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August 10, 2006

Ms. Eileen Donovan
Acting Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

Re: Comprehensive Review of the Commitments of Traders Reporting Program
Federal Register Notice, June 21, 2006, Volume 71, No. 119, pp 35627-35632

Dear Madame Secretary:

The National Grain and Feed Association (NGFA), established in 1896, is comprised of 900 member firms involved in all aspects of the cash and futures businesses. Our member companies include country elevators, feed mills, grain and oilseed processors, exporters, livestock and poultry integrators, and futures commission merchants. Futures markets are widely used by our members to efficiently price grain and hedge purchases and sales. The performance of futures markets is a key ingredient to the continuation of efficient and cost-effective markets that serve consumers, farmers and the commercial sector.

In the comments below we offer our response to the questions posed by the Commodity Futures Trading Commission (CFTC). At the outset, we offer our views on the significance of this issue of greater transparency in the Commitments of Traders Report to the performance of the overall futures marketplace for agricultural commodities.

In April 2005, the NGFA supported substantially increased speculative limits being proposed by the Chicago Board of Trade (CBOT). We did so, however, with the stipulation that the CFTC and CBOT would address the needs of market users to have access to more detailed information regarding the types of trading activity entering the market, including non-traditional hedgers, that were expected to add both tremendous volume and liquidity as well as increased volatility to the market.

As anticipated, volume is up sharply at the CBOT and the other regulated exchanges since the increase in spec limits. We applaud this success, but it has become much more challenging for market participants, particularly smaller elevator operators and farmers, to gauge order flow and anticipate market swings due to the forces that have driven the sharp increased volume. There is no doubt that the increased participation of non-traditional hedgers is responsible for a portion – probably a large portion – of the volume growth. Unfortunately, no one is certain how much because much non-traditional activity is imbedded in the "commercial" category. The ability of most market participants to utilize the report to gauge trends, determine fair value from various user perspectives, and to manage risk is negatively impacted.

Another impact of the increase in volume, particularly from new user groups, is to create an environment where cash and futures markets are struggling to find balance. This makes it much more difficult and risky for farmers and commercials to take advantage of the increased volume and liquidity in the market. Volume and price movements in futures markets generally send a signal to market users of trends and shifts in value. Reports such as USDA crop reports, export sales reporting, and the CFTC COT report add clarification allowing users to make marketing, transportation, and risk management decisions.

For elevators to assume a flat price rally is driven by "consumer" demand can lead to an underestimation of storage requirements. For farmers to perceive a flat price rally is driven by supply/demand fundamentals can result in missed sales opportunities and increased basis risk or, in the case of today's wheat market, can mislead farmers to conclude there is a need for more wheat acres rather than corn acres. For investment funds to conclude that elevated futures prices are due to consumer demand or lack of commercial hedging of farmer purchases could lead to poor investment decisions. These are just a few examples of why an effective COT report is critical to market participants. (Please see the Addendum to this letter for a brief case study of reasons behind the historically wide basis in this year's soft wheat market – which indicates that new non-traditional futures market volume has contributed to potential shifts in basis risk.)

The Commitments of Traders report was intended to provide all market participants with information about open interest. With open interest of the CBOT corn, bean and wheat contracts up 130%, 92%, and 219%, respectively, over the last two years, and a significant portion of that from new user groups having different economic interests, the COT report is more important than ever. Providing more detail in the COT report – specifically, differentiating fund or other investment activity from traditional "commercial" activity – is critically important to our members. It also is critically important to farmers, who need the added transparency to make appropriate business and hedging decisions. In our view, all market participants should have access to information that will enable them to understand and interpret what it is that's moving price.

It has been suggested that the large amount of investment capital entering agricultural futures markets recently is largely non-responsive to price because it represents a long-term investment vehicle. We believe that is true and that this "long-only" bias of investment capital results in the "securitizing" of non-traditional positions – that is, this non-traditional activity has characteristics more like securities rather than traditional hedging activity, which can be long or short and is very responsive to price in helping manage price and inventory risk of traditional market participants. As CFTC staff noted in the August 1 meeting of the Agriculture Advisory Committee, the non-price responsiveness of investment capital in futures markets could affect the nature of price discovery itself on regulated exchanges.

