National Grain and Feed Association

1250 Eye St., N.W., Suite 1003, Washington, D.C. 20005-3922, Phone: (202) 289-0873, FAX: (202) 289-5388, Web Site: www.ngfa.org

February 15, 2013

Ms. Sauntia Warfield
Assistant Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington, D.C. 20581

RE: RIN 3038-AD8: Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 77 Fed. Reg. 67866, November 14, 2012.

Dear Ms. Warfield:

The National Grain and Feed Association (NGFA) appreciates the opportunity to submit comments to the Commodity Futures Trading Commission (CFTC) regarding the above-referenced notice of proposed rulemaking. Improving customer protections is a critically important task, and the CFTC is to be commended for many of the enhancements proposed in this rule. There is much to like in the proposed rule. However, the NGFA urges the Commission to be mindful of the potential impacts of new or tighter regulation that could significantly change the manner in which futures commission merchants and their customers do business and that could impose new costs on the system that likely would be passed through to customers. We encourage the Commission to take a deliberate approach that fully analyzes costs and benefits – analysis that is lacking in some sections of the proposal – before moving to publish a final rule.

The NGFA is the national trade association representing many hundreds of traditional customers of agricultural futures markets. Our member firms are not investors or speculators; rather, they are commercial hedgers that use futures as a critically important risk management tool. As such, the NGFA has a strong vested interest in maintaining an effective and efficient marketplace that can be accessed at reasonable cost and risk levels. We share the fear of one participant in the Commission's February 5 roundtable who commented that some of the changes in the proposed rule would bring about a dramatic and sudden change in the eco-system of the futures market as it has existed for decades, with disproportionate adverse impacts on the traditional users who are NGFA members, their farmer-customers and the FCMs that serve the agricultural hedging community.

Customer Protections – Encouraging Progress…But More is Needed

We commend the Commission for its commitment to enhanced protections for customers of futures commission merchants (FCMs) and derivatives clearing organizations (DCOs) in the aftermath of the collapse of MF Global and Peregrine Financial. Positive steps already are being implemented through the actions of the CFTC as well as the National Futures Association and other self-regulatory organizations (SROs). Online access to FCM financial data, near real-time verification of FCM financial data by their regulators, enhanced internal controls at FCMs, and restrictions on allowable investments of customer funds and on disbursements all are positive steps.

While these changes represent progress, the NGFA believes strongly that additional measures need to be taken. A major study supported by the Futures Industry Association and others examining the type of customer protection fund that will best serve customers in the event of future FCM insolvencies is an important effort. We look forward to results early in the spring. Stakeholders also have begun to consider how badly needed changes to the U.S. bankruptcy code – that became apparent during the MF Global debacle – can be moved forward.

Importantly, the NGFA continues to support testing of concepts that will lead to an optional full-segregation model, whereby segregated customer funds would be held securely without risk from FCM or fellow-customer failure (though we understand some reforms to the bankruptcy code also will be needed to thoroughly safeguard customer funds). A fully segregated account structure likely would impose additional costs on participants. For that reason, we have recommended that such a structure, when operational, be at the option of FCMs and their customers. The NGFA recognizes that other protections may be desirable and feasible, and we certainly will take a collaborative approach with the CFTC and other stakeholders to support such efforts.

Concerns About the Proposed Rule – Impacts on Customers

The proposed rule aims to accomplish a number of goals, including providing greater certainty to market participants that funds will be protected; establishing robust risk management programs; implementing a risk-based, forward-looking perspective; ensuring that FCM capital and liquidity are sufficient; forming joint audit committees; and enhancing information provided to customers about risks. In concept, these are laudable goals.

As noted previously, the NGFA believes that a serious examination of costs and benefits will need to occur. Detailed information about some CFTC proposals will need to be addressed directly by the FCM community to fully understand the costs, benefits, and ramifications of proposed changes. However, the NGFA is well-qualified to comment on impacts on customers.

FCM Capital Charges

Sec 1.17 would require an FCM to take capital charges for customer, noncustomer and omnibus accounts that are undermargined for more than one business day after a margin call is issued. Current regulation applies the capital charge for undermargined accounts after three days.

The Commission asks if the proposed change provides a sufficient and objective standard for FCMs to assess compliance and whether the Commission should consider alternative time frames for the imposition of capital charges.

Generally, the proposed changes to Section 1.17 would materially and dramatically change the manner in which FCMs and their customers handle margining. We have serious concerns that the benefits anticipated by the CFTC will be outweighed by additional costs that disadvantage the very customers we seek to protect – agribusiness and agricultural hedgers, including processors, exporters, country elevators and farmers and ranchers – as well as the smaller to mid-size FCMs that serve agricultural hedgers and provide the high level of personalized service needed by the industry.

The proposed one-day requirement is overly stringent. Many, if not most, hedgers operate with excess funds regularly moving in and out of their segregated accounts, but this is not typically an automated process. Instead, it requires telephone and email requests for wires, time for subsequent verification of intentions, and then compliance with the request. A margin call first issued mid-morning on Monday may not be fulfilled by the client bank until late that afternoon, or possibly Tuesday. This leaves little to no room for routine delays that sometimes arise in the course of business. It also fails to balance the fact that outgoing wires from an FCM generally would precede incoming funds on a daily basis, leaving FCMs to face a continually imminent capital charge.

