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May 15, 2020

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.

The NGFA’s member firms are bona fide hedgers who hedge physical commodity risk and depend on futures markets for price discovery and risk management. Access to efficient and effective risk management through U.S. futures exchanges gives the NGFA’s members confidence to provide highly competitive bids and risk management services to U.S. agricultural producers. Clearly, an effective and workable final rule is critically important to producers, agribusiness, and ultimately consumers who enjoy the benefits of U.S. agriculture’s productivity, efficiency and global competitiveness.

The NGFA is the national nonprofit trade association representing more than 1,000 companies that operate an estimated 7,000 – 8,000 facilities nationwide in the grain, feed, processing, and export industry. Member firms range from small country elevators to very large multinational companies; are organized as cooperatives, privately-owned, and publicly traded; and handle or process an estimated 80% of all U.S. grains and oilseeds annually. NGFA-member companies include grain elevators, feed mills, flour mills, oilseed processors, biofuels producers/co-product merchandisers, futures commission merchants and brokers, integrated livestock operators, and many other related commercial businesses. NGFA also consists of 33 affiliated state and regional agribusiness associations and has strategic alliances with the North American Export Grain Association and the Pet Food Institute.

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The NGFA generally is supportive of the direction of the proposal. We commend the Commission for proposing to vest significant decision-making authority with the exchanges, which are best-equipped to make decisions concerning their contracts and their customers – this with appropriate oversight authority from CFTC. We also appreciate that many concerns the NGFA has voiced over the years about previous proposals have been addressed constructively. Key points in this regard include:

* The NGFA supports raising spot-month limits for grain and oilseed complex contracts to the proposed levels but advocates observation of the new spot-month limits by the exchanges and the CFTC to ensure that cash/futures convergence is not adversely affected.
* The proposal contains extremely large increases in both single-month and all-months-combined non-spot limits. The NGFA believes that lower single-month limits must be applied to avoid overwhelming any particular contract month in grain and oilseed complex contracts, especially in the nearby months.
* It is very important to NGFA’s members that using a futures calendar spread to hedge an unpriced basis purchase or sale is included in the proposal as an enumerated bona fide hedge. This letter contains a detailed example of this commonly used strategy; an explanation of why the current proposal creates uncertainty; and recommendations to resolve the problem.
* The proposed review period by CFTC of a non-enumerated hedge approved by an exchange is too lengthy given fast-moving commodity markets. NGFA recommends a shorter review period and a slightly revised process.

**Spot-Month Speculative Position Limits**

The grain and oilseed complex futures contracts utilized by NGFA’s member companies have been subject to speculative position limits for many years. The NGFA historically has supported the so-called “legacy limits” of 600 contracts for corn, wheat, and soybean contracts as well as current levels for soybean meal and soybean oil contracts. Current limits have performed a valuable role to ensure that these markets are not overwhelmed by large, non-traditional participants and to encourage convergence at contract expiration.

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However, the NGFA now supports the Commission’s proposed increases in spot-month limits. The consensus opinion within NGFA is that increases in deliverable supplies support the increased spot-month limits. It is worth noting that this change of position by NGFA, while a consensus, is not unanimous. There are some who believe current limits work well and that the increases could be a threat to regular and predictable convergence. Therefore, the NGFA’s support of the proposed spot-month limits comes with a strong recommendation that both the CME Group and the CFTC monitor market performance carefully and make adjustments if convergence is adversely affected.

**Non-Spot Month Speculative Position Limits**

The proposal contains very large potential increases in non-spot month speculative position limits. The NGFA supports ending risk management exemptions for certain market participants – indeed, we believe that is a healthy improvement for grain and oilseed complex contracts, which at times have threatened to be overwhelmed by large-scale participation of non-traditional participants. However, the very large proposed limits – viewed, perhaps, as a tradeoff of sorts for eliminating risk management exemptions – would open up participation at dramatically higher levels to a larger number of participants. The goal of the Commission should not be to seek “fairness” in the sense that non-spot limits are increased just to provide equal access. Rather, the overriding goal of the Commission should be to establish non-spot limits that will telescope down to relatively much-smaller spot-month limits in an orderly fashion. We believe it is relevant to keep in mind that the grain and oilseed complex contracts are not merely an attractive asset class or an alternative investment – they serve critically important price discovery and risk management functions for U.S. producers and agribusiness, the original bona fide hedgers.

