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To: Commissioners
Commodity Futures Trading Commission
Washington, D.C.
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The National Chicken Council (NCC) which represents companies that produce and process about 95 percent of the chicken in the United States appreciates the Commodity Futures Trading Commission holding the record open for its April 22, 2008 Agricultural Forum that focused on important concerns in the agricultural markets. NCC requests these comments be part of the official record of the Forum's proceedings.

Unlike most other major agricultural commodities, there is no futures market for broilers nor broiler products. Companies processing and processing broilers prefer to accept the market price risk for broilers rather than having a mechanism that directly helps offset that risk. However, many, if not most, broiler companies do seek price and market protection for their primary feeding ingredients, namely corn and soybean meal. It can be legitimately argued that because no futures market exists for broilers nor broiler products, having a very properly functioning futures market for corn and soybeans is even more important for broiler companies.

The Forum discussed a number of important issues, but for broiler companies the most important problem requiring prompt and effective resolution by the CFTC is the lack of normal convergence of cash and futures prices or as a contract nears expiration. As this problem becomes more commonplace the credibility of futures as a true price risk management tool lessens. At the same time, forces outside the basic fundamentals of certain agricultural commodities have increased volatility and the lack of predictability to unacceptably high levels. Even basis cannot be determined in many cases with any reasonable degree of reliability.

American Farm Bureau Federation President Robert Stallman suggested three possible solutions to the convergence issue in his statement to the Forum. He listed the following:

- establish additional delivery points for futures positions
- end the certificate of delivery system and return to the original notice process
- consider the use of cash settled contracts in lieu of having to make or take delivery

NCC supports these three possible steps to better address the convergence problem.

On the other hand, NCC recognizes that certain interests believe hands-on actions are not necessary because the problem will correct itself as the fundamentals return when a more adequate supply/demand balance of basic agricultural commodities occurs.

For example, at the Forum representatives of the Chicago Mexican Tile Exchange (CME) predicted that convergence between cash and futures will improve. CME noted that one of the legitimate fundamental reasons for higher prices was the long decline in the value of the dollar which helped neutralize higher commodity prices for importers and kept import demand much stronger.

While this reasoning and other explanations may well provide some answers, NCC believes it is not the entire answer to lack of convergence. A bakery industry participant at the Forum noted that Sara Lee, the biggest bakery in the United States, uses about 10,000 contracts per year. At the same time index funds which do not use fundamental factors in their trading had already established a net long position of over 185,000 contracts, according to the bakery industry statement.

The National Grain and Feed Association representative and the bakery industry representatives argued that index fund traders are incorrectly considered “hedgers” and thus have much broader trading limits than speculators. NCC agrees that if index funds cannot prove to have cash markets exposure on the short side to offset their huge long position in futures they should not be considered “hedgers”. CFTC needs to review its oversight authority and its interpretation “hedgers” to bring better discipline to index funds.

Dr. Matthew Roberts, associate professor of economics at Ohio State University, clarified this point in his statement by concluding that CFTC cannot determine the positions of the OTC dealers in the markets. Dr. Roberts added that the decision as to which dealers have primarily index clients and which are discretionary clients is based solely upon the activities of the dealers. Over time, he said, “the client mix of a dealers is likely to change and is also unlikely to be comprised solely of one type of client.” He suggested that a better title for the ‘index’ category in the CFTC’s weekly Commitments of Traders Report is probably ‘positions held by OTC dealers to hedge OTC instruments that we think are mostly held by index funds.’ Dr. Roberts noted in his summary paper that, “if this is true, that these positions are a veil to the owners, then the position limits are irrelevant.” NCC believes Dr. Roberts’ conclusions are valid and deserve CFTC’s full and deliberate attention. Possible means to address the problem is curbing speculative position limits. The current situation of no limits needs to change, just as the index/speculative funds activities have changed. Another possibility for improvement involves having funds roll positions forward with sufficient time before delivery. If the primary purposes of futures are price-discovery and risk management, rather than profit-making, then it is time to return to the basics.

The index funds positions in commodities have grown such that currently no one entity can adequately estimate the total dollar exposure that the index funds have invested in commodities. It is widely accepted that somewhere between $150 and $200 billion dollars are currently invested by the index funds in the commodities markets. Based upon money flow, some analysts expect the number to grow to $300 billion by the end of 2008. It is disturbing that we are considering granting hedging status to entities which we cannot yet determine their size and potential impact to the market.

Also concerning is the fact that the long-only funds have been tremendously inflationary to the raw commodity prices. Hedging status previously had legitimacy as the hedging status was reserved for those dealing with the physical commodity, thereby keeping the market in balance and limiting the impact that one side (natural buyers) vs. the other (natural sellers) may have. There is no natural offset to a long-only index speculative fund. The suggestion that this class of speculator is to be treated as a hedger brings unbalance to a market which can only be inflationary. As concerning, is the fact that unnatural relationships between commodities are being created as the speculative index funds are buying a fixed proportion of a basket of commodities thereby linking the commodities together in a proportional fashion which is unrelated to their natural relationship.

NCC concurs with CFTC Commissioner Jill Sommers' statement that the cause of the unusual price volatility and record high prices for many agricultural commodities may not be fully determined. In turn, this situation, whatever the cause, is creating a lack of convergence between futures and cash prices. Increased futures price volatility and uncertainty about basis relationships have raised the cost of hedging Commissioner Sommers added. CFTC is tasked with ensuring that U.S. futures markets serve their price discovery role while providing a useful hedging tool to market participants, Commissioner Sommers concluded. NCC endorses that conclusion.

Respectively submitted,

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