National Grain and Feed Association

1250 Eye St., N.W., Suite 1003, Washington, D.C. 20005-3922, Phone: (202) 289-0873, FAX: (202) 289-5388, Web Site: www.ngfa.org

June 16, 2009

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St., NW
Washington, DC 20581

Dear Mr. Secretary:

RE: "Concept Release on Whether to Eliminate the Bona Fide Hedge Exemption for Certain Swap Dealers and Create a New Limited Risk Management Exemption From Speculative Positions Limits" – *Federal Register,* March 24, 2009

The National Grain and Feed Association (NGFA) appreciates the opportunity to provide comments on the CFTC's advance notice of proposed rulemaking (ANPR) on whether to eliminate the bona fide hedge exemption for certain swap dealers and create a new limited risk management exemption from speculative position limits. Generally, we believe such action would enhance performance of U.S. agricultural futures contracts; and, specifically, we believe this action could be an important contributor toward re-establishing a predictable relationship between cash and futures in the CBOT wheat contract and restoring convergence.

The NGFA believes strongly that increased participation of investment capital in U.S. agricultural futures markets has contributed to a cash/futures disconnect and to lack of convergence in the wheat contract. The situation came to a head in 2008 when futures advanced strongly, resulting in much wider basis levels than seen historically and subjecting commercial grain hedgers to significant financial stress in meeting margining requirements. Even today, following a retreat in futures price levels, commodity index traders as defined in the CFTC Commitments of Traders report hold open interest equivalent to more than twice the annual soft wheat crop; and basis levels continue to demonstrate a cash/futures disconnect. It is clear to us that a close examination of the Commission's hedge exemption policy for swap dealers is merited, and that a more limited granting of such exemptions could be beneficial to contract performance.

The NGFA offers the following observations in response to questions posed by the Commission in its March 24 concept release:

Question 1: Should swap dealers no longer be allowed to qualify for exemption under the existing *bona fide* hedge definition?

Response: The NGFA agrees that the current swap exemption, in place since 1991, is due for re-examination. As the March 24 Federal Register ANPR notes, U.S. agricultural futures markets and, in particular, over-the-counter (OTC) markets have changed dramatically since 1991. We believe it is no longer appropriate to automatically grant *bona fide* hedge exemptions to swap dealers; rather, a new process for granting conditional and limited exemptions to swap dealers could contribute to much-improved contract performance.

Question 2: If so, should the Commission create a limited risk-management exemption for swap dealers based upon the nature of their clients (e.g., being allowed an exemption to the extent a client is a traditional commercial hedger)?

Response: The NGFA supports replacing the swap exemption with a limited risk management exemption. As the question suggests, we believe granting such an exemption to swap dealers may depend on the nature of the swap dealers clients – in other words, to the extent the client is a traditional commercial hedger who would otherwise qualify for a hedge exemption, the swap dealer could be granted a risk management exemption for that client's legitimate commercial business. If a swap dealer is granted an exemption for a client or clients deemed noncommercial and subject to position limits, in no way should the dealer's exemption be allowed to modify the client's position limits. Position limits must continue to apply to the noncommercial client under all circumstances.

Question 3: If the bona fide hedge exemption were eliminated for swap dealers, and replaced with a new, limited risk management exemption, how should the new rules be applied to existing futures positions that no longer qualify for the new risk-management exemption?

Response: The NGFA does not advocate forced liquidation of swap dealers' existing positions. Such action could be disruptive to the marketplace. We suggest that these positions could be grandfathered until expiration of the futures or option contract in which the swap dealer holds a position. Alternatively, it may be logical to require compliance with a new limited risk management exemption at such time as the swap dealer's agreement with a customer expires.

Question 4: The existing *bona fide* hedge exemptions granted by the Commission extend only to those agricultural commodities subject to Federal speculative position limits. Should the reinterpretation of bona fide hedging and any new limited risk management exemption extend to other physical commodities such as energy and metals, which are subject to exchange position limits or position accountability rules?

Response: The NGFA's primary concern is to apply the new limited risk management exemption to agricultural commodities. Generally, though, it would seem to make sense that the new rule be applied consistently to commodities that currently are subject to position limits or accountability limits.

Question 5: If a new limited risk management exemption were to be permitted to the extent a swap dealer is taking on risk on behalf of commercial clients, how should the rules define what constitutes a commercial client?

Response: We suggest that a commercial client is an entity involved in the production, processing, merchandising, manufacturing or utilization of a product traded on a contract market. This traditional definition of a commercial hedger seems a good, common-sense place to start.

Question 6: How should the Commission (and, if applicable, the responsible industry self-regulatory organization (SRO)) and the swap dealer itself verify that a dealer's clients are commercial? Is certification by the dealer sufficient or would something more be required from either the dealer or the client? If so, what should be reported and how often – weekly, monthly, etc.?

