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October 29, 2010

## **By Electronic Submission**

David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
1155 21st Street, N.W.  
Washington, DC 20581

**Re: Agricultural Swaps ANPRM;  
Agricultural Commodity Definition (RIN 3038-AD21)**

Dear Mr. Stawick:

We submit these comments on behalf of our clients, the Agricultural Commodity Swaps Working Group (The “Ag Swap Working Group”), in response to the Commodity Futures Trading Commission’s (“Commission” or “CFTC”) September 28, 2010, Advance Notice of Proposed Rulemaking and Request for Comment (the “Advance Notice”)<sup>1</sup> regarding treatment of swaps in an “agricultural commodity” under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”),<sup>2</sup> as well as the Commission’s Notice of Proposed Rulemaking regarding the definition of “agricultural commodity” under the Dodd-Frank Act.<sup>3</sup> The Ag Swap Working Group is comprised of the diversified financial institutions identified below that provide risk management and investment products to agricultural end-users. The Ag Swap Working Group supports the Commission’s efforts to reduce systemic risk, increase transparency, and promote market integrity within commodity markets and appreciates the opportunity to address the appropriate framework for rules governing the trading of agricultural swaps.<sup>4</sup>

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<sup>1</sup> Agricultural Swaps, 75 Fed. Reg. 59666 (Sept. 28, 2010).

<sup>2</sup> Pub. L. No. 111-203 (2010) (to be codified as an amendment to the Commodity Exchange Act in 7 U.S.C. ch. 1). The Ag Swap Working Group appreciates the opportunity to provide advance comments to the Commission; however, as such, it respectfully reserves the right to supplement or revise these comments after reviewing and considering the Commission’s proposed agricultural rules.

<sup>3</sup> Agricultural Commodity Definition, 75 Fed. Reg. 65586 (Oct. 26, 2010).

<sup>4</sup> The Ag Swap Working Group respectfully requests that the Commission consider its comments even though they were submitted one day after the end of the comment period.

## **I. SUMMARY OF COMMENTS**

The Ag Swap Working Group supports the Commission's proposed definition of "agricultural commodity," including its treatment of agricultural commodity indices. As the Commission considers an appropriate rule governing agricultural swap transactions, the Ag Swap Working Group requests that the Commission treat agricultural swaps and options on an equivalent basis with other commodity swaps under the Dodd-Frank Act. The Ag Swap Working Group also requests that the Commission propose a rule that treats agricultural swaps, swaptions, and options consistently.

We respectfully submit that our clients' recommended approach to regulating agricultural swaps is in the public interest because it would subject all commodity swaps to substantially the same regulatory requirements. Applying many aspects of the Dodd-Frank Act to agricultural swaps on an equivalent basis as other commodity swaps (*e.g.*, registration, clearing, and reporting) would promote the Dodd-Frank Act's goal of bringing more transparency to the over-the-counter ("OTC") derivatives markets.

## **II. FRAMEWORK FOR AGRICULTURAL SWAP EXEMPTIONS**

### **A. The Ag Swap Working Group Supports the Commission's Proposed Definition of Agricultural Commodity**

On October 26, 2010, the Commission issued a proposed definition of agricultural commodity, which groups agricultural commodities into four categories:

- the enumerated commodities listed in CEA §1a, including such things as wheat, cotton, corn, the soybean complex, livestock, etc.;
- all other commodities that are, or once were, or are derived from, living organisms, including plant, animal and aquatic life, which are generally fungible, within their respective classes, and are used primarily for human food, shelter, animal feed, or natural fiber;
- tobacco, products of horticulture, and such other commodities used or consumed by animals or humans as the Commission may by rule, regulation, or order designate after notice and opportunity for hearing; and
- commodity-based contracts based wholly or principally on a single underlying agricultural commodity.<sup>5</sup>

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<sup>5</sup> Proposed Rule, 75 Fed. Reg. at 65593.

The Ag Swap Working Group supports the Commission's proposed definition to the extent that it treats all agricultural products consistently—as opposed to the current approach of the Commission's rules, which divides agricultural commodities into enumerated and non-enumerated categories. Our clients also support the Commission's treatment of commodity indices, which provides greater clarity with respect to when a commodity index is considered an agricultural commodity. Finally, the Ag Swap Working Group supports the Commission's exclusion of commodities like ethanol, biodiesel, fertilizer, and other products that are used as industrial inputs from the definition of "agricultural commodity." Our clients agree that it is more appropriate to treat those types of commodities as exempt commodities.

