



## National Milk Producers Federation

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703-243-6111 • www.nmpf.org  
"Connecting Cows, Cooperatives, Capitol Hill, and Consumers"

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Agri-Mark, Inc.

Arkansas Dairy  
Cooperative Association

Associated Milk  
Producers Inc.

Continental Dairy  
Products, Inc.

Cooperative Milk  
Producers Association

Dairy Farmers of  
America, Inc.

Dairylea Cooperative Inc.

Dairymen's Marketing  
Cooperative, Inc.

Ellsworth Cooperative  
Creamery

Farmers Cooperative  
Creamery

FarmFirst Dairy Cooperative

First District  
Association

Foremost Farms USA

Land O'Lakes, Inc.

Lone Star Milk Producers

Maryland & Virginia Milk  
Producers Cooperative  
Association

Michigan Milk  
Producers Association

Mid-West Dairymen's  
Company

Northwest Dairy  
Association

Prairie Farms  
Dairy, Inc.

Premier Milk Inc.

St. Albans Cooperative  
Creamery, Inc.

Scioto County Cooperative  
Milk Producers' Association

Select Milk Producers

Southeast Milk, Inc.

Swiss Valley Farms Company

Tillamook County  
Creamery Association

United Dairymen of Arizona

Upstate Niagara  
Cooperative, Inc.

Zia Milk Producers, Inc.

Filed via Commission Web site: <http://comments.cftc.gov>.

February 10, 2014

Melissa Jurgens, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street NW.  
Washington, DC 20581

Re: RIN number 3038-AD99: 17 CFR Parts 1, 15, 17, 19, 32, 37, 38, 140, and 150,  
Position Limits for Derivatives; Proposed Rule, **Federal Register** / Vol. 78, No. 239 /  
December 12, 2013, and

Dear Ms. Jurgens:

This letter contains comments by the National Milk Producers Federation in response to the Federal Register notice of December 12, 2013 regarding the Proposed Rule for Position Limits for Derivatives and the Federal Register notice of November 15, 2012 regarding Aggregation of Positions. The National Milk Producers Federation, based in Arlington, VA, develops and carries out policies that advance the well-being of dairy producers and the cooperatives they own throughout the United States. The members of NMPF's cooperatives produce the majority of the U.S. milk supply, making NMPF the voice of more than 32,000 dairy producers on Capitol Hill and with government agencies.

The U.S. dairy industry has developed a growing array of risk management mechanisms over the past quarter of a century in response to the growing volatility of prices for milk and dairy products. Figure 1 below shows the monthly average price of all milk sold by dairy farmers throughout the United States to manufacturing plants since 1980. This price represents not only the major portion of dairy farmers' gross incomes – 88 percent in 2012 according to cost of milk production analysis by USDA's Economic Research Service – but also the largest cost item for the nation's processors and manufacturers of dairy products. During 2013, the price of milk, and the price of milk components that are reflected in this price, represented 79 percent of the wholesale price of natural cheese, 86 percent of the wholesale price of butter, and 52 percent of the retail price of fluid whole milk. The growing volatility of this key price indicator over this period stems from a variety of sources. During the 1980s and early 1990s, the

role of federal farm policy in the form of the dairy price support program was significantly reduced. In the past decade, substantial increases in prices of feed grains and hence the cost of dairy feed, coupled with increasing exposure of the U.S. industry to world dairy market forces, as U.S. dairy product exports grew from the equivalent of about six percent of national production ten years ago to nearly 16 percent in 2013, have increased milk price volatility even more.

The most important risk management tools developed to address this growing price volatility have been the CME Group futures and options contracts for Class III milk, one of the 28 Core Referenced Futures Contracts specifically included in this rulemaking, and also those for Class IV milk, cheese, butter, nonfat dry milk and dry whey. Use of milk futures contracts has grown in recent years, as has the associated use of swaps, but they are still at a relatively early stage of development in contrast with those of longer standing for other commodities, such as corn and soybean meal. Increased liquidity for milk contracts, which would be provided by greater speculative participation in them, would greatly increase their value and effectiveness as risk management tools for dairy industry stakeholders. The need for increased speculative interest, coupled with several features that are unique to dairy futures and options contracts, make it critical that position limits imposed on them not be overly restrictive. **In particular, the proposed spot month, single month and all-months-combined position limits, established using methodologies appropriate for other commodity contracts, are overly restrictive for dairy.**

One of the most important features that distinguish dairy futures and options contracts, and the Class III milk contracts in particular, from those for other commodities, is that the former are all cash-settled. This results, in practice, with the vast majority of such contracts being held until maturity. Figures 2, 3 and 4 below contrast the patterns of open interest for the Class III futures contracts with those for the corresponding futures contracts for corn and soybean meal for three different contract months in 2013. Each of these charts begins with the trading day on which one of these three contracts first achieves its maximum level of open interest and continues through settlement. While open interest for the delivery-settled corn and soybean meal futures contracts drops to less than one percent of their respective maxima prior to settlement, open interest in the May, September and December 2013 Class III futures contracts was 77 percent, 79 percent and 96 percent, respectively, of their maxima on their respective settlement dates.

