Testimony

of

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Chairman Lucas, Ranking Member Peterson and Members of the House Committee on Agriculture: Thank you for convening this hearing on various elements of the Dodd-Frank Act. I am Todd Thul, Risk Manager for Cargill AgHorizons. AgHorizons is our business that works directly with farmers. Many of them are your constituents and all of them are constituents of this committee. We offer a wide variety of grain marketing options for producers of all sizes. We provide many forms of risk management and price protection that meet individual producers' desired level of opportunity and control. We also offer agronomic services, seed, fertilizer, consulting services and crop input financing to help producers manage their operations. Our goal is to be the partner of choice for our farmer customers.

Today, I am testifying on behalf of the Commodity Markets Council (CMC). CMC is a trade association that brings together exchanges and their industry counterparts. The activities of CMC members include the complete spectrum of commercial end users of all futures markets including energy and agriculture. Specifically, our industry member firms are regular users of the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Kansas City Board of Trade, Minneapolis Grain Exchange and the New York Mercantile Exchange. CMC, in conjunction with the Coalition for Derivatives End Users, is well-positioned to provide the consensus views of commercial end users of derivatives. Our comments represent the collective view of CMC's members.

The Commodity Future Trading Commission (CFTC) has been working aggressively to implement the regulations required under the Dodd-Frank Act. Today, I would like to provide perspectives on a number of these issues.

Inter-Affiliate Swap Transactions

Many firms use a business model through which the number of affiliates within the corporate group that enter into derivatives transactions with dealer counterparties are limited. Rather than having each corporate subsidiary individually transact with dealer counterparties, a single or limited number of corporate entities face dealers. These entities then allocate transactions to those affiliates seeking to mitigate the underlying risk. This allocation is done by way of "inter-affiliate swaps" – swaps

between commonly controlled entities. This structure allows the company to more effectively manage corporate risk on an enterprise basis and to secure better pricing on derivatives transactions. The transactions are largely "bookkeeping" in nature and do not create systemic risk. Regulators are reportedly considering whether to subject inter-affiliate swaps to the same set of requirements that apply to swaps with external dealer counterparties – possibly including margin, clearing, real-time reporting, and other requirements. This would be a mistake and would impose substantial costs on the economy, on consumers and on end-users. Accordingly, the CMC strongly endorses the thrust of the Stivers/Fudge bill. It is the right thing to do. CMC understands the intent of the bill is to cover all business operating models that might be negatively affected by the inter-affiliate interpretation and therefore would like to work with the sponsors to be sure the proposed legislation accomplishes that objective.

Bona fide and Anticipatory Hedges

One area of ongoing rulemaking which has recently garnered a lot of attention by our industry is the CFTC's proposed rules on position limits and, more specifically, the proposed definition of bona fide hedge transactions.

Under Dodd-Frank, Congress for the first time created a statutory definition of bona fide hedge transactions. The statutory definition enumerates various kinds of hedging transactions, among them anticipatory merchandising positions.

An anticipatory hedge occurs when a commercial entity takes a position in the futures market to offset a position that it anticipates taking in the cash market in the future. A simple example is the buying of corn futures now in anticipation of buying physical corn at harvest from farmers, or the selling of cotton futures now in anticipation of selling physical cotton at some point in the future. In these cases, a commercial entity is taking a position in the futures market to meet a physical need for a commodity it anticipates buying or selling in the future.

While Congress made clear in its bona fide hedge definition that companies engaged in the physical trade should receive an exemption for anticipatory merchandising positions, the CFTC through its proposed rules would deny companies the exemption and would recharacterize them as "speculative". This is not only inconsistent with the law, but has the potential to have calamitous effects in the cash commodity markets in the physical commodity marketplace.

