AMERICAN FARM BUREAU FEDERATION®
600 Maryland Ave. SW | Suite 1000W | Washington, DC 20024

ph. 202.406.3600
f. 202.406.3606
www.fb.org

February 10, 2014

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

Re: Position Limits for Derivatives, RIN 3038–AD99

Dear Ms. Jurgens:

The American Farm Bureau Federation (AFBF) appreciates the opportunity to provide input to the Commodity Futures Trading Commission (CFTC) on this proposed rule. AFBF represents a broad section of more than 6 million member families engaged in every type of production agriculture. Many of our members produce grains, livestock and other commodities that utilize the futures market, both directly and indirectly, for two critical purposes – risk management and price discovery.

Farm Bureau members rely on convergence of cash and futures in agricultural futures markets to facilitate risk management and risk management strategies. It is important to note that these strategies are not structured as an investment or as a speculative tool; rather, farmers and ranchers use futures markets to manage business risk. As such, they rely on a consistent and predictable approach to bona fide hedging and position limit policy decisions made by the CFTC.

Bona Fide Hedging

The current definition of bona fide hedging and CFTC's interpretation of that definition have worked well for many years. Fundamentally, we see no compelling need to rewrite the definition now. Changes in the definition itself and changes in the way it is interpreted by the CFTC would have far-reaching consequences for bona fide hedgers in agriculture. As noted at the outset of this letter, long-standing business practices and capital investment decisions have been made under current bona fide hedging rules. We urge CFTC not to constrict what has been the industry's and the CFTC's historical understanding of what constitutes bona fide hedging.

However, it appears that the proposed rule would do just that. At the least, it creates a significant lack of clarity about CFTC's intentions toward U.S. agriculture. At worst, it could invalidate as bona fide hedges a number of very common types of agricultural hedging transactions. In turn, such action likely would lead to a markedly reduced ability for grain elevators, feed manufacturers, processors and other businesses to hedge their physical commodity risk and force grain and oilseed purchasers to reduce bids to farmers and limit the risk management programs that can be offered to farmers and ranchers.

Under the proposed rule, we fear that a number of common hedging transactions used for agricultural business risk management, but not enumerated in the proposal, could be put at risk under the proposed rule are listed here. Among these transactions would be:

- pre-setting futures spreads;
- hedging basis contracts
- hedging delayed-price purchases;
- hedging unpriced sales contracts;
- cross-hedging; and
- anticipatory hedging.

This rulemaking re-opens issues that we believe were resolved two years ago during CFTC's previous rulemaking on position limits. In essence, discussions with CFTC led us to believe that we could continue to rely on CFTC's consistent, historical interpretation of bona fide hedging rules. Now, it appears that CFTC for some unexplained reason is proposing to roll back – or at least force a rehashing of – previous CFTC statements. Notwithstanding the fact that the previous final rule has been vacated, AFBF respectfully suggests that CFTC should stand by its previous assurances. We believe strongly that the intent of Congress in passing Dodd-Frank was to "preserv(e) the use of derivatives for end users to hedge price risks associated with their businesses."

Anticipatory Hedging

A comment specific to anticipatory hedging of grain is merited. Grain merchandisers serve the critical function of providing liquidity for producers and end users of grain. Merchandisers provide a market when our producers want to move grain, including during harvest or when prices are favorable, and end users are not interested in buying. They have stored supplies when end users need grain and producers are not interested in selling. The current role of the merchandiser allows for the management of price risk at both ends of the supply chain. The current proposal would harm the participants it claims to protect by preventing grain merchandisers from hedging "anticipated" transactions.

Anticipatory hedging is a specific exemption allowed by the Commodity Exchange Act as amended by Dodd-Frank. Anticipated merchandising hedges, and hedges for legitimate commercial users to hedge unfilled storage, need to be fully recognized as bona fide hedges in the final rule. This would merely affirm CFTC's recognition of anticipated hedging as bona fide hedging, consistent with CFTC and industry interpretation for many years.

Bona Fide Hedging – Conclusion

The proposed rule errs in attempting to define bona fide hedging for <u>all</u> entities – across widely disparate markets, participants and contracts – by enumerating specific types of transactions and excluding others. In effect, the proposal draws lines around certain risk management practices and supposes that transactions "outside the box" must not be bona fide hedges. This treatment is unnecessarily rigid and narrowly drawn. If adopted, it would preclude from bona fide hedging status many common transactions in the grain industry that have been utilized with CFTC's

blessing for many years. In a final rule, CFTC must allow for flexibility for market participants and for common sense based on years of consistent interpretation and business practices.

Speculative Position Limits

Federal speculative position limits have been in place for the enumerated agricultural commodities for many years. They are a very important element of properly functioning contracts for wheat, corn, soybeans and other enumerated commodities.