The Class III milk futures and options also settle to a fully-transparent price that is calculated and announced monthly by USDA's Agricultural Marketing Service. The announced Class III price is determined using the following product price formulas:

$$\text{Class III Price} = (\text{Class III skim milk price} \times 0.965) + (\text{Butterfat price} \times 3.5).$$

Class III Skim Milk Price = (Protein price x 3.1) + (Other solids price x 5.9).

Butterfat Price = (**Butter price** – 0.1715) times 1.211.

Protein Price = ((**Cheese price** – 0.2003) x 1.383) + (((**Cheese price** – 0.2003) x 1.572) – Butterfat price x 0.9) x 1.17).

Other Solids Price = (**Dry whey price** – 0.1991) times 1.03.

The prices for cheddar cheese, butter and dry whey used to determine the announced Class III price are collected through reports under the Dairy Product Mandatory Reporting Program. Under this program, reporting of prices and sales volumes is mandatory by industry participants who make sales of these dairy products, and reported sales volumes represent a substantial portion of all such products sold.

These factors make it extremely difficult for any trader to distort the underlying dairy product price series that serve as the basis of cash settlement for Class III milk futures and options contracts, especially through the action of taking large open interest positions in the Class III milk contracts themselves. This is amply supported by empirical evidence. Figures 5, 6 and 7 below show the daily settlement prices for all twelve Class III milk futures contracts in each of the calendar years 2011, 2012 and 2013, respectively, together with the announced Class III milk price to which they settle (indicated by the date of announcement). The charts, which begin a few months before the respective calendar years, show that, despite substantial variation in the daily settlement prices over the life of an individual Class III milk futures contract, those contracts all exhibit a very stable convergence to the announced Class III milk price during the spot month.

Figure 8 below shows this spot month convergence specifically. It shows the daily settlement prices for all 36 Class III milk futures contracts during 2011-2013 during the final 22 trading days for each contract, encompassing the trading days of all respective spot months, with the daily settlement prices expressed as a percentage of the respective announced Class III milk price. The chart shows that the spot month daily settlement prices for all Class III milk futures contracts for the last three years have all been within just a few percentage points of the announced Class III price to which they settle. The chart shows no evidence of any sudden or unreasonable fluctuations or unwarranted changes in spot month pricing behavior for any of these contracts.

In addition to these considerations, many of the member cooperatives of the National Milk Producers Federation offer risk management programs for their dairy farmer members. Under these programs, individual dairy farmers who wish to manage the risk to which their gross incomes are exposed can contract with their cooperative on an individual, voluntary

basis to be paid a stable price for the milk they deliver to the cooperative over a period of their choice. The cooperative accomplishes this by taking offsetting Class III milk futures positions on these milk volumes. In the course of conducting its risk management program operations, the cooperative can end up with sizeable positions in the Class III milk futures, options or associated swaps contracts. However, the cooperative acts in such instances as a passive bundler of positions initiated by its members' requests and as a bona fide hedger on their behalf; the cooperative does not pursue an independent, self-initiated trading strategy on behalf of its farmer members.

### **Class III Milk Spot Month Limits**

In light of the preceding discussion, the National Milk Producers Federation considers the initial spot month limits in proposed appendix D to part 150 of 1,500 contracts for Class III milk to be too low. As a minimum, NMPF recommends an initial spot month limit of twice this amount, based on the proposed use of its same formula for limits for physical delivery-settled and look-alike cash-settled contracts. In this case, a minimum spot month limit of 3,000 contracts would equate to 1,500 contracts for cash-settled futures and options and 1,500 contracts for swap equivalents, which are included in the proposed position limits. In addition, NMPF supports the proposed alternative spot month limit based on 25 percent of deliverable supply, if this results in a higher spot month limit than 3,000. The Commission estimates this limit at 5,300 contracts, based on a July 1, 2013 estimate by the CME Group of deliverable supplies of Class III milk. This limit meets the criterion of being larger than the recommended minimum of 3,000 contracts. However, the proposed updating of estimated spot-month deliverable supplies no less frequently than every two calendar years, together with the lack of explanation of the methodology used by the CME Group to make its 2013 estimate, and the lack of clarity as to whether this methodology would be used to make updated estimates in the future, with similar results, prevents NMPF from giving unqualified support to this alternative as the sole criterion for establishing spot month limits for Class III milk contracts.

