they understand that that convergence issue is a requirement for that contract to be successful. If we're going to use deliverable supply, there's talk about updating them and we would agree if you're going to use that deliverable supply, you might as well use the most current. But we also strongly endorse the CFTC to allow these exchanges to maintain the ability to set limits less than what may be recommended by deliverable supply. Some of the issues, one how do you have an orderly exit from the whole month limit to a spot month limit. And then if you increase spot month limits, are you increasing speculation in a time where you really need to be focusing on the convergence of cash and futures, which is what the commercial entities are trying to do in that timeframe.

DR. FORTENBERY: Any response from the panel or from the Commissioners? Yes, sir.

MR. KOTSCHWAR: Randy, I'd just like to second what MJ said. The Commodity Markets Council, we're, you know, very much in favor of updating the estimates of deliverable supply, but we too want to make sure that the primary purpose of these contracts, is to make sure convergence continues to happen. So we definitely need the exchanges to continue to have the ability to go lower than whatever number we come up with. So that's critical.

DR. FORTENBERY: Go ahead.

MR. CLARK: Yes, for the MFA, I think taking a step back, we'd like to see some more clear guidance on what exactly what goes into the deliverable supply computation. For example, we'd love to see some guidance on the inclusion of remotely located commodities in the deliverable supply computation or whether certain conditions must first exist before the inclusion of those commodities are appropriate. We believe this would provide some clarity. Also, we'd welcome some guidance on barge traffic and would request that the Commission confirm that commodities transported to a delivery point and priced within a specified percentage of the prevailing spot price are appropriately included in any DCM's estimated deliverable supply calculation.

DR. FORTENBERY: Go ahead, Ed.

MR. GALLAGHER: Ed Gallagher with National Milk Producers Federation. Seems that from the earlier discussion from Dave Lehman, that at least for the CME that they've got a process in place already that does a pretty good job of going out looking, finding information to use for deliverable supply. Maybe they're not going as far as some of us would like in some cases, but maybe they haven't done that because they haven't necessarily seen the need to do that. And so I guess as I look at it from an outsider looking in, what I'm impressed with, the way commodity regulation seems to have worked so far, is that there's really strong public, private partnership between the CFTC and the exchanges to provide some kind of oversight of what's going on in the commodity and the derivatives industry. And I think that's a real strength that we need to lever.

And so I think with the contacts that the exchanges have made, I know with my interactions with them at the CME, they have people that have gained a strong expertise in the dairy industry. And that they have the contacts, they know the people to reach out to to, have discussions with, to determine what else should be included in deliverable supply. And I think a real opportunity here isn't necessarily recreating everything at the CFTC. Obviously to create oversight and to encourage, but I think the CME has the expertise and the ability and the contacts to be able to go through and determine the deliverable supply and I would encourage that process to continue.

DR. FORTENBERY: Yes.

MR. CORDES: Scott Cordes again. A question I've got for you and maybe I should have asked Dave too when he's here. One of the thoughts I have is you get into deliverable supply and probably specifically if you look at like corn along the Illinois River, is there factors in there for load out capacity at all? Because one of the thoughts I have is you can have a lot of supply, but if you can't get it onto the river, you know, how does that impact especially when you get into the spot months, just curious if that's part of the discussion or not?

MS. LACHENMAYR: Yeah, I think that goes a little bit to the contract design element and review process. We look at, you know, three years of data and we look at anomalies with transportation and logistics and do a full cash market study that also informs our review of deliverable supply. So that's absolutely a good point. I think, you know, when there are logistical issues, those need to be well-understood and incorporated into our review.

MR. STRONG: Yes, Scott, you know that there are minimum load out requirements by the delivery houses. The reality is echoing some of these other comments that the CME is a very good custodian of liquidation of their contracts and of convergence. It's certainly been my experience that you don't load out corn to load a boat. But yet, the process of this convergence drives prices slightly above delivery equivalent and at that point, the cash market responds. And the cash market gives you what you need, not necessarily a certain level of deliverable supply that turns into a Panamax of corn, so.

DR. FORTENBERY: Are there -- yes, go ahead.

MR. KOVANDA: Joe Kovanda. Just to echo a little bit off of what Stephen was saying there. I think that creates a challenge, frankly, in measuring deliverable supply in physically settled contracts because if the convergence in the contract is working accurately, you'll never be able to practically experience the amount of deliverable supply that's available if it were not. Now, in a cash settled contract, you're observing that every day, every expiration because it goes into the quantification of the financial settlement. But I think it's prudent on the CFTC and the DCMs to continue to monitor that deliverable supply. In particular, I speak for the cattle market, a commodity that is perhaps more dynamically changing in quality and specifications than other commodities here today. This is something that needs to be monitored not just like was discussed earlier this morning on the, you know, two expirations of problems in that process, but on an ongoing basis, how dynamically that commodity changes and how it might affect the listing of very deferred months in a livestock market that, well, in particular to put some meat to the bones of what I'm talking about, I mean, we have record livestock prices today and a dramatically, they're not record input feed grain prices, but they're dramatically lower. It's almost a structural shift in shock in industry and it's having implications on the quality and the size of the underlying physical commodity. The contract design and the position limits need to reflect that and be monitored as such.

