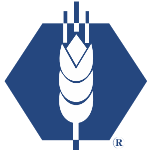

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July 13, 2016

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

RE: Position Limits for Derivatives: Certain Exemptions and Guidance, RIN 3038-AD99

Dear Mr. Kirkpatrick:

The National Grain and Feed Association (NGFA) appreciates the opportunity to provide input to the Commodity Futures Trading Commission (CFTC) on this very important proposed rule. For the NGFA's member firms – bona fide hedgers who are hedging physical commodity risk and who depend on futures markets for price discovery and risk management – the outcome of this rulemaking is vitally important to our industry.

The NGFA is the national nonprofit trade association representing more than 1,000 companies that operate an estimated 7,000 facilities nationwide in the grain, feed and processing industry. Member firms range from quite small to very large; privately owned, publicly traded and cooperative; and handle or process well in excess of 70% of all U.S. grains and oilseeds annually. Companies include grain elevators, feed mills, flour mills, oilseed processors, biofuels producers/co-product merchandisers, futures commission merchants and brokers, and many other related commercial businesses.

There are a number of critical factors that CFTC will decide on in the final rule. This letter addresses some that are most directly related the Supplemental Proposal; others are contained in the NGFA's letter of February 10, 2014, to which we refer the Commission. However, in the context of the supplemental proposal, issues of greatest import include the following:

- The Supplemental Proposal's bona fide hedge definition is a significant improvement.
- Administration of non-enumerated bona fide hedge exemptions by exchanges is the correct decision by CFTC.
- CFTC's "economically appropriate" test needs to be broadened, and price risk must be interpreted more broadly than simple flat-price risk.
- The five-day rule has potential to negatively impact convergence.
- Allowing spread exemptions into the last five days of trading must be maintained.

Our comments will be targeted to impacts on grain and oilseed futures contracts, the primary area of expertise for the NGFA.

Position Limits

As noted in the NGFA comment letter of February 10, 2014, speculative position limits are a very important element of properly functioning futures contracts for wheat, corn, soybeans and related commodities. If position limits are not established at correct levels, consequences for price discovery and risk management will be dire. Convergence of physical grain (known in the trade as "cash grain" or "cash) and futures in the spot month, the very bedrock principal on which risk management is based in our industry, will be threatened.

We remain unconvinced that the Commission's proposed formula-driven approach based on estimates of deliverable supply is the appropriate metric for determining spot-month position limits. Likewise, we remain unconvinced that a formula based on open interest yields appropriate position limits for all-months-combined. As noted in our February 10, 2014, comment letter, the formula-driven methodology would lead to ruinous outcomes for grain and oilseed contracts.

The real test for the Commission in its final rule should be this: will spot-month and all-months-combined position limits allow convergence of cash and futures so that futures markets can still perform their price discovery and risk management functions? Using that yardstick, the current "legacy" limits are working and should be maintained. Further, the NGFA urges strongly that exchanges maintain authority to set speculative position limits for both spot months and all-months-combined below federal limits to ensure that convergence continues to occur. In consultation with their customers, such a process has worked well for decades.

Bona Fide Hedge Definition

Through formal comment letters, public roundtables, CFTC advisory committee meetings, face-to-face meetings and other means, the NGFA since publication of the proposed rule in December 2013 has expressed very deep concern with efforts to redefine bona fide hedging. The original proposal, if implemented as written, would have threatened bona fide hedge treatment of many commonly used hedging strategies in the grain, feed and processing industry.

With regard to the Supplemental Proposal, the NGFA is highly appreciative of improvements made to the bona fide hedge definition relative to the December 2013 proposal. By essentially mirroring the bona fide hedge definition contained in statute in the Commodity Exchange Act, the Commission has recognized the importance of maintaining risk management tools that have been available as bona fide hedging strategies for decades. These strategies are critically important not only to commercial grain handlers and processors but also to agricultural producers seeking to optimize their income from the marketplace and to manage risk. In the end,

consumers also will benefit through lower prices enabled by an efficient hedging mechanism as existing strategies remain readily available.

However, despite the improved definition, there are still areas related to the Supplemental Proposal and the underlying December 2013 proposal that fall short of meeting the needs of commercial grain hedgers and threaten to constrict use of risk management strategies that have benefitted U.S. farmers and ranchers, agricultural hedgers, and consumers for decades. The bulk of this letter will focus on revisions that the NGFA believes strongly still must be made and included in the final rule.

