COMMODITY FUTURES TRADING COMMISSION

AGRICULTURAL ADVISORY COMMITTEE

10:00 a.m.

Wednesday, June 9, 2021

Teleconference

A P P E A R A N C E S

COMMODITY FUTURES TRADING COMMISSION MEMBERS

Acting Chairman Rostin Behnam

Commissioner Brian D. Quintenz

Commissioner Dawn DeBerry Stump

Commissioner Dan M. Berkovitz

AGRICULTURAL ADVISORY COMMITTEE

BUDDY ALLEN

AMERICAN COTTON SHIPPERS ASSOCIATION

JOE BARKER

NATIONAL COUNCIL OF FARMER COOPERATIVES

CHRIS BETZ

MICHIGAN AGRI-BUSINESS ASSOCIATION

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FARM CREDIT COUNCIL

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AMERICAN SUGAR ALLIANCE

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AMERICAN SOYBEAN ASSOCIATION

CHRIS YOUNG
INTERNATIONAL SWAPS AND DERIVATIVES ASSOC., INC.

A G E N D A

A G E N D A [CONTINUED]

A G E N D A [CONTINUED]

P R O C E E D I N G S

(10:00 a.m. EST)

MS. MERSINGER: Good morning, as Designated Federal Officer and Acting Chair of the Agricultural Advisory Committee, it's my pleasure to call this meeting to order.

I'd like to welcome everyone to today's meeting. Before we get started there are a few housekeeping items to mention. Since this is a virtual meeting, and is being broadcast, please make sure to identify yourself before you begin speaking. Also, please signal when you have completed your comments, so that we may continue to the next speaker or question. Please ensure your phone is unmuted before you start to speak, and that you're speaking clearly into your device.

For the committee members, please send a message with your questions to the panelists group through the WebEx chat function box at the appropriate time and you will be recognized to unmute your line and to ask a question. If we do not get to your question, please feel free to chat or email during or after the meeting. And finally, please keep your telephone line muted when you are not speaking. If you do not mute yourself, the conference operator may put your line on mute.

Now that we have the housekeeping issues taken care of, I'd like to turn to our current committee sponsor, Commissioner Dawn Stump for her opening remarks.

Go ahead, Commissioner Stump.

COMMISSIONER STUMP: Thank you Summer and thanks to all who joined us today for the virtual Agricultural Advisory Committee meeting. I'm very hopeful that sometime during in 2021 we will eventually be allowed to have the opportunity to meet again in person. But as the Committee has some pressing business I'm pleased that we're taking the opportunity today to have these important conversations from the various remote locations.

I'd like to begin by expressing how honored I am to sponsor the Agricultural Advisory Committee, and how much I appreciate my fellow commissioners supporting my request to do so. This committee was the CFTC’s first Advisory Committee and has been sponsored by many commissioners who I consider to be friends, worthy of admiration and tremendous respect. So I am today delighted to be the custodian of this important committee.

Also, as many of you know, my roots are in agriculture and the many challenges and issues that face this sector are near and dear to my heart. However, my excitement to sponsor the Ag Advisory Committee does not suggest that I am any less excited about the other committee that I'm honored to sponsor, the Global Markets Advisory Committee, also known as the GMAC. Quite the opposite, I'm very passionate about matters involving our markets globally and I continue to be honored and committed to the work and effort of the GMAC.

At first glance, it might seem as though these two advisory committees are vastly different. Our focus on international financial market structure and operations and the Ag Advisory Committee’s focus on the U.S. based farm economy - and the use of our traditional commodity markets - are somewhat different.

However, I see a great deal of synergies between the Ag Advisory Committee and Global Markets Advisory Committee. And I'm hopeful after our presentation today from Owain Johnson and Fred Seamon from the CME Group, and FIA’s Will Acworth, that we will have a better appreciation of the connection of these two committees, as it relates specifically to the global landscape of agricultural commodity markets.

I hope that looking at Ag commodity markets with a global perspective will help to inform the work of the committee as well as the work of the Commission in maintaining competitive and efficient agricultural futures markets here in the US.

Likewise, The US agriculture sector supports not only our domestic consumers, but they feed and clothe the entire world. And we recently witnessed challenges to that task during the pandemic. So today we have another panel to provide a glance into how some of the most heavily impacted agricultural sectors manage the uncertainty and significant supply chain disruptions during the pandemic.

We'll hear from risk management leaders in dairy, pork, and cotton; all industries that contribute heavily to the U.S. farm economy, but with supply chains that have a significant global footprint. I'm very grateful to have Christian Edmiston, Senior Director of Sourcing and Risk Management from Land O'Lakes; David Rossen, Global Hedging Manager for Cotton at Louis Dreyfus Companies; and Dhamu Thamodaran, former Executive Vice President, Chief Strategy Officer and Chief Commodity Hedging Officer for Smithfield Foods, on a panel to share their insights with us today.

I believe this conversation will be the kickoff to more discussions on how our commodity futures markets can contribute to securing those goods that are so important to consumers today, and always, but especially as we recover from the pandemic.

Last but certainly not least, I'm looking forward to hearing the full Ag Advisory Committee discuss and consider the final recommendations offered by the Subcommittee to Evaluate Commission Policy with Respect to Implementation of Amendments to Enumerated Agricultural Futures Contracts with Open Interest, much more easily spoken and commonly known as the Ag-OI Subcommittee.

This subcommittee reflects months of hard work between various stakeholders to come up with a consensus-based approach to managing open interest when making changes to ag commodity contracts. I sincerely appreciate all of the time and effort members of subcommittee put into this report. I know there were members who literally had to pull over their tractors in the field to jump on a video conference to ensure the report came together in a timely fashion.

And special thanks to Professor Joe Janzen from the University of Illinois Department of Agricultural and Consumer Economics who serves as the chair of the subcommittee. Professor Janzen was the steady hand and driving force in completing the report, and he did this work while being a full-time professor. I would also like to note that Joe and his wife became parents again in the middle of this undertaking. Understanding how crazy life can be with a newborn in the house, I cannot thank Professor Janzen enough for his dedication to this project and the final work product.

Given our full and fascinating agenda I do not want to use any more of the time today with my introductory remarks, but I do want to offer a special thanks to Summer Mersinger and Christa Lachenmayr for their tremendous efforts in organizing the committee and the subcommittee. Thanks to our speakers and presenters for sharing their valuable time. Thanks to the subcommittee for their hard work on the report.

And finally, thanks to the entire Ag Advisory Committee for welcoming me as your sponsor. Even though this may be a temporary arrangement, I'm thrilled to have the opportunity. With that we'll turn it back to Summer to facilitate opening remarks from my fellow Commissioners. Thank you.

MS. MERSINGER: Thank you Commissioner Stump. Next up is Commissioner Quintenz. Commissioner Quintenz, you have the floor.

COMMISSIONER QUINTENZ: Thank you very much, Summer. First, let me thank Commissioner Stump for taking on the responsibility of serving as the sponsor of the Ag Advisory Committee, while also maintaining her sponsorship of GMAC. These are complicated assignments, require a lot of thought and planning and work. And Commissioner Stump - the Ag Advisory Committee is in very good hands and I appreciate your interest in making sure that it can meet and consider the work on a timely basis. So thank you.

I'd also like to thank Summer and Christa on a staff level for their tireless work in convening all of the meetings, especially the one we have today.

And let me just lastly say a special welcome to all of the members. I particularly look forward to the Agricultural Advisory Committee meetings because I get to see so many folks with whom I feel like I've been able to develop a strong professional, as well as in many cases, personal relationships and friendships over my time here at the Commission, and I've had the opportunity to visit a number of you on your farms, ranches, or places of business. And it's always good to reconnect.

Let me also thank you for the extraordinary work you did on behalf of the American public, the American consumer, American families by making sure that we could put food on the table during the extraordinary pandemic. You’re heroes of this last year and a half and I'd like to recognize you here. Thank you for everything that you've done and that you continue to do. Thanks very much.

MS. MERSINGER: Thank you Commissioner Quintenz. Commissioner Berkovitz, you have the floor.

COMMISSIONER BERKOVITZ: Thank you Summer. And thank you Commissioner Stump for sponsoring this Committee and taking on this assignment. I think you mentioned previous chairs of the Advisory Committee and the admiration and respect you have for those previous chairs, so I think that I could speak for all the Commissioners and say that the feeling of us extends to the current chair of the Committee in terms of admiration and respect, and so we thank you for your leadership on this committee.

Agricultural products and agricultural futures contracts are really the origin of the futures markets going back a century and a half now, approximately. So this -- really no pun intended, is the bread and butter of our work, and the issues that the agriculture industry faces in terms of using the futures markets to manage their risks and discover prices is really central and key to what we do here at the CFTC and the ability of these markets to work for the agricultural community is absolutely critical importance to us. It's of critical importance to American families in their daily lives. If we go into the supermarkets, if we go to restaurants, and we've certainly had an extraordinary year and a half of challenges in many, many sectors and the agricultural sector certainly faced some of those key challenges and continues to face those today.

So the topics today are of utmost interest and utmost importance to this country and American citizens, and I thank the members of this Committee for their work above and beyond, it's unpaid. There's no remuneration for it. It's volunteer service in the public interest. And so, I'd just like to thank all the members of the Committee, everybody who participates and volunteers their time in this greater public interest to really work on the important issues for the CFTC, for the Committee, and for the American public.

So with that, I'm looking forward to the meeting and thank you all very much.

MS. MERSINGER: Thank you, Commissioner Berkovitz.

And before we get started with today's agenda, we're going to go through a roll call vote. Committee members, when I call your name, please unmute your phone and you also have to unmute your WebEx. So it's kind of a double unmute process. So when I call your name, please unmute, and indicate that you are present.

First up, Buddy Allen, American Cotton Shippers Association.

MR. ALLEN: Present.

MS. MERSINGER: Thank you, Buddy. Joe Barker with National Council of Farmer Cooperatives.

MR. BARKER: Present.

MS. MERSINGER: Thank you. Chris Betz Michigan Agri-Business Association.

MR. BETZ: Present.

MS. MERSINGER: Thank you. Larry Bergen, National Farmers Union.

(No response.)

MS. MERSINGER: Larry are you on? I'll check back after we go through the roll call. Robbie Boone, Farm Credit Council.

MR. BOONE: Present. Good morning.

MS. MERSINGER: Good morning. Amanda Breslin, Coalition for Derivatives End Users.

(No response.)

MS. MERSINGER: Let’s check back for Amanda. Patrick Coyle, National Grain and Feed Association.

MR. COYLE: Present.

MS. MERSINGER: Thank you Patrick. Rob Creamer, Futures Industry Association/Principal Traders Group.

MR. CREAMER: Present.

MS. MERSINGER: Thank you. Robert Crosby, Managed Funds Association.

MR. CROSBY: Present.

MS. MERSINGER: Thank you. Neil Dierks, National Pork Producers Council.

(No response.)

MS. MERSINGER: I think they actually have their annual meeting today. Ed Elfmann, American Bankers Association.

MR. ELFMANN: Present.

MS. MERSINGER: Thank you. Jim Fryer, National Cattlemen’s Beef Association.

(No response.)

MS. MERSINGER: Edward Gallagher, National

Milk Producers Federation.

(No response.)

MS. MERSINGER: Tommy Hayden, Commodity Markets Council.

MR. HAYDEN: Present.

MS. MERSINGER: Matt Hines, American Farm Bureau Federation.

MR. HINES: Present.

MS. MERSINGER: Thomas Hogan, Cocoa Merchants Association of America.

(No response.)

MS. MERSINGER: Cynthia Nickerson, USDA, Office of Chief Economist.

DR. NICKERSON: Present.

MS. MERSINGER: Tom Kadlec, Futures Industry Association.

MR. KADLEC: Present.

