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National Grain and Feed Association

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June 22, 2000

Ms. Jean Webb, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre, 21st St., N.W.
Washington, D.C. 20581

Dear Madam Secretary:

This letter is in response to the F.R. notice published June 8, 2000, concerning an expansion of daily price fluctuation limits in certain agricultural commodities. The National Grain and Feed Association is a voluntary trade association comprised of 1,000 member companies involved in all aspects of cash grain and feed marketing and handling, as well as futures-related risk management and grain pricing activities. Our members own and operate more than 1,000 facilities nationwide, and merchandise more than two-thirds of the grains and oilseeds sold through commercial channels nationwide.

We have already had dialogue and provided formal input to the CBOT as it has wrestled with this issue. In an effort to ensure a complete representation of our views, attached to this letter is the complete communication we forwarded to the CBOT on May 12, 2000.

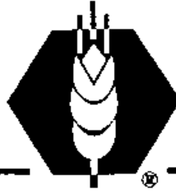
In general, while we have not done any formal surveys, it appears that a majority of NGFA's members are concerned about substantial expansion of price limits, because: 1) price limits provide circuit breakers that are useful at times to prevent temporary over-reaction in markets that may be driven by emotion; 2) increased risk to hedgers may encourage market users to find less volatile hedging mechanisms; and 3) financing potentially higher margin calls could add to the financial pressures and risks for all participants. There are, however, some of our members who think the expanded price limits will not pose a significant change, and might even enhance contract performance.

NGFA recognizes that the CBOT is under pressure to develop its electronic marketplace and some trade-offs may become necessary to make that happen in a timely way. But it is somewhat troubling that in this rapidly changing marketplace, the limits of technology can at times be a more important driver of structural change than the considered judgment of the CBOT's customers. Thank you for the opportunity to comment.

Sincerely yours,

Tom Coyle
Chairman, Risk Management Committee

1250 Eye St., N.W., Suite 1003, Washington, D.C. 20005-3917
Phone: (202) 289-0873, FAX: (202) 289-5388, E-Mail: ngfa@ngfa.org, Web Site: http://www.ngfa.org



National Grain and Feed Association

VIA FAX

May 12, 2000

Mr. David Brennan
Chairman
Chicago Board of Trade
141 W. Jackson Blvd.
Chicago, IL 60606

Dear David:

I understand that the CBOT Executive Committee will be reviewing the ag contract price limits very soon. On behalf of NGFA members, we wanted to share our views with you.

We do want to work with the CBOT on this matter, recognizing that there is no perfect solution for all concerned. The attached position document offers our initial candid views on the basis of NGFA's broad membership base, most of whom are in the cash business and are the hedging users of the contracts.

Thanks for considering our views.

Sincerely yours,

Kendell

Kendell W. Keith
President

Enclosure
CC: David Lehman

1250 Eye St., N.W., Suite 1003, Washington, D.C. 20005-3917

Views of National Grain and Feed Association

on

Proposed Amendments to Price Limits on Ag Contracts

May 12, 2000

The National Grain and Feed Association appreciates the opportunity to participate in the dialogue concerning price limits on CBOT agricultural contracts. The NGFA has strong reservations about all of the proposals being actively considered. At the same time, we understand the changes are being evaluated within the context of adoption of the Eurex-based electronic trading technology, which is viewed as quite important for the future business expansion of CBOT contracts. Therefore, NGFA pledges to work with the CBOT on the best nearby and longer-term solution, recognizing that there are conflicting objectives and very likely some trade-offs required.

Previous Views of the NGFA

The last time the CBOT considered amending its price limits was in 1994. At that time the NGFA filed a statement with CBOT that expressed opposition, both to the elimination of price limits as well as increasing the limits by 50%. We are attaching that 1994 letter to this statement as general background information While industry views may have changed during the last six years, that 1994 letter gave a thorough accounting of the rationale for the expressed concerns, and therefore, may provide some useful additional information as CBOT reviews the alternatives.

Survey of NGFA Risk Management Committee

Since receiving a copy of the CBOT proposed alternative solutions, we surveyed our risk management committee's views. Of 15 committee members, two offered support for no-limits markets with the rationale that limits curtail execution and can prevent an offset trade that defines a loss. Most of the other members of the committee expressed views ranging from moderately-to-strongly negative toward expanded price limits or a market with no limits. Issues raised by these respondents included: 1) price limits provide "circuit breakers" that many believe are a useful device to prevent temporary over-reaction driven by emotion; 2) increased risk to hedgers may encourage market users to pursue alternative hedging mechanisms; and 3) financing margin calls in a potentially more volatile environment may reduce the number of participants, and adds to financial pressures and risks for all participants.