Responses to specific questions

1. *What types of traders in the futures and option markets use the COT reports in their current form, and how are they using the COT data?*

COT reports on agricultural commodities are used by many traders, including but not limited to:

a) farm marketing advisors/brokers
b) commercial hedging advisors/brokers
c) FCMs, IBs, and CTAs
d) Cash merchandiser/hedgers or similar decision-makers, including end-users, exporters, processors, merchants
e) OTC dealers or other trading desks

COT data show the makeup of market participants, reveal whether open interest is increasing or declining, and reflect the scope of position changes week to week. Market participants will use this data to assess whether prices are being driven by hedging in the underlying cash market; by speculative interest that may be shorter term; or by investment interest that may tend to be longer-term. This will be one factor used to determine when decision-makers enter or exit positions, when to recommend that others enter or exit, or whether to trade at all. Such analysis could also affect decisions on spread trading.

a. *How do traders use the COT information on commercial positions?*

Each participant group – speculators, commercial grain operations & marketers, farmers, and now investors adding agriculture products to their investment basket – have different economic needs, hedging goals and investment time-lines. Market participants traditionally used "commercial" to determine the pace of hedging in the physical commodities. Sharply increased commercial short positions can be one indication that farmer selling is rising. For speculators or consumers, this would be an indication that farmers are attracted to the price. For commercial grain handlers, it may affect basis and logistics decisions. A steady and substantial rise in the long side of commercial positions would traditionally be an indication of end-user buying or hedging of export sales. Speculative traders or commercial hedgers might consider changes in net commercial positions as a signal of whether a market move may be accelerating or running into resistance. This could affect the selling recommendations that farm advisors give to producers.

Individual traders will have a different perspective and participant groups will have different tendencies, but all market users need to understand the data to be useful. With the growth in volume along with participation of various types of investment funds and use for hedging swap transactions, the current report is less useful to all participants because the "commercial" category no longer represents traditional "commercial" hedging of the underlying commodity. With investment capital expected to increase, the utility of the commercial category will erode further.

b. How do they use the COT information on non-commercial positions?

This category includes positions of small and large speculators, professional traders, and actively managed funds. As such the positions are viewed as shorter- term and more opportunistic. The positions would reflect the full range of market factors – fundamental and technical, and often anticipatory. Traders use the data in this category to gauge the magnitude this type of trading activity has had on prices.

c. In particular, with respect to information on non-commercial positions, what information or insights do traders gain from the COT reports regarding the possible impact of futures trading on the underlying cash market?

This question was answered in parts a and b above.

2. Are other individuals or entities (academic researchers or others) using the COT reports, and if so, how?

Yes. The interest in these reports is broad. Farm advisors use the report in developing recommendations for their customers. Journalists write stories about the futures markets for wire services and advisory publications who, in turn, refer to the COT reports for information on market composition, level of total open interest, and changing patterns. Individual traders or exchange members may track these data. Academicians have written numerous pieces on market size and composition, especially as it relates to delivery months, concentration, and convergence.

3. Do the COT reports, in their current form, provide any particular segment of traders with an unfair advantage?

Potentially, yes. For some time the rising open interest on the long side of commercial positions has been misinterpreted as related to export activity and end-user buying (potentially by ethanol plants). This potentially gave an advantage to the actual traders behind the unidentified holders of some unknown percentage of those positions – the "non-traditional commercial" firms. That sector better understands the scope of money entering the markets (index funds, swaps, etc.). Most of the marketplace has had little access to this information and many traders were unaware of this "non-traditional" hedging until this reporting issue came to light. Even now, the scope can only be estimated and inferred by much of the market.

The current system also obscures who holds positions as delivery nears. Rising long positions (by large commercials) could infer narrowing spreads; but if such front month positions are held by index funds that must liquidate the bulk of those positions prior to First Notice Day, just the opposite could occur and spreads could weaken. This leaves smaller firms and traders with potentially misleading signals about delivery dynamics and potential moves in spreads. Conversely, as the scale of "non-traditional" hedger longs in futures has become more public, it is relatively easy to gauge the impact on spreads when their front-month 'long hedges' are rolled forward.

