UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

AGRICULTURAL ADVISORY COMMITTEE MEETING

Washington, D.C.

Tuesday, July 29, 2008

ANDERSON COURT REPORTING
706 Duke Street, Suite 100

Alexandria, VA 22314
Phone (703) 519-7180 Fax (703) 519-7190

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Phone (703) 519-7180 Fax (703) 519-7190

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P R O C E E D I N G S

(9:00 a.m.)

MR. DUNN: We had an excellent meeting in April with the Commission at a roundtable and it set the groundwork for this particular meeting. I am going to go through and ask each of the members of the Commission to make their opening statements and then I'm going to ask for a real quick run around the table here so the members of the Advisory Committee can introduce themselves and who they're with before we get going. The other little piece of maintenance here is that you have to press the button to be able to speak, and I'm told that I can cut you off from up here if I need to, and if that's not enough I've got the traditional mallet.

With that, welcome to the Agricultural Advisory Committee of the CFTC. This is the thirty-second meeting of the Advisory Committee and probably is one of the most important that we have ever had. The lack of convergence between the futures and cash price in some contracts has

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shaken the confidence in the ability of the futures markets to act as a price discovery mechanism. This lack of confidence has resulted in major problems for those who use the futures markets to hedge risk. In your packet there is an article from the "Minneapolis-St. Paul Star Tribune" that really outlines what the problem have been out in the countryside as a result of this.

For instance, many have expressed great concern regarding wheat markets where convergence has been particularly problematic. At our April 22 Agricultural Roundtable we began a dialogue with participants on the futures industry to address those concerns and explore solutions. The CFTC took a number of actions as a result of this meeting. The Agricultural Advisory Committee was asked to follow-up on a number of issues identified at that meeting including development of solutions to improve convergence in the futures and cash markets, discussing practices of exchanges for determining margin daily price

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limits and methodologies in setting settlement prices, facilitating discussions on the role and size of over-the- counter agricultural swaps, and determining whether there are additional studies agricultural market users believe the Commission should undertake relevant to current commodity prices.

Since that meeting I have a spent great of time with many of you who are here today discussing the issues that we will address today. I want to thank all the members and the presenters for your time, effort, and advice on these matters. What we will discuss today is vitally serious to the agricultural markets. We must do everything we can to protect futures markets' hedging and price discovery. If recent convergence problems are the canary in the coal mine, we need to take action now. Again I thank you for your participation. I will now welcome our Acting Chairman and fellow Commissioners for any comments. Mister Chairman?

MR. LUKKEN: Thank you, Mike, Mister

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Chairman, for hosting this morning's meeting, and thank you all for participating.

Since this Committee last met last December we've obviously seen unprecedented prices across the board in all commodities. These higher energy and commodity prices are painfully felt by all Americans. Specifically, these record prices have put considerable strain on agricultural producers and commercial participants in these markets due to higher and unexpected costs of inputs and margining. Although recent prices have come off their highs, regulators cannot be complacent. Protecting the integrity of these markets as well as the public who relies on the pricing that comes from these market lies at the heart of the CFTC's core mission, and today we look to you the experts to help us and give us expertise and assistance.

Most if not all of you participated and attended the Agricultural Forum on April 22 when the CFTC brought together a broad cross-section of the agricultural industry in an effort to form a

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collective understanding of what was occurring in these markets. Our goal was and continues to be to work closely with the industry not only to help us identify problems in the markets, but also to partner with us in finding consensus solutions should it be determined that the markets are not functioning properly. As you know, following the Agricultural Forum as Commissioner Dunn mentioned, the CFTC announced a number of initiatives the agricultural markets. First, the Commission announced that it would use its special call authorities to collect additional information from swap dealers regarding the amount of off-exchange pension and index funds that are flowing through these institutions into our markets and provide a report by September 15 on whether these traders should be reclassified for regulatory and reporting purposes. Commission staff is making substantial progress on this unparalleled undertaking.

In addition, the Commission announced that it would examine greater risk-management

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options for farmers and agribusinesses. The Commission also announced publicly and unveiled the existence of an ongoing cotton investigation which is continues to vigorously pursue. Also announced, the Commission continues to facilitate discussions with banking authorities to ensure that proper credit lines are available to agricultural entities during these times of higher prices and margins.

As Mike mentioned, a number of these issues arising from the Agricultural Forum required greater market expertise and input and were referred to this committee for discussion. One issue is the lack of convergence between the futures and cash prices of certain commodities. This matter is of great concern to me and the entire Commission. Some commercial participants have lost confidence in the ability to hedge in certain of these markets and it is critical that market participants work with the Commission to address this matter aggressively and head on. Moreover, we must continue to work together to

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ensure that producers and merchandisers have proper margin financing and alternative risk-management options in order to promote proper hedging in our markets. These issues are on today's agenda and I look forward to hearing from market participants. Again, Mike, thank you so much for hosting this incredible agenda and I look forward to hearing from all of you today.

MR. DUNN: Thank you very much, Walt. Commissioner Sommers?

MS. SOMMERS: Good morning, and thank you, Commissioner Dunn for holding this important meeting of the Agriculture Advisory Committee.

These are extraordinary times in the agriculture commodity markets. Our mission is to make sure that the agricultural futures markets are discovering prices and are providing an opportunity for producers and commercial entities to hedge their price risk. We have devoted significant time and effort this year to examining conditions in the agricultural futures markets. On April 22, as you've heard, and most of you were

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here for, the Commission held their special Agricultural Forum and brought together government, academic, and industry experts to discuss these important issues. And on June 3 we announced a series of agricultural initiatives that Walt just went over to improve the oversight of the futures markets and to bring greater transparency to the marketplace.

Today's meeting is the latest step in this ongoing process and I'm looking forward to the discussion particularly regarding the convergence of futures and cash prices. Some argue that the convergence problem may be due to futures contract terms or conditions, delivery costs, or capacity issues. Whatever the cause, it appears that the increased futures price volatility and uncertainty about basis relationship has raised the cost of hedging. Throughout this process we have received valuable input from a wide array of people who have a tremendous amount of experience and knowledge of the agricultural futures markets. I appreciate

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all of your input. It's extremely valuable to this Commission and I thank you all for taking time out of your busy schedules today to be with us, and I am looking forward to the discussion. Thank you.

MR. DUNN: Thank you, Commissioner. Commissioner Chilton?

MR. CHILTON: Thanks, Mister Chairman, and thank you and the staff for setting this up, and also thank you to the presenters, both CFTC presenters, Mr. Kass, and others who I know have taken a lot of time to put something together. Thank you for being here to help educate us. Will Durant is a respected philosopher. He said, "Education is the progressive discovery of our own ignorance." It's a progressive discovery of our own ignorance, so we've got a robust agenda that Commissioner Dunn has put forward and will help educate us.

But what do you do when you get information and you have conflicting results, when you've got a dataset and it's analyzed and the

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results are published and you're not sure if they're the same? What do you do when something impedes progress on your education whether or not it's politics or spin which also happens in this town as we all know all too often? I think the answer is you look to a third party. You look for an independent analysis. You look for somebody who is respected in a field so that you can get the right information or get a second take on information. So among other questions that I have for you all, the members of the Ag Advisory Committee is, do you think given what you know about the emerging disagreement over noncommercial's role in these markets about the potential of a speculative bubble? Do you think it's time that we in government have sort of a blue ribbon panel, somebody independent, the best and brightest minds in academia for example, so look at this and give us an independent different view?

Does that mean that I want to wait until we get some exhaustive study before we do

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anything? Absolutely not. No way. That's why I think things like the House bipartisan bill that passed out of the Agriculture Committee makes a whole lot of sense. If gives us more information that we don't have now that could be impacting the markets, it gives us the potential to use additional regulatory tools if we think it's needed, if we think that there's not true price discovery, and it gives us the resources here at the Commission to actually do that job. Now might not be a bad time also to say if there are enterprising economists, that people have thoughts on what's going on in these markets, go to cftc.gov. Look at the interim report that we issued last week. Look at what other people are saying on these sorts of issues. I'm sure we'd all welcome those comments. But I'll sort of take Durant's advice today and try to progressively educate myself of some my ignorances and listen to the best and brightest, and in that regard I'll listen to you guys. Thanks.

MR. DUNN: Thank you, Commissioner. If

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we will now quickly go around and introduce yourselves and who you represent, and Sam, if we could start with you.

MR. MILLER: Thank you, Commissioner. My name is Sam Miller. I'm with M&I Bank in Appleton, Wisconsin, and I'm here representing the American Bankers Association. I serve as their vice chair of the Ag and Rural Affairs Committee.

MR. NICOSIA: I'm Joe Nicosia and I'm Executive Vice President with Louis Dreyfuss and I'm here representing the American Cotton Shippers as its president.

MR. WELLMAN: I'm Steve Wellman. I'm the American Soybean Association treasurer, a full-time farmer, and I'm accompanied by Bev Paul.

MR. SCANLAN: I'm Mark Scanlan with the Independent Community Bankers of America here in Washington.

MR. STOKES: I'm Fred Stokes, the Executive Officer for OCM. I'm here representing RKF USA.

MR. WATSON: I'm Leroy Watson,

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Legislative Director with the National Grange here in Washington, D.C.

MR. BAGAN: I'm Mark Bagan, CEO of the Minneapolis Grain Exchange.

MS. WINKLER: I'm Julie Winkler, Managing Director of Research and Product Development at CME Group.

MR. LEHMAN: Dave Lehman. I'm Director of Commodity Research and Product Development, CME Group.

MR. KASS: David Kass, Senior Economist out of the Chicago office for the Commission's Division of Market Oversight.

MR. REINHART: Terry Reinhart, Advance Trading out of Bloomington, Illinois. I'm a broker, vice president and a board member.

MR. COYLE: I'm Tom Coyle with Nidera Holdings in Chicago. I'm representing the National Grain and Feed Association.

MR. GREEN: I'm Paul Green. I'm an agricultural economist consulting to the North American Millers Association. I'm actually

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replacing Jim Behr who is not available today.

MR. GOULD: Eldon Gould, risk-management agency administrator, Department of Agriculture, and also a producer from Northern Illinois of corn, soybeans, and a hog operation as well.

MR. GAINE: I'm Jack Gaine representing the Managed Funds Association.

MR. DINNEEN: I'm Bob Dinneen, President of the Renewable Fuels Association representing the U.S. ethanol industry.

MR. CRYAN: I'm Roger Cryan representing the National Milk Producers Federation.

MR. BUIS: Tom Buis, President of the National Farmers Union.

MR. BROPHY: Dan Brophy representing the Commodity Markets Council.

MR. DUNN: Are there other members in the audience who are part of the Advisory Committee or are there other presenters out there who would like to be introduced at this time?

If not, we'll go forward. Again, please press your button when you speak and turn it off

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when you're finished speaking. Speak into the microphone. This will assist our court reporter. It will also help those who are home who are listening either via telephone or video conference.

With that I'd like to introduce quickly the first panel. I'm not going to you any of the background. It's in the biographical information that you received. So in the interests of time I'll just tell you that our first panel is going to talk about the history and current fundamental of convergence and basis problems. We have Dave Kass from the CFTC, Tom Buis, Terry Reinhart, Tom Coyle, Roger Cryan. Then for the exchange presentation we'll have David Lehman and Mark Bagan. Then we will have open discussion. With that I'd like to turn it immediately over to Dave to begin.

MR. KASS: Good morning. Of course, this is an advisory committee to advise the Commission, particularly the Commissioners, our policymakers. They hear from me all the time so

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they don't need to hear a lot from me, but I do hope to spend at least a few minutes here to establish some factual background on where we are in terms of basis and convergence. Of course, basis is based on fundamentals and a regional convergence are sort of the Holy Grail of what makes the markets work. You could have really a no more important issue.

I've got some slides here. This is an update from the one I presented at the Agricultural Forum showing some of the broad price changes year to year. The markets with the little asterisks after them are those that are published commodity index trading for, and I think the same point I made at that forum holds true today, that there doesn't seem to be much correlation between the percentage held by index trading versus some of the price rises. You've got some markets, cattle, hogs, feeder cattle, they all have very large if not the largest percentages of commodity index trading and yet you can see they're among the weakest prices, and you've got something like

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rice and oats that again have very little if any index trading involved and yet they're among the highest prices. So just to kind of throw that out that there doesn't seem to be much correlation there.

This is another chart to update you on where we are in terms of broad price trends over the last several months. Obviously we had quite a bit of volatility. You can see back in the February period we set all-time record high prices for the three wheat contracts, rice in late April, and much more recently we had the soybeans, corn, and oats hitting all-time record high prices, but generally you can see most prices have been in a bit of a decline of late. The other thing of note is if you look at these three, these are the three wheat futures contracts, over the last couple of weeks or so they've come into a much more traditional stack of the spring wheat, the hard winter wheat, and the soft winter wheat, and they look a lot like they did let's say about last November. So with quite a bit of volatility in

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between, some 8 months or so ago we're back into a more historic, traditional sort of a relationship.

First I want to talk about market composition. Again, those who have followed these proceedings in the past should be familiar with this. This light blue line represents net number of contracts held by index traders and you can see that's been fairly flat, actually in terms of number of contracts, a bit of a decline of late. The red line represents the price movement, and that scale is over here. The green line represents managed money, and here again you can see quite a big decline in the holds of managed money, again long, and the negative numbers represent short positions, of course on the opposite side of all of that are our commercial traders and you can see they're reduced their short position. There is a similar chart for soybeans and a similar sort of result where you see a bit of a decline in the index trading, kind of flat to declining. The scales are different so you got to be a little careful when you look at

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this just because of the size of these markets. And finally in this regard, wheat again flat to a bit of a decline. Managed money is about out of the market now at least on a net basis. You can see here's the zero line meaning net even and they're slightly above that, so not much there in terms of participation. If you looked across the three markets you'd have to say at least over the last several weeks, index trading has declined, managed money has declined both from the long side, and commercial trading while still huge shorts, have also liquidated a bit.

Just to establish a key fundamental in determining basis relationships are fuel prices. This happens to be the diesel price, and we're at now around $4.80 a gallon. Obviously we all see the reality of this particularly in the farm community when they fill their farm equipment, and anything that moves agriculturally whether it be by truck, rail, barge, ocean vessel, it's all related to diesel prices. You can see at $4.80 more or less and compared to let's call it $3.00,

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that's a 60- percent increase. Presumably if what I'm seeing at the gas pumps in the national averages, we should be seeing some decline on that. These are monthly prices, so hopefully we'll see some decline. Then of course barge as I mentioned particularly for the corn and soybean contracts which are essentially an Illinois River barge contract, these are the barge rates historically. Again the bars represent a fairly long historical period, in this case 11 years, and then I highlight the median as the red and then I highlight the last few years, and here is the green line representing 2008. The thing to note is that we're at about 75 cents or so per bushel barge rate to carry something down the river. Of course, barge rates are also very much affected not just by fuel prices but the logistics of the river transportation. We had flooding this spring which of course created a bit of havoc when you close down navigation and restrict navigation. Then just last week of course there was a fuel spill down near New Orleans which also put

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restrictions. So barge rates are affected by a lot of other things as well as the supply and demand of barges.

Corn basis, this is for the third week of July where we're at. Again the range is representing the vertical line, the red representing the median, and then I highlight the last 2 years with the green diamond representing this year. You can see at the gulf which is clearly a big price determinant for the Illinois River type contract we're talking about here on the futures is actually above median, a bit below last year, but historically well within the range and slightly above the median. Then you have the Illinois River at about 46 cents let's call it under, and this is maybe around 28 cents over. That difference of 76 cents is virtually equal to the barge rate down there so even though the Northern Illinois River is quite weak historically, it's not surprising given the very, very large barge diesel prices and of course barge rates. Similarly for soybeans. This year at the

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gulf we're actually quite, quite strong historically outside the range, and compared to last year which was just the opposite, it was outside the range but on the weak side, and again for 2008 we're looking pretty good in terms of where we've been historically and again particularly in contrast to 2007 which were extremely weak. Again the difference here between the two rates is largely reflecting the difference in barge rate. In this case I think the difference is roughly 80 cents. So quite good this year and the difference representing barge rates.

Soft red wheat on the other hand can't say the same sorts of things. It's a different kind of contract. It's not an Illinois River export contract. It's a storage contract with Toledo being the primary delivery point in terms of historically where we see the stocks and where we see the deliveries. Of course, a number of deliveries come out of Chicago as well. Here you see the historical ranges, and then where it was a

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year ago are the triangles, and this year it's abysmally weak compared to last years, certainly not explained by transportation issues or something like that. When you can deliver in Toledo at part and theoretically at least make a dollar and a half a contract, it certainly raises very strong issues that aren't explained strictly by the normal sorts of fundamentals in the market.

Historically this is the corn spot basis week to week going back through 1998. I think it started in year 2000 where we switched to the Illinois Waterway System delivery points, and you can see where we've been historically. We've had some weak basis, but this year we're still a bit on the low side, but again this year's seem to be reflecting barge rates. Soybeans, we've had some spikes at times. A lot of that is typically going to be end of crop year sorts of spikes and very unusual situations. But here's the situation for soybeans and you can see currently we're at least over the last few years looking pretty good. Then just as with the other chart, when you get to

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wheat it's an entirely different story. There you see the difference historically on wheat. We had an Ag Advisory Committee meeting in late 2006 where we were trying to explain what was going on when the basis had gotten down to around a dollar or so at Toledo, a dollar under, it's difficult to explain this kind of basis at less than a dollar and a half. It certainly doesn't represent the normal sorts of fundamentals and you have to look I believe toward structural types of issues in the contract.

What's the effect on hedging? Again this all boils down to the use of the contract and it real reason for being is the hedging. This shows new crop hedging, so this would be for corn, the DEES (?) contract and all those months beyond, the comparison of total aggregate positions, again the bars representing an historical range for a 7-year period, and then we have 2007 and 2008 and you can see we're very much above not only historically, but even last year, so there's quite a bit of new crop hedging still going on in corn.

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Similarly for soybeans. Even though soybeans while rising in terms of amount of new crop hedging, and you can see that's typical historically where you see a bit of a rise, we've fallen below a year ago but still at very, very high levels of short hedging and this would be the November future and those beyond, and this goes up to pretty current.

What. This is a little bit different time period. It ends at the end of April as we're finishing out the crop year, and this was for the July 2008 and beyond at that point in time so it would represent the new crop wheat as we were winding down the harvest of the old crop wheat. Again you see 2007 wasn't much different historically, 2008 we had had quite a bit of grow short hedging. So you wouldn't know it by the amount of hedging going on here. Perhaps it's in wheat. Of course you don't have a lot of alternatives necessarily. Where else are you going to hedge? But that's the situation and that concludes my remarks and I look forward to hearing

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from the rest of the panel members on that.

MR. DUNN: We appreciate that primer and I appreciate the assistance from the Acting Chairman. I've heard a great deal from producers out there who are seemingly very frustrated, not seemingly, they are very frustrated from not being able to deliver at the futures price, that they're unable to do forward contracts as they have in the past. I've asked Tom Buis to tell us some of the concerns that we're hearing from producers. Mr. Buis?

MR. BUIS: Thank you, Commissioner Dunn, and Commissioners for this opportunity. I don't have any fancy PowerPoints or charts, but I do have a phone and an email and it's been busy all winter and spring regarding this issue.

I've heard from a number of farmers beginning last winter that they were being precluded from the market primarily when the markets have reached their historical highs. And while farmers love to get that higher price, they were often precluded from the market. The rapid

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increase in margin calls from many elevators forced them to literally quit offering contracts anything beyond 60 days and some even more restrictive than that.

Ironically, the ability to market wheat got better when wheat prices ended up being about one-half of this historical highs. So when it got down to $8, then the farmers were able to market it. The same has happened in some of the spring planted crops, most recently corn when corn got up to the high $7 range, almost $8, many of the elevators, ethanol plants and others quit offering contracts. Now that the prices have come down 20 percent, that may be changing. But I think the end result in all this is the persons probably most affected are the producers themselves which is the beginning of this whole process. They're producing the products that all these entities, whether it's hedge funds or speculators or other commercial users to take and either add value or purchase or make money off of.

A couple other concerns that keep

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popping up is the extremely wide basis. Farmers like everyone else follow the futures contracts and then they go try to market and there's this never-ending drumbeat that there's all this demand for this product yet the basis doesn't demonstrate there's that demand. I don't know where that breakdown in the linkage has been, but those bases have been historically high even in areas where normally you have a very narrow basis year round.

Another concern that I hear over and over is something fairly new, that you can only trade for about a 4-hour period, in central Kansas from 9 o'clock until 1 o'clock which I think corresponds with the opening of the markets. The concern is why can the producers only contract during that timeframe, yet the markets have 24-hour electronic trading.

Finally, a big concern that I hear again and again is that if you're going to be given a contract, there's a minimum number of bushes, and it's often 5,000 bushels. Many family farmers, many retired farmers who operate on shares often

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don't have volumes big enough and are being forced out of the market.

What can we do about all this? You guys have studied this for quite some time. Thankfully Congress is weighing in. Hopefully there will be some new legislation passed maybe this week that will help. But my opinion since last March or April, whenever you had that first hearing down here, is it's pretty tough to say what's going on if you can't count what's going on. And with the exemptions and the foreign exchange and the swaps and the over-the-counter trades that you don't really have a handle on, it's difficult and I think it's not fair to say that nothing out of the ordinary is happening. I was intrigued by Commissioner Chilton's call for maybe an independent, objective analysis of what's going on because we really need the answers. I don't think anyone has a true handle on what's going on and what's needed, and until we do that we may be missing the boat and a lot of people's livelihoods are at stake. In American agriculture today we're

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at greater risk than we've ever been because of the skyrocketing inputs which may relate back to another item that you regulate, energy prices. The high price of fuel has driven up the input costs of agriculture to historical levels. If you talk to producers today, and I was back home at my farm in Indiana and heard an earful from my neighbors, $5 corn today is like $2.50 corn was 2 years ago. They're not doing any better. Again I would urge you to do everything possible to make sure you have a handle on this because the livelihoods of many are at stake. Thank you.

MR. DUNN: Thank you, Mr. Buis. Our next presenter is Terry Reinhart who is with Advanced Trading. Terry is someone who has followed this for a long period of time and has a specific recommendation. Terry, if you will, please.

MR. REINHART: Thank you very much to the committee for their service and for the invitation to be here.

As the Commissioner stated, I'm here to

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convince you to double the premium charge on the futures contracts for grains and soybeans traded on the CME, KCBOT, and the MGE, and further, to make these changes effective with the January 2009 contracts. The current terms of these futures contracts has served the U.S. and the world well a few years ago. Simply stated, the premium charge often to as the storage charge which is inaccurate but more descriptive has not kept pace. You may review the details of this chart later, but in the interests of time I will point out that the current cost of building grain storage space is 325 percent of its cost in 1970, and the premium charge is only 4 percent higher than it was in 1970. Using USDA numbers, the dollar value of the U.S. corn, soybean, and wheat crop in 2006 was $61 billion, and in 2008 it's projected to be $122 billion, or double. Pointing out the obvious, the increase in the value of those crops is equal to the total value of those crops back in 2006. These value changes have taxed all elements of agriculture. One result has been the leveraging

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of assets of all agriculturally involved parties including warehousemen, lenders, farmers, ranchers, and in many cases are leveraged out.

One clear example of the resulting problem is with grain farmers. Grain farmers are being trapped into locking in their expenses for 2009 and beyond crops and this is the result of the need for longer-term leases, buying farmland, upgrade machinery, and specifically to sign purchase contracts for 2009 for inputs like fertilizer and seed in order to be assured of supply. The farmer is hard pressed to find a buyer for his 2009 and beyond production because the buyers do not have the tools necessary to hedge the risk. The result is the farmer is being forced to take career-ending risk, and this can be fixed.

A little elementary stuff here, but if the cash price is not offset by the futures price change, hedging did not occur. In the grain merchandising arena, the test of whether or not there is a hedge occurs during each delivery month

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and at the delivery point and only at the delivery point. If cash and futures converge at these times and at those places, there is or was a hedge. If they don't converge, there is not or was not a hedge.