The CFTC is taking a narrower view of bona fide hedging than that defined by Congress in the Dodd-Frank law. The CFTC's proposed rules would limit bona fide hedge exemptions to five specific transactions called "enumerated" hedges. The Commodity Exchange Act, as amended by the Dodd-Frank Act ("Act") provides that position limits shall not apply to transactions or positions shown to be bona fide hedges, as defined by the CFTC consistent with the purposes of the Act. Section 4a(c)(1) of the Act also provides that a bona fide hedge may be defined to permit producers, purchasers, sellers, middlemen and users of a commodity to hedge their legitimate anticipated business needs. Thus the statutory language provides for hedges of legitimate business needs at each step as the commodity moves from producer to user, and recognizes that merchandiser are entitled to hedge anticipated needs.

The Act [Sec4a(c)(2)] also provides its own definition of bona fide hedge, and states that the CFTC shall define what constitutes a bona fide hedge. This statutory hedge definition includes an

anticipatory merchandising hedge, because it permits hedges of the potential changes in value of assets that a person anticipates owning or merchandising, as long as the transactions are a substitute for physical transactions to be made at a later time and they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise.

The Commodity Markets Council and the Working Group of Commercial Energy Firms filed public comments to the CFTC on June 5, 2011, urging the Commission to reconsider its proposed rules and, in particular, the proposed bona fide hedge definition. The CMC subsequently transmitted in a June 10, 2011 letter its concerns about these types of hedges to the respecting Chairs and Ranking Members of the House and Senate Agriculture Committees, Senate Banking Committee, and House Financial Services Committee. I would ask that copies of these letters be included in the hearing record.

Through the summer, the CMC, its member companies and other interested parties also engaged in direct meetings with the CFTC to respond to requests for additional information about the relationship between anticipatory hedges and cash market efficiencies.

We remain hopeful that the CFTC will take into account these comments and provide the commercial trade with a meaningful exemption for anticipatory hedges. However, recent press accounts suggest the final rule may disappoint in this area. We understand that the CFTC is considering limiting anticipatory merchandising hedging to unfilled storage capacities through calendar spread positions for one year. If this turns out to be the case, the CFTC's action will reduce the industry's ability to continue offering the same suite of marketing tools to farmers that they are accustomed to using because the management of the risk associated with those tools may be constrained if the hedge of that risk is deemed to be anticipatory. Serious questions have been raised about how to provide weekend bids for farmers going in to large harvest weekends, or manage risk associated with export elevators that might have limited one-time capacity but very large throughputs. Merchandising of grain could be curtailed because of the inability to manage the risk if the hedge is considered speculative and not bona fide under this rule. As serious as all these issues are for farmers, the implications are far broader with the potential to impact energy markets as well.

From a risk management perspective, a better limitation on anticipatory hedging would be annual throughput – or volume – actually handled on a historic basis by each company. For example, an export elevator may have 4 million bushels of physical storage capacity, but might handle 100 million bushels on an annual basis. If it is full, how will it establish a bid and manage the risk on the 96 million bushels of grain it has yet to purchase from farmers that it not only anticipates, but knows it will be exporting from that facility? Unless revised, the CFTC's approach will severely limit the ability of grain handlers to participate in the market and impede the ability to offer competitive bids to farmers, manage risk, provide liquidity and move agriculture products from origin to destination. The irony is that limiting commercial participation in the market actually introduces volatility. Clearly this is not what Congress intended.

Recording and Recordkeeping Requirements

In a proposed rule described only as conforming amendments, the CFTC has proposed imposing expensive and burdensome recording and recordkeeping requirements across a broad swath of the cash grain marketplace. The proposal would require all members of a designated contract market (DCM) such as the Chicago Board of Trade, Kansas City Board of Trade or MGEX to capture and maintain extensive records of all communications related to a commodity transaction. Even country elevators

operated by those firms would be required to record telephone conversations with producers when discussing cash sales or contracts.

