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July 13, 2016

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

RE: Position Limits for Derivatives: Certain Exemptions and Guidance. Federal Register/Vol. 81, No. 113/June 13, 2016 (RIN 3038-AD99).

Dear Mr. Kirkpatrick:

On behalf of the more than two million farmers and ranchers who belong to one or more farmer cooperative(s), the National Council of Farmer Cooperatives (NCFC)[1] submits the following comments in response to the Commodity Futures Trading Commission's (CFTC) supplemental notice of proposed rulemakings *Position Limits for Derivatives: Certain Exemptions and Guidance* (RIN 3038-AD99).

NCFC member organizations appreciate CFTC's efforts to take the agriculture industry's views into account as it makes modifications to its initial December 12, 2013 Proposed Rule, Position Limits for Derivatives. NCFC's earlier submissions to that proposal, dated February 10, 2014, and August 4, 2014, can be viewed at: (http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59613&SearchText=); and (http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59942&SearchText=Farmer%20Cooperatives).

I. Introduction

NCFC members represent a broad section of the agriculture industry. Many NCFC members rely on the derivatives markets – both exchange-traded futures and options, and over-the-counter products – to hedge the commercial risk inherent to agriculture production, processing and marketing. These cooperatives use derivatives to hedge the commercial risk of the commodities they supply, process or handle/merchandise; i.e. they have a physical interest in the underlying asset. As such, derivative transactions that cooperatives enter into have largely been recognized as bona fide hedges for the purpose of being exempt from speculative position limits.

[1] Since 1929, NCFC has been the voice of America's farmer cooperatives. Farmer cooperatives – businesses owned and controlled by farmers, ranchers, and growers – are an important part of the success of American agriculture. NCFC members include regional and national farmer cooperatives, which are in turn composed of over 2,500 local farmer cooperatives across the country. NCFC members also include 21 state and regional councils of cooperatives.

Throughout the Wall Street Transparency and Accountability Act of 2010 (‘‘Dodd-Frank’’) rulemaking process, NCFC has advocated for including broad exemptions for agricultural end users hedging their legitimate business risks. We have highlighted that while intended to address “excessive speculation” in the markets, certain provisions would inadvertently apply to cooperatives, grain companies, and many other end users whose hedging activities are legitimately being used to manage commercial risk. We appreciate CFTC taking into account a number of our previous comments, as well as publishing the Supplemental Notice to receive additional input as the Commission revises and finalizes the rule.

To ensure Dodd-Frank implementation achieves the goals of the law, while at the same time preserving the ability of end users to effectively hedge their risk, we outline several areas where we encourage the Commission to make adjustments in the final rule.

II. Bona Fide Hedging Definition

NCFC supports CFTC’s proposal to align the general definition of a bona fide hedging position with that in the Commodity Exchange Act (CEA) section 4a(c)(2) by eliminating the incidental test and the orderly trading requirement. We also encourage CFTC to consider the following:

A. Economically appropriate test

In the Supplemental Proposal, the Commission noted that "it interprets risk, in the economically appropriate test, to mean price risk." In our previous comments we discuss, and outline in detail, the common practice of using unfixed price contracts, or basis contracts, as not only an economically appropriate risk reducing activity, but one that should fall in the enumerated category. However, we continue to be concerned that such contracts, as well as fixing of unfixed forward contracts, may fall out of being considered a bona fide hedge given CFTC’s narrow interpretation of “economically appropriate.”

NCFC urges CFTC to broaden its interpretation of "economically appropriate" beyond hedges that address price risk. Playing a key role in physical marketing channels by connecting producers and consumers in different parts of the world, commodity merchants take significant risk by taking title to commodities, and assuming storage, transportation, and other variables. A merchant’s inability to adequately hedge those commercial risks may increase the merchant’s costs and ultimately raise the price to the consumer.

In addition, if CFTC interpretation further narrows the standard to only fixed-price risk, ultimately parties will be forced into long-term fixed-price contracts, which will impose additional credit risk. Therefore, we believe CFTC needs to provide the necessary flexibility to allow hedgers to determine what is “economically appropriate” in reducing their commercial risks. To do otherwise will result in adding costs due to increased risk premiums.

