

Comment on the U.S. Commodity Futures Trading Commission (CFTC) proposed definition of “agricultural commodity” (RIN 3038-AD21)

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IATP commends the CFTC staff for its thorough deliberation in proposing a definition of “agricultural commodity” that is necessary and sufficient to implement the statutory provisions of Title VII of the “Dodd-Frank Wall Street Reform and Consumer Protection Act” (Dodd-Frank Act). The importance of this definition to the implementation of the Dodd-Frank Act cannot be over-estimated. As the notice of proposed rule-making states, “the definition will be necessary for later substantive rule-makings, such as setting speculative position limits for exempt and agricultural commodities . . . and determining the permissibility of trading agricultural swaps” (FR, October 26, 2010, p. 65592). IATP has already given its views on agricultural swaps in response to the CFTC’s preliminary request for comment.

With respect to the CFTC’s cost benefit analysis of this proposed definition and subsequent rule-making based upon it, the “public interest considerations” of this analysis, including food security, should be paramount. An emergency September 24 intergovernmental meeting hosted by the United Nations Food and Agriculture Organization noted “unexpected price hikes and volatility” were “major threats to food security” and agreed that among the root causes of these threats are “insufficient market transparency”, and the “impact of “financialization” on futures markets”.¹ CFTC rule-making to reduce the scope for Over the Counter trades of agricultural commodity derivatives and to set and enforce position limits to prevent excessive speculation will do much to reduce the FAO government delegate identified threats to food security.

Comments on the four categories of the proposed definition of “agricultural commodity” and related considerations

IATP commends the CFTC for proposing a definition of “agricultural commodity” that is structured in such a way as to provide overlapping legal certainty and to minimize the opportunity for regulatory arbitrage and circumvention. The first category of existing specifically enumerated commodities provides a solid statutory underpinning for the proposed definition.

The second category, the “operative definition of agricultural commodities,” provides a flexible basis for extrapolating from the enumerated list, e.g. from “frozen concentrated orange juice” to “frozen

concentrated apple juice,” etc. The operative definition also provides a broad platform of commodity origins and uses that extends beyond those of the enumerated commodities. However, the qualification “generally fungible, within their respective classes,” may require some further consideration to take into account those non-enumerated commodities, such as hemp, that can serve as both the basis for human food and natural fiber. Such a commodity that transgresses the “within their respective classes” criterion is likely to be captured by the CFTC’s case by case review, as stated under “Category Three – Other Agricultural Commodities.”

IATP is further concerned about how and whether the operative definition may take into account the commercial commodification of currently experimental commodities, such as switchgrass modified by synthetic biology to pre-process enzymes for cellulosic biofuels. The “used primarily” criterion of the operative definition would exclude such an engineered biofuels feedstock, as an industrial input, from the operational definition. In response to the fourth question in the CFTC request for comments, IATP believes that the proposed definition of “agricultural commodity” appropriately excludes biofuels, which should be categorized as an energy commodity. Significant price discovery in physical and futures contracts of biofuels will have greater price correlation in response to other energy contracts, rather than to agricultural contracts.

However, huge government and private firm investments in synthetic biology to produce food, feed, energy and industrial materials from broad array of “bio-mass” may result in the commercialization of such commodities with or without regulation. If their commercialization grows to the extent that synthetically engineered commodities are proposed for futures and options contract trading, the high degree of use fungibility of engineered commodities may make it difficult to apply the “used primarily” and “within their respective classes” criteria except on a case by case basis.ⁱⁱ It perhaps goes without saying that the modification of traditional commodities by synthetic biology and other nanotechnologies will pose many and complex regulatory challenges to protect the public interest, should these commodities be traded under contracts subject to CFTC rules.

The fourth category of the proposed definition, concerning commodity index contracts “based solely or principally on an underlying commodity,” must be included if the Dodd-Frank Act is to be implemented and enforced. The CFTC’s justification for proposing this inclusion, to prevent evasion of the Dodd-Frank Act limitations on the trading of agricultural swaps contracts, is well-founded. IATP would add that including the index contract within the definition of “agricultural commodity” is necessary because of the increasing concern of regulators internationally about the lack of transparent information in the trading of physical commodities.ⁱⁱⁱ Information opacity in physical markets and in the OTC commodity swaps market combine to form a lethal synergy for market integrity. Part of the reason that the French government proposed on August 27 that the European Commission draft legislation for an European commodity regulatory authority is to prevent cross market manipulation in “dark” physical and futures markets.^{iv} Inclusion of the fourth category of definition would strengthen Dodd-Frank Act implementation against regulatory arbitrage that would result if the European Commission undertook strong measures against cross-market manipulation, while the CFTC excluded “commodity-based contracts” from the definition of “agricultural commodity.”

IATP is grateful for this opportunity to comment on the proposed definition of “agricultural commodity” and looks forward to further assisting the CFTC in rule-making to implement Title VI of the Dodd-Frank Act.

ⁱ “Final Report,” Extraordinary Joint Intersessional Meeting of the Intergovernmental Group on Grains and the Intergovernmental Group on Rice,” Committee on Commodity Problems, United Nations Food and Agriculture Organization, September 24, 2010 (CCP:GR-RI 2010/2), paragraph 2.

ⁱⁱ “The New Biomasters: Synthetic Biology and the New Assault on Biodiversity and Livelihoods,” The ETC Group, October 2010 at http://www.etcgroup.org/upload/publication/pdf_file/biomasters_v12.pdf

ⁱⁱⁱ Javier Blas, “Regulators extend commodities push: Watchdogs focus on physical markets,” *Financial Times*, November 23, 2010.

^{iv} The original French proposal is at <http://www.tradeobservatory.org/library.cfm?refID=107769> An unofficial English translation by David Frenk of Better Markets, Inc. and Steve Suppan, Institute for Agriculture and Trade Policy is at <http://www.tradeobservatory.org/library.cfm?refID=107771> The cover letter for the French proposal, to Michel Barnier, EC Director General of Internal Markets, is at <http://www.tradeobservatory.org/library.cfm?refID=107829>