MR. DIERLAM: I have a question. The deliverable supply is used as a benchmark to set limits, exchange limits. However, from an ISDA point of view, the limits that are established in the proposed position limits rule are used to set limits across all the positions that a particular trader may hold be it across exchanges or potentially in swaps. Could you shed any light or make any commentary or insight into how deliverable supply calculation might go into how a specific trader or firm may hold positions across categories of instruments and how it works in that context?

MR. SHERROD: So, Bryan, I think you're asking about our general approach?

MR. DIERLAM: Yes, specifically, or yes, generally.

MR. SHERROD: Generally, okay, let's deal with the general one first. The Commission for a long time has in its guidance to the DCMs suggested that for a cash settled contract, use the same analysis to deliverable supply that you would as if it were physical delivery. So look at the quantity that's trading in the normal cash market that's underlying your cash settlement index and use that same benchmark, the upper benchmark we use, the outer limit in setting the spot month limit as 25 percent of that estimate of deliverable supply. So that's kind of at the high end.

And what we've observed and what a number of commenters have observed, is that in practice the exchanges often set their spot month limits at less than 25 percent of estimated deliverable supply. And certainly under the proposal, the Commission has provided that leeway so that an exchange need not set their limit at the federal level, which would be based on 25 percent of deliverable supply. They can set it at what lower level they're experience and judgment leads them to believe is appropriate for maintaining an orderly market and meeting their objectives in their own marketplace. So maybe you could ask a follow-on question if you want more, Bryan. Are you good? Okay.

MR. GALLAGHER: Yeah, let me just a quick follow- up question on that. So there'll be a separate limit for financially settled instruments and separate limit for physically settled instruments or is there one limit combining both?

MR. SHERROD: Ed, it's a good question. I've answered this a lot so hopefully this will be clearer this time. We have our federal limits just like we do in the existing nine agricultural, but those only apply to futures contracts. Under the proposal, the federal limits would apply to what we call referenced contracts. So whether it's a futures or a swap that has the same characteristics, we add them together for purposes of the federal limit. Outside of the spot month, in the non-spot limits, the Commission's proposal is to net everything together so a long swap and a short future would be netted together outside of the spot month. Within the spot month, the Commission's proposal is to have two separate limits. One for physically delivered contracts and another for a cash settled contract. And a little bit of the motivation behind that is if I had a very large long position in a physical delivery futures contract and a short position in a cash settled contract, if I netted those in the spot month, I would have a zero position. And yet

I might be demanding as a long futures position holder more than could possibly be delivered. So that's the federal level.

At the exchange level where we have a federal limit, the exchanges would need to have a limit. And so in the current system where the exchanges currently have a limit on a physical delivery contract or a cash settled contract, they would also continue to have those limits at a level no greater than the federal level.

MR. GALLAGHER: Follow-up? So currently then there are no limits on swap transactions, right?

MR. SHERROD: The only limits the Commission has on swap transactions were those that were a result of the 2008 Farm Bill on the significant price discovery contracts, right? And a number of those have been shifted from swaps trading to futures, right?

MR. GALLAGHER: Okay, and so in many cases then we're going from really an infinite X on swaps to something less. I guess my question is has there been convergence issues because there's been infinite X on swaps?

MR. SHERROD: In many respects, we haven't known the answer until we started receiving the Part 20 data. As we've said publically again and again, we've had problems with the quality of the Part 20 data, but it's getting better and we appreciate the efforts of the industry to give us that better data. Now that we can get an insight day-to-day into that data, we can start to answer those questions. But literally, Ed, we haven't known about a trader's position in a cash settled contract that's a swap unless we've gone out with a special call after we've seen some sort of price anomaly. So the answer is we're looking at it. I don't have something to share with you right now.

DR. FORTENBERY: Scott.

MR. CORDES: I would say for our membership, probably of greater concern than what the actual position limits are is the definition around the bona fide hedge. And I know we've got comments on the record and I'd like to reiterate them that that needs to be right. We're more concerned about what a hedge exemption is and how that fits. And one of the biggest ones we have a hardest time with that's not included today is these unpriced contracts. We think there's very valid reasons why they should be considered a hedge and part of that calculation. And I just want to bring that up to reemphasize it. I think that needs to continue to be looked at and get better defined as this rule gets finalized.

MR. SHERROD: Do you want to say a little more to help us out?

MR. CORDES: Yeah, typically, you know, probably the biggest example we've got is if you've got a basis sale on and you probably haven't priced the futures because you may be it's a long period of time. You got counterparty risk you might be worried about so you want to price that as you get closer to actual shipment. Well, as you start getting in those delivery months and you want convergence to come together, you need to maintain your positions on how that is. So it's that calculation as we go.

MR. SHERROD: Is that something that you would be engaging in say a calendar-month spread to lock-in your basis?

MR. CORDES: It could be a calendar-month or it might just be on the trading months that are taking place. You know, it might be a situation where you've got a sale for something June that you're managing your risk in the May corn contract as it works its way towards that delivery period.

DR. FORTENBERY: Yes, go ahead.