The Commission can make a relatively minor but crucial improvement to the final rule by preserving smaller single-month limits within the non-spot month regime. This is especially important to prevent multiple market participants with extremely large positions from bunching their activity in nearby non-spot months, thereby creating the potential for severe market distortions. The NGFA suggests to the Commission, in response to its question in the proposal, that such a problem likely can be avoided by adopting one of the following approaches:

* The final rule could set single-month limits at some percentage of the all-months combined limit. One potential such level would be at 50% of the all-months-combined limit. Certainly, that percentage level merits additional analysis and discussion as a solution.
* Alternatively, the Commission could maintain existing single-month limits in non-spot months while adopting the larger all-months-combined limits.

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* A third option would be to adopt a phased-in approach to the higher non-spot limits, together with very active monitoring of contract performance, though the NGFA does not favor this option.

Any of these three options would provide at least some protection against nearby contracts becoming overwhelmed, thereby distorting market signals and hampering orderly convergence in the spot month.

Finally, concerning the methodology of using open interest to establish federal non-spot month speculative position limits, the NGFA still is not completely convinced that open interest is the best yardstick for this exercise. Under the proposal, an increased number of non-traditional market participants would have the ability to access grain and oilseed complex futures markets at much larger volumes. As volume and open interest grow, federal non-spot limits expand correspondingly…which leads to yet higher volume and open interest…which again prompts expanded federal non-spot limits…and so on. For the contracts utilized by our industry, we do not believe that kind of “perpetual motion machine” is healthy. Certainly, this spotlights the importance of allowing exchanges the flexibility to establish limits lower than federal limits that are appropriate for specific markets. Whatever position limits are adopted in the final rule, the NGFA recommends that additional analysis by the Commission is warranted with a review conducted within the first two years following implementation.

**Bona Fide Hedge Recognition**

The NGFA is very appreciative of and strongly supports the Commission’s inclusion of additional enumerated bona fide hedges in the proposal. In particular, the CFTC’s recognition of hedges of anticipated merchandising as an enumerated bona fide hedge is extremely useful to our industry and a significant enhancement from previous proposals. Further, the NGFA strongly endorses the proposal that enumerated bona fide hedges identified in Appendix A be self-effectuating for purposes of federal limits.

However, an area of concern remains for the grain, feed, processing and export industry. We believe strongly that the Commission needs to explicitly recognize or clarify that using a futures calendar spread to hedge an unfixed basis purchase or sale is an enumerated bona fide hedge in the final rule – description and a detailed example follow, along with narrative explaining why the strategy’s status remains unclear in the proposal and suggested solutions.

The most important thing to remember in the following example is that buying or selling futures represents a responsibility to take or make delivery of grain if the position is carried to expiration. Therefore, when an entity buys futures, it is buying an instrument that represents

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physical commodity at a designated loading point. The conversion from futures contract to physical grain happens in the delivery process.

It is also important to remember that grain merchandising companies rarely want to own a physical commodity without hedging it. To hedge the physical (represented by the futures), the grain merchandising company can sell a deferred month futures position.

Said more simply, by buying front end futures and selling deferred futures, the grain company has bought physical grain (in the form of futures) and hedged it using a deferred futures month. The basis is the difference between the deferred futures price and the spot futures price, plus expenses for loadout and storage.

If a grain merchandising company did this exclusively in the cash market (buying truckloads of physical grain for future delivery and hedging with short futures in a deferred month), it would constitute an enumerated bona fide hedge

Physically settled markets allow a user to convert long futures to long cash (physical) grain. However, the only way to do that is by staying long through the delivery cycle. This inherently leads to opportunities in the spot month which could easily exceed the proposed 1200-contract spot month limit.

Allowing firms the option to purchase grain through the futures delivery process if it is the most economic source of grain is FUNDAMENTAL to allowing futures contracts to converge with the physical market.  Additionally, it gives an exporter of grain confidence to provide a price quote in cash markets for global users because he can always see at what price he can buy grain in the futures market, even if cash markets are illiquid and not defined.

With that in mind, consider the following example of a grain merchandiser seeking to hedge a basis sale of grain (unfixed price) by buying physical grain in the form of a futures spread.  It is NGFA’s belief that this strategy should qualify and be included as an enumerated hedge in the final position limit rule.