MS. MERSINGER: Chris Klenklen, National Association of State Departments of Agriculture.

MR. KLENKLEN: Present.

MS. MERSINGER: Ron Lee, National Cotton Council of America.

(No response.)

MS. MERSINGER: Randy Melvin, National Corn Growers Association.

(No response.)

MS. MERSINGER: Erin Morris, USDA, Agricultural Marketing Service. Erin you might want to double unmute. We'll come back to you.

MS. MORRIS: Now can you hear me?

MS. MERSINGER: Yes, yes. There you are. Thank you.

MS. MORRIS: Sorry about that.

MS. MERSINGER: That's all right. John Owen, USARice Federation.

MR. OWEN: Present.

MS. MERSINGER: Brandon Wipf, American Soybean Association.

MR. WIPF: Present.

MS. MERSINGER: Paul Riniker, National Farmers Organization.

(No response.)

MS. MERSINGER: Mark Scanlan, Independent Community Bankers of America.

MR. SCANLAN: Present.

MS. MERSINGER: Stephen Strong, North American Export Grain Association.

(No response.)

MS. MERSINGER: Justin Tupper, U.S. Cattlemen's Association.

MR. TUPPER: Fellow South Dakotan and present Summer.

MS. MERSINGER: Good to hear from you. Hayden Wands, American Bakers Association.

(No response. MR. WANDS later indicated he was present via email.)

MS. MERSINGER: Ryan Weston, American Sugar Alliance.

MR. WESTON: Present.

MS. MERSINGER: Chris Young, International Swaps and Derivatives Association.

MR. YOUNG: Present.

MS. MERSINGER: Let's go back and through and do a double check on a few people. Larry Bergen, are you on the phone?

(No response.)

MS. MERSINGER: Amanda Breslin?

(No response.)

MS. MERSINGER: Do we have Jim Fryer?

(No response.)

MS. MERSINGER: Ed Gallagher?

(No response.)

MS. MERSINGER: Thomas Hogan?

(No response.)

MS. MERSINGER: Ron Lee?

(No response.)

MS. MERSINGER: Paul Riniker?

(No response.)

MS. MERSINGER: Stephen Strong?

(No response.)

MS. MERSINGER: Hayden Wands?

MS. MERSINGER: Hopefully they can join us later. With that, thanks again to the Committee and to the Commissioners for making time to take part in this important meeting today. We know that this is a particularly busy time of the year for those engaged in agriculture production and we really appreciate your presence.

As noted in today's agenda, we will start with the discussion on the final report of the Subcommittee to Evaluate Commission Policies with Respect to Implementation of Amendments to Enumerated Agricultural Futures Contracts with Open Interest, easier said the Ag-OI Subcommittee.

I'm going to turn the floor over to Christa Lachenmayr, the Alternate Designated Federal Officer for the Ag-OI Subcommittee.

Go ahead Christa.

MS. LACHENMAYR: Thank you Summer. I'm very pleased to introduce our Subcommittee Chair, Dr. Joe Janzen, to present a summary of the Ag-OI Subcommittee’s work, its findings and recommendations. Can we have the presentation loaded and give Joe control of the slides?

Joe, please begin when you are ready.

DR. JANZEN: Sure. While we're waiting for the slides, I'll just start by thanking the Commissioners and especially to the Commissioner Stump for her sponsorship of both this Ag Advisory Committee and our Subcommittee, whose name I will not continue to repeat due to … due to its length. I want to thank you all for your consideration of the report and of this presentation.

So my name is Joe Janzen. I'm a Professor of Agricultural Consumer Economics here at the University of Illinois, here in Urbana-Champaign. I’ve served as the chair of this committee and worked alongside 21 other members, plus Commission staff to prepare the report that we submitted. The report wouldn't exist without the hard work of the Commission staff and especially Christa Lachenmayr and Summer Mersinger. It also couldn't have been prepared without the Subcommittee members, who I won't go through and thank by name but they, again, willingly volunteered their time, their effort, knowledge and wisdom.

I want to say every single member provided candid and constructive input into this process and the report that you're going to hear today reflects a consensus outcome across that … the diverse membership of this subcommittee.

So today if I can advance the slides --

STAFF: If you go to the left of your screen, hover, there are up and down arrows.

DR. JANZEN: There we go. Perfect. Thank you.

All right. So I want to just talk today about why the Subcommittee was formed. some of the issues at-hand was describing really what was at play here, how the Subcommittee went about addressing those issues. So the process and procedure, and then just describe our findings and recommendations that you're being asked to consider and possibly endorse.

I also want to leave enough time for a robust discussion of the report, including time for questions. As a preview, I'll say the Subcommittee found that the current process for evaluating changes to agricultural futures contracts with open interest works well to support necessary change that preserves the integrity of our markets. And that the Commission's role in this process is generally trusted. However, there are some areas where current practices could be improved or formalized.

And so, our report makes six recommendations that I'll share with you today.

At the heart of the committee's work is … is a trade-off. Futures contracts are useful when they represent the value of the commodity across time and space. They represent commercial practice within the trade of that commodity. But because market fundamentals change, futures contracts must change. These markets wouldn't have persisted for now over 150 years, unless they could adapt to changing market fundamentals. The adaptation process is not something that occurs once in a generation. It's not a once in a blue moon thing. It's a process of constant monitoring, evaluation, and updates.

For example, in the last 14 years there have been 112 approved amendments to agricultural futures contracts with open interest. These changes occur because they're necessary to achieve the goals held in common by the exchanges, market participants, and the Commission. Namely, the mission to foster price discovery and enable risk management.

Related to those goals, are a set of core principles found in regulation and each of the parties at play here - the exchanges, market participants, and the Commission - want markets to comply with those core principles. Those are, I think, widely agreed upon principles for managing our markets. In the case of enumerated agricultural commodities, the kind that we're considering here today, the CFTC provides additional oversight through formal approval of those changes.

So all parties want timely implementation of these changes to foster price discovery and achieve compliance with those core principles. However, changing the terms and conditions of a futures contract may be a disruptive process and creates this trade-off. Necessary changes to achieve regulatory compliance may have a material impact on the value of existing positions. Should they be applied to existing open interests, to contracts that have already traded and have a willing buyer and a willing seller?

So here, when I say a material impact, I mean, an impact that would materially affect the price and thus the value of the position. Okay.

So in weighing that trade-off, exchanges and market participants typically identify needs for changes and try to manage that trade-off as best as possible prior to submitting an amendment to the CFTC. What types of amendments might they submit? What types of -- how do you change futures contracts?

We kind of really binned these things into a number of buckets, but the primary one relates to things around the delivery process. And this is why -- you can see why -- these, these terms might have a material impact on the value of the commodity because they pertain to the terms and conditions and the types of commodity that's deliverable against the futures contract, and really gets at that nexus between both physical and futures markets. So really connecting the cash and futures.

There are other changes related to things like risk controls, so price limits and trading halts, and also another set - a large set of changes - related to position limits, which also have a material impact on the value of the futures contract.

So these types of changes are being submitted to the Commission for approval, except in limited cases where they maybe don't apply to existing open interest or a few other very limited exemptions. But the Commission really asked for input here in terms of thinking about how they can best manage this process so that it is both effective and efficient in complying with core principles and fostering price discovery and risk management.

Complicating this is a lengthening listing cycle for -- in the case of many agricultural futures contracts, where there's significant open interests, further out in deferred -- in trading for deferred month delivery.

So this graph just shows the share of open interest that's more than 12 months from delivery. We can see that in the case of some of our agricultural markets, this is a pretty significant share of open interest in the last 15 years. This has been up to 17 percent of open interest in the corn market and a smaller, but significant share across the grains, maybe less so in livestock. But still, this could comprise a substantial share of the position that any one trader might hold in a particular commodity, and thus, the concern about these material impacts on the value of the contract.

So if we want to make timely change, that's going to be more difficult when there's open interest in, say, the corn futures market two, three, four years out. We can't just sort of put off those changes until they no longer apply to open interest.

Okay. So what did the Subcommittee try to do? What were our objectives?

When we sat down initially, we laid out, I think, the following … the following sort of objectives for how we would tackle this issue. We wanted to maintain a focus on Commission policy and procedure. So while individual market participants might have opinions about what exchanges should do, what other market participants should do, and sort of around the horn, our focus was really on what can the Commission do to make this process more effective and efficient.

We wanted to develop consensus-based recommendations. And so, really trying to find common ground among a diverse membership. In addition, we sought to be forward-looking. So to focus on how the process could be improved going forward rather than re-litigating past changes that people might have opinions about whether that was handled well or handled poorly, but use some of that past experience. And so, we spent some time reviewing the history of past changes, and past amendment approvals in order to inform our deliberations.

And then finally, a broader goal to improve market quality and to mitigate risks for all parties. So all parties may have sort of concerns about possible amendments that may occur in the future or the need for possible change, and we want to sort of manage that change in a way that mitigates risk to all parties.

Okay. So briefly, what did the Subcommittee do? Sort of here's a timeline of our activities. So last fall the Commission approved the Subcommittee, published a notice in the Federal Register calling for nominations for membership and put together a group. And I want to thank the Commission, both the Commissioners and staff for convening a group of both willing and wise participants who really were representative of the participants in our agricultural futures markets, both on the, sort of, on the commercial and non-commercial side, across a wide range of commodities.

If anything, there's an emphasis in the committee on commodity representation. So making sure that issues that pertain to large markets, small markets, all of those things were taken into consideration. If anything, there's an emphasis in the committee on commercial participants who are active in the delivery process. And I think the reason for that goes back to the history of changes that have been made to futures contracts with open interest, namely that a lot of those rule changes pertain to the delivery process.

Starting in early December we began a series of what ended up being seven meetings by teleconference. An initial set of informational meetings where we heard presentations from the exchanges who are the ones submitting these changes and developing the specifics of these rule changes. And then from Commission staff, who are doing the evaluation and then we sort of brought together our opinions via group discussion, via a set of surveys and informal votes. And I want to, again, thank the Subcommittee members for their active participation when that wasn't always easy because of the fact that we were meeting entirely remotely due to the pandemic.

After Christmas, we circulated a draft report and iterated through that as a committee and sort of concluded that process in early March. The report that we developed was finalized and adopted in -- on April 21st via unopposed vote of the committee. And now we're here to you today.

So I want to say that this process moved, I think, relatively quickly for a committee of 22 people. But I think that speaks to the willingness of all sides to engage and to sort of see the other side of some of these issues and develop a consensus-based set of recommendations.

So just to really get into the meat of the report, we, again, find that the current process tends to work well. These changes to our agricultural futures markets tend to move relatively smoothly through this process and make changes that are necessary to maintain market integrity. If anything, market participants and exchanges really value Commission engagement in the process both before and after a submission. And we find that that engagement is beneficial. It helps the process move forward more efficiently.

There was some consideration of ways to make the process potentially more efficient by saying, you know, let's treat some of these changes, which may not have a material effect on open interest an define this concept of materiality and say, these changes aren't going to affect the value of a futures contract. We can move, fast track these through the approval process, something like that. And that was found to generally be overly prescriptive and incompatible with a principles-based system of regulation. So the committee thought, really sort of -- having considered that issue in great detail, saw the value of a principles-based regulatory regime and upheld that and decided that that's something we don't want to change. I think there could be a whole host of unintended consequences to such a change.

As well, the guidance that's used by the Commission to evaluate proposed changes is generally useful and encompasses what we would want, how we would want these changes to be evaluated, but often requires sort of a process of continual approval, improvement, and updating to remain relevant. And we identify a couple of specific instances where that might be the case.

So with that, I'll go through our recommendations.

The first set of recommendations really hit two areas related to, again, how the Commission deals with exchanges and market participants, and really sort of seeks to foster transparency and openness in how the Commission does its evaluation, carries out its evaluation, and also how it just engages with the public generally, and participates in the process of both identifying necessary change and bringing that change to fruition.