MR. STRONG: So before we leave, I sense we want to move off the deliverable supply issue, but before we do, I guess most of NAEGA's members are most familiar with the CME Group for the agricultural commodities. And I guess everything I'm hearing here is going to still preserve the ability of CME to determine their own limits. And I think initially when we saw that many of our members saw the 25 percent of deliverable supply, some members immediately projected in their head, oh my gosh, it's automatically going to go up limits, and in particular spot month limits, which we thought was really going to make the job of the market and the CME harder in determining or in creating convergence. So as long as your intentions are to preserve the CME's or the local exchange's ability to have a lower limit that they deem that the market can handle and they're customary and can manage correctly, NAEGA's is in support of a review of deliverable supply if it creates a potential higher federal limit that we know the exchange can self-manage.

MR. SHERROD: Right, that's correct. The Commission's proposal only sets a cap, an upper limit, on what the exchange can set.

DR. FORTENBERY: Other questions, comments? We have, sir, yeah, go ahead.

CHAIRMAN MASSAD: Steve, did you want to ask any other particular questions that you had on the standard of review or anything like that or what do you want to do?

MR. SHERROD: So I do have a set of questions that the Chairman's office sent out to the committee members. And, you know, I don't want to put anyone on the spot today, but to the extent during the comment period that's open until I think January 22, if you would think about them and provide some input if you don't have any thoughts today.

I did want to circle back to one of the comments from one of the committee members about what if we can move a commodity into delivery position? And it's long been our view that if a commodity can be moved into delivery position in the normal flow of commerce, it can be included in deliverable supply. We did have some commenters though that asked some -- or made some comments that left me scratching my head. We had some commenters that suggested permitting a commodity that's not currently of deliverable quality on a futures exchange, about whether that should be included in deliverable supply if the exchange would allow an EFP including during the spot month with that non-deliverable commodity. I don't know if any of you have faced that in the agricultural space, but I'd be interested in anyone's views.

MR. KOVANDA: I read that in your advance and that does not seem logical at all. I'm not sure why the EFP was connected to that. But if the commodity is not the correct specification to deliver, it should not be a part of deliverable supply. It's going to negatively affect convergence. Maybe someone else can enlighten me on how it may, but it just doesn't make logical sense to me.

MR. SHERROD: Well, that's good that I'm not alone in being a bit confused. I could understand if a commodity could be readily converted through a quick process and placed in a deliverable position that that might make some sense. But for a commodity that's never able to be converted, I'm kind of at a loss.

MR. KOVANDA: So, Stephen, it could be that way, but as we all know there's probably a cost in converting that. So it's not the same product because there's a cost involved in getting it to a deliverable spec. So it's going to create a wider potential basis for that to become a part of the deliverable supply. That's the way I would look at it.

MR. SHERROD: Well, we touched on a little earlier the issue of physical delivery versus cash settled contracts. And I think Bryan asked the question about what's our approach and our approach traditionally has been generally to use the same methodology for a cash settled contract as for a physical delivery contract. And I wondered if anyone had any thoughts about for a particular contract, whether the deliverable supply estimate for setting a spot month limit is the reasonable approach to use.

MR. GALLAGHER: I guess it all depends on the number you come up with. How's that for an answer? So the main markets that I trade in would be cash settled futures. And the particular one that's open for this proceeding is Class III, and it's a USDA formula that determines the Class III price, the futures, end of the day settling against that Class III price. There doesn't seem to be any convergence problem. And just because of the commodity in and of itself, tanker loads of milk that is highly perishable, I don't think there's any way to inventory that to have any type of an impact on trying to manipulate that market. And so I think it's a little bit -- I guess where I'm going with this is that and I've commented on this and probably you've all read my comments, is that be careful not to do a one size fits all regulation because each commodity has some nuance that's slightly different. And certainly, you know, Class III would be one that's out there, and I'm sure there are others that at the end of the day it needs to work for the bona fide hedgers. And, you know, at the end of the day if something happens that creates a need to take positions off, I think you create volatility at the end of the day in that market that isn't necessary.

And then leading on to another topic that was one that you asked about, or in talking about this, this comes to my mind, is if you do every two years you look at deliverable supply and determine if you need to make a change to it. And if you do, then how much time before the change occurs. And I'd be interested in what others would have to say about this. But I'm sure that there are lots of strategies that have been put in place that if you make the change maybe too soon, that it may have an impact on trading that may create some volatility in the markets that would be because of regulation as opposed to trading strategies. And so I don't know what the right answer is. If the right answer is to wait until you've gone through enough months or you preannounce the new position limit levels that may impact what the CME does or the other exchanges do. You preannounce them so that they're far enough off in the future that it doesn't impact contract months where there's a lot of open interest.

MR. SHERROD: So, Ed, if I understand you right, when we look at the USDA price series, that's the Class III milk formula that's underlying the market for cheese and whey and -- I never get it right -- dry powdered milk? Non-fat dry milk. I have my aide on the side. When we look at that type of a contract, we look at the cash market transactions and the size of what's flowing, actually going into the index. And we absolutely recognize that milk's not storable, but the cheese and the whey and the non-fat dry milk are storable and they are actively traded. And so we look at the size of that as the estimate of the supply. And so it makes good sense that we try and circle back to the exchange that lists those contracts and that's exactly what we did at the Chairman's direction. We solicited input from the exchanges to give us those estimates and the CME responded. And for those in the wheat industry, Minneapolis, for example, said we don't need to update our estimate. The current spot month limit accurately reflects 25 percent of the estimate. So we do look back to the exchanges.