*HEDGING IN THE SPOT MONTH*

*Example:*

*Grain Merchandising Company (GMC) sells corn FOB U.S. Center Gulf for January 5-25 Delivery, unfixed futures and basis +.75 the March corn futures contract. On the pricing date, GMC will take long March futures contracts from the buyer (via an EFP) to price the cash corn.*

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*Terms include Letter of Credit (LC) payment; no futures pricing until the LC is open to limit flat price exposure with the customer; and the LC is to be opened 15 days prior to delivery period (Dec 20).*

*Between the contract date and shipment date, the cash corn market is a premium versus taking delivery of corn on the December futures contract. To cover its sales commitment at the cheapest price, GMC buys December futures and sells March futures.*

*If purchasing corn in the cash market is still more expensive than taking delivery on its long futures contract position as the market enters the delivery cycle, GMC takes delivery during the December delivery cycle. Because actual delivery against the futures contract is determined by the entity that is short futures and makes delivery, GMC must be long in the spot month until the short delivers. By taking delivery, GMC’s long December futures are now physical grain. GMC retains the short March futures to hedge the physical grain.*

*If at any time purchasing corn in the cash market becomes cheaper than taking delivery on its long futures contract position, GMC will liquidate the long December/short March futures position and will buy cash grain and hedge the March futures contract.*

*The corn sourced via the December futures contract position or the cash market will be loaded out and will arrive by barge in the Gulf between December 25 - January 10.*

*The end user prices futures on the basis contract on January 10. When the customer prices futures on the basis contract, GMC’s short March futures position is offset by the long March futures position it receives from the customer via the EFP.*

*At this point there is no futures position and GMC simply will perform on the cash contract by delivering grain. Its counterparty will perform by paying for the grain.*

***There are a few takeaways from this example:***

*By leaving the sales contract price unfixed, the GMC reduces counterparty price risk which is sound business practice.*

*The ability to use the futures market as a proxy for the cash market allows the GMC to be an active participant in the export market and mitigate his risk in the cash market by using the futures contracts as they were designed.*

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*The risk in the example above is applicable to merchants on a daily basis, and they should not be forced to go through the non-enumerated process to obtain hedge exemptions to mitigate these risks. The non-enumerated process should be reserved for unique risks that are relevant to individual market participants.*

**Would GMC’s Position Qualify as an Enumerated Hedge?**

Anticipatory Merchandising

The proposed rule includes Anticipatory Merchandising in the list of enumerated hedges.  After reading the requirements to qualify for this enumerated hedge in the text of the proposed rule, it appeared that the CME Group would have the authority to grant a bona fide hedge exemption under the enumerated process that would allow GMC to buy December futures and sell March futures to manage the risk described above.  However, after reading the below comments in the proposed rule, NGFA is concerned that this may not be the case:

“Regarding examples #3 (unpriced physical purchase or sale commitments) and #7 (scenario 2) (use of physical delivery referenced contracts to hedge physical transactions using calendar month average pricing), while the Commission has preliminarily determined that the positions described within those examples do not fit within any of the proposed enumerated hedges, market participants seeking bona fide hedge recognition for such positions may apply for a non-enumerated recognition under proposed §§ 150.3 or 150.9, and a facts and circumstances decision would be made.”

Hedges of Offsetting Unfixed-Price Cash Commodity Sales and Purchases

The proposed rule includes Hedges of Offsetting Unfixed-Price Cash Commodity Sales and Purchases in the list of enumerated hedges. However, to qualify for this enumerated hedge, a firm would be required to hold both an unfixed sale and an unfixed purchase in the cash market.  In the above scenario, GMC is subject to risk as soon as it agrees to the unfixed sale basis the March futures. However, it is NGFA’s understanding that GMC’s position would not qualify for this enumerated hedge until it executed an offsetting unfixed purchase in the cash market basis the December futures**.**

**Potential Solutions**

NGFA respectfully requests that the Commission craft a final rule that clarifies this strategy’s enumerated bona fide hedging status and ensures that our member firms can properly manage their risk. We offer three potential solutions:

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1. Anticipatory Merchandising

Clarify that a merchant has the ability to utilize a granted hedge exemption for anticipatory merchandising to hedge risks associated with unpriced purchases or sales.

2.  Offsetting Unfixed-Price Cash Commodity Sales and Purchases

Modify the definition of the enumerated hedge for Offsetting Unfixed-Price Cash Commodity Sales and Purchases to allow a person to hold spreads in a futures contract that do not exceed in quantity the amount of the contract’s underlying cash commodity that has been either bought or sold by the same person at unfixed prices.

