NCFC

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October 28, 2010

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

RE: Advance notice of proposed rulemaking; request for comments: Agricultural Swaps (Federal Register/Vol. 75, No. 187)

Dear Mr. Stawick:

On behalf of the more than two million farmers and ranchers who belong to one or more farmer cooperative(s), the National Council of Farmer Cooperatives (NCFC) submits the following comments in response to the Commodity Futures Trading Commission's (CFTC) request for comments: Agricultural Swaps (17 CFR Part 35).

Since 1929, NCFC has been the voice of America's farmer cooperatives. Our members are regional and national farmer cooperatives, which are in turn composed of over 2,500 local farmer cooperatives across the country. NCFC members also include 21 state and regional councils of cooperatives.

As processors/handlers of commodities and suppliers of farm inputs, farmer cooperatives are commercial end-users of over-the-counter (OTC) derivatives. Due to market volatility, cooperatives use swaps to better manage their exposure by customizing their hedges. This practice increases the effectiveness of risk mitigation and can reduce the costs of those activities.

In addition, swaps give cooperatives the ability to offer customized products to producers to help them better manage their risk and returns. A cooperative can aggregate its owner-members' small volume swaps or forward contracts and transfer that risk to a swap partner. The swap partner would otherwise not have the interest in servicing so many small producers.

Agricultural cooperatives are "natural" end users and have used swaps as an extension of their risk mitigation business, as was intended when futures and options markets were implemented. Agricultural cooperatives are not a cause of systemic risk. In fact, cooperatives' swap transactions seek to hedge commercial risk and support the viability of their members' farms and cooperatively owned facilities. As such, agricultural cooperatives should be treated as end-users, whether acting as an eligible swap participant (ESP) or as an aggregator. We believe this was the intent of Congress when writing the Dodd-Frank Act.

In order to provide risk mitigation services to their farmer-members, a local cooperative must have the ability to enter into swaps with a member of its cooperative federation (or its subsidiary). In addition, the cooperative must have affordable access to the OTC market with other commercial counterparties. This allows the cooperative to aggregate the risk of offering forward contracts to farmers and swaps with its members. Although the function is similar in nature to a swap dealer, cooperatives do not take speculative positions from investment firms, nor do they accept cash for investment purposes. For these reasons, cooperatives should not be considered swap dealers.

For example, a local cooperative may buy grain from farmers using forward contracts with a guaranteed minimum price. These contracts can range in size from a truck load to barge load. By offering these contracts, local cooperatives are exposed to higher prices, yet must guarantee a minimum price to the farmer if prices fall. To manage this risk, local cooperatives enter into swap contracts with their regional or federated cooperatives that aggregate quantities for volume discounts and favorable terms. The cooperatives in turn may use swaps with swap dealers to transfer their price risk and lock in their margins, effectively reducing the exposure of price risk from the entire supply chain of farmers to the regional or federated cooperative. Similarly, cooperatives provide customized hedging solutions to dairy farmers, allowing them to lock in margins to help ensure future profitability. The cooperatives, in turn, offset that risk by buying financial futures on corn and soybean meal, while selling class III milk futures.

Given the importance of forward contacts to producers, the Commission should provide as much certainty as possible about what constitutes an excluded forward contract. Treatment of forward contracts that require delivery but provide for some price flexibility, such as forwards with embedded options, should not be regulated as swaps but rather as forward contracts. This is because an embedded option does not give the option of delivery and represents a hedge and an interest in the underlying commodity. Similarly, swap options should be treated the same as agricultural swaps.

As aggregators of end users, farmer cooperatives should not be subject to the mandatory clearing requirement. The low volume and odd lot amounts of some products in agriculture would not be of enough significance to be formally listed on an exchange with a futures contract. Additionally, increased requirements for capital and margin, business conduct standards reporting and record keeping could render the cost of the transaction higher than the value of continuing to provide a needed risk management tool.

Agricultural cooperatives that enter into swaps with third parties (or members) in the course of marketing their members' agricultural products also should be treated as end-users because any swaps they enter into are for the purpose of hedging the physical product that the cooperative is marketing on behalf of its members. An affiliate of an agricultural cooperative also should be entitled to rely on the end-user exemption to the extent it is executing swaps with third parties (or members) to hedge risks associated with products marketed by the cooperative.