### **Class III Milk Single-Month and All-Months-Combined Limits**

The Commission proposes to establish initial single, non-spot month and all-months-combined position limits using the 10/2.5 percent of total open interest formula, resulting in a limit of 3,400 for Class III milk contracts, based on calendar year 2011 and 2012 open interest in Class III milk futures, options and swaps. These levels are proposed to be updated at least every two years. While 3,400 contracts could be an appropriate limit for a single non-spot month, it would be far too restrictive as an all-months-combined limit. A preferable alternative that would be appropriate for Class III milk contracts in light of the

foregoing discussion would be to establish the limit for any single non-spot month equal to the spot month limit recommended above and to establish the all-months-combined limit equal to 24 times this spot month/single non-spot month limit, for the 24 monthly Class III milk contracts that are traded at any given time.

**Five-day Rule**

Class III milk contracts should not be required to meet the five-day rule, as proposed. This rule is only appropriate for physical delivery contracts, to prevent excessive speculation as such a contract nears expiration. The cash-settled Class III milk contracts, as discussed above, have no need of such restrictions, which would severely deprive the market for such contracts of sufficient liquidity for bona fide hedgers.

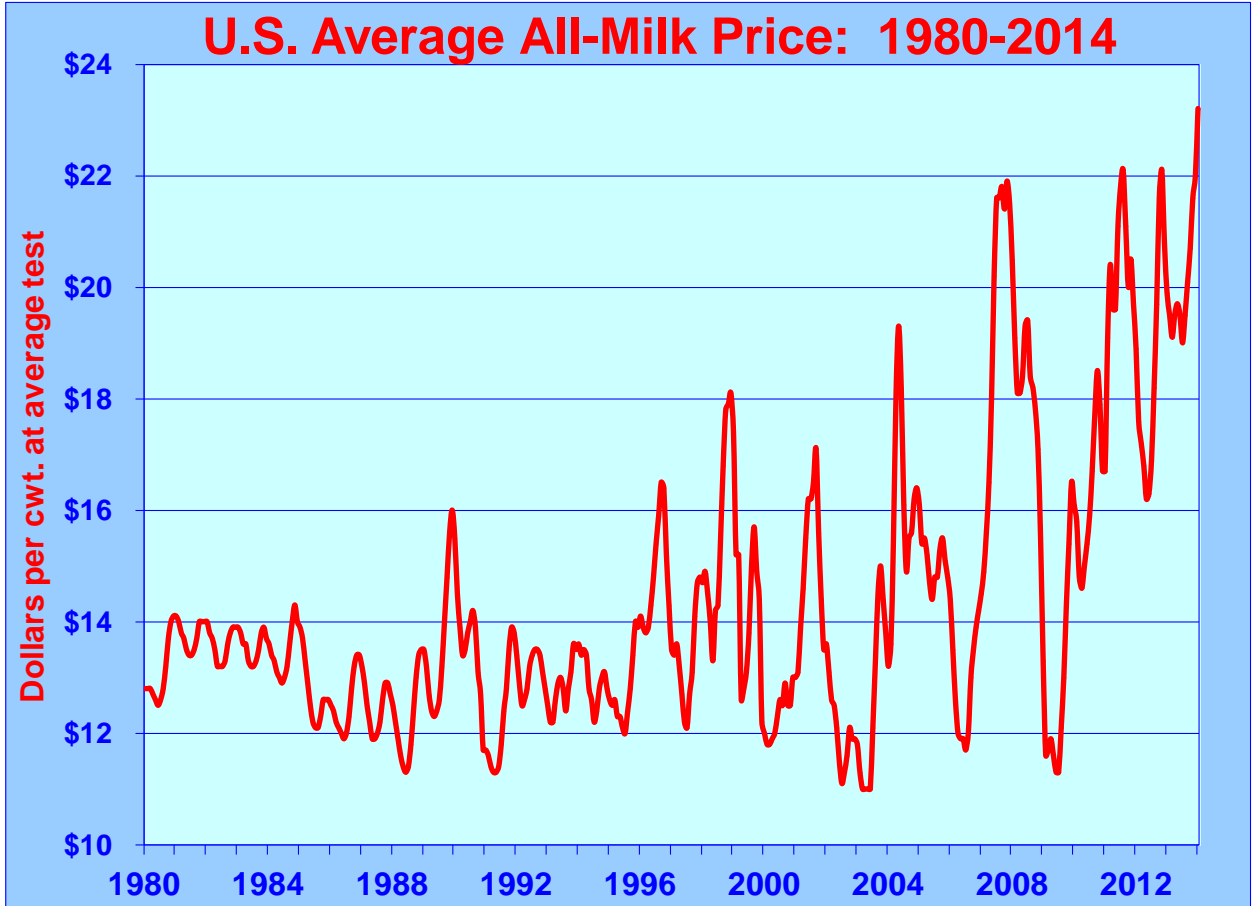
The National Milk Producers Federation appreciates this opportunity to make its views known to the Commission on these important issues.