And I also look to the committee to

anyone else in the written process about this issue that Ed says preannounce in advance and how far in advance. For those of you with trading strategies, it would be useful for us to know how far in advance. We've also asked the question of if the last three years have been a relatively low production cycle relative to the longer historic norms, because we only ask for three years' of data, should maybe the Commission have a discretion not to drop the federal spot month limit, particularly if the exchanges are already at that level? So I ask that question of the group. Does anyone have any thoughts about whether the Commission should kind of stick on the way down and wait and see for another cycle of two years whether we really need to lower the federal level?

DR. FORTENBERY: Any response to that?

MR. DIERLAM: I think I might respond. And I think in many of the conversations, you know, leading up to coming here today, I think that to the extent that you can allow the exchanges to evaluate their markets and the commodities and the contracts in conjunction with the industry and market participants, I think that that's the place you want to be. I think that as was testified to earlier today, you know, they're watching these markets very regularly as is the CFTC. I think that simply, you know, going through a mechanical process of changing them every three years just because -- regularly to update it, just because -- the supply and demand, you know, may have gone up or down, isn't necessary regularly and routinely if the markets are working appropriately. I think that that's what the first slides were placed up there to demonstrate is basis occurring? Is convergence occurring? And if it's occurring, then that's a good sign that the markets are working appropriately. That doesn't mean you don't look at them. But I don't think that the limits need to be adjusted, you know, every month or every contract month three years out. I mean, I think that...are the exchanges doing their job? Are you doing your job watching the exchange do their job? And I think if that's the case, then that's a good place to be.

MR. GALLAGHER: So following up, a question for you, Bryan. So would you suggest something that they don't necessarily have to make a change at all, but just regularly look at all the factors, see if the markets are working well, and if they are, regardless of what the deliverable supply calculation is, you might just leave them alone?

MR. DIERLAM: Yeah, I think that what we've heard today is that the deliverable supply calculation is updated on an annual basis and that, you know, a key component to whether or not the markets are working right is are you seeing convergence? And I think the question Steve asked is whether or not the actual position limits would be adjusted by some amount during that delivery during that spot month period or even during the outer month, and would that happen during some period, would the CFTC require that or would the exchanges do that? And would we be notified through comment? Would there be a comment period? Would there be some public notification? I think that's the question being asking is how often would the position limits be changing?

And I think that it's not that would you be subject to a situation where the position limits are constantly changing as crop size gets bigger or smaller. I think what you want to know is are the markets working and is there convergence? I mean, conceivably could you end up in a scenario where you've got a different limit on different contracts throughout the, you know, over the course of three years, could you have different limits on different months if you were constantly changing them? I mean, the question is, is the market working based upon the current data? I don't think you want to go through a process where you're constantly adjusting limits within marginal changes of marginal crop changes, unless I'm missing something.

MR. GALLAGHER: I guess by my question,

maybe I'm suggesting maybe there's an alternative approach. Congress didn't mandate that we do 25 percent of deliverable supply, correct? That's sort of CFTC decided maybe that's a good way to do it, right? So we're not bound by something legally necessarily. So would it make sense then that to start the process, you use your formula 25 percent of deliverable supply. Every two years, you look at deliverable supply. You go through all the analysis, maybe even a little bit more in depth than what Dave was explaining earlier. And then you look and see has there been an issue? Do you foresee an issue? And if there hasn't been an issue, you don't necessarily change position limits and you don't tie it that, every two years, it's a recalculation of 25 percent of deliverable supply. It's just the starting point and then you adjust it as you need to if there's an issue.

MR. SHERROD: So I guess I go back, yeah, to Bryan's point which is the ISDA comment letter about whether there would be an opportunity for notice and comment when the Commission resets every two years. It's proposed basically just to have it on autopilot, if you will, that the Commission would have limited discretion. It could set the levels of the limits for spot months at 25 percent of the estimate of deliverable supply. And that's pretty much the default under the proposal that would just be reset. So what I hear you saying is, you know, maybe if there's a bad series of crops for a few years, just leave it where it is, if convergence is working. And give the Commission that discretion not to tighten down if there doesn't appear to be a problem. Is that fair?

MR. DIERLAM: I think that's correct, yes.

MS. LACHENMAYR: Can I just clarify? I wanted to remind you that it's "not greater than" 25 percent is the current Commission guidance. So it's not necessarily an automatic 25 percent of deliverable supply. And kind of what I'm hearing Bryan and Ed say kind of goes to our question about additional factors that the Commission should consider when they're looking at the estimates of deliverable supply and coming up with a spot month speculative position limit. So I draw your attention to that question.

MR. MJ ANDERSON: To that question specifically, I think we would argue continue to look at convergence. Then continue to rely on the exchange. Again, Steve made the point, they're watching the orderly liquidation of these contracts. But it's the convergence that's the biggest thing for all of us.

MR. J. ANDERSON: I want to echo what MJ is saying here. I'm John Anderson with American Farm Bureau. It's hard for me to overstate how serious convergence issues are to our members. When there are convergence problems, it's a serious problem and I guess the one caution I might have is I'm sort of hearing and maybe I'm misunderstanding, but I'm sort of hearing what sounds like a really backward looking process to set these limits. And so I agree that monitoring convergence, which is a real time concept, I think is really important to make sure that we don't get behind the curve and end up with a problem that we're seeing too late.