Response: Consistent with existing CFTC rules, we believe the onus would lie with the swap dealer and/or the dealer's clients to satisfy the Commission that they qualify as a commercial hedger. We believe certification by the dealer and/or clients probably is not sufficient. Regular reporting to the Commission should be a requirement for the dealer and its clients, with such reporting subject to auditing by the Commission.

Question 7: For a swap dealer's noncommercial clients, should the rules distinguish between different classes of noncommercials – for example: (1) Clients who are speculators (e.g., a hedge fund); (2) clients who are index funds trading passively on behalf of many participants; and (3) clients who are intermediaries (e.g., another swap dealer trading on behalf of undisclosed clients, some of whom may be commercials)?

Response: While the added transparency of differentiating between noncommercial clients of swap dealers may be desirable – and while such information may be useful to the Commission – as a practical matter, it would be unnecessary to distinguish among different types of noncommercials for purposes of granting the limited risk management exemption. Simply put, noncommercials should not qualify for a hedge exemption, regardless of how they access the futures markets. In the specific case of a swap dealer trading on behalf of another swap dealer whose clients are undisclosed, we would urge that the Commission exert heightened vigilance, as this could be an attempt to work around position limits.

Question 8: If a swap dealer were allowed an exemption for risk taken on against index-fund clients, how would the dealer satisfy the Commission that the fund is made up of many participants and is passively managed? Is certification by the dealer or fund sufficient or should the dealer or fund be required to identify the fund's largest clients?

Response: The NGFA believes that index funds, as noncommercial participants, should be subject to speculative position limits. This would be the case whether a fund accesses the futures market directly or through a swap dealer. The NGFA would suggest that certification by the dealer or its clients is not sufficient and that regular reporting to the Commission should be required to help ensure that all noncommercial clients of swap dealers are held to position limits.

Question 9: If a swap dealer were allowed an exemption for risk taken on against another intermediary, how would the dealer satisfy the Commission that its intermediary client does not in turn have noncommercial clients that are in excess of position limits? Is certification by the dealer or second intermediary sufficient or should the dealer or intermediary be required to separately identify the intermediary's largest clients.

Response: As noted above in the response to Question 7, the NGFA would strongly suggest that the Commission exercise special vigilance in this instance. Establishing an intermediary entity could be an attempt to circumvent position limits for noncommercial participants. In all cases, but especially in this scenario, the Commission should require regular reporting by the swap dealer, the intermediary client and the ultimate client to ensure compliance with position limits, and regular auditing by the Commission should be expected. While it likely will prove difficult, the Commission should vigorously pursue a policy of looking through the swap dealer and any intermediary parties to the final client.

Question 10: What futures equivalent position level should trigger the new limited risk management exemption reporting requirement? For example, under the rules of the on-going special call to swap dealers and index funds described earlier, a swap dealer must report any client in any individual month that exceeds 25% of the spot month limit, or the net long or short position of a client that in all months combined exceeds 25% of the all-months-combined limit.

Response: The reporting rules established by the Commission in its ongoing special call seem appropriate as a starting point for the limited risk management exemption proposal.

Question 11: If none of a swap dealer's clients exceed required reporting levels in a given commodity, or none of such clients exceed reporting levels in any commodity, what type of report should be filed with the Commission – e.g., a certification by the swap dealer to the Commission to that effect?

Response: Whether or not a swap dealer's clients exceed required reporting levels, the dealer should still be responsible for reporting aggregate activity.

Question 12: Should there be an overall limit on a swap dealer's futures and option positions in any one market regardless of the commercial or noncommercial nature of their clients? For example, “A swap dealer may not hold an individual month or all-months-combined position in an agricultural commodity named in Section 150.2 in excess of 10% of the average combined futures and delta-adjusted option month-end open interest for the most recent calendar year.”

Response: It seems reasonable to place some limit on a swap dealer’s positions. While we do not have a specific figure to recommend at this time, the limits should contain specific reference to single-month and all-months-combined open interest.

Question 13: If a new limited risk-management exemption for swap dealers is created, what additional elements, other than those listed here, should be considered by the Commission in developing such an exemption?

Response: No additional elements to suggest at this time.

Question 14: How should the two index traders who have received no-action relief from Federal speculative position limits (see footnote 15) be treated under any new regulatory scheme as discussed herein?

Response: We advocate treating all noncommercial participants the same; therefore, we suggest that the two index traders be required to comply with new position limits within some reasonable period of time.

Question 15: What information should be required in a swap dealer’s application for a limited risk management exemption?

Response: Generally, we would like to see the swap dealer demonstrate that the limited risk management exemption is being sought to hedge risks incurred by the dealer as the result of a transaction with a commercial hedger or hedgers. This may involve reporting to the CFTC the identity of clients to enable the Commission to verify their commercial hedger status.

Sincerely,

Rod Clark

Rod Clark
Chair, Risk Management Committee