Agricultural Commodities Definition

Since the Commission has drafted a proposed rule for comment concerning the definition of "agricultural commodities," NCFC will review that proposed rule and respond during that comment period.

Current Agricultural Swaps Business

1. How big is the current agricultural swaps business—including both agricultural swaps trading under current part 35 and ATOs under §§ 32.4 and 32.13(g) of the Commission's regulations?

Response: The business is insignificant on swaps cleared through CME ClearPort with only 378 contracts traded on October 5th and open interest of only 4,896 contracts. The ATOs are of significant volume, as many of these structures are traded bilaterally initially, with the CME Group's Board of Trade as the ultimate counterparty to offset price risk.

2. What types of entities are participating in the current agricultural swaps business?

Response: Entities that farmer cooperatives enter into swaps with include: farmers, local cooperatives, non-member commercial entities, product brokers, consumer product companies, and multi-national banks.

All sizes of entities are participating in agricultural swaps. There are farmers with a few hundred acres, member-owned cooperatives that would have a net worth of less than and greater than $10 million and federated cooperatives with a net worth greater than $10 million that work with a number of their member cooperatives. The federated cooperatives consolidating their member cooperative needs may then enter into a swap with a multinational bank or offsets the risk themselves by utilizing futures and options through the CME Group.

It is important for the CFTC to allow access to swaps for all sizes of entities and allow a wide variety of products. Agricultural swaps can include quantities of products that are in odd lots or low volume in respect to the interest level of exchanges.

3. Are agricultural swaps/ATO participants significantly different than the types of entities participating in other physical commodity swaps/trade options?

Response: Farmer cooperatives enter into both agricultural swaps and swaps in other physical commodities, such as fuel, fertilizer and propane, to hedge their commercial risk. However, farmer cooperatives tend to be different than other entities. The primary purpose is to hedge price risk facing the cooperative and its affiliates. The cooperatives represent an aggregated base of farmers. Swaps are generally entered into only to the extent a market risk exists for the entity. While cooperatives may offer swaps to interested customers – these swaps are backed by physical product (whereas other swap participants may not hold an interest in the underlying commodity).

Agricultural Swaps Clearing

4. What percentage of existing agricultural swaps trading is cleared vs. non-cleared?

Response: For some NCFC members, as it relates to enumerated commodities such as corn, beans, and wheat, 100 percent of swaps with other end users are non-cleared. The offsetting of the price risk on those swaps is roughly 85 percent non-cleared through a multinational bank and 15 percent offset through exchange-traded futures and options, and zero percent cleared through exchange-cleared OTC products.

It is a number of NCFC members' perspective that less than one percent of cooperatives' agricultural swaps are currently being cleared. It is important to note that as end-users, NCFC member cooperatives have underlying interest in the physical commodity and their use of swaps is as a risk management tool.

5. What percentage of existing agricultural swaps would be eligible for the commercial end-user exemption from the mandatory clearing requirement?

Response: One hundred percent of the swaps NCFC member cooperatives enter into should be eligible for the commercial end-user exemptions. NCFC members enter into OTC swaps to hedge the price risk of the commodities they supply, process or handle; i.e. have a physical interest in the underlying asset. Farmer cooperatives that enter into swaps with third parties (or members) in the course of marketing their members' agricultural products should be treated as end-users because any swaps they enter into are for the purpose of hedging the physical product that the cooperative is marketing on behalf of its members. Essentially, the Commission should look through the transaction to the underlying physical position of the cooperative or its member. An affiliate of an agricultural cooperative also should be entitled to rely on the end-user exemption to the extent it is executing swaps with third parties (or members) to hedge risks associated with products marketed by the cooperative.

6. What percentage of trading would be subject to the Dodd-Frank clearing requirement, if that requirement applied automatically to agricultural swaps (other than those eligible for the commercial end-user exemption)?

