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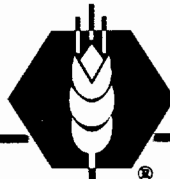

National Grain and Feed Association

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April 14, 2005

Jean A. Webb
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Dear Secretary Webb:

The National Grain and Feed Association (NGFA) submits the following comments in response to the Commission's notice of proposed rulemaking in the March 15, 2005, Federal Register concerning proposed changes to Federal speculative position limits. The NGFA's comments are specific to proposed changes for corn, oats, soybeans, wheat, soybean oil and soybean meal on the Chicago Board of Trade; hard red spring wheat on the Minneapolis Grain Exchange; and hard winter wheat on the Kansas City Board of Trade.

The NGFA is comprised of more than 900 grain, feed, processing and grain-related companies operating about 5,000 facilities that store, handle, merchandise, mill, process and export more than two-thirds of all U.S. grains and oilseeds. The NGFA's member companies use and rely heavily on futures markets for the efficient hedging and pricing of grain, oilseeds and derived products in both futures and cash markets.

Speculative Position Limits

In general, the NGFA's position on increasing speculative position limits remains consistent with answers provided to the Commission in an August 13, 2004, letter in response to a series of questions posed by the Commission. At that time, the NGFA wrote in support of petitions by the Chicago Board of Trade, Kansas City Board of Trade, and Minneapolis Grain Exchange to repeal Federal speculative position limits on enumerated agricultural commodity markets or, in the absence of repeal, to increase Federal speculative position limits to certain levels. The Commission's proposal to increase speculative limits, while not identical to the exchange petitions, is consistent with their requests. Therefore, the NGFA supports the Commission's proposed speculative position limit increases.

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Some concerns have been raised that increased speculative limits could cause additional volatility in the marketplace. The NGFA's view, as set forth in the August 13 letter, is that the speculative limits of exchanges do not necessarily limit the size of a position or affect volatility *per se;* the speculator can simply go to an over-the-counter (OTC) operation to take a larger position, beyond the exchange speculative limit. Such positions generally then are hedged by the OTC operation on an exchange. Then, the OTC's position is reported as a "commercial" position, even though it is not a "traditional" hedge and, in fact, likely understates the real proportion of exchange volume represented by speculators. Increasing speculative limits may, therefore, improve the accuracy of data reported on the level of speculative activity in agricultural markets.

Index and Fund Trading in Agricultural Markets

A larger question that has arisen recently for the NGFA's members that utilize the exchanges – and one that in some minds has become linked to increasing speculative position limits – is the volume of fund and index money entering the agricultural markets. That activity, mostly on the "long" side of the market, has resulted in a dramatic increase in market volatility. Further, some market users have questioned whether this new fund activity threatens the convergence of cash and futures at contract expiration, a bedrock principle on which the NGFA's members have relied to ensure hedging performance and efficiency.

Two core issues are involved here: first, as indices and funds add agricultural commodities to the "basket" of goods in their portfolios, traditional market users question the extent to which market moves represent fundamentals. Being able to answer this question lies in large part with having accurate information and knowing the identity of market participants.

Currently, the activity of non-traditional "hedgers" like commodity indices or funds is not broken out separately in the CFTC's Commitment of Traders report. Rather, it is lumped together with commercial traders (i.e., traditional hedgers). The NGFA submits that enhanced reporting of fund activity is essential for market transparency.

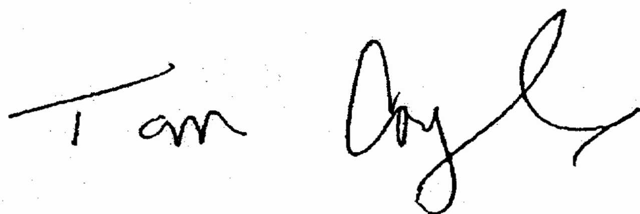
Information from one exchange and from the Commission has indicated that a currently unused field in the report submitted by traders to the Commission and then reported in the Commitment of Traders report could be utilized to provide the additional information. The NGFA urges the CFTC and exchanges to collaborate to report market activity in such a way that creates transparency for all market users.

A second issue revolves around a core principle of the futures markets: the convergence of cash and futures at contract expiration. The NGFA's members rely on convergence to effectively manage price risk. The question has arisen: What happens if a fund maintains its long position to expiration and takes delivery? Is it far-fetched to imagine such a scenario? The NGFA strongly suggests that rather than waiting for this scenario to occur, the Commission and the exchanges should examine the issue and take steps to ensure the integrity of the markets and the reliability of convergence.

The enhanced liquidity generated by an increase in speculative limits will strengthen the regulated exchanges and benefit market participants. Market participants will be able to operate in an environment of potentially higher volatility if sufficient information about order flow is available and as long as they can rely on orderly convergence during expiration.

The NGFA appreciates the opportunity to provide comments on the proposed rule. Please feel free to contact me or NGFA staff if any questions arise.

Sincerely,



Tom Coyle
Chair
NGFA Risk Management Committee