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May 15, 2020

Mr. Christopher Kirkpatrick
Secretary
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:

On behalf of the two thousand farmer-owned cooperatives across the country, and the two million farmers and ranchers who belong to them, the National Council of Farmer Cooperatives (NCFC)[1] submits the following comments in response to the Commodity Futures Trading Commission's (CFTC) Proposal, Position Limits for Derivatives, 85 Fed. Reg. 11596 (February 27, 2020). NCFC previously submitted comments on February 10, 2014, August 4, 2014, July 13, 2016, and February 28, 2017, in response to prior Commission proposed rules and requests for comments regarding position limits.

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 have largely been recognized as bona fide hedges for the purpose of being exempt from speculative position limits. Additionally, two NCFC members operate Commission Futures Merchants (FMCs) that provide hedging services to the agriculture sector, primarily to farmers, ranchers, and local agriculture enterprises.

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 appreciate CFTC considering a number of our views outlined in previous comments, as well as publishing this proposal to receive additional input as the Commission revises and finalizes the rule.

[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 approximately 2,000 local farmer cooperatives across the country. NCFC members also include 21 state and regional councils of cooperatives.

Specifically, NCFC supports the following contained in the February 27, 2020 proposal:

1. The general definition of a bona fide hedge;

2. Expanding the list of enumerated hedges to include anticipated merchandising hedging as well as other specific enumerated hedges;

3. The exclusion of location basis contracts, swap guarantees and trade options from speculative position limits;

4. Expanding the use of the cross-commodity hedge exemption to a majority of enumerated exemptions;

5. Not imposing position limits outside of the spot month for certain agricultural core referenced contracts;

6. The ability for market participants to apply to an exchange for an exemption from federal limits and the process for seeking such relief;

7. Providing market participants with the flexibility to decide whether to hedge on a gross or net basis; and

8. Simplifying market participant reporting through the elimination of the unnecessary and duplicative Form 204.

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 would like to offer the following suggestions as CFTC works toward finalizing the position limits rule.

II. Bona Fide Hedging Definition

NCFC supports the general definition of bona fide hedge for contracts subject to position limits, including CFTC's revisions of the "Temporary Substitute Test," the "Economically Appropriate Test," the change in value requirements, as well as eliminating the incidental test and orderly trading requirement.

However, we urge the CFTC to retain discretion to recognize bona fide hedges that reduce risks other than "price risk." Markets have clearly evolved, and will continue to evolve, to recognize various other risks such as those relating to operational risk, credit and liquidity risk, weather, and political risk. To seemingly delink risk management and price risk appears to conflict with market fundamentals that can ultimately create price risk. For example, by 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. Therefore, NCFC encourages the CFTC to recognize that those commercial risks are legitimate for a bona fide hedge transaction or position for commercial end-users.

As such, NCFC believes that many of commercial end-users' concerns can be allayed by adding more examples to the enumerated list of bona fide hedges to sufficiently address many commercial hedging practices that they employ. While we appreciate the currently proposed

expansion of those hedges, we believe there are additional hedges that should be enumerated or clarified in a final rule. This would help eliminate any uncertainty that may discourage the use of these legitimate risk reducing strategies.

Unfixed Price Contracts

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 may not be considered a bona fide hedge.

For example, 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.

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.

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 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.

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 only be executed at a time where the cash market and the futures market prices are not aligned/converged. If that were 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.

This example should be considered a bona fide hedge, not only because it is analogous to an anticipatory merchandising hedge, but also because Co-op X has a legally binding contract that specifies how and when the sale contract will be priced. In order to fulfill its delivery obligation, it must buy cash corn. 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.

Fixing of Un-Fixed Forward Contracts

As NCFC understands the proposal, such an anticipatory hedge would not constitute an enumerated hedge. However, unpriced contracts should also be covered by an enumerated exemption given unpriced forward contracts may expose a commercial enterprise to counterparty performance risk. To ensure the making or taking of delivery in these situations, it is appropriate to take a futures position to offset the risk of the counterparty’s risk to perform on an unfixed price forward contract.

For example, Co-op X may avoid allowing a customer to price a contract due to performance concerns. In the event that Co-op X has already purchased grain on a fixed price basis (May delivery, for example), but has sold on an Un-fixed Forward Contract basis for July delivery, Co-op X is exposed to performance risk if the price were to decrease and the customer did not take delivery of the grain.

Synthetic Price Fixing of that sales contract would entail simultaneously buying back the May futures and selling out the July futures to establish and lock in the margin. This also provides a reliable sales channel for Co-op X to sell the grain through the delivery mechanism in the event of a default by its customer.

If the customer fulfills its commitment, Co-op X would either accept a long EFP from the customer or purchase a long position in the market to flatten its July short upon price fixing.

Forcing parties into long-term, fixed-price contracts would make them incur increased credit risk. Therefore, NCFC respectfully requests that CFTC include the unfixed price hedge as an enumerated hedge. Such inclusion will provide much needed clarity for market participants.

III. Federal Position Limits

NCFC supports CFTC’s proposal to mandate federal speculative position limits in the spot months for all 25 core referenced futures contracts and their referenced contracts, and that all-months combined limits would only apply to the nine legacy agricultural futures contracts.

IV. Inclusion of Economically Equivalent Swaps

We appreciate that CFTC proposed a narrow definition of an economically equivalent swap under a federal position limit regime. Likewise, we do not object to an inclusion of such swaps in theory since our members use them for legitimate hedging purposes. However, NCFC continues to be concerned with the operational difficulties, burdens, and costs for commercial end users and small- to mid-sized FCMs that focus on the needs of agricultural hedgers of including swaps for position limit purposes. The costs of compliance on such participants will likely be large and time-consuming, and possibly entail some risk of operational error arising out of the implementation process.