Response: As commercial end-users and aggregators of end-users, cooperatives using agricultural swaps for risk mitigation should not be subject to clearing requirements, or zero percent.

If all entities are required to clear agricultural swaps through an exchange or standardize a non-standard transaction (both in terms of quantity and structure) we would likely see costs increase to a point where the use of swaps as a bona fide hedge/risk management tool would not be available to segments of the agricultural marketplace. This would increase the risk to users of swaps and is counter to the intent of the Frank-Dodd Act to decrease risk to the market place.

7. What would be the practical and economic effect of a rule requiring agricultural swaps transactions (other than those eligible for the commercial end-user exemption) generally to be cleared? The Commission is interested in the views of agricultural swaps market participants (both users and swap dealers) regarding a potential clearing requirement for agricultural swaps.

Response: Farmer cooperatives are aggregators of end-users and should not be subject to the clearing requirements. However, if all entities are required to clear agricultural swaps, the clearing activity would require increased recordkeeping and margining. As agricultural swaps can be subject to considerable market volatility, margin would be a particular concern related to increased costs. As farmers work to manage their margins through forward contracting with their cooperatives the cooperatives work to mitigate the risk of ownership. As forward contracts are not considered to be derivatives there is no respective margin to the farmer. If clearing is required, agricultural cooperatives, while fully hedged, may experience cash flow timing issues due to one side of the hedge being subject to margin requirements and the other not. This could put a considerable cash constraint on farmer owned organizations and/or it could result in fewer risk management opportunities to farmers as they would become cost prohibitive.

8. What would be the practical and economic effect of requiring agricultural swaps to be cleared under the Dodd-Frank clearing regime?

Response: Agricultural swaps and "ATOs" are used by all sizes of U.S. farmers as an effective, bona fide hedge against volatile price swings in the very markets that directly affect their operation. However, if all entities are required to clear agricultural swaps through an exchange or standardize a non-standard transaction (both in terms of quantity and structure), costs would likely increase to a point where the use of swaps as a bona fide hedge/risk management tool would not be available to segments of the agricultural marketplace. In addition, the low volume, small sizes and odd lots likely would not be attractive for exchanges or clearing houses to offer those specific products. This would increase the price risk to cooperatives and farmers, and would be counter to the intent of the Dodd-Frank Act to decrease risk to the market place.

Trading

9. Have current agricultural swaps/ATO participants experienced any significant trading problems, including: (a) economic problems (i.e., contracts not providing an effective hedging mechanism, or otherwise not performing as expected); (b) fraud or other types of abuse; or (c) difficulty gaining access to the agricultural swaps market?

Response:

(a) NCFC members have not had issues to date. Research and evaluation of the counterparty is part of the risk management process.
(b) NCFC members have not reported having issues in this area. Evaluation of the market and counterparty is part of the risk management process.
(c) NCFC members have not had difficulty to date. Access could become difficult if all agricultural swaps are required to be cleared and standardized. Very specialized products, odd lots and low volumes are not of great interest to the exchange.

Agricultural Swaps Purchasers

10. Do agricultural swaps/ATO purchasers need more protections than participants in other physical commodity swaps/trade options?

Response: No. Current participants know their marketplace well, do research on the markets and tend to trade through longstanding relationships. If more protections add to the regulation and cost of risk management tools, the risk management tools may be available to fewer participants and the Dodd-Frank Act would increase marketplace risk instead of reducing it.

11. If so, why, and what should those protections be?

<u>NA</u>

12. Would additional protections for agricultural swaps purchasers unduly restrict their risk management opportunities?

Response: Yes. Increased costs associated with increased regulation on agricultural swaps "sellers" would ultimately be handed down to the agricultural swaps purchasers. The increased costs could reach a point that is equal to the risk exposure, making some risk management tools unavailable.

13. Should the Commission consider rules to make it easier for agricultural producers to participate in agricultural swaps—for example, by allowing producers who do not qualify as ECPs to purchase agricultural swaps?