Administration of Non-Enumerated Bona Fide Hedge Exemptions and Spread Exemptions

The process by which non-enumerated bona fide hedge exemptions and spread exemptions are granted to market participants is another area of significant improvement in the supplemental proposal. Rather than taking a huge new responsibility on itself, the Commission has made the correct decision to allow exchanges such as CME Group to manage these processes. By virtue of intimate knowledge with their contracts and their customers, the exchanges are most well-positioned to perform this highly important task. In fact, for the enumerated agricultural commodities, CME has performed just such a role for many years. Given years of experience and immediate knowledge of their customers' business needs, CME and other exchanges should be given broad leeway to manage the process without prior constraint or pre-judgment by the Commission. With few adjustments, we believe the procedures and the personnel essentially are in place to manage this protocol very effectively.

The NGFA urges the Commission in its final rule to clarify just how the process will work if cases arise in which CFTC disagrees with non-enumerated bona fide hedge determinations by CME and other exchanges. Such action by CFTC would be a momentous decision, with potential far-reaching ripple effects on risk management strategies and across markets. If needed, a vote by the full Commission should be required on the weighty decision to invalidate a hedge exemption, preceded by thorough analysis and careful consideration. The NGFA recommends that the final rule preclude the Commission from delegating these decisions to staff. Further, NGFA recommends that the final rule establish an appeal process for commercial hedgers that have had exemptions overturned by the Commission.

The time frame within which market participants must liquidate a position to comply with speculative position limits if a strategy is found not to meet the bona fide hedge definition is an additional point of concern. It has been suggested that the "commercially reasonable time period" for unwinding positions should be one day. While perhaps appropriate in some cases, there certainly are situations in thinly traded contracts without broad liquidity in which one day could be extremely disruptive. The NGFA recommends strongly that the relevant exchange be allowed to work with the market participant, in the context of the particular contract market, to determine a reasonable time period for compliance.

Finally, the NGFA urges that the reporting requirements on exchanges linked to managing non-enumerated bona fide hedge determinations not be overly burdensome. We are well aware that inefficiencies introduced by overly strict regulation serve to increase costs of hedging, and that such costs ultimately find their way to customers and end-users. Therefore, the NGFA urges CFTC to work cooperatively with the exchanges to agree on a reasonable but non-constrictive level of reporting.

Price Risk Must Not Be Limited to Flat-Price Risk

As explained in previous comment letters and discussions with the Commission, commercial firms must have the ability to use the futures market to hedge against various types of risk. However, the Supplemental Proposal states that risk, in terms of the "economically appropriate" test, should be limited to price risk. The NGFA requests that the Commission clarify that price risk in terms of the economically appropriate test is not limited to flat-price risk but should include other types risk that impact price such as basis risk, quality risk, locational risk and timing risk. In addition, the NGFA requests that the Commission allow exchanges to grant exemptions to hedge against additional types of risk not necessarily enumerated in the final rule on a case-by-case basis, with oversight by the Commission as an appropriate safeguard.

The interpretation of a fixed price contract should include basis priced contracts which are purchases or sales with the basis value fixed between the buyer and seller against a prevailing futures option. By including these contracts in the definition of a fixed price contract, the true risk management function of the underlying futures and calendar spreads are allowed to function properly ultimately resulting in seamless trade flow, convergence of cash and futures in the delivery window, and a true hedge for managing risk on large physical transactions of product. The example below shows how this hedge is used in large quantities every day in the management of an export grain merchant's position.

A very large percentage of the grain traded out of the United States is sold FOB (Free On Board) the United States via a basis fixed vs underlying CBOT futures. The Basis represents true risk to the merchants on both the buy and sell side of the transaction especially in shipment windows that bridge the calendar from one option expiration to another becoming the "front" month. Merchants use calendar spreads to manage this price risk until the grain on both their purchase and sale contract are priced vs the underlying futures. Until this point in time, merchants maintain a position in the calendar spreads to lock in their purchase and sale margins.

In the export markets, basis trades are the majority of the transaction styles. As sellers of very large quantities, exporters remove risk from the business by trading in basis and only pricing futures at the time of loading the vessel. This reduces their counterparty risk and allows them to be more competitive on price as they do not have to price in extra credit risk in their trade. By reducing this risk, export pricing is allowed to be more competitive with other sellers around the world and allows the exporter to increase overall grain traded in the world market which helps add liquidity to cash and futures markets in this country.

Five-Day Rule and Spot-Month Spreads

The Supplemental Proposal requests comment on a potential prohibition on hedge exemptions for spreads during the last five days of trading. The NGFA strongly opposes such action.