The proposal presents steep technology and cost challenges to small-town country elevators who deal extensively with producers on the phone when arranging cash sales and forward cash contracts. This proposal raises anti-competitive concerns because it could create a bifurcated cash marketplace by imposing the requirement on country elevators who are owned by members of DCMs but not on other companies. Who will the producer call to sell his cash grain: the elevator that has to inform him they are recording his phone calls, or the elevator a few miles down the road that is not required to do so? The CMC believes the proposal may prompt companies who are members of a DCM to reconsider their membership in order to avoid the regulatory burden. This result exposes not only the discriminatory application of the rule, but also highlights the fundamental question within the industry about the proposed rule. Dodd-Frank was intended to address concerns about systemic risks created by an unregulated over-the-counter market. The CFTC's proposed recording and recordkeeping rule does not address any of those concerns. Rather it seems targeted at the cash market and the real commercial trade, neither of which were responsible for the financial crisis and both of which suffered because of that crisis. All this proposal will do is add cost to the real economy -- costs that are ultimately shared throughout the value chain from farmer to consumer.

Swap Dealer Bill (not yet introduced)

It is important that end-users who engage in only a small amount of swap dealing relative to their non-dealing activities and whose dealing does not create systemic risk not be treated as swap dealers. As such, the de minimis exception to the definition of “swap dealer” must be expanded to a reasonable level that protects end-users from being regulated the same as the largest swap dealers.

Cost-Benefit Analysis Bill (H.R. 1840)

Rigorous cost-benefit analysis creates better rules. The CFTC is subject to a cost-benefit analysis requirement but it does not require the regulator to consider such key factors as available alternatives to regulation, whether the regulation is tailored to impose the least burden possible while achieving its goals, and whether the regulation maximizes net benefits. These and other factors would be required to be considered under the Conaway-Quigley bill, which CMC strongly supports.

Summary

The proposed restriction on anticipatory hedging is inconsistent with current commercial practice which did not contribute to the financial conditions that led to passage of the Act. The proposed restriction significantly narrows the hedging definition included in the Act by Congress and without question will curtail our ability to serve farmers with risk management programs. The Act states that bona fide hedge term shall be defined by the CFTC consistent with the purposes of the Act. The proposed restriction is not consistent with these purposes:

(a) The express purpose of the position limits is to prevent excessive speculation which causes sudden or unreasonable fluctuations or unwarranted changes in commodity prices. [Act, sec. 4a(a)(1)]. An anticipatory merchandising hedge, done in accordance with current commercial practice, is not speculation and does not cause unreasonable or unwarranted price changes.

(b) The Act says hedges of legitimate anticipated business needs by middlemen are permissible hedging to be the subject of CFTC rulemaking. Under current commercial practice, anticipatory merchandising hedges are for the purpose of satisfying legitimate anticipated business needs for merchandisers, and it would be contrary to the purposes of the Act to prohibit them.

(c) Congress recognized in the statutory definition that anticipatory hedges can include those which hedge commodities that are anticipated to be owned or merchandised, and the proposed restrictions relating to dedicated unfilled capacity and calendar spreads undermine Congressional intent as reflected in the broader statutory definition.

The CMC along with the Working Group of Commercial Energy Firms has submitted specific comments and proposals for the CFTC to consider during its rulemaking. Absent the adoption of significant change, the new rules defining bona fide hedging and by negative inference speculation will create cash market inefficiencies. Moreover, the proposed rule would make CFTC reports on market participation meaningless because they would no longer reflect real cash market activities .

The modest proposals suggested to the Commission would allow farmers and the industry to manage risk consistent with longstanding practices while remaining consistent with the statute and subject to CFTC oversight. They will allow farmers and the grain industry to continue to have access to risk management, price discovery and marketing options that have long served the industry well. Limiting anticipatory hedging will result in risk that must somehow otherwise be managed. This risk was heretofore managed in the futures market—now the risk could manifest itself in wider basis spreads, more volatile basis, limited bids, or wider bid-ask spreads, all of which run counter to the intent of Congress, the statute, the interest of farmers, the marketplace, end-users and market participants.