On July 1, 2008, using FOB barge values at Peoria, Illinois, corn was 56 cents a bushel from convergence. The July futures price could not get down to the cash price because the July SEPS (?) spread was wide enough to pay the owner of the spread at a rate that exceeded the return on T bills or FDIC-insured CDs. This is the economic condition referred to as full carry. I know this because on July 1 I was one of those people. While this investment opportunity may be good for people looking for short-term places to invest, it is injuring those using short futures as a hedge. These economics allow investors to buy in this case July corn because of its relative value to September corn and ignore the value of July corn futures relative to the underlying value of the cash grain resulting in nonconvergence.

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This has been a reoccurring event and has lowered the usefulness of hedging with futures. The reason is not reliably occurring is that the premium charge is not large enough. In recent times the physical commodity price has been well belong the futures contract price because the applicable futures month price cannot get lower than that represented by a low-risk spread to the next futures month. Every penny that the premium charge is raised is a penny closer to allowing convergence. For CME corn futures, currently the premium is $7.50 per contract per day or about 4-1/2 cents a bushel per month. Using the 56 cents per bushel in the example above which his the amount the cash grain was under futures, i.e., lack of convergence, the equilibrium charge for the premium charge would be $53.40 per contract per day or about 32 cents per bush per month, or about 7 times the current charge. Some would argue that raising the charge sevenfold is crazy and irresponsible. I would argue that leaving it unchanged or only raising it to $8.25 per contract

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per day as was done for example with Chicago corn starting in December 2008 is crazier and more irresponsible.

This chart tells the history. The axis on the left is the spot corn truck basis at Ottawa, Illinois, which is an Illinois waterway delivery system delivery location on first notice day versus the spot month starting back in March 1998. The axis across the bottom is the spot futures month to the next futures month expressed as a percentage of full carry. Each blue diamond marks what the basis was in relation to the percentage of full carry. The black trend line clearly shows that the closer the spread is to full carry the less the convergence, and you can see down at the bottom is the July 2008 contract. Based on this history as carrying approaches or exceeds 80 percent, convergence is so bad that in a low-margin, high-volume industry such as grain merchandising, hedging did not occur. At 100-percent of full carry, convergence has never occurred.

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We implore your support and ask to raise the premium charge to $16.50 per day which is approximately 10 cents per bushel per month, and relative to history and what's going on in the rest of agriculture, we view that as a modest change. This change, due to the shortage of time today, we understand that there is opposition to it and that's fine. While I'm here, we have the spirit of our convictions that we think this change will make a difference and are prepared to debate it as long as there continues to be progress. Generally, however, with objections to this we think that there's a tendency to overcomplicate it, and one of the things in favor of doing this is we've done before. When the Illinois waterway delivery system was started, the premium charge was $5 a contract per day or approximately 3 cents per bushel month and issues similar to those being discussed this morning developed. The premium charge was increased 50 cents to the current $7.50 per contract per day or approximately 4- 1/2 cents per bushel per month

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and again we had convergence. The July 17, 2008, NGFA newsletter reported a proposal by Co-Bank to create a new loan guarantee program to be administered by the USDA's Commodity Credit Corporation. The article went on to say the presumption is that the participating banks would be able to lend grain to hedgers at higher ratios on -- grain on forward-contracted grain. I hope this presumption is correct. I hope banks are not losing confidence in the value of the futures hedge against their collateral. While we can support a taxpayer guarantee to the extent to make more capital available in the short-run to allow companies time to strengthen their balance sheets to a level that banks are comfortable lending against, if we do this, this in fact increases the burden on the CFTC, the exchanges, and you and me to achieve convergence in fact. The collateral for inventory financing is the grain, the collateral for forward- contracted grain financing is the cash grain contract. The reason the banks take a security interest in the grain elevators

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futures account is because the futures are the price offset thus security to the cash grain position. If the value of the collateral does not converge with the value of the futures, the efficiencies are lost. The price risk transfers tool we are talking about today is hedging with futures contracts, and for there to be a hedge there must be convergence in fact. We urge the CFTC and the exchanges to double the premium charge effective with the January 2009 contracts to improve convergence. We think it's efficient, effective, low risk, and simple. This action will restore efficiency to America's agriculture industry. Thank you.

MR. DUNN: Thank you very much, Terry. That was an excellent presentation. Tom Coyle with the National Grain and Feed Association is someone who has been as active as anyone who I know in this particular arena. I have had many phone calls one-on-one with Tom, on conference calls, and I know he and his committee has been very, very active in this. They've actually put

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together some pros and cons of the various solutions for convergence, and I think we'll all find this very interesting.

MR. COYLE: Thank you, Commissioner Dunn. Chairman Lukken, Commissioners Dunn, Sommers, and Chilton, the NGFA thanks the Commission once again for their continued efforts to understand the issues facing our industry and to pursue ways to enhance market performance. I have presented a number of times before the Commission including the recent open forum to discuss the topic of convergence and its importance to elevator operators in a smooth-functioning market. The NGFA's core position related to this issue has not changed, transparency and periodic adjustments to the contract specifications are critical to allow market participants to respond to changes in the risk-management landscape. What has changed is the sense of urgency for a solution.

Mr. Kass's charts once again clearly demonstrate particularly for wheat that

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convergence does not exist and is creating an unmanageable risk for elevator operators and creating a burden for financial liquidity. In my comments today I fill focus on identifying the issue with a single slide and then focus on the pros and cons of various solutions we have considered.

Convergence is not occurring in wheat because futures are leading rather than the cash leading the futures. Wheat futures today are trading $1 to $1.50 higher than they should and the wheat basis levels are compensating by trading $1 to a $1.50 lower than they should. The net price to the consumer is actually not going up because the basis is offsetting the higher price in futures. Futures are trading at $8, but the price of a barge delivered to New Orleans is $6.50 to $6.75. The consumer is actually paying the value of cash and not the value of futures. They used to be similar adjusted for transportation costs. Essentially we have a situation where we have demand for futures contracts rather than

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demand for physical bushels. These numbers are so far out of line that traditional relationships for risk management are lost resulting in lost confidence in hedge performance leading to a reduction in liquidity selling from hedgers and also risk to reduced financial liquidity. Even more concerning is that lack of convergence has reduced our industry's ability to provide forward cash contracts to our producer customers.

Why are futures leading and why is convergence deteriorating? Generally, tighter U.S. oil supplies combined with higher transportation costs and demand for biofuels has led to more volatile futures and a greater tendency for futures to price future supply and demand rather than current cash values. The traders are generally able to manage these trends during droughts and things like that. This seems to be a systemic shift.

What is causing the lack of convergence in wheat is the high percentage of futures that are owned by index funds that have a longer-term

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horizon for investment and are therefore not responsive to short-term supply-and- demand fundamentals. As this slide will show, it actually addresses a question that asked by Commissioner Chilton in the open forum when we looked at the numbers somewhat different than Dave Kass did in his presentation. If we just look at the wheat for a second, there has been a lot of dispute or discussion about what share of open interest is really owned by a passive law and you can draw different conclusions based on what that percentage is. If you take the yellow columns, those are the longs in the wheat, and then you'll notice to the far right is the total longs. If you take the green which is the short positions, you'll get the total shorts and as you can see they match. Then you have the spread positions and if you add the spreads to either the longs or the shorts, you're going to get the total open interest. Often times the index ownership is compared to the total open interest but it's a bit misleading because the spreads really don't have

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an impact on the flat price per se. If the market goes up, a spread trader is not going to sell one and take advantage of the rally, if he does, he's going to sell one and buy another, so he's really not providing liquidity in a bullish market and the same happens in a lower market. So there are three numbers that I use on top. One is the CIT long share of total open interest which is 48 percent in wheat. If you take their net, the long and the short, it's only 40 percent. But if you take the net long position and compare to the open interest excluding spreads, it's 56 percent and that's a huge percentage of the open interest. What's more compelling is the number below it. If you look at the net long percent, their ownership, the total number of contracts they own as of the most recent reports, their total number of contracts represents 145 percent of U.S. Wheat production, and this year's wheat production is a record or almost a record. So you can imagine how big an issue that is. If you go farther down you'll see that in corn that same number is only

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15 percent and in the case of soybeans it's 29 percent. So you can appreciate that the number of 145 percent in a nutshell demonstrates why we have a problem in wheat.

There are those who would conclude that the easiest solution is to simply ban in some way long-term commodity investors from the market. Fundamentally we believe that this is the wrong approach. First, any limitation could simply result in more administratively complicated solutions to allow individual investor accounts to be established so they can still enter the market which means just a more costly way to enter the market but we still get the market participation. Second, bears the question why should a long passive investor who has no intention to manipulate the market be precluded from using the market to manage portfolio risk? Rather than limit performance, we believe it is more logical even if more difficult to modify contract terms or specifications to protect the hedging value for a traditional hedger while accommodating the new

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market participant. The CME has implemented changes to contract specs at our request, but it appears those changes are insufficient to assure regular and dependable convergence. There are ways to either dramatically improve or assure convergence. What I'd like to do now is go through some of the things we've considered and the pros and cons of each of those and hopefully that will lead to more discussion.

One of the first things we looked at was the idea of adding more delivery points. When I say par, it means that the same value as Chicago-Toledo elevator in the case of wheat, but just add it to a broader geographic area. What this would likely do, for instance if you added a delivery point in Memphis or somewhere along the mid-south is that it would improve the local basis. Today their basis is 200 under, but if you had a guaranteed sale to the CME at option price, clearly the local elevator would be able to provide a guaranteed bid to their local producers if they could store the grain. It provides

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certainly better stability in the basis in that trade area. It also reduces the volatility in that area. And with the introduction of shipping certificates, if a facility in the river can offer that, they can branch that out and provide service to -- elevators as well. That's the positive side.

The negative side of that is it does not resolve the problem with convergence, and also the market is not suffering from lack of deliveries. We've been able to get to full carry as it's calculated with the current storage rates at full carry with a limited amount of storage and it would represent a disadvantage for the stopper. So a long hedger, for instance a mill that's nowhere neat the mid- south that ends up with ownership in that area would actually be disadvantaged so it would be a reason for them not to use it as a hedge. So while you've benefited a short hedger in the mid-south or the Ohio River, you would be disadvantaged in the long.

A second way of looking at that would be

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to use these additional delivery points as a safety valve at a significant discount to the current price of delivery. Let's say we would use Toledo and figure the transportation cost from Memphis to Toledo and it would be significant. Maybe it's 60 or 70 cents a bushel, but in today's environment that would still provide a safety net for the local elevators, they would still be able to improve the stability of the basis in their area which means that they would likely have better access to capital and more confidence in their bankers. By having the delivery points at a discount, you remove one of the big obstacles to having the additional delivery points in that it is no longer a disadvantage for a stopper. If you're a mill that's getting ownership of inventories in an area you really would prefer not to have but it's at a big enough discount, you really don't have an economic disadvantage. That was one of the key areas, adding delivery points.

The second key area that we looked at was changing storage rates. We've had a range of

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ideas there. One would be a modest increase in storage rates, kind of the processing we've been seeing the CME use for the last few years. Certainly if we increased the storage charges, and it's something that we requested at the ag forum in April, is that it would better reflect the current value of storage and that's a minor shift in storage, maybe it's a penny, maybe it's 2 cents. Again the negative side of that is it does not solve the problem with convergence. It just better reflects the value of storage capacity.

The second alternative that we looked at which is something Mr. Reinhart was promoting a few minutes ago was a large increase in storage rates, maybe doubling of the storage rates. This certainly would allow more of the volatility to shift to the spreads in the futures markets and away from the basis levels. Second, it would enhance convergence in surplus years. The negative side of that is that it would make the market less responsive to bullish fundamentals in the years when you have tight supplies but you

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have this economic incentive to tender shipping certificates with high storage rates and the market would be less responsive when the market needed to go higher. Second, it would create potential for, again, the opposite imbalance in tight years. In the summer when you're expecting spreads to invert and you're looking for flat prices to rally, if there's an economic incentive to tender shipping certificates, the market simply wouldn't respond, people would calculate the storage costs and the storage costs would be so great from July to August when you harvest and in that period the market wouldn't respond in the way that it needs to. It also would create a situation where they actually have an incentive to produce for storage or produce for the CME as opposed to producing for the consumer. Finally, it increases the burden on the long hedger. If they do need the inventories that they need to get to a mill, they're paying a very high price for that so a genuine hedger, a long hedger, would have a disadvantage. I would say that there's one

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other risk of something which has significant higher storage rates. If capital really wants to chase agriculture, if they really want to own raw materials and grains being one of them, if they find that going to the futures market is too expensive then their next alternative would be to find a way to get into country and to buy grain, physical bushels, in the country and most don't want to do that today for a number of reasons, but if they did that you can imagine today if they owned 880 million bushels of wheat in a market that only produces 670, if they own that and then the market got tight later, you can imagine the kind of imbalances that could be created.

The third thing we looked at in terms of storage was seasonal rates which might be significantly higher during the peak storage periods but more reasonable or market based during the other times of the year. This certainly would better reflect the value of storage during those peak periods. Again the negative side of that is it does not resolve the convergence. It improves

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things so you can get more of the risk in the futures market away from the basis, but it doesn't solve the underlying problem of convergence.

The other novel concept that we had looked at, we talked about it in the forum in April and frankly it was the idea of compelled load-out. We surveyed our committee to ask different scenarios. One is that it was unlimited, that a delivery elevator that tendered shipping certificates if they found that they couldn't find demand, if they could compel the long to load the bushels out to make space for us to buy more bushels in the country. The benefit is it would immediately create convergence. The spread may go to a $1.50, but we would definitely get convergence. The problem is that it creates an unmanageable risk for the long hedger, it creates an imbalance in favor of the short hedger, it could dramatically reduce liquidity as long hedgers find some other alternative, OTC market or some other way to avoid the risk that they now have by being long, the same risk that a short

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hedger might have today. Again it also could force the current on-exchange volume to the OTC market and then we wouldn't have the transparency that we want, but recognizing that the real benefit is that it would solve convergence which is the problem.

We asked the next question, if you added that feature but with some limits, and I can talk about some ideas of limits, that it would force convergence in cash in futures, it would restore confidence and dependability for short hedgers. This would represent a material change that could destabilize the market. All the comments I mentioned about having an unlimited ability to compel load-out would be true unless this was structured properly. So it's not something that could happen overnight, but I suspect that the CME working with the trade over the next 60 to 90 days could probably find some way to structure a limited ability to compel load-out that would be able to restore balance.

The other possibility that has been

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talked about periodically is the idea of a cash settle index. Certainly this is a potential solution at convergence. The problem is that it represents a radical change with unknown consequences. It creates new basis exposure for elevator operators and it eliminates the delivery system as the ultimate source of grain and also the ultimate market for grain. It could also create an advantage for companies that have large networks of elevators and a disadvantage to small elevator operators who are in one area of the country. Finally, there is no guarantee that it would create convergence.

One of the other ideas that was considered is the concept of serial futures where you would have futures every month as opposed to every other month that's currently the case, or every 3 months. Certainly this would create enhanced hedging opportunities and it would reduce the timeframe in the event that there was an imbalance in the market, but it's not a solution for convergence.

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We have surveyed our risk committee and also some of the members of our country elevator committee. I would say that first there were a couple of key areas of consensus, although no one can agree to all the specific issues. The consensus was that some action needed to be taken now and that there was an interest to encourage early implementation of any changes that were determined to make sense by the Commission or the CME. In terms of general biases, there was some consensus on adding delivery locations or wheat at least. There was also a general view that increasing storage rates somewhat would make sense. There was a range. Some people think that it should be modest, and as we heard Mr. Reinhart say, some say that it should be significant or doubling of the rates. The other I would say consensus is that there is a sense of support for some form of compelled load-out, a demand certificate of some type. There was unanimous agreement that having it unlimited would be a problem, but there was general support for adding

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some feature to compel load-out. What's interesting about that is this was an idea that was dead on arrival when we did our task force a year ago, and even when we met in April we had talked about it but there was absolutely no support. But we've gotten to the point right now where there is such an imbalance between the cash and the futures that something fundamental needs to change to allow that to happen. Those are my comments. I'd be happy to answer any questions.

MR. DUNN: Thank you very much, Tom. We appreciated the overview and the pros and cons. That certainly is going to help the Commission, but I think it gives a lot of food for though for the advisory committee and for our discussion.

Roger Cryan who represents the National Milk Producers Federation has a particular view of this from an industry that relies very heavily on having protein available. Roger, if you could, please.

MR. CRYAN: I'm Roger Cryan. I'm with the National Milk Producers Federation. The

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National Milk Producers Federation represents 31 dairy farmer co-ops whose owners produce three-fifths of the nation's milk and we appreciate the opportunity to express our concerns about futures markets and their regulation through our participation in this committee.

NMPF does not believe that speculators in the futures markets are substantially distorting feed prices. Farm prices reflect supply-and-demand fundamentals even when futures markets do not. However, National Milk does believe that overwhelming speculative volume in these markets is causing the poor performances in the futures markets for feedstuffs and that this is undermining both livestock and crop farmers' ability to manage their price risks. This has substantial costs for farmers, for the food industry, and for the public.

Dairy farmers feed 7-1/2 billion pounds of soy meal and 46 billion pounds of corn to their cows every year. Feed represents a half to two-thirds of their cost of production. Like hog

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farmers, poultry growers, and beef operators, they depend heavily upon forward pricing opportunities to hedge these costs. Some participate directly in the futures markets and others participate indirectly through their cooperatives or their feed and grain dealers. Our members have shared their grave concerns about the explosion of their basis risk when futures prices fail to converge predictably with the prices they pay for feed. Dairy farmers are very heavily capitalized with much of their capital fixed and firmly sunk into dairy farming and only dairy farming for its productive life. They have all this at stake in the effective operations of these futures markets.

Crop farmers face an obvious and dramatic loss when their short contract goes off the board a dollar above the expected convergence price, but a volatile basis moves in both directions and livestock operators can face an equal risk once basis expectations shirt upward and the basis on their long contracts moves back down. Those who hedge feed costs directly through

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the futures market suffer direct losses. More importantly, over time feed dealers and grain elevators are unwilling to forward contract feed or will do so only at a substantial additional cost to feed buyers. Forward price discovery for swaps and forward contracting becomes ineffective, and in some, a lack of convergence in these markets is just as serious for livestock producers as it is for crop farmers.

Farmers need effective price discovery through futures markets that respond to fundamentals of supply and demand. It has always been assumed that liquidity is a good thing. On recent occasions though it seems clear that commercial interests have been drowning in speculative liquidity. Speculate interest in commodity markets has grown so large and with so little concern for day-to-day market fundamentals that their noise appears to overwhelm the ability of the physical side of the market to achieve arbitrage. Futures markets must be structured to carry out the public interest for which they are

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legalized. This means that they must work for the true hedgers, those with a meaningful connection to the physical market to the benefits of buyers, sellers, and consumers in the physical market.

Protecting farmers lies at the historical root of the CFTC's mission to maintain the integrity of these markets. Agricultural commodity futures markets need substantial dedicated and sustained attention from the CFTC. That function is as important as ever and remains a key reason for CFTC's continued independence. As I said, we do not believe that this excessive speculation in the futures markets is causing the exceptionally high feed prices that farmers are paying, but at just the time that price risk management tools are of especial importance to farmers, those tools have been badly blunted by an excess of mindless speculative interest.

Recent months have demonstrated the havoc that can ensure from unbalanced commodity futures markets and the economic literature is beginning to explain the cause and effect. We

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applaud the Commission's initial steps to address these structural issues and we urge the Commission to continue its examination of these issues and to seek additional remedies to reassert the soundness of structure that these markets need in the public interest.

There are a few things that came in the packet and one of the things that I thought was most significant was the testimony by Mr. Masters specifically about the differences between traditional speculators and these index speculators and the way that index speculators consume liquidity instead of adding liquidity. I think that's a very important point that deserves consideration by everybody here. I think there are structural issues that need to be addressed by the CFTC because nobody else necessarily is in a position to fix it or who has an interest in fixing it. So I thank you on behalf of National Milk for the opportunity to express our concerns.

MR. DUNN: Thank you very much, Roger. I appreciate your appearance here today. I don't

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know if we've got all our technology quite put together, so I just want to take a quick break and recognize a former commissioner here, Tom Erickson. Thank you.

With that let's hear from the exchanges themselves on what they've been doing to look at this problem area. I must say I have been very, very impressed with the openness that the exchanges have taken in addressing this problem. They have not been sitting on their hands since our meeting in April. I know they've gone through a number of different steps to take a look at how can they fix the convergence problem. They have tried some things. They have not been successful on some things. But I do feel that the relationship between the industry and the exchanges is probably as close as it's ever been because I know they've been talking to each other tremendously during this period. With that I'll ask David Lehman give the CME overview.

MR. LEHMAN: Thank you, Commissioner Dunn, and thanks to all the Commissioners, and for

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the Agricultural Advisory Committee for giving us the opportunity to be here today and hear from you about what you think needs to be done to help us improve performance of our contracts. It's the number-one priority for us obviously that our contracts work for you, for our customers, and we recognize that they've fallen short a little bit. I also thought Commissioner Chilton's mention of a blue ribbon panel to do a study was an interesting coincidence. Yesterday what I consider a pretty blue ribbon study came out of Purdue University and I hope you all get a chance to read it. I got it on the plane last night. I was grounded at O'Hare Airport for about 4 hours so I spent a little too much time traveling and not enough time being able to look at this, but it's out from Professor Hurt (?) and the Farm Foundation was involved in sponsoring that and it sounds like they reached conclusions that energy prices are probably worth $3 of our corn price increase, biofuels a dollar, and they don't see that speculation has any long- term effect on prices.

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But certainly read the study and draw your own conclusions.

We were here in December of last year, CME Group was, to talk about swaps primarily, but at that time we had just announced changes in our wheat contract that were referenced by other speakers this morning, an increase in the storage rate, a modest increase of about 10 percent. We also changed the delivery instrument to a shipping certificate. The goal of those changes was to improve convergence and better reflect the underlying cash market storage cost and also how grain flows in the cash markets, not really flowing into storage as much as going directly from production to consumption.

At that time we actually saw very good convergence on the December contracts. The December 2007 wheat contract looked excellent in terms of convergence. In fact, I'll flip ahead to that. That's the chart showing basis in Chicago, the lower blue line, and Toledo is the red line. So Toledo went off at maybe 10 under but we talk

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about convergence really as a band and not futures and cash coming together exactly, and of course this band I think has probably widened because of transportation cost increases and other transaction costs, but we had very good convergence. Why? I think we had a very strong cash market, that the U.S. became the supplier of wheat to the world market, the world market really was fearing it was running out of wheat and that's why we saw what we saw.

Since December we'd had 6 or 7 months of significant fundamental changes in the markets. We did see world wheat stocks fall to 30-year lows early in 2008, U.S. Stocks fell to 60-year lows, sharp increases in input costs led by fuel and fertilizer, and then as Dave Kass showed earlier in his slide, significantly higher prices in corn, beans, and wheat, record prices in fact in those three markets.

What we've done to address or ensure contract performance in this period of extremely dynamic fundamentals, we worked with the three

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exchanges, and I know Jeff is going to talk about that a little later, in coordinating price limit increases in our wheat contracts. This occurred in February in wheat and then in March in corn and beans, and what we were seeing is really the markets became very volatile and we were really shutting them down too often with our price limits. So we worked on a coordinated expansion and certainly with the Commission and Commission staff to get that in place quickly, and we appreciate the support from the Commission and all three exchanges in getting that done.

As I mentioned, we made the changes in the wheat contract that went into effect in July of this year, so we've just gone through the first expiration with the new delivery instrument and with the higher storage rates, and I'll show the results of that in a minute. Then as we got into the new crop, the market really kind of turned and in March we saw increased plantings of wheat obviously in response to high prices, and one of the sayings in the markets around the Board of

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Trade where I've been for 20 years is that the best cure for high prices is high prices. So what that means is as prices move higher, consumers start to use less, they look or substitutes, they reduce consumption as we're all doing with our gasoline consumption now, and then supply increases as well. So we saw a big increase in soft red winter wheat acreage and it looks like our crop is going to be about 70 percent higher this year than last.