Sincerely,

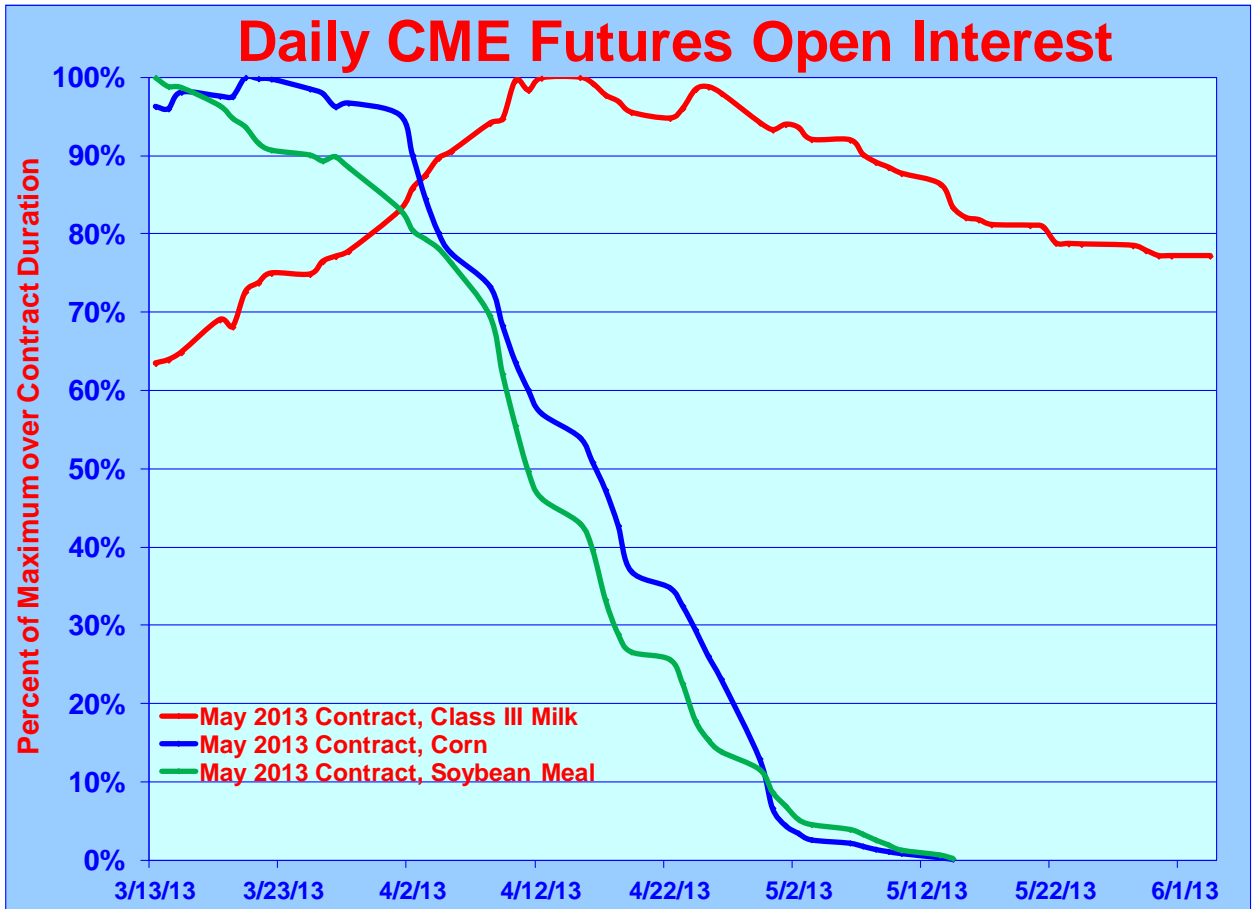
A handwritten signature in black ink, appearing to read "Jim Mulhern". The signature is fluid and cursive, with the first letter "J" being particularly large and stylized.