B. Cross-commodity hedges

NCFC encourages CFTC to eliminate the “quantitative factor” in any assessment as to the appropriate relationship between commodities as being considered a bona fide hedge. There are legitimate cross-hedge strategies that are more complex than those that have a straightforward correlation such as a sorghum/corn type relationship discussed in the 2013 proposal.[2] We remain concerned that some current cross hedges may not qualify under the

[2] See NCFC Comments for example, February 10, 2014.

proposed rule due to the “quantitative factor” test, and also that this test would stifle the future development of needed hedges as non-traditional agricultural product markets develop. We request that these circumstances be assessed on a case-by-case “qualitative” basis at the exchange level. This process will provide more flexibility and better facilitate the ability for bona fide hedgers to reduce their business risk.

C. Last five days restrictions

The broader proposed rule includes enumerated hedging exemptions for general positions, but in the last five days of trading some of the exemptions no longer apply. For example, anticipatory hedging for unsold production, offsetting unfixed purchases and sales, and cross commodity hedges, among others. Additionally, CFTC is contemplating whether or not non-enumerated hedges should be treated similarly.

In cases when the futures market is the least expensive source to originate grain (as in the below unfixed price example), holding a position through the last 5 days would be necessary in order to buy the grain and fulfill the contract. It would be illogical to force market participants to exit a position if they are willing and capable to take delivery given it may be the most economically sound option available.

> **Example:** Unfixed Price Contracts (Cash Basis Sales) – Co-op X may enter into forward “Unpriced Contracts” where the specific final price has yet to be determined; *however,* Co-op X has contractually agreed to the volume of a purchase or sale, as well as committed to price the commodities at a specified premium or discount *to a particular, identified futures contract and month.* The decision whether or not to price a contract at a specific time is generally driven by customer preference (it is even possible that agreement on a final contract price may happen after delivery), or by performance risk concerns, as requiring a contract to be priced increases credit exposure.
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> In this example, Co-op X sells corn FOB for June delivery and contractually agrees with the customer that the contract will remain unpriced until a Letter of Credit is opened in favor of Co-op X. There also is agreement to price the cash corn at 75 cents over the July corn futures contract, and that Co-op X will accept a futures exchange (Exchange for Physical or EFP) to price the contract.
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> After the contract is agreed to, the cash corn market for May moves and is priced at a premium to the May corn futures contract. Since there is a binding sales contract for volume that will be delivered in June, entering into a long May futures position is the most economical origination of corn at that time. Thus, to cover the sales commitment at the lowest price, Co-op X will buy May futures as a substitute for purchasing cash corn.
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> Because the futures price component of the sales contract has not yet been established, taking a long position in the May contract alone would increase Co-op X’s overall risk position. While Co-op X is contractually obligated to price the sale of corn with the July futures contract, it knows it will ultimately take a July long futures position from its customer via EFP. Therefore Co-op X will simultaneously sell (go short) the July futures contract. The short July futures position combined with the long May futures position is a risk-reducing transaction that is economically appropriate because it is locking in the spread between the July futures and the May futures.

If the market converges prior to the last trading date, Co-op X would sell the May contract and purchase the cash physical. However, if the cash market is still more costly than taking the May futures position into delivery, Co-op X would either a) purchase the corn from the cash market and execute an EFP to transfer the May long futures position to the seller, or b) take the long futures position through the delivery process as a substitute for buying directly in the cash market.

The above scenario would be executed only at a time when the cash market and the futures market prices are not aligned/converged. If that was not the case, no hedges would be placed on the July sale contract and Co-op X would source the corn in the cash market. Additionally, Co-op X would intend to take the futures long through the delivery process (i.e. past the last 5 days of trading) and as such, the futures month where the long was held would align with the delivery window of the sales contract, including reasonable timelines for logistics for the sales delivery location.

It should be noted that Co-op X would take the same actions in the futures market, regardless of whether the sale of cash corn had been fixed, except that Co-op X would have held a long in July and the sale of July futures would have offset that existing long vs. the long received via EFP at the pricing date offsetting an existing short. The May futures execution would remain the same under both scenarios.

