National Grain and Feed Association
Issues & Actions

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NGFA Issues Statement on CME Group Proposal to Adopt Variable Storage Rates for CBOT Wheat Futures Contract

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[***Editor's Note:*** *This publication keeps you – as a stakeholder in the NGFA – informed about issues being addressed and actions being taken to serve your business interests.* NGFA members are encouraged to contact the NGFA office to provide input, ask questions and raise other topics you believe should be addressed by <u>your</u> Association.]

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The NGFA on Sept. 30 issued the following statement in response to the CME Group's proposal to implement variable storage rates for the CBOT wheat futures contract, effective in September 2010, as a tool to enhance convergence – or narrowing – of cash and futures market values as futures contracts approach expiration:

"The CME Group has announced a proposal to implement a variable storage rate concept in the CBOT wheat futures contract. The NGFA believes this concept has considerable merit and can improve convergence, performance and balance in the contract.

"While we fully support the concept, the NGFA has recommended that the implementation date be December 2009 (rather than the September 2010 implementation proposed by the CME Group) because of the pressing need for a solution to this market challenge which affects many sectors of the industry and commercial hedgers. In addition to the NGFA, a subcommittee to the Commodity Futures Trading Commission (CFTC) Agricultural Advisory Committee also has recommended the December 2009 implementation. The NGFA supports the conclusions of that CFTC subcommittee."

"The NGFA also recommends that higher storage rates be implemented when 80 percent of full carry is reached in the market, rather than the 85 percent trigger being proposed by the CME Group.

"While the NGFA acknowledges that the CME Group's recommended extended implementation period is consistent with the traditional approach to assure sufficient notification to all market participants on material changes in contract specifications, and we respect this principle of market rule changes in general, there are trade-offs in delaying further action. There have been problems with CBOT wheat futures contract performance for several years that need to be addressed sooner rather than later. Because of the lateness in the current decision-making process, December implementation could prove to be very challenging. But we would urge the CME Group and the CFTC to work cooperatively for implementation as soon as possible, well before end of the current marketing year. The NGFA would urge a March 2010 implementation if the December 2009 date cannot be met.

"The NGFA has worked diligently with the CME Group and CFTC on this important issue and we continue to support their efforts to bring balance and viability to the contract. We stand ready to continue with that support, and we will provide technical and practical assistance in bringing conclusion to this matter as soon as possible."

Under the variable storage rate concept, storage (premium) charges assessed by grain elevators approved by the CME Group as locations for physical delivery of wheat to satisfy outstanding CBOT wheat futures contract obligations would expand or contract based upon the carry in the market that is implied by futures-market spreads. If an increase in storage rates is triggered, it would make it more costly to continue to hold market positions until the next delivery period. The current system has contributed to the significant gap between futures and cash market values. Under the proposal, the maximum that storage rates could increase or decrease would be 3 cents per bushel per contract month.

The lack of convergence in the CBOT wheat futures contract has had significant adverse impacts on farmers and the grain, feed and processing industry, particularly during the volatile grain market environment that occurred in 2008.

NGFA Says EPA-Proposed RFS-2 Recordkeeping Burdensome, Would Create Inefficiencies in U.S. Grain-Handling System

In a statement submitted Sept. 25 to the U.S. Environmental Protection Agency (EPA), the NGFA said that onerous and burdensome recordkeeping requirements that would be imposed under the agency's proposed renewable fuels standard (RFS-2) would add unnecessary costs and inefficiencies to the U.S. grain-handling system.

The NGFA cited the agency's proposals designed to implement a congressional mandate that renewable biomass eligible to be counted toward meeting the required increase in biofuels production be derived from plant crops and crop residues from land cleared or cultivated prior to Dec. 19, 2007. The Energy Independence and Security Act of 2007, signed into law on that date, requires the use of 15 billion gallons of renewable fuels by 2015, with an increase to 36 billion gallons by 2022. The law also requires the blending of 1 billion gallons of biodiesel produced from vegetable oils and/or animal fats by 2012.

EPA proposed several recordkeeping options that renewable fuel manufacturers would be required to use to document that feedstocks being used for biofuels production originate from eligible land. Specifically, the agency proposed that biofuels manufacturers be required to: 1) obtain and verify the accuracy of documentation from suppliers that feedstocks are derived from eligible land; 2) certify on renewable fuel production reports submitted to EPA that feedstocks being used meet the land-eligibility requirements, retaining sufficient records to support such claims; 3) establish and maintain a quality-assurance program of sufficient "rigor" to demonstrate feedstocks originate from eligible land; and/or 4) develop an industry-wide quality-assurance program that utilizes independent audits of feedstock suppliers.