While understanding the need for CBOT to move forward in the adoption of electronic technology, many members of NGFA's committee expressed dismay that the new technology would place limitations on fundamental market parameters, and potentially drive market process. Therefore, whatever solution is determined to be optimal at this time, we would encourage the CBOT to search for a longer term solution that will permit Eurex to replicate the exchange rules that members and customers believe are in the best interest of market performance for price discovery and risk shifting. Our view is that it is

better for market participants to decide on the best market rules, rather than having technology issues or, in this case, limitations drive the rulemaking process.

We understand from the data you have provided that price limits have been triggered only a few times in recent years. However, we now may be entering a period of more volatile weather-driven markets, in which price limits could be triggered more frequently. Thus, an effective solution to this issue is critical and could easily be tested multiple times in the near-term.

Comments on the Specific Proposals

CBOT's "alternative 1" would eliminate price limits on both the open-outcry and electronic trading. While the market presently has no limits in the nearby contract during the delivery period, we believe this is not the best approach for the market long-term. Hedgers will be required to discuss this new financing risk issue with their lender, and some hedgers may not meet new credit-qualifying requirements imposed by lenders. It is also possible that the clearing corporation might decide to increase initial margins which would elevate the cost and the entry fee for using the CBOT markets. While we see this as a highly significant issue for the market, if imposed on a temporary basis only, during the period while technical adjustments are being made to permit price limits to be instituted on the Eurex system, it could be considered as one of the options (although less desirable than some other alternatives from our perspective). One committee member also raised the question as to whether this kind of dramatic shift in limits could affect volatility, and therefore the pricing on existing exchange-traded options. Is there a way to address this question?

Alternatives 2 and 3 would both institute trading halts when prices reach the limits. There is some healthy skepticism among our committee members about how this would work, and how it might affect cross-commodity spreads and other trading. At least when price limits are hit in today's market environment, synthetic positions can be created with options that allow some protection and market processes to continue. A halting of trading would appear to eliminate this important market utility. Expanding the limits to 150% of current values would reduce the frequency of trading halts, but trading halts would remain a concern.

Summary

NGFA's Risk Management Committee is charged with representing the interests of our entire membership, 750 of which are relatively small businesses in the cash grain and feed business who rely on the CBOT for pricing and hedging. A survey of our committee concerning an appropriate NGFA position that would best represent our members' interests, revealed a strong leaning toward supporting the existing limits. If an expansion is necessary to accommodate the new system, an increase to 150% would be preferred to the alternative of no limits. To the extent feasible, NGFA's membership would prefer that any significant expansion in limits be considered temporary, and effective only until the Eurex system can be changed to adapt to the consensus preferences of the membership and customer base of the CBOT. Thank you for the chance to comment.

FINAL
TO CBT
PX LIMIT

National Grain and Feed Association

October 11, 1994

Mr. Patrick H. Arbor
Chairman of the Board
Chicago Board of Trade
141 West Jackson Boulevard
Chicago, Ill. 60604-2994

COPY

Dear Pat:

Thank you for your letter of September 27th concerning your board's action considering changes to daily price limits on agricultural contracts traded at the exchange. The National Grain and Feed Association (NGFA) represents the principal commercial interests using the grains and oilseeds futures contracts to hedge their commodity transactions. We appreciate this opportunity to provide you the views of our industry on this important issue.

NGFA is absolutely opposed to the CBOT proposal to eliminate daily price limits on agricultural futures and options. We are also opposed to the earlier proposal to raise daily limits by 50%. NGFA members constitute one of the largest groups that use CBOT's agricultural markets for risk transfer. Our members must be able to measure -- and make decisions on how to manage -- daily price risk, as reflected in CBOT futures' prices. We believe both of these important functions would be undermined by the proposals under consideration at the CBOT.

Among the issues we have with this proposal:

- The proposals are contrary to the current industry trend of "self regulation."

- The proposals' potential impact on market volatility is unclear.

- We are not familiar with the past performance of other futures contracts without daily price limits and what that performance might mean to agricultural contracts.

- We do not believe these proposals will generate trading volume.

- Our members believe that the proposal will result in increased risk to market users especially among small hedgers.

- The proposals will force FCMs and IBs to be more stringent in their evaluation of customers.

- We do not agree that price discovery is adversely affected by existing daily price limits.