We've talked about full carry spreads and this is the spread for the DEES March when we had excellent convergence. The blue line is the percent of full carry. It started at an inverse 4 months before expiration, moved to near full carry in November, and then went into delivery period at about 75 percent of full carry. So when the spread is inside full carry, you tend to see deliveries. Those deliveries did come out. I think we had about 9,000 deliveries, I've got that in a chart a little later, and we achieved convergence.

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This is the July 2008. This is the contract that I just mentioned that was the first expiration with the new delivery instrument and the higher storage rate. As Dave Kass showed in his slide, cash prices are about a $1.50 under futures at first notice day. I should have pointed out this heavy vertical black line is the first delivery day on the contract. That's when we expect to see prices in the cash market approaching futures because at that time you can convert a futures position into a position in the physical market. If you're short you can deliver against your short, and if you're long you get assigned delivery and it's an electronic piece of paper when the delivery occurs in the market, but it's a right to load out grain or a right to ownership of grain in a warehouse. So that's the convergence theory of futures and cash coming together. Obviously we didn't see it in July. We were disappointed in this performance. We thought we would see better performance with these changes in storage rate and delivery instrument and we

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didn't. Why? Again we have a crop that's almost 70 percent larger than last year's crop so we've got a very good crop coming on, not finished yet certainly in terms of soft red winter wheat harvest, but getting close. And then as Tom Coyle mentioned, the spreads went to full carry and that takes away the incentive to make delivery or take delivery and this is the result. This is a chart of the spread on the July- September contract. The top blue line is that percent of full carry, and as you can see, it hit 100 percent just before delivery and then came off some.

I mentioned the quantity of deliveries and this is something that shipping certificates do. They allow the warehouseman to more effectively use their space and increase the effective capacity and even though the storage may not increase, you're able to issue certificates up to your full storage capacity regardless of the wheat that's in the elevator. So July 2008 is in the middle, and what this chart shows is average number of contracts delivered over the last 5

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years versus the most recent expiration in that month. So in March on average we have about 9,000 to 9,500 contracts of deliveries over the last 5 years, in March of this year we had 3,000. In May of this year we had 3,500, compared to 6,000 or 7,000 on average. So this is what this is telling us, and if we looked at each one of these expirations you could see that spreads have moved near full carry on each of these expirations and that then could be one of the explanations for lower deliveries. In July of this year we had about 2,500 deliveries, and our average for July over the last 5 years has been close to 6,000. So here's the month that we thought we would see additional deliveries of the change in the instrument, the shipping certificate, and also the higher storage rate which is really an earning to the issuing warehousemen, they're paid that storage rate when a delivery is made and we didn't see it. Index funds are something that is talked about in almost every conversation about the grain markets these days and about commodity markets in

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general. This is a chart that we put together and it kind of mirrors one of the charts that Dave Kass showed of the percentage of open interest held by index funds. Of course you can look at this in many different ways and I compliment Tom for noting those ways, that you can look at it as a percentage of open interest, it's about 41 percent today, or you can look at it as a percentage of the long side of open interest, or you can take the spreads out. So we look at it as a percentage of total open interest and just plotted this against price of the near-by wheat futures contract and over the last 2 years since January 2006 when this data become available, index fund percentage has declined from 49 percent to 41 percent while wheat prices increased 151 percent. So that tells us that there are economics behind the wheat price increase and it's not index funds.

What's the CME Group doing to address the convergence issue? We've had a number of meetings. We started last fall with an industry

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meeting with trade associations, with commercial market participants, to look at contract performance. That led to the recommendation from the National Grain and Feed Association which we implemented to increase storage rates and implement the shipping certificate delivery instrument. We then saw the extreme volatility in February and March of this year in the wheat markets. The Commodity Markets Council sponsored meetings with the three exchanges and their customers, one- on-one meetings, to discuss contract performance and identify potential solutions and following those discussions we participated in the Commission's roundtable here in early April. Then in June we worked with the National Grain and Feed Association to develop another storage rate survey and go out and find out really where the market was in terms of the cost of storage. In July after the July expiration just last week we held an industry meeting in Chicago with a little more urgency, I think, that we felt the changes we were

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implementing in July were going to help address the problem and they didn't seem to, that we really now need to take stronger action to improve the performance of the contract. So the areas that we discussed, and Tom gave a pretty good overview of what his committee or the Risk Management Committee at NGFA is looking at and it happens to be very similar to what we looked at last week, and it is to look at a seasonal storage rate, a different rate during harvest than during the rest of the year, looking at the safety valve delivery points, Memphis, actually the whole Mississippi River from St. Louis to Memphis. It's got about 80 million bushels of storage capacity compared to about 70 million that we've got in our current Chicago-Toledo-Burns Harbor-St. Louis areas. Central Ohio is another location that we're looking at. Then we're looking at the possibility of serial futures or expirations every month. The delivery certificate or mandatory load-out concept is something that we're going to study. We think it does have a benefit of

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assuring convergence but if not structured properly it could be detrimental to the long hedging side of the market, but that's something we certainly are going to look at very closely. Changing the quality of the contract, upgrading that again by lowering the vomatixin limit to 2 parts per million. And then looking at the potential for cash index settlement.

Our timetable on moving forward from here is over the next 30 days we intend to vet more broadly with the marketplace two issues that we think could be implemented relatively soon, seasonal storage rates, and additional delivery locations we think have very good consensus within the industry or at least within the roundtable that we held last week and we think that's a pretty microcosm of the broader industry. The delivery receipted or forced load- out we think as I said is going to take more research and more time to come up with a way that that can be implemented and maintain balance in the contract between buyers and sellers. We intend to do this

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via a broader industry meeting in September and then also move forward in a little longer timetable obviously on the compel load-out and cash index settlement methodologies. One thing that I know we're going to need is certainly to work very closely with the Commission and staff to look at how we can implement some of these changes maybe in a more timely fashion than normally would be considered, but I think I've spoken with some of your staff and briefed them and will be looking to having that discussion soon. Thanks very much.

MR. DUNN: Thank you very much, Dave. It does appear that you have been extremely busy. One of the things that you're considering is a cash settlement contract and I know that's something that the Minneapolis Grain Exchange has implemented. Mark Bagan is here as head of the Minneapolis Grain Exchange. Certainly this is the exchange that experienced probably the most volatile wheat market last year. So Mark, if we could get your thoughts and comments, please.

MR. BAGAN: Thank you, Commissioner

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Dunn, as well as the Agricultural Advisory Committee participants here. The Minneapolis Grain Exchange is pleased to have the opportunity to address this group today. I also thank Commissioners Lukken, Sommers, and Chilton.

I am Mark Bagan. I am the CEO of the Minneapolis Grain Exchange, and as a designated contract market, the Minneapolis Grain Exchange works very closely with the Commodity Futures Trading Commission. As designated contract markets, it's out job to ensure that our risk-management products are working properly for the marketplace. We take that obligation very, very seriously. Thank you for convening this forum today as we in the industry gather and work as a group toward addressing the challenging facing our marketplace. The exchanges, the CFTC, and the Agricultural Advisory Committee has market integrity to protect and we at the Minneapolis Grain Exchange are pleased to be part of the forum today.

At the Minneapolis Grain Exchange we're

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very familiar with the concept of convergence and monitoring that convergence particularly as it relates to our hard red spring wheat contract. As Commissioner Dunn mentioned, we also became experts in monitoring volatility in the marketplace this past winter. Hard red spring wheat prices went from under $10 to $25 in a very short amount of time and Mr. Borchardt will be talking later about what the exchanges did in conjunction with one another to increase those price limits.

I'm pleased to report that there was nearly total convergence between the futures and cash price prior to our first notice day in our delivery contract for our May hard red spring wheat contract. Convergence was evident very early on. The July hard red spring wheat contract moved toward convergence prior to the first delivery day as well. This is an important fact because the July contract month for the Minneapolis Grain Exchanges are last cold crop month and there were relatively small amounts of

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supply of hard red spring wheat at that time. Additionally, the wheat conditions for the hard spring wheat market were uncertain at that point as well.

From our perspective, we believe we've got some alternatives here for this group and the marketplace to consider here today. It's my pleasure to offer some thoughts on the convergence problem that brings us all here. Grain futures, while they're a traditional hedging vehicle, they've also become an important investment vehicle in the marketplace today. In today's market, commodity investors accumulate permanent long positions well ahead of the delivery period, but they do not net sell these positions out. Instead, they roll these positions from month to month. In my opinion, this is the essence of the convergence problem. The Minneapolis Grain Exchange is not among those who see these investment flows as manipulation or unjustified speculation. Consequently, the Minneapolis Grain Exchange does not support regulatory or

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legislative action designated to penalize these selected market participants.

We at the Minneapolis Grain Exchange believe we have an alternative toward this solution and that is the cash-settled index futures contracts that Commissioner Dunn mentioned earlier. These products currently are listed on the Globex platform and are traded side by side with the Chicago Board of Trade and the Kansas City Board of Trade grain contracts. What we think we could do in terms of bringing in additional solutions is to link these products as single interexchange spread products, and we're working with the CME to do so. So half of the solution is complete in my opinion today. The fact is that these products are traded on the same platform, the Globex platform, as the other agricultural contracts.

The Minneapolis Grain Exchange's cash-settled index contracts differ from traditional grain futures in a number of ways. These contracts are financially settled and

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represent the national interior or country origin price of grain. They trade exclusively electronically and we have contract months available in all 12 calendar months. Most notably, the Minneapolis Grain Exchange's cash-settled index contracts guarantee convergence. All parties can participate in the futures market without disrupting the settlement mechanism. As Mr. Coyle mentioned earlier, cash settlement for agricultural contracts is a radical change and it's one that the Minneapolis Grain Exchange has battled with and struggled with over the last 5 years as we've tried to gain market acceptance with these products. The educational curve on these products is steep.

It's vital to understand the distinction though. The Minneapolis Grain Exchange's index design does differ from the physical delivery design because no market participant can influence the convergence process since the financially settled products settle into the average price that producers are being paid at their local

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elevators across the nation. The traditional basis hedged reduced risk in the past may actually increase the risk today. Hedge effectiveness has become a bigger issue as basis predictability has dropped. Today the grain industry hedging instrument is represented by the horizontal line on one of the charts that we'll have here. This graph shows the collapsing basis of the wheat contract. The severity of this convergence problem has prompted an array of solutions brought forth that industry participants are considering making as well as exchanges are considering making in changes to our current physical delivery contracts. The Minneapolis Grain Exchange's soft red wheat index contract and the national average cash price are one and the same which again guarantees near perfect convergence. Soybeans are beginning to have some of the similar challenges that the wheat contracts have and it's our belief that the corn basis at times may be weakening there as well.

Back to the national products that the

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Minneapolis Grain Exchange offers, the data that comprises each one of these contracts is collected by DTN. It's compiled from the cash bids at the grain-handling facilities across the country, elevators, terminals, and so forth. With these index products there are no storage costs, no delivery concerns, and no grain differentials on grain load-out. Financial settlement of grain futures contracts is a model that accommodates all players in the marketplace, short and long hedgers, speculators, index, and financial investors, and we're convinced that it could be a powerful tool in combination with the traditional physical delivery products that the Chicago Board of Trade offers. As I mentioned earlier, the Minneapolis Grain Exchange is working closely with the CME in an effort to provide single-click, single-product electronic spread trading between the traditional grain futures and our cash-settled futures on the Globex platform. Once available, we believe that single-click spread trade volume will gradually build, improve

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liquidity, and bring greater transparency to cash basis values for every market participant. This all-important transparency is something not offered in all products that are out there today, particularly the OTC products and the swap markets. In contrast, trades of the Board of Trade's current contracts spread against the MGEX products will take place on an exchange in a fully transparent public marketplace with instant price and volume dissemination and worldwide market access.

The Globex interexchange spread product gives the market a new and appealing risk-management tool. A few examples for its use, hedgers and speculators will be able to rotate positions in and out of both contracts based on basis risk perceptions, basis expectations, position sizes, and position limits. Those who choose to trade exclusively in the traditional contracts and accept the basis volatility risk can do so, but we expect interest in these spread trades to be high, contributing to significant

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liquidity for both hedgers interested in trading and in our of the two contract markets. Index managers facing constant demand for new grain investment products who can't obtain hedge exemptions today from the CFTC can initiate their hedges in the Board of Trade grain contracts and spread those positions over to our financially settled products in Minneapolis. Initial index buying at the CBOT will be followed by selling which is a vast change from the situation we have today where they just generally roll their positions over. Similarly, index investors worried about political or regulatory risk for their existing Board of Trade long positions can roll into MGEX contracts, earning the premium between the cash and the futures that has created the convergence. Here again the Board of Trade contracts will see a net selling from index investors which is a huge change as opposed to the continuing roll of the positions. Just this activity alone in my opinion will improve convergence perhaps substantially for the short

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hedgers. Let me emphasize that the MGEX index contracts are a complementary product and not a competitive product to the traditional grain products. They represent a risk- management opportunity needed by our traditional customer base.

Let me conclude my comments in saying as designated contract markets, each exchange has a vested interest in bringing innovative market solutions to the marketplace and on behalf of all of the exchanges let me assure you that we all take that responsibility extremely seriously. Thank you, Commissioner Dunn, for giving the Minneapolis Grain Exchange an opportunity to take part in this forum today.

MR. DUNN: Thank you very much, Mark. I appreciated that. And I note that Mark's presentation is not in the handouts that we gave you. We're going to try to get those reproduced and distributed before you leave here today.

With that I'd like to open it up for discussion, and at this period rather than having

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the Commissioners having Q and A and making their comments, I would like to have the Advisory Committee and folks in the audience who have questions or comments on any of the presenters that we had this morning. Please identify yourself when you get ready to ask a question. Also folks at the table, if you have a question, please do so by holding your name up so that I can see who is requesting to speak. Dan Brophy?

MR. BROPHY: I'm going to ask some questions of Dave Lehman and Dave Kass in relation to what Mark just said which would seem to contradict my understanding of your slides, although I had difficulty seeing them from my vantage point here or my lack of vantage point here.

The way I interpreted Dave Lehman's and Dave Kass's slides both is that you do not think there is a correlation between index activity and in one case wheat prices. I agree with that, but Mark thinks there's a correlation between the convergence problem and the index activity which

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to me is pretty well demonstrated on that first slide that Mark showed on soft red wheat which appears to indicate that 3, 4, 5 years ago, I couldn't quite see it, but a couple of years ago there was no convergence problem and now there is, and of course we know that the index investing trend started about 4 years ago and has gotten bigger except for the last couple of weeks. If you can comment on that or not as you wish, but I happen to accept Mark's thesis and I think somebody else here said the same thing, that the correlation to problem is due to that, and it's also due, Tom Coyle mentioned as well, to a lack of net selling. So I wonder if we could have some discussion about, A, whether that is the case, and B, if it is the case that the index investment trend presents a problem, are they speculative or are they not speculative? The Commodity Markets Council which I represent has argued in the past that it's financial hedging by one definition or another and if anybody in the index market, index management business, is speculating around other

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than a one-to-one matched book against a security product that has been sold, that's a different matter and that is speculation. But the Commodity Market Council's view on this has been that they have the right to participate in our markets.

So what I'm getting at is this. I think that they are the cause of the convergence problem. I don't think it would be healthy for futures market liquidity or for the exchanges or for the users of the exchanges to run one segment of the market out, in this case index investors, by revoking all their hedge exemptions and imposing very restrictive speculative limits on them. So I wish we could come out of this meeting with that as an agreement and if that is the agreement or a consensus, then we have to find a way to deal with this investment trend and also allow our physical delivery contracts to survive. I think that's the challenge to this group and the Commission, and actually I think Mark has come up with a very powerful idea which probably needs further explanation.

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MR. LEHMAN: Thanks for your comments, Dan, and just in terms of the correlation between index fund trading and prices, the point that I was making in the slide that I showed is that we don't see a correlation between price levels and index funds. In fact, we ran the correlation coefficient on index fund percentage of open interest and price changes from January 2006 to July 2008 and it shows a minus.59 correlation, so they're actually inversely correlated.

Your real question though I think is a good one, Dan, is that participation affecting convergence and if so is there a way we can adjust the contract specifications to allow that participation to remain in the market, because I think we all know that if we restrict it, it's going to get into the market some way. It's going to find a way through the over-the-counter market, it's going to find a way in non-U.S. exchange markets which are less transparent to all of us. And I think this is one thing that we all really appreciate the Commission having accomplished a

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little over a year ago, to create new commitments of traders report, the supplemental report, that shows their positions in our markets. We can argue about how accurate that category is, but I think everyone agrees that it's certainly an improvement over not having it. So we can begin to see their activity and if we restrict it some way then we'll lose that transparency again and I don't think we want to see that happen.

I think there are a lot of reasons for convergence occurring less consistently, and that's what I think we're seeing. We saw great convergence in December wheat, we saw terrible convergence in July wheat, so it's not that we can't converge, but it's that we're not doing it consistently. I know others have looked at this, the University of Illinois has, and they presented here in April at the forum and I think found the same result. Obviously transportation costs and changes in transportation are a big part of this relationship. Flat price levels at record highs certainly have to be a part of the relationship.

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Should basis be 20 cents when wheat prices are $5 as when wheat prices are $10? Is basis a percentage of the flat price? These are some of the questions I think that we're all struggling with intellectually to understand. But I think there are changes in contract design, in contract specifications, that can be made to address this problem. I think I outlined a couple of those that we see good industry support for, and National Grain and Feed seem to agree with that.

We are working with the Minneapolis Grain Exchange on spread trading functionality between our contracts and theirs. It seems pretty easy or on the surface it seems pretty easy when you have two products traded on the same platform on Globex as Mark mentioned to allow intermarket spread trading between those, but of course we're separate self-regulatory organizations, we don't clear at the same clearinghouse, and then really just the functionality of integrating order books in the component legs with the spread order book is something that takes quite a bit of work on the

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matching engine. So we're working on it and, Dan, those are my comments. I think you make some good observations. I think that the convergence issue is more complicated than just saying it's index funds.

MR. KASS: Dan, I guess I would echo that. It's I think not so much that we've eliminated index trading as having any influence on convergence even though we've not seen any demonstrable correlation between the size. Sometimes the amount of index trading has been large and we get excellent convergence and sometimes it's small and we don't get convergence. I think the point is that it's not the smoking gun. There needs to be more research done. It's the data on it, and I thank Dave Lehman for the observation that we have added this transparency and we hope to add some additional transparency with this special call project that we're working on and we owe a report by mid-September.

It's a confluence of so many things. It's a world wheat contract, the Australians come

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in here, the Canadians, the Europeans, anybody who wants to hedge wheat, they go to where there's liquidity and all that influence. But as Mr. Coyle said, the bottom line is at some point it has value and it's being reflected in the basis and the actual price that it's exported and traded, that represents the value and the futures price is something above that as it turns out.

So, no, we're not seeing a high correlation between the amount of index trading. I think more research needs to be done and I understand there are some efforts now and that researchers don't like to work with 6 months or a year's worth of data, even 2 or 3 years is really a scant amount of information to do research, but that's what we're left with in terms of this. I think there are a lot of things happening here. It's what we're not seeing. It's not the smoking gun, it's not a clear correlation, and I think that's where we come out.

MR. DUNN: Mark?

MR. BAGAN: I want to follow-up on a

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point that both the two Daves just made here and that is the unintended consequences of limiting passive money in the marketplace. That money is going to be in the marketplace regardless of whether the CFTC limits passive money in there or not. The real question is one of transparency in my eyes and that is if the CFTC further limits passive money coming into the agricultural markets, that's just going to go to the OTC market or to the swap market and it's my belief, and a very strong belief of mine, that all market participants including producers, elevators, grain companies, they're all better served by having those transactions take place on a regulated market.

MR. DUNN: Roger, on this same subject?

MR. CRYAN: On defining hedging?

MR. DUNN: One moment because Commissioner Chilton I believe wanted to address this particularly.

MR. CHILTON: I just wanted to mention two things. I agree with Mr. Kass who is just an

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exceptional public servant and gives us great information every Friday but that we need some more research. Dave Lehman you've mentioned this Purdue study and it's just possible that Purdue is about the best school in the universe, so I couldn't let it go without saying something. But I don't agree with the conclusion that you read. I read the report and it doesn't say speculators have no impact, it says, "While the effects of supply and demand on commodity prices are clear, the effect of changes in the structure of the commodity markets, in particular increased speculative activity, are not. There is no doubt that the amount of hedge funds and other new monies in the commodity markets has mushroomed. Price volatility has increased partly due to trading volume. Based on existing research it's impossible to say, it's impossible to say, whether price levels have been influenced by speculative activity." The sort of questions that Dan is asking is where I was going earlier in my comments, that people feel very strongly like you

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do that it's not having an impact, but smart people disagree on this and we're the ones who are supposed to be making policy and I'd rather have some pretty good information. That was my point about some blue ribbon study, somebody who's not connected with anybody, the best and brightest in academia. That was my point. Thanks.

MR. DUNN: Thank you, Commissioner. Dan, if I could get you to turn off your microphone. Thank you very much. Let's go to Roger and then we'll go to Joe.

MR. CRYAN: I wanted to make the point about the hedge exemptions and the speculative limits. I think that as the CFTC has moved toward a lot more work on financial stuff there's been kind of a fuzzing of the understanding of what hedging is and I thought that this had been addressed by the Commission I had hoped for good, but there's a difference between financial hedging and physical hedging on the commodities markets and I think the Commission has recognized that and I think it's very important to recognize that the

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speculative limits and these hedge exemptions were established a long time ago for reasons that really didn't anticipate exemptions or there isn't really a justification for exemptions for financial hedging on the commodity markets as having exemptions. That's all I waned to say.

MR. DUNN: Thank you, Roger. Joe?

MR. NICOSIA: A couple comments about what we just heard. One is I think that we're kind of missing the point a little bit on some of the research being done on index flows and index positions. It's not a question of whether they're causing high prices or not and to the correlation -- if you get a negative correlation against high prices is really useless. The question isn't are index funds causing high prices. The question is are they causing higher prices. Therefore, the correlation to price in and of itself doesn't tell you the answer to that whatsoever. So the research really has to be done on whether if anyone can honestly believe that by creating an additional demand point the only way to bring any

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selling against that is to bring in additional risk takers, those risk points of equilibrium that take place at higher levels, they have to take place at higher price levels. Otherwise the conclusion would be that at any point in time you can bring in any amount of buying and it would not change prices whatsoever and we all know that's not true.

The convergence problem issue comes to really rear its head in some of the smaller and medium markets and when we see the index money that becomes such an overwhelming percentage of both the open interest or the crop sizes, that's where the convergence stars to break down severely. It happened in cotton to a great extent, it's happened to wheat to a great extent, and in both of those cases the index fund position alone exceeded the crop size or the carry-outs that existed at that time and it was simply a cornering of the marketplace.

When the index funds position, and some people say if they're not in the delivery market

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they don't necessarily maintain any effect on cash price. We saw earlier I think in Terry's study showing that the cash-and- carry situation, even if you're in the second month or the third month out, those long positions create demand points and they do draw the necessity for supply and it can draw in the form of capital being moved forward. So the fact that they're not in the delivery market doesn't really remove the issue from it.

Lastly, I thought it was interesting what Mark just said about the passive money and where it's going to go and that if we try to rein it in or limit it that just like water it's going to seek another level, go to the OTC marketplace or the swap marketplace, and I agree with that which is why it's so critical for the CFTC to take a leadership role in being able to aggregate these positions, to get all the information from them, and to not allow people to circumvent the laws and the rules simply by trying to go to a marketplace that is unregulated or is unaccumulated. So if you're not going to turn around watch the OTC

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marketplaces or the swap marketplaces or accumulate them, then remove position limits totally because the only person you're hurting is the person who is playing by the rules and who stays in the commodity.

