



March 28, 2011

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

Via Online Submission

SUBJECT: RIN 3038-AD15 and 3038-AD16

Dear Mr. Secretary:

The Minneapolis Grain Exchange, Inc. ("MGEX" or "Exchange") would like to thank the Commodity Futures Trading Commission ("CFTC" or "Commission") for this opportunity to respond to the Commission's request for comment on the above referenced matter published in the January 26, 2011 Federal Register Vol. 76, No. 17.

MGEX is both a Designated Contract Market ("DCM") and Derivatives Clearing Organization ("DCO") and appreciates the continued efforts the Commission has put forth to address the requirements placed upon it by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Non-Spot-Month Position Limits

The proposed rulemaking establishing non-spot month position limits based on a formulaic approach using open interest presents a number of concerns including accurate representation of the needs of market participants of the underlying market. A formulaic approach itself does not prevent "excessive speculation" as that term is not defined and probably cannot be defined. Therefore, a formulaic approach seems arbitrary.

However, the Exchange welcomes the Commission's recognition of an exception to the proposed general open interest based formula for enumerated agricultural commodities. "Legacy position limits" seems an apt term. While these limits are not perfect, the agricultural markets, futures industry and contract markets have generally accepted the consistency and certainty the enumerated contract limits provide. Market participants in the MGEX hard red spring wheat contract particularly appreciate the open interest parity among the three wheat contract markets.

All three wheat contracts may be used in conjunction with each other for legitimate risk management purposes. Should position limits be different among the three wheat contracts, price volatility or concentration in one contract may unduly affect the price of the other contracts. This parity approach has been followed by the three DCMs since 1938 and has been adopted by the CFTC since its inception. The value and certainty that parity presents to the marketplace has been proven and resulted in effective and efficient markets for all involved. Parity offers ease of entry and exist for all market participants. Without parity, inequities are introduced into the marketplace which could result in unintended consequences which, in turn, could lead to market distortion and arbitrage. Therefore, legitimate spread and hedge activity may be hurt should different position limits be permitted to exist among the three wheat contracts. As such, MGEX strongly recommends that that the non-spot position limits be kept consistent across the wheat contracts.

The Commission specifically requested comment on the Chicago Board of Trade's April 6, 2010 petition to increase wheat limits. In general, agricultural position limits have not kept pace with production and those needing to use futures as part of their risk management strategy. Therefore, MGEX supports an increase in the non-spot month position limits provided the limits are applied to all wheat contracts. Again, the value of parity among the wheat contracts is essential.

Spot-Month Position Limits

"Proposed §151.4 would impose and aggregately apply spot-month position limits for the referenced contracts."¹ For physical delivery referenced contracts these position limits would be set at 25 percent of estimated deliverable supply and the spot-month limits would be adjusted annually thereafter. MGEX addresses the following issues regarding this proposal for spot-month position limits: (1) the difficulty in accurately determining the deliverable supply; and (2) the definition of spot-month.

First, proposed §150.4(c)(2) states that "[e]ach designated contract market shall submit to the Commission an estimate of deliverable supply by the 31st of December of each calendar year for each physical delivery referenced contract that is subject to a spot-month position limit and listed or executed pursuant to the rules of the designated contract market."² MGEX believes that it is impractical to ascertain an accurate estimate of deliverable supply by December 31st for each delivery month of the following calendar year and then have the Commission fix an amount regardless of events. There are too many variable and unknown factors that affect an agricultural commodity's production and the amount that goes to the delivery points. By way of example to show the difficulty, the USDA gathers its estimates and surveys, and does not release a plantings estimate until the end of March. Even with waiting until March to release an estimate, and with their considerable knowledge, experience and resources in calculating and producing estimates, the USDA numbers can be incorrect. The same applies to reports gathered during the year. Therefore, due to the great difficulty in predicting the long-term weather impact, global political, economic and natural events, as well as a plethora of other factors, MGEX believes that an estimated deliverable supply is not a reliable method for determining spot month position limits. An annual

¹ 76 FR 4752, 4757 (Jan. 26, 2011).

² *Id.* at 4770.

adjustment is not practical and introduces uncertainty into the marketplace with no apparent measurable benefit, certainly not one for the MGEX wheat futures contract.

Instead, MGEX recommends the continued use of current spot month position limits for the three enumerated wheat contracts. The Commission has proposed using the current spot month limit as the initial spot month limit. Until there is sufficient evidence of a need to change the spot month limits, they should remain consistent across each delivery month and consistent from year to year. A DCM need only have adequate legal authority and power to address delivery month concerns regarding deliverable inventory or position limits.

Second, the Commission is proposing in rule §151.3(a)(2) to expand the definition of the spot month from essentially the close of business two days before the first trading day to the close of business three days before the first trading day without any discussion or explanation as to why the current definition of a spot month for the wheat contracts needs to be modified. Since the Commission has not provided commentary as to why this is necessary, it must be assumed this is not a material issue. Changing the spot month would require procedural, rule and regulatory changes for the Exchange and the cost of doing so has not currently been justified by the CFTC. Consequently, absent providing rationale by the Commission for the change, MGEX would recommend retaining the current two day definition.