Jim Mulhern  
President and CEO

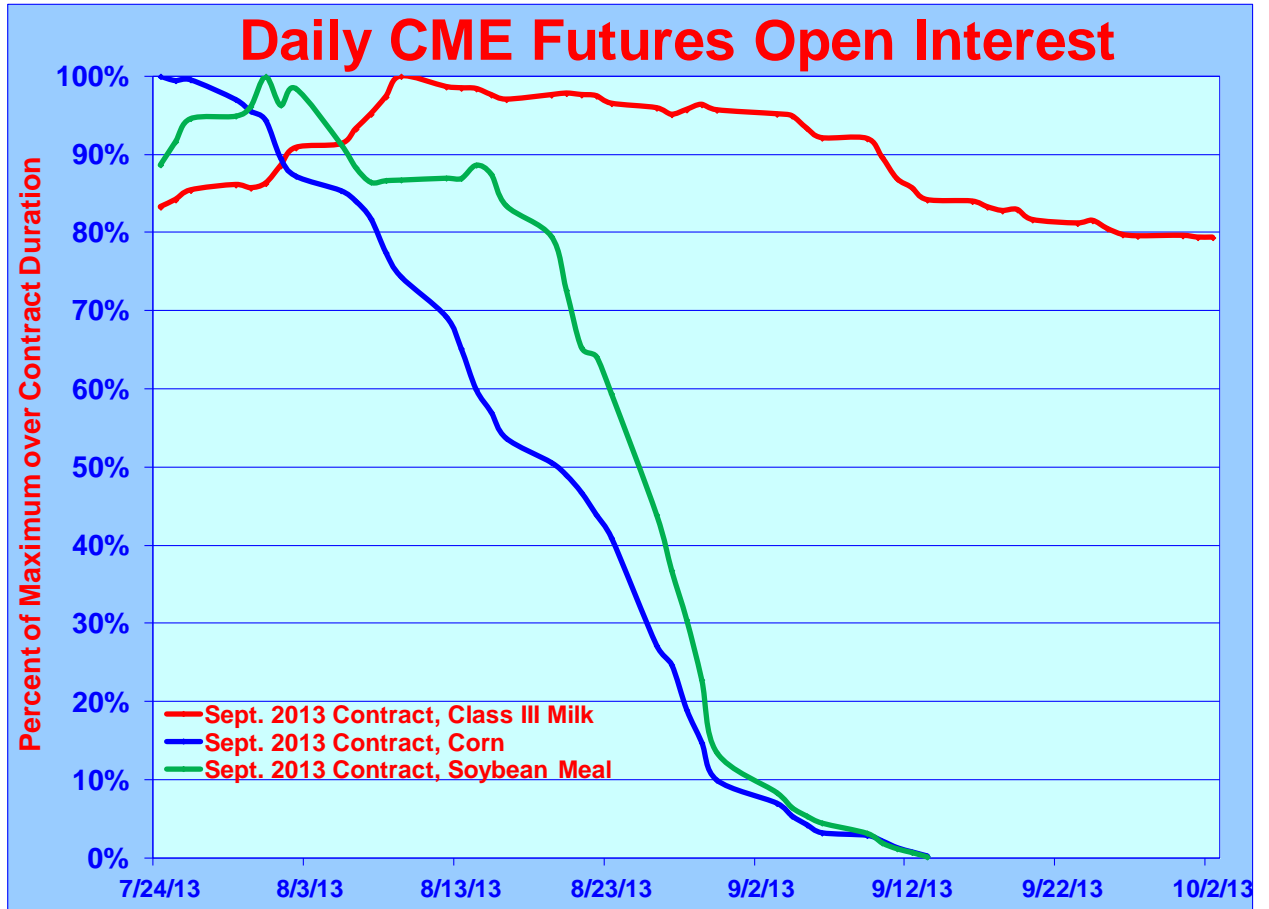
**FIGURE 1. INCREASING VOLATILITY OF U.S. MILK PRICES**



