Statement of the American Farm Bureau Federation

TO THE

COMMODITY FUTURES TRADING COMMISSION

PUBLIC MEETING TO DISCUSS RECENT EVENTS AFFECTING THE AGRICULTURAL COMMODITY MARKETS

BOB STALLMAN, PRESIDENT

April 22, 2008

600 Maryland Ave. SW | Suite 1000W | Washington, DC 20024 | p. 202.406.3600 | f. 202.406.3606 | www.fb.org

The American Farm Bureau Federation (AFBF) respectfully submits its views to the commission as it reviews the turbulent conditions in the futures market. As the nation's largest general farm organization and the representative of millions of farmers and ranchers in every state in the nation, AFBF has a vital interest in how commodity marketing issues affecting our members are perceived, examined and decided. We are seriously concerned about the effective performance of futures exchanges as mechanisms for price discovery and risk management.

Over the past months, we have witnessed extreme price volatility, expanding and volatile cash/futures basis relationships, and the difficulty of hedgers to meet margin calls. In addition, the role of speculative and commodity-index-related trading in agriculture futures markets, while growing for some time, has reached historic levels and added to the uncertainty in these markets.

The basic purpose of the Commodity Futures Trading Commission (CFTC) is to ensure that futures and options offered by the designated contract markets under its jurisdiction manage price risk and discover cash prices.

However, the futures market mechanism is, at least, bent at this point in time, and the fact that several major grain and oilseed marketers are only offering firm crop price bids 60 days into the future is a rather ominous sign the breaking point might not be far away.

Lack of Convergence Between the Futures and Cash Prices

Convergence is the idea that futures prices by the close of the contract eventually equate to what is occurring in the cash market. It varies by commodity and geography, but historically the relationship between the cash and futures markets has been fairly constant with predictable seasonal variation. Certainly local market conditions might move the basis level around a few cents on any given day, but the underlying basis figures – predicated on the futures and cash markets coming together at the end of the contract – allowed all involved to function in a well-informed manner.

Today neither the convergence of futures to cash nor reasonable expectations of basis levels applies for a number of contracts. This is significantly increasing the risk faced by producers and will likely induce major structural change in the grain/oilseed/fiber handling sector over the next few months.

These developments challenge producers' abilities to develop and implement risk management programs for marketing their products. The problem is compounded by the fact that many producers are being asked to make firm price commitments for inputs. In some instances, they are even being asked to pre-pay for inputs they will not utilize until next crop year. This results in the uncomfortable position of producers locking in future input costs without similar opportunities in future crop prices.

Possible technical solutions to these issues could be implemented by the exchanges either voluntarily or via order of the CFTC. For example, one reason futures prices may not be making an orderly convergence to cash prices is part of the process established in 2000 when the river system delivery process was instituted by the Chicago Board of Trade. This system introduced

the concept of a certificate of delivery that does not have to be redeemed by any certain date. Consequently, there is little incentive for the taker to move the grain into the physical market and force convergence. There also has been much discussion regarding the exchanges' increasing the cost of carrying these certificates by boosting the cost of grain storage.

Some possible solutions to the convergence problem may be:

1. We encourage the CFTC to require additional delivery points to prevent market manipulation and assure an adequate delivery system. We note the Kansas City Board of Trade is currently in the process of increasing its wheat contract delivery points from two to four. We would encourage other exchanges to consider similar changes.

2. End the certificate of delivery and return to the notice process originally used for delivery against the futures contract. This should not cause any major disruption to futures trading. Once the change is made and traders realize delivery means actual physical acceptance of the commodity or that there will be some monetary penalty for re-tender, then we should see the orderly liquidation of open interest going into a contract delivery period and moving toward contract expiration and a more orderly convergence.

3. An option which merits examination is cash settlement. There are cash-settled grain and oilseed contracts today; however, the volume for those contracts is probably too small to test this in practice. Moving to cash settlement should not be undertaken lightly, but it should be studied as a way to improve convergence.

Impact of Higher Margin Requirements and Expansion of Daily Trading Limits

Volatility is at a record high in the agricultural markets. With already high trading limits and high margin requirements, the average farmer has a difficult time using futures and options for price protection. Even larger commercial hedgers are having problems with financial liquidity.