The Ag Swap Working Group requests that the Commission clarify that the second prong of the definition includes agricultural commodities that are now or in the future could be the subject of derivatives trading without the need for additional Commission action. This approach would be consistent with the Commission's interpretation of the definition of "commodity" in the CEA, which includes certain enumerated agricultural commodities, as well as "all other goods and articles, . . . and all services, rights and interests in which contracts for future delivery are presently or in the future dealt in."<sup>6</sup> The Commission has interpreted this to include any good, article, service, right, interest or other commodity if in the future it may become the subject of a futures contract.<sup>7</sup> Encompassing agricultural commodities that may be developed in the future is in the public interest because it will promote legal certainty by making it clear that all transactions involving different types of agricultural commodities will be regulated in the same manner. Increased legal certainty, in turn, will enable participants in the agricultural commodities market to continue to innovate and transact within a consistent regulatory framework.

## **B. The Commission Should Harmonize the Regulation of Agricultural Swaps with the Regulation of Other Commodity Swaps**

Customized OTC agricultural swap contracts provide farmers, cooperatives, grain elevators, processing facilities, food manufacturers, and other agribusinesses with very important hedging tools that enable them to mitigate in a cost-effective manner the commercial risks associated with volatility in production, input, and output prices. Moreover, the agricultural swaps market functions well and did not contribute to the financial crisis in the United States.

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<sup>6</sup> 7 U.S.C. § 1a(4).

<sup>7</sup> See, e.g., *Statement of the Commission*, June 14, 2010, available at <http://www.cftc.gov/ucm/groups/public/@otherif/documents/ifdocs/mdexcommissionstatement061410.pdf>. (CFTC has jurisdiction over all commodities "which are or may be the subject of futures contracts."); see also Concept Release on the Appropriate Regulatory Treatment of Event Contracts, 73 Fed. Reg. 25669 at 25671 (May 7, 2008) ("[A]n underlying interest that is not enumerated in [the definition of a commodity] may be a statutory commodity under the Act if it reasonably can underlie a futures contract on a forward looking basis.").

Thus, there is no policy reason to impose restrictions on agricultural swap transactions that are additional to those applied to other commodity swaps, or that will limit access to this important OTC swap market. The costs of imposing additional obligations on this well-functioning and important market would outweigh any potential benefits and could result in fewer market participants hedging their commercial risks.

Treating bilaterally executed agricultural swaps on an equivalent basis with other commodity swaps is generally consistent with the manner in which they historically have been regulated under the CEA.<sup>8</sup> Given the increased oversight of all swaps under the Dodd-Frank Act, the Commission should continue to treat bilateral agricultural swaps the same as other commodity swaps. The Commission should consider requiring the registration of swap dealers (“SDs”) and major swap participants (“MSPs”) if they qualify as such based upon their agricultural swaps transactions. It also should consider requiring that agricultural swaps be cleared to the extent they are able to be appropriately valued, and accepted for clearing, by a designated clearing organization (“DCO”), except for end-user swaps used to hedge commercial risk. Additionally, the Commission should permit uncleared OTC agricultural swaps to be traded by “appropriate persons,” which should be defined as eligible contract participants (“ECPs”), and exempt pre-existing swaps from the clearing requirement.<sup>9</sup>

As in other industries, many agricultural market participants rely on customized OTC swaps because they may not have volumes that are big enough to hedge with standardized contracts, their volumes may not equate precisely to one or more futures contracts, or there may be no standardized contracts available to hedge their specific commercial risks. For example, they may need to hedge production for a particular month for which there is no standardized contract, *e.g.*, corn and soybean meal futures, which do not trade on a monthly basis, or they may produce a variety of specific agricultural by-products for which there is no standardized contract. For these reasons, it is very important that, as with other commodity swaps, the Commission provide a broad end-user exception from mandatory clearing of agricultural swaps. Failure to do so likely would materially increase the costs associated with entering into swaps, and thus reduce the benefits that agricultural producers and processors can achieve through hedging. If end-users were required to conduct all of their hedging activities with cleared swaps, they would incur higher margin costs and would have even less capital available to continue their farming, marketing, and processing operations. They also may be forced to pass some or all of the increased hedging costs along to their customers.

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<sup>8</sup> Part 35 of the Commission’s rules currently provides an exemption for bilateral agricultural swaps between eligible swap participants (“ESPs”) that is very similar to the exemption that Congress in the Commodity Futures Modernization Act provided for swaps in exempt commodities between ECPs; however, Part 35 does not provide an exemption for trading swaps on a multilateral transaction execution facility. Compare CEA § 2(h) and Part 35 of the Commission’s regulations.

<sup>9</sup> Rather than having separate categories of appropriate persons for separate commodities, *e.g.*, ECPs and ESPs, as defined in Part 35 of the Commission’s rules, the Commission should use one category to promote legal certainty.

