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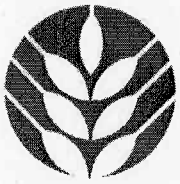

American Bakers Association

Serving the Baking Industry Since 1897

Received CFTC
Records Section
6/16/09

June 15, 2009

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

COMMENT

C.F.T.C.
OFFICE OF THE SECRETARIAT
2009 JUN 16 PM 3 20

RE: 17 CFR Part 150: Concept Release to Eliminate Bona Fide Hedge Exemption for Swap Dealers & Create New Limited Risk Management Exemption from Speculative Position Limits.

Dear Secretary Stawick:

The American Bakers Association (ABA) would like to thank the Commodity Futures Trading Commission and its Commissioners for allowing participants of the commodity futures markets to submit comments regarding the CFTC Concept Release on whether to eliminate the bona fide hedge exemption for swap dealers and create a new limited risk management exemption from speculative limits.

As you are aware, ABA represents the interest of bakers before the U.S. Congress, federal agencies, state legislatures and international regulatory authorities. ABA advocates on behalf of over 250 members, both bakers and their suppliers. ABA members produce bread, rolls, crackers, bagels, sweet goods, tortillas and many other wholesome, nutritious baked products for America's families. The baking industry generates over $70 billion in economic activity annually and employs close to half a million highly skilled people.

When implementing possible new regulation on the futures markets, ABA urges the CFTC to take into account its proposals to address market volatility and convergence issues:

Redefine the parameters of a true commercial hedger: The definition of a commercial hedger should exclude those who do not purchase the physical product for production purposes.

ABA believes the index/swap participant is not a commercial hedger, but is a speculator, exercising a bias that commodity prices will generate a negative correlation to changes in stock returns and capital market returns. Although the swap dealer is hedging a financial obligation in the futures pits, the originator of the position (the retail investor) is speculating.

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Restructure reporting classifications to accurately report contract holdings of commercial hedgers, index funds, and all other contract holding entities.

ABA believes the current market participant classifications group together too many dissimilar entities into too few categories. More classifications would help provide better transparency and improve the confidence in the market's function. The CFTC should report all index fund positions and not just the agricultural positions. Agriculture represents only about 20% of the total index fund positions. Reporting all positions would greatly improve the transparency of the market.

Using this premise, ABA's responses to the questions posed in the concept release are as follows:

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?
   Yes, unless the swap is executed to hedge against a genuine (and demonstrated) physical exposure.

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)?
   The exemption would need to clearly define a traditional commercial hedger: those entities who consume or produce physical commodities and therefore have a legitimate quantified exposure to price changes in physical commodities as a part of the ongoing operation of their business enterprise.

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? Should swap dealers holding such position be given a time limit within which to bring their futures position into compliance with Federal speculative limits? 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?
   These positions should be liquidated. If it is inappropriate to hold them, they should not be held. A methodical reduction in holdings over a prescribed period is acceptable.

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?
Yes. The logic also applies to energies, base, and precious metals. Speculators can continue to participate, utilizing CFTC position limits.

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?
See number A.2. above....

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 CFTC form 40 should suffice. This is a legal document subject to prosecution. However, a footnote should be added to the Form 410 to make this abundantly clear.

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)?
For reporting purposes, yes, so that all classes of participants can be tracked. For position limits, no. All participants above are speculators.

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?
ABA does not support any exemptions for swap dealers for risk taken against index-fund clients. Index funds should be under strict contract limits, similar to the traditional non-commercial market speculator.

In reference to the question, if CFTC allows swap dealers an exemption for risk taken on against index-fund clients, as all exchange participants are required to

register, all swap participants should be required to register with the CFTC. Swap Dealer clients should also register and disclose holdings to the CFTC.

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? ***See C.8.***

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.
A new limited risk management exemption reporting requirement should be triggered when any non-commercial category exceeds 10% of open interest, not 25%. While index funds are composed of many participants, they all act as a single participant.

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?
This is not the problem; the root cause is that the index has created a group of individual participants who carry up to 25% of all open interest, yet they operate as a single unit - all buying and selling at the same time.

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."
Yes.

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?
Index participation as a percent of futures open interest. For example, in agricultural commodities, possibly consider annual production as a measurement.

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?
Similar to the scenario in question 3, these positions should be liquidated. If regulation deems these positions inappropriate to hold, then the contracts should not be held. Again, a methodical reduction in holdings over a prescribed period would be acceptable.

A recent example of the impact of index speculators occurred in early June. On June 1st, wheat contracts at the Chicago Board of Trade (CBOT) increased by 37 cents, or over 5 percent of the total price. Then, just two days later, wheat contracts at CBOT ended 52 cents lower than the starting price. While these two examples may be the extremes of recent volatility, these examples are representative of the larger issue: volatility is increasingly unmanageable for most traditional market participants.

To reiterate ABA's position on this issue, commodity futures markets have never been considered an investment class until recently. As defined in A.2. above, index speculators have no physical reason for participating in these markets and must be treated as a speculator. The position that their activities are passive and have no impact is erroneous, as all market participants have some impact on market functionality.

ABA applauds the Commodity Futures Trading Commission for taking a proactive approach in addressing volatility with the markets. ABA believes that by eliminating the bona fide hedge exemption for swap dealers, the markets will be given an opportunity to return to operating under their original intent.

Thank you for your consideration of these recommendations.

Sincerely,

Robb MacKie
President and CEO