Further, it is essential that the Commission allow exchanges to have the ability to grant non-enumerated and spread exemptions during the last five days of trading. We understand the Commission's sensitivity towards the last five trading days, especially with regard to cross-commodity hedges, and we appreciate Commission's efforts to protect the physical delivery process. However, it is the physical delivery process itself that makes it critical that commercial firms be allowed to hold positions until expiration and take delivery. A short can make delivery at any time; however a long is not assured of the ability to effect delivery until the final expiration of the contract. This means that any strategy that would use long futures as a substitute for cash cannot be used with any measurable effectiveness, unless that strategy can be carried until such a time as cash and futures converge, or the contract month expires. While the number of firms that will require an exemption in the last five days is few, the role they fulfill to ensure the convergence of cash and futures is critical to all member firms in the industry and the futures contracts we use.

To sum up, forcing the exit of commercial, physical participants would advertise when all commercials have to be out of the front month and would leave no participants to affect the principles of convergence. Such action could disconnect cash markets from the underlying futures market with significant impacts on end-users and a historically changed cash/futures relationship.

Two hedging strategies commonly utilized by commercial grain hedgers follow as examples.

Example 1

On February 28, an exporter has sales equaling 20 million bushels (approximately nine vessels) that will load between March 15 - April 1. The prices for these sales are at a fixed basis to CBOT May futures. These sales likely will be covered by grain shipping off the U.S. river system between Feb 15. - Mar 15 as the transit time for barges is 10-25 days on average.

# cargo	Ton/Cargo	Bu equiv	Contracts of cbot corn equiv
9	55,000	19,487,160	3,897.43

Since the exporter is likely to be buying barges for shipment in March that will trade basis March futures, while he has sales on basis the May futures, he is at risk to price movements of March futures relative to May futures (in other words, he is at risk to the Mar/May spread moving to an inverse). This risk remains in the exporter's position until both sides of the transaction are priced in basis and futures to create a complete flat-price

transaction. To reduce this risk, the exporter can enter into a calendar month spread by buying March futures and selling May futures.

As the exporter purchases physical (cash) grain for shipment in March versus the March futures, he will sell (or exchange) March futures, thus reducing his spread. At the time the March futures goes into the delivery cycle, if the exporter remains short in his physical grain position fixed against the May futures, he will need to remain long March and short May futures against his short cash position. The holder of long futures cannot force delivery of physical grain until the last day of the contract expiration. While the short can deliver at any time, the long may be required to hold his long position until the contract has expired to allow him to fulfill his hedge. To force the exporter to exit his position prior to eliminating his risk in physical grain markets (in the last five days or otherwise) leaves him financially exposed to spread risk.

If March futures should narrow against May futures after he has been forced to exit his spread position, the change would cause a loss for the exporter because the cost of his physical grain replacement would be higher versus his sale, while he had no offsetting gain in the March/May spread position.

It is necessary for the exporter to keep bidding versus March futures until the March-May spread reaches a price that creates enough movement in the physical grain market that the market can cover their positions. March futures rallying versus May will eventually give commercial firms the signal to sell their stocks (because the market is not paying them to carry stocks); this is part of the convergence mechanism. Once this price has been reached, the market has converged and the need to maintain a long calendar spread position is reduced as the exporter can cover his short naturally in the physical market. At this time, he will reduce/exit the hedge he initiated by selling the calendar spread (selling March futures and buying May futures).

The fact that the exporter has the option to take delivery of corn futures during the delivery month and ship them to his terminal to load his vessel sales (if that option is cheaper than buying physical corn to his terminal) ensures that cash and futures converge. If the exporter did not have the ability to take delivery of CBOT futures and load them out, cash and futures could disconnect.

Example 2

An elevator on the river has sold corn to a nearby ethanol plant for first-half August delivery at +$.35 over the September CBOT futures contract, and the ethanol plant has the option to fix the flat price any time prior to August 1. The elevator will need to buy corn for delivery into his elevator during the month of July or earlier. If corn is not available at a price that is cheaper than using the futures contract, the elevator may need to use July futures to hedge the risk of changing prices on his unpurchased corn supply. However, because the sale is indexed to September futures and the futures used to source the physical corn will be July futures, the elevator is exposed to calendar spread risk. To mitigate this risk the elevator buys July CBOT corn futures and sells September CBOT corn futures.

The elevator will now determine whether it is more economical to fulfill his sale commitments by purchasing physical corn or by taking delivery of July CBOT corn futures. If the elevator is able to purchase corn below the delivery equivalent (the cost to stop July corn futures, load it out, and deliver it to the ethanol plant), the elevator will purchase the physical corn and liquidate its July futures positions (please note this is required by the CBOT during the delivery period). However, if July futures remain the cheapest option to fulfill the sale commitments, the elevator needs to have the ability to hold July futures until expiration and take delivery to fulfill the sale contracts.