4. *Should the Commission continue to publish the COT reports?*

Yes. The CFTC, in this request for comment, states the COT reports are the single most-visited area of CFTC's website. This speaks to the interest and demand for this information. With the increase in trading volume and the addition of new market participants, this report is more important than ever. To discontinue publishing this data would provide a potentially sizable advantage to large firms with the resources to "estimate" privately the size and breakdown of market sectors. Discontinuing the COT reports would have a similar impact to the U.S. Department of Agriculture discontinuing its numerous reports on production, disappearance, and exports. That information has always been assessed, likely quite accurately, by private firms and analysts, but USDA reports help to level the playing field for all. Publicly available information allows all market users – commercials, farmers, funds and speculators – to better interpret market signals and make appropriate decisions on buying, selling, pricing and hedging.

5. *If the Commission continues to publish the COT reports, should the reports be revised to include additional categories of data – for example, non-traditional commercial positions, such as those held by swap dealers?*

Absolutely. For our members and customers this is critically important. The "non-traditional" sector is growing rapidly. The increase in participation by this user group is changing the balance in the market and their impact is expected to expand. Market participants and researchers need to have more detailed information about various user groups to manage risk and to enhance price discovery. For example, by early 2006, total open interest in CBOT wheat futures represented almost 105% of the size of the US wheat crop. During the years 1995 to 2004, open interest never exceeded 40% of U.S. wheat production, and seldom exceeded 30%. A significant portion of the 219% increase in CBOT wheat open interest from June 2004-June 2006 is presumed to be from non-traditional users. Precisely how much is unknown because the information is currently imbedded in the existing categories.

Such a dramatic shift in concentration of market participants has to warrant public scrutiny. The data necessary to support this more detailed reporting already are available according to CFTC staff. Any expense of modifying the report formats should be mostly a one-time event.

6. *As a general matter, would creating a separate category in the COT report for "non-traditional commercials" potentially put swap dealers or others at a competitive disadvantage? (Since other participants would generally know their positions are usually long, concentrated in a single month, and typically rolled on a specific schedule.)*

We do not believe creating a separate category in the COT report to reflect "non-traditional commercial" activity would place any market participant at a competitive disadvantage. In fact, reporting the magnitude of non-traditional open interest in the market likely would be beneficial to all participants and would contribute to a level playing field. All participants, including non-traditional hedgers, should have interest in knowing the proportion of open interest held by as many distinctly different user segments as possible when evaluating the suitability and risks associated with trade placement. Current CFTC rules restricting the reporting of aggregate positions of market segments containing less than 20 reportable individual participants is very conservative and more than adequate.

Any clarification of the nature of the activity in a market for all participants without compromising absolute strict protection of the identity of individual participants would be desirable. The fact that, up to this point, the bulk of positioning by non-traditional hedgers is perceived to be from the long side has become even more significant as their level of activity has increased dramatically the past couple years. It is likely that the magnitude of the long position bias of non-traditional hedgers up to now has contributed to the lack of convergence during futures expirations the past several months for the commodities in which they hold significant positions. If this continues to be the case, then at the very least market participants should be able to consider the magnitude of participation in the market by non-traditional hedgers when considering position bias and placement of hedges.

As long as the identity of all market participants is strictly protected we do not perceive the collective reporting of the non-traditional hedging segment as a disadvantage to them. The nature of their positioning, and rolling of positions, is already well established by their own public disclosure documents. There are differences from fund to fund. They don't all act the same all the time. Furthermore, there is some movement among non-traditional hedgers to modify or differentiate their position rolling activities to improve their performance. We would expect this differentiation to increase over time as both the number and diversity of non-traditional hedging entities increase, and as existing entities evaluate their portfolio management performance history.

7. *More specifically, if the data in the COT reports are made subject to further, and finer, distinctions, such as adding a category for non-traditional commercials:*

(a) Would it increase the likelihood that persons reading the reports would be able to deduce the identity of the position holders, or other proprietary information, from the reports?

(b) Could such persons use information gleaned from the reports to gain a trading advantage over the reported position holders?

(c) In such case, in order to reduce the likelihood of publishing categories with few traders, which might provide information giving other traders a competitive advantage over the reported traders, should the Commission consider raising the threshold number of reportable traders needed to publish data for a market from 20 traders to some larger number of traders?