**FIGURE 2. OPEN INTEREST FOR MAY 2013 FUTURES**

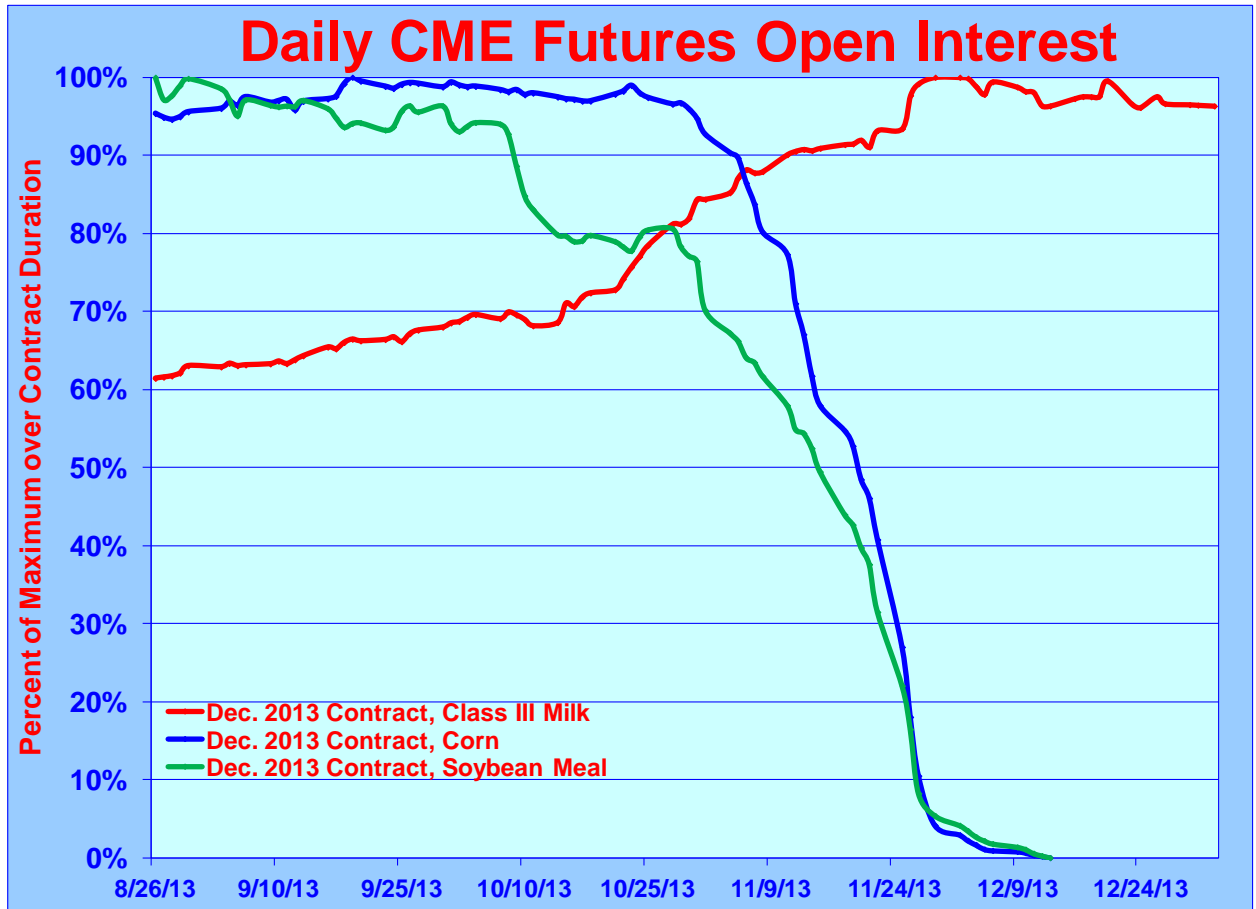


**FIGURE 3. OPEN INTEREST FOR SEPTEMBER 2013 FUTURES**