So we would recommend that, to the extent possible, the Commission provide information on which markets are subject to this approval process and information related to past determinations of sort of approval and the materiality of a change so that market participants have a better idea of when this approval process kicks in, and how that approval process is carried out, and can set expectations going forward about the future, because we know that market fundamentals will change and thus we will need to make changes to the terms and conditions of agricultural futures contracts going forward.

Secondly, there should be a more systematic process of engagement with market participants, specifically that the market participants value the engagement that the Commission carries out, but a lot of that is maintained informally and sometimes there can be value to formalizing that process. For example, defining the conditions under which, say, a formal public comment period would be used to gather market participant feedback and really sort of permitting, to the extent possible, and in an efficient manner as possible, the consideration of as wide a set of viewpoints as is feasible.

Thirdly, the Commission should develop guidance and policy related to its dialogue with exchanges and market participants prior to and following formal submission. So there was a sense the participants want to know how the Commission will engage and if there's anything that can be done to sort of describe that process and ensure that the Commission is engaging both regularly and in a consistent fashion that would be valued.

Finally, in the spirit of sort of mitigating risk, updating the risk disclosures that are given to market participants related to this area of potential changes to contracts that have open interest. So making market participants aware that timely change, necessary change, may happen to contracts with open interest. And that's a risk that must be borne in taking a position, especially if a position in these long-deferred month futures contracts.

Finally, we have -- turning from sort of how the Commission engages with the public to its actual evaluation process. We, again, would recommend that we maintain a principles-based approach, concentrating attention on changes, more likely to be material, that is, changes that are more likely to impact the value of an existing position, but there's not sort of a way that we can, sort of, from top-down -- we would want a top-down approach to defining that materiality. Again, the recommendation here is to, again, encourage the use of a principles-based approach.

Finally, that the Commission should continually improve its guidance to reflect current market conditions and contract specifications such as -- one instance that we identified, the use of self-adjusting contract terms, things like adjustable price limits, changing storage rates. When those terms can adjust, that situation is not really -- it's not really considered in existing guidance, and that may be a situation where the Commission should review its staff policy and guidance in that area and define the criteria that it will use for evaluation.

Those are the recommendations that we've put forward. I summarize them here, but again, I want to sort of highlight two things. One, the Subcommittee finds that the current process is not broken. The current process works well. It does foster compliance with core principles. It does align contract terms with common commercial trading practices, and it does weigh the interests of exchanges and market participants who don't always hold the same views and it can consider the relative weight of all those views in developing Commission action with respect to changes, necessary changes, to our agricultural futures markets.

With that, I'll turn it over to the committee members who I hope can engage in a robust discussion of these recommendations. So I thank you for your consideration.

Thank you, Christa and Summer, again, for your hard and tireless work in this area.

MS. LACHENMAYR: Thank you, Joe, for all your hard work in facilitating and synthesizing the discussions of the Subcommittee into this report and recommendations. We really appreciate that you were holding the pen on this and that is definitely a large responsibility, so we appreciate it.

I would also like to thank the Subcommittee members as well for the time and thoughtfulness that they put into this endeavor. And I'd like to thank former Chairman Tarbert and Commissioner Stump, and Summer Mersinger for their support of this important initiative.

So at this time I'd like to open the floor to discuss some of the key recommendations that arise from this report. Please either enter your questions into the chat box or unmute your phone and WebEx to be recognized.

(No response.)

Don’t everybody start at once.

MR. ALLEN: Good morning. On behalf of American Cotton Shippers Association, this is Buddy Allen. I want to thank the Chairman of the Subcommittee, and on behalf of Azeez Syed, who represented us on that subcommittee. A job well done, as you said, there was consensus and we’re supportive. So thank you for your service.

MR. BARKER: Thank you.

So if we have no discussion, I just want to make a motion that we vote on the Subcommittee report.

MS. LACHENMAYR: Let me go -- do the Commissioners have any questions or any other members have any additional comments or questions on the report?

(No response.)

MS. LACHENMAYR: Okay. Because Joe was a Subcommittee member, the motion does not need to be seconded. Are there any -- so we ask for any further additional comments and AAC members are you ready to consider this question? I just need a yes from someone. (Let the record reflect that MR. BARKER is able to make a motion without a second because he is a member of both the Ag-OI Subcommittee and the Agricultural Advisory Committee.)

UNIDENTIFIED SUBCOMMITTEE MEMBER: Yes.

MS. MERSINGER: Okay. We will now take a vote on the motion that the AAC adopt the Subcommittee's report and submit the report to the Commission for consideration. As a point of order, a simple majority vote is necessary for the motion to pass. I will turn this over to Christa to conduct the roll call vote. Go ahead Christa.

MS. LACHENMAYR: Okay. I'll start with Mr. Buddy Allen.

MR. ALLEN: In favor.

MS. LACHENMAYR: Thank you. Mr. Allen votes, yes. Mr. Barker?

MR. BARKER: Yes.

MS. LACHENMAYR: Mr. Barker votes, yes. Mr. Betz?

MR. BETZ: Yes.

MS. LACHENMAYR: Thank you. Mr. Betz votes yes. Mr. Bergen is not in the meeting unless he lets us know otherwise. Mr. Boone, how would you vote?

MR. BOONE: Yes.

MS. LACHENMAYR: Thank you. Mr. Boone votes yes. Ms. Breslin did not indicate that she was in the meeting, unless she tells us otherwise at this point. We can go to Patrick Coyle, Mr. Coyle?

MR. COYLE: Yes.

MS. LACHENMAYR: Thank you, Mr. Coyle votes yes. Mr. Creamer? We can come back to him.

MR. CREAMER: I'm sorry, I had a mute failure there. I approve and support.

MS. LACHENMAYR: All right, Mr. Creamer votes yes. Mr. Crosby?

MR. CROSBY: I vote yes.

MS. LACHENMAYR: Thank you, Mr. Crosby votes yes. Mr. Elfmann?

MR. ELFMANN: Yes.

MS. LACHENMAYR: Thank you Mr. Elfmann who votes yes. Mr. Jim Fryer, have you joined the meeting?

(No response.)

MS. LACHENMAYR: Is Mr. Gallagher available?

(No response.)

MS. LACHENMAYR: All right. Mr. Hayden, how do you vote please?

MR. HAYDEN: I'm in favor.

MS. LACHENMAYR: Mr. Hayden votes yes. Mr. Hines?

MR. HINES: Yes.

MS. LACHENMAYR: Thank you very much. Mr. Hogan is not in the meeting, unless he indicates otherwise. Mr. Kadlec, how do you vote please?

MR. KADLEC: Yes, thank you.

MS. LACHENMAYR: Thank you very much, Mr. Kadlec votes yes. Mr. Klenklen?

MR. KLENKLEN: Yes.

MS. LACHENMAYR: Thank you very much. Mr. Klenklen votes yes. I don't believe Mr. Lee is in the meeting. Have you joined us?

(No response.)

MS. LACHENMAYR: No. And I don’t believe Mr. Melvin is in the meeting either. Ms. Erin Morris, how do you vote please?

Are you muted Ms. Morris?

MS. MORRIS: Yes, in favor. Thank you.

MS. LACHENMAYR: Thank you very much, Ms. Morris votes yes. Dr. Nickerson, how do you vote please?

DR. NICKERSON: Yes.

MS. LACHENMAYR: All right. Mr. Owen, how do you vote please? John, are you there.

(No response.)

MS. LACHENMAYR: We can come back to Mr. Owen.

I don’t believe Mr. Riniker is in the meeting. Mr. Scanlan, how do you vote please?

MR. SCANLAN: Yes. Thank you.

MS. LACHENMAYR: Mr. Scanlan votes yes. Mr. Strong, have you joined the meeting?

(No response.)

MS. LACHENMAYR: We can go back to you. Mr. Tupper, how do you vote please?

MR. TUPPER: Yes.

MS. LACHENMAYR: I did receive an indication that Hayden Wands votes in favor. Mr. Wands are you able to vocalize your vote?

Okay, let the record show that Mr. Wands is noting that he would vote in favor.

Mr. Weston, how do you vote please?

MR. WESTON: Yes.

MS. LACHENMAYR: Mr. Wipf, how do you vote please?

MR. WIPF: Yes.

MS. LACHENMAYR: Mr. Wipf votes yes. Mr. Young, how do you vote please?

MR. YOUNG: Yes.

MS. LACHENMAYR: All right. We have 19 affirmative votes. Let the record also show that Mr. Dierks is not able to make the meeting and he would have voted in favor if he had been able to speak.

So we have 19 votes in favor and zero votes against. And so, the motion carries.

MS. MERSINGER: Yes, the ayes have it. The motion carries and the Ag-OI Subcommittee’s report has been adopted by the AAC and will be submitted to the Commission for consideration. Thank you so much again, Professor Janzen and Christa for all your hard work.

Next up, we will hear presentations on the International Agricultural Derivatives by representatives from CME and the Futures Industry Association. I will let the presenters introduce themselves before we get started with the presentation.

Owain, please feel free to get us, get us started. Thank you.

MR. JOHNSON: Okay. hopefully you can hear me. This is Owain Johnson. I am the Global Head of Research of the CME Group based in London.

Right. Let's go. Lovely. Let’s see if I can make this work.

Anyway, we will be looking, firstly, at the agricultural pricing concepts, and then we'll have a little look after that at cash settlement. So some of you have noticed astutely that we've been listing a few more cash-settled contracts rather than physically settled contracts in recent years. So we've heard some questions about the theory behind that in the concept. So I'm just going to walk you through that briefly and then happy to take any questions. Can we move to the next slide?

Excellent. Right. So agricultural futures as you know go back -- agricultural derivatives, particularly go back a very long way. So whenever people will like to talk about, you know, how these are modern and difficult, dangerous derivatives, I say that the Mesopotamians were using derivatives in 4,000 BC. They were taking clay tablets to the market instead of taking the livestock themselves.

And then they would trade the clay tablets. There's not a vast amount of difference between that and what we do today.

So, you know, really this is, this is something. Agriculture is the first of the asset classes to be traded. It's the first tradable asset class. It's the first exchange-traded asset class. The 17th century saw Amsterdam and the Dojima in Japan developed. And then really things move to the next level in the 19th century in the U.S., but this is the oldest exchange-traded asset class. And I'm sure we're all very aware of that glorious history, but there's an (audio loss).

Can we go forward? Lovely. Thank you.

So the cash-settled -- there have been cash prices published for agriculture again, since the 18th century. So "The Public Ledger" is still publishing today. You can see it on the right, it doesn't look like that anymore. But that was just in 1760. That's the longest running price publication of anything, certainly, that I've come across on the planet. And that's been publishing agricultural prices.

Again, like we saw with the exchange world. This was something that was born elsewhere, but really taken it to the next level by the U.S. in the 19th century. So you can start to see these 19th century publications emerge, "Urner Barry" is still a force in the agricultural market, "The Packer," is still a force in the fruit and soft fruits market.

These big publications emerged in the 19th century as the U.S. really took off as an agricultural superpower. So I just wanted to give you a sense that although you might think of cash settlement as something new in the agricultural markets, there have been price reporting agencies for agriculture and cash publications for a very long time now. A couple of hundred years, at least.

And then you can see just in the last 20 or so years, we've really seen the big global price reporting agencies that came out of the energy markets, moving to agriculture, and that's really taking things to another level because those are well-funded, well-capitalized price reporting agencies.

But yeah, just to let you know, although the cash settlement is maybe the younger brother of physical settlement, it does also have a very long and storied history. Okay. Next slide please.

