March 28, 2011

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

Re: Position Limits for Derivatives (RIN 3038-AD15 and 3038-AD16)

Dear Secretary Stawick:

Cargill, Incorporated ("Cargill") is an international provider of food and agricultural products and services. As a merchandiser, processor and exporter of agricultural commodities, Cargill relies heavily upon efficient and well-functioning methods of risk management, including forward contracts, futures, options and swaps. Cargill appreciates the opportunity to provide comments to the Commodity Futures Trading Commission ("Commission" or "CFTC") on its proposed rules regarding Position Limits for Derivatives in 76 Fed. Reg. 4752 (Jan. 26, 2011) ("the Proposed Rules"), which have been issued pursuant to the Commodity Exchange Act, as amended by the Dodd-Frank Act (collectively the "Act").

Cargill's business will be significantly affected by the Proposed Rules. The hedge exemption is vital to Cargill's management of its commodity price risk in its business activities as a purchaser, processor and seller of physical commodities. In turn, Cargill's ability to manage its own risk impacts the prices it pays to agricultural producers who supply commodities to Cargill, as well as the prices it charges to processors and end-users who buy from Cargill. Position limits and the hedge exemption are also important for Cargill's business of providing risk management services to other businesses, by acting as a swap counterparty to businesses using swaps to hedge their risks.

In order to manage its physical commodity price risks efficiently and economically, for the benefit of producers, processors and consumers as well as for its own benefit, Cargill supports orderly functioning markets. To ensure efficient risk management and transfer of risk, such markets must provide good convergence, accurate price discovery, and high levels of liquidity. If the Proposed Rules were adopted without changes, however, there is a substantial risk that they would undermine the efficiency of the markets for hedgers, by reducing liquidity and disrupting markets which currently function well. Accordingly, Cargill has identified a number of specific provisions in the Proposed Rules which should be revised to promote markets that function well and provide sufficient liquidity for efficient hedging by commercial enterprises that produce, process and merchandise physical commodities.

Comments

1. The Hedge Exemption Should be Revised to Reflect the Realities of Commercial Commodity Hedging

a. The Proposed Rules Should Clearly Provide for Portfolio Hedging

Cargill purchases physical commodities from thousands of agricultural producers on a daily basis, and similarly sells these commodities to merchandisers, processors and end-users on a daily basis. Many producers who sell corn and other grains to Cargill deliver on a per truck-load basis, which in the case of corn is only 1000 bushels and therefore less than one corn futures contract. It is not practical or feasible to hedge these purchases and sales on an individual basis or to account for them as such. In addition, the hedging instruments which are used by Cargill include a combination of futures, swaps, and both on-exchange and off-exchange options, which generally cannot be individually identified to particular physical transactions, which may be priced, unpriced, minimum priced, minimum-maximum priced, spot or forward. Therefore Cargill hedges its obligations on a portfolio basis, which takes into

account Cargill's entire position, both physical and hedge, when entering into purchases and sales, and when placing and lifting hedges.

The Proposed Rules do not clearly state that hedging may be done on a portfolio basis. Moreover, the reporting requirements in the Proposed Rules suggest that individual hedge positions need to be identified. A requirement to match and report physical and hedge transactions on a one to one basis would not be practical for a diversified physical commodity firm such as Cargill. Such a requirement would also be highly inefficient, and its complexity could generate errors in the reports. A matching requirement would also impose enormous costs on those who hedge on a portfolio basis, and would potentially increase basis costs to commodity producers, processors and end-users.

The Commission should revise the Proposed Rules to make it clear, in both the definition of a hedge and in the reporting requirements for hedging, that the determination of hedges and the reporting of hedges on a portfolio basis are permissible.

b. **Daily Hedge Reporting Should Not be Required; Monthly May be Appropriate**

The Proposed Rules require daily reporting of hedges on Forms 404 and 404S, with Form 404 containing information on cash commodity transactions and corresponding hedges, and Form 404S containing information on swaps used for hedging. Daily reporting is onerous and unnecessary for hedgers of physical commodity price risk. For portfolio hedgers such as Cargill, moreover, such dual reporting is duplicative and inefficient, because portfolio hedging does not treat swaps separately, but rather as part of a portfolio of physical inventory, forward and spot purchases and sales, and futures, options and swaps.

