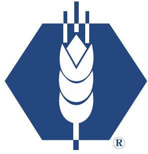

National Grain and Feed Association
www.ngfa.org

1250 Eye Street, N.W., Suite 1003
Washington, DC 20005-3922
P: (202) 289-0873
F: (202) 289-5388

February 28, 2017

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, 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.

Here is a quick summary of the priority issues that follow; each of them is critically important to maintaining risk management practices among agricultural hedgers utilizing grain and oilseed futures contracts:

- Administration of non-enumerated bona fide hedge exemptions by exchanges is the correct decision by CFTC, but the final rule needs to provide certainty for both exchanges and end-users.
- Basis hedging must be an enumerated bona fide hedge, consistent with decades of historical treatment by the Commission and exchanges.
- In the context of the bona fide hedge definition, anticipatory merchandising hedges must be specifically enumerated in the final rule.
- 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 cannot be allowed to interfere with convergence in physically delivered contracts.
- Allowing spread exemptions into the last five days of trading must be maintained.

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.

Consistent with NGFA's previous submissions to the Commission, we remain unconvinced that the proposed formula-driven approach based on estimates of deliverable supply is the appropriate metric for determining spot-month position limits for grain and oilseed contracts. Likewise, we remain unconvinced that a formula based on open interest yields appropriate position limits for grain and oilseed contracts for all-months-combined. As noted in our February 10, 2014, comment letter, the formula-driven methodology if implemented could 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 retain authority to set speculative position limits for both spot months and all-months-combined at levels below federal limits to ensure that convergence continues to occur. In consultation with customers, allowing exchanges to implement position limits through 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.

Beginning in the Supplemental Proposal in June 2016, and carrying through to the current reproposal of the rule, 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. 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 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 and clarifications that the NGFA believes strongly must be included in the final rule.

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

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 non-enumerated bona fide hedge (NEBFH) determinations. By virtue of intimate knowledge and long experience with their contracts and their customers, the exchanges are ideally positioned to perform this critically important task. In fact, for the enumerated agricultural commodities, CME has performed just such a role for many years. We believe CME and other exchanges should be given broad discretion to manage the NEBFH process without prior constraint or pre-judgment by the Commission. With few adjustments, the procedures and the personnel are in place to manage this protocol very effectively.

We believe the following elements of the NEBFH administration process need to be clarified in a final rule:

- Certainty, Consistency, Continuity – It is imperative that exchanges and their customers be able to rely on NEBFH decisions made by the exchanges over time. This principle argues strongly for treatment of hedging strategies in a manner consistent with past practice. Pressure flowing from CFTC oversight cannot be allowed to bias or overly influence exchange decisions in advance. As noted above, it is the exchanges who know their customers and understand the appropriateness of hedging strategies.

  Once a NEBFH determination has been made, customers need to be able to rely on that decision with confidence so they can execute their business and risk management strategies effectively. Currently, many hedge exemption decisions are made by the exchanges on an annual basis, rather than on an *ad hoc,* case-by-case basis. This needs to continue to ensure timely and consistent determinations on typically well-known strategies.

  Continuity of operations is extremely important to retaining confidence in markets and effectiveness of hedging for farmers and ranchers, agribusiness hedgers, and end-users. The NGFA cannot make the point forcefully enough that CFTC involvment in the exchanges' NEBFH determinations should be done with a light touch and an assumption that exchange determinations are appropriate. While the NGFA acknowledges the Commission's oversight authority, we believe very strongly that the ideal should be that CFTC review or overturning of NEBFH decisions by exchanges should be very rare.

- Review Process –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 NEBFH 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. In the rare cases that Commission action is merited, the NGFA believes 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 – and that the market participant involved should be able to rely on the exchange's NEBFH determination in the meantime. The NGFA recommends that the final rule preclude the Commission from delegating these decisions to staff. Further, NGFA recommends that the final rule establish a timely appeal process for commercial hedgers that have had exemptions overturned by the Commission.

- Commercially Reasonable Time – 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. Some have 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 reporting requirements on exchanges managing NEBFH 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.

<u>Price Risk Must Not Be Limited to Flat-Price Risk</u>

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. For the grain, feed and processing industry, it is not an exaggeration to say that hedging basis risk is the lifeblood of the industry – at its core, hedging basis risk is what allows NGFA-member firms to make highly competitive bids and offers to producers and consumers as they seek to optimize opportunities from the marketplace. It is critically important that basis risk be included as an element of price risk in the Commission's "economically appropriate" test.

To that end, the NGFA urgess 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 – not only basis risk, but also quality risk, locational risk and timing risk. By extension, the NGFA posits that basis hedging and other similar hedges impacting price should be enumerated by the Commission rather than relegated to the NEBFH process administered by exchanges. 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.

Example

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 contract month. 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 following example 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 exported from 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 futures contract 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 NGFA believes strongly that the five-day rule has no relevance to or place in physically-delivered grain and oilseed contracts. We respectfully request that the Commission abandon the five-day rule with respect to grain and oilseed contracts when it takes final action on this proposal. 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 in a contract.

We understand the Commission's sensitivity toward 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 very likely would 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 not impose the five-day rule on commercial participants in physically-delivered grain and oilseed contracts;

2) 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

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

Anticipatory Hedging

A comment specific to anticipatory hedging is merited; per previous NGFA comment letters, this revisits issues that seemingly were resolved during discussions between the CFTC and our industry during the original position limit rulemaking.

Grain merchandisers serve the critical function of providing liquidity for producers and end-users of grain. Merchandisers provide a market when producers want to move grain, including during harvest or when prices are favorable, and end-users are not interested in buying. Merchandisers have stored supplies when end-users need grain and producers are not interested in selling. The role of the merchandiser allows for the management of price risk at both ends of the supply chain. The reproposal would harm 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, futures hedges for legitimate commercial users to hedge unfilled storage, and flat-price long futures positions ahead of anticipated processing requirements need to be fully recognized as enumerated bona fide hedges in the final rule and not left to the NEBFH process. We request that the Commission maintain and convey an understanding in its final rulemaking that legitimate merchandising and processing activities of the kind described are enumerated practices and will not require a special exemption or the burden of additional application/reporting. This merely would affirm the Commission’s recognition of anticipatory hedging as bona fide hedging, consistent with CFTC and industry interpretation for many years.

Reporting Obligations

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.

Wheat Contract Parity

The reproposal breaks with longstanding CFTC policy of establishing the same limits for the three wheat futures contracts: CBOT soft red winter (SRW), KCBT hard red winter (HRW), and MGEX hard red spring (HRS). In particular, the reproposal establishes a spot-month limit for MGEX HRS of 1,000 contracts, above the legacy spot-month limit of 600 contracts established for SRW and HRW. We find it odd that the largest non-spot month limit under the reproposal would be established for the class of wheat (HRS) that in some years is the smallest in production volume among the three contracts.

The NGFA and the DCMs historically have united in supporting equivalent position limits for the three contracts. Varying limits could have unintended and undesirable effects in terms of competition among the contracts for growth and liquidity. In addition, different limits would reduce liquidity available for spreading transactions between the three wheat classes that help discover price differentials for different protein levels and milling characteristics. The NGFA urges the Commission to remain consistent with historical practice in maintaining position limit equivalence across the three contracts.

The Case for Treating Enumerated Ag Commodities Differently

In closing, the NGFA suggests 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 reproposal. 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.

One size truly cannot fit all. Markets are 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 enumerated agricultural commodities like wheat, corn, soybeans and related commodities are 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