The likely result would be FCMs requiring clients to pre-fund potential margin calls. The proposed rule also could easily result in intra-day margin calls on customers becoming common practice to protect the FCM against inadvertent failure to comply with the revised requirements in volatile, fast-moving, near-24-hour-per-day markets. Both consequences would place additional financial stress on hedgers at a time of relatively higher commodity values and already-steep margining requirements. This stringent policy would have the added impacts of further alienating customers who would quickly learn that same-day and intra-day margin flows are only one-way: from the customer to the FCM.

In addition, FCMs could move away from accepting checks and/or ACH transfers to satisfy margin calls, an additional stress on customers who would be expected to bear the costs of added fees to wire funds; or added wire fees to customers currently utilizing ACH. We fear the impacts would be felt most keenly by small businesses and individual hedgers like agricultural producers. While the intent of increased capital charges is to protect customers, the outcome could be to drive business away from the safety of futures and into over-the-counter or ”back to back” transactions in cash markets, with the result that futures exchanges and FCMs lose volume.

Looking back at the MF Global situation, many customers kept excess funds in their hedge accounts held by the FCM. Customers believed their funds were segregated and perfectly safe. Today, we know that was not the case. A significant percentage of customer funds still has not been returned to the customers. The proposed rule likely would have the effect of compelling hedgers to pre-margin their positions and send yet more money to their FCM – the polar opposite of many hedgers' best practices today. When the next FCM failure occurs, it

would appear that an even greater amount of customer funds would be put at risk under the current proposal. It would be the ultimate irony that a rule designed to enhance customer protections in the aftermath of MF Global accomplishes the opposite. Customers and the Commission and the Congress share a desire to achieve a safer environment for futures customers. However, we believe strongly that these provisions of the proposed rule run counter to the goal of customer protection. Indeed, the proposal would not have prevented the MF Global and Peregrine debacles, nor would it have done anything to enhance prospects of returning customer funds in either situation.

The CFTC's Commitments of Traders report shows that the processor/commercial category represents around 40+% of open interest in agricultural futures; additional volume is generated by smaller agricultural hedgers. This major market sector currently is served in large part by mid-size FCMs that provide the hands-on order processing, research and assistance this sector needs. Agribusiness and agricultural hedgers present a far different situation than the needs of high-frequency traders, large index and hedge funds, and other clients served by more institutional-type FCMs that may also be a bank or broker/dealer. For these larger FCM entities, capital charges may produce a relatively smaller impact on a balance sheet. However, we fear the impacts on smaller to mid-size FCMs that provide valuable "hands-on" service to smaller clients. An overly prescriptive rule could have the perverse effect of relatively disadvantaging FCMs serving production agriculture and agribusiness, with the end result that risk could be consolidated and concentrated in a smaller number of FCMs.

In summary, the NGFA urges the CFTC to maintain the current three-day standard for capital charges in order to prevent adverse financial impacts on customers and to prevent increased risk with regard to the magnitude of funds potentially at risk in the event of future FCM insolvencies. The standard has worked well for decades and it is unclear to us what problem the proposed change seeks to address. Until we better understand the Commission's objectives and how the proposal furthers the goals of the Commodity Exchange Act, we find it difficult to offer alternatives. The NGFA sees no compelling reason to make such a momentous change now.

Use of Futures Customer Funds

A proposed amendment to Section 1.22 is intended to clarify "…that the prohibition on the FCM's use of one futures customer's funds to margin or secure the positions of another futures customer, or to extend credit to another person, applies at all times." Together with the afore-mentioned language in Section 1.17, this could be read as requiring an FCM to be in continual "real time" compliance on margining. As written, the proposal seems to mandate that an FCM cannot be undersegregated at any point in time during the day. We are unsure whether this is a correct reading of the Commission's intent, but continual 100% compliance on segregation at all points during the day seems to be an unrealistic standard that could lead to many of the same outcomes described above.

Public Disclosures by Futures Commission Merchants

Section 1.55 in the proposed rule would put in place additional disclosure requirements by FCMs, and the Commission asks about the appropriateness of the suggested changes and their implementation. Generally, the NGFA supports disclosure of risks and agrees with the intent of the amendments.

However, we bring to the Commission's attention the point that some of the proposed disclosure changes may need to be revisited soon. Several concepts for customer protection funds in the event of future FCM insolvencies are under consideration. As noted previously, the Futures Industry Association currently is conducting a major study in this area. Would it be prudent to delay changes to risk disclosure for some brief period of time to avoid the potential for needing another change in short order? We do note that providing updated risk disclosure – with signed acknowledgement of such to the FCM – is a sound concept. One twist on risk disclosure that the Commission may wish to consider is an *interim* additional risk disclosure to clarify the current status of fellow customer risk; lack of insurance protection at present; and that segregated customer funds may not automatically be considered as superior claims in bankruptcy proceedings, as had long been assumed.

Conclusion

In summary, the NGFA appreciates and endorses the Commission's intent to enhance customer protections. However, there are a number of important and complex concepts embodied in the proposed rule that deserve additional time for analysis. The Commission has demonstrated willingness in recent months to hold in abeyance certain sections of proposed rules until such detailed analysis is accomplished. We urge such an approach here.

Sincerely,

Diana Klemme, Chair
Risk Management Committee