So maybe some of you haven't come across this term before, PRA, or price reporting agency. So here's a definition for you. It's a firm that assesses the fair price of commodities. They report those values for a wider audience, and then people can essentially do with those prices what they like. They can use them for information. They can use them to help do negotiations, but they can also use them as an index to settle physical or financial transactions.

This is something that really developed aggressively in the 1970s in the energy markets with all the massive volatility that we saw due to disruption there. And also because the globalized nature of the energy markets meant that it was very hard for people to agree on a price. Prices were out of date almost immediately. So what people did was they said, rather than arguing about whether something should be $65 or $64, they just said Platts plus 30 cents or Argus minus 20 cents. And they felt that that floating index would give them all some comfort, irrespective of what happened in terms of volatility. And it was just something that everybody could agree on.

Now, we haven't really seen that traditionally in agriculture, but we're starting to see a lot more. If we move on to the next slide.

So again, I don't suppose anyone on the call is unaware of this, but just to be clear what we're talking about here, physical expiry, I provide you with a commodity or you provide me with a commodity. You make or take delivery so that the actual futures flow into the spot or cash market. There can be no difference between the two, because one becomes the other. We would consider that still to be the gold standard, obviously for commodity markets. And it's something we're very proud of that we host so many of these physically settled markets.

Now cash on the other hand, at the end of the month, we plus or minus -- we cash out against the value of the index. So if I've sold at 60 and the index comes out 70, then there's a cash adjustment accordingly to someone who's taken the other side. So cash passes hands -- from hand-to-hand rather than commodities. That's the main difference.

Now, the key for cash obviously is that you pick the good index because obviously the index has to reflect the cash value in that market. You know, I said just now that with physical futures, it works very nicely because the futures become the physical. I have to therefore be sure that my cash index really reflects what's happening in that cash spot market.

So as an exchange or for any of you that are looking to trade on a cash futures basis, or that even do cash indexation, you have to be very confident in the index. You have to be very confident in the methodology behind it. So that's really crucial. Okay. Next slide please.

There we go. So as I said, this really began in energy, this use of cash settlement, and then it was taken up in metals. So why has agriculture been relatively slow to adopt it? Given that I showed you that we've had cash prices in agriculture since 1760? Why has it taken so long to be used as a contract basis?

But I think there's a few points here. Physical deliveries work really well and you know, although 1760 has been a long time, we've seen that physical futures were in existence even before that. It is a very well-established path that people are very comfortable with. It’s working really well.

Agriculture, as well. There has been more data available. Typically, USDA does a fine job. There's been more intervention by government, so there's been less drive for PRAs to emerge and to price agricultural markets historically. There's also a bit more vertical integration in the agricultural markets than you get in some of the other energy or metals markets. And also, typically an oil tanker is worth more than a a Panamax of grain.

So the profit levels that the energy firms have generated over the years have been sufficient to justify quite high PRA subscriptions and make the energy PRAs quite profitable businesses. And the agricultural markets have been less willing to pay those fees typically. So there's been less of an opportunity for the PRAs historically.

There's also great fragmentation, as I say here, you've got hundreds of oil producers out there, but you've got hundreds and thousands of farmers. It's not realistic that a PRA is going to sell a subscription for their price report to a hundred plus thousands of farmers. So it's just that great fragmentation at the base level has slowed down the cash development, I would say. But if we move to the next slide, we will see that things are changing.

I think partly it is to do with the fact that the world is getting more global. People want benchmarks in different parts of the world, apart from just in the U.S. or in Europe. And in those, some of those locations, it's not always realistic for the exchange to manage physical delivery for various reasons. So that's one big factor.

So a good example of that would be the Black Sea, which you see a nice chart of on the right, the Black Sea. We did launch originally a physical Black Sea contract, but problematic, difficult, geopolitics intervened. We're having a lot more success with the cash-settled contracts.

And there's a couple of other points. Really agriculture and energy started to blur at the edges with the energy transition: biodiesel, ethanol, and biomass. So the oil guys that were the off-takers of agricultural material, they were lots more used to PRAs, and they were happy to use PRAs for ethanol and biodiesel. So they kind of dragged that through, into the agricultural market.

Energy PRAs were also looking for new business. And I think just to that point, our Black Sea contract worked really nicely. Australia contracts worked quite well. You get this halo effect. If it works, it's proved itself. Why not try it? So, you know, people have been prepared to try at least to understand cash settlement, to get used to it because they've seen that we can generate liquidity. We can generate new price benchmarks in different regions. So I think that's been a really valuable, success breeds success, right? You get into a virtuous cycle.

So things have changed. Okay. Let's move forward. So as a bit of background for you, we've had a bit of background history of cash. Why we've started using it now, why it's taken a while for it to take off, let's have a look in some of the areas we're using it.

So really kind of two key elements before the -- I don't want to say the modern era and make us all sound really old. But before the turn of the century, were that we did update the Feeder Cattle and Live Hog from physical to cash because of the problems we were having on the physical side. And those worked really well.

But as you can see, the last kind of 10 years have really been where we're starting to see a big surge in interest. So you saw the biggest of the energy PRAs, Platts, entered the agricultural markets and from there start to really push aggressively on providing agricultural benchmarks and CME responded to that by listing Australian Wheat, Black Sea Wheat, eventually Soybeans. We've been listing Rice. So we've listed the number of these cash-settled contracts and we've had a lot of success.

So there's been a lot of interest in the traditional PRAs getting into agriculture. And at the same time there's been a lot of interest from us as the Exchange in listing to those contracts. So again, somewhat of a virtuous cycle. Let’s move forward.

So when we come and make this decision and you have Fred Seamon on the line who carries a lot of the water in these decisions on our agricultural research side. What the key decision for us is before we start with product design, is -- is this going to be physical or is just going to be cash? And it's not that we have a strong preference, either way. We're looking really at what will work best.

So the key is delivery infrastructure. I use the Black Sea as an example, are we confident in the delivery infrastructure that we can manage in the Black Sea or in that case would it be better for a cash index to emerge? But equally, are we confident in the cash index? And we confidant in the PRA? Are we confident in the methodology? Are we confident they're accurately reporting the market because as I said, it's really crucial that that index reflects the spot value because it's going to converge at the end of the month.

Obviously we have a regulatory requirements to ensure that there's adequate deliverable supply, that that convergence is accurate and works really well. So these are all the questions we look through. This is kind of our starting point for any new product development. Okay. Next.

So just thinking here a little bit about the kinds of products we've launched that have been cash. So, you know, on that previous slide, that was the menu we went through. That was kind of the iteration we went through before we came up with the decision, cash or physical? It was just interesting to me to see what kind of commonalities that were in those cash-settled listings. And it would be that they tend to be located outside of the U.S., obviously easier for us to manage infrastructure within the U.S.; better oversight, bankruptcy rules, whatever it might be.

Also, the other thing is that they tend to trade the spreads of existing major physical benchmarks. So when people trade Brazil Soybeans, they're often trading it in relation to CBOT. Same with Black Sea Wheat.

So it's not in any sense the case that these cash-settled contracts will replace in any way, the major physical benchmarks. That is not going to happen. In fact, what they do is they enhance the liquidity in the underlying physical products because a lot of spreads trade and when a lot of spreads trade you get increased liquidity on both sides. So actually the more spreads we list, the more cash-settled spreads, the more activity we get in the core physical benchmarks we list.

Also, it makes sense in smaller markets for us no to establish a chain of delivery locations for Black Sea Sunflower Oil, it’s obviously going to be worth an economic -- we’re going to have an economic disincentive to do that relative to the value of that contract, the amount that contract is going to trade. So this does allow us, cash settlement, to list smaller contracts, which provide a super useful risk management tool for certain participants in the market, which wouldn’t justify the major significant expenditure of launching a physical contract and establishing warehouses or delivery locations.

So, you know, it's a new concept. Agricultural traders have grown up with physical and they are still coming to terms in some cases. So, you know presentations like this are really useful. So thank you so much for having the time for me to just try to explain what is happening there and why we will be looking to do that. And it's not competitive. Okay, next please.

Right. So as I said, this is nothing new. We've had cash PRAs since 1760 and the energy and metals markets have been doing this for decades, successfully. It's easier in some ways to launch product because it's quicker to market and you don’t need that on screen liquidity, often it can be brokered. So that is a benefit.

But the absolute key decision for us is the choice of the PRA and the choice of the index, the methodology, the cash settlement. Because as I said, the crucial thing is that convergence with the cash market, without that these aren’t valid, they won't work. No one will use them.

The fact that they are working, people are trading, and that liquidity is growing suggests that they have a place and that people do trust that index.

So these will not -- just to repeat, I cannot be any clearer -- these will not replace existing physical delivered benchmark contracts. They are additive rather than a replacement, but they do allow people to trade different spreads. Whether it be quality, whether it be international, they allow us to provide risk management in areas where otherwise we wouldn't have been able to and that then benefits through that spread mechanism, the core benchmarks, the core physical benchmarks.

All right, I'll leave it at. Thank you so much for the time. Fred and I are happy to take any questions.

MS. MERSINGER: Thanks Owain. In the interest of time, I think we're going to move ahead and have Will go ahead and start his presentation and then we'll follow up with questions at the end for both presentations.

So, Will, do you want to go ahead and get started?

MR. ACWORTH: Sure. I just want to check. You can hear me, right? Hopefully, yes?

MS. MERSINGER: Yes, we can hear you. Thank you.

MR. ACWORTH: Great. First let me just say thank you, Commissioner Stump, for inviting me to join this discussion. To state the obvious, Ag futures are shifting forms of the real economy and one of the pillars of the industry that FIA represents. I also want to thank Christa and Summer for giving some guidance on what topics might be of interest to this committee, and to several members of the committee itself for some very helpful feedback on our initial draft. To state the obvious, however, any errors in this presentation are purely the responsibility of yours truly.

Just to give you a little bit of background on FIA, in case those people who may be attending this meeting who don't know FIA. We are the main trade association for the listed and cleared markets. We are headquartered in Washington, DC. We have offices in Brussels, London, and Singapore, our members include most of the major executing and clearing brokers, as well as nearly all the derivative exchanges around the world.

Our members also include a small number of commodity producers and commodity merchants, some of whom are representatives on this committee. We’re primarily an advocacy organization, we work with regulators like the CFTC, to promote open, fair, and competitive markets. I want to emphasize that we also work within the industry to bring the community together, it has been particularly important in the last year or so, to share insights on how these markets can grow and develop and to promote common standards, so we can make the trading and incurring of futures as efficient as possible. Can we go to slide two?

So my presentation today is actually organized into two parts. First, we're going to look at the volume and open interest, and find the number of contracts traded. Then we're going to look at the same markets. This is part two, but from a different perspective, we're going to try to look at certain markets and measure the volume of interest by metric ton equivalents, which, in my view, is closer to how end-users look at these markets. Go to slide three.

So very briefly, again, I'm sure you all know this, but I’m going to clarify why volume? Why open interest? There are really two different ways of looking at market size, volume represents the flow of transactions on an exchange and the open interest is the number of outstanding positions, which effectively is the stock outstanding at one moment in time. Jumping head to the next slide.

I know I’m going very quickly. There's a lot of slides here and I want to try to get to them within the time frame that will allow some discussion at the end.

So, just to emphasize the third bullet point here, I just want to emphasize that the first part of this presentation, makes no distinction or contrast. That matches more or less how exchanges and intermediaries see the world, but it doesn't really make any difference, or doesn't distinguish between contracts that are relatively small versus large, and that's what we address in the second part. Next slide, please.

Okay, so here's our first bit of data. So the rest of this presentation, I'll be showing a lot of charts that look like this. They're essentially comparing markets in different jurisdictions. This is based on the location of exchange, not the customer, the exchange. As you can see the number of contracts that trade in China -- that’s on the left -- is much larger than any other jurisdiction, including the U.S.