Daily trading limits are of great interest to our members. While the rationale behind the increased limits is to let the markets clear and resume trading, in practicality, margin calls have become prohibitive. In fact, many hedgers simply do not have sufficient lines of credit to cover these high margin calls.

We request the CFTC analyze the possible effects on market participants of lowering the daily trading limits. We are not necessarily seeking to lower price limits, but we believe a study of the potential effects on margin requirements, risk, volatility, and financing charges could be instructive for the exchanges and market participants, as well as the commission. A thorough economic review should examine adjustments that could reduce volatility while still allowing the markets to clear.

Role of Speculators and Commodity Index Traders

As hedgers, our members understand that speculative interest is an important component of any commodity market by facilitating its primary function of price discovery and providing market

liquidity. Though speculators – including small investors – have always been integral to market function, they are now playing an exponentially greater role than ever before. Market analysts report a continued, massive inflow of capital into the grain pits, much of it by long-only, passively managed index funds that buy futures and roll them forward according to a set schedule.

According to Chicago-based agricultural research firm AgResource Co., total index-fund investment in corn, soybeans, wheat, cattle and hogs has increased to $42 billion, up from just over $10 billion in 2006 – more than quadrupling in less than two years. That number doesn't even include the flood of index funds that have moved into other agricultural markets, primarily cotton, during the same period. Barron's estimated in its March 31, 2008, cover story that "index funds right now account for 40% of all bullish bets on commodities."

The recent level of long positions translates to the funds actually "owning" significant amounts of the entire U.S. corn, soybean and wheat crops. Independent analyst Steve Briese calculated at the end of March that index funds had effectively bought 36.6 percent and 62.3 percent of the 2007 domestic soybean and wheat crops, respectively.

Trading activity by funds is certainly one of the contributing factors generating high futures prices for commodities. Ordinarily, this would appear to be positive for agriculture. But if the futures markets do not converge with cash markets, there is little information on what real price levels should be either for producers or consumers of the commodity in question. With convergence, even if futures market prices fall precipitously in the delivery month, there are still economic signals being sent that producers can respond to. Without convergence, these trades become just so much froth.

In mid-March, index funds represented approximately 42 percent of the open interest in Chicago wheat, meaning that roughly two out of every five outstanding contracts were held by funds with limited need to trade on supply and demand fundamentals – they simply buy and hold. The result was a disconnect of the cash price (traditionally based on futures as a means of price discovery) from the high of the futures market. Forward contracting virtually ceased.

Historically, AFBF has supported open market participation and encouraged interest from speculators as well as hedgers, and we continue to support market involvement. However, our policy also supports CFTC oversight to ensure that market integrity is maintained and to curb practices that result in artificial price swings. In essence, it is up to the CFTC to ensure that participants do not prevent the futures markets from serving their roles as price discovery tools.

AFBF policy opposes restricting speculative funds from the commodity markets because they do provide pricing opportunities and liquidity that might not otherwise be available. We do not want to end speculative participation, nor do we believe the CFTC has that authority. Even if CFTC could restrict index fund investment activity, such an action could result in less liquidity and lower prices in the markets.

However, we do have some concern that from time to time fundamental price movements may be overwhelmed by extreme levels of financial speculation. It is critical for hedgers trying to

manage price risk of the physical commodity to fully understand who is in the market and, perhaps more importantly, why. Therefore, additional transparency about the funds involved in the futures market should be required so that the markets can fulfill their primary functions of price discovery and risk management.

The CFTC is charged by Congress with ensuring the commodity markets do not become solely a speculative trading arena, rather than a price discovery/marketing tool for the agriculture industry. To that end, it must restore marketplace integrity with appropriate transparency.

Conclusion

We reiterate that we continue to support the CFTC's regulation of the commodity futures business. While there has been discussion of merging the CFTC and the Securities Exchange Commission in response to the volatile trading environment, we vigorously oppose efforts to weaken the CFTC by transferring or reducing its authorities, or by combining it with the SEC.

Finally, we thank CFTC officials for arranging this public meeting to better understand recent market happenings, and for allowing us to share producers' views of current issues. We hope this discussion will inform the commission's future actions where it has regulatory authority to correct market situations. If additional authorities from Congress are needed in order to ensure future market functionality, we stand ready to work with the CFTC and legislators.