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C.F.T.C.
COMMENT

May 21, 2009

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

Re: 17CFR Part 150
"Whether to Eliminate the Bona fide Hedge Exemption for Certain Swap Dealers and Create a New Limited Risk Management Exemption from Speculative Position Limits"

Dear Mr. Stawick,

The National Cotton Council (NCC) represents producers, ginners, cottonseed merchandisers and processors, merchants, cooperatives, warehousemen and textile manufacturers. Approximately 18,000 thousand cotton farmers produce a crop with an annual farm-gate value in excess of $5 billion. The industry and its suppliers, together with the cotton product manufacturers, account for approximately 200,000 jobs and generate total annual economic activity in excess of $100 billion.

The cotton industry remains concerned about the ability of futures markets to fulfill their primary functions of price discovery and risk management relative to real market conditions. In February, the NCC joined with the American Cotton Shippers Association and AMCOT, a trade association of marketing cooperatives, to offer the following recommendations to the House Committee on Agriculture:

- Establish trading limits to prevent excessive speculation,
- Subject all contract and over-the-counter market participants to speculative position limits,
- Subject speculative entities to the same weekly reporting requirements as the trade,
- Limit hedge exemptions and limit eligibility for hedge margin levels to those actually involved in the physical handling of the agricultural commodity,
- Disaggregate index funds and publish the number of positions and total value of the index funds and other passive, long-only and short-only investors, and data on speculative positions relative to their *bona fide* physical hedges, and
- Establish reporting requirements for index traders and swap dealers in designated contract markets (exchanges), derivative transaction execution facilities and all other trading areas.

In response to the Concept Release published in the March 24, 2009 Federal Register, the NCC submits the following comments.

A. General Advisability of Eliminating the Existing Bona fide Hedge Exemption for Swap Dealers in Favor of a Limited Risk Management Exemption

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

> Hedge exemptions should be limited to commercial entities actually involved in the physical handling of the commodity. Therefore, swap dealers should no longer be allowed to qualify for exemptions under the existing *bona fide* hedge exemption.

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)?

> We agree with the concept of creating a limited risk-management exemption, but with certain conditions applied to the involved parties. Specifically, both the swaps dealer and the commercial hedger, on whose behalf it is trading, should be required to file a weekly report of all transactions entered into for or on its behalf and that such trades be reconciled and aggregated by the Commission from all risk management exemption entities to prevent the speculative limit from being exceeded.

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? For example, should existing futures positions in excess of current Federal speculative position limits be grandfathered until the futures and option contract in which they are placed expire?

> No, there should be no "grandfathering" of existing futures positions in excess of current Federal speculative position limits. Instead, a timeline should be applied after which all positions would need to be in full compliance with the new regulations. Otherwise, positions could be moved to much later expirations to avoid compliance. All positions should be afforded the same consideration by the Commission. A trading entity with a position in a nearby month should not be treated differently than trading entities with distant month positions – each should be subject to the same liquidation schedule.

Should swap dealers holding such position be given a time limit within which to bring their futures position into compliance with Federal speculative limits?

> Yes, as noted in the previous answer.

Should swap dealers holding such positions be required to bring their futures positions into compliance with the Federal limits as of the effective date of the new rules?

> Yes.

B. Scope of a Potential New Limited Risk Management Exemption for Swap Dealers

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?

> The NCC believes that any reinterpretation of *bona fide* hedging and a new limited risk management exemption should be applied to all commodities for which companies use contract markets for hedging purposes in their commercial business.

C. Terms of a Potential New Limited Risk Management Exemption for Swap Dealers

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?

> A commercial client would be an individual or entity that either produces, processes, merchandises, manufacturers, or consumes the commodity traded on a contract market.

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.?

> The Commission should require all individuals/entities claiming to be a commercial enterprise to register with the Commission and report their commercial activities. Annual verification audits by the Commission should be used to validate the reporting.
>
> Similar reports should be filed by the swaps dealer for each of its commercial clients, and the Commission should be required to reconcile and aggregate the positions of the commercial client and the swap dealer.
>
> As noted above, a more thorough reporting procedure is required.
>
> Regular reporting is required by the swaps dealer and their commercial client. The reports should be monitored closely.

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)?

We recommend that all noncommercial clients of a swap dealer be treated similarly. Since each of the noncommercial clients are speculators, each should be held to the same standards of reporting compliance, and each should be monitored to prevent trading in excess of the speculative limits. Particular attention should be given when a swap dealer is acting on behalf of another swap dealer allegedly trading on behalf of an alleged undisclosed commercial since this approach has been extensively used in recent years by swaps dealers to exceed the speculative limits.

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?

The index funds should be required to report the amount of each individual or entity's investment so as to be certain that no single investor has exceeded his speculative position limits through a large index fund investment.

Is certification by the dealer or fund sufficient or should the dealer or fund be required to identify the fund's largest clients?

The Commission should require all funds or dealers to register, and all of the funds clients should be identified to the Commission in order to assure that the fund is not being used by any commercial or non-commercial interest to exceed the limits.

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?

Consistent with an earlier response, there should be no such exemptions permitted.

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?

All of the intermediary's clients should be identified to the Commission in order to assure that limits are being adhered to by all no commercial or non-commercial interests.

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.

The reporting requirement should be established at the same level currently required for each contract traded on a regulated commodity exchange.

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?

> Aggregate activity by the swap dealer should be regularly regardless of whether or not his client exceeds the speculative limit.

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 Sec. 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."

> In order prevent any distortion or market control, a reasonable standard should be applied to the aggregate positions of the swap dealer and his or her commercial and non-commercial clients.

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?

> Weekly reporting, aggregation of positions and disclosure of counter parties should be requirements for a new limited risk-management exemption.

D. Other Questions

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?

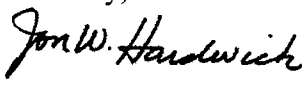
> The no-action relief should be rescinded.

15. What information should be required in a swap dealer's application for a limited risk management exemption?

> The minimum information required should include its reporting capabilities and compliance procedures.

The NCC would like to thank the Commission for the opportunity to offer these comments.

Sincerely,



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Chairman