3. New Enumerated Hedge Category

Add a new enumerated hedge category that would allow a market participant to hold calendar spread positions in a futures contract that do not exceed in quantity the amount of the contract’s underlying cash commodity sold by the same participant at unfixed prices.

The proposal notes that, “The Commission would be open to adopting additional enumerated hedges as it becomes more comfortable with evolving hedging practices…provided the practices comply with the general bona fide hedge definition.” The NGFA strongly supports this concept. Once a non-enumerated strategy is approved by an exchange and/or by the CFTC, it seems there should be strong impetus to include the strategy as enumerated in a future rule update. NGFA encourages the Commission to update the universe of enumerated bona fide hedges in Appendix A every year or two.

**Elimination of Federal Five-Day Rule**

The NGFA strongly endorses the Commission’s proposal to end the restriction that market participants cannot hold bona fide hedging positions in excess of position limits during the last five days of the spot period (i.e., the five-day rule). As we have repeatedly commented on previous position limit proposals, it is the physical delivery process itself that makes it critical that commercial firms be allowed to hold positions until expiration and take delivery. While the number of firms that will require an exemption in the last five days is few, the role they fulfill to ensure convergence of cash and futures is critically important to all industry firms and the contracts they use. It is appropriate that exchanges continue to have discretion to adopt their own such restrictions for purposes of exchange-set limits, and that they have authority to waive such limitations for purposes of their own limits.

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**Non-Enumerated Hedge Exemption Process**

The NGFA supports the Commission’s proposal that market participants have the option either to apply directly to the Commission for a non-enumerated bona fide hedge exemption or, alternatively, to apply to the applicable exchange, which we agree is more likely. In addition, we strongly agree that disapprovals of exchange determinations be undertaken by the Commission (not Commission staff). In any case, our expectation is that rejections by the Commission of exemptions approved by the exchanges for our industry would be very few and very infrequent.

That said, we believe that ten business days is too long for the Commission to review a bona fide hedge determination by an exchange.  A shorter time period – we would suggest two business days for both bona fide hedging needs known in advance and for sudden or unforeseen bona fide hedging needs – would be preferred to reduce uncertainty and risk on the hedger.  This shorter review period acknowledges the fast-moving nature of today’s commodity markets, which require a similarly fast-paced regulatory response.

Some uncertainty seems to exist in interpretations of the proposal regarding the CFTC review process. We respectfully request that the Commission clarify the following questions during development of the final rule:

1. During the proposed 10-day (or shorter, as we would prefer) CFTC review period of a non-enumerated bona fide hedge exemption approved by an exchange, can the hedger take the position approved by the exchange without fear of penalties imposed by CFTC for federal position limit violations?
2. For a hedger with sudden or unforeseen bona fide hedging needs who applies to an exchange for a hedge exemption, can the hedger rely on the exchange’s approval of the exemption and take the approved position during the two-day CFTC review period without fear of CFTC penalties for federal position limit violations?

In our view, the market participant should be held harmless for purposes of a federal position limit violation in both above scenarios; further the participant should not be subject to position limit violations if the Commission issues a rejection. Especially in the case of Question 1 above, we believe the need for a speedier review is amply illustrated – ten days without certainty merely exposes the hedger to more risk; and if the Commission retains the 10-day review in the final rule, it is even more imperative that the hedger be able to take the position during the review and not be held liable for violations if disapproved.

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If the CFTC stays an exchange determination to provide the Commission additional time beyond the review periods to study the issue and make a final determination, NGFA urges that such determination should be made within thirty business days in recognition of the market risk that the market participant is managing.  If the CFTC disapproves an exchange approval of a non-enumerated bona fide hedge exemption, we believe the CFTC should hold the market participant harmless for any position limit violation and provide that the position be reduced in a “commercially responsible manner,” and, as proposed, within a “commercially reasonable time.”  We respectfully ask that the Commission note that a “commercially reasonable time” and “commercially responsible manner” could vary from market to market.

**Conclusion**

To reiterate, the NGFA believes the proposal contains many positive elements and is a significant improvement over previous versions. With a few clarifications and refinements as discussed herein, we believe the final rule would foster an even more efficient and effective futures markets, one of U.S. agriculture’s competitive advantages, and serve the price discovery and risk management needs of hedgers in both the producer and agribusiness sectors very well. We would be happy to answer any questions the Commission may have about the NGFA’s views.

Sincerely,

A drawing of a face

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MJ Anderson, Chairman

Risk Management Commee