The Proposed Rules should be revised to provide for a single monthly report, which permits portfolio hedgers of physical commodity price risk to report their hedging on a portfolio basis.

Currently, the Commission collects information of this type on a monthly basis through a special call procedure, and this procedure appears to be working well. If more details are needed, or if updated information is needed between reports, the Commission can obtain the information through a special call for information.

c. Current Hedge Exemptions Should Continue in Effect When the Act Becomes Effective

In order to minimize market disruptions and individual business disruptions, hedging authority existing at the time the Proposed Rules become effective should remain in effect pending an orderly transition to the new provisions. Hedgers have obtained their current hedging authority from the appropriate regulator and have relied on it in entering into both physical and hedge transactions. Moreover they have been permitted to enter into swaps as hedges without need for any hedge exemption. They should not abruptly be required to conform to new rules for hedging and obtaining hedge authority, as such drastic changes would be disruptive to ongoing business relationships and to the markets.

In particular, there should be a lengthy time frame for hedgers to apply for and obtain anticipatory hedging authority, and they should be permitted to rely on current authority during that time frame. Applications for anticipatory hedging authority can require presentation and analysis of historic data regarding purchases and sales, and sometimes the information provided with the initial application needs to be supplemented as issues arise during the approval process. Moreover, the current regulations impose limits only on exchange traded futures and options, and not on swaps, so that hedgers currently have hedge authority only for the exchange traded hedge contracts and not for swaps used for hedging. Hedgers need the certainty of specific hedge authority in order to manage their price risk, and they should not be placed in a position of having to conform to abrupt changes without time for an orderly

transition. They should therefore be given a significant time period to operate under current anticipatory hedge authority for exchange-traded hedges, and not be required to have hedge authority for swaps, while they apply for and obtain hedging authority under the new rules.

The Proposed Rules do not provide a procedure for pre-approval of hedging transactions other than anticipatory hedges. Rather, a report identifying hedges and commitments is required to be filed on Form 404 when a trader's position first exceeds the position limits as a result of hedging transactions. The lack of a pre-approval procedure, however, creates uncertainty for hedgers. In order to promote certainty, Cargill suggests that the Commission provide an optional procedure for pre-approval of all enumerated hedges, while retaining the contemporaneous filing procedure for those who prefer that method of claiming a hedge exemption.

The Proposed Rules should also permit a hedger to seek approval of hedges other than those specifically listed as enumerated hedges, as is currently permitted for non-enumerated hedges. Among other reasons, this flexibility is needed because the application of position limits to swaps will be new, and issues may arise with respect to swaps which are outside the strict confines of the enumerated hedge definition. For example, the most efficient way to hedge some anticipatory requirements for physical commodities may be with swaps which extend beyond one year, and it therefore may be appropriate in particular cases to hedge more than one year's anticipated production or requirements. Hedgers should have a procedure whereby they can make a showing to the Commission that such hedging should be permitted, and obtain advance approval for it.

d. **The Hedge Exemption for Swaps Should be Clarified to Facilitate Hedging**

The Proposed Rules clearly provide that a non-hedging counterparty to a swap, where the other party is a hedger, will have a hedge exemption for positions offsetting the non-hedger's risk on the

swap. It is not clear, however, that the non-hedging counterparty to a swap with a hedger may claim a hedge exemption for the swap itself. By way of example, assume Cargill enters into a swap with ABC Cereal (a qualified hedger) whereby ABC Cereal can lock in a maximum price for flour inputs for a six month period. Cargill then buys futures to hedge its obligations under the swap with ABC Cereal. Under the Proposed Rules, the swap is a hedge for ABC Cereal and the futures Cargill buys are hedges, but it is not clear that the actual swap Cargill enters into with ABC Cereal is a hedge. Logically it should be, so we would like this point clarified in the revised rule. Without such a hedge exemption, there would be less liquidity available to hedgers using swaps, because potential counterparties to the swap would be subject to position limits for the swap itself. Moreover, providing a hedge exemption to the non-hedging counterparty for a swap with a hedger is consistent with section 2(h)(7) of the Act, in which Congress has exempted from the clearing requirement a swap where only one of the parties is a hedger.