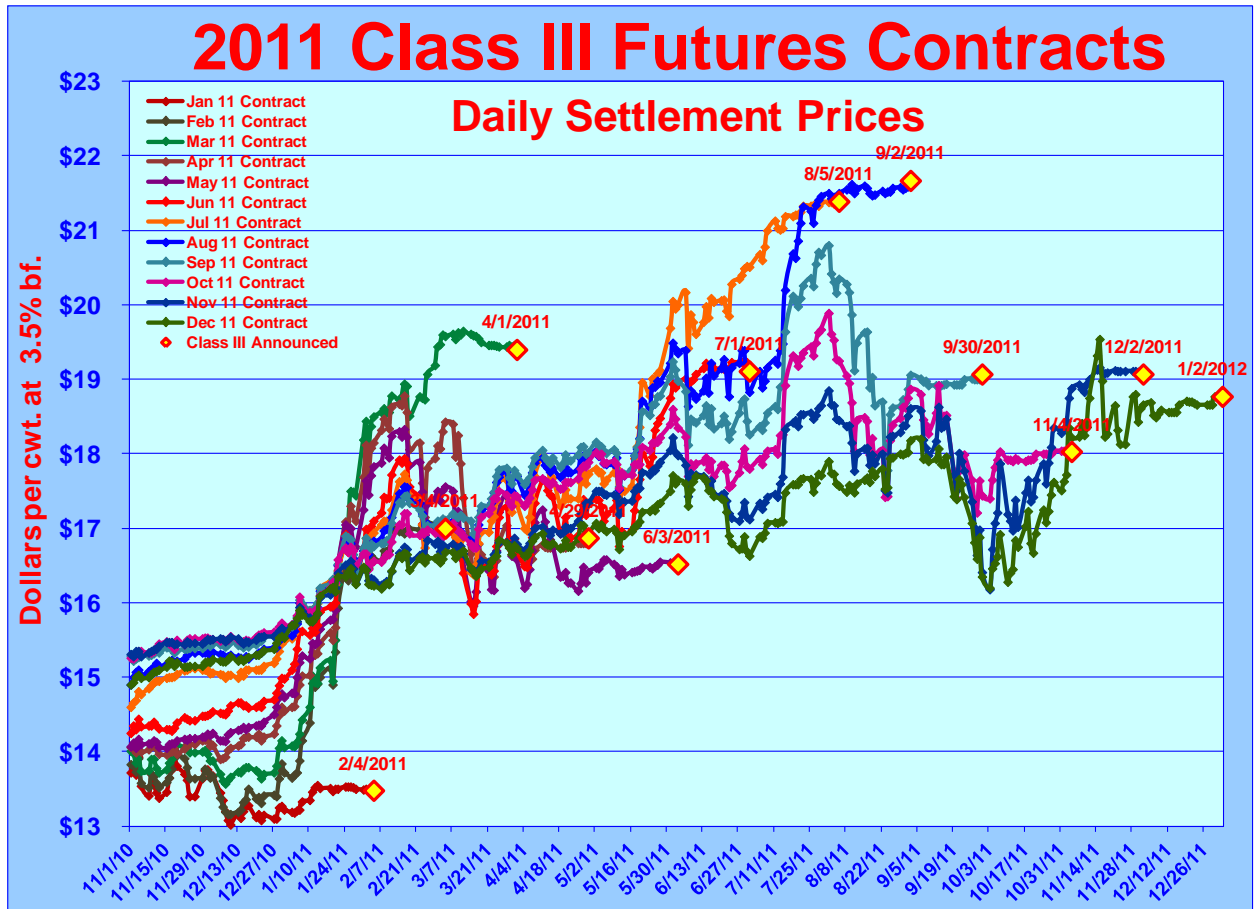




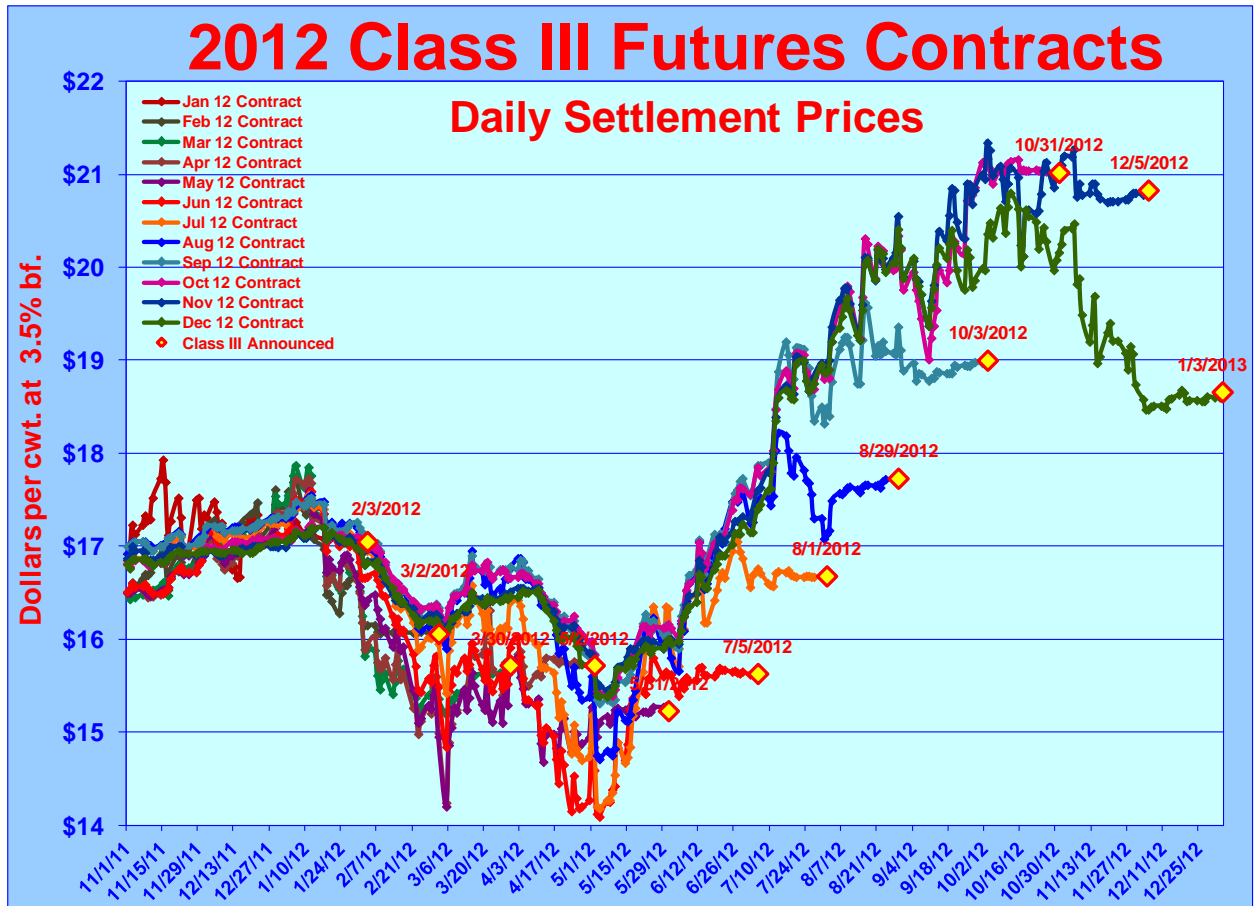
**FIGURE 4. OPEN INTEREST FOR DECEMBER 2013 FUTURES**