MR. KOTSCHWAR: I want to refer back to something that Scott mentioned a little bit earlier when he was talking about we also want to discuss a little bit more about bona fide hedging here. I think there is a connection here with the deliverable supply. I think, you know, everybody would expect if we update deliverable supplies, we're probably going to be probably increasing in many cases, the position limits. And that's fine. So that's probably going to give us some higher speculative limits. At the same time, we have some concerns about if we need to be -- so we're going to be increasing supply at the exchange. We also need to be thinking about increasing demand. And that's all about bona fide hedging. We've got a lot of legitimate risk reducing activity that we use the exchange for right now. It's not currently being treated as bona fide hedging here and, you know, if you look down the road if you're only increasing the supply and we're keeping demand limited there, a lot of unintended consequences could occur. We could get away from the exchange being, you know, the market of last resort and have it become, you know, basically an origination market. We don't want that. You could be driving supply to delivery. We probably don't want that either.

So we need to make sure that as we're looking at deliverable supply, we look at all the other things that make a market function correctly too at the same time. So just keep that in mind. We'd like to see these move together. Dodd-Frank was four and a half years ago. Anticipatory merchandising was added to the Act four and a half years ago. We're still waiting. We're still waiting for that part of the Commission action. So it's really important to keep these together, we think.

MR. MJ ANDERSON: I'd just like to pile on to that too. You know, the strictest interpretation that could exclude a lot of commonly used transactions that our industry's taking every day to hedge risk, and that in effect allows us better pricing to producers, many of which are represented here by a lot of you.

Further on to Lance's point, if we're limited by that, we may move more to cash markets and move away from futures markets. Commissioner Giancarlo mentioned in his opening comments the concept of that food security. The forward market has a lot of ability to send price signals to producers to grow the crop that returns the most. If you limit participation in the futures market, you may blur some of those signals to the producer of what he needs to be growing, which in turn can lead to a supply disruption down the road. So we really encourage you to take a close look at that bona fide hedge and we'll certainly submit more written comments as well.

MR. DIERLAM: John, on the bona fide hedge, I couldn't agree with Lance and MJ anymore. On the bona fide hedge piece I know hundreds of comments have been submitted on the bona fide hedge piece; many firms, many trade associations on the importance of recognizing that many of the transactions that firms have long used should be considered bona fide hedges by the Commission as you finalize this position limits rule. There are terms that are in that we now commonly use that didn't exist a few years ago.

Lance used the phrase a merchandising hedge, or anticipatory merchandising hedge. That really wasn't used a few years ago until it kind of came up in the context of post Dodd-Frank. We now talk about irrevocable bids or offers. You know, those were terms that we didn't necessarily use before, but we had to begin talking about them in the context of Dodd-Frank. Those really are types of transactions that are used commonly in the industry to bid to farmers or to offer products to customers that create risk on the part of commercial enterprises as we conduct our operations. They're risk. We try to hedge that risk and we need to be able -- that should be considered a bona fide hedge by the CFTC when you finalize this rule. That's real risk that has real consequences if it can't be managed. And like MJ said, if you can't manage it in the futures market, it's going to have to be managed in the cash market. And that's real consequences to farmers, real consequences to customers, ultimately, real consequences to consumers.

DR. FORTENBERY: Any other questions or comments for Stephen or Christa?

COMMISSIONER GIANCARLO: Steve, perhaps you could just remind those in the room the logic behind the 25 percent deliverable supply. Why that figure? Why not 30 percent? Why not 20 percent? What was the thinking behind that?

MR. SHERROD: Well, like most things in position limits, these things have been around since the thirties. And at the time when limits were initially adopted, I think they picked if I remember the numbers right, 3 million bushels, which with a 5,000 bushel contract, is 600 contracts. It sounds a lot like the spot month limit today in certain agricultural commodities.

It turns out it's kind of a rule of thumb that's worked over the decades since the thirties, but the Commission has long articulated in its rulemakings that spot month limits and non-spot month limits, it's not an exact science. There's a range of what may be a reasonable position limit level. And the Commission has provided back in the old days we used to call it Guideline Number One. It's now the Appendix C to Part 38. We provided that guidance to the exchanges on what would be kind of the outer bounds of making something big. So a spot month limit, you know, when you deal, I don't know if you guys know this better than I probably, but I think 3 million bushels of wheat is probably about a four-mile long train full of wheat. It's not a small amount.

So we look at these amounts as guidance to the exchanges on where they should be on the top end. In realistic terms, four traders that were all speculators could have 25 percent of the market of the deliverable supply. They would be at that spot month limit. And if those four traders acting independently all demanded delivery, they would be taking all the estimated deliverable supply and that certainly would be potentially a problem. At that point, you know, prior to that occurring, both the exchange surveillance staff and the CFTC surveillance staff would be on the phones behind the scenes with those traders asking about their intentions, asking about what they intend to do with that commodity if they do take delivery. Because as we've said before, just because someone is below a spot month speculative position limit, does not make that a defense against a charge of attempting to manipulate or corner the market. So that's a little bit of the flavor of how we use these as guidance to the exchanges and how in the Commission's proposal, we've used these formulas to set kind of the upper bounds for the federal limits, with leeway for the exchanges to set tighter levels.