MR. DUNN: Thank you, Joe. I know we've got a couple folks in the audience who would like to say something. Are there any other ag advisers? Let me go back to the back here and then I'll come back to you.

MR. COYLE: I want to make a comment on a couple of things. One, referring to what Joe said, I think we might be able to make an observation that the sheer size of the index length is actually reducing liquidity in the market which as a result is increasing the volatility. Secondly, the sheer size is also adding to an overall base in prices that is creating the convergence problem. But the statistics in your report are kind of interesting and maybe answers Dave's question related to why the charts from the CME demonstrate how the price

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is going up while the index share of open interest is actually going down. If you look at the open interest from CIT when the report was started back in January 2006 and then compare that to right before the open forum it shows a small increase, probably a 10-percent increase, in the index length. Since that time there's been a reduction in that, but during the same time from January 2006 to right before the forum we actually saw a significant increase in the noncommercial position which went from a significant short of 33,000 to basically an even position. So during that 2-year timeframe we actually saw the noncommercial length buying and actually was twice as big as the index funds. That would explain why the share of the index funds actually went down and also might be able to explain why the prices rallied to the extent they did, also supported by the commercial factors with right supplies around the world, but you had this noncommercial buying.

It's interesting that since the forum we've actually seen a reduction in everything, but

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the biggest change in the open interest is that we've seen these noncommercials which were even, they're now short 29,000 contracts which is three times a big a change as saw in the reduction in the CITs which means you had the noncommercials getting short again. That may again describe why the futures market is significantly lower than it was 3 months ago again supported by the fundamentals that have changed as well. But I think the breakdown of the numbers do demonstrate why the market does what it does in hindsight.

MR. DUNN: Yes?

MS. LUDLUM: Kelli Ludlum with American Farm Bureau. I just wanted to comment on particularly Dave's comments about CME moving to implement additional safety valve delivery points and that's something that we've worked with you on for a while, and particularly our Illinois Farm Bureau has worked with you on as well. I would also note that part of the problems that we hear from producers is not just the availability of delivery points but the availability to actually

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deliver to those delivery points. So I think that we also need to revisit the certificate process and examine some other options maybe could go into that. We would also like to see some additional biofuels delivery points added since that's an option that more and more of our producers are using. We're very appreciative that we've been calling for additional delivery points for a while and appreciate you looking into that, but as you move forward those are two additional things that we think need to be taken into account to make sure that what we do really does address the problem of producers being able to deliver on a hedge and with the possibility that will also help with the Commission problems.

MR. DUNN: Gregg, I think you had a comment that you wanted to make.

MR. DOUD: Gregg Doud with the cattlemen, but I'm old wheat guy as many of you know. One of the things that you said, and I think, Tom, your comments really hit it in reaction to this. One of the things that I would

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encourage the CFTC to look at is the participation in the markets by Australia and Canada and their influence on the fact that we have a very wide basis level right up until we get ready for delivery and then all of a sudden things really begin to come together quite quickly when they do come together. I'd be curious into a little research of the fact that the term nonresponsive kind of clicked with me, the fact that these guys are hedging but they're not using our grain, they're using their own.

MR. DUNN: Tom, do you have a response?

MR. COYLE: I can make one comment which is quite interesting. A concern for the market is that many of these foreign users who currently use the CME wheat contract as a hedge for Black Sea wheat, Australian wheat, and Canadian wheat, are actually finding it more difficult. I know our company is having a very difficult time so they're less likely to use CME futures as a hedge today because as they're long in another origin they're finding that because they don't have the -- much

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like we see in the U.S., they don't see the correlation is strong either so they're finding that selling futures which is a natural offset for let's say an index -- it becomes a risk for them so they're more likely to trade OTC or not hedge futures.

MR. DUNN: In this same area, I have also heard folks say that if we're going to develop new delivery points that perhaps we need international delivery points. Is that something that's being thought about?

MR. LEHMAN: I'd like to respond to that if I could. The international correlations, we ran the correlations domestically and they looked very good. I had my staff run them this morning for foreign points, Rotterdam.93, Argentina.93, Canada.82, and Australia.96. So this is something that's another -- I can't think of the term I'm trying to use -- but it's ironic that we're talking about problems in using the markets, problems with hedging effectiveness related to convergence, but yet correlations have remained

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very robust. Just a quick response to the question about foreign participation and how the markets are working, we are hearing from our commercial users that they are doing less hedging of their foreign wheat in CBOT wheat futures. I'm not sure that it's hedging effectiveness that's causing that as much as it might be issues related to credit or volatility or a number of factors, transportation perhaps. Looking at foreign delivery points, they're not easy to design and implement. We have some experience with that at CBOT in our South American soybean contract but it is something in terms of looking at a world wheat contract we are actively pursuing.

MR. DUNN: Thank you. Do we have members of the audience who wish to ask questions?

MR. KUNDA: Thank you very much, Mr. Dunn. My name is Eugene Kunda with the University of Illinois. If I may have just a few minutes to elucidate or to educate a little bit about the delivery process and maybe why in some ways we're seeing a disconnect here, and then also propose a

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solution simplistic as it might be, but I think it's backed up with some examples that have worked in the design of the contract.

First of all in the delivery process, you do have two markets, a futures market and a cash market. They two markets are distinct and separate. They are however through the shipping certificate market or the warehouse receipt market or the delivery instrument market if you will. That is the process from which you take a delivery in the futures market of a delivery instrument whether it be a shipping certificate or a warehouse receipt and the holder of that has rights and he has obligations. His obligations are to pay the storage or in the case of a shipping certificate where it doesn't actually have to be physically stored it's called a premium but it's the same effect as storage. Those are his rights and obligations. It doesn't then enter into the cash market until that holder either sells that certificate back to the issuer, he may sell a futures contract and redeliver it, so

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neither of those two options that he has as the holder of that certificate bring about that entry and connection to the cash market. But until he actually cancels that certificate or warehouse receipt and requests a load-out does then the cash market become involved in what would be a whole process of delivery and load-out.

So first of all, you have to make it clear in your mind that there are two different markets, a futures market which I think by all examination we've had is very successful, volume is up, people are content, there are correlations, people are using it. The cash market on the same side we're hearing the same kinds of maybe the sense that it's working fine, cash is providing sources of commodities. So the link is the certificate market so I'm going to propose a solution to help with what may help us in that particular segment, just looking at the certificate market. The reason I'm proposing it is because we've got examples of how we've worked out these differences between the issuers and the

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takers and holders of these certificates in the past, because there's an asymmetry in the markets, I can give a little bit of an example, first of all when you have the inversion or when cash is greater than futures, there's no problem in getting convergence because the long simply stands for delivery, receives the shipping certificate or warehouse receipt, then cancels it for load-out. So you had both steps, delivery and load-out to bring about convergence when cash is greater than futures. It's a bit of a different situation when cash is less than futures because that buyer doesn't have the need to stand for delivery, he'll just buy it in the cash where it's cheaper.

So what we did in the rules of the Chicago Board of Trade when we designed the river delivery system for that holder of less than 11 certificates was created a little cake auction. If you remember back when you were a kid and you had one candy bar and it was your sibling who you needed to split it with, it was one person cuts, the other person chooses, the cake auction. We

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did that with the less than 11 certificates for the holder that you needed 11 certificates, 55,000 bushels, to load a barge and if you had less than 11, then you were closed out of any options to do anything. So the rules state that the holder of less than 11 can present them to the issuer and request either that that issuer supply the other number of certificates needed to fill the barge or buy those that they're holding back at a price, and it's one price that's determined by the issuer. So the issuer now has in his mind two options. Do I want to give them a price that's low if I have grain that I can just go ahead and load the barge, or if I don't have grain, maybe I have to have a higher price so I can buy those back. So it's always in the decision to be made by the shipper at which price that they want to either load the barge or buy them back.

So let's take this same example and apply it now to the situation of the shipper, of the issuer, because we're hearing in the solutions that are being proposed two general areas of

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solutions, to either change the storage rates or to force a load-out. So let's marry those two possibilities into one and give the shipper a call on either one. In the previous example it was the holder who had the call on whether to load the barge or buy their certificates back, now what we want to do is keep the symmetry and allow the issuer to have the option of either requiring the holder to load out or pay a higher storage. So you've married the two concepts and it has to be in the mind of the holder who has the rights of these certificates. They're in his hand and so what he is going to now present to the issuer is a price, and now the issuer then who is either demanding a load-out, that's what he wants, or he wants more storage, that's what he wants, and he is given a call to the holder to give him a price. So the holder now can say I will either give you a price in my mind at which I am willing to pay you more storage until the next delivery period perhaps, so it's just for that increment of the month because then it could be another call, or

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this is the price that I know it's going to cost me as the holder because remember I don't have to load out, all I have to do is pay the storage charge, but if you're going to force me to load out, it's going to cost me something so it's going to cost me some cents. So I'm going to give you a cents number, 5 cents, 10 cents, whatever, for the rest of the month because you're talking about doubling the storage 4-1/2 cents, I'm going to give you that number, and then as an issuer you're going to have to decide whether you're going to pay me that to load out now or you'll be willing to take from me to store it for the rest of the month.

MR. DUNN: Thank you, Gene. I appreciate that. If you have that in a written piece and could submit it to us.

MR. KUNDA: -- today.

MR. DUNN: Thank you. Jack Gaine, and then we'll go to Tom Erickson.

MR. GAINE: Thank you, Commissioner. This is a terrific gathering of more expertise on

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the subject matter than I imagined you could put together anywhere. But I can't help conclude as a lawyer that it really confirms what Congress did in 1974 in creating this Commission as an expert independent body. This discussion here, and I think I agree with Commissioner Chilton in that of course we always need more data, we need more analysis, but the complexity of foreign versus domestic, who's in, who shouldn't be in, who's not in these markets lend itself to this kind of forum with this kind of body. I don't see how the legislative process ever could grapple in any meaningful way the way this group has done it this morning and I commend you for that and I hope that Congress is appreciative of that fact. That's my first point.

But more importantly, I want to correct what I consider a fairly material misrepresentation by Commissioner Chilton, and I think that this is something that Walt Lukken would agree with. Purdue is not even the best school in Indiana.

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MR. LUKKEN: It's not in South Bend either.

MR. DUNN: We'll let the Boilermakers and the Fighting Irish figure this out later on. Tom?

MR. ERICKSON: Thank you, Commissioner. This has been a great discussion and I think the last part of this has been pretty insightful as well because I know we as a company have expressed to you, Dave, and I think others have, that we're very concerned about the precarious situation the Chicago wheat contract is in today. I think that's in part why we're seeing a fair amount of sea change as reflected in Tom Coyle's comments as well in looking at what can be done now, and I think that's one of the things that struck me as you, Dave and Tom were both presenting here earlier today.

I think one of the things that brings us here is the issue of convergence and in the NGFA presentation in going through all the various options the one change that gets us to convergence

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is some kind of a demand certificate or forced load-out. I noted, Dave, that there seemed to be a little bit of reluctance to move quickly on that from the exchange's perspective given that adding delivery points and increasing storage rates may get us somewhere. Is that a short-term solution to really finding a solution to getting us to convergence?

MR. LEHMAN: Thanks, Tom. To be really honest with you on that, I think the reluctance on implementing a forced load-out or delivery receipt mechanism is really one that we aren't sure how that concept would work for all sides of the market, how it might upset the balance of the market between short hedgers and long hedgers, and I think we just have to have a better understanding of what the implications of that would be on the whole market. If we do reach that understanding, and this is what I think I'd heard Tom say, they'd like to work with us over the next 60, 90, or 120 days to try to figure out, then we have some alternatives in terms of implementation.

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It's something that I don't you could implement on the existing contract but there are other ways to approach that of listing a side-by-side contract, the same would be true if you moved to an index settlement contract, it would be such a dramatic departure from where we are today that I think you would have to come up with an innovative way to implement it. So those are some thoughts I have on that, Tom.

MR. DUNN: Neal?

MR. GILLEN: I agree with John Gaine that we've had a very stimulating discussion. But overriding the obvious which is brought out by Mr. Brophy and Mr. Nicosia that the additional speculation may be creating higher prices. We're talking about solutions to how to remedy this and we're not talking about eliminating it. In its findings when Congress created the Commodity Exchange Act it indicated right on the first page that the primary purpose of the Act was for price discovery in hedging and we don't have that in the contracts we're discussing this morning. So I

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think the Commission has to deal with the obvious and not make all these little fixes here and there in contracts. I think you got to get at the overriding issue and that's what the Congress is telling you. That's what the people are telling the Congress.

MR. DUNN: Thank you, Neal. Are there any questions or comments from the members of the Commission? I still start with Commissioner Sommers. Commissioner Chilton?

Let me thank this first panel. You have done an excellent job. Mr. Gillen, I think you did wrap it up very succinctly for us, that there is pressure for some action for some relief out there and this is a core principle that the exchanges must to adhere to, a normal operation of the exchanges and if folks cannot use this for price discovery and cannot use it to mitigate the risk, then we have a fundamental problem that we need to look at. I am encouraged about the amount of interaction between the industries of coming up and looking at solutions, but I do feel that there

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is a sense of urgency that something comes out of this.

Our next panel was to look at settlement of prices, margin requirements, and credits, and we were supposed to have a 20-minute break in there and we went through that break process because of the intense amount of concern here. What I'd like to do is take a 5-minute break to allow the next panel to get in place but also remind people that our bio break facilities are very limited here so if you need to those, feel free to do it throughout the time period. But let's take about a 5-minute break and try to get back near schedule. Thank you.

(Recess)

MR. DUNN: We are running a bit behind schedule. The Acting Chairman and Commissioner Chilton said they're going to be tied up for just a few minutes but they will be right back. So let's begin with our next panel and talk about settlement prices, margin requirements, and credit. Again the bios on the presenters are in

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your packets so I'm not going to go through that, but we're going to hear about settlement prices in times of high volatility, and Tom Farley will be talking about that, with coordinating actions in price limits by Jeff Borchardt, so we'll have an opportunity here to hit two more of the exchange operators right off the bat. Then we're going to hear Dan Brophy talk about the role of exchanges and clearinghouses and margin requirement. Then the issues with margin credit by Phil DiProfi and Sam Miller. Phil is with Co-Bank and Sam is with American Bankers. With that if we can get started. Tom?

MR. FARLEY: Thanks so much, Commissioner Sommers, and especially Commissioner Dunn for hosting this meeting and having me here today. I appreciate it.

Back in April, on April 22, I believe it was, at the roundtable meeting of the Ag Advisory Committee, we at ICE Futures U.S., the former NYBOT, were fresh off an interesting experience in the cotton market. The cotton market experienced

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essentially a perfect storm in early March. There were three factors or waves if I can extend the storm metaphor that crashed into one another. The first is the credit crunch in general, tightening lending standards as it impacted the cotton industry. The second was gradually rising prices of all commodities, but cotton in particular. The price of cotton went from 52 cents at the end of February 2007 to 79 cents at the end of February 2008. The third factor was as the price of cotton increased dramatically, the cash markets for cotton largely shut down as buyers were resistant to pay this higher price for cash cotton, and similarly related, sellers were resistant to sell cash cotton for a lower price than was reflected in the futures market. So that set the stage for trading February 29, March 3, and March 4, where the price of cotton in the nearby contract closed at 79 cents on February 28 and we used a settlement price for margin purposes of 94 cents on March 3, just 2 trading days later. So that's an increase of 26 cents, greater than 20 percent

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in just 2 trading days.

That trading activity raised a few fundamental questions which were raised here at the roundtable, and the roundtable I should add really helped facilitate conversations about both of those issue. One question was, were index funds and/or speculators behind that dramatic price increase, particularly March 3 where the price went from 81 cents to 94 cents in a single day? Clearly a very dramatic move. We have researched that, in part taking feedback at the roundtable meeting on April 22, and we found that there was no significant buying activity from index funds or speculators, inclusive of swap dealers, during those days, February 29, March 3, March 4. So we've come to some conclusion on that question.

But a second question equally important and perhaps more confounding was do we have the appropriate margining approach at ICE Futures U.S. for margining futures in an extreme price move scenario? So please let me explain here if I can

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flip to the first slide. On the chart you see the 4 days that I described, February 28, February 29, March 3, March 4. The blue line represents the limit up price of cotton which is the official exchange settlement. But we at the exchange have a long-standing clearinghouse role to use synthetic prices to margin cotton futures. Synthetic prices are the prices being discovered in the options pit and it's very easy to derive what the equivalent futures price is from looking at trading in the options pit. The reason you would look at options trading is because we have a limit up price for futures on a day where the price spikes dramatically, the futures top trading so you only have the options markets that are still trading.

So on March 3 we margined at 93.9 cents as you can see on the chart as opposed to a limit up price of 84.9 cents. Keep in mind the price stated that day at 81.9 cents. This move as you would expect put extreme stress on the short hedging community as they had to pay variation

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margin for their short hedge positions based on a 13-cent move. Very, very dramatic. So the question from industry was, is that the appropriate margin technique or should we consider using the limit up price. So we came to this April 22 CFTC meeting and we discussed this at length. We then went away and caucused with the industry. We have a Cotton Contract Committee that comprises mainly the leaders of the cotton industry, Joe represents Dreyfuss now and -- is here today as well as many others on our Cotton Contract Committee. Ultimately we revised our rules and now we use an approach where in a limit up or limit down situation, we use that limit up or limit down price to margin futures. The clearinghouse as always and as with other exchanges reserves the right to use another price in some extraordinary circumstance, but by and large we don't expect that to be the case.

This new rule gives the short hedging community in a price rise environment more time to put together financing to be able to pay their

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variation margin. Coupled with this change in margining policy, we also agreed to expanding limits, and I give credit to Jeff here and our friends Mark Bagan and Dave Lehman. We followed their exchange model for expanding limits into certain of their agricultural products and so now in cotton if the price is limit up on day one if it's a 3-cents limit, if it's limit up on day 2, the limit goes to 4 cents and so on.

Finally, I'd just like to point out that we resolved those questions, but there are still more questions and it seems like there are always difficult questions when it comes to risk management, margining, and volatility, but I wanted to share a few of those with you. One question that we're dealing with actively is how best to set margins for options contracts. During these limit up, limit down situations, the options on our exchange continue to trade freely and that provides price discovery. But one thing we're considered with the Cotton Committee is is it prudent to -- I went out of order so if you're

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following the slides I hope I didn't confuse you. I'm on the third point here. But one thing we're considering with the Cotton Committee is the model that's used by for instance the CME the best approach for setting margins on options contracts. A second question, the first question on the slide, is how best to set margins for options contracts because right now we're in a situation where we use the traded prices for options as they are in the options pit, but yet we use the limit up price for futures. So you can imagine an options trader who's long a synthetic future in the options pit, he's short a real future, and yet our clearinghouse is going to tell him he has risk even though in theory he has no risk, he's long a future and he's short a future. So it's a bit of a screwy situation.

Finally, the third point is do price limits contribute to volatility and even if they do contribute to volatility is the positives that they bring to the market, namely some more financing security and some more time to be able

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to make these variation margins, does that outweigh a potential con of contributing to additional volatility. So there are more questions for us to consider as a exchange, with industry, maybe a future meeting of the Agricultural Advisory Committee. Thank you very much.

MR. DUNN: Thank you, Tom. Jeff Borchardt, would you give us a little background on the coordination of the actions in price limits that Tom just mentioned?

MR. BORCHARDT: Thank you, Commissioner. I appreciate the opportunity to brief the Committee on the events leading up to and the actions taken earlier this year by the Chicago Board of Trade, the Kansas City Board of Trade, and the Minneapolis Grain Exchange in coordinating increased wheat futures price limits.

The actions taken by the exchanges were necessary and prudent to restore the market's price discovery and transparency functions. We applaud the Commission for recognizing the need

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for swift action to alleviate the constraints on trade and for working closely with the exchanges to approve the increased price limits on a very fast-track basis.

The run-up in wheat prices from April of last year to February of this year is attributed to several factors in what is commonly referred to as a perfect storm of events, namely, the Easter weekend hard freeze and subsequent flooding in the winter wheat belt, the second consecutive year of severe droughts in Australia coupled with production declines in both the E.U. and Canada, projected world grain usage outpacing production gains, USDA forecasts of U.S. wheat stocks at 60-year lows, global wheat stocks at 30-year lows, and the lowest grain stocks- to-usage ratio since the USDA began tracking this data back in 1960, a weaker U.S. dollar resulting in increased wheat exports and reduced domestic stocks, and export demands or tariffs instituted by other governments, namely, Russia, India, China, and Argentina, resulting in the U.S. becoming the

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reliable global supplier of wheat.

As the price of wheat increased last year, the three grain exchanges began experiencing an increasing frequency of price limit moves, in particular, when wheat reached $8 a bushel in September of last year. Minneapolis hit their limit on 16 of 21 business days in January and every business day in February leading up to the price limit change. The consecutive limit moved days of February 4 through 8, and all three wheat exchanges encumbered the market's ability to discover price and conduct trade. Something had to be done quickly for the critical price discovery function to resume.

Later in the week of February 8 the three exchanges began discussions of a coordinated increase in daily price limits. All agreed that a coordinated price limit effort would best serve the industry because of the significant intermarket spreading activity that goes on between the three wheat contracts and also to lessen confusion that might arise from the markets

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having differing limit provisions.

As a result, the three exchanges filed for identical increased price limits that became effective on February 11 and set forth an initial price limit of 60 cents per bushel and expanded limits provisions that increased by 50 percent each time those limits are reached. The trigger for the expanded limits was when 2 months within a crop year closed limit bidder offer and the expanded limits remained in effect until no contract closed limit bid or offer for three consecutive business days.

When the markets opened on February 11 with the new 60-cent price limit, price discovery resumed. The new price limit provisions worked well and the three wheat markets were once again able to conduct business under either the initial or expanded price limits. After a few weeks of experience with the new price limits, the wheat markets compared notes and discussed minor changes to the price limit provisions. The catalyst for this discussion was input and suggestions offered

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by both commercial market participants and also FCMs. Among the changes discussed were, number one, capping the expansion provisions so that institutions financing margin requirements would have a better idea of the maximum daily amount that would be required to fund variation margin. Secondly, setting the trigger for expanded limits based on contract months where the majority of open interest in trade resides thereby eliminating the possibility that lesser liquid back months can cause the expansion of limits. And finally, the ability to contract or decrease the price limits as quickly as they expanding resulting in additional flexibility in regulating margin requirements and current limits that are more reflective of actual market pressures. As a result of these discussions, Chicago and Kansas City agreed to move ahead with coordinated price limit amendments. Minneapolis determined that they were better served by the existing price limit provisions due to the continued extreme volatility in hard red spring wheat at the time.

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Chicago and Kansas City filed for and received approval from the Commission of price limit amendments that became effective on Friday, March 28. The changes covered all three areas addressed by the industry input. We capped the expanded limit provisions at $1.35 a bushel maximum. The trigger for the expanded limits became now when two of the front five months closed limit bid or offer. And finally, any day that the market is under an expanded price limit level and does not close limit bid or offer, the market reverts back to the preceding price limit level. That way you have price limits that come back down in the same fashion that they expand.

In summary, the coordinated action taken by the three wheat exchanges worked well to resume the price discovery and transparency functions that are of paramount importance to our markets. The coordinated effort provided the marketplace with a relatively uniform set of price limit rules to apply in order to minimize the possibility of significant intermarket spread disconnects and

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maximize convenience in application. The effective resolution of this market predicament is a laudable example of exchanges, regulators, and industry working together to recognize and very quickly address a significant market issue. Thank you.

MR. DUNN: Thank you, Jeff. With the increased price limit there was also a corresponding increase in the margin calls. I'd like to have Steve Hurst with Merchants' Exchange talk about the new concept of margin credit swaps.