In addition to being "risk reducing" to Co-op X (the market exposure of the relative value between the deferred cash delivery that is unpriced, and the current cash physical price), these transactions serve to promote convergence between the cash and futures market.

III. Process for Non-enumerated Hedge Exemption

As noted in our previous comments, NCFC supports the exchanges being designated as taking the lead in a bona fide hedge review process. This seems especially appropriate given that Designated Contract Markets (DCMs) have a long history of reviewing hedging activities, and it will take time for CFTC staff to build their knowledge and become more familiar with commercial hedging practices.

However, we cannot stress enough the importance of developing an accurate list of enumerated hedges in the broader rule. We continue to be perplexed over Commission's concerns about existing bona fide hedge transactions in the agricultural commodity space. The proposed rule continues to omit transactions that are used by farmers and their agricultural cooperatives and others in agriculture. We are not aware of issues these transactions have had that threaten the resiliency of markets to determine price discovery or support price convergence. On the contrary, the omission of these transactions may result in reduced liquidity and less opportunity to mitigate commercial risk as some entities may reduce their use of these transactions and be limited by their overall speculative position limit for that commodity.

A. Overly burdensome reporting issues

Without change the proposed rule will require some current bona fide hedge transactions to seek non-enumerated bona fide hedge exemption status from an exchange. The additional reporting requirements will be costly and burdensome to participants. Adding to the burden are concerns of unintended reporting errors that could result in fines by the CFTC. We request that the CFTC simplify and limit all reporting that will be necessary as a result of a bona fide hedge rule change. Again, what will alleviate much of the uncertainty, confusion, and additional paperwork burdens on end users and exchanges of having to go through the process of being granted a non-enumerated hedge, is to ensure common hedging practices are included in the list of enumerated hedges.

B. Orderly time to unwind position should CFTC disagree with DCM

In the case that the CFTC rejects a DCM or SEF bona fide hedge determination of a non-enumerated transaction, a multitude of factors should be considered if the CFTC maintains its proposed rule that such transactions should be "unwound" and there should not be a one-size fits all approach. Using dairy as an example, what may appear to be a small transaction size in the context of the corn market may be a significant transaction size for the dairy market. Requiring the same time period and the same process to unwind the dairy transactions could lead to a market disruption, disorderly trading and regulatory-influenced and unnecessary price volatility. In some cases, the best course of action may be for CFTC to allow the transaction to continue as a bona fide hedge until the existing set of trades run their course, but allow no new transactions to have bona fide hedge status from the point of reporting the change in status to the entity holding the transactions.

C. Sufficient phase-in period for exchanges to review non-enumerated hedges ahead of implementation

It is hard to discern the number of current bona fide hedge transactions that won't be considered bona fide hedges in the proposed rule unless granted a non-enumerated bona fide hedge exemption from an exchange. If there are a large number of these transactions, it could overly burden the exchanges to work through the filing process ahead of rule implementation. We ask that the Commission recognize this potential bottleneck and provide for: 1) adequate information immediately after the announcement of the final rule for market participants to better understand which transactions need to be reviewed by an exchange; 2) an adequate amount of time to provide the exchanges with the necessary information; and, 3) an adequate amount of time to allow the exchanges to review all of the material and respond to all of the applicants. To date, we are not aware of any regulatory issues in the agricultural space with the use of transactions that may, in the post-rule world, fall out of the bona fide hedge space. With that being the case, there should not be a need to rush the final rule implementation of agricultural commodities and instead to assure adequate time for all agricultural participants and the exchanges to prepare appropriately.

D. **Publication of approved non-enumerated hedges**

Occasionally 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 it may choose to protect it as a proprietary competitive advantage. If such were to occur, and an entity sought and was granted a non-enumerated bona fide hedge exemption for the transaction, the question arises as to whether the transaction should be described on a website in any detail, 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.

IV. Conclusion

We ask that CFTC craft more flexible regulations taking into account the legitimate hedging needs of farmer cooperatives and other commercial end users. Any federal speculative position limits rule should not unduly burden commercial end-users who utilize derivatives markets for economically appropriate risk management activities.

We appreciate your consideration of these comments, as well as our previous comments, in drafting the final position limits rule.

Sincerely,

Charles F. Conner
President & CEO