Presentation by
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"Coordinating Actions on Wheat Price Limits"

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I appreciate the opportunity to brief the Committee on the events leading up to and the actions taken earlier this year by the Chicago Board of Trade, Kansas City Board of Trade & Minneapolis Grain Exchange in coordinating increased wheat futures price limits. The actions taken by the exchanges were necessary and prudent to restore the markets' price discovery and transparency functions. We applaud the Commission for recognizing the need for swift action to alleviate the constraints on trade and for working closely with the exchanges to approve the increased price limit provisions on a fast-track basis.

The run up in wheat prices from April 2007 to February 2008 is attributed to several factors in what has been commonly referred to as a "perfect storm" of events, namely:

- The Easter weekend hard freeze and subsequent flooding in the winter wheat belt;
- Second consecutive year of severe drought in Australia coupled with production declines in both Canada and the EU;
- Projected world grain usage outpacing production gains;
- USDA forecasts of US wheat stocks at 60-year lows, global wheat stocks at 30-year lows, and the lowest world grain stocks to usage ratio since the USDA began tracking this data in 1960;
- Weaker US dollar resulting in increased wheat exports and reduced domestic stocks; and
- Export bans or tariffs instituted by other governments, most notably, Russia, China, India & Argentina, resulting in the US becoming the "reliable global supplier" of wheat.

As the price of wheat increased over 2007 and into 2008, the three grain exchanges began experiencing an increasing frequency of price limit moves, particularly after wheat reached $8.00 per bushel in September of last year. The MGEX hit limit on 16 of 21 business days in January of this year and each business day in February leading up to the price limit change. The consecutive limit move days of February 4-8 on all three wheat exchanges encumbered the markets' ability to discover price and conduct trade. Something had to be done quickly for the critical price discovery function to resume.

Later in the week of February 8, the three exchanges began discussions of a coordinated increase in daily price limits. All agreed that a coordinated price limit effort would best serve the industry because of the significant inter-market spreading that goes on between the three wheat markets and also to lessen confusion that might result from the markets having differing limit provisions. As a result, the three exchanges filed for identical increased price limits provisions:

- An initial price limit of 60¢ per bushel;
- Expanded limit provisions that increase by 50% each time the price limits are reached;
- The trigger for expanded limits - when 2 or more contract months within a crop year (or the remaining month of a crop year) close at limit bid or offer; and
- Expanded limits remain in effect until no contract closes limit bid or offer for 3 consecutive business days.

When the markets opened on February 11 with the new 60¢ price limit, price discovery resumed. The new price limit provisions worked well and the three wheat markets were once again able to conduct business under either the initial or expanded limits.

After a few weeks of experience with the new price limits, the wheat markets compared notes and discussed minor changes to the limit provisions. The catalyst for this discussion was input and suggestions offered by commercial market participants and FCMs. Among the changes discussed were:

- Capping the expansion provisions so that institutions financing the margins requirements would have a better idea of the maximum daily amount that would be required to fund variation margin;
- Setting the trigger for expanded limits based on contract months where the majority of open interest and trade resides, thereby eliminating the possibility that lesser liquid back months cause the expansion of price limits; and
- Contract (decrease) the price limits as quickly as they expand, resulting in additional flexibility in regulating margin requirements and current limits that are more reflective of actual market pressures.

As a result of these discussions, CBOT & KCBT agreed to move ahead with coordinated price limit amendments. MGE determined that they were better served by the existing price limit provisions due to the continued extreme volatility in HRS wheat.

CBOT & KCBT filed for and received approval from the Commission for price limit amendments that became effective on Friday, March 28, 2008. The changes covered all three areas addressed by the industry input:

- Capping the expanded limit provisions at $1.35 per bushel;
- The trigger for expanded limits – when 2 or more of the nearest 5 non-spot contract months (or the remaining contract month in a crop year) close at limit bid or offer; and
- Any day that the market is under an expanded price limit level and does not close limit bid or offer, the market reverts back to the preceding price limit level.

In summary, the coordinated action taken by the three wheat exchanges in February worked well to resume the price discovery and price transparency functions that are paramount to our markets. The coordinated effort provided the marketplace with a relatively uniform set of price limit rules to apply in order to minimize the possibility of significant inter-market spread disconnects and maximize convenience in application.

The effective resolution of this market predicament is a laudable example of exchanges, regulators and industry working together to recognize and very quickly address a significant market issue.