We offer that the best practical solution would be to exclude from a commercial end-user's federal speculative position limits those agricultural commodity swaps that are transacted by invoking the "End-User Exemption to Mandatory Clearing" rule. Those swap contracts already must meet the test "to hedge or mitigate commercial risk," and are "not used for a purpose that is in the nature of speculation, investing, or trading," as outlined below in § 50.50. Thus, by definition, these contracts should not be subject to end-user federal "speculative" position limits.

> **§ 50.50 Exceptions to the clearing requirement.**
> (a) Non-financial entities.
>
> > (1) A counterparty to a swap may elect the exception to the clearing requirement under section 2(h)(7)(A) of the Act if the counterparty:
> >
> > > (i) Is not a "financial entity" as defined in section 2(h)(7)(C)(i) of the Act;
> > > **(ii) Is using the swap to hedge or mitigate commercial risk as provided in paragraph (c) of this section;** and
> > > (iii) Provides, or causes to be provided, the information specified in paragraph (b) of this section to a registered swap data repository or, if no registered swap data repository is available to receive the information from the reporting counterparty, to the Commission. A counterparty that satisfies the criteria in this paragraph (a)(1) and elects the exception is an "electing counterparty."
> >
> > (2) If there is more than one electing counterparty to a swap, the information specified in paragraph (b) of this section shall be provided with respect to each of the electing counterparties.

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> **(c) Hedging or mitigating commercial risk. For purposes of section 2(h)(7)(A)(ii) of the Act and paragraph (b)(1)(iii)(B) of this section, a swap is used to hedge or mitigate commercial risk if**:
>
> > (1) Such swap:
> >
> > > (i) Is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where the risks arise from:
> > >
> > > > (A) The potential change in the value of assets that a person owns, produces, manufactures, processes, or merchandises or reasonably anticipates owning, producing, manufacturing,

processing, or merchandising in the ordinary course of business of the enterprise;
(B) The potential change in the value of liabilities that a person has incurred or reasonably anticipates incurring in the ordinary course of business of the enterprise;
(C) The potential change in the value of services that a person provides, purchases, or reasonably anticipates providing or purchasing in the ordinary course of business of the enterprise;
(D) The potential change in the value of assets, services, inputs, products, or commodities that a person owns, produces, manufactures, processes, merchandises, leases, or sells, or reasonably anticipates owning, producing, manufacturing, processing, merchandising, leasing, or selling in the ordinary course of business of the enterprise;
(E) Any potential change in value related to any of the foregoing arising from interest, currency, or foreign exchange rate movements associated with such assets, liabilities, services, inputs, products, or commodities; or
(F) Any fluctuation in interest, currency, or foreign exchange rate exposures arising from a person's current or anticipated assets or liabilities; or

(ii) Qualifies as bona fide hedging for purposes of an exemption from position limits under the Act; or
(iii) Qualifies for hedging treatment under:
(A) Financial Accounting Standards Board Accounting Standards Codification Topic 815, Derivatives and Hedging (formerly known as Statement No. 133); or
(B) Governmental Accounting Standards Board Statement 53, Accounting and Financial Reporting for Derivative Instruments; and

(2) Such swap is:
(i) Not used for a purpose that is in the nature of speculation, investing, or trading; and
(ii) Not used to hedge or mitigate the risk of another swap or security-based swap position, unless that other position itself is used to hedge or mitigate commercial risk as defined by this rule or § 240.3a67-4 of this title.

However, to the extent that swaps are part of the position limit regime, we encourage CFTC to:

1) Establish a transition period sufficiently long enough for market participants to develop, test and implement the information technology, reporting, supervisory, and compliance systems necessary to comply with the new position limit requirements; and,

2) Adopt a "safe harbor" under which demonstrable good faith compliance with respect to inadvertent violations would not serve as the basis for an enforcement action. Throughout the Dodd-Frank implementation process, NCFC has requested that CFTC

afford some leniency to market participants as they work toward understanding and coming into compliance with new recordkeeping requirements.

V. Risk Management Exemptions

NCFC members rely on counterparties in the financial industry, among others, to provide the liquidity they need to hedge their commodity risks. We would be concerned with market access and liquidity for commercial end-user counterparties to hedge their risk if those entities reduce or stop providing those services.

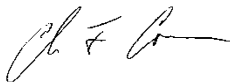
However, we are confident that the substantial increase in the overall speculative position limits and allowances for pass-through swaps will limit any potential loss of liquidity. In fact, NCFC has long advocated for increased competition in these markets to preserve the ability of farmer cooperatives to effectively and cost-efficiently utilize the futures and swaps markets to hedge their risks. We believe the proposal would allow for more participants in that space, resulting in increased market liquidity and hedging options.

VI. Conclusion

NCFC believes any federal speculative position limits rule should not unduly burden commercial end-users who utilize derivatives markets for economically appropriate risk management activities. As such, we have asked CFTC to craft more flexible regulations considering the legitimate hedging needs of farmer cooperatives and other commercial end-users throughout the rule making process. We certainly appreciate all the work that CFTC has done in working towards those ends, which are reflected in the proposal.

We appreciate your consideration of these comments in drafting the final position limits rule.

Sincerely,



Charles F. Conner
President & CEO