On the right, you're seeing the same type of data, but I've taken out China and the U.S., the two largest, so you can see the distribution in the rest of the world. Now what I want to highlight here is that you have a very high degree of fragmentation in terms of geography, but a high degree of concentration in terms of products. For example, that blue slice at the top there for the EU, that consists of for example the Paris wheat contracts, and the rapeseed contract that trade on Euronext. The next slice the green one is the really dominated by the softs that are traded on ICE Futures EUA. The gray slice the bottom, Malaysia, that's actually the palm oil contract --

primarily palm oil contract, that trades in Bursa Malaysia. Singapore, naturally the home of one of the most important rubber contracts. Next slide please.

Okay, so here's the data behind those pie charts. I don't think -- we obviously have time to go through every single one of these -- but I did want to highlight several key points here.

First, we've included the open interest, as I said before that represents the kind of stock of the open interest that’s outstanding at year-end 2020. And if you compare the volume to the open interest, you can see they're not correlated one-to-one. One of the most important takeaways, at least from my perspective, if we look at the markets outside the United States. It’s that Many of them are more geared to trading than to hedging. Next slide.

So here's the visualization of open interest, broken down by jurisdiction. And this is really kind of the same type of view that we saw two slides back on slide five, and right away you can see the difference. The U.S. markets actually hold, roughly 50 percent of the open interest in all ag futures around the world. And China has around -- well, the Chinese exchanges have around - 40 percent. Again, this doesn't represent the customers. This is what the exchanges are reporting, and what we are collecting, what we are collecting from foreign exchanges.

Now if you contrast that to volume, which we saw a few slides back. That was really kind of 80/20 ratio with China having around 80 percent and the U.S. having about 20 percent. Next slide.

So the next two slides are ranking individual contracts, so you get a sense of what are some, what are the most, of the most heavily traded contracts. The first one is based on volume. And what we'll highlight here is that 12, out of those 15 contracts, are listed on Chinese exchanges. Now only three are listed on U.S. exchanges. Also worth noting, all of those Chinese contracts, enjoyed double digit rates of growth in 2020, compared to the previous year. Before they grew at a triple digit rate. Next slide please.

So, same type of structure and type of ranking, except this time we're ranking them based on which contracts have the biggest open interest. That’s the column on the far right. And you can see that the list changes quite a bit. The first -- corn futures, traded on the Chicago Board of Trade, which many of you know extremely well. It’s ranked number 11 by volume but jumps up to number two in terms of open interest. Sugar futures, again I know many people on this committee are very focused on that. Sugar futures trade on ICE Futures U.S., ranked number 15 by volume, but goes up to number five by open interest.

One other point worth noting. When we rank by open interest, three options contracts join this list; corn, soybean, and sugar options. Those are all traded on U.S. exchanges. I think it's worth noting here that no other jurisdiction in the world has such a well-developed and heavily used set of agricultural options. China, about three to four years ago, began introducing these options, and they're starting to take off, and you also have options on futures trading in many other markets in the world.

So as we think about this going forward, we may well want to start looking at the combination of options on futures and futures as almost two parts in one market. Next slide please.

So this is what we call a sunburst type of visualization, essentially giving you a breakdown of all of the trading volume and open interest outside the United States, based on which sector of the market it is, rather than jurisdiction or exchange. The inner ring is essentially the sector and the outer ring is the sub-sectors within that sector. So, the largest one is the oil and oil seeds and within that you can see that soymeal, rapeseed, palm oil, soybeans themselves - that's what makes up that kind of ring, as it were.

I think this gives you kind of bird's eye view on which sectors of the agricultural economy are most represented in the global futures trading. Next slide please.

All right, in the next several slides I'm going to try to give you some sense of the growth trends and look at three in particular, that is oil and oil seeds, grains, and the softs. It’s just to give you some sense for how things have changed over those next five years.

So starting with oil and oil seeds, what you see really here to me is on the trading side, China is really driving the ups and downs. Trading volume hit a record level last year, driven mainly by China. Over on the open interest side also has been rising pretty steadily, also set a record late last year. Again driven primarily by an increase in open interest in the Chinese exchanges. Next slide, please.

I should pause here by the way, I believe that copies of this deck, have been made available to all members of the subcommittee. I realize I'm flying through a lot of data here, and I'm hoping that over time you can kind of digest these things, and return perhaps, in later sessions.

But, grains. Here as well we see, you know, a kind of a surge in growth in the second half of last year. But what I think is particularly interesting here is the size of the open interest on the right. That orange band, that's the U.S., and I think it really does highlight how much the U.S. market is used for risk transfer and risk management, rather than just purely speculative trading. Next slide please.

So, softs. To me, what's interesting here is that it's not a bipolar world but rather a tri-polar world. The InterContinental Exchange operates two markets for sugar, coffee, and cocoa futures, one in the US and one in the UK. And as you can see from the chart on the right, that UK market of open interest is roughly the same size as the open interest in China, which I think highlights one of the kind of really important things to think about. It's not just the U.S.-China story, it's really the agricultural markets are linked together across a lot of national boundaries. Let’s go to the next slide which is the beginning of Part Two.

So just to reiterate, we're adjusting for contract size. I'm narrowing it down to just six commodities and converting the contract volume of interest into metric ton equivalents, which I think gives you a better sense for the size of these markets in the way that end-users -- commodity merchants, producers, and consumers -- would think about them. Next slide.

Starting with soy. So the next five slides all relate to the soy complex, I promise you won't go through all of them but I did want to provide as much information as possible because the importance of this complex to the agricultural industry, and also because epitomizes some of the interesting trends that we're seeing in particular the rise of China as a center for price discovery.

So how does this conversion process work? Just to be very clear. The first thing we do is convert the underlying measure into metric tons. That means taking bushels or pounds or short tons and converting it to metric tons. And then second, we multiply the number of contracts by the number of tons to get that kind of size in terms of how many metric tons it is.

Looking at this table, long story short, you can see very clearly that the contracts listed on the Dalian Exchange are much smaller than the comparable contracts trading in the U.S. The U.S. contracts range from three times larger to 12 times larger, are all based on physical delivery, and as Owain explained, very clearly that is the gold standard for futures trading, and as members of committee know very well, size really matters when taking physical delivery. Next slide, please.

So how does the world look after we adjust for size? Well, here's the same kind of visualization that I was doing earlier except we're now looking at the volume of this in terms of the metric tons. The main takeaway here is that yes, the Chinese contracts are smaller, but even so, the level of trading in that market is an important part of the global futures markets in the soy complex. What we've heard from our members, is that even though firms may not be able to access this market directly, they're definitely looking at this market, as another source for information about supply and demand, and a very important what I should say, the most important consumers of soy. Next slide.

So growth trend over time. You know the main takeaway here is that there actually wasn't that much growth. It did pick up a little bit in the second half of the year, but neither market is setting any records. It also, I think, highlights something interesting to think about, which is that the -- of course, the Chinese market is rising and falling in terms of trading activity, but over time, you know, it's been a pretty consistent kind of share of the global market, which suggests to me that it's going to be around for a long time to come, and is likely to become more important going forward.

Can we jump to -- I think let's go two slides forward to 35. One more. Again, just to save a bit of time.

Well, okay, we'll go right to canola. So canola and -- also known as rapeseed -- and palm contracts, here we have a different cast of characters in Rapeseed, on Euronext, which is the largest agricultural futures market in Europe. In the EU rather. And in palm, you have Bursa Malaysia in Malaysia, obviously, and Asia Pacific Exchange in Singapore.

Same conversion process, and similar kinds of results. The Chinese contracts tend to be smaller, although in this case, not that much smaller from their international counterparts. Next slide.

So how does that break down? Right away you see that these are very, very different types of markets, the ICE and Euronext markets have a relatively low share of the volume, but more than half of the open interest, which again, highlights the differing emphases between trading versus hedging between speculating on the direction of prices versus trying to manage your risk exposures. Next slide.

Palm oil, is somewhat different, actually quite different, particularly when you look at that open interest chart on the right. It's really a kind of 50/50 split, but they serve very different customer bases. The Malaysian exchange, as many of you know, has many international customers. The exchange has had a very strong relationship over many years, with CME. An there are a lot of People are using the palm oil, they are using that Bursa Malaysia contract to hedge their risk. On the other hand, the Dalian Exchange is really serving customers within China. And it's interesting to see that both of them have roughly the same amount of open interest. Next slide please.

Sugar and cotton. So, again, a similar kind of pattern. We find that the contracts traded in China are significantly smaller. However, there's an important distinction. If you look at the cotton contract, the Zhengzhou Commodity Exchange contracts. The volume is larger than the comparable contract traded in the U.S., even after the conversion, which I defer to the experts on this committee who knows a lot more about the cotton industry than I do, but I think that probably reflects the fact that China is such an important force in the production, consumption, and export economy. Next slide please.

Here's the sugar market. I'm sure my friends in ICE would be happy to see this. They are really the primary center for price discovery and risk management. The Chinese market is really still very much secondary to what trades on ICE in London and in New York. Next slide, please.

Here's the cotton contract, or the cotton market, I should say. You see again that the Chinese contract is very large, even after adjustments for size. It’s certainly much larger in terms of volume, and even when it comes to open interest. It’s almost a third the size of the U.S. market. It's a pretty exceptional performance for a much younger market. Next slide, please.

Wheat and corn. This is the last set I'll talk about, I know this is near and dear to many of your hearts. This is, again, a case where the Chinese contract is significantly smaller, but so is the Euronext contract, in the case of milling wheat. And you can see how that affects the amount of tons being traded over on the second columns on the right. Next slide.

This I think is, to me, a pretty interesting indication that even though you have markets that are two markets that are, you know, -- there are very few barriers to access. I am sure there are many there are global trading firms very active on the Euronext market. It doesn't mean that one replaces the other. Each one of these contracts, reflects differences in specifications differences in the types of wheat, differences in delivery locations.

Also, currencies, and I think that illustrates something that Owain said -- discussed before, and we've heard about from our members which is that, you know, it's not a zero-sum game. Instead it's more a situation where it provides that additional granularity for price discovery and risk management. Next slide, please.

Corn. Well corn here is probably the least interesting chart of the whole bunch because really it's -- the CBOT contract is just so important, and so much larger than any competitors outside the U.S. The Dalian Exchange does indeed have a contract, but it remains relatively at one-seventh of the size that you see on the Chicago Board of Trade. Next slide.

Well, that brings me to the end. I would certainly welcome, we here at FIA would certainly welcome any follow up questions you may have. We provide this type of data to our members on a regular basis. We don't do this kind of analysis on a regular basis, but we certainly provide the data and we’re more than happy to share the data with the CFTC and other policymakers.

I did want to -- I did want to kind of summarize my presentation with a few kind of overall observations.

First, as we've seen, China now has a very large agricultural futures market that covers a wide range of sectors. Second, no other jurisdiction comes close except the U.S. Third, China, or the Chinese markets, differ from the U.S.

markets in these two important ways: one, the contract tend to be smaller and two, more of a trading comes from speculation, rather than hedging. Fourth, agricultural futures trading in the rest of the world is highly fragmented by geography and highly concentrated in terms of liquidity.

As I mentioned earlier, pretty much all the palm oil trading is in Malaysia, all the sugar trading outside the United States is in London. All the wheat trading is in the EU. Rubber trading in Singapore and Japan, and so on and so on. In certain sectors, such as corn, soybeans and sugar, U.S. markets are currently the global center for price discovery and risk management, but in other sectors, such as palm oil, the U.S. relies entirely on foreign markets for those functions.

So I think if we draw any conclusions from these data is that cross-border access is critically important. A point we've been making here the FIA for many, many years but it bears repeating. Improving cross-border access is a win-

win. It's positive for the end-users who need access to these tools for risk management, and it's a positive for the markets themselves in the sense that more participation, leads to deeper pools of liquidity and better price discovery.