This shows how, during the delivery month, CBOT corn futures represent the price of physical corn in Chicago or along the Illinois River (the deliverable locations for CBOT corn). The cash corn price in Chicago, by definition of "cash price" (futures plus "basis" or futures plus "location differential"), includes a basis component. If the elevator did not have the option to hold July futures until he bought in the cash basis against his sale, he would be forced to bid up the cash basis in the area and there could be lack of convergence between cash and futures. The physical delivery mechanism allows for convergence. Eliminating the commercial users of this contract from the last five business days could force the two markets to disconnect, effectively destroying convergence.

The examples above provide every-day, real-world examples of why the Commission:

1) Must allow the exchanges to have the ability to grant non-enumerated hedge exemptions and spread exemptions during the last five days of trading; and

2) Must recognize that risk in regard to the economically appropriate test should not be limited to flat-price risk.

<u>Reporting Obligations</u>

The cash market reporting requirements ("04 Reports") in the proposed rule are overly burdensome on commercial participants and will not achieve the Commission's objective. Therefore, NGFA respectfully requests that the final rule maintain the current Form 204 process for grain and oilseed products and eliminate proposed Form 504 and proposed Form 704.

The Commission states that the goal of the proposed 04 Reports is to obtain the information necessary to ensure that when a hedge exemption is invoked that it is done so for legitimate reasons. However, regardless of how extensive the Commission makes reporting requirements, this goal will not be achievable without requesting additional information from the market participant on a case-by-case basis. Therefore, NGFA feels that the goal of reporting should be to obtain enough information regarding a market participant's cash positions to

determine (using a risk-based approach) whether to request additional information to ensure that an exemption is being invoked for legitimate reasons.

This goal is achievable by using currently available information (e.g., Form 204, Form 40, Hedge Exemption Applications, Large Trader Reports). Therefore, the NGFA believes that the additional burden of the proposed 04 Reports on commercial participants outweighs any potential benefit to the Commission.

Hedges for Ag Commodities Should Not be Limited to One Year

The definition of enumerated hedge position in Section 150.1(3)(iii)(A), "Hedges of unfilled anticipated requirements – Long positions…", contains arbitrary limits on volume that do not adequately meet the needs of commercial end users in the food/agriculture sector. Specifically, there may be margin opportunities and/or investment requirements that require long positions of agricultural commodities that exceed twelve months for an agricultural commodity for processing. It is counterproductive to commercial market participants to limit their ability to execute sound hedging strategies for reasons that have no economic or market-based rational. Commercial end-users in the food/agriculture sector should be able to execute hedging strategies, and hold bona fide hedge positions, of greater than twelve months as long as those positions, and exemptions, are based on sound economic reasoning, as reviewed by the exchange and the CFTC, and do not have an adverse effect on the derivatives market.

Quantitative Test for Cross-Commodity Hedging

It is our understanding that the 80% correlation for cross-commodity hedging likely will be omitted from the final rule, as will any quantitative measure of cross-commodity hedging. The NGFA fully supports such a change and concurs in qualitative rather than quantitative analysis.

Why is Agriculture Different?

In closing, the NGFA would like to suggest that the contracts in which our member firms are most engaged – wheat, corn, soybeans and related commodities – are substantially different than many other commodities addressed in the December 2014 proposal and the Supplemental Proposal. First, speculative position limits have been in place in our markets for many, many years. Our industry has a demonstrated track record of success and established relationships/process built up around position limits. We believe that should inspire a high level of confidence from CFTC that a CME-managed process will be highly successful.

Second, the fact that these are physically-delivered contracts traditionally used for price discovery and business risk management should mitigate against restrictive new rules. There is a finite supply of grain and soybeans produced annually. Usage must be rationed through the year. If commercial hedgers are forced out of grain and oilseed markets – or artificially constrained from using them according to historical risk management

business practices – we believe convergence of cash and futures will be threatened or will fail, a severely adverse consequence that harms everyone along the supply chain. In addition to making operations more difficult for commercial grain and oilseed hedgers, it means lower bids to producers and higher prices to consumers, with ripple effects throughout the U.S. economy.

With respect for the challenge that writing this rule poses to CFTC, the NGFA submits that one size truly cannot fit all. Markets are so dramatically different for financials or energy or metals than for the legacy agricultural contracts in terms of size and function. We understand that the Commission may not want to grant a generic enumerated exemption for certain strategies across all markets and all commodities – but denying risk management practices that have been considered bona fide hedges in our markets for decades likewise would have far-reaching negative consequences.

The NGFA proposes that agriculture is different and that there is a justification for treating our contracts differently. We suggest that this may be best achieved at the exchange level, perhaps by allowing CME the authority to more broadly recognize certain types of hedging strategies as enumerated for their review purposes, to streamline the timing of decision-making, and to provide clarity to market participants who have utilized the same strategies for years. We stand ready to discuss further how such a procedure might be structured.

Sincerely,

MJ Anderson, Chairman
Risk Management Committee