2. The Aggregation Rules Should be Revised to Ensure Accurate Market Information and Orderly Implementation

a. There Should be an Orderly Transition Between the Independent Account Controller Exemption and the Owned Non-Financial Entity Exemption

Under the rules now in effect, diversified corporations have qualified for and relied upon the independent account controller exemption to disaggregate positions which are owned but independently controlled. Under the Proposed Rules, this exemption would be replaced by the owned non-financial entity exemption.

It is essential that the Commission provide for an orderly transition between these two exemptions as one is discontinued and the other takes its place. In some cases, business activities now subject to the independent account controller exemption will need either to be aggregated or to be restructured in a way that aggregation is not required. By the same token, there will be some businesses

that are currently aggregated but will potentially qualify for the owned non-financial entity exemption, and some businesses not currently subject to limits, because they only use swaps, that will be required either to aggregate or qualify for an exemption under the new rules. In some cases, businesses will be able to satisfy the owned non-financial exemption only by undergoing some change in their operations. But until the final rules are issued, they will not know whether or not changes are required to qualify for the exemption, and what those necessary changes would be. For these reasons, the Commission should provide time and procedures for an orderly transition between the two exemptions.

b. The Owned Non-Financial Entity Exemption Should apply to Divisions as Well as Separate Entities

Cargill has numerous divisions, known as business units, which are operated independently with each having a focus on a specific business. It is a much more efficient use of Cargill's capital and human resources to operate these business units as divisions rather than separate entities. Moreover, persons who deal with Cargill, such as commodity producers, processors and end-users, also benefit, because their contracts with Cargill are backed by the financial resources of Cargill, and not by the balance sheet of a smaller subsidiary or affiliate.

The Commission should permit business units which are divisions to qualify as owned non-financial entities for aggregation purposes. Functionally, these business units operate the same as separately organized entities, and they should not be forced to undergo the costs and inefficiencies of becoming separately organized merely to obtain separate position limits.

Congress recognized that commercial companies should not be forced to re-organize their corporate structures in order to comply with the Act. For example, Congress specifically provided in section 1a(49)(B) of the Act that a swap dealer function housed within a larger commercial company may be regulated as such without making the entire company's swap activities subject to swap dealer

regulation. Congress recognized that commercial companies dealing in physical commodities were not the cause of the financial problems which led to the enactment of the Act, and these companies should not be forced to restructure to comply with those portions of the Act which apply to their businesses. This same rationale supports allowing divisional business units to qualify for the owned non-financial entity exemption. Non-financial companies such as Cargill would thereby be able to continue to operate their businesses efficiently and with the least disruption possible as a result of having some of their activities caught up in the new regulatory environment established by the Act.

c. **As Written, The Owned Non-Financial Entity Exemption Would Not Permit Information Sharing Needed for Risk Management and Governance Purposes**

As currently drafted, the owned non-financial entity exemption prohibits sharing of trading information, and requires separate risk management systems. This is much different from the requirements that currently apply to independent account controllers, which must have independent trading control, but which are permitted to share information necessary to maintain control consistent with fiduciary responsibilities and to diligently supervise trading. In addition, the independent account controller exemption does not require separate risk management systems.

The complete prohibition on sharing of trading information by an owned non-financial entity, and the requirement of separate risk management systems, are counter-productive and would undermine an important purpose of the Act, which is to reduce risk. While it is reasonable and appropriate that this exemption require that trading decisions be made independently, the sharing of information for risk management purposes and corporate financial control should be allowed.