COMMISSIONER GIANCARLO: And do we have

any current analysis that these levels originally established in the 1930's are still valid for contemporary markets?

MR. SHERROD: No, I think that's a good question. I think the proof of what's a good level is looking at the current exchanges where they set their spot month limits. And the current exchange spot month limits outside of the federal limits, generally are set at levels much lower than 25 percent. Some of them are quite tight. As Greg mentioned earlier, the process for an exchange to change a rule is simply to submit it. We review it. And so if the exchanges were wanting to increase those levels other than the nine federal limits, they certainly could do that at any time. And the fact that they haven't is some evidence that the exchanges believe those were appropriate levels.

COMMISSIONER GIANCARLO: Just lastly, Steve, when we then review those, what methodology do we use to review those limits?

MR. SHERROD: Similar to the process we

used in Table 12 in the reproposal. We will look at the size of the traders in the marketplace. Historically, we've looked at the size of the traders to see whether traders are extraordinarily large relative to other traders. The surveillance department in the Division of Market Oversight is in fairly regular contact with the very largest traders to have an understanding of what's the purpose of their positions, whether they're hedging fixed-price sales contracts, fixed-price purchase contracts, or whether they're simply engaged in speculation. If those large traders appear to be kind of clustered together, historically we've looked at that and said, no one of those large speculative traders looks extraordinarily large relative to the others. So in Table 12 in the reproposal, we gave a flavor of that because we gave sizes of those speculative traders or hedgers, without identifying one or the other, to get a count of how many people were over certain percentages of the proposed limit levels.

COMMISSIONER GIANCARLO: Thank you.

MR. GALLAGHER: I've got another position limit issue that is embedded in the embedded volumetric optionality issue. And I appreciate the CFTC's coming out with a new proposed rule helping to clarify the seven steps. Speak up still? Sorry. I appreciate the -- oh, that is better isn't it? I appreciate the CFTC coming out clarifying the seven steps. But I am concerned that there could be an interpretation difference at the end of the day where a marketer may go through the seven steps and absolutely 100 percent feel that that transaction that they have is an excluded forward contract. And later on maybe a CFTC review comes in and says, "you know what, you're wrong for these reasons," and my fear is we lose that argument. And if we had, we frequently we've had a lot of growth in our forward contracting business with dairy farmers understanding that the risk in the marketplace is so great that they absolutely have to find ways to forward price their product in order to make sure they'll make a profit and stay in business.

We've had tremendous growth in use of our programs where we're at a point where at least once a year it seems like I'm calling the CME suggesting they need to relook at our position limit again, our hedge exemption again because I'm afraid we're going to go over it. And so if we're in a situation like that and for whatever reason what we thought was an excluded forward contract, was actually an agricultural trade option, and somehow that then got added into our position limit, we would, our members, we'd have to stop doing stuff for our members that would economically harm them. And so my request would be that in those cases, that if it does get changed to an ATO, that it doesn't get added to our position limit.

DR. FORTENBERY: Any other discussion? Yes, go ahead.

MR. KOVANDA: There was a question in the advance packet about the estimation of supply committed to long-term contracts and how you've relied on confidential business information. I wondered if you could give us an example of that idea there and how it impacts the measurement of deliverable supply.

MR. SHERROD: So the guidance the Commission has provided, the baseline, is if something's subject to a long- term contract, it's out of the estimate unless the exchange can provide evidence that the people that are on the long side of the cash transaction regularly make that available to the shorts in the derivative markets or would make it available at a fair value. Those are the discussions that the exchange would have in the first instance with the commercials in the cash market. And so the commercials would be revealing confidential information about the extent to which they're engaged in long-term contracting and of that amount, what portion of it would they have leeway to remarket, if you will.

The Commission's approach then would be to verify through doing cash market interviews with some of the same people that what the exchange has done was a reasonable process to estimate first the long-term contracting amount and then of that amount, what's readily made available in the secondary market after someone's contracted for a long term. I know that sounds sort of circular, but that's just the process.

MR. KOVANDA: So to follow-up, how do you measure then that it is available? That it would be available by the owners of those long-term contracts?

MR. SHERROD: Right, so that's simply a representation that the person on the purchasing side of the long-term contract has made back to the exchange or back to the Commission staff that are verifying the exchange's estimate.

MR. KOVANDA: So you're taking their word for it?

MR. SHERROD: Generally, we expect when people are providing us with information, it's truthful.

DR. FORTENBERY: MJ.

MR. MJ ANDERSON: I want to bounce back

to the bona fide hedge. I can't overemphasize how important that is to us. So just as the Commission moves towards a final rule, we'd really encourage you guys to continue to read the examples that have been submitted and continue to engage industry members, all of whom would love to spend time with you and walk through those examples. Again, we think that's critical to our industry to hedge risk and also to provide the most competitive bids we can to the agricultural industry.

CHAIRMAN MASSAD: Thanks, Ed. I appreciate that and I know others here feel the same way. As I've said publically, we want to make sure we get it right. We're very aware of the importance of enabling participants to engage in bona fide hedging. And that's why we are spending a lot of time digesting the comments and we'll certainly contact you if there are things in someone's comment that we aren't clear about, but we are giving it a good close look, thanks.