### **C. The Commission Should Regulate Agricultural Swap and Option Transactions Consistently**

The Commission should consider adopting a rule for agricultural swaps that regulates swaps and options in the same way.<sup>10</sup> This approach is consistent with the Dodd-Frank Act's definition of a swap, which expressly includes options. *See* Dodd-Frank Act § 721(a)(21). The definition of a swap also includes any contract "that is any combination or permutation of, or option on, any [swap]."<sup>11</sup> The new definition of swap, which encompasses options and swaptions, reflects Congress' intent that the Commission should regulate all financially-settled OTC commodity instruments in a similar fashion.

Although options on enumerated agricultural commodities historically have been subject to more stringent regulation under the CEA, there is no longer a need for the Commission to impose additional requirements on such options given the Commission's proposed definition of agricultural commodity and the enhanced regulatory framework mandated by the Dodd-Frank Act. Indeed, options on non-enumerated agricultural commodity options already are treated the same as agricultural swaps under the Commission's regulations. In its Proposed Rule regarding the definition of "agricultural commodity," the Commission explained that:

Because the term "agricultural commodity" in the Act refers to more than just the enumerated commodities, the Commission recognizes that certain options authorized under § 32.4 (*e.g.* off-exchange options on coffee, sugar, cocoa, and other agricultural products that do not appear in the enumerated commodity list) will be considered to be swaps in an agricultural commodity—and subject to any Commission rules that specifically address agricultural swaps.<sup>12</sup>

The current restrictions on enumerated agricultural options, which only may be offered to a counterparty that has at least \$10 million in net worth and is entering into the option for hedging or inventory management purposes, prevent many market participants with legitimate commercial or investment interests from using agricultural options. This is inconsistent with the Commission's rules that allow these same market participants to enter into agricultural swaps and swaptions on both enumerated and non-enumerated agricultural options, as well as options on non-enumerated agricultural commodities. The Commission should consider replacing Parts 32 and 35 of the Commission's rules with new regulations that treat swaps and options consistently and allow them to be executed bilaterally between ECPs.

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<sup>10</sup> Under the pre-Dodd-Frank CEA, market participants only may enter into agricultural swaps and swaptions pursuant to Part 35 of the Commission's regulations, whereas they only may enter into options on enumerated agricultural commodities pursuant to Part 32 of the Commission's regulations.

<sup>11</sup> Dodd-Frank Act § 721(a)(21) (to be codified as section 1a(47)(A)(vi) of the Commodity Exchange Act).

<sup>12</sup> Proposed Rule, 75 Fed. Reg. at 65589.

**D. Allowing Agricultural Swaps To be Executed On The Same Basis As Other Commodity Swaps Meets The Requirements of CEA § 4(c)(2)**

Section 4(c)(2) of the CEA requires the Commission to adopt a rule that is in the public interest and that does not give rise to contracts, agreements, or transactions that materially adversely affect the Commission's or any DCM's regulatory or self-regulatory duties under the CEA. Allowing agricultural swaps (including options) to be executed on the same basis as other commodity swaps meets these requirements because Title VII of the Dodd-Frank Act introduces a regulatory regime that provides for more comprehensive regulation of all swaps. As discussed above, a consistent approach to the regulation of all types of commodity swaps would eliminate the need to impose additional conditions on agricultural swaps. Equivalent treatment also would increase regulatory certainty in commodity markets by allowing market participants to structure documentation and compliance protocols consistently across commodity desks. Applying many aspects of the Dodd-Frank Act to agricultural swaps on an equivalent basis as other commodity swaps (*e.g.*, registration, clearing, and reporting) also would promote the Commission's stated mission of bringing more transparency to the OTC derivatives markets.

**III. CONCLUSION**

The Ag Swap Working Group supports the Commission's stated mission to protect consumers by bringing more transparency and oversight to the OTC derivatives markets generally and to agricultural markets specifically. The Ag Swap Working Group also recognizes the complexity involved in significant regulatory reform and submits its comments to assist the Commission in designing its implementing regulations in order to reduce any unintended negative impacts on the market.

Please contact me at the number listed above, or my partner, Athena Velie at 202-756-8007, if you have any questions about the Ag Swap Working Group's comments.

Respectfully submitted,



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Paul J. Pantano, Jr.

**Agricultural Commodity Swaps Working Group:**

Barclays Capital  
Citigroup  
Credit Suisse Securities (USA) LLC  
JPMorgan Chase & Co.  
Morgan Stanley  
Wells Fargo & Co.

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cc: Honorable Gary Gensler, Chairman  
Honorable Michael Dunn, Commissioner  
Honorable Jill E. Sommers, Commissioner  
Honorable Bart Chilton, Commissioner  
Honorable Scott O'Malia, Commissioner  
Daniel Berkovitz, General Counsel  
Donald Heitman, Senior Special Counsel  
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