AFBF appreciates the difficult task facing CFTC as it seeks to establish reasonable position limits for a wide range of diverse commodities and markets. We believe strongly that a "one size fits all" approach is unlikely to provide the right solution for commodities as diverse as energy, metals, financial products and agricultural commodities. Even within the agricultural commodities, the enumerated commodity markets display characteristics different from other agricultural commodities. We urge the Commission to recognize these unique characteristics – functionally and in terms of market size and participants.

Conditional Spot-Month Limit

AFBF believes that maintaining the current, so-called "legacy," speculative position limits is the correct first step for CFTC, particularly in the spot month. There is no appreciable support within our industry or, as far as we know, from the relevant exchanges to move beyond current levels. To the contrary, much time has been spent in recent years on revisions to contract terms – especially the CBOT and KCBT wheat contracts – to help ensure that convergence occurs consistently. CFTC itself established within the Agriculture Advisory Committee a convergence subcommittee, on which an Illinois Farm Bureau member served, to review the extreme lack of convergence across many contracts, particularly during times of significant price volatility. Changing current limits, as proposed in the rule, will have a negative impact on futures-cash market convergence and will compromise contract performance.

All Months Combined Limit

AFBF is concerned that proposed all months combined limits for enumerated agricultural commodities based on open interest levels could lead to contract performance issues if not properly considered. The truly appropriate question for CFTC and stakeholders to address: Are we sure, at any given level of position limits, that futures markets are performing their price discovery and risk management roles adequately for traditional market participants who rely on futures for the fundamental purposes of price discovery and risk management?

With that test in mind, AFBF is concerned that too-large position limits in the non-spot months could lead to a repeat of convergence problems experienced by certain contracts. A review of proposed all-months limits in the CFTC proposal again reveals some very large increases – as much as a 79% increase in soybeans and 62% in corn. Will those all months combined limits "telescope" down to spot-month levels in an orderly fashion to facilitate convergence? That is the analysis that AFBF would urge on the Commission prior to finalizing the rule. Again, we

would urge that DCMs be given flexibility to adjust federal speculative position limits downward when appropriate to specific commodities and futures contracts.

Furthermore, the imposition of all months combined limits in continuously produced non-storable commodities such as livestock and dairy will reduce the liquidity needed by hedgers in deferred months who often manage their risk using strips comprised of multiple contract months. The current exchange limits for livestock and dairy contracts that specify single month limits enable speculators to provide liquidity to hedgers and have worked well.

Wheat Contract Equivalence

The proposed rule breaks the longstanding CFTC policy of establishing the same limit for the three wheat futures contracts: CBOT soft red winter (SRW), KCBT hard red winter (HRW), and MGEX hard red spring (HRS). Varying limits could have unintended and undesirable effects in terms of competition among the contracts for growth and liquidity. If implemented, this change will reduce the competitiveness of the HRW and HRS contracts at a time when these markets are poised for strong growth due to changes in Canadian government policy related to marketing of milling wheat and the transfer of the HRW contract to the CBOT designated contract market.

In addition, end users actively trade spreads between these three classes of wheat to help discover price differentials for their different protein levels and milling characteristics. Different limits will reduce the liquidity available for these spreading transactions. We urge CFTC to remain consistent with historical practice in maintaining position limit equivalence across the three contracts.

Conditional Position Limits

AFBF opposes conditional position limits at 5X those for physically-settled contracts. We fear that a 5X limit in the spot month has the potential to skew price discovery in physically-settled contracts by artificially pushing liquidity out of physically-settled futures contracts. Worse yet, we fear that such a large conditional limit could create the opportunity for mischief and deleterious impacts on spot-month convergence if participants were allowed to hold cash-settled futures or swaps positions as large as 125% of a commodity's deliverable supply in the final trading days of the physically-settled contract.

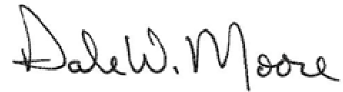
To our knowledge, only one contract currently utilizes the 5X position limit in the natural gas sector. There is no comparable contract for any of the enumerated agricultural commodities. There is no history to guide us, no data to analyze, and no track record at all in our markets. Based on this lack of information, we believe a 5X limit would be imprudent given the potential negative consequences.

Finally, it is unclear to us why cash-settled contracts should enjoy a material, government-imposed advantage over the physically-settled contracts that are so important to traditional hedgers.

Conclusion

AFBF appreciates the opportunity to provide input on the proposed rule and improvements that should be made to the final rule. We would be happy to respond to any questions, and we look forward to additional dialogue with CFTC on these critically important issues prior to publication of a final rule.

Sincerely,



Dale Moore
Executive Director
Public Policy