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National Grain and Feed Association

August 7, 2000

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COMMENT

Commodity Futures Trading Commission
Three Lafayette Centre
1125 21st Street, N.W.
Washington, D.C. 20581

(This response addresses four regulatory proposals published by the CFTC in the June 22, 2000 Federal Register notice: MTEFs, Intermediaries, Clearing Organizations, and Exemption for Bilateral Transactions.)

Regarding: "New Regulatory Framework for Multilateral Transaction Execution Facilities"

The National Grain and Feed Association is a voluntary trade association of 1,000 companies involved in all aspects of the grain marketing, handling, processing, feeding and related businesses. NGFA member companies operate more than 5,000 facilities and handle approximately two-thirds of the grain entering the commercial marketing sector. Our members use the futures and options markets to commercially price grain in the cash markets and manage price risk.

In concept, the proposal offered by CFTC to provide some regulatory relief appears structurally sound. The design of the proposal recognizes that there is a wide range of risk management products and provides at least some flexibility for the regulated exchanges to choose the preferred or appropriate level of regulation based upon a business perspective. That should make U.S. markets generally more competitive and attractive for trading. While generally supportive of the proposal, we raise the following concerns about the proposed changes.

1. How should agricultural contracts be treated? The preamble to the proposed rules is somewhat misleading as to how agricultural contracts can be treated under the proposal. The preamble states, "The Commission is proposing that the agricultural commodities listed in section 1a(3) of the Act not be eligible for trading on a DTF." However, the proposed rule, section 37.2 (a)(2)(i) states that the Commission can permit such deregulation of agricultural contracts on a case-by-case basis "...if determined to have a sufficiently liquid and deep cash market and a surveillance history based on actual trading experience to provide assurance that the contract is highly unlikely to be manipulated;" Thus, there seems to be some confusion as to the proposed treatment of the agricultural contracts. We would recommend that some clarification be made in the preamble to the final rule.

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NGFA recommends that CFTC seriously consider amendments to the proposed rule that would more specifically grant the exchanges the flexibility to have agricultural contracts regulated as "derivative transaction facilities (DTFs)." Provided that small commercial or retail users have the ability to use the market through futures commission merchants, moving the primary grain markets to the mid-range of regulation (DTF) would seem to be appropriate, and would provide access to all levels of market users. Proper exchange self-regulation and CFTC oversight can permit these markets to properly handle this new level of responsibility and the benefits would be broad across market participants. Customers of today's markets are protected most by the controls and financial strength of the exchange members and clearing corporation. While we support the DTF concept, we are concerned that, if exchanges are given the flexibility to split markets on the basis of type or class of trader, existing exchange volume and liquidity would be reduced, and would raise the cost of doing business on the thinner market. Thus, we would support the DTF concept for agricultural contracts, but limit the ability of exchanges to split markets on the basis of type of trader.

To keep agricultural markets in the most highly regulated class (with associated high transaction costs) in the face of mounting competition from abroad and elsewhere will entail risks for agriculture. There is risk that institutional investors that provide liquidity, particularly for out months, will be less willing to participate in the markets. There is also risk that commercial commodity interests will seek lower cost alternatives to hedging products, including electronic exchanges, private contracting, swaps, etc.

CFTC states that agricultural markets should be regulated differently because they are somehow more subject to manipulation. We would take issue with the CFTC's premise that there is somehow a bright defining line among exchange products being traded. There are few, if any, markets that have such unlimited supplies that they cannot be manipulated. Given a concentration of enough resources in the hands of one entity, any market can be manipulated. Additionally, it is not clear that efforts to prevent manipulation in the past have had a great deal of success. Energy markets may provide one recent example. We agree that there should be some controls in place to protect against manipulation, but there may be more limited (and less costly) ways for markets and the CFTC to effectively police and have a deterrent effect on efforts toward manipulation without a continuation of existing regulations in their entirety. We would request that CFTC carefully consider the benefits and costs of such regulations for agricultural commodities.

2. <u>What should be the definition be for "eligible participant?"</u> The CFTC is proposing that the exemption levels for swaps be used for defining "eligible participants" that would be eligible to trade on less regulated exchanges. This definition, which includes companies with a minimum of $1 million net worth or $10 million in assets, continues to rely solely on the level of financing or equity to assess trader "sophistication" and need for federal regulatory oversight. We are concerned that this definition is too restrictive, and would urge that CFTC consider other methods of qualifying individuals or companies to trade as eligible participants.

3. <u>Exempt contract categories</u>. The CFTC is proposing to permit certain cash-settled index contracts that are not under the control of any individual to be traded on

unregulated exchanges. Included as examples are crop yield contracts. It would be helpful if the CFTC could provide further guidance as to the treatment of potential contracts that are related to the enumerated commodities, yet will be considered as exempt.

Regarding: "Rules Relating to Intermediaries"

Most of the proposal provides increased flexibility for introducing brokers (IBs) and futures commission merchants (FCMs), including simplified registration procedures, elimination of ethics training, and greater flexibility in the investment of customer funds. We support the CFTC's proposal in an effort to increase market performance and efficiencies.

Regarding: "Regulatory Framework for Clearing Organizations"

We are supportive of the general framework outlined in this part of the proposed rule. Certainly clearing corporations must be given the flexibility to offer clearing services for more than one regulatory class of exchanges, simply for operational efficiency purposes. Providing that a clearing organization would be deemed recognized by sixty days following application unless a specific violation of the Act is identified should speed the regulatory process. Both of these proposed changes would appear to contribute to enhanced marketplace competition.

Regarding: "Exemption for Bilateral Transactions"

This rulemaking proposes to replace the swap exemption with a broader exemption covering all cash-settled bilateral contracts, with the exception of enumerated agricultural commodities. While we applaud the clarity this will provide to the non-agricultural marketplace, it will only further widen the chasm separating regulatory treatment of agricultural commodities and all other products traded off-exchange. The CFTC created unnecessary confusion for the agricultural swaps markets in its pilot program for agricultural trade options when the agency suggested that the traditional exemption for agricultural swaps of $1 million might not be relied upon in all situations. Also, in that rule the CFTC used as part of its justification for a $10 million net worth requirement for ATOs that the swaps exemption level had not been reviewed in some time (implying an increase from the $1 million might be considered for all swaps). Given this current review that proposes to not only retain the $1 million net worth exemption, but also expand the definition of exempt transactions to include more contracts than just swaps, we urge the CFTC to reconsider its treatment of the agricultural contracts, to at least reduce the extreme differences in regulatory treatment.

Concluding Comments (regarding all rulemaking proposals)

The CFTC has a long history of being very protective of agricultural interests. Being overly protective and overly cautious can, however, effectively restrict access to

useful risk management tools, contributing a **net cost** rather than **net benefit** to the overall economy. This is increasingly a concern to agricultural market participants, as it is perceived that every other market will be given more freedom and greater access to a wider range of risk management tools, while agriculture is granted little, if any, additional contracting and risk management flexibility.

We believe CFTC should take the time to carefully and objectively weigh the benefits and costs of its regulation of the enumerated agricultural commodities. Is there really a justification or is the division of treatment arbitrary? Agricultural markets are not, in our judgment, sufficiently different from other markets to justify the proposed disparity in regulatory treatment.

Thank you for the opportunity to comment.

Sincerely yours,

Tom Coyle
Chair
Risk Management Committee