MR. HURST: Thank you, Commissioner Dunn, and thanks to the rest of the Commission and staff for inviting us to participate in this forum. It's always illuminating to be able to hear first hand about problems that are facing the industry. I have the happy task today of being able to tell you about a project that we've undertaken that has the promise of bringing a solution to the margin credit swap problem that has been so much in the news of late.

The Merchants' Exchange has been working

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with other members of the industry to develop a swap product. We'll describe it here in a little more detail in a moment with the help from Gene Kunda from the University of Illinois. The concept is really quite simple. For a merchandiser who has a short position on to hedge a cash purchase, when the margin call is made there will just by the nature of the market always be someone on the other side, a corresponding long position. We have developed a financing instrument that will enable longs to provide financing assistance to the short side to hedgers who are in need of financing assistance to be able to make margin calls. The point that I want to make before we get into the mechanics of this is that this has been a solution that has been underway for about 6 months. We began working with the Chicago Mercantile Exchange, with the Kansas City Board of Trade with Jeff's assistance, most recently with the Minneapolis Grain Exchange. We've had a lot of assistance from the Commission and its staff providing us guidance with regard to

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how our product will be regulated. The National Grain and Feed Association has been very active in providing input and guidance with regard to the structure of this product. And I'm pleased to be able to report that we have transactions underway as part of a pilot program today. These transactions are being conducted in the over-the-counter market in preparation for the exchanges to be able to accept these trades into their clearing systems.

The concept is that if a hedger needs financing in order to be able to get a hedge off at the Chicago Mercantile Exchange, that the swap will be cleared at the Chicago Mercantile Exchange. If the hedge is to be made at the Kansas City Board of Trade and financing assistance is needed, the swap will be cleared at Kansas City. The same at Minneapolis. If it's in the wheat product at the Minneapolis Grain Exchange, the hedge will be cleared by the clearinghouse at the Minneapolis Grain Exchange. The message that I'd like to deliver in concluding

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my remarks is that this truly has been an industry effort. It is a work in progress. We are in the midst of a pilot program and we thank the Commission for providing us with the guidance and the ability to move forward with this experiment.

With that I'd like to introduce Gene Kunda from the University of Illinois who is the architect of the product.

MR. KUNDA: Thank you, Steve. Thank you, Commissioner Dunn and others who have allowed us to again participate in this meeting with what we hope would be a potential solution.

The margin credit swap was again inspired by the forum that you had last April in addressing some of the issues that were brought up then particularly in financing margins. If I could have the overhead, please. The description of the product is what I'm going to focus on in my brief comments here in terms of preserving the existing relationships of the cash market between the grain elevator, the farmer or producer that they're forward contracting with, and their

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consumers who they will be selling with in yellow, as well as the existing exchanges in which they use to hedge those positions whether it be at CME, Minneapolis, or Kansas City, the designated contract market. We want to preserve those relationships and not affect the pricing or the merchandising activity or the hedging that is committed to those purchases.

What we've done is create an additional product called the margin credit swap which would mirror those referenced contracts that are being hedged so that the contract terms of the swap are identical to the contract terms of the underlying hedged contract. But what you would take a hedger, and in this example uses a short hedger, you're short on the futures market, you're long cash, you bought from the farmer and you're short futures, if you take a long position in the margin credit swap you've essentially established a spread position. The credit counterparty we've identified in our investigations at least four different parties that would be available to take

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the counterparty to that credit, the traditional lending provider now whether that's your bank or even self- financed, the other would be outside credit, another source of credit provided by the industry, third, it could be long position holders, and of that it could either be another long hedger or even a long noncommercial, so that those participants would be willing to provide the margin to those hedgers. They would do that at an interest rate so that is the traded price for the product, the interest rate at which a hedger is able to obtain margin credit to make margin calls.

In maintaining the swap since the positions are balanced as the prices go up on our short hedge and you as a hedger are receiving margin calls, you have the long position in the margin credit swap and it also then is going up and you are receiving a margin collect. That same product, the margin credit swap, the counterparty if it's short is making the margin call. If that counterparty were a long position holder in the underlying, they would be making a margin collect.

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It's simply a recycling if you will of the capital between the short hedger and the long noncommercial through the margin credit swap.

This would go on whether the market is going up or down, the flows of variation margin, pays and collects would be balanced across that spread. When it comes time to liquidate the swap at the time when the merchandiser now has a cash market customer or consumer, that sale is made and with those funds and at the same time that the hedge is lifted since it's no longer needed, margin credit swap is also liquidated. What's interesting about the margin credit swap though is that it is not a price risk managing instrument so that the price at which it was put on is going to be the exact same price at which it's taken off and that results then in a final payment or if you will a repayment of the margin credit that was borrowed by the hedger and that repayment is made from the funds from their cash sale at which point the swap counterparty, the credit provider, then also is repaid and as a result has earned an extra

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return from its capital by lending to that short.

Another illustration in a graphic here to conclude is that you would start at some period in time where the farmer makes a forward sale at $6, the elevator hedges it at $6.30 so it has a buying basis of 30 under. He also buys the margin credit swap at $6.30 and there's a seller of that margin credit swap at $6.30. Prices go up 50 cents, there's margin pays and collects on both the hedged contract and on the credit contract which even each other out and it would be the same when prices go down. The last set of boxes then is at liquidation. The consumer who the elevator/merchandiser has found buys is at $6.50 and pays the elevator so the elevator has a net gain then from his buying basis of 30 under to a selling basis of even. He's made a 30-cent gain on his merchandising activity. The elevator buys back the hedge at $6.50 and sells the margin credit swap back at $6.30, the same original price. The 20-cent loss on the futures is less than any interest on the margin credit swap. The

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credit provider goes and sells the position at $6.50, buys back the margin credit swap at $6.30 and had a 20-cent gain on his futures. The farmer is paid his $6 at delivery.

MR. HURST: So if I could just sum up, this is very much a work in progress but we have made progress since the April 22 forum. We've got a product that's been developed. The clearinghouses have become actively involved in determining how to bring this product into their clearing systems. We've received guidance from the CFTC. We're now in a pilot program. We have one last hurdle and that is working with the FCM community to understand and address the risk that's embedded in this product. It is a different kind of risk than exists for a standard futures contract in that in any futures contract traded at any of the exchanges, the only risk that the clearing firm is asked to undertake is a 1-day variation margin move in the underlying product. In the margin credit swap, the risk that's embedded is very different. Because it acts like

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a loan and must be repaid, you have the full move in the underlying market that results in the margin call being made and the loan being given and that must be repaid. We think that's an important risk to be understood by the industry and we're looking forward to working with the clearinghouses and their clearing members in terms of how we will go about addressing and managing that risk. Again thank you for the opportunity to appear before you today and we'll be available for questions after the session.

MR. DUNN: Thank you, Steve and Gene, for an excellent presentation. I note that this presentation isn't in your handout package. We'll try to get copies of that made and distributed to you all.

The role of the exchanges and the clearinghouses in setting margin requirements are extremely important and I'd ask Dan Brophy to discuss that. Dan?

MR. BROPHY: Thank you very much. I'm speaking for myself but also I have to admit I'm

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speaking for the Commodity Markets Council. I have experience on the clearing side in Chicago with both CME and the former clearing organization for CBOT called BOTC that's now called the Clearing Corporation. It's an independent entity but I've had a number of years of exposure on the user side of this and I've also seen it to some extent from the perspective of a member of a board or a committee in the case of the CME.

We believe that margin requirements should be the exclusive province of exchange-owned or independent clearinghouses. Clearinghouses are responsible for the financial integrity of their clearing members and their customers, and certainly not least, the preservation of the exchange's own reputation. Clearinghouses know their firms, their markets, and their customers. They interact with each market traded on the exchange minute to minute, they have great expertise to assess market risk, the firm risk posed to the clearinghouse relative to that firm's financial resources, and the total risk

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underwritten by the exchange's own mutualized risk pool. Clearinghouses have highly sophisticated risk-assessment capabilities and very good software in particular for real-time risk assessments. I'm going to give you just a quick example. I made a call yesterday across town to the folks at the CME which is not to give short shrift to our friends in Kansas City, Minneapolis, or New York, but just to give you an idea of the expertise and the scale of the risk-management going on every day at CME, I think it's somewhat smaller than the other firms, but as of last Friday, the total collateral held by the CME is $65 billion. The average daily pay collects, intraday margins, those flows are $3.4 billion. The highest in history for CME was $10 billion. The total security deposit guaranteeing the mutualized risk pool, all the firms who sign on the bottom line, is $1.6 billion. And the total financial safeguards pool which includes security deposit and assessment powers and some other links is over $6 billion.

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I want to make a remark about our smaller exchange friends if you will. Jeff was far too modest in describing the risks that were so magnificently handled during the wheat market explosion this winter, and two exchanges, the Minneapolis Grain Exchange and the Kansas City Board of Trade, probably saw, I didn't ask either Mark or Jeff, flows through their clearinghouse 10 to 20 times, maybe even 30 or 40 times, on a daily basis what they had seen in the past, and you don't know about it and that's a great thing and that means that they did a beautiful job. So I think they really deserve a vote of thanks from the entire industry and the Commission as well. As CME, we would not like to see any outside interferences from regulators or legislative bodies to disrupt the clearinghouse systems that have been many decades in development and have proven so successful in contending with markets that are even more stressful than what we're seeing right now.

Margin levels have to be set with great

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care and attention to the consequences. It's very easy to impose high margins with the intent of dealing with a specific risk or problem or targeting a group of users and thereby unwittingly triggering the negative consequence of diminished liquidity on the exchange. Loss of liquidity can easily exacerbate the risk that's being targeted with high margins. So our point is that the best decisions about margin levels should be left to the exchanges and their clearinghouses who are closest to the situation. Thank you.

MR. DUNN: Thank you, Dan. I appreciate that insight as to the clearing corporations and the impact that they have. I think this is probably as you well point out one of the unsung underlying safeguards of our futures industry. But the high prices did have a tremendous impact on those that were short in the marketplace and there was a tremendous demand for credit out there. I'd like to have Phil DiProfi from Co-Bank talk a little bit about issues with margin credit and what they saw during this time period and

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steps that they're taking. Phil, if you will, please.

MR. DIPROFI: I sure will. Thank you. I'd like to start by thanking the Commission for the opportunity to participate in today's session. Co-Bank is clearly committed to working with the industries we serve as they continue to navigate these very volatile market conditions. I hope today's discussion will leave you with an understanding of the bank's reaction to its farm supply and grain marketing customers as we experienced unprecedented demand for credit.

Again I'm Phil DiProfi and I'm Executive Vice President of Co-Bank and I manage their Agribusiness Banking Group as well as Strategic Relationships Division. As of March 31, the portfolio totaled approximately $31 billion comprised of the bank's credit relationships with its middle-market agribusiness customers, our farm credit leasing subsidiary headquartered in Minneapolis, as well as our wholesale lending to other farm credit entities.

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This chart identifies the Agribusiness Banking Group portfolio at the end of the first quarter. As you can see, farm supply and grain is a prominent segment of our portfolio standing at about 72 percent. It makes up just under 28 percent of the bank's total outstandings as of that date. In fact, we have over 750 customer-owners who operate country elevators and farm supply businesses in 37 states, the largest concentration of which both in terms of customer account as well as loan amount per customer are those customers located in the central part of the country in the U.S. grain belt. The bank's customers in this business segment have experienced unprecedented loan demand over the past 24 months with loans committed increasing to $17.5 billion as of February 2008, from $7.6 billion just 2 years earlier. This unprecedented demand for credit has been the direct result of the rise in prices in the three primary commodities merchandised by our customer-owners, that being corn, soybeans, and wheat. In order of

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magnitude, our customers have sold short futures on more than 2 billion bushels of corn, beans, and wheat. Most of those short futures were contracted at lower prices earlier in the year and have been subjected to substantial margin calls over that period of time.

The tightening of supply and demand over such a short timeframe and the rapid price increases have challenged the bank's traditional lending practices particularly as it relates to the relative amount of working capital deemed appropriate to support seasonal loan amounts secured by current assets. Frankly, the balance sheets of many of our local grain customer-owners were not constructed to deal with the level of high prices and the amount of volatility that's occurring in today's marketplace given the traditional risk-management practices of forward purchase contracting and short futures hedging.

To illustrate the point, this charts shows the substantial increase of credit used by our grain customers through May 2008. To further

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demonstrate the magnitude and velocity of today's volatile market conditions as prices reacted to weather events in June, loans increased another $3.5 billion in addition to what's illustrated on this chart. To further demonstrate the amount of volatility, those same customers' loan demand decreased $4 billion over the past 2 weeks. Co-Bank and has continues to support its customer-owners as they and we position ourselves in our organizations for a high price, highly volatile market environment. The undeniable facts are that the risks are greater as are the capital requirements. In addition to working with our customers as they transition, Co-Bank has raised third-party outside capital totaling $1.2 billion over the past year and 2 months, $700 million of which was raised over the past 60 days that was both in the form of subdebt as well as preferred stock. In addition to strengthening our financial capital, the bank has also had to strengthen its human capital. The chart that I have illustrated for you shows the amount of same-day credit

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actions that the bank was subjected to in order to deal with the credit demands of its customer-owners in its grain merchandising segment. The bank has actually added approximately 8 percent to its staff if you were to go back 16 months when the volatility started to become very evident that it was going to remain for more than a short period of time.

The bank is also bringing additional capacity to our customers and the industry through partnering with other lenders on our larger credits to local cooperatives. Prudent risk management limits the amount of credit we expose the bank to in any single borrower. This entails a higher threshold on due diligence for our customers and it also requires them to enhance their financial reporting. Although we work with commercial banks on a regular basis, our primary partner up to this point in order to provide additional capital to the industry and to our customer base has come through the farm credit system. In our view, there is capacity in the

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farm credit system and this chart indicates that farm supply grain currently stands at about a 7-percent exposure for the entire farm credit system.

In summary, we're adapting an asset-based approach to size and credit relationships. We've established a borrowing base report that establishes prudent loan advance rates against various asset classes. We have or will be recognizing that the additional risks require a modification of our existing loan pricing. We will work with farm credit and commercial banks to increase overall loan capacity to the industry. And we will work with others to source capacity from alternative arrangements to provide a relief valve if you will in the event of continued market disruptions.

MR. DUNN: Thank you very much, Phil. That gives us a great insight as to what was going on on the credit side during this particular period. I'd now call on Sam Miller with the American Bankers Association to talk about the

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perspective of the commercial banks during this same time period and actions that they're taking. Sam?

MR. MILLER: Thank you, Commissioner Dunn. As you mentioned, I'm with the American Bankers Association, but my day job is I'm a banker. I work for M&I Bank in Appleton, Wisconsin. I head up their agribusiness banking and we do business in a number of states in the Midwest and finance not only grain elevators and farm supply firms but many farmers as well, and I'd like to visit with you a little bit about both of them.

I did not have a copy in your packets but the Federal Reserve Bank of Kansas City, the "Main Street Economist" just published a recent paper called "Can Grain Elevators Survive Record Crop Prices" and discussed some of the issues that Mr. DiProfi just was mentioning and that we've been discussing not only today but since the April 22 meeting. I'd like to read to you the final paragraph from that paper. It says, "In 2008,

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record crop prices and rising input costs have strained the short-term financial position of grain elevators. To date, creditors at both commercial and farm credit banks appear to be working effectively with the elevators to ensure that financing needs are met. Banks are likely to pay careful attention to the strength of the risk-management practices at grain elevators when deciding to increase cash advances. While the sharp rise in agricultural commodity prices has eased heading into the summer, unexpected dry conditions or strong demand could further boost crop prices and rekindle the financial stress at grain elevators." I think that summarizes very well that the banking and financial sectors have met the need of funding margin calls for financing inventory accounts receivable on margin calls on contracts for future delivery. But this increase in agricultural commodities has added a great deal of balance sheet and operating leverage to the grain and farm supply sectors. As an example, 2 years ago a bushel of corn which we may lend as

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Mr. DiProfi said 90 cents on the dollar for, if that bushel of corn was worth $2.50 a bushel, that means that the country elevator had to come up with 25 cents of working capital to fund it. With today's current prices as of last Friday, the December 2008 contract at $5.99, call it $6, means that they needed now 60 cents of working capital. That's a significant increase in the working capital requirements that that local firm needs in order to operate their business. In addition, the added debt borrowings have increased their underlying leverage or debt to worth of that same firm. So that same country elevator may have had leverage of 2 to 1 which means for every dollar they had invested in equity we would lever up with $2 of debt. Today with the same amount of bushels that they're operating under, that leverage means that for every dollar they have invested, I might have $4-1/2 or $5 invested with them. So they've really increased the operating of that business as well. That puts added financial stress on the business, on prudent lending, and regulatory

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oversight. Much of that added leverage is short-term assets in nature like grain inventory, but it's also in meeting margin calls on contracts for this fall, next year, and beyond. We're lending on margin calls for inventory that does not exist yet and bankers are going to pay careful attention to that.

A number of grain elevators have added term debt in order to adequately provide the working capital margin to stay in the borrowing formula which has added additional cash-flow burden to the underlying business so it's imperative that the business remains profitable in cash flows to meet the increased interest and principal debt service requirements of that added borrowing.

Let me change gears. Given the added borrowings and working capital and balance sheet leverage of the grain storage and handling sectors, risk management and hedging may need to be a greater component of the farm operation. Historically, marketing decisions and marketing

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plans have been executed by farmers, but in recent years the grain- handling sector began to offer contracts as a way to attract and lock up more supply to operate their business. A greater emphasis should be placed on farmer education of risk-management tools such as hedging, options, crop insurance, contracts with end users, and frankly, combinations of all of the above. The grain and livestock producers need to understand and control the cost inputs and sales output of their business and can benefit from understanding and using these tools. Bankers have had a long history of advocating and providing risk-management education for both its constituency and for its farm customers. In fact, in 1922, the ABA president at the time who happened to be the president of my bank, Marshall & Ilsley Bank, John -- had this to say about agriculture: "Agriculture at the present time is going through a serious crisis. There are many problems in production and marketing to be solved. There is a call for close any sympathetic

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cooperation not only between bankers and farmers, but between all intelligent citizens of our great commonwealth." While agriculture is not in a serious crisis at this time, there are problems in production and marketing to be solved. ABA has provided its membership with risk-management training since the early 1900s in many types of risk. My bank offers joint marketing sessions and crop insurance presentations over the winter months to our farm clients to better provide information and to understand the tools available. And I believe that over the last 56 years American Bankers has enjoyed a great working relationship with the CME Group, Minneapolis Grain Exchange, and Kansas City Board of Trade, to provide educational sessions for our ag bankers and our farm clients. I propose that we further emphasize farm producer education about risk-management tools as one way to help address some of the issues currently being felt by the industry.

MR. DUNN: Thank you very much, Sam, and that is something I think needs to be taken into

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serious consideration for the producers to take a greater role in assuming some of the risk and offsetting that through the futures market.

With that I'll entertain open discussion. Anyone who has comments or questions, please be recognized. Joe?

MR. NICOSIA: I had a question for Gene. On your credit swap idea, how do you handle the credit risk that's going to take place for the individual if you took on the opposite side of that credit risk, you had a market blowup and that other entity became insolvent? What would happen to the other side of that credit risk?

MR. KUNDA: That's exactly the key point as Steve was mentioning that is critical for the clearinghouse to be aware of. Having that be a cleared product, that credit risk would be managed by the clearinghouse.

MR. NICOSIA: But they're going to manage it on an individual counterparty-by-counterparty base?

MR. KUNDA: I'm going to defer that to

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Steve in terms of how the clearinghouse will handle that.

MR. HURST: That's part of the point of conducting a pilot program so that we can learn by doing, but the clearinghouses have a built-in infrastructure where risk are assumed by the clearing member firm that brings the trade into the clearinghouse and this is a risk that is managed in the marketplace every day in the current environment and we think it's going to need to be managed every bit as aggressively as these products move through the clearing systems. But to answer your question directly, that will be a risk that will need to be managed by the clearing firm that brings the trade to the clearinghouse to be cleared.

MR. NICOSIA: I would only add I guess that it is not a new risk, it's a risk that's currently being as it exists.

MR. DUNN: Mr. Coyle?

MR. COYLE: I'll add a few comments there because I've spent a lot of time with Gene

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and with Steve, and Joe you've really identified the key issue. They've developed a product that actually makes a lot of sense. There is a need for the capital. The capital is available. It appears to be reasonably priced. The exchanges have the ability to clear and they're working through the details on how to clear it. The FCMs will have the administrative ability. But the single biggest question and it's not resolved yet is really related to this exposure. The current margining system is well adept at handling day-to-day margin requirements but with this product you might have a 1-month, 2-month, 3-month, 4-month margin issue. So at the end of the day the question is whether or not an FCM is willing to put that trade on their books because if the CME decides or the other exchanges decide they're willing to clear it, they're relying on the FCM and you may find FCMs that say they're unwilling to accept the trades because they don't want to have an exposure that there's a $4 margin call when the contract expires.

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That brings up a question of whether or not there are ways for the government to get involved on that support. There are crop insurance programs today. The risk is that there is a default from a producer to an elevator and if the producer defaults because of production to the elevator and the elevator then defaults to the FCM then the burden is on the FCM and they may be unwilling to take that exposure. So the farmer has generally been very good in honoring their contracts, but these are crazy times and so the question is out there using the crop insurance system is there some way to embed some kind of default protection in the contract? The farmer has crop insurance today to protect his revenue. Is there some way to use that? Because the capital is out there. The people who are long on the market today, their liquidity goes up right as our industry is losing liquidity so that it makes a lot of sense to do what they're trying to accomplish. But you're hit the nail on the head. It's not solid yet but there certainly is plenty

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of interest.

MR. HURST: The only thing I would add to that is that the transactions that are going on today in the over- the-counter market are being done counterparty to counterparty with the risk being negotiated and dealt with counterparty to counterparty. It is our hope that these products when they move into the clearing system will be more broadly available because of the risk-management protections that are embedded into the various clearinghouses. But today the trades that are being done are being done with counterparty credit.

MR. DUNN: Are there other questions or comments from the Advisory Committee?

MR. WATSON: I'd like to talk a little bit also about the margin credit swap issue. The analogy with some of the financing situations that arose in the real estate market in the past few years is too apparent for me. Essentially, longs providing capital to shorts sounds an awful lot like the seller of a house providing the down

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payment through an intermediary so that they could buy the house and not reflect what we now know, that price discovery should have told us is houses should have come down slower than they did in the past and saw the cascade of problems that ran through financial instruments based on housing transactions. Why is this not a similar type of inherent risk? I guess the basic question here is why do we assume that the clearinghouses are smarter than the Wall Street banks who all basically collapsed or basically saw financial problems related to their sophisticated products, very sophisticated people with very sophisticated computer systems but yet failed to see for the degree of risk? And certainly seller-financed down payments are not the only thing that relates here, but the analogy for me just seems a little bit too close for comfort and to just sort of take on a word that smart people are working on this and that we're working through it. Why is this fundamentally different and why are we going to be able to make sure that this type of risk

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management related to the financing doesn't leave us with a similar type of cascading collapse problem?

MR. KUNDA: I'd begin by saying that in the sense that it's different, it is not a price risk-management tool so it is not meant to be a hedge, your hedge is still on in the underlying market, so that the risk of any of the failures that would result as Tom mentioned either from the farmer or at the grain elevator level are the same risks that currently exists today, it's just a matter of who's bearing that risk. And right now it's as we've heard from the banking community that that risk that they're bearing is at a point now that they're expressing how much it is. So this allows that access to capital to be broader than that and when it is offered in the senses of being from a long hedger for example, it would be another participant, or the long noncommercial to the short hedger, is an ability for them to persist in that position that would be put on for a business transaction that if they could have

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extracted the equity in that rising cash grain price they would be able to make those margin calls.

So if you could extract that from a rising value that you have on your books, then you'd be financially fine. Just because prices are going up for a merchandiser doesn't mean that he's losing money when he's making those margin calls, it's just that he doesn't have a source of capital to make those margin calls because he can't tap into his rising cash position and so this margin credit swap is a substitute for that cash position.

