July 13, 2016

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street NW
Washington, DC 20581

RIN: 3038-AD99

Dear Mr. Kirkpatrick:

Dairy Farmers of America (DFA) offers the following comments, regarding the Position Limits for Derivatives rule, on behalf of its more than 13,000 members operating dairy farms from Maine to California. As America's leading dairy cooperative, DFA is a diversified milk marketer, dairy food and ingredient manufacturer and farm services provider. A key member service is DFA Risk Management which offers forward contracting programs to assist members to protect their profit margins by managing their milk and input price risk. We hedge the commercial risk of these programs by utilizing futures, options and over-the-counter derivatives. Additionally, DFA offers forward contracting services to our commercial customers purchasing milk and dairy products. We also utilize derivatives to de-risk the operations of DFA's 41 milk processing and manufacturing plants.

Bona fide Hedge Considerations

DFA is generally supportive of designated contract markets (DCMs) and swap execution facilities (SEFs) having a greater responsibility in assisting the CFTC monitor adherence to rules implemented to conform the Commodity Exchange Act to the requirements of the Wall Street Transparency and Accountability Act of 2010 ("Dodd-Frank Act"). The recent supplemental notice of proposed rulemaking relative to Position Limits for Derivatives: Certain Exemptions and Guidance (FR Vol 81, No. 113, Monday, June 13, 2016) is a step in the right direction. Additionally, we are supportive of the wider latitude provided in the Section 150.1 definition of bona fide hedging positions.

In the final rule, we suggest providing DCMs and SEFs additional latitude to reduce the overall regulatory burden on them and on the bona fide hedgers they support, to broaden the types of bona fide hedge transactions that fit the definition – reducing the need of non enumerated exemptions and to recognize the distinct differences in Class III derivatives.

DFA suggests that the CFTC be more of an auditor of the non enumerated bona fide hedge exemption determinations made by DCMs and SEFs. The proposed structure is more of a clerical

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facilitation process. To best utilize overburdened CFTC resources and to assure resources are properly deployed to meet the ultimate missions of the Commodity Exchange Act and the Dodd Frank Act, we suggest an audit process to determine if appropriate exemptions are being made as opposed to a CFTC review of each and every exemption. The audit process will allow you to focus on your most significant concerns and provide a mechanism to partner with the DCMs and SEFs in addressing any regulatory concerns resulting from the exemption.

We are also concerned about additional and potentially burdensome reporting in order to qualify for a bona fide hedge positon, in some cases. Undoubtedly, there will be some transactions that, at present, qualify as a bona fide hedge, but under the proposed rules – will not. Additional reporting requirements emanating from an ensuing non enumerated bona fide hedge exemption may result in added costs and burdens that heretofore had not existed for those particular transactions.

Your purview of the regulatory needs is far greater than ours, and we recognize there may be transactions that will no longer meet the bona fide hedge definition without the more burdensome non enumerated bona fide hedge exemption. However, we suggest that some of the burden can be reduced by broadening the bona fide hedge definition to fit more transactions. If there is a narrowing of the bona fide hedge definition from its current state, resulting in fewer transactions meeting the definition, it would be appropriate to broaden the speculative limits to compensate. Allowing a larger amount of transactions to fit under the speculative limits may partially reduce some of the new reporting burden upon an entity that may lose bona fide hedge status for some transactions under the new rules.

As we have commented before, farmers and agricultural cooperatives were not the cause of market disruptions leading to the passage of the Dodd-Frank Act. Since its passage, we have been your allies in developing workable regulations to help the CFTC meet its Dodd-Frank Act mandates. We continue to be concerned about regulatory costs and burdens that emanate from the Dodd-Frank Act. Changing bona fide hedge status in legacy agricultural and other agricultural core referenced contracts that increase cost and burden on farmers and agricultural cooperatives seems like an unnecessary regulatory reach. This is especially at issue for Class III which has not heretofore had a Federal position limit.

Dairy is Different than Other Commodities

From the beginning, we have been concerned of a one size-fits-all regulatory approach to meeting the Dodd-Frank Act requirements. Your approach has been to develop Dodd-Frank-related regulations similar to those used for a small number of agricultural commodities that currently have Federal position limits. We continue to believe that a one-size-fits-all approach is not in the best interest of the US dairy industry. Our futures and options contracts are significantly different than most other agricultural commodities and their use differs as well. As such, their Federal regulation should differ.