Granting of Hedge Exemptions

The proposed process for granting hedge exemptions in the rulemaking is not clear. Under proposed §151.5, it appears that the CFTC is assuming responsibility for all aspects of the bona fide hedging exemptions process – from application through approval and the subsequent monitoring thereof. However, a registered entity, such as a DCM, appears to be charged under proposed §151.11 with adopting, monitoring and enforcing position limits. Further, under §151.11(d)(2), persons seeking to establish eligibility for an exemption must comply with the DCM's procedures for granting exemptions. Therefore, it is unclear as to whether a DCM need only refer a person to CFTC regulations to satisfy proposed §151.11(d)(2). MGEX would support the current practice where the Commission handles the requests and then provides the documentation and information to the applicable DCM(s).

For a DCM to effectively monitor the marketplace or enforce compliance with the position limits, a DCM needs information. The proposed rulemaking does not indicate whether or how the Commission will share the filing of the various 404 reports or other information. MGEX believes that any reporting entity granted an exemption should only need to file one report with a single entity. Since the Commission is that primary entity for processing and monitoring bona fide hedge exemptions, that information should be readily available to the CFTC and shared with the necessary DCM(s).

Finally, the proposed hedge exemption appears too narrow, as some current, legitimate hedging practices, including those employed by end users, appear to be excluded from the exemption. The Commission should listen carefully to those contract market participants currently using futures as a hedging tool.

Cash Settled Index Contracts

Proposed §151.4(a)(2) “incorporates a conditional-spot-month limit that permits traders without a hedge exemption to acquire position levels that are five times the spot-month limit if such positions are exclusively in cash settled contracts and the trader holds physical commodity positions that are less than or equal to 25 percent of the estimated deliverable supply” provided that the trader “[d]oes not hold or control positions in the physical delivery referenced contract based on the same commodity that is in such contract’s spot month.”³ MGEX has five financially settled agricultural index contracts: Hard Red Spring Wheat Index (HRSI), Hard Red Winter Wheat Index (HRWI), Soft Red Winter Wheat Index (SRWI), National Corn Index (NCI) and National Soybean Index (NSI) (the “MGEX Index Contracts”). However, cash settled index contracts, particularly current MGEX Index Contracts, that do not settle to a referenced contract should be considered exempt from position limits. The Commission is concerned with price manipulation and disruption in the cash market. By their very design these cash settled index contracts are not subject to potential market manipulation or creation of market disruption in the way that physical delivery contracts might be since deliverable supply is not a factor in an MGEX cash settled index contract. Instead, they are valued based on actual cash spot prices from a broad number of locations across the U.S. However, if the CFTC mandates position limits for the MGEX Index Contracts, they should be permitted greater position limits than a physical delivery contract.

New and Illiquid Contracts

MGEX believes there should be an exemption or exception from the proposed spot and non-spot position limits for new or illiquid futures contracts. New and illiquid contracts cannot practically be held to such stringent position limits methodologies because the burden will potentially inhibit the products from becoming liquid and sustainable. Without an exemption, competitiveness and innovation can be quashed. Alternatively, DCMs should be given sufficient flexibility to establish reasonable limits until there is enough history to impose realistic and meaningful limits. If such flexibility is not possible, MGEX is not opposed to the exemption contained within proposed rule §151.11 which adopts a limited exemption similar to the current Guideline No. 1 permitting new tangible commodities other than energy products a default position limit of 1,000 contracts unless the DCM demonstrates otherwise.

Related Matters/Burden

The CFTC estimates the total hours to accomplish the proposed estimate of deliverable supply under this notice of proposed rulemaking for DCMs to be 6,000 hours per year for all DCMs at a combined annual cost of \$50,000 among all DCMs, which results in an hourly wage of less than \$10 (approximately \$9.16 per hour) to comply with the proposed rules. MGEX believes these estimates – both in hours and cost – are extremely low given the difficulty of estimating the deliverable supply and considering the CFTC does not appear to account for the costs of the set up, documentation and CFTC review of the deliverable supply calculation.

³ *Id.* at 4758, 4770.

Conclusion

The Exchange thanks the Commission for the opportunity to comment on the notice of proposed rulemaking. If there are any questions regarding these comments, please contact me at (612) 321-7169 or lcarlson@mgex.com. Thank you for your attention to this matter.

Regards,

A handwritten signature in cursive script that reads "Layne G. Carlson". The signature is written in black ink and is positioned to the right of the typed name.

Layne G. Carlson
Corporate Secretary

cc: Mark G. Bagan, CEO, MGEX
Jesse Marie Bartz, Assistant Corporate Secretary, MGEX
Eric J. Delain, Legal Advisor, MGEX
James D. Facente, Director, Market Operations, Clearing & IT, MGEX