Mr. KOTSCHWAR: I'm going to completely

go off the agenda here, but this was not on the agenda, but I want to remind folks that this is still an issue and that's my favorite issue of 1.35. We appreciate the Commission's efforts and the continued efforts to try and make it workable, but the expansion of the 1.35 relief to include text messages has been illusory to many members of the Commodity Markets Council, my company included. I don't even know what a text message is. I just know here if you text more than one person at a time, it turns it into something called multi-media messages. Is that a text message? My IT people tell me absolutely not. Similarly, what about the propriety messaging system on Apple devices? Or Blackberry Messenger? There are all these different kinds of communication, which begs the question, we need to get to the real issue of 1.35, which is the notion of what membership is on an exchange and whether members of an exchange today are properly in this pool with the members of yesterday. We're a member of an exchange. We don't have a fiduciary duty. We're a customer. That's why we're a member of the exchange. And the text message relief I'm still now required to keep all sorts of pretrade communications. That's not something I normally do. It's a gigantic headache and I just want to remind folks that's still an issue.

DR. FORTENBERY: Okay, thank you Stephen and Christa. Appreciate your time. What we want to do now is move toward looking forward just a little bit. I think the idea going forward is that we would try to meet about every six months. So that would make a meeting sometime early or maybe even mid-summer for our next meeting time. And what would be useful is to get some ideas about topics that we should be investigating and discussing at our next meeting. And maybe at the same time, either panel members or presenters that you would like to see giving you some guidance or some input or some insight that would help lead your discussion going forward. So let me just throw it open and see if we have suggestions for the kinds of things we should pursue for our next meeting. Yes, go ahead.

MR. STRONG: So there wasn't a presentation here on what is a bona fide hedge or points that are currently being debated by the Commissioners. So I would suggest the bona fide hedge question needs further venting within this realm of this group with a presentation and a bit more time to dress out the issues.

DR. FORTENBERY: Other members agree with that as a topic? Yes, MJ does, okay, good. Are you thinking about a presentation from CFTC staff? Are you thinking about potential hedgers? Who would be most useful?

MR. STRONG: So I know some of the written comments that NAEGA and NGFA presented and I guess maybe I'm not exactly clear where those are in the Commission's minds. And are maybe some of the concerns that, were unknown the decision on really, the Commission has put to rest that they will be considered a bona fide hedge or maybe they're still up for debate. So, yeah, I would I guess I am asking for some kind of a staff presentation of, you know, your four hot buttons that are still up for debate or kind of unknown or need a little more information on or walk me through these examples one or two more times.

And if the forum for that is a smaller group and a smaller trip here, that's fine. And if the correct forum is this group, that's fine too. But it seemed, I mean, if I heard around here we had a lengthy talk on position limits. And it seemed like there were a number of people around the room who wanted to go to bona fide hedging. So it seems to me there's a need there at least from some people around this table.

DR. FORTENBERY: Other suggestions? Is that an entire meeting? Yes, go ahead, Scott.

MR. STRONG: That plus Lance's 1.35.

MR. CORDES: One of the other thoughts I've had is with all the new regulation, there's a lot more market data being collected. It'd probably be helpful maybe for this group to understand what the Commission's doing with it, how it's being used to understand, okay, everything's being put in. Is this just busy work? You know, what's taking place with this stuff?

DR. FORTENBERY: Lance, do you think the 1.35 six months from now is a point we should be taking up again?

MR. KOTSCHWAR: God, I hope not.

DR. FORTENBERY: Okay.

MR. KOTSCHWAR: Sadly, alas, probably so, yes.

DR. FORTENBERY: Any other suggestions? Go ahead, Mr. Massad.

CHAIRMAN MASSAD: Let me just say this isn't your last opportunity. I'm sure we'll be in touch with people as we get into next year in the spring and start looking at potential dates for the meeting. We'll certainly be reaching out to you and getting your input then on what we should be talking about.

DR. FORTENBERY: Yeah, we have a couple of minutes left still and so I didn't know if there were specific bona fide hedging questions anybody would still like to ask today. We'll certainly put that down as a topic for the later meeting. There were several asked. I didn't know if that was --

MR. STRONG: Well, should we get specific?

MR. MJ ANDERSON: My comment was going to be we could probably spend four hours this afternoon going through them, so I don't know if it's the best use of five minutes here.

CHAIRMAN MASSAD: Okay.

DR. FORTENBERY: Okay.

CHAIRMAN MASSAD: Yeah, I mean, I guess I would say I don't think anybody should feel a need to repeat what you've already given to us in writing. We're certainly aware that there have been a lot of comments on this. As I said, we're certainly trying to digest and think about those. If someone feels like there's a point that maybe hasn't been raised, we certainly welcome that. Steve, I don't know if you want to raise any questions for anyone or have anything to add.

MR. SHERROD: You know, I wasn't able to attend the staff roundtable this summer, but the most relevant person did attend. What I did hear was a willingness of the CME Group, exchanges -- from Tom LaSala, and likewise from ICE Futures U.S. -- to entertain a process that we described in staff questions to the exchanges and that would be that the Commission could, as one of the alternatives, delegate to the exchanges effectively the ability to process a request for a non-enumerated bona fide hedge. The exchanges would then process that, decide whether to grant it, and then provide to the Commission a summary of those non-enumerated bona fide hedges granted at the exchange level. So I refer you back to the transcript and the webcast that's on our website for that discussion. I think Tom LaSala was pretty clear in discussing that. And that would be one way forward to address numerous non-enumerated exemptions that could be granted by the exchanges subject to Commission review. Any thoughts?