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The following highlight some major differences between Class III and other core-referenced contracts.

- Class III futures and options are not physically delivered contracts but cash settled.
- Class III futures prices do not determine cash prices – differently, it is the cash price as determined by the United States Department of Agriculture that the Class III futures price settles against.
- Class III futures and options trade on a monthly basis.
- They are listed for 24 consecutive months.
- There is no such event as a "crop year" as milk is produced and marketed daily.
- Milk is not stored on a farm for more than three days due to its perishability.
- Significant asset investment is required to change milk from a perishable to storable product.
- Open interest is vastly smaller than the commodities that currently have Federal position limits.

The transactional use of futures and options is different as well. The following table depicts Class III and corn open interest on July, 11, 2016. It highlights the usage difference between the two cooperatives and presents a picture of some of the differences described above.

CME Group Futures and Options Open Interest for Class III Milk and Corn upon Settlement on July 11, 2016

Class III Milk

Contract Month	Calls	Puts	Options Total	Futures	Options as % of Futures
Jul 16	6,466	7,155	13,621	5,391	253%
Aug	5,187	5,756	10,943	4,563	240%
Sep	4,431	5,544	9,975	3,961	252%
Oct	4,075	3,847	7,922	3,429	231%
Nov	4,244	3,777	8,021	3,142	255%
Dec	3,819	3,628	7,447	2,777	268%
Jan 17	1,134	1,556	2,690	1,133	237%
Feb	1,075	1,506	2,581	969	266%
Mar	1,086	1,446	2,532	917	276%
Apr	1,123	1,137	2,260	847	267%
May	1,121	1,146	2,267	718	316%
Jun	774	991	1,765	618	286%
Jul	221	167	388	193	201%
Aug	169	161	330	194	170%
Sep	189	165	354	171	207%
Oct	156	137	293	170	172%
Nov	158	135	293	163	180%
Dec	181	151	332	187	178%
Jan-Apr 18				16	0%
Total	35,609	38,405	74,014	29,559	250%

Corn

Contract Month	Calls	Puts	Options Total	Futures	Options as % of Futures
Jul 16				720	0%
Aug	152,853	85,285	238,138		N.A.
Sep	268,727	172,706	441,433	539,207	82%
Oct	8,088	4,631	12,719		N.A.
Dec	333,275	294,217	627,492	516,735	121%
Mar 17	42,578	34,887	77,465	104,904	74%
May	3,553	2,555	6,108	25,167	24%
Jul	7,447	12,727	20,174	62,941	32%
Sep	281	290	571	11,969	5%
Dec	13,094	6,693	19,787	34,914	57%
Mar 18			0	1,681	0%
May			0	523	0%
Jul	423	327	750	623	120%
Sep			0	325	0%
Dec	201	94	295	1,229	24%
Jul 19			0	49	0%
Dec			0	98	0%
Total	830,520	614,412	1,444,932	1,301,085	111%

Data Source: CME Group

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The use of option strategies is a more important transactional process in Class III than in corn. This is shown by the columns Options as % of Futures. For Class III, options open interest in most months is 240 – 300 percent of the open interest in futures. For the December 2016 corn contract, options are 121 percent.

Dairy hedgers make significant use of options strategies. As examples:

1) A typical strategy for a dairy farmer is to buy a put and sell a call at a higher strike price and in the same month. This allows them to purchase a more affordable floor on their milk price – protecting a known margin over feed costs or margin over total costs, keeping the strategy's cost within their risk management budget by selling the call and thereby limiting how high their milk price will rise – or limiting how much profit they might make.
2) Another typical strategy is to lock in the milk price and their margin by selling futures but, knowing of the significant volatility in milk prices, choosing to perfect the strategy by buying a call at a strike price in excess of their locked-in position, in the same month as their locked-in position, in order to improve their profit if global fundamental factors drive prices to record highs – as seems to occur every three or four years.
3) As the futures market provides pricing opportunities, it is common for dairy farmers to execute hedge transactions 18 or months in advance of producing the milk.

DFA and its members execute forward contracts that include these strategies. To protect our price risk from these contracts, we execute bona fide hedge transactions in futures, options and over-the-counter derivatives.