Cargill has risk management and corporate control policies which apply throughout its organization, both internally and with respect to subsidiaries and affiliates. In order to ensure that these policies are enforced, Cargill management needs the information necessary to monitor compliance with

them. At the same time, however, Cargill can impose and enforce a requirement of independent trading decisions by its divisional and separately organized business units. Furthermore, because these business units will be required to be non-financial entities, their non-financial business objectives will dictate the market positions they take, and they will not be subject to the risks posed by the trading done by financial entities.

Proper risk management and corporate control require that information be shared for these purposes, and such information may be shared without sacrificing independent trading control. Accordingly, the terms of the owned non-financial entity exemption should permit sharing of information for risk management and corporate control purposes.

d. **The Process for Claiming Exemptions from Aggregation Should be Simplified**

The requirements for claiming exemptions are unnecessarily burdensome and should be simplified. Under the Proposed Rules, a person seeking an exemption from aggregation as a passive limited partner or shareholder, or as an owned non-financial entity, must file an initial application for exemption which includes an independent assessment report regarding the applicant's policies. In addition, an annual application for exemption renewal, containing unspecified information, is required. These requirements would impose unnecessary costs, and would also create uncertainty each year as to whether an exemption will be renewed.

An exemption application should be required only on a one time basis, with a requirement that material updates of the information in the application be provided by the person holding the exemption. Similarly, the Commission should make it clear that an independent assessment report concerning the policies of the person claiming an exemption should be required only when the exemption is first claimed, and not on an annual basis.

3. Provisions for the Determination and Application of Position Limits Should be Revised to Accurately Reflect Net Positions

a. Netting Across Classes Would More Accurately Reflect Market Positions

The Act calls for the application of position limits on an aggregate basis across different instruments and trading venues where contracts are based on the same underlying commodity. The Proposed Rules, however, prevent economically equivalent contracts from being netted across classes for certain of the position limits, leading to a distorted and inaccurate view of contract activity. Without netting, volume and open interest figures are inaccurately inflated, with adverse effects on the price discovery function of the market. This lack of netting thus appears to be inconsistent with the intent of the Act. On the other hand, if netting were allowed, the intent of the Act would be promoted, because all speculative activity, whether by end-users, swap dealers, major swap participants or others, would still be subject to limits, as speculation would result in a net long or short position that would count against the limit.

Changes in the Proposed Rules are required to achieve proper netting. Under the Proposed Rules, each person who is party to either a swap or a futures contract will be subject to both aggregate position limits, applicable to swaps and futures combined, and class limits, which would measure swaps and futures separately. Without netting, however, the class limits would have market distorting and unfair consequences for persons who are merely facilitating the trading of others by intermediating swaps. If these persons offset swap obligations with another swap, they will be flat on their obligations for both class and aggregate limits, and therefore will not have a net position for position limits purposes. If, however, they offset swaps with futures, they will not be flat for purposes of class limits, but rather would have a net position in each class, even though they have no net position overall. The effect of this proposal will be to encourage intermediaries to maintain their risk reduction positions in

the swaps market rather than the futures market, and to double count the volume of positions within the class limits.

In the absence of netting across classes for intermediaries, the Commission will be erecting an artificial obstacle to the use of exchange traded futures and options to offset swap obligations. By offsetting a swap with a swap, the intermediary will not have a net position for position limits purposes, but by offsetting a swap with a future, the intermediary will be holding two offsetting positions that will each count against the intermediary's class limit. As a result the intermediary will have an incentive to use a swap rather than an exchange-traded future to offset another swap. This is an undesirable incentive, as the Commission either should want to encourage the use of exchange-traded instruments, or at the very least should want the choice to be neutral from a regulatory standpoint so that the intermediary will take the most economical position. Position limits should not drive this decision.

