

secretary

From: dhiller@wcoil.com
Sent: Friday, October 03, 2008 8:12 AM
To: secretary
Subject: CBOT Wheat contract changes

Dear Sirs:

After reviewing the proposed changes to the CBOT wheat contract to cause convergence of cash and futures, I conclude it will not work due to the how soft red wheat moves in the marketing year. Most soft red wheat is delivered to the elevators right at harvest and they in turn want to get it moved out before fall harvest. The movement is not spread out over the year which is needed for a delivery based contract to work. This is clearly the evident in the quarterly grain stocks reports as well as the grain movement reports from the USDA.

The basic requirement for a futures contract to have convergence is the Futures Contract must determine the value of the commodity in the commercial flow. Clearly the commercial wheat market has change which has allowed has resulted the non convergence. This contract is based on the concept that delivery will will cause that convergence. It required someone willing to hold the grain in storage till needed. In the commercial handling system, the profits are made by the number of turns you get of the storage space, not storing grain for others. The cost of building storage vs the returns of holding grain for others makes it very unlikely anyone will build storage to do that. The reason this problem has not been as large for corn and soybeans is the flow of corn and beans through the Illinois River points is spread out over the year which makes the forced movement delivery contact workable.

These changes will have some very negative effects within a couple years. The biggest is it will create a justification to continued large basis for wheat as the storage space needed for delivery will have to be bought. The second is it will increase the basis swings and the risks associated. This will make the contact less useful for the grain merchandisers. It will encourage the end users of soft red wheat to build enough storage to own and control their requirements for the year from the harvest flow and not buy any post harvest. This will speed up the demise of the CBOT contact of being a viable tool for risk management and price discovery.

I am a retired commodity broker. I worked for 25 years in western Canada where we had this problem with the Rapeseed/Canola contract. No matter what they tried they could not get convergence until they went to a contract that the price was based on the price paid to farmers at a number of locations adjusted for freight difference to the west coast. Once they did that, the contact worked and the basis/convergence problem was resolved.

They need to develop the contact to fit into the commercial market, not trying to get the commercial market adjusting to the contact. If they do not do that, the relevance of the CBOT wheat futures contact and it usefulness will disappear, along with the commercial use of it. Now is the time for major changes to the contact to correct the problems, the the band-aid of this proposal.

I do want the CBOT contact to be an effective tool for price discovery and risk management for the commercial users ranging from farmers to the final consumer. Only when that occurs does will the convergence problem disappear. They will need to think outside the box of delivery based contracts and look at a cash settlement contact like used on the Minn Grain Exchange for corn and soybeans. There are problems with those contacts but they are much smaller then the ones for delivery contacts. Those problems can be resolved by designing the contact to fit into the real commercial market.

If you or you staff like me to expand on this or wish to talk to me personally, please email me to arrange a time to talk on the phone. I am back in Ohio looking after my parents and their farm which we do grow soft red wheat one.

Yours truly,
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