Response: No. The ECP requirement is appropriate. The Commission should recognize the structure that cooperatives use today. Cooperatives aggregate positions on behalf of their member owners so that risk management products are available to all producers. NCFC members also work with markets that are too small to be listed on an exchange. This provides an extremely valuable service and opportunity for farmers who are exposed to volatile prices as well as production risks. The threshold for farmers to use swaps and swap options should be set the same at $1 million in net worth. However, farmers that do not meet the ECP requirements should be allowed to purchase agricultural swaps through DCMs or their agricultural cooperative.

Designated Contract Markets

14. Should agricultural swaps transactions be permitted to trade on DCMs to the same extent as all other swaps are permitted on DCMs?

Response: Yes. The challenge of volume, odd lot sizes, multiple specifications and expiration dates remains the same for agriculture. Trades on DCMs should be allowed continue as they do today, and the swap should be allowed to clear at the discretion of the commercial end user.

15. If yes, why?

Response: There is less concern about counter-party risk and performance with a DCM. This also provides transparency to swap participants in the form of price discovery data.

16. If no, what other requirements, conditions or limitations should apply?

NA

Swap Execution Facilities

17. Should agricultural swaps transactions be permitted on SEFs to the same extent as all other swaps are permitted to transact on SEFs?

Response: Yes.

18. If yes, why?

Response: For the same reasons for allowing on a DCM, while promoting more competition in the marketplace.

19. If no, what other requirements, conditions or limitations should apply?

NA

Trading Outside of DCMs and SEFs

20. Should agricultural swaps be permitted to trade outside of a DCM or SEF to the same extent as all other swaps?

Response: Yes.

21. If yes, why?

Response: For NCFC members, non-cleared swaps provide a means for execution of trades. While there is counter-party risk introduced into these transactions, it is manageable. In many instances swap partners are also commercial customers of the processor/handler. The companies are set up to assess counter-party risk in commercial transactions, whereby non-cleared swaps are an extension of this risk assessment process. In addition, cooperatives work with low volume and unique production systems of all sizes. Aggregating this production, developing marketplace relationships and meeting very specific needs of farmers on a regular basis is a part of the risk management process that may not be well suited for the more established exchanges or larger markets.

Overall, agricultural swap transactions cooperatives enter into do not pose a significant risk to the health of the U.S. financial system. As such, over-regulation could be detrimental to legitimate risk management activities, namely of cooperatives, which could lead to weakening of farmer cooperatives and farmers as a whole.

22. If no, what other requirements, conditions or limitations should apply?

<u>NA</u>

23. Should agricultural swaps be permitted to trade outside of a DCM or SEF to a different extent than other swaps due to the nature of the products and/or participants in the agricultural swaps market?

Response: Yes. Agricultural swaps used as bona fide hedges by end users, processors, producers, handlers of the commodity should be permitted to trade outside of a DCM or SEF to a different extent than other swaps due to the nature of the products and/or participants in the agricultural swap markets. However, speculative positions in the agricultural swaps market should be limited.

24. In general, should agricultural swaps be treated like all other physical commodity swaps under Dodd-Frank?

Response: No. Agricultural swaps should not be treated like all other physical commodity swaps under the Dodd-Frank Act when used by farmer cooperatives because cooperatives are aggregators of end-users. The low volume and odd lot amounts of some products in agriculture would not be of significance to be formally listed on an exchange with a futures contract. Additionally, any increased requirement for capital and margin, business conduct standards reporting and recordkeeping could render the cost of the transaction higher than the value of continuing to provide a needed risk management tool.

25. If yes, why?

<u>NA</u>

26. If no, are there any additional requirements, conditions or limitations not already discussed in other answers that should apply?

Response: None at this time.

27. If agricultural swaps are generally treated like swaps in other physical commodities, are there specific agricultural commodities that would require special or different protections?

Response: NCFC is unaware of any at this time.

Conclusion

As volatility in commodities markets has increased, producers are increasingly dependent on their cooperatives to provide them with the tools to manage price risk. Agricultural swaps have become an important means to assist in managing that risk. As the Commission drafts regulations to implement the agricultural swaps regulations, we strongly encourage you take into account the importance of swaps in helping farmers and their cooperatives.

We would be please to provide further information or clarification upon your request.

Sincerely,

Charles F. Conner
President & CEO