Regulatory/Legislative

There is nothing inherently wrong with rules and oversight. In our view, price limits represent an effective and relatively benign form of self regulation. Daily price limits provide protection for market users, while only infrequently limiting market potential. Our members gladly accept the limit on potential in return for this protection. Since the stock market crash of 1987, the overall approach to managing market volatility has been increasing reliance on circuit breakers, one form of which is price limits. Agriculture fought aggressively to keep futures from being pulled under the jurisdiction of the SEC, and won in large part by defending the CFTC's ability to be a tough regulator, and publicizing the futures exchanges' ability to self-regulate.

This proposal to eliminate price limits (or even dramatically increase them) flies in the face of the current trend of self-regulation. A "meltdown" or "blowoff" is very rare, but when it occurs--without price limits--our industry would not only face staggering financial exposure, but federal policymakers would have a field day. The potential for negative PR is huge.

Volatility

The CBOT staff says research is mixed on whether eliminating price limits increases, reduces or has no effect on overall volatility. We are interested in reviewing such studies and evaluating other futures contracts that currently have no limits. Specifically, we are interested in how effective such markets are for hedging, the size of the market, and other appropriate criteria for comparison.

Volume

Our members do not believe CBOT's trading volume will rise if limits are increased, and believe it will decline if limits are eliminated. There are so few days per year when the market closes locked limit, that the potential additional volume is small relative to annual volume. At the very least, without limits volume would become concentrated in the hands of fewer participants--the largest and best financed, whether speculators or hedgers.

We recognize the CBOT is concerned about losing volume to less-regulated markets. Some of that may be inevitable but we do not see the CBOT's price limit proposal as being a remedy. The CBOT is at a turning point. This proposal to eliminate price limits, if combined with the petition for a Pro-Market exemption, fuels our concerns that the CBOT may seek to exclude some current market participants. What is the place of a small hedger or speculator in such a marketplace? The NGFA supported the CBOT's petition for a Pro-Market exemption, but voiced its concerns at the time about protecting the place of the small trader in agricultural markets.

Market Risk

CBOT statistics show there are a minimal number of days most years when markets lock bid or offered. There are many more days when prices move sharply but don't close on the limit. Yet we can't be sure of what will occur until each session begins. Without daily price limits as a buffer, potential users of futures would have to approach risk management much differently. Although the odds of a dramatic adverse price move will be low, such events will occur. The only question is when. (Witness 1988, or the Embargo of 1980). Limits may not prevent such moves, but they do make sure they are orderly and measured rather than a knee-jerk reaction.

For instance, even a moderate size agribusiness could easily be net short 2MM bushels (or more) soybeans at various times through the year. Even with a 30-cent limit that means a Day 1 variation call of $600,000. Price limits provide a one-day lag before further demands for variation margin will occur. This provides time to produce the cash flow to meet margin requirements, or exit the futures positions in an orderly manner versus cash, or outright liquidation. Without that overnight cooling-off period, hedgers and speculators must always be financially able and prepared for a potential "meltdown" market. How can hedgers make a rational risk-management decision if they can't quantify the potential cash flow exposure to their business?

The bottom line impact, we believe, would be less trading volume for the CBOT. Small- to medium-size hedgers will have to be more cautious in deciding how much they hedge, especially in soybeans. More risk transfer will go intra-market -- cash seller to cash buyer -- rather than through futures. Agribusinesses are increasingly diversified and vertically integrated. They have a greater capacity to manage risk internally, without direct use of futures if necessary. Small hedgers will turn to these buyers to accept any risk they can no longer afford to carry, or are not willing to take on. Most businesses have a finite amount of cash/credit immediately available for hedging needs. This leaves only one way to lessen margin exposure if there are no daily limits: hedge smaller quantities.

FCMs/IBs

The NGFA believes the proposals under consideration at the CBOT will force the brokerage community to be much more stringent in evaluating potential customers. FCMs and IBs will enact stricter financial standards, or will refuse to open some accounts now considered reasonable risks. Businesses primarily look at risk in terms of dollars; they set the parameters and then allocate the dollar exposure. If limits are removed, it raises the exposure. FCMs and others will respond as they consider prudent.

Farmers in particular are likely to find it much harder to use futures directly, especially soybeans. Many brokerage firms simply won't accept the exposure from small accounts, given the potential revenue.

Risk management alternatives

The likely first alternative is for agribusinesses to turn to the cash market to lay off risk. There are other choices, however. New futures exchanges are developing, and may be viable for some agribusinesses. OTC instruments, carefully constructed, can also provide a viable risk-management vehicle. Short-term swaps are not yet common in agriculture, but several swaps firms are seriously interested in the potential market in agriculture. Some swaps participants would use the CBOT as an offset, but some would absorb risk internally, lay it off overseas or in other instruments. Again, the CBOT stands to lose more volume.