The NGFA said EPA's proposed options are excessive and unwarranted, given the "minimal-to-nonexistent" risk that new land would be cleared for renewable fuels production in the United States. The NGFA cited federal data that showed non-federal forested land in the United States has remained fairly constant since 1982, while U.S. cropland acreage has declined. That makes it "very unlikely" that any "new" land brought into production would have been uncleared, uncultivated and forested previously.

Yet, the NGFA said, imposing such a recordkeeping requirement to create a tracking system that currently does not exist would impose significant costs and constraints on existing storage, transportation and distribution systems for feedstocks, particularly for corn and soybeans – a fact acknowledged by EPA. For instance, the NGFA said, EPA's recordkeeping proposal could require grain elevators to create a system to identify and document whether each and every load of feedstock received met the eligible-land requirement, and then segregate those feedstocks in identity-preserved storage so they would not be commingled with other, potentially non-compliant stocks.

For grain elevators, the NGFA said, EPA's proposed recordkeeping requirements would "disrupt" efficient facility operations and raise grain-handling costs, which would be reflected in commodity prices. "Conversely, grain elevators simply could choose not to participate in the renewable biomass program because of these operational and cost burdens, denying the use of these feedstocks to the renewable fuels market," the NGFA said.

Rather than imposing a burdensome, costly recordkeeping regime on all renewable fuel manufacturers and their feedstock suppliers for what EPA itself believes will be a very low level of noncompliance, the NGFA suggested that EPA consider more appropriate alternatives to verify that renewable biomass is not derived from ineligible land. For instance, the NGFA said EPA could utilize existing U.S. Department of Agriculture conservation and farm program data that track cropland usage and impose restrictions on clearing of previously unused land, as well as existing satellite and aerial imagery and mapping software used to monitor land usage.

In its statement, the NGFA also urged EPA not to use "unproven models" to make assumptions regarding indirect land use changes that potentially could result from increased U.S. biofuels production. "We believe that the science on indirect land use is very immature, and the models used by the agency are not sufficiently developed to provide validated outcomes on which to base sound, science-based regulations," the NGFA said.

As an example of faulty conclusions resulting from EPA's modeling of indirect land use, the NGFA cited the major assumption made by EPA that 34 million acres will remain in USDA's Conservation Reserve Program (CRP) – even if crop prices and U.S. land values increase as a result of increased feedstock demand. By assuming the CRP will remain at 34 million acres, the NGFA said, EPA's model limits potential U.S. acres available for crop production in response to growing biofuels demand and inflates adverse indirect land use changes in foreign countries.

The NGFA told EPA that recognizing the potential for non-environmentally sensitive cropland to exit the CRP as contracts expire, in response to growing demand, makes more sense than relying upon unproven modeling of indirect land use changes in other countries. EPA's model, based in part on the CRP assumption, found that both corn-based ethanol and soy biodiesel would be disqualified from meeting the tighter greenhouse gas emission targets mandated by Congress under the new U.S. renewable fuels standard, largely because of the indirect land use calculation.

NGFA Risk Management Committee Meets in Washington

A busy agenda greeted the NGFA's Risk Management Committee when it convened in Washington on Sept. 23-24.

The committee met with officials and staff of the Commodity Futures Trading Commission (CFTC), developed strategy on next steps to reestablish convergence in the CBOT wheat futures contract and discussed other major policy issues, including financial regulatory reform legislation currently being considered by Congress.

The committee met with CFTC Commissioner Bart Chilton and his staff to voice support for the variable storage rate concept developed by the CME Group to address the lack of convergence in the CBOT wheat futures contract, and to provide the NGFA's reasoning on why expedited implementation is important for commercial grain hedgers. Two NGFA Risk Management Committee members – Vice Chairman Matt Bruns, vice president, exports for Archer Daniels Midland Co., Decatur, Ill.; and Jeff Hainline, risk management adviser, Advance Trading Inc., Bloomington, Ill., who represents Missouri Agribusiness Association on the CFTC Subcommittee on Convergence – participated in the subcommittee's conference call. The remainder of the committee monitored the call from a CFTC conference room.

A follow-up meeting with CFTC staff members on Sept. 24 provided an opportunity to reinforce support for the variable storage rate and to respond to questions about impacts of a December 2009 contract implementation. The NGFA subsequently notified CFTC Commissioner Mike Dunn, who chairs the agency's Agricultural Advisory Committee, about the association's support of the convergence subcommittee's findings and recommendations, and urged quick CFTC action after the concept was proposed by the CME Group.

The committee also met on Sept. 24 with Mary Johannes, director of U.S. regulatory policy for the International Swaps and Derivatives Association, to discuss the contents and timing of financial regulatory reform proposals currently being debated in Congress. The committee focused its discussion on a proposal by the U.S. Treasury Department to regulate over-the-counter swaps and derivatives and its potential impacts on NGFA-member firms.

A five-person legislative working group from the NGFA's Risk Management Committee is working on this legislative issue, focusing particularly on the legislative definition of swaps and derivatives, and will explore potential participation in a coalition of end-users to monitor developments and advocate commercial grain hedgers' interests.