MR. DIERLAM: Yeah, Steve, I'm glad you raised that. I won't try to go through the list because I would miss some, but I do know having reviewed many of the comments that numerous organizations in their comment letters spoke about modifying from the Commission's proposed rule into allowing some sort of a process to allow enumerated hedges along the lines of -- an exchange process to allow enumerated hedges. I think going through the Commission going through a public notice and comment, you know, candidly, I think that's too burdensome, too onerous. But I think allowing in a final rule whenever that's done, a Commission process to allow enumerated hedges I think would be a streamlined process that that could be a step in the right direction.

I think we are sorry that you weren't here back in June for the roundtable. I think if you think about things that maybe haven't been said, I think it's easy to look at many of the examples that have been submitted by companies, by firms, by trade associations, and they're often provided to you in a one-off instance. They say here's an irrevocable bid or offer. Here's a merchandising hedge. Here's an example of a specific hedge. And it ought to be considered bona fide. And I think that, as a stand alone example, to us it's correct. It ought to be considered bona fide.

But I think what's often maybe not included or talked about is, its business, is not they're not one-off instances. Business is done in a continuum, meaning, you buy something, in our case a farmer, and it goes all the way through an ultimate customer. So all of those examples that are used are part of one continuous flow of business. You might use an irrevocable bid or offer to acquire something from a farmer, an irrevocable offer to sell something to a customer, a merchandising hedge to manage it, to manage your inventory, a processing hedge to manage it, and you might have a firm basis contract or a firm contract in there that would meet, kind of, your letter test that you're looking at today, but during that entire process, there's all matter of things that are happening around the world. Russia invades Ukraine. Argentina freezes you out. There's weather here, there's weather there. All of these risks that affect all of that. So I think that's a large portion of the reason why so many of these types of examples we use are being looked at by commercial entities as ought to be considered bona fide. Because while trying to engage in the business we're engaged in on a regular basis, we're trying to manage the risks in the external world. And while we look at them as bona fide, we believe that you should too.

DR. FORTENBERY: Steve.

MR. STRONG: Were you talking about Tom LaSala's description in that hypothetical example he was given of a new company that bought a bunch of futures anticipating they were going to do business or not? Or was there a different example I should be looking for in that roundtable?

MR. SHERROD: The staff had asked the question and Tom was responding to the question and one of the keys was he was concerned as was the ICE representative about whether they would be held accountable for a core principle violation if they granted a bona fide hedge and then the Commission staff came back and said you shouldn't have granted that. You should not have granted that. So that's a little bit of the context. We'll get the point, the time in the videotape and we can have that sent out to the Committee so that you can conveniently find that, okay?

MR. KOTSCHWAR: I'd just like to follow-up on what Bryan said. You know, there are a lot more risks that we think about than just price risk. And in addition to price risk, price risk is always not just fixed-price risk either. Volatility is a risk. And there are ways today that we use the futures markets to manage risk, to reduce risk.

So, we just, it's evolution and we need to be thinking about how we're using these markets today. And, you know, let's look at what Congress did. You know, Congress has added the words anticipatory merchandising to the Act, which we're still waiting for the rules on. But that's an extreme broadening of where we were before that.

So, you know, that's...I just can't overemphasize, we need to be thinking broadly about what bona fide hedging is because we manage a lot of different kinds of risk beyond price risk. And it's not always fixed-price risk either.

DR. FORTENBERY: Okay, as we move forward if you have other ideas or suggestions about what we might want to cover in the next meeting, feel free to email Cory, Christa, or myself and let us know. In the meantime, I really want to thank Cory and Christa for all of their significant efforts in helping put this together and keeping us with an agenda and moving forward. And now what I'd like to do is turn to Chairman Massad and the rest of the Commissioners for some closing remarks.

CHAIRMAN MASSAD: Well, I just want to say first of all, thank you to all of you for coming and participating. This is extremely valuable for us and I really appreciate your time. I look forward to the next meeting. I want to thank Randy for chairing, for doing a great job as chair and for his guidance and advice as we put together this meeting and as we turn to the next one. I want to thank the various members of our staff who helped put the meeting together and also made the presentations, Greg, Tom, Christa, Steve.

I really appreciate all the staff effort. And let me also thank my fellow Commissioners. It's great that we had everybody here. Most of us were able to be here for the entire session, which is, I think, indicative of the fact that the entire Commission cares very much about the agricultural issues and the agricultural sector. And we intend to make it a priority in terms of the things that we're thinking about and doing. Thank you.

DR. FORTENBERY: Commissioner Bowen, any?

COMMISSIONER BOWEN: I just want to say

thank you as well. And my door is open. You need not wait until your next committee meeting. Feel free to engage me at any time.

DR. FORTENBERY: Okay, any last comments? If not, thank you very much for participating. I appreciate everybody's participation. Please travel safely. And again, thank you very much to the CFTC staff for making this possible. I adjourn the meeting now.

(Whereupon, at 2:32 p.m., the PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

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I, Carleton J. Anderson, III, 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; that the witnesses were sworn to tell the truth 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 attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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