MR. HURST: I would also point out that the people who seem to be most heavily impacted in the rising prices this summer are not the merchandisers who were out on the edge speculating in the market but, rather, those who were doing everything right. The issue that we're trying to address here is simply to provide a new source of margin credit financing that stays within the clearinghouse system. This is targeted to the

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margin needs of the merchandisers. It never will leave the clearinghouse. There is a moral hazard and you're correct in pointing that out, that if credit becomes too easy that operators who are not paying attention to doing things the right way might have opportunities for chicanery and that's where the infrastructure that's embedded in the clearinghouse will be important. The clearing firms are going to need to know their customers, the customers of the clearing firms, the brokers are going to need to know their customers and there will be a risk transfer that's going to be a part of bringing the product into the clearinghouse and that's the way that we think that it will be managed, by the people who are managing that risk today.

So it's an excellent question. The only point we're trying to make is that it may not be a fair analogy.

MR. WATSON: If I can continue, then assuming this risk remains entirely within the clearinghouses or on their books, do we know that

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that is the case or at some point in time because this is not a separate and distinct product and with a certain amount of time to develop a degree of experience with it that we're not going to come back here in a couple of years and talk about some form of securitization so that the clearinghouses are able to in essence bring in additional investors and saying we can clear this. It seems to me that with this product the natural progression would be toward some sort of securitization and bringing in even more outside sort of investment even if we assume that the clearinghouses are maintaining some sort of credit management involvement here so that can you keep this inside the clearinghouse and provide the capital necessary for this product?

MR. HURST: That's the whole point of the pilot program, and if you're interested in following it, I'd welcome your participation.

MR. DUNN: Are there other questions or comments? My Coyle again?

MR. COYLE: I'll make one observation.

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The difference is that this is really not a new risk. Traditionally, we buy grain or an elevator buys grain from farmers well in advance and then has margins on their books every day. It's just the magnitude of the demand for the capital. A farmer sells grain at $3 a bushel and the market goes to $6 a bushel, what happens is you sell to the customer later in exchange futures 3 months later. When the farmer delivers the bushels you then price your sales contract and the grain is received, shipped, a nonissue. But in this case, the magnitude has gotten so large and there's been such a demand for capital so you're just shifting how the money gets through the system. The capital is available. The same person who's long in the futures contract today is basically pulling money out of the market every time the market goes up so you're just shifting the timing when margins are paid. In fact, the clearing is going to take money both ways so it's not going to be out the money at all. It really ends up being the final payment. So instead of the grain elevator having

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to pay margins every day and eventually collecting that when they sell it to a customer, they're getting that money every day through their margin swap and eventually the same thing happens. It doesn't change the fact that there still is the exposure because now you have a margin call for a month instead of a day. And the reason there's never been a breakdown in the system is because you have those margin calls that has the checks and balances, so this changes that and a lot of the clearing firms or a lot of the FCMs will have a lot of heartburn with accepting that change.

MR. DUNN: Are there other questions or comments? Mr. Clark?

MR. CLARK: Maybe you are already, but I guess I would just encourage you to work with the banking community because my sense is exchange clearinghouses are famous for protecting themselves and that's why they work. So to the extent you get too deep into this and then you have a default, my presumption is that the exchange clearinghouse is probably going to the

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assets of the defaulted entity before the banks have time to do it and I think it raises a lot of issues about how financing is provided to the whole sector if the underlying value or the equity of the enterprise is somehow called into question. I presume you're already doing that, but I would encourage you to do so if you're not.

MR. HURST: We have a working group that's been meeting on I'd say a monthly basis for the past 6 months that's included representatives from Co-Bank, we've recently been contacted by commercial lenders who have expressed interest in joining it, and your point is very well taken and it is something that we are attuned to.

MR. DUNN: Are there other questions or comments from the audience? My fellow Commissioners? Commissioner Sommers, do you have any questions? Let me ask a couple then. In our interagency task force study, that interim report under the hedgers and speculators portion, there was this paragraph that was inserted in there. It says, "While hedgers are not generally associated

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with price discovery activities, these commercial interests often do play an important price discovery role. In essence, futures prices are a consensus of the opinions of those who enter the market. Moreover, the actions of those who choose not to enter the futures market are also quite important in price discovery. For example, a commercial trader holding physical inventory but choosing not to hedge this inventory with short positions in the futures market will withhold a downward pressure on the price." My question, has the threat of high margin calls been a stimulus for commercial traders holding physical inventory not to enter into the futures market? Mr. Coyle?

MR. COYLE: I'll make a couple of observations. First, what does happen as a general rule, commercials hedge what they buy. I would say it's standard operating procedure, but what you're finding is because of higher margin requirements that people are selling bushels earlier than they would like to sell which is putting downward pressure on the basis for

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instance because they simply can't afford to store the bushels and yet they can't afford the risk to unhedge at $15 beans and watch them go to $13 and they're out of business. So I think it is changing the marketing patterns.

The other observation, I don't know if it's accurate or not, I saw Mr. Kass's chart where he showed deferred hedging in soybeans where you showed that there's actually less commercial selling in the new crop months compared to what we had in 2007. That's a little unusual when you had futures prices so much higher than a year ago and farmers taking advantage of the higher prices. So what that might be is an indication that as elevators have reduced their bids and stopped bidding for deferred grain because of the fear of margin calls or they didn't put a bid out at all that they didn't have a need to hedge. That doesn't give you the pressure and it also means you're not giving a bid to a farmer who you want to give a bid to. I don't know if that's accurate or not, but that's what the chart indicated to me.

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MR. DUNN: Joe?

MR. NICOSIA: I think actually the opposite is what's taking place. As the capital has been withdrawn, and I agree with what Tom said a little bit, I don't think you're finding people who are continuing to accumulate physical positions instead of hedging them. I think you're finding that anyone who finds themselves in that position at short capital and actually has to liquidate inventory and therefore you would be selling your physical positions to raise money so that you could hedge the balance of it. So I think the only place where you're really seeing that is maybe in an ETF type situation or another group, but that has nothing to do with the traditional hedger so I think you're actually probably seeing if anything less of what I would say is outright pure spec flat price positions by holding the commodities than you did 2 years ago because of the lack of capital.

MR. DUNN: In Mr. Reinhart's presentation this morning he talked about USDA's

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announcement that we had a $61 billion grain crop 2 years ago and it's $122 billion today. Has that money filtered back to the countryside or is it offset on additional production costs? Mr. Coyle again?

MR. COYLE: Sorry to be a hog. I guess I'll say both. Costs are higher, fertilizer costs, fuel costs, I'm not a farmer but production costs I'm sure are significantly higher than they were before. On the other hand, we have had some underlying change in demand. We have biofuels. So there's a genuine increase in consumption for instance for corn which is raising price levels. We have improved diets around the world particularly from China and India which is raising demand as well, so that's raising the overall price. So I guess I would conclude that the money is getting back to the farm community in a number of ways, from construction to farming itself, land values, but it's also offset by higher costs. I hope it's a net gain, but you'd have to ask a farmer the answer to that.

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MR. NICOSIA: Plus don't forget that although the total value of the crops are higher today, whatever portion that was presold or sold ahead in years is only benefited by the price that they sold. So if they were selling corn or a great deal of corn traded hands at $4 and as we moved up those levels, that net benefit of $7.50 corn for those bushels were never received. As we go through this cycle as those bushels are delivered, as those bales are delivered and the producer catches up with the current pries, then more of this price will eventually get passed on back into the country but a good portion of it has not been passed through because of that.

MR. GOULD: I would agree with my producer hat on that I think there's also a difference in timing. We have a significant increase in commodity prices coming back to the farm community in the 2008 crop year. The increased costs that we're talking about are really going to take effect for the 2009 crop as fertilizer and other inputs are priced into that

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crop. I think that's where the real net is going to be magnified or maybe even at risk of being negative. I've heard different numbers that $5 corn is the same as $2.50 corn was 2 years ago with increased input costs.

MR. DUNN: Mr. Wellman?

MR. WELLMAN: As a producer, I would pretty much agree with the three earlier comments here, and to tie this back to the credit situation that we've discussed is as producers are buying our 2009 inputs at this point in time at three times the cost that we have paid previously, we're also facing a credit crunch because we don't have the income yet from the 2008 grain that may or may not be priced but we're paying the 2009 inputs at this point in time. So I think that ties in with the credit, and maybe to Mr. Miller's comments here about producer education, I understand that but also it ties into if multinational corporations with much larger balance sheets and better balance sheets than some producers have are staying out of the market because of volatility

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and the cost, how's that going to come back to a producer and what makes you think that a producer should be in that situation to face those risks? Thank you.

MR. DUNN: Thank you very much. This morning's panels have just been fantastic. You've given us a lot of insight. I announce that for the members of the Ag Advisory Committee, we do have a lunch for you up on our ninth floor as we usually do. It's the only type of payment we can give you, and the panelists as well as advisory members. For the remainder of the folks, there are restaurants in the front of the building and behind the building a new restaurant has opened up. What we will do is break for lunch and be back here at 1:45. This afternoon we're going to talk about agricultural swaps, and we're also going to talk about ongoing research. So we will see you all at 1:45. Thank you.

(Luncheon recess.)

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A F T E R N O O N S E S S I O N

MR. DUNN: I want to thank everyone for their participation in this morning's meetings. I found them absolutely fascinating and I think this afternoon we're going to get more of the same.

The first issue that we've got are agricultural swaps. To begin this we're going to have Don Heitman from the CFTC to give us the history and current policies on agricultural swaps and ATOs or agricultural trade options. Then we're going to hear from Tom Farley from ICE and Dave Lehman and Julie Winkler from the CME on the benefits of clearing agricultural swaps. So if you will, Mr. Heitman?

MR. HEITMAN: I'm going to go through this as quickly as I can because I've got way more than 10 minutes' worth of material.

Starting off with swaps, I'm going to skip the first slide which is just an introduction and the early history of agricultural swaps we're going to skip too. In 1993 I think the significant thing is that the CFTC adopted Part 35

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exempting swaps meeting certain criteria from the exchange trading requirement of the Commodity Exchange Act, and at that time it applied to swaps on everything. Then in 2000 the CFMA included a new section, 2(g), the swaps exclusion which superseded Part 35 for everything else, but 2(g) by its terms applies to transactions in a commodity other than an agricultural commodity. So Part 35 remains in effect for only agricultural commodities. The conditions governing agricultural swaps are they're between eligible swaps participants and then there's a bit long list of who's an eligible swap participant in the rules. I think for the purposes of the agricultural community probably the most important eligible swap participant is a person with a net worth of a million dollars who enters into the swap to manage a risk in connection with its business. And the other qualifications are that they're not fungible, credit worthiness would be a material consideration, and they're not created on an exchange.

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Interestingly enough, Part 35 does not apply to options. Even though it defines a swap agreement, and there's a big long list of different kinds of swaps including a commodity swap, and then it says, "Including any option to enter into any of the foregoing." But when they published the ag trade option rules somebody specifically asked for clarification that the Part 35 swaps exemption and not the ag trade option rules would apply to off-exchange agricultural options and the Commission relied, sorry, any off-exchange option on an enumerated agricultural commodity has to comply with the ag trade option rules and no other exemptive provision is available so that if it's an ag option you're stuck with the ag trade option rules.

Under Part 35, probably the most significant restriction is you can't clear an agricultural swap because you fail two of the four criteria, you can't clear something that's not fungible, and number two, credit worthiness is not a material consideration if you're got a

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clearinghouse interposed to take the risk. So clearing agricultural swaps would require an exemption under the Commission's general exemption authority at Section 4(c) of the Act. And in fact, the CME Group on April 21 petitioned the Commission, asking us to exercise 4(c) authority to permit the clearing of corn basis swaps and corn, wheat, and soybean calendar swaps. That was published for comment on July 7, the comment is open and the deadline for comments is August 21. On May 21 the CME Group made a more general petition in asking us to exercise exemptive authority to amend the regulation itself to permit the clearing of standardized OTC ag swaps which would mean you would need to file a petition every time you wanted to submit a new cleared swap contract, and that has not been published for comment yet. I suspect that people are waiting to see what the comments look like on the April 21 petition.

The last question about swaps is where does ethanol fit in? The Commission has already

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allowed the clearing of ethanol swaps without a 4(c) petition which represents an implicit finding without expressly saying so that ethanol is not an agricultural commodity for purposes of the CEA, therefore it's within the general swaps exclusion and you don't have to worry about Part 35 for ethanol.

So that's the swaps presentation and that brings me to agricultural trade options which is what I really wanted to talk about. As for ag trade option, there's a big long definition in 32.4. The significant thing about the definition is that the option buyer has to be commercial, the option seller does not. I don't understand that and I never have, but that's the way the rule reads. There is a general regulatory exemption for trade options. Trade options are exempt from all CFTC regs the prohibition against unlawful representation and fraud. Then in 32.2 there's a prohibition against options in agricultural commodities except as provided in the ag trade option regulation. So if you want to have an

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agricultural option, trade options are a special case and if you want to trade an agricultural trade option you have to do it under a set of rules that the CFTC has issued and there's a long statutory and regulatory history going back about ag trade options which is on the next couple of slides. I'm just to skip those except that I think probably the most significant point is that in 1991 the agency actually proposed lifting the ban on ag trade options which would have allowed them to trade just like any trade option subject only to the fraud and misrepresentation rules.

When we proposed that we got 16 comments, nine for, seven against, and the opposing commenters included CBTO, National Grain Trade Council, National Grain and Feed Association, and Cargill, and the proposed rules were never acted upon. So the Commission basically went back to the drawing board and in 1995 we had a roundtable and then they got a white paper from the staff and then advance notice of proposed rules, proposed rules, and finally in

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1998 they issued the initial set of ag trade option regulations with a number of requirements including that the trade options had to be settled by physical delivery, and nobody signed up for the program. So we said we'll go back. We redesigned the rules, and in 1999 we streamlined the reporting and disclosing requirements and allowed cash settlement, and then only one firm in the 9 years since then has registered as a ag trade option merchant, it was Kent Feeds. The gentleman was here at a meeting of the Ag Advisory Committee a few years ago but they have since withdrawn their registration so nobody is participating in this program at the moment.

The as for the current regulatory and market situation I don't have to tell anybody in this room that the agricultural community needs all possible risk- management tools to deal with current market conditions. The existing ag trade option program clearly isn't helping anybody and producers and agribusiness interests have had an additional 10 years since the ag trade option

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rules took effect to develop further risk-management expertise. In this environment the question is what should the Commission do about the ag trade option program? There are three possible alternatives. Obviously we can just leave things the way they are which doesn't really address the ag community's risk-management needs. We could modify the ag trade option rules to make them more acceptable to potential registrants which is fine if it would work, but in fact it's really difficult to visualize anything we could do to make the program more acceptable. The current regulations have really been pared down to the bone already. The only logical change that people have suggested would be to lower the exemption level to a million dollars but all that means is you're going to allow more exempt trading outside the program, you're certainly not going to attract anybody in to participating as an ag trade option merchant if you just narrow the universe of possible customers. Really all you're doing if you lower the exemption level is you're

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disenfranchising smaller producers and nobody with under a million dollars net worth would have access to ag trade options.

So the third option obviously then is just revoke the ag trade option rules and allow ag trade options to trade like any other trade option. The pros to that are it would open up new risk-management possibilities for the ag community. It resolves the legal uncertainty about existing products that may or may not be ag trade options because we've heard anecdotally that there are products trading out there right now that are to put it charitably on thin ice and they may or may not be illegal under the ag trade option program and if we revoke the rules that takes away any uncertainty about those products. And it would reverse the Commodity Exchange Act's paternalistic attitude and treat farmers like the operators of any other business. My first boss at the CFTC, Commissioner Heineman, God rest his soul, one of the first things he said to me was, "Farming isn't a way of life, it's a business, and

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if you can't make a living at it you ought to go find another business." And he was a farmer his whole life so he had the right to say that. I certainly don't, but I'm just quoting him.

The one big con of revoking the ag trade option rules is that it's going to open up the possibility of fraud and economic loss in this less-regulated environment. We're going to have an antifraud rule, but if you're going to legalize cars, even you post a speed limit, there are going to be car wrecks. If you revoke the rules and start trading ag trade options, sooner or later there's going to be a scandal. I think that's just the price you pay and you have to rely on people to have the good sense to deal with trade option offerors who they know and trust and in fact notwithstanding the possibility of fraud, that's the option that the CFTC staff is in favor of and we are going to recommend to the Commission a proposed rule amendment to withdraw the ag trade option rules. If that's approved it would be published for comment in the Federal Register and

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we would certainly encourage members of the Advisory Committee to comment on that proposal or to comment now if you can do it in 10 seconds, 9, 8, time's up.

So that's the status. If the ag trade option rules are withdrawn, ag trade options would be subject to the same conditions as trade options on every other commodity, they could be offered only to a commercial in connection with its business as a commercial, and they would be exempt from all CFTC regulations except those prohibiting unlawful representation and fraud. So that's my pitch for revoking the ag trade option rules.

MR. DUNN: Thank you, Don. Just a point of clarification here. From the April 21 request we are under the comment period of that so we have to follow the Administrative Procedures Act rule and we're under ex parte so anything that is communicated here will become part of that record. Is that correct?

MR. HEITMAN: Yes, sir.

MR. DUNN: Thank you. Our next

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panelists on the benefits of clearing agricultural swaps will be Tom Farley from ICE Futures. Tom?

MR. FARLEY: Thanks again, Commissioner, and thanks for allowing me to say a few words about the benefits of clearing agricultural swaps. I believe Dave from CME is also going to say a few words about agricultural swaps, and I did as well back on April 22, so I'll be brief. And I'm also going to focus on a slightly different area of agricultural swaps than was covered before or I expect will be covered later today.

One of the benefits of clearing OTC agricultural swaps, I think these benefits will be familiar to you. They're the benefits broadly of clearing really any product. You reduce counterparty risk is the primary benefit as opposed to having a web of bilateral agreements as exist currently in the OTC market. By clearing swaps, clearing OTC instruments, you substitute a highly rated central counterparty, namely an exchange clearinghouse, for your multiple counterparties. The second benefit is that these

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OTC instruments level the playing field. What do I mean by that? OTC trading occurs now and we all know it occurs. It largely occurs between very large parties, very sophisticated parties, and by bringing OTC trading onto an exchange it allows more people to participate, and there are some real benefits to trading swaps and some more tailored products when I'm going to discuss in just a minute here.

The third benefit is that it provides additional transparency to already existing OTC markets, and I've highlighted already existing because some people nitpick about how much transparency will there be with cleared swaps on an exchange, and is it precisely equal to futures. I think that's largely missing the point. There is very little if any transparency with the existing OTC markets, certainly some of those exist in OTC markets, and bringing OTC instruments onto an exchange for clearing, you're instantaneously heightening the level of transparency that's provided to the marketplace

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whether it's simply by the act of the clearinghouse settling these instruments on a daily basis and providing some price transparency or disclosing the total volume in these instruments or the open interest in these instruments, these are all additive to transparency.

Finally, and this is where I would to focus for just a minute or two, clearing OTC swaps enables more customized risk-management solutions for a broader swath of the marketplace. Let me give you a few examples. I want to just if I can digress and explain to you our intention and what we have actually requested of the CFTC and which they're considering is clearing look-alike swaps in sugar, coffee, and cocoa, and that's our initial plan. However, we also have a plan to expand that over time into clear swaps in cotton, to clear OTC options, to clear basis swaps over time. So I just want to focus a minute on a few hypothetical instruments and I intentionally chose a few that are entirely hypothetical just to give

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people an idea of how these might benefit a customer's risk-management needs.

For example, in the first instance if you have a cotton producer who wants to implement a capital expenditure it's going to cost a lot of money and there's going to be a 5-year payback, and in order to secure financing they need to hedge 50 percent of their production going 5 years old. That producer could enter into a long- dated swap contract and they could clear that on the exchange. Our exchange traded contracts don't even go out 5 years. In the OTC market they might find a counterparty who's willing to do that 5-year transaction. Now they can clear with a central counterparty and they can solve this risk-management need.

A second example, a Chinese mill owner purchases cotton from a Chinese free trade zone. You could imagine a swap transaction where the miller owner can entered into a cash-settled swap with a merchant who settles against an index that's tied to the price of cotton in that region

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in China in this example. So the customized solution is we clear that swap. Again, it enables somebody to more appropriately hedge their specific risk.

A final example is an investment firm sells a 2013 principal-protected note with upside tied to the price of sugar. Let's say it's a wealthy individual planning for their retirement, they want to diversify their portfolio, they want a principal-protected note long term but they want some upside tied to commodities to diversify their portfolio. Now that investment firm can purchase a 2013 OTC, I've written swaps in here but think of it as an option, to hedge that position to be able to provide that product and they can again clear that with the central counterparty.

So this was just go give you a few ideas of the longer-term benefits of clearing swaps. In the near term as I explained we're looking to clear coffee, cocoa, and sugar swaps. That's all I have. Thank you.

MR. DUNN: Thank you very much, Tom.

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We'll now hear from Dave Lehman and Julie Winkler from the CME Group.

MR. LEHMAN: Thanks again, Commissioner. It's our pleasure to be here again to talk about clearing ag swaps. We did make an initial presentation as Tom mentioned at the December 2006 meeting and again in April when we were here at the roundtable that coincided with filing our petition, and that petition is to allow us to clear basis swaps for corn and calendar swaps for corn, soybeans, and wheat.

What's driving this demand for OTC products or interest in OCT products? It's we think really many of the same factors that are driving our commodity prices to more volatile levels and high levels. They're listed here, the supply-demand factors of weather and disease, developing- country demand, falling dollar. That is even a bigger factor in some of the more recent studies than we though; higher input costs, biofuel production. Biofuel is probably the biggest factor that's driving the interest among

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our existing clients in swaps. It's actually our first commodity swap cleared product at CME Group, and Julie will look at some of the data on that, but this sector is also driving the interest in the basis swaps for corn.

As Tom mentioned, our traditional futures go out about 3 years. We've listed some of our grain futures contracts a fourth year but swaps tend to be done farther out than that. We're out 10 years in ethanol with those swaps and an OTC product gives you the ability to expand out the curve. They certainly give participants more flexibility in developing tailored risk-management solutions that are more effective hedges and obviously the dealers in the over-the-counter swap market are playing an important role in creating these products, and we're having discussions and a lot of the demand is coming from those dealers who are working directly with end users. So it's kind of a way to leverage product development if you will.

Benefits. These are the same that Tom

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covered for the most part, but we are hearing of interest in cleared OTC transactions in our enumerated commodities now in the grain contracts in dairy and in meat products as well. These are trading today in the over-the-counter market. They're trading presumably among eligible swap participants but without a clearing guarantee. So what we can do by bringing these into the clearinghouse is help offset that counterparty risk, and that's really probably the biggest benefit of reducing counterparty risk but also the regulatory transparency that comes with these products. In our submission seeking an exemption from the CFTC we listed the conditions that we would be willing to impose on these products of large trader reporting, position accountability, daily reporting of volume and open interest. So the bottom line is the introduction of OTC products that are a cleared product will give market participants a way to managing increasingly volatile risk especially in the basis market and also reduce their counterparty exposure.

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This chart shows the growth in the OTC market over the last 3 years. This data is from the Bank for International Settlement so it's only available for commodities broadly and that includes energy. It does not include metals, but as you can see, this market has grown from a $5 trillion market to about an $8-1/2 trillion market. We estimate that it's about five times the size of the exchange-traded commodity markets.