Further questions on the Risk Management Committee's meeting and activities may be directed to NGFA Director of Marketing/Treasurer Todd Kemp at 202-289-0873, ext. 16, or at tkemp@ngfa.org.

NGFA Joins in Urging U.S. Trade Representative to Defend GSM-102 Export Credit Program

The NGFA joined with 34 other diverse national agricultural producer, agribusiness and agricultural marketing organizations in late September in urging U.S. Trade Representative Ron Kirk to defend the GSM-102 export credit guarantee program from an adverse ruling rendered in August by the World Trade Organization in the case involving Brazil's trade complaint against U.S. cotton.

Specifically, the NGFA and other groups urged Kirk to ask the WTO to form a new compliance panel to update the cotton case ruling to reflect substantive changes made to the GSM-102 program by the U.S. Department of Agriculture (USDA) and Congress to conform to WTO rules. In a Sept. 21 statement, the organizations noted that these changes include:

- Measures, including risk-based guarantee premiums, adopted by USDA on July 1, 2005 for its three export credit guarantee programs – the GSM-102 and GSM-103 programs, as well as the supplier credit guarantee program.
- Legislation adopted by Congress as part of the 2008 farm law that eliminated the GSM-103 and supplier credit guarantee programs, and embodied in statute USDA's changes to the GSM-102 program. Congress also abolished the statutory 1 percent cap on guarantee premiums that could be charged by USDA, and required USDA to operate the GSM-102 program at no net cost to the U.S. government, thereby ensuring that it would not constitute an export subsidy program in violation of WTO obligations and ensuring that guarantee premiums cover the program's operating costs and losses.

The groups said the changes have resulted in the GSM-102 program generating a net positive return of $54 million to the U.S. government, more than offsetting its costs, including any credit losses.

"We believe that, if implemented, the WTO decision would cause unwarranted harm to U.S. agricultural producers and agribusinesses," the NGFA and other groups said. "Under the WTO panel's ruling, each year moving forward Brazil would be entitled to place tariffs or other import penalties on an amount of U.S. products based upon the use of a program that clearly is not a subsidy."

The groups stressed the importance of the GSM-102 program in providing financing to middle-income countries that rely on trade credit to import purchases of essential food, feed and fiber products.

The organizations noted that the WTO panel's ruling in the Brazilian cotton case was inconsistent with the WTO Doha Round trade-negotiating text, which allows for export credit guarantee programs that have been subject to appropriate disciplines. "The panel's decision to award Brazil retaliatory authority in amounts based upon the future use of a program that now is compliant with WTO rules makes no sense," the organizations said. "The panel's award decision seems to punish the United States for its compliance efforts."

Other major organizations joining the NGFA in urging that the U.S. government request a new WTO compliance panel were such groups as the American Farm Bureau Federation, American Soybean Association, National Cattlemen's Beef Association, National Chicken Council, National Corn Growers Association, National Cotton Council, National Council of Farmer Cooperatives, National Farmers Union, National Milk Producers Federation, National Oilseed Processors Association, North American Export Grain Association, North American Millers' Association, Pet Food Institute, United Egg Producers, U.S. Grains Council, U.S. Meat Export Federation, U.S. Rice Producers Association and U.S. Wheat Associates.

NGFA Joins in Supporting Increased Funding for Ag, Food Research

The NGFA on Sept. 3 joined 43 other national producer and agribusiness organizations in notifying key House and Senate leaders of support for legislation that would increase funding for agricultural research and extension programs during the fiscal year that begins Oct. 1

The groups supported the Senate version of the agricultural appropriations bill, which would provide $295.2 million for the U.S. Department of Agriculture's Agriculture and Food Research Initiative, a competitive research grants program. USDA reported it had to reject – solely on the basis of funding constraints – 78 percent of the meritorious research proposals it received and peer-reviewed during fiscal year 2007. The rejection rate was even higher in fiscal year 2006 – 84 percent.

While supporting the funding level in the Senate bill, the groups urged that House-Senate conferees reject guidance included in the Senate version that would designate at least 10 percent of future funding under the competitive grants program for research related to forestry and natural resources. "We fear that such set-asides establish a dangerous precedent and could undermine the objectivity and integrity of the competitive process, and efforts to secure future funding for this program," the NGFA and other groups wrote.

In addition to the NGFA, agribusiness organizations signing the letter included the Biotechnology Industry Organization, CropLife America, National Council of Farmer Cooperatives, National Oilseed Processors Association, North American Millers' Association, Pet Food Institute and USA Rice Federation. Twenty-nine agricultural producer, livestock and poultry organizations also signed, as did such organizations as the American Veterinary Medical Association, Council for Agricultural Science and Technology, and National Association of Federal Veterinarians.