Grain Service Corporation

January 7, 2015

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

Re: Position Limits for Derivatives,
Federal Register Release: 79 FR 71973

Dear Ms. Jurgens:

Grain Service Corporation submitted a letter on this issue on February 10, 2014 and wishes to supplement that submission with additional comments. Some of the proposed changes to the definition(s) of hedging are especially troublesome and could potentially upend traditional risk-management strategies used by countless agribusiness firms.

Narrowly defining what strategies qualify as a hedge would be a reversal from the long-standing Commission approach that has assumed a broad interpretation. Market risk is dynamic rather than static and encompasses areas from price risk, spread risk, basis risk, logistics risk, to related commodity risks such as fuel costs, currency exchange rates and freight risk. Global export/import trade may look much different in the years ahead, processing and/or other domestic usage such as livestock feeding may change significantly, and a flexible approach will be needed in managing market risks.

Using exchange-traded futures and options as well as Over The Counter instruments to reduce and/or eliminate these evolving market risks has long allowed agribusiness firms to handle massive volumes on small margins and to adjust risk management strategies as conditions change.

The risk of freight costs has recently become a major concern for many US agribusinesses, for example, and in the future a new type of freight futures contract could be developed that allows shippers from country elevators to exporters to hedge such risk directly, or indirectly to reduce basis risk. Yet would the proposed definition of hedging allow for the use of a new tool such as freight futures for a country elevator whose basis risk is directly linked to freight costs?

Re Anticipatory Hedging: Elevators, terminals and other firms that buy, hedge, and hold inventories have long used pre-setting of futures carrying charges to manage spread risk – one of the biggest risks a country elevator operation faces each year. A grain elevator is in the business of buying from farmers, hedging, aggregating volumes, and reselling to end users and exporters.

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But grain that farmers sell at harvest may not be needed by consumptive buyers until months later. And futures carrying charges are not always at their peak at or after harvest or when farmer selling arises. Pre-setting carrying charges when favorable opportunities exist, allows the elevator to maximize revenue and remain competitive. To cite a real situation: In the spring/summer of 2014, the futures carry of July2014 against December 2014 CBOT wheat futures peaked at 37¢/bushel in June 2014, before harvest even began. By late June 2014 that futures carry had narrowed to 22¢. Forcing an elevator to wait until they actually buy the wheat to set a carry would have caused an elevator last summer to forfeit 15¢ per bushel of potential revenue for that 5 month period. Setting a futures carry before harvest is **not** speculative for an elevator that is in business to buy and hold inventory, providing the spread is done in a quantity proportional to the capacity and history of that business. An elevator in Tennessee or Ohio, for example, just weeks before wheat harvest is to begin, knows they will buy significant quantities of soft red wheat and will not be able to immediately ship all they buy at harvest. The firm could appropriately buy July CBT wheat futures and simultaneously sell CBT December wheat futures (as a spread) before harvest, and then sell the July futures as the firm buys wheat from farmers when harvest begins. The elevator would be left with fixed price company-owned inventory and short hedges in December wheat futures. Such a strategy also surely passes the current "Incidental" threshold ("*purpose of the position must be to offset price risks incidental to commercial cash operations*"; and *the position must be established and liquidated in an orderly manner in accordance with sound commercial practices* (the "Orderly Trading" requirement). The absence of a fixed price purchase *prior* to the spread transaction does not negate the risks this elevator faces at the onset of wheat harvest.

In this example, the elevator not only benefits from pre-setting a carry to reduce risk, but depends on being able to capture such opportunities. It may be 'anticipatory' but this example clearly meets the standard of a bona fide hedge. The pre-setting of the carry would be a "*temporary substitute", would be "economically appropriate", and "arises from the potential change in value of assets (the wheat the firm will buy)"*. The wheat will be moved into commercial channels later, so this anticipatory pre-setting of a futures carry is one part of the strategy being *"a substitute for positions taken or to be taken at a later time in a physical marketing channel."* If this elevator had not pre-set the futures carry, the firm would at some time have had to subsequently buy back July short wheat hedges and simultaneously sell December wheat futures, with the eventual outcome being exactly the same as via the anticipatory setting of the carry, only with the unfortunate outcome of less revenue/protection for the elevator in this example.

There are myriad detailed examples of how agribusiness firms utilize futures (and options) to manage risks – far too many to outline even in numerous letters. Writing any definition of hedging with enough specificity to address every current or future event or need that might arise is surely beyond the task of any Commission.

An unintended consequence of narrow language is that it may be interpreted that any use of futures/options outside that language will be deemed speculative. That carries other costs: The tax treatment of gains/losses of futures & options is very different for hedges versus speculative trades. The Initial Margin requirements for hedging are typically much lower than for speculative trading. A very narrow definition of hedging will add unquantifiable costs to businesses and could have the unintended consequence of discouraging smaller firms from hedging at all, or could give rise to large companies creating new off-exchange cash market contracts that would serve as

surrogate ways to manage risks that seemingly no longer qualify as bona fide hedges. **A workable, broad definition of hedging is not critical as a means to circumvent speculative position limits for most market users, but as a way to stay within the umbrella of hedge margins and/or tax treatment. Very few commercial agricultural hedgers will hold net positions that even approach speculative position limits, and therefore the Commission concerns over the nuances of the definition of hedging seem misplaced – especially so given the problems that will result as described herein.**

Also worrisome is the question posed in the Proposed Rule: *"Under the proposal for hedges of physical commodities, additional enumerated hedges could only be added to the proposed definition of bona fide hedging positions by way of notice and comment rulemaking. Should the Commission adopt, as an alternative, an administrative procedure that would allow the Commission to add additional enumerated bona fide hedges without requiring notice and comment rulemaking?"* Requiring 'notice and comment rulemaking' in every potential hedging strategy is unworkable and would be a drain on Commission resources. Businesses would face the prospect of being guilty until proven innocent if they try new strategies.

The stated intent of the Dodd-Frank legislation was not to tie the hands of businesses that depend on using futures and options to reduce risk and manage market exposure. And Dodd-Frank was not intended to drive business risk-management off-exchange. We respectfully encourage the Commission to revise the proposed language and return to the long-standing broader interpretation of hedging that has been workable for decades in agricultural contracts.

Respectfully

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