What is a swap and how is it defined? I'd like to note that we just got a white paper on our swap products published this morning. It's over on the credenza in the back of the room. It wasn't here at the beginning of the meeting so I encourage you to drop by and pick that up. It's about an 8- or 10-page paper. In its simplest form it's simply an exchange of cashflows between counterparties. These instruments in the interest rate markets initially. A commodity swap is very similar to an interest rate swap where the two counterparties are exchanging a floating price for a variable price for the commodity. I'll go

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through a little example of an ethanol producer. This is where we're seeing the demand certainly on the product side for a fixed-price product supplying it to a blender, but on the input side since the ethanol producer is really providing his product to a blender at a fixed price, he wants to be able to fix a price on his inputs. In this example, they agree at a $5 per bushel price for corn. The farmer agrees to pay the variable, and that's based on the futures price. It adds transparency. The settlement for both our calendar swaps and basis swaps will be our futures price in the case of the calendar swap and that's averaged over the final month of settlement. In the case of the basis swap, the settlement price will be the difference between futures and a cash price provided by a well-known cash price provider.

I have included contract specs for one of the basis swaps. There are six of them that we've asked CFTC for authorization to clear. These are all for corn today. Again it's really

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to respond to the ethanol industry's demand for additional risk-management tools. I'm hopeful as Mr. Heitman noted that our request for a blanket exemption will be considered expeditiously and approved and that will allow us to add more tools quickly as the market demands them. With that I'm going to switch chairs with Julie and I'll let her go over the next section.

MS. WINKLER: Thank you, Dave. I think it's important to stress too that how we see these products working is continuing to operate as they currently do in the OTC market. So what the exchanges are trying to do is provide a clearing mechanism along with all the benefits that we see, primarily that being increased transparency, and we do believe that that is going to allow more market participants to transact in these OTC swaps who cannot currently do that.

As David mentioned, the exemption that we are seeking is looking for both the corn calendar swaps in six different basis swap contracts. We will be utilizing cash prices

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collected by grain elevators throughout the Midwest as the basis for that. And just to clearly make sure everyone understands exactly what the exchange and the CME clearinghouse will be doing and the services we will be providing is that we do intend to publish daily settlement prices for all these swaps. We'll be distributing daily volume and open interest for all the swaps listed for clearing as we currently do for our futures products. We have also recommended that we adopt position accountability for these products both for single months and all months combined. And we really believe that this helps to provide a certain level of transparency that we are clearly not getting in the OTC market now. We will continue to provide financial surveillance of our firms and oversight of these FCMs that are going about clearing these swaps which we believe is vitally important utilizing span in the clearinghouse as we do not to establish appropriate margin levels. And we believe that the daily and final mark to marketing of these

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products is really probably one of the most important aspects that we can provide. What that allows for is the collecting of a variation margin every single day, and certainly the example that we've seen in the credit market over the last few months with mortgage books and credit default swaps not being daily mark to market really allowed things to get away from many of the global investment banks. We believe that daily mark to marketing of these OTC swaps is going to certainly prevent that and we believe our clearinghouse can do that in a very prudent manner. So I really can't underestimate the importance of the CCP in how it can provide integrity and transparency to these markets.

CME clearing is also going to provide a number of other services they do for existing products, multilateral netting, post-trade give-up, and the other value that they do provide is that they're going to be able to provide market participants with margin offsets if they have corresponding existing futures positions at CME

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Group. So if they were enter into a corn calendar swap and also have existing corn futures positions, there will be a spread credit provided to those market participants if they have positions in both offsetting contracts. We believe that will be a very valuable service to the market participants. And as mentioned earlier, certainly the financial safeguards package of CME Clearinghouse, I think the number that was mentioned is now over $6 billion and we believe that backing is going to be significant in order to protect the clearing of these products.

This is a graph of our daily ethanol swaps and this is the first OTC product that was introduced by the board of trade for clearing back in December 2006. You've seen some dramatic growth over the last 2-1/2 years of this product. Average daily volume is now over 780 contracts. We see open interest over 22,000. We also have a suit of products around this both in terms of cash-settled options and also cash-settled products based on the forward months swap. It's

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been a really good example and I think learning experience for us as an exchange to go out how to margin these and how to learn from other markets. The market participants came to us saying we're used to doing this in the energy market. Can you do a similar thing for us in ethanol? It's really been about working with many of the people in this room to help make this product even more successful and being willing to modify the product along the way to truly address the risk-management needs that people had. So we've been very happy with the success of this product.

In summary, we see a number of benefits that cleared swaps can provide particularly at the CME Group. We do see this as a bridge between the OTC markets and the futures markets. Certainly you've heard us all talk about the increased transparency that's going to result as a matter of clearing these ag swaps. The market surveillance that the exchange can provide, the safety and soundness that we bring to the marketplace, and certainly the margin benefits could be significant

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for those customers who are already active in our futures markets. In many regards too we see these as having the ability to provide risk- management tools for really bespoke OTC products that are already taking place in the marketplace but they're probably too small to actually provide a futures market that is a liquid alternative for people. So we do believe that this customization and individual markets certainly has value. So in summary I'd like to thank Commissioner Dunn and all the fellow Commissioners for their support on this. I think the communication with you and your staff has been great and we hope you will seriously consider the benefits that clearing ag swaps could bring to our marketplace. Thank you.

MR. DUNN: Thank you, Julie and Dave. Now we are open for comments and questions by the members of the Advisory Committee. No comments or questions by the Advisory Committee. Leroy?

MR. WATSON: Thank you, Commissioner. I just want to ask some details of some of the transparency and reporting that we're going to get

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out of this. One of the things that we've heard is that one of the reasons that swaps exist or swaps become popular is because they have a larger timeframe or a longer timeframe than existing futures market products. When you're talking about reporting interest on a monthly basis, are you talking about potentially reporting monthly interest on a June 2018 product out there? Are you going to extend that out there so we're going to have actually month-to-month add on on what swaps bases are 4, 5, even 10 years not depending if those are the products that are being offered on the exchanges?

MR. LEHMAN: Yes, Leroy, we would publish the volume in open interest no matter how far out the curve it is. We do that for ethanol today and we've got ethanol swap open interest out 10 years. As I mentioned, our futures contracts are listed out 3 to 4 years so if we're settling the swap to the futures then we need to list the futures contract to have a settlement price for the swap. So that actually will lead to expanding

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the forward curve in our futures markets, and as we do that, at least our experience in ethanol has been that the swap participants then become interested in a vested way if you want to put it in what the futures settlement price is so that creates liquidity in futures and the two tend to feed off of each other. So it is going to be more information farther out to curve than what we see today in these grain markets and the other agricultural markets.

MR. WATSON: And as I also understand the proposals, unlike a standardized futures contract which can only legally be traded on an exchange, swaps would still have the legal ability to be traded OTC. So that what we've got is we're working with two different regulatory programmings here in that if you want to trade a futures contract you've got to come to an exchange, but you continue to have somewhat of the moral hazard risk of the fact that the swaps market could leave the exchanges at some point in time in the future depending on what market or regulatory situations

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are. Is that correct?

MR. LEHMAN: Yes, I think that's absolutely correct. It's not on the exchanges today in the agricultural markets because of the regulatory restrictions. You can't clear agricultural swaps, as Mr. Heitman mentioned they can't have standardized terms, and credit must be a material consideration in the negotiations. So all of those restrictions prohibit that market from being on exchange and we feel that there is a demand, we're hearing it from our customers, to allow clearing to help with this mark to market, with this counterparty risk, and then I think it has a dual purposes in that it provides that benefit to the marketplace and then it provides a benefit to the regulators in giving them a better picture of the entire market.

MS. WINKLER: And it's important to note that it wouldn't prevent -- and even suppose that all of those OTC swaps would need to come to the exchange for clearing. That would certainly be up to the two counterparties that had negotiated that

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swap to determine whether they wanted to bring it to the exchange for clearing. I think one thing to point out is even though we have an idea that this is now an $8-1/2 trillion market, it's not even possible to break down of that number how much of it is agricultural swaps that also includes energy. So we're really talking about there not being much transparency at all in terms of what these OTC swaps are doing right now so to get some of that on the exchange is certainly going to make a big difference.

MR. DUNN: Are there other questions or comments?

MR. CRYAN: What would stop the exchange from replacing all the futures contracts with equivalent swaps and abandoning regulation by the CFTC? How does it become different from a futures contract aside from the fact that it's not standardized?

MR. LEHMAN: It's negotiated on a bilateral basis so there really isn't a liquidity element to the swap market. These are tailored

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instruments and liquidity is not the primary concern. The primary concern is a tailored risk-management solution. I think for a lot of the marketplace, liquidity is the primary product that exchanges provide, and let's be honest, that's what we hear every time we go and talk to market participants about our product is what can we do to expand the liquidity and expand the breadth of users of those markets. So I they're distinct markets from that sense or they provide different benefits. I'm speaking personally here, I don't think exchanges would want to see a transition away from their centralized price discovery markets to a bilateral negotiated swap market. I think we envision them complementing each other and we see kind of different role for each one in my view.

MS. WINKLER: And I think the exchange-traded futures market certainly now with the preponderance of that volume being electronically traded, you're seeing the depth of book out there every single bid and offer and

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trade being made. The way the OTC swaps work is that those bilaterally negotiated trade prices will not be available to the public and those will not get disseminated by the exchange -- that end-of-day settlement price so you're really talking about two totally different market conventions each having distinct value I think to the marketplace.

MR. DUNN: Are there other questions or comments from the Advisory Committee? Joe?

MR. NICOSIA: Not in regard to the clearing of the agricultural swaps which I think are fine, but just the Commission again and we've touched on this in our last meeting. I think it is critically important for the Commission to get its handle on the size and the participants of the activity that's taking place in the swap and OTC market and relate it directly to individuals' position limits and their other trading activity as far as regulation of the marketplace. So although this is agricultural swaps, we haven't really touched on that as far as any of the

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discussion yet today. I think that as far as agricultural swaps go, that is by far much more important.

MR. DUNN: Thank you. Are there other questions or comments from the Advisory Committee or from the audience? From my fellow Commissioners? Commissioner Sommers?

MR. LUKKEN: The Commission has spent a significant amount of time over the years talking about the ag trade options program and as Don said we've thrown two parties and no one came to either one of them. So this is something we I think are interested in revisiting in whether we treat ag trade options similar to the way we treat energy and metal trade options as well.

I'm interested too before we dive into this and try to revisit this issue whether there would be demand for this types of instruments. Certainly there may be an interest in a fixed-cost risk-management option out there. What I'm trying to find out maybe from the producers around the table or those who might use these ag trade

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options whether this is something that they think might be beneficial in their risk-management schemes. Come on. Somebody say something.

MR. NICOSIA: As far as the use of those within the agricultural space, again there are ways to get around everything that you have so you might as well just move forward as was presented where it is because between swaptions in the swap market, guaranteed price contracts, minimum-price contracts are taking place all over the place. So to try to fence in or catch someone who's trying to present something wrong is massively ineffective, it's regulation that's there that's not preventing nor helping anything, so I think you should open the marketplace up.

MR. DOUD: Is there any discussion of any of this for the livestock industry? I've never heard tell of it for livestock. Have you guys?

MR. HEITMAN: Actually the one person who we had who registered as an ag trade option merchant was Kent Feeds and they were offering

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trade options to hog producers who were locking in feed prices and it was part of their deal with Kent Feeds to lock in price on feed and then selling their hogs. So the one example we have of an ag trade option under the rules did involve livestock in fact. But what's going on, I'm sure there are as the other gentleman said all kinds of options and swaptions and guaranteed minimum-price contracts and so forth going on out there some of which are probably technically over the line of the ag trade option rules but I'm not aware of that and actually I'm glad I'm not because that might impose some kind of duty on me to call the Division of Enforcement which I'd rather not have to do.

MR. GAINE: I would make two comments. As a producer before I came to Washington as a part of the Risk- Management Agency I probably did participate in some minimum-price contract arrangements although I never heard them referred to as swaps, they always had some kind of fancy title to them that sounded pretty impressive, and

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frankly sometimes they worked pretty well.

Secondly, I'll respond with my Risk-Management Agency hat on now with the livestock products, the agency does offer gross-margin contracts for basically all species of livestock, sheep, hogs, and cattle, and are now just about to roll out a dairy gross-margin this week as a matter of fact. But frankly, there's not a lot of interest in those certainly not relative to other aspects of crop insurance. Again I guess I'd just throw that out as a point of information that those products are available but generally speaking of limited popularity.

MR. DUNN: Yes?

MR. COYLE: I guess I would just make one observation. I see the chart that the CME put about the growth in their ethanol swaps. It would seem to me that you'd see the same kind of offset product in the grains and if you throw basis swaps on top of that with the transportation volatility it would seem by tying those together you may be able to lock in margins that counter basis for

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ethanol facilities so that would be one use.

MR. DUNN: Are there any others? Mr. Heitman, in the CME's presentation they indicate that increased transparency through public reporting of volume, open interest, and settlement price, and enhanced marketing surveillance of over-the-counter activities by requiring position accountability and reportable levels of 25 contracts would be one of the benefits of cleared ag swaps. How important is that to the Division of Marketing Oversight? And maybe Mr. Kass I can get you to come up and talk about our current 1805 request and what it entails with our staff to go through that since you're overseeing a good part of that.

MR. HEITMAN: I would just like to go on record as saying that the Division of Market Oversight is four- square behind the concept of market transparency. So anything that increases market transparency is fine with us. As far as the details of our current efforts to increase transparency in these OTC markets, David is the

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one who's ram-rodding that effort so I'll defer to him.

MR. KASS: Yes, we have gone out on this using our 1805 authority which applies only to traders currently holding reportable futures positions. The original thrust was to talk about commodity index investment whether through a swap or through direct investment, but we're also asking about OTC participation in all the markets that they may be involved in but they have to be at least reportable in futures before we have that authority. Yes, that project is currently underway. It's a massive sort of an undertaking for this Commission because typically when you go after a reportable trader for information you're asking one trader, occasionally we've asked for a couple I think, and you're asking for one market. Here we're asking for quite a large number of traders and we're asking it for dozens of markets. So it's quite a huge undertaking, but the agricultural products are covered as well.

MR. DUNN: Thank you. Would having this

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type of information available assist you in this effort?

MR. KASS: It would point to certain participants who we would know would be involved and so I guess, yes, any additional transparency is good for everybody I think and that's what we hope to come out of this 1805. We're just getting the data in now so it's a little premature to talk about what may come from the data, but that's clearly something we're going to be dealing with is recommendations going forward, any policy implications that come out of the data, and beyond policy, in terms of future transparency. But the additional transparency of that any OTC market is I think good for us and good for the industry.

MR. DUNN: Thank you very much. Thank you to that panel. Now we'll have our next panel on ongoing research and we'll start off on policy issues with identifying and managing commodity bubbles. Eric Juzenas of my office will make that report. Let me give the disclaimer right now: anything he says reflects his own bias and not

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that of the Commissioner. We have a summary of ongoing interagency and CFTC research. Jeff Harris from who is our chief economist. And then experiences with particular markets from Julie Winkler again from the CME. Mr. Juzenas, if you will, please.

MR. JUZENAS: As Mike said, my opinions are my own. I think it's no surprise to anybody here that the Commission has been getting beat up a little bit by certain segments on the Hill about whether we're doing enough to address speculation which reflects the belief that prices currently are not justified by market fundamentals. Sometimes I think it's good to step back and examine what we're doing and once I looked through some of the questions we were getting from Congress and looking at some of the newspaper accounts, it seemed to me that this was a debate about whether or not we're in a commodity bubble and there are certainly people who believe that to be the case. A lot of the research our own economists have been doing is trying to look at

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the fundamentals and study some of these relationships and determine whether that might or may not be the case. But I thought maybe it was worthwhile just to dig a little deeper into this and look to see what we know about asset bubbles and how it might apply to commodity markets in the hope that better understanding this might point the way to both new areas of research that the Ag Advisory Committee thinks we might look into, and also hopefully help communicate the complexity of these issues whether it's to the media, to Congress, or the public at large because a lot of times it seems when we're up on the Hill we can be trying to relate what we see as market information and the conversation we're getting back from some of the other people just seems to be a totally separate conversation.

Now to deflate any hope that anybody has, unfortunately in looking at the research, there really is not a whole lot of consensus about what causes asset bubbles, what they are, or what you should do about them, and this is a quote from

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an economist who is reviewing it. There's the perception held by many that we're in the midst of a commodity bubble particularly in energy markets and the general theory which is probably not a surprise to anyone here is that commodities have become an investment class, an asset class, and then the influx of investment into there is creating an upward pressure on prices which is not justified by fundamental market conditions.

When you look at the definitions of bubbles, the central one, the first one is sort of common sense in that prices go up and then they come down, and of course this can be applied to a whole bunch of different economic phenomena, Tickle Me Elmo dolls, Hurricane Katrina, or even from my childhood Pet Rocks. There are a lot of things where initially there can be a lot of demand and then it falls off that doesn't necessarily have anything to do with the market. The second definition that's been used is that price departs from fundamental value, i.e., that there's a speculative component to prices and this

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is the one that's probably more relevant to the issues that we've been facing. Of course, the problems with asset bubbles is that they distort the price-discovery function of futures market or whatever market they're impacting and then cause misallocation of resources.

In general, if you look at the research, it really hasn't been studied that much as to how it applies to futures markets. A lot more of the research into this has been into asset markets, stocks, equities, real estate, and physical markets. The existence of an asset bubble once you think that it exists almost by definition implies that something has gone wrong with price discovery in the affected market and there are various theories that have been proposed about why this might be. The first is the greater fool theory and that's that prices are going up but you can always sell it to somebody else I guess until you can't and then the bubble collapses. The next one is investor herding which I think is pretty well understood and that's just the idea that

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investment seems to move together so if markets are going up, everybody gets in which can create further pressure for prices going up. The third one I think which has gotten a lot of attention when it comes to deciding what to do about asset bubbles or whether they exist is liquidity, too much money chasing too few assets, and this has certainly been the case I think in the world of the Fed when they've looked at whether they should have a pro-bubble policy, an anti-bubble policy, or neutral and in the stock run-up or in the recent real estate markets should the Fed intervene and this is probably relevant to what we've been talking about and what the Hill has been talking about in relationship to the futures markets. We heard this morning from one of the presenters a theory that wheat futures prices may be leading cash prices due to the demand for futures contracts and that starts to sound like maybe there's a potential liquidity issue there. While I doesn't appear to be causing a bubble since what we see is that the cash prices are

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offsetting the futures prices, it clearly causes problems for price discovery and I think this may be part of the challenge. Even if an increase in liquidity or an increase of investment isn't leading to a bubble or higher prices, it's gets difficult to communicate this message to people, you're right, it's having an impact but, no, it's not driving prices higher, and it gets even more difficult if you have to say it's driving prices higher in one part of the market and consequently it's lower in another part of a market. Then there are some economists who firmly believe there is no such thing as a bubble.

What is a regulator supposed to do about bubbles? I think this is the key thing for this committee to consider and I think something that the Commission needs to get some input from people on. There seem to be more than ever at least in recent times the thought among many on the Hill that we should be doing something to address what might be a bubble in energy markets or what some people think is a bubble in energy markets. Most

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of the attention on this issue has been paid to the Federal Reserve Bank and there of course the general theory is that if you raise interest rates you'll contain whatever liquidity is driving the bubble and that will deflate the bubble. You can look and see that there is a fair amount of research looking at historical incidents on the Japanese real estate market, the Great Depression and the stock market crash of 1929. They talk about monetary policy but they really don't talk about what other possible interventions there might be. A fellow from the Fed Reserve Bank of New York proposed a decision tree that I thought was interesting. It says, first, can policymakers identify a bubble? I think just the debate we've had at the Commission and the interactions we've had with the public and the Hill show the difficulties in coming to agreement on whether a bubble exists. Then if you do have a bubble, will the fallout be significant hard to rectify after the fact which goes to is it something you really need to address. Then the third, what tools can

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deflate the bubble?

Sorting through all these questions isn't easy and part of trying to make these determinations implies you have to have some pretty good knowledge of the markets that we may or may not have. There is a great debate through the years about whether the Fed should engage in asset bubble popping or whether they should just let them be and there have been different chairmen who have had different viewpoints. Our current chairman, Chairman Bernanke, had said that given that there's no generally accepted criteria, who is supposed to determine whether the bubble causes it? And more importantly, monetary policy is a very blunt too. Basically, if you're raising interest rates you're saying the approach to popping the bubble is going to be slowing the economy and I think this leads into the options that have been suggested for the CFTC that we should consider pursuing and in many respects these are similarly blunt options and I think the questions then become trying to evaluate these for

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what their effects might be. Raising margin requirements for speculators, position limits, and limiting market participation through defining acceptable hedging practices have all been proposed and these all get to that question again of trying to limit liquidity into the markets.

The questions associated with these are first I think going to Chairman Bernanke, can we figure out what a commodity bubble is and when it exists? Then I think the question is in making that determination, you really have to figure out what is going to be our objective measure of prices, so how do you determine that prices have really departed from fundamentals? Then a question of these different policy options, are they actually going to bring prices lower or if there were a bubble, would these be the appropriate measures for addressing it? Then again is there a potential for detrimental impacts?

For today I thought some of the questions were most of the debate on commodity

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bubbles really seems to be in energy markets, but I think it's worthwhile considering whether people here are concerned that there might be a commodity bubble in agricultural markets or is what we're facing just difficulties with price discovery or issues that need to be addressed related to the efficiency of the markets. And I think this is particularly important, if there is further research we can do that might help better communicate the message or better answer some of these questions that we've been facing or maybe our research has been fine so far, but it seems like there are still people are wanting more from us. I hope it's not just the answer that, yes, we agree that there's a commodity bubble, but we've just tried to do some thinking about what types of things we might look at that might hopefully address some of these questions. Then I think there's this general question for the CFTC that we haven't really looked at as much that the Fed has examined and that's is there a role for the CFTC in doing this and do people expect the CFTC to

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manage potential commodity bubbles.

MR. DUNN: Thank you very much, Eric. Jeff Harris is our Chief Economist and the team leader for the Interagency Task Force. Jeff, if you would, please.

MR. HARRIS: Thanks for having me, Commissioner Dunn. In following-up on Eric's comments I think what I would like to do is give a little overview on what the Interagency Task Force has been doing for the last month and a half or so, give you a little preview of what we plan to do with agricultural markets looking forward, and to start off I just wanted to give a little bit of an overview of what we do in the Office of the Chief Economist. We have a research objective to provide basic knowledge for the Commission to make decisions on. So we do basic research is the bottom line. We try to do systematic analysis of market function and part of that market functioning is obviously looking at bubbles and different types of price patterns to make sure that our markets are functioning effectively and

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to do that we employ mostly Ph.D. economists to do statistical and econometric analysis. And we also have a little bit of a support role in the sense that we interface with our market surveillance staff and enforcement people, we provide independent advice on enforcement cases and some expert testimony either as a primary source or as a secondary opinion for experts outside the Commission.

From the Interagency Task Force's standpoint we have partnered with the USDA, the Treasury, the Federal Reserve Board of Governors, the Federal Trade Commission, and the SEC, to have an examination this summer of conditions in commodity markets. It's fairly general, fairly wide in scope, but trying to address the price concerns and volatility concerns that we see in both agriculture and the energy markets. To date obviously for those of you who have been keeping up we had an interim report on the study of crude markets released last Tuesday. The basic outline of the report is listed here. We covered demand,

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supply, and macro factors in these markets, and the central role that the CFTC played with that is to provide an overview and an analysis of the functioning of the futures markets. We looked at the past 5-1/2 years, from 2003 to 2008 date up through June focusing on the roles of various traders and speculators in the markets, looking at a little bit of the term structure clues on what we see in developing open interest in developing long-term contracts in the energy space, and then applying some statistical tests, and I just wanted to give an overview of that, correlations in particular, looking at the detailed trade data that we do have within the CFTC for price changes on a daily basis and how they relate to position changes by various categories of traders each day over that timeframe.

The bullet there for the energy markets is that there really hasn't been consistent correlations over time. We have that in our interim report. Following-up on the correlations though, much more interesting is is there any

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group of traders who are causing price changes. The test we employed in the particular interim was the Granger causality test. I put it on quotes because the Granger causality test is not really a test of causality, but it's a statistical relationship that asks can we see position changes by a particular group that leads price changes? So you'd expect that if a group of speculators were able to move prices up, then you'd see that the buying of those speculative groups would precede the price change so they're able to move prices up and their trading would be related. In the oil markets we've seen little evidence of this. It's related to the ag markets because we're planning a follow-up study. The final product that we do in September, we're updating our study and we'll be using some of the same techniques that we've applied to the crude oil market to a number of different agricultural products. In fact, we have another Interagency Task Force call in about 20 minutes so we'll be on to the next topics there.