As mentioned in the answer to question six, we submit that twenty traders is a more than adequate threshold level of participants to protect the identity and activity of individual traders. If anything, up to this point the most credible information about the nature of the market activity of non-traditional hedgers has been described in their own public filings, and subsequently observed *en masse* by market action. To our knowledge, nothing in this activity has compromised the identity of any individual participant. In our view, there is nothing that could be gleaned from a COT report with the current threshold level of reporting that would compromise any individual trader's identity.

8. *If the data in the reports are subject to further and finer distinctions, should the reports be revised for all commodities or only for physical commodity markets?*

If the COT report format is being modified, it seems logical to do so for all commodities. The absence of "non-traditional" participation at this time doesn't preclude that changing in the future. At worst the reports would document where such "non-traditional commercial" trading occurs or is absent. "Zero" as a total for such a category still provides useful information.

9. *If a non-traditional commercial category were added to markets in physical commodities, what should be done with financial commodities?*

Our industry tends to focus on the physical commodity markets, and in particular the agricultural contracts. Therefore, we do not hold strong views regarding the treatment of data reporting for financial markets. While such additional information would appear to hold value for those markets as well, it would depend on the parameters of those markets, including proportion of traditional hedgers, degree of speculative activity, and spec limits.

10. *The Commission has observed the non-traditional commercials tend to be long only, and tend not to shift their futures positions dramatically even in the face of substantial price movement. If the data in the reports are subject to further and finer distinctions, would issuing the additional data on a periodic basis (quarterly or monthly?), be sufficient?*

No. Modern markets are growing in size and speed. A quarterly or even monthly report would be light years behind the underlying events and would, in our view, be of greatly diminished value, other than perhaps for academicians studying broad trends, or for regulators "deconstructing" events after the fact. The market needs this information on an ongoing and continuous basis, published as close to the event as possible.

11. Some reportable traders engage in both traditional (physical) and non-traditional (financial) commercial activity in the same market. If these data are made subject to further distinctions such traders would have to break out their non-traditional OTC hedging into a separate account. Would such a requirement represent an undue burden on those traders?

CFTC staff have indicated that these data are available through information currently being submitted. If some firms are required to make an additional division of their own reported trading in some markets, we would anticipate that such firms would have sufficient staff and accounting capacity to handle the task without too much added burden. From our standpoint, the significance of the level of trading represented by such firms simply is too important and too significant to the market not to be reflected in reported trading data.

Sincerely,

Rodney Clark
Chairman
Risk Management Committee

ADDENDUM

Soft Wheat Basis – Factors Behind Historically Wide Basis Levels

Much has been made of the historically wide basis levels for soft red winter wheat this year. Factors contributing to the situation include dramatically higher transportation costs, changes in domestic markets, lingering logistical affects from Hurricane Katrina, and changes in the vomitoxin specifications in the soft wheat contract. We believe that the influx of investment capital from non-traditional sources that tend to be long-term and less responsive to market prices into the Chicago Board of Trade's wheat contract also has had a significant impact on basis levels.

A quick look at several market factors from June 2006 compared to the same factors in June 2005 is instructive:

Open Interest – According to the June 27, 2006 Commitments of Traders report, total open interest in the July 2006 wheat contract at CBOT was 461,737 contracts, compared to 231,720 contracts in the same period in 2005 – an increase of 99%.

Futures Price – The closing futures price for CBOT wheat on June 30, 2006 was $3.66/bushel. The closing futures price a year earlier was $3.38 – an increase over the past year of 8.2%.

Soft Red Winter Wheat Stocks – At the same time CBOT wheat futures rose 8.2%, U.S. stocks levels as reported by the U.S. Department of Agriculture skyrocketed from 88.00 million bushels to 316.02 million bushels, an increase of 259%.

Barge Freight – Transportation costs from Chicago increased from $14.45/ton on June 30, 2005 to $26.00/ton on June 30, 2006 – an increased cost of almost 35 cents/bushel.

Basis – Mid-Mississippi basis levels for soft red winter wheat moved from 20 under on June 30, 2005 to 60 under on June 30, 2006 and have widened even further since June 30.

Conclusion: Futures prices have rallied despite a significant drop in basis levels. We believe the increase in futures values has been driven by a significant increase in open interest rather than by a positive change in supply and demand fundamentals. This demonstrates the importance of tracking changes in open interest, by user group, and is the clearest example of the need for more detail in the Commitments of Traders report. The addition to the marketplace of a new non-traditional user group increases the importance of the information.