And with that, thank you very much and I look forward to questions.

MS. MERSINGER: Thank you Will, and if anyone has questions for Will or Owain or Fred, please at this time, unmute your line and go ahead and ask. Thank you.

MR. OWEN: Will, this is John Owen. I was curious why you don't think there is an active futures market for rice in China?

MR. ACWORTH: Excellent question. There is a futures market for rice. I didn't show it here, to be honest with you. It doesn't come up into that list of the top 15, but there is an active futures market for rice, I believe, but I'd have to check my data. I'd be more than happy to get back to you with the exact figures and the growth rate over the last five years.

MR. OWEN: Thank you.

MR. BARKER: This is Joe Barker. I just wanted to thank Will and the FIA for this great summary of the data. The growth in the global futures markets is a clear trend. Access to these markets is going to be important to agriculture hedgers going forward. For example, on one of your slides, you showed the eeg futures. Currently, there's not an egg futures listed on a U.S. exchange, and there are many producers that feed chickens corn and soybean meal, but they sell eggs. And so their access to risk management is not as good as some other agricultural producers.

So I just want to encourage the CFTC to continue the work you've been doing on cross-jurisdiction, regulations. Transparency, of course, you know, if we're going to trade in China, we want to make sure that those markets are fair and transparent to all market participants and work on market access to these global exchanges.

I think this is a very important topic and maybe where the puck is going for some of these markets, at least. So thank you.

MS. MERSINGER: Thanks, Joe. Anyone else have a question or a comment?

COMMISSIONER STUMP: This is Commissioner Stump, I didn't know if you were going to turn the Commissioners or if we should just jump in here. I thought that – I don’t know if it's possible to pull up the slide deck again and go back to cotton slide because Will, I thought it was really interesting. And I know you're limited on time today, but you had actually asked a question relative to the trend we see with regard to cotton and the large presence we see of the cotton, I think, volume and open interest outside of the United States.

But I'm just curious if anyone else from the committee wanted to address that. And if not, that's fine. I just, I felt like that was a very good question that you presented, Will, and I would be curious to know also if others on the committee have input as to the significant trading presence on the Chinese exchange with regard to cotton.

MR. HAYDEN: Thank you Commissioner Stump. This is Tommy Hayden. David Rossen is a panelist coming up and may be better served to answer that. David, I'll call on you if you want to make a comment, you may be addressing that later in the meeting.

COMMISSIONER STUMP: And we can certainly cover it later. I just wanted to offer the opportunity.

MR. ROSSEN: Hi, Commissioner Stump. This is David Rossen. Can you guys hear me?

COMMISSIONER STUMP: Yes.

MR. ROSSEN: Good. So you know, Will had commented on the relative size and importance of the physical trade in China. And so, if we kind of just have very high-level look at magnitude of production in China. It's about 130-to-150 percent of the United States. And their use is significantly larger.

So in the United States we use between two and a half and 3 million bales. In China they can use as much as 40 million bales or about a third of the entire global production. So I suspect the dynamics that Will is highlighting in this slide are reflecting the physical realities of just how much of the product is transacted and traded and the size of the industry that exists in China for cotton and textiles.

COMMISSIONER STUMP: That makes sense. I thought that the distinction here largely might be -- and Will you can confirm if this is right or wrong -- that in the case of cotton, as compared to some of the other contracts that are trading on the Chinese exchange, this is far less speculative activity, which I think is apparent by the two charts and the way they lay out compared to some of the other commodities.

Thank you.

MR. ACWORTH: I do think it's worth emphasizing that the Chinese markets are much younger than what we have in the U.S. You know, it really only has been a relatively few decades since when these exchanges really got started and the expansion of the range of contracts has been actually relatively slow. I think the Chinese authority has been very careful about proceeding along this line. And I think that there's a definite interest in that country in having more participation from the outside world. And I think they recognize that in order to really make these markets serve the real economy, you've got to have this whole infrastructure around the markets with, you know, clearing firms and data vendors and you know, people that like introducing broker community people that can explain how to use these products to really help a producer or a merchant manage their risks. So we benefit from that here and we see that in other parts of the world, perhaps, but certainly the Chinese markets are just beginning to have those elements of a complete ecosystem.

On that rice question, I did a quick check. It looks like several hundred thousand contracts per month in a rice contract is traded in China. On the -- give me a sec on, I don't have it unfortunately. I'm not sure which exchange. So if you interested in the details, I’m happy to follow up.

MR. OWEN: Thanks, Will. I’ll send you an email.

MS. MERSINGER: Are there other questions or do any of the Commissioners have any further questions on the presentation?

(No response.)

MS. MERSINGER: If not, you can always email. Oh, go right ahead.

COMMISSIONER BERKOVITZ: Thank you Summer. Excellent presentations; really extremely informative, both presentations. I'd like to ask on the CME presentation, in terms of the pricing and in terms of whether the agricultural markets can be like the energy markets, which I'm the sponsor on the EEMAC -- the Energy and Environmental Markets Advisory Committee -- and as CME mentioned their price reporting in those markets for a number of years and critical to many of the derivative markets there. But in the agricultural markets, I guess what I've been reading about is trends, particularly on livestock, where there are fewer and fewer points of sale or market interactions along the chain, the supply chain that it's becoming more contracted from a few big suppliers to the feedlots.

And I'm wondering from CME’s perspective, how do you view the robustness of the spot market on livestock and the prices that you're able to -- the futures contracts are based on -- given the trends in those markets and the availability of a vibrant arms-length cash market?

MR. SEAMON: I can take that one, Commissioner. Actually a really, really good question and something that has been discussed particularly around our Live Cattle futures contract because all of our other livestock contracts are currently cash-settled. Live cattle still has physical delivery and based on what we hear feedback from our customers that it is still the preferred method for a live cattle settlement.

So there's still quite a bit of underlying support for that physically delivered contract.

That being said, exactly what you say, there is less negotiated trade that underlies our futures market in the, you know, in the cash market. There's less of it now than there was in the past, so that is from a research perspective, something that we keep tabs on because, from our perspective, you know, Live Cattle has been performing well, but our concern is, you know, assuring that it still continues to meet all core principles and as long as it does that, and our customers still prefer, you know, a physical delivery on that, we are happy with the current makeup of it.

However, if the underlying cash market does evolve away and there's not enough information flowing into the futures market, cash settlement would have to be a consideration. I don't think we're at that point. But rest assured, what you're reading is, you know, us also looking at and keeping tabs on how that market continues to evolve.

And I'll also bring up that we did recently launch a beef cutout index, not a futures contract, so there's no market on it yet, but that is basis USDA data that gives some -- it gives some transparency into the price out of the processing plant and Live Cattle is the price into it. But if the beef market evolves like we saw the pork market evolve -- we had launched years ago, a pork index, a cutout index -- and just recently did we actually launch a futures on that and that's been very successful.

So we will continue to also, you know, look at the cattle markets and the beef markets and if indeed they evolve, like we saw the pork markets evolve, could at some point in the future have a futures contract on the beef cutout.

COMMISSIONER BERKOVITZ: Thank you. I appreciate that. Thanks very much.

MR. FRYER: This is Jim Fryer at NCBA and Commissioner, I'd add a couple of comments to that, too from the Cattlemen's perspective. Is the amount of negotiated trade we've been losing over a long, long period of time has somewhat stabilized. And right now, the industry has been working very hard to actually increase the negotiated trade and there has been some success in that. So there's overriding macro influences as to why there would be more formula business, but at the same time, the industry's noticed the need for negotiation. So there's an effort well underway to make sure our markets are very sound.

And in terms of a beef market, you know, there's a lot of chatter in the industry we'd be willing to -- well excited to know what the prospects of that are in the future as well.

COMMISSIONER BERKOVITZ: Thanks, Jim.

MS. MERSINGER: Thank you, Commissioner Berkovitz. Are there any other questions or comments at this time?

(No response.)

MS. MERSINGER: Again, if you do have follow-up questions, please feel free to send a text or a chat or email to Christa or myself, and we will make sure to get your questions to the presenters. And thanks again, Owain, Fred, and Will.

The next item on our agenda is a panel

discussion, which will be moderated by Christa Lachenmayr, who is not only the Alternate DFO for the Ag-OI Subcommittee, but she's also an economist in the CFTC Division of Market Oversight with the Product Review Team. And she serves as the CFTC's liaison to the Department of Agriculture.

Today's panel will focus on perspective on the pandemic from end-users and on the importance of risk management in those markets. I'll turn it over to Christa for introductions and to kick off the panel. Go ahead Christa.

MS. LACHENMAYR: Thank you so much, Summer. First I'd just like to apologize, we are running a little bit behind schedule, but this this next panel is a really important discussion. So I think we're just going to power through. We understand your time is very valuable and thank you for continuing to listen in. So … and thank you Summer.

As we were putting this meeting together, when the economy was opening back up, we thought that it would be an opportune time to build on some of the previous discussions about the impact of the pandemic on various agricultural sectors, and that it would be particularly instructive to hear directly from risk management professionals in some of the most heavily impacted sectors about the pandemic's impact on their businesses, the importance of risk management, and the markets during the severe supply chain disruption, and for them to share any lessons learned with the committee and policymakers.

So to that end, I am so delighted that we have a trio of very skilled individuals with us here today, from the merchant and processor segment of the value chain. We'll begin with a brief introduction of each panelist followed by a summary of the impact of the pandemic from their experience and perspective. I'll delve a little further into some of the key points raised by the panelists and then open up the floor for questions and comments.

So our first panelist is Christian Edmiston. Christian is Vice President of Procurement and Risk Management at Land O’Lakes, which is one of the nation's oldest and largest agricultural co-ops with $14 billion in net sales of dairy products, including butter and cheese, as well as feed nutrients and sustainable agricultural technology products.

Welcome, Christian. Can you tell us a little bit more about your role and give us a high-level overview of your experience at Land O'Lakes during the pandemic?

MR. EDMISTON: Absolutely. And thank you for the chance to speak here. So my role Land O'Lakes, I have responsibilities for procurement of all of our commodities and inputs for our products across our dairy foods and feed businesses, as well as risk management for our core businesses.

The pandemic from our perspective was, you know, honestly a really crazy time. I'll highlight like kind of three areas of impact. One being market volatility that provided plenty of challenges. And the best example of that is in the dairy space where block cheese reached within pennies of all-time lows only to set record highs less than 60 days later. A key component of that was government programs and the associated demand that they provided.

While needed, those were a key contributor to the volatility that we saw. And I think that the execution of those programs was understandably about speed of execution and maybe not as much around the nuance of considering unintended market consequences as they were implemented. So that volatility obviously contributed to, you know, big swings in our positions, as well as swings in customer orders. You know, as our customers saw those markets change dramatically and then adjusted their ordering and reordering patterns in association.

So, and that would be the second thing that I would highlight. The volume volatility for us was a huge challenge. If you think about our risk management program, you know, it's a key part of our businesses across huge portions of what we do.

One thing that we really discovered through the pandemic that we hadn't considered was, or really hadn’t built out, was the ability to adjust our risk management positions in volumes on the fly. So as we saw the big shift from retail-to-food service as restaurants shut down. In some places that meant, you know, having to place additional positions and in other places that meant having to quickly remove positions. And so, that was a huge challenge for us. It really stressed our systems and stressed kind of the communication, the way we communicate across functions within our business.

One of the things that you know, is definitely we're calling out, you know, in our risk management program at Land O’Lakes, is it's highly cross-functional. If you think about all the way from you know, our warehousing and inventories to our sales and finished goods, to our planning group and expectations for what we're going to sell in the future -- all of those things are required for kind of good risk management program at Land O’Lakes.