Cheese manufacturers utilize similar strategies as illustrated above, but would take the opposite transaction positions. Manufacturers will also take transactions to protect their inventory. In some cases, this may entail locking in the purchase of milk in one month, months ahead of buying the milk by using a long futures in anticipation of buying the milk, and protecting their inventory by taking a short futures position in a later month when they anticipate selling their product.

These are a few examples of normal every day hedging transactions that occur in the US dairy industry and used by dairy farmers, manufacturers, end users and dairy cooperatives like DFA. Due to the use of these strategies and there prevalence, there should not be regulatory restrictions impeding there use or requiring additional and burdensome reporting.

Spot Month and Five-Day Rule

Although Class III is a physical commodity, the futures contract is not a physical futures contract. Instead, it is a cash-settled futures contract. Most Class III futures and options transactions are held until final settlement due to the ease of the cash settlement process and the "perfection" of the

hedge. As such, requiring Class III transaction reductions or other limitations, or a prevention of holding cross hedge positions in the spot month or during the last five days, would likely harm convergence, create price volatility and add risk and cost to bona fide hedge transactions. We do not believe that the proposed rule subjects Class III to these limitations. We also do not believe that cash-settled swaps are subject to these limitations. However, if our interpretation is incorrect, we request that it be exempted from spot month and five-day rule regulations.

Reporting Positions Held in the Spot Month

For Class III futures, option and cash-settled swaps, additional reporting of positions held in the spot month is unnecessary and would result in a reporting burden with no beneficial outcome. Since there is no physical futures delivery in Class III derivatives, there are no concerns with issues that may arise in the spot month as there may be with physically delivered derivatives.

Definition of Actively Traded

From the table above, Class III futures and options open interest is about 3.8 percent of corn open interest. In fact, open interest in the nearby month for corn dwarfs the entire open interest for all 24 months of Class III.

Since dairy futures and options have a lower daily trading volume than many other agricultural futures, we would be concerned that a definition of actively traded that included a daily volume de minimis may exclude Class III and, later on as the position limits rule is expanded, other dairy contracts. Due to this, we would recommend that if a daily volume de minimis is utilized that it be a very low threshold. Again, with our concern of a one-size fits-all approach, a de minimis may be crafted that will work for Class III. Later on, as you expand your scope and set position limits on other milk and dairy derivatives, whose open interest may be significantly smaller than that for Class III futures and options, this may not work well.

Reporting of Non Enumerated Hedge Exemptions

From time-to-time, a novel idea may arise that results in a never before used transaction to mitigate commercial risk. Such a transaction may be considered an intellectual asset by the entity that devised it and the entity may like to protect it as a proprietary competitive advantage. If such were to occur, and the transaction did not meet the new bona fide hedge rule and an entity sought and was granted non enumerated bona fide hedge status for the transaction, the question arises as to whether the transaction should be described on a website or divulged to market participants in any format. In the case of a novel idea, the transmission of the transaction facts should be at the discretion of the entity that devised it.

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Timing of Implementation

As you move to your final rule and identify an implementation date, we encourage you to provide bona fide hedgers enough time to prepare for the forthcoming changes. To a degree, we are in a holding pattern until we have better knowledge and guidance about the status of transactions meeting the bona fide hedge definition or for the need to seek a non enumerated hedge exemption. We are concerned that the DCMs and SEFs may find themselves inundated with requests for exemptions. We ask that you take this into account when determining the amount of time allowed preparing for the new rules.

In closing, we appreciate your willingness to allow DCMs and SEFs a greater role in the regulatory structure and for clarifying and broadening the definition of bona fide hedge. As we move to the final rule, we ask that you generate an easier path for commercial hedgers to achieve bona fide hedge status on their transactions that reduces risk associated with their businesses. We are members of the National Milk Producers Federation and the National Council of Farmer Cooperatives. Each of these associations is submitting comments. We have assisted them in the development of their comments and are in support of the positions that they address.

As we focus on the dairy industry, we ask that your rules allow for the continued growth in Class III volume and open interest and that the regulatory regime supports increased liquidity even at the expense of uniform regulatory structure.

We look forward to our continued work with you both to develop the new rules and also to discuss issues that impact dairy and agricultural commodity derivative markets, as they arise.

Sincerely,

Edward W. Gallagher

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President, DFA Risk Management
a division of Dairy Farmers of America

More Cooperative.

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