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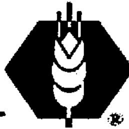

National Grain and Feed Association

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January 28, 2008

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

COMMENT

RE: Risk Management Exemption From Federal Speculative Position Limits

Dear Mr. Secretary:

This letter transmits the position of the National Grain and Feed Association (NGFA) on the Commodity Futures Trading Commission (CFTC) proposal to establish a new risk management exemption for index and pension funds, as published in the November 27, 2007 edition of the *Federal Register*.

The NGFA is the national trade association representing the grain, feed and processing industry. About 900 companies nationwide comprise the NGFA's membership, including grain elevators, feed manufacturers, grain and oilseed processing companies, futures commission merchants, introducing brokers, biofuels producers and marketers, flour millers, integrated animal operations and related commercial businesses. We estimate these companies operate upwards of 6,000 facilities nationwide. The NGFA's member firms are traditional hedgers who rely on efficient and predictable performance of U.S. futures markets and contracts to manage inventory and price risk and to assist their farmer-customers to market their production.

<u>The NGFA is opposed to establishing a hedge exemption for index and pension funds at this time</u>. We recommend that CFTC reconsider the stance it has taken on this proposal, with the understanding that agricultural futures markets were established with an economic purpose to serve as efficient, central public pricing and hedging vehicles for grain and oilseeds – a function that is not being well-served today. The CFTC may also want to evaluate any future no-action requests for hedge exemptions from index and pension funds and similar investment vehicles in this same light.

Rationale

In our letter of Jan. 21, 2008, in response to the CFTC's proposal to increase speculative position limits, we detailed some of the conditions in today's agricultural marketplace that led to the NGFA's position on the proposed risk management exemption. To recap:

Today's agricultural marketplace is undergoing dramatic change: tight stocks, strong demand growth, higher transportation costs, and a seemingly endless supply of investment capital that wants to own agricultural commodities. At the same time, a lack of consistent cash and futures convergence has in some cases dramatically reduced hedging utility of the exchange-traded contracts and raised uncertainty for future performance.

Together, these changes have resulted in an environment that is causing severe financial stress to commercial grain hedgers. With lending requirements to finance inventories and margining at several multiples of usual levels, grain elevators are running up against borrowing limits. Banks, wary of convergence issues noted above, are beginning to restrict financing – particularly to hedge deferred grain purchases. One result is that some grain buyers are restricting or completely eliminating bids for deferred grain purchases from producers.

Another consequence is that some elevators are being forced to liquidate inventories to eliminate margin calls and to free lines of credit for margin calls on deferred ownership. There is a genuine risk of "fire sales" if grain elevators run out of margin money – and to reiterate from the Jan. 21 letter, these are not grain elevators speculating on futures price movement – these are simply prudent operators hedging grain purchases from producers.

In this environment, the marketplace is ill-equipped to efficiently absorb more investment capital and perform its core function of serving as an efficient tool for businesses hedging physical grain purchases – particularly when virtually all that investment capital is long-only and a large share of open interest essentially is "not for sale" for long periods of time.

While there are those who might contend that the risk management exemption could provide a financial hedge of invested money for the middleman, the NGFA's view is that agricultural futures markets were established for the purpose of serving as efficient, central public pricing and hedging vehicles for grain and oilseeds. Until that purpose is fulfilled, we believe it is inappropriate to establish a direct, new route to the marketplace for more investment capital which could exacerbate current problems.

Recommendations for Analysis

In addition to several recommendations for analysis in our spec limit letter, the NGFA would like to pose these additional questions for analysis specific to a potential risk management exemption for index and pension funds:

1) What would be the impact on convergence of grain and oilseed contracts of establishing a new risk management exemption?

2) What would be the impact on agricultural futures volatility of establishing a new risk management exemption?

3) What are projected impacts on agricultural futures market volumes if index and pension funds are allowed to go directly on-exchange with positions exceeding spec limit levels? Will such action attract more investment capital than might be expected under the current regulatory approach?

4) Is there evidence that a risk management exemption would allow speculative investors to take larger positions on the "short" side of the market and bring better balance to the marketplace? Have any index or pension funds, or swaps dealers hedging OTC transactions with such funds, taken short positions? How long do such funds, or swaps dealers hedging OTC transactions with such funds, typically hold their long positions before rolling?

5) The CFTC has issued several "no action" letters to funds allowing them to exceed spec limits. What have been the impacts of those actions? Have any of these market participants taken "short" positions in agricultural futures markets? Given current conditions in agricultural markets, does the CFTC envision issuing more no-action letters if requested?

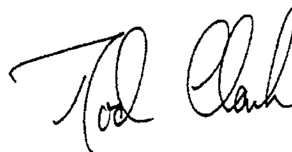
6) The CFTC approved a hedge exemption for swaps dealers in 1991. Is there information on volumes of over-the-counter business being hedged in the agricultural futures markets by swaps dealers? Have any swaps dealers taken "short" positions?

7) Are there instances in which firms normally classified by CFTC as commercial hedgers engage in an OTC transaction with an index or pension fund or similar entity and then hedge futures on-exchange? Are such transactions reflected in the "Index" category of the Commitments of Traders report? Is any additional volume of investment capital being categorized as "Commercial" instead of "Index" due to the way funds or other products are designed?

Answers to these questions should help all market participants determine whether a hedge exemption for index and pension funds is advisable, and under what conditions exemptions should be granted.

As always, the NGFA deeply appreciates the opportunity to provide input. We look forward to a constructive conversation with CFTC and other market participants to help ensure that agricultural futures markets remain an effective tool for commercial grain hedgers.

Sincerely,



Rodney Clark
Chair, Risk Management Committee