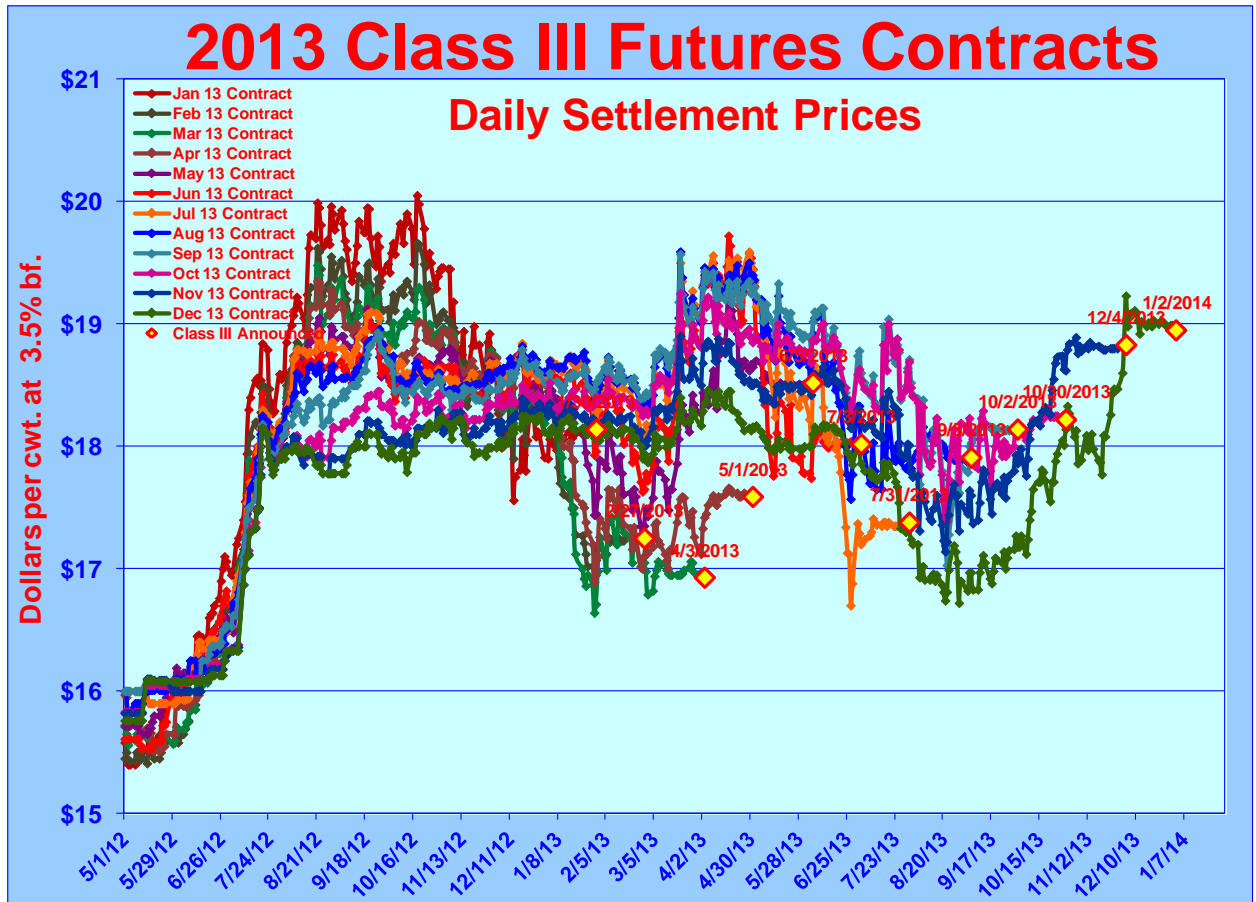
**FIGURE 5. DAILY SETTLEMENTS, 2011 CLASS III FUTURES**



**FIGURE 6. DAILY SETTLEMENTS, 2012 CLASS III FUTURES**



**FIGURE 7. DAILY SETTLEMENTS, 2013 CLASS III FUTURES**



**FIGURE 8. DAILY SPOT MONTH SETTLEMENT PRICES, 2011- 2013 CLASS III FUTURES**