The third thing I would put in as far as impacts for us is, you know, just the burden of keeping product moving. We talked about and I know I talked about with you in our preparation for this, the idea of the dairy is pretty unique. Milk is perishable, it's continuous, you know, it's coming every day from the cows, whether you like it or not. Can’t turn it off. It's coming from our member owners, which adds some complexity and it's also, you know, and being 80 percent water, it's hard to transport. And so, when big segments of the economy shut down and demand really fell off. There was a lot of time and attention for our supply chain, really devoted towards making sure we kept things moving and maintained our stewardship of our producers’ milk. And it was hard honestly splitting time between managing our financial positions, but also managing, you know, our positions in the physical world as well.

So those were kind of the three areas I would highlight in terms of the pandemic impact on our risk management programs.

MS. LACHENMAYR: Thank you, Christian. And we appreciate your comments and we'll get back to some of those key points. Our next panelist is David Rossen, who we met a little bit earlier. David is currently the Global Hedging Manager for Cotton at Louis Dreyfus, a leading global merchant and processor of agricultural goods with products ranging from cotton to grains, biofuels and ocean vessels. While most of his career has been with Louis Dreyfus, David also spent time as the Senior Director for Commodity Risk Management at Restaurant Supply Chain Solutions, which is the sourcing arm for Yum! Brands.

David, thank you for being here. Can you give us a recap of the pandemic's impact on the cotton sector and some of the issues you faced at Louis Dreyfus?

MR. ROSSEN: Good morning. First I'd like to convey my appreciation to Commissioner Stump, the other Commissioners, Summer, Christa and the AAC for the invitation to participate today. It's an honor to do so.

When speaking about the impacts of the pandemic, it's hard to first not acknowledge the vast human toll inflicted. In that spirit, I suspect we'd all like to pass along our thoughts and prayers to those individuals and families impacted by COVID-19 and also our appreciation for the frontline workers who worked and continue to work tirelessly to get us through this trying time.

Aside from the direct human impacts, one of the most noteworthy hallmarks of the pandemic was an extraordinary, and in many cases, unprecedented change in demand. In the context of commodities that the demand shock was not consistent across the entire landscape. Food and the food supply chain remained an essential linchpin to society addressing and moving beyond the pandemic, even within the broader heading of food, there was a variety of impacts with eat at home-focused ingredients performing better than that of restaurants or school-based products.

Energy and industrial commodities saw a wide range of demand responses. Those that were deemed essential in the context of the pandemic behave more favorably than those whose demand-base was impaired or even furloughed. And as time evolved, some were net beneficiaries.

My most recent and applicable work experience has been focused on the cotton market. I'd like to direct my comments this morning on this third category, which are commodities like cotton that have a demand profile not fully aligned with either food or industrial use. In some sense, at least a portion of their demand-base could be categorized as discretionary.

As governments around the world issued, stay-at-home orders last spring, the textile industry essentially ground to an abrupt halt. This triggered one of the most dramatic negative demand shocks our industry has ever experienced. As one measure of the magnitude of this demand shock, USDA’s pre-pandemic estimate of global cotton mill use was about 120 million bales. By the end of the crop year, about six months later, that number had dropped by 18 million bales or 15 percent to 102 million bales.

So what were the implications of this demand shock? Global futures prices and cash prices all plummeted with the ICE contract dropping more than 25 percent, and foreign cash cotton basis levels witnessing historically large discounts. With many mall and retail stores closed, inventory of apparel and home textile goods started the backup. Brands and retailers responded to these stock builds by attempting to cancel or delay their purchase orders, which then backed up through the supply chain to finished goods manufacturers, fabric makers, yarn spinners, and ultimately merchants and growers.

The various participants in the value chain behaved as though the pandemic was a get out of jail free card. They had high price commitments, which were then underwater in the newer low price index. It's created a great deal of friction between counterparties and the system as a whole incurred many delays and defaults and had increased carry and storage charges. Just to name a few.

Given the time of year, at least in the United States, the merchant community had assumed a large percentage of the price risk from the growers and as such were disproportionately impacted by these dynamics. As these extreme price dislocations and contract sanctity issues occurred, the viability of just how good one's hedge was at any point in time was called into question.

In this light, I'd like to take a moment here to acknowledge the Commission's recent work regarding position limits.

During the pandemic, we witnessed a variety of instances where certain counterparties, either out of opportunity or necessity, attempted to delay or default or call force majeure. The flexibility allowed in the existing rules was a critically important risk management ingredient for many market participants and likely contributed to the resilience of futures markets. As such, I’d like to applaud the Commissions for its forethought on this topic.

In addition to the fast moving parts of any given commodities-specific supply chain, there were larger influences afoot as well. Many other dramatically impactful dynamics had to be assessed concurrently -- things like U.S. and international fiscal and monetary policy, the stimulus. Large currency market swings, logistics and transportation; both availability and price swings. And as we've seen, many of these influences are ongoing and may take some time before normalizing.

If I was asked to summarize a key learning from having lived and worked through this experience. It would be that a robust risk management framework is an essential part of any commodity business. And at the same time, ensuring that there's enough flexibility in that framework to adapt and absorb even the most extreme of events.

Thanks.

MS. LACHENMAYR: Thank you so much for those comments. And then last but not least we're joined by Dhamu Thamodaran, who has recently retired from a long career at Smithfield Foods, where he led strategy development for the firm’s vertically integrated business, managed its commodity hedging activities, and oversaw its Global Economics Commodity Research and Analysis Group.

Dhamu, welcome. Can you share with us a little bit about the impact of the pandemic as experienced by the largest pig and pork producer in the world?

I think you're on mute.

(Pause.)

MR. THAMODARAN: Can you hear me now?

MS. LACHENMAYR: Yes.

MR. THAMODARAN: Sorry. Thank you, Christa for the kind of introduction and thank you, I appreciate the Commissioners and CFTC for having an opportunity to participate in the panel. Again, Christa introduced that I retired after 36 years with Smithfield. That's a pretty long time in a commodity hedging role.

And so, I want to add a disclaimer. Whatever comments would make it’s my experience in my past, nothing to reflect on today's environment.

In Smithfield hedging and price risk management, it has played a very strategic important role as far as I know, we always planed ahead. We always had a process in place where hedging is executed more often. CME has a limitation on position limits so we had to go beyond CME. But this pandemic posed an important challenge.

And I am a contrarian. When I heard about this disease in China back in December, I thought it will be a global issue that's like so far, but I never thought this will impact this much, the U.S. I think most of our hedging decisions was made well-beyond the pandemic and that served well for the company because there are many challenges the company faces.

Number one challenge, our goal is to keep the plant employees, 54,000, healthy and not sick. That's the goal we had. The number two goal we had is, how do we keep our customers happy, engaged, all those things that got challenged quite a bit during the pandemic.

First of all, in meat plants most of the people work in close proximity, and there is no six feet spacing in the location, and most of the employees are higher age, so they are susceptible to the disease. That was a big challenge, and the disease outbreak that one case that became nine, nine become at 81, 81 become 400. The next thing is one thousand. So we had to shut down plants and modify, we had all these things; it takes time.

During the closing of the plant because the pork production dropped 30 percent, no pigs ever die of old age. And the whole pig processing is an efficient supply chain, a biggest barn is like a hotel room. Every hotel room is occupied by some pig. If that hotel room is not vacated, the whole backwards supply chain is challenged.

So there is, the producer have to make tough choice, do I -- what do I do with the pig if the plants are not running. Do we have to -- they have to do some drastic measures. I don't want to discuss at this meeting, but whatever it is that are good for the livestock industry, but that's what happened.

The second one is that demand challenge.

Overnight, the food service demand -- and they look at the pork and the majority of the pork is retail and 16 to 20 percent is food service restaurant, and 25 percent is exported. But in certain parts 75 percent of the bacon is consumed by food service, that demand came to a screeching halt. Overnight.

Then we had so much product in the freezer, and we ended up -- the company ended up giving it to food banks and all to charity. At the same time the retail demand jumped 40 percent, the supply chain is not set up to handle any of the change -- 40 percent increase in demand. We don't have a freezer. We don't have the shipping or the customer doesn't know how to receive.

So, it is an enormous challenge, of course, for a company. Customers are unhappy, producers are unhappy. It was a big challenge, a learning lesson for any protein company, at the same time the labor force.

And in the hedging side, the position we took, served very well for the company. But the challenge is the accounting rules, we had hedge accounting. We could not match our hedges with actual delivery. Because if we have X-number of contracts, if the pigs are not slaughtered, what do with the contract? It has to be a market-to-market contract.

And the second one is, we get a robust hedging program for the producers, as well as all the restaurants. Like one of the roles I played as I became an advisor to many of the restaurant chain. They all had a commitment, but they can't take the product. And what do I do with the futures position? We ended up deferring to extending to beyond next year. And that is tough with auditors. That's how sure are you they will be back in business next year?

And those are the challenges they face. I think those are the challenges now, the plants are running fine. But the issue now that the whole protein industry is facing is a labor shortage. The industry has a severe labor shortage problem, and many of the time, the industry is having a tough time running the plant full.

On the futures side, the big challenge the industry is facing is the volatility is extremely high now, whether it's fundamentally driven or speculative driven, I have seen the livestock futures go up and they are limit up, limit down multiple times in a week.

So if I’m a small producer, I don't have the margin capacity to manage a hedging position. So more often, they ended up coming to the big companies to manage the position for themselves. So more and more I’ve seen in my 36 years, robust hedging by farmers that is slowly disappearing. It's concentrating in the big player.

This is my view, not Smithfield’s view. I have seen this, because if I’m growing corn, my corn is now up 345 cents in one day, and then CME calls for a margin call. Do I plant the corn or worry about the margin call? More and more producers are moving away from hedging themselves, they are still doing the hedging, but it’s being done through somebody else.

That would be the comments, introductory, that I can make, and questions later.

MS. LACHENMAYR: Very interesting. Thank you.

I did want to first touch on something that came up during our prep calls, which was specifically the demand factor of the Phase 1 commitments. So just for context, but the U.S-China trade deal was finalized in February 2020, including specific commitments for China to purchase an additional $200 billion of U.S. goods over 2017 levels, which included 12 and a half billion in agricultural goods.

Maybe we'll start with David here, but can you tell us a little bit more about the impact of the Phase 1 commitments on your industry and driving demand?

MR. ROSSEN: Certainly. So as the trade war began to kick off in 2018, and the relationship between the U.S. and China deteriorated, we began to see a shift. This is true for cotton, as well as grain and oil seeds and other products, a shift away from China choosing the U.S. as its preferred supplier of these products. And began to find alternative suppliers from either the Black Sea, or South America, Brazil, Argentina.

And so, U.S. export values began to feel the effects of that, and overall volumes were impacted as well. At a time when markets were relatively well-supplied the burden of carrying those inventories then fell on the U.S. and the U.S. producers. The implementation of the Phase 1 trade deal most definitely began to shift those buying patterns back to the U.S. and that has been reflected significantly in the way that we've seen the trade flows evolve and prices as well.

So I do believe that the overriding intended benefit ascribed to the Phase 1 trade deal has been realized where we have seen significant volumes pick back up as far as Chinese demand of U.S. agricultural products.

MS. LACHENMAYR: Thank you very much. Dhamu or Christian, do you care to comment on that as well?

MR. THAMODARAN: Yes. David mentioned when the trade war started in 2018, China retaliated U.S. pork industry putting a 50 percent tariff on pork exports and more often all the 50 percent was paid by the U.S. producers because the pork prices in the U.S. fell more than 50 percent because China can buy the pork from Europe at a price that the tariff was paid by the U.S. producers and it cost the U.S. pork industry several billion dollars.

The tariffs were paid -- in Economics 101, I got a PhD. More often with the tariffs, the buyer will pay for it. In the meat industry, I tell the student when I give a lecture, in pork's case, the U.S. was paying the tariffs. It came out of the producers' market.