Once the Act becomes effective, position limits will apply to swaps as well as to exchange-traded futures. Therefore, after the Act goes into effect, any offsetting of swaps by an intermediary on the futures market will simply transfer the counterparty's position from the swaps market to the futures market, but it will not permit the counterparty to exceed position limits because limits will apply to the counterparty's swap positions. Accordingly there is no reason to prevent the intermediary from netting its positions across classes, and allowing such netting will cause the offsetting trades to be made on the most economical market, instead of artificially driving them to the swaps market. Moreover, permitting netting across classes would treat swap intermediaries similarly to futures commission merchants, when they are acting as intermediaries for futures contracts made between a customer and the exchange clearing house. This would harmonize the application of position limits in the futures and swaps markets, relative to offsetting obligations.

Proper netting for purposes of all position limits would require intermediaries, like all other market participants, to be subject to position limits when they trade for speculative purposes, because speculative activity would not net out to zero. In addition, netting would ensure that all market participants receive accurate information about the true size of all speculative and hedging positions in markets which perform a price discovery function.

b. Position Limits for Swaps Should be Determined Only After Sufficient Data Has Been Collected

Position limits place an artificial restriction on the ability of traders to take positions, because a trader with sufficient funds and a willingness to commit those funds to a particular position can be prevented from taking that position, merely because it exceeds a limit set by a regulatory authority. Limits can thus be harmful to both liquidity and price discovery. Accordingly they should be imposed only where they achieve the objectives set by Congress, which are to deter excessive speculation and manipulation while at the same time ensuring sufficient liquidity for hedgers and ensuring that the price discovery function of the underlying market is not impaired. In other words, to achieve the Congressional objectives, limits must be set at levels that are neither too high nor too low.

Position limits have not previously been imposed on the swaps market. Therefore, unlike in the futures market, there is no experience as to what levels will best achieve a balance between the opposing Congressional objectives. Nor is it clear how deliverable supply should be determined, how open interest in the swaps market should be determined, and whether, once determined, how these measurements will apply to the swaps market.

Cargill commends the Commission on structuring its proposal to implement limits in two phases, with spot month limits to be implemented in the first phase based on deliverable supply, and non-spot month limits based on open interest to be implemented in a second phase. The Commission has also

properly recognized that the second phase must await the availability of data on open interest in the swaps market, which the Commission currently does not have. The Commission's proposal is deficient, however, in that it assumes greater certainty regarding the measurement of deliverable supply and open interest than what actually exists. Due to the potential for limits to artificially constrain legitimate economic activity, the Commission should conduct additional study before making decisions on the bases for limits in the swaps market.

The Commission's proposal on spot month limits assumes that the exchanges' current measurements of deliverable supply, which are used by the exchanges for limits on futures contracts, will be a suitable basis for spot month limits on swaps. Cargill believes that deliverable supply cannot necessarily be measured precisely in some markets, or that it is necessarily applicable to the swaps market in the same way as it applies to the futures market. Accordingly, Cargill urges the Commission to study this issue further before accepting at face value, and applying to the swaps market, the measurements made by the exchanges for their purposes.

Similarly, the Commission should not, as it has proposed, determine the formula to be used for non-spot limits at this time. It may be difficult to determine how to obtain the necessary data and calculate what open interest is in swaps, and to determine how such a calculation should relate to the optimum non-spot month position limits for each commodity. These are issues which can be addressed in the second phase of implementation, and the Commission should not take premature action by proposing a formula or any other determinants of second phase position limits, but rather should wait and deal with those issues after the necessary data has been collected and evaluated.

Cargill would be pleased to call on its internal knowledge and expertise to assist the Commission in developing appropriate methods for measuring deliverable supply and open interest. Please contact us if we can assist in this manner.

Conclusion

Consistent with its past participation in the rule-making process, Cargill appreciates the opportunity to comment on the Commission's proposals for position limits. Cargill also appreciates the Commission's openness to input from Cargill and other interested market participants, and would be pleased to provide any further information that the Commission may request to assist it in developing the final rules.

Sincerely,

Linda L. Cutler
Vice President, Deputy General
Counsel and Assistant Corporate
Secretary

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