Knight Ridder carried a story on October 3 on this issue. The author had interviewed Ron Hobson, chief of economic analysis at CFTC, and said "Structured notes may be outpacing swaps as the new 'vehicle of choice' for agricultural firms seeking to hedge interest rate risks and currency risks." While this wasn't directed at corn or soybean hedging, it clearly reflected a growing acceptance of alternative strategies by agricultural firms. The story also went on to say "CFTC would be interested in keeping tabs initially on whether a lot of notes are being created that are more futures and options than notes. In the meantime, there is a good chance CFTC soon will start probing the futures markets to answer the long-standing question of whether swaps are being used at the expense of futures or in conjunction with them."

Cash grain market exposure

Our members are mixed on this issue. Some feel that the potential for an "unlimited" adverse opening will increase cash market exposure outside trading hours. Others believe the genuine risk lies only in the margin financial exposure.

Initial Margins

The CBOT states the Initial Margins will not go up. Our committee sees no evidence to confirm that at this point. Your present rule increases Initial Margins by 50% when expanded price limits go into effect. This reinforces our concerns. If IM is not tied to daily price limits, then this existing rule needs to be eliminated. That change would alleviate one of the margin concerns voiced by some CBOT members.

Synthetics

We hear that limit days force potential futures volume into synthetics, and that this raises the cost of doing business. We agree that the cost goes up. We regard that increased cost as an acceptable tradeoff for the protection of the limits. Any serious market user -- large or small -- can enter or exit a futures equivalent in all but the most dramatic trading session. We find nothing wrong with taking this extra step. If our members are prepared to use synthetics, CBOT and member traders should be pleased. It adds volume.

Price Discovery

We agree price discovery via futures is temporarily impeded in limit markets. Again, synthetics offer a way to allow price discovery to continue. That aside, is there anything that

tells us that price discovery delayed until the following morning is any less efficient than that obtained immediately by having no limits? It reminds us of the comparison of mules and horses. If you leave several days' rations of food in front of a horse, it will often eat until it becomes sick or even dies. You can put that same amount of food in front of a mule however, and leave for days. A mule always self-rations; it instinctively knows overindulgence can be deadly, and that moderation has its rewards. Which animal better reflects the true demand for feed?

Futures are a unique vehicle and require special treatment. Short sales are legal, and those with the most ready access to the market -- locals or fund managers, for example -- can bring large orders to the market virtually instantly. The flow of broader public business to counter the first wave will come more slowly. This is another value of the price limits; they provide time for information to be disseminated and more orders to flow in. True price discovery results when a broad base of interests have all contributed to the process. This also enhances market integrity.

Summary

If the CBOT wants agricultural participants to continue to use its markets, we urge you not to eliminate daily price limits. Limits provide an important safety net for all market participants, including brokerage firms. Without that safety net, the CBOT has a real likelihood of losing volume.

These two proposals provide virtually no discernible potential benefit to hedgers in general, and to our membership in particular. The proposals do pose clear risks. The CBOT may say some of our concerns are unwarranted, but we firmly believe that these concerns merit serious consideration by the exchange. Initial margins can be raised at any time. A potential dramatic swing can happen at any time. We do not have any track record yet of whether Phase 2 of the higher speculative limits will have any impact on market volume, liquidity or volatility.

If the CBOT wants to be the marketplace of the future, and attract increasing volume from a diverse group of customers, it must command respect as an institution responsive to customer needs and concerns. We do not believe these proposals demonstrate that responsiveness.

To summarize, we are firmly opposed to raising or eliminating daily price limits. If this proposal does move forward for consideration by the CFTC, we intend to oppose it before that regulatory body. We ask for an opportunity to meet with you in person to discuss this issue before it is put to a Board vote.

The NGFA has always been committed to working with the CBOT and other exchanges to maintain viable markets that meet the needs of our members, the public in general, and the CBOT membership. We have worked closely together on a number of significant issues, and have accomplished many things, including: defusing futures transaction taxes, CFTC

reauthorization, definition of insider trading, the lengthy review of contract grade and delivery specifications and much more. We propose that the CBOT and NGFA meet periodically, as we have before, to discuss issues. It's in our mutual interest to work closely together on both immediate concerns and long-range needs and goals.

Sincerely,

Diana Klemme
Chair, Commodity
Exchange Committee

cc.:

Ms. Mary L. Shapiro, CFTC Chair
Ms. Shelia C. Bair, Commissioner
Mr. Joseph B. Dial, Commissioner
Ms. Barbara P. Holum, Commissioner
Mr. John Tull, Commissioner
Mr. Gordon Linn
Ms. Ann Berg
Mr. Ralph Goldenberg