When the Phase 1 deal was signed, the tariffs went from 50 to 25 percent. Even now that it's 25 percent tariff. However, China had a major disease, ASF. And China produces half of the world's pork. Can consume more than half of the world's pork. Pork is the primary meat. So they needed to import meat and there is no other market bigger than, Europe is the biggest next to the U.S.

So they ended up buying a record amount of pork from the U.S.

But two reasons. One is ASF. They need it. Whether a Phase 1 deal of Phase No-deal. They would have bought it. The second is the price difference, what Chinese pork price is versus the U.S. pork price is much lower. So the U.S. is at an advantage and this is going to continue for a while, whether we have trade deal or not, but it will take another two to three years before China recovers their livestock supply.

So the Phase 1 deal really helped. But I won't say that's the reason pork exports went up, but that, our -- if I am a pork industry guy -- our number one request would be, we need the tariff off. The U.S. tariff of 25 percent is hurting close to 800 million dollars to the U.S. pork industry. Even now that tariffs is paid by the U.S. pork producers.

MS. LACHENMAYR: Thank you, Dhamu. Christian, do you have any comments on the Phase 1 demand?

MR. EDMISTON: Yeah, definitely.

You know, I'll tag onto the comments that were just made, you know, relative to pork. One of the primary feeds for baby pigs as China has ramped up their pork production after ASF, is whey, which is the byproduct of making cheese.

And so, I know it's a dark little corner of the commodity markets that a lot of folks probably don't think about, but if you want to see an interesting chart, pull up whey. It's at near record highs at this point. And China has been a significant driver of that.

China is the largest global importer of dairy products, and it's not really all that close. The U.S. exports between 15 and 20 percent on a milk equivalent of milk production here in the U.S. And so, China is important to the U.S. as it relates to dairy, even if the trade flows aren't always direct. Volatility in that relationship clearly can have an impact on the U.S. dairy industry and dairy producers.

So, you know, as the trade war started and tariffs were put in place, obviously it contributed to what was already a relatively low price scenario. As China's demand has ramped up here over the last six to 12 months, and they've opened up, you know, at times faster than the U.S., it's been a significant driver of export demand out of the U.S. on dairy. And it's been a big help for U.S. dairy producers for sure.

MS. LACHENMAYR: Thank you very much. I think all three of you kind of mentioned regulatory flexibility and the need to be nimble in your hedging activities, particularly in order to really maintain those commitments to your producers and also your customers.

So is there anything that we should take away as the Commission or that the Committee should take away or look into further that could enhance -- further enhance -- that regulatory flexibility? I guess, maybe start with David on that. Not to put you on the spot.

MR. ROSSEN: No, that's fine. From our perspective, I think, you know, the futures markets behaved appropriately and were an important risk management ingredient and tool. I think in the most recent actions, some of the components that contributed that to that were the ability to incorporate anticipatory merchandising, some of the increased position limits, and then also where appropriate utilization of gross versus net hedging.

So again, as I mentioned in my opening comments, I’m just appreciative that those tools were available to the industry at a time when it was really put under stress.

MS. LACHENMAYR: Great. Thank you. I wanted to go back to Dhamu a little bit. It's very interesting that you mentioned that the producers are coming to the large entities, their large customers in order to manage some of those hedging activities. Do you have -- could you expand upon that a little bit more, or perhaps offer some ideas about how that may impact the Commission's decision-making or any need for regulatory change in order to facilitate that?

MR. THAMODARAN: I don't think it's a

regulatory change. I think most of these companies, like food service companies in generality, they don't maintain a hedge futures position because of market-to-market hedge accounting and all these things. I think from our standpoint, when you can establish as the customer relationship. So we are willing to offer one year contract on certain time when I was there, but the issue with the position limit at Smithfield, when I was there, we were always close to the edge of the position limit.

So we had sometimes, we had to deny that hedging requests because we do a strategic hedging for the company, a bigger risk than I am doing for customer hedging and do I take the customer in mind or company's risk in mind?

So there is some position limits was a big item. I think I have spoken at the CFTC conference before. I raised the same position limit issues.

Now I'm retired, I can make an independent comment. That was a big challenge. And, I think the customers see the volatility of the market.

They don't understand. They don't understand why oil went to negative. I spoke at a conference. In fact, I'm speaking at a restaurant conference two days from tomorrow. One of the questions is why did the oil went to negative, a commodity can stay negative?

I know fundamentally the market works fine. But from a customer, a common sense perspective, how can a commodity can price negative? And they don't understand market call, limit up, limit down. These things are very, very complex, but they are interested in selling sandwiches.

They are not interested in -- they think a crazy guy like me can manage the risk. They don't have any interest in managing the risk. They don't have a big interest or a huge staff, like David, all of that, to worry about the market 24 hours a day.

MS. LACHENMAYR: Thank you. Thank you very much. I also wanted to turn to Christian on that. You have similar experience in being a really significant player in a moderately sized market.

So could you talk a little bit about the challenges there?

MR. EDMISTON: Yeah, definitely. And I guess I would say that, you know, calling the butter market, moderately sized, is being pretty generous at times, you know, and nonfat dry milk would follow kind of closely behind.

So you know, I'd echo some of the comments that David made on position limits. And in some of my work experience also, I spent some time at Kraft Foods with which where it's basically a similar kind of setup relative to cheese that Land O'Lakes would experience relative to butter or nonfat, where liquidity can be a challenge given the exposures that our business faces on a pretty regular basis.

And, you know, I'll get a little bit -- a lot, specific. The idea of a spot month scale-down in a cash-settled contract where the underlying index is a audited government survey, to me has always been a challenge. It was really interesting to hear the CME presentation around cash settlement, all dairy contracts, all dairy futures contracts are cash-settled. So I'm certainly familiar with cash settlement as a structure. And there's been changes made, you know, for non-fat dry milk as an example, eliminating the spot month scale-down.

But it's something that wasn't necessarily caused by the pandemic or exacerbated by the pandemic, but it was a preexisting condition of sorts, where it creates volatility. Creates the need to adjust positions when the underlying index is pretty firm.

So that's a challenge I would highlight. You know, the other thing I would say is just we made a shift and we're making a shift over time, our industry, from futures to options. And the flexibility that comes with that is really beneficial. In times when, you know, you have the kind of volatility in both markets and in volumes that while volatility obviously strikes into options and it provides -- can provide some buffers that that futures don't necessarily provide.

So they need to continue to develop liquidity in the options markets for dairy, and then also the need to be able to use swaps. As we basically look for liquidity where we can find it due to challenges with liquidity in the underlying futures market and the size of the risks that our businesses are based.

MS. LACHENMAYR: Thank you very much for those candid remarks. I think that I have asked enough questions. I'd like to turn it over to the committee members and Commissioners, if they have questions for our esteemed panel.

MR. BARKER: This is Joe Barker. Just a general question and there was a couple of comments made about the government supports and roll outs. And I don't know, so how was the coordination? Did you have liaisons from the government, you know, working with you on that stuff? Or was it just, kind of, you read about it in the newspaper?

MR. EDMISTON: I can comment from a Land O'Lakes perspective. I would say it was a bit of a combination of both. You know, things obviously happened really, really fast during the pandemic, in terms of the government support programs. And that was the intention, there was a lot of need and it was a dire situation and things had to happen really fast.

So I would say at times the coordination was really a challenge. And I think there's some of that that was entirely unavoidable, just because of the state of the state at the time. You know, I think that as time has gone on and I like to, I've kind of likened the adjustment of the markets and the economy and the food service versus retail trade-off into a dampening sine curve. There's still waves, but they seem to be getting smaller every time as we shift and reopen food service. And there's still a lot of volatility along with that here in the current state.

As those sine waves dampen I think that it's left a lot more room for more deliberate planning, more deliberate communication around government supports, which has been, you know, government support programs, and that's been -- from at least from my perspective, very helpful.

MR. THAMODARAN: I will comment a little bit. I think from a government support on the pork industry, there is a limitation on dollar income. I think probably only small percentages of the people met the criteria. In that way it was helpful. But overall from Smithfield, this pandemic from a real cost standpoint, it was several, several hundred million dollars. Well over $500 million.

Although the company put in the plan with the modification, salary increase, all those things, and we already wrote down so much of the food service inventory because the restaurant demand collapsed 70 percent, whatever is in the freezer you cannot -- there was talk of can you repackage it and sell it to the grocery chain? No. That's two different animals, and totally different supply chain. You need to modify the product. So the company ended up taking a huge loss, huge cost during the time.

MS. LACHENMAYR: Any more questions?

(No response.)

MS. LACHENMAYR: Well, thank you so much. I really appreciate your time and preparation from the panelists. It was really a treat to hear from you today. And thanks for hanging in there a little bit late. I appreciate it. We all appreciate it.

MR. THAMODARAN: Thank you.

MR. ROSSEN: Thank you.

MR. EDMISTON: Thanks Christa.

MS. MERSINGER: Thank you to Christa and all of our panelists today. That was very informative and we greatly appreciate your time. We are getting close to the end here, but before we adjourn, I just wanted to check in to see if we have any closing comments from any of the Commissioners.

COMMISSIONER BERKOVITZ: I'd just like to say thank you to all the participants again. Thanks. Thank you for your excellent presentations and the time you devote to this. So thank you Summer, and thank you, Christa for all the work that you put into it. I know that when these meetings go smoothly and the presentations appear and people speak and we see them, there's a lot of work that goes into this.

So thank you both. Thanks also to our IT team to make this possible, and of course, Commissioner Stump for your leadership on this committee. So thank you all.

MS. MERSINGER: Thank you Commissioner Berkovitz. Commissioner Behnam.

COMMISSIONER BEHNAM: I would just echo Commissioner Berkovitz’s comments and comments and I apologize for missing the opening. Thanks to Commissioner Stump, to you Summer and to Christa, as well. Interesting conversation, especially on the market access and the different contracts that we're seeing the growth across the globe.

I think there's certainly implications for our industry from a risk management perspective and a market access perspective for hedging, but then also larger geopolitical issues in terms of our markets remaining the largest in the world, having a benchmark setting role, price setting role, and how that's going to evolve and change over the future. But interesting to listen to.

Thanks again, to Commissioner Stump for her leadership and stepping in here as the new sponsor of the AAC. Thank you.

COMMISSIONER STUMP: I'll be very brief, unless there's other comments.

Thanks to everyone for sticking with us. I know we went a little over time, but I think it was really worthwhile.

So my takeaway from all of this that as we started this meeting, I said there were a lot of similarities between the things this committee can consider and the things that the Global Markets Advisory Committee can consider. And one of my themes and the Global Markets Advisory Committee, for those of you who don't follow that committee, it's been market access.

It hasn't been specific to the agricultural markets, but I think you all have provided a tremendous example for exactly what we have to be cautious. Market access is critical to those who have hedging needs. And we have to be careful that we don't impede that access. There are obviously consumer and customer protections that we have to be cognizant of -- and we are cognizant -- but we have to be very careful that access is tantamount to how we do our jobs.

So whether that is -- you guys have -- we cannot anticipate what you're going to need in the way of your hedging in the future, trade disputes, unexpected demand shifts paralyzing the supply chain, carry storage costs for those more discretionary goods, transportation disruptions, labor issues. I mean, this has been a tremendous summary of all the things you guys deal with and the reason that our markets need provide you with the hedging tools that you need.

So thanks to everyone who participated and I look forward to continuing this conversation next time. Thanks.

MS. MERSINGER: Thank you, Commissioner Stump. With that, thanks again to everyone for joining the meeting today. We know it's a busy time of the year and we did go a bit over here, but it was a worthwhile discussion and we really appreciate your time.

With that, the meeting is now adjourned.

(Whereupon, at 12:25 p.m., the Agricultural Advisory Committee meeting was adjourned.)