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One of the central topics in this report that you've heard today and most people are familiar with is the issue of commodity index trading. Obviously they mimic a broad class of commodities. These are traders in our markets only for the sake of diversification so they say. They look at the correlation, the portfolio theory behind risk and return tradeoffs, and perhaps have no information whatsoever about the type of commodity they're investing in but they want exposure as they say to a broad class of assets. The flows are estimated to be $100 billion plus in the last few years. That is a number under considerable debate. One of the issues is again with our special call like Dave Kass mentioned, we hope to get a better grasp of the flows that are going into these index funds through part of that special call. So the bottom line again with these index traders is they're trying to do portfolio enhancement and better risk in return tradeoffs by adding commodities to their basket of portfolios.

This is the major commodity index and

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what I've highlighted in red of course is from our surveillance staff. We have identified in our agricultural commodities fairly specifically and fairly well the 12 agricultural products that are in our supplemental commitment of trader reports so we keep track of the index flows within those. So in the agricultural space we have a fairly good understanding of the size of these particular traders in a number of the agricultural products. To date we've been analyzing these positions on a daily basis looking at daily price changes and daily position changes and we do see very little evidence that these index positions are affecting price levels or changes the prices on a daily basis. There seems to be very little correlation between the CIT market share in the cross-section so of you look at the number of agricultural commodities that have high levels of index trading, they don't seem to have the biggest price increases. We don't seem to have a correlation in the cross-section that way. They don't also seem to be related to increased volatility in our

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markets either. One of the reasons for that I think as we've tried to educate people on the Hill is that the supply of contracts in the futures market is not a limited supply. We've heard some analogies that if five people show up to buy my cow I get one price, and if 50 people show up to buy my cow I get a higher price. It's not quite that same obviously in the futures markets because we can write new contracts at the same price and so the supply of contracts is a fungible component of the futures markets that's not well understood I don't think on the Hill and we've been trying to educate people that way.

One of the things again as we've mentioned from the Chief Economist's office is we have been tracking open interest in particular with the eye on the fact that if open interest stops going up and prices continue up, that might be a sign that we're in a bubble situation or that we're in a position where there's no longer liquidity being added into the markets and that we're all bidding up the current supply. So in

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the crude oil market in particular we've seen what we think is healthy growth in the open interest. Some of the other markets like I said in the agricultural commodities we still have record open interest. But we continue to monitor those levels on a day-to-day, week-to-week basis to see if we find inflection points or we might see that the open interest stops going up and prices continue on that there might be evidence for overreaction or some sort of bubble behavior in the markets.

We have anecdotal evidence, we don't have a strong set of research here but we're working on that this week actually, that commodity index traders actually reduce conditional volatility. Not to go into too much of the econometrics of it, but put in the time series of commodity index trading and the series of volatility and prices into a model that looks at the predicted volatility and then we did the simple exercise of dummying out the times when index traders are rolling from the near-month contract into the next near-month contract and it

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turns out based on the parameters of those types of models that there is a dampening actually of volatility in many markets based on index trading. The final bullet point in the statement there would be that it looks like they're providing some liquidity to the market, they're buying when other people wouldn't necessarily be there, they're providing selling opportunities to people who want to get in or out of the market during the roll period. We have engaged with people on Wall Street and around the world to find out of that's true and we have anecdotal evidence that people do defer purchase or sale opportunities and we have actually seen individual traders taking the antiroll positions trying to margin out a little bit of profit and taking positions opposite to the rolling of the commodity index traders. You've maybe seen graphs like this. I pulled this off our commitment of trader report last week just to plot it out and you can see like in Chicago Board of Trade wheat almost 50 percent of the open interest is held by the commodity index traders.

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We see that there are a number of markets like hogs and the live cattle market where they are almost half of the market as well. So this is the basis of much of our analysis in looking at the cross-section of the level of index trading and price changes and if you notice, some of the highest, the hogs and the cattle market for instance, the index trading even though it's the greatest there, those are markets with some of the weakest prices. The counterargument to this obviously could be that the prices would even be lower had these index traders not been in the market but from that point on is where we step off and say we can look at the simple correlation or we can then step in to look at some more statistical evidence on the grains or causality looking at the dynamics of who's buying each day and who's selling each day with the prices that are changing on those days.

Beyond index trading we also look at other types of speculators primarily in the ag markets. We look at managed-money traders

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otherwise know by their street names as hedge funds. We recall group hedge funds is the general term perhaps, but they include CPO, CTAs, as well. We can segment out floor brokers and traders to look at their trading behavior and other nonreporting traders among noncommercial sets. So this is the breakdown of the noncommercial categories within our public commitment of trader reports. Most noncommercial traders are actually spread traders and that comes out in our weekly reports as well so they're long in September for instance and short the December contract so most of the noncommercials despite their increased participation in our market are taking spread positions and taking a position on the curvature of the term structure. We can also do the same analysis among these speculators and ask the same question if they have an overall effect in their position changes and price changes are they related to price changes in the marketplace. I just wanted to point out that I updated this I guess over the weekend again for different net

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speculative positions, one of the things in crude oil that we've been tracking for a long time, the long-term crude oil average is about 4 percent long among noncommercial traders and actually last week it's down to 2 percent so there has been a little bit of a dip. Then you can see a nice breakdown that looks like gold has by far the most speculative activity, sugar, cocoa, coffee and some of the other ag products haven't changed appreciably and if you look at the change from February to July in fact most of those speculative positions are down and so you could do the same analysis with our publicly available data each week, but I just wanted to highlight that as the prices have weakened here over the last 6 months it's not nearly as attractive for speculators to be into agricultural products.

As to other speculators what do we find? Some of the correlations between managed money or hedge funds in this case have been positive and have been seemingly persistently positive at least for this year for the last 9 months. Then the

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question becomes is that positive correlation with price changes actually due to causation. Again it's not an easy thing to determine whether someone's causing the price changes, but we put in statistical models looking for whether these position changes are leading price changes in any way, we don't find much evidence. Once again in the ag markets we are still working on that particular project as a part of our Interagency Task Force but I wanted to point out that we are doing this, we're actively engaged each week doing new specifications of various combinations of different types of traders looking at open interest in the near term, the near term plus the next month, the full slate of open interest, and every combination thereof.

Related to Eric's talk I think the other thing we've engaged with is whether there is any herding in our markets. We have a working paper where we had a version of this done last fall and we're working on updating that where we look at 32 different markets and the propensity for these

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particular traders to trade on one side with the expectation again that if all the speculators are buying or all the speculators are selling that we should be looking at that imbalance that there's not a fifty-fifty split for instance in the number of buyers and sellers in the marketplace. One of the things that we have found regularly among hedge funds is actually countercyclical, that we do see some evidence of herding among hedge funds but it's almost always on the other side of the market so when prices are going up we see an increase in the herding behavior of hedge funds on the sell side and as prices are dropping see these hedge funds tending to herd on the buy side. With herding metrics there is no clear-cut guidance of what's a herd and what's not, but the basic metric we're using is the propensity of how many of these traders are on one side or another of the market. So we are engaged there and we're working on updating some of that for like I said a broad cross-section of agriculture and energy products as well.

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You've seen these again earlier this morning but I wanted to reiterate that this is one of the difficulties I think of determining statistical analysis when you look at this as just the corn market again. The corn market going up through the beginning of March this year and you can see the challenges we face. The top line is the commodity index traders in the blue, the green line is the managed money or hedge funds, and the red line is the price change. You see very little change in the structure of the participants in the marketplace while prices are really changing dramatically. So as an econometrician or as a statistician or someone who tries to uncover what's going on in the market, you can use your eye test which is nonspecific where you look at it and it looks like not much is going on in the net positions of any one of these groups or traders. So this is the picture for corn, a similar position for wheat. We look at the healthy mix or what we think is a healthy mix of different types of traders and we don't see dramatic changes in

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the composition of traders within the market even as positions or as prices are changing dramatically.

Where does that leave us? For most of the analysis we've done to date is that there is strong worldwide demand for most of the commodities are leading to higher prices. There is little evidence at least in the crude market that groups are systematically leading to higher prices. There's the conclusion in our interim report on crude. There might be some evidence of commodity index traders' positions actually reducing volatility in some of these markets but we continue to engage our data, try to enhance our data, and try to look at multiple ways of assessing whether something is eluding our view.

I wanted to wrap up by saying we have plans for further study. We continue to look at these issues. One of the issues outstanding is whether open interest and prices actually respond to buying or selling pressure. I mentioned earlier that we think that the addition of new

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open interest provides some litmus test for health of the market, that there's liquidity being provided, that there are enough people out there writing contracts and that we're not all just bidding up a fixed amount of contracts in our market, but we don't really have a good grasp of whether there's a good stable relationship there or how the historic levels of interest pricing, open interest, and price changes might be happening.

The second point is looking at the interaction between futures and options markets. This has come out of our work where we've seen open interest for instance in crude oil going up for most of 2008 but most open interest increases come from the options market. So we do think that something is happening clearly between the tradeoff between using futures or options in trading strategies and in fact during the most recent run-up in crude for instance we've seen most of the open interest, in fact almost all of the open interest, is coming from options

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positions rather than actual new futures contracts. So that's something we continue to look at.

The other bullet point is to look at the commodity index trading within ag markets and non-ag markets. We continue to try to apply some of these statistical techniques to multiple different markets to try to get an assessment of that the status quo is on markets that maybe aren't moving up too much in price so we can get a normative view of what the market looks like when there are no price changes to compare those results with markets where prices are going up a lot. We also anticipating hoping to have special call data available for the crude oil market so we can add to the preliminary report that the Interagency Task Force has brought out. And I think as to the bottom bullet my office is more interested in the basic science. We classify traders by the type that they self- report. Are they commercial, noncommercial? Are they manufacturers or producers? Are they swap

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dealers? But what we've noticed is that within the set of these particular classifications there is a variety of different trading strategies so we've gone back to some of our basic data and said are the CFTC classifications useful? How well do they correlate with what you would expect a particular group of traders to be trading at? And are there alternative ways to try to break down the types of traders in our market that would provide more insight or better insight into what's going on with price changes? With that we'll end.

MR. DUNN: Thank you very much, Jeff. Julie, if you will give us the background on some of the experiences with particular markets at the CME.

MS. WINKLER: Thank you. I realize we're in the final stretch and you have to listen to two economists in a row so I'm going to keep this brief.

When Commissioner Dunn was in Chicago in June, one of his questions certainly to us was we know what's going on in the agricultural markets,

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but what is going on in some of these other commodity markets and is this something that you guys have been looking at? Certainly it is. CME Group has taken the education effort on the Hill very seriously and with the broader marketplace and realizing the futures industry is a difficult thing for people to understand it's really up to us as experts to help with that education process and part of that is understanding the differences and some of the fundamental factors that are impacting both our markets and other commodities so we're just going to go through a couple of quick examples today on that.

This is a graph of some of the events that have been impacting corn prices just since June 2006. Since 2000, world corn production has just met or exceeded use two times over this time period. The U.S. corn-to-stocks ratio is now at 13 percent. The 10-year average ratio for that is about 22 percent which really demonstrates the declining supply in the U.S. of corn. A lot more of that is certainly being used for ethanol.

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Ethanol production is expected to consumer over 30 percent of the U.S. corn crop in 2008, so over 4 billion bushels. And certainly we've all seen this spring the severe flooding that took place across the U.S. and this is really the cause for a lot of these price increases in that circled portion of the graph both the price spikes and declines. In general, historical monthly volatilities for corn in 2008 have been averaging over 30 percent and this is nearly double what the long- term historical averages have been for that product.

We've mentioned it a number of times today, but certainly the weak U.S. dollar we believe has been a key driver across commodities. When we look at our corn, beans, and soybean products, that impact just from January through July 1, 2008, has been 20 percent. We looked at the same thing for crude oil prices and we're talking about a 23-percent impact. So it certainly is something that has been significant.

Jeff had shown this a little bit

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earlier, but just so that people can understand, these key commodity indices, the Goldman Sachs Commodity Index and also the Down Jones AIG, both of these indices have very different constructions and while the number is debated over how much is indexed to these indexes, right now the number that we've heard is somewhere over $150 billion. What you see with the GSCI index is certainly a much higher concentration in the energy market and over 77 percent of that index is currently composed of energy products and 40 percent of that is crude. The other thing to point out is the returns that these indices have had year to date. The year-to-date return through the second quarter for GSCI has been 23.9 percent compared with the year-date-return for the S&P 500 has been negative 16 percent, for the Dow Jones AIG index, again the returns have been over 26 percent. So it's only natural that we're going to be seeing investors move toward commodities when that is where there are positive returns.

What we wanted to look at was some of

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the prices in commodity markets where there's little or maybe no index participation or speculative participation in those markets so we've got a few examples here and I'll show graphs of all of these trying to look at other unrelated markets and in the case of rough rice we do have a futures market but in general what has been the price performance of these markets given the fundamental factors going on in their markets and the fact that these index funds or hedge funds do not have an ability except going into the cash market to gain exposure to these commodities.

If we look at the rough rice market, there certainly has been some significant price increases in this product. This is an example of a product that is not part of either of the key commodity indices but there is an active rice futures market that's traded at the Chicago Board of Trade and we've got average daily volume of about 2,000 contracts and that volume is up over 38 percent just in 2008 and open interest is about 15,000 contracts. So again it's a product that's

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heavily traded electronically and therefore has global access through the CME Globex platform. The dramatic price increases that you see here starting out at more the September timeframe of $11 per hundred weight we see this increase all the way to over $24 in April 2008 and then we see this price retreating that's happened as some of these export tariffs in some of these major rice-producing countries have been lifted and the market is anticipating further lifting of those restrictions. To date the rice market has been up about 17 percent since the beginning of January but as you can see most of that is declining.

When we look at in this case the North American hot rolled coil market, you definitely see some very different and interesting price charts here of what happens in terms of world steel but also I think it speaks to the growing world demand in that these commodities are part of a larger global marketplace and as China, India, and other countries in Asia have continued to build their industries, a lot of these core

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components and inputs to those prices have also seen dramatic increases. The weak dollar obviously with the exports that go on in this marketplace have also certainly fueled a lot of these price increases and now we're starting to see some excess production causing some of these price declines in recent months. So since the beginning of January we've seen over a 100-percent price increase in the HRC markets.

We thought one other thing that would be interesting to look at would be freight rates so what we've done here is taken the Baltic Exchange Panamax Index and the Baltic Exchange publishes a series of indexes on freight costs across various global markets and those are based on prices from international shipping brokers. So this index in particular is on vessels that are capable of fitting through the locks of the Panama Canal and are used for dry bulk shipping. This index can speak more to the demand for shipping capacity versus the supply of the dry bulk. Obviously it's not easy to quickly create more cargo ships to

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carry this type of cargo and it ships so many different types of commodities so it really does become a leading economic indicator that many in the marketplace look at for what the role of future commodity prices are going to be.

Lastly, we looked at hay prices. Again, much related to the other commodity products that we see in the United States, if you're giving more land to corn and soybeans it likely is coming at the expense of some other commodity and in this case it has been hay. There have been a lot of disappointing yields that have taken place that are causing a lot of these price increases and also a lot of differences in wealth throughout different regions, some places that have seen a lot of rain and others that haven't seen much at all and so for this market even since the beginning of January we've seen a 25-percent increase in prices.

In summary, I think very much like Jeff had spoken of earlier, there are fundamental factors that are impacting these commodity prices

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and in the case of the commodities looked at in this presentation, it's not the presence of the index funds that is necessarily driving these prices higher, those fundamental supply-and-demand factors are really at work and certainly we believe that the dollar and the weak dollar has had a significant impact on prices as well across many commodities and for us making sure that we're keeping open and transparent markets is key because these commodity markets are not just U.S. markets, they're global markets, they're 24-hour markets and it is important that we continue to monitor them closely and provide them as a risk-management tool for the marketplace. Thank you.

MR. DUNN: Thank you very much, Julie. I will now open it up for questions or comments from the Ag Advisory Committee. Yes, Roger?

MR. CRYAN: Mr. Harris said that index trading seems to reduce volatility and I would ask if another way of saying that is that it blunts market signals so that there is just less reaction

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to fundamentals. I think that may be a price-discovery undermining explanation for why there would be less volatility associated with some of that trading. I also want to comment on the bubble discussion. It's a very interesting discussion. Central banks have enormous resources and one of the big things they focus on is just that and they still screw it up. So I really think that as far as the CFTC is concerned given that you really are not fundamentally in the job of regulating underlying cash prices and given how difficult it is to do that it makes an awful lot more sense to just focus on a structure for the futures market that tends to avoid bubbles in futures by making sure things are transparent and that the effective linkages to the cash markets are there and to do all the things that we're talking about to address the more immediate problems and I think those would address the bubbles to the extent that there are bubbles in futures markets independently of cash markets, and go for it. Thank you.

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MR. DUNN: Are there other questions or comments? Are there any from the floor? Fellow Commissioners? Commissioner Sommers? Commissioner Chilton?

MR. CHILTON: I have one for Mr. Harris, one or maybe two, Jeff. I think you've explained it to me before but it might be helpful for other people, when we talk about speculators essentially netting, people say they're long, no, actually they're short too. That's what we've said, that they're essentially netting, that they're not really long in the market?

MR. HARRIS: I think the one table I did show actually showed the net and most speculative groups are net long. Crude oil like I said was about 4 percent net long down to about 2 percent. In most markets there was I guess one on the chart that I showed that was net short, but in most markets they are net long.

MR. CHILTON: That's not in the same month. Right? That's all of their positions?

MR. HARRIS: Right.

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MR. CHILTON: So they're probably short in the spot month. Right?

MR. HARRIS: Depends. The way we define it, we can look at for instance the crude oil market I know for sure they're long dramatically in the near-term market because the rolling behavior of index funds creates this tremendous long position in the near-term contract and you look out in the curve and in crude that means that they're almost entirely short into 8-year contracts.

MR. CHILTON: Is it generally accepted though that they are buying and holding in these markets for the long-term?

MR. HARRIS: For the group of index traders, yes, that is exactly what -- statement is they don't try to time the market, they don't try to analyze the markets, they just simply want exposure so they're just buying and holding. But people who are holding obviously in the futures market requires them to roll.

MR. CHILTON: People have made this

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argument that they get out of the market and so it doesn't matter and that has a downward effect, but if they're immediately rolling it like you're saying then maybe it's just -- I think everybody knows they're just going to roll so there could potentially be the theory goes keeping prices up.

MR. HARRIS: I think we acknowledge the fact that if there are additional flows every month and they continue to roll every month that that additional flow would create upward pressure on markets. In fact, I didn't get into the details of what we did there, but we've looked at that roll period and we have determined -- actually we can discern that there is a price effect. The interesting part of that price effect is either good or bad in the sense that there tends to be a couple pennies price impact up but also perhaps a little bit of pressure downward as they roll out of the contract they're getting out of. I guess the point is we can discern some effects of their trading in the marketplace on the index fund level but it's on the order of cents

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and it's not necessarily $2 in corn.

MR. CHILTON: Thank you. On the 1805, we still don't have the information about the commercials and noncommercials and that's a big group that you would want to look at for this task force study. Right?

MR. HARRIS: Yes. I would say that the caveat with the task force study to date is an interim report on crude oil. Not to get too much into the nuances, but swap dealers are what we're analyzing in the speculative groups in crude oil. In the energy market space, swap dealers handle both index trading and over-the-counter trading and so what we don't know is for instance the independent effect of the index trading so that most of the index trading information that we have directly is only from the 12 ag markets where we track that closely.

MR. CHILTON: Is it fair to say we don't know for sure yet the impact because we don't have the information?

MR. HARRIS: I would think that's why we

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called this particular report an interim report. We would love to have the full time series. The information I would caution is that we're doing a one-time call and it's not clear we're going to have a good 5 years of time series data to analyze on index fund trading in crude oil.

MR. CHILTON: A lot of times I think people are just looking for a quick nugget and particularly the media are trying to figure out like what is the quick story. I want to make sure that people understand that when we put out the interim report it was a snapshot, we didn't have all the information that we're still getting, and what the report said, the bottom line is, that fundamentals you think are the major factors? They're not necessarily the only factors, there's a devalued dollar, there's potentially speculators, we haven't ruled it out because we don't have all the information yet. And I think people focused and sort of glomed onto the first part of it without reading further into the report. Do you think that's maybe a fair

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assessment?

MR. HARRIS: I think to the extent that we do identify index traders in the ag products and we haven't seen dramatic effects of index trading there, there's obviously some of that evidence that's not directly related to crude oil markets. But, yes, we were trying to be very careful in the report to make sure it was an interim report, that we were saying that we have this call out for more data in the crude oil market in particular and the state of the market today of the evidence that we have to date would suggest that the claims that speculators are driving the prices is not necessarily supported with what we know today.

MR. CHILTON: But you don't have the information yet so it's not not supported. Right? I don't have the information and so I can't tell you that it's that?

MR. HARRIS: Right. We do have information on hedge funds so that was one group that we did have.

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MR. CHILTON: But on the noncommercial speculators we don't have the information so we're not blaming them.

MR. HARRIS: On index traders in particular we don't have them identified specifically.

MR. CHILTON: And we're not going to blame them because we don't have the information yet. Right?

MR. HARRIS: I guess.

MR. CHILTON: Thank you.

MR. DUNN: Mr. Lukken?

MR. LUKKEN: Just a follow-up question, Jeff. You have all futures markets data though. Right? We have all the positions of the swap dealers. What we're asking for in this special call is off-exchange trading. Correct? But you did your analysis on all the futures market data which the CFTC has complete transparency over.

MR. HARRIS: The point is I guess we did all the analysis and that we couldn't identify index traders but we can identify the total

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trading by swap dealers. To the extent that swap dealers handle two different types of markets, over-the-trading and index trading, that's lumped together in our analysis. That as a group we couldn't find as evidence, so, right. One of the things I would point out and this is in response to the Ag Advisory Committee specifically is that 2 years ago when we put the supplemental reports on index trading in ag products it was in response to the idea that there were these new traders in the marketplace and we wanted to know what they were doing. One of the things that has come out of the swap dealer special call and the things that we have recognized is that it's a big advantage to us to have swap dealers in our markets because they are conveying a large degree of the information that they do in the over-the-counter markets to the organized exchanges so that we have now more than ever information about what's going on over the counter especially in the energy markets where the over-the-counter market has been large and in existence

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for decades well in advance of these active participants transferring their risk into the organized exchanges.

MR. DUNN: Thank you, Walt. Jeff, a follow-up on the interim report. The interim report says that the CIT does not lead the movement in the marketplace but comes in actually afterwards. Does this then provide a ceiling or a floor if you will that reduces the downward pressure?

MR. HARRIS: Just to be clear again, we didn't actually identify commodity index trading specifically, but the swap dealer order flow actually turned out to be responding to price changes and it turned out that the net order flow of swap dealers is actually the opposite, it's actually selling into price increases so when prices go up they're actually responding in the opposite direction. So that is the result that we got in the interim for the task force.

The other thing we pointed out in there is despite the fact that we have this very large

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influx of index trading in crude oil, the net positions for most of 2008 in the swap-dealer category has been short so that highlights I think the problems of viewing swap dealers as a proxy for index trading, it's not a very good proxy at all, but it also gives us an indication that the over-the- counter market has been short the crude oil market and in dramatic size because for all the long positions we have reported on index trading, they're more than offset for most of 2008 by short positions in the over-the-counter market.

MR. DUNN: One other thing. In the interim report you do touch on the devaluation of the dollar and Julie made mention that they felt at the CME that that had a significant impact. What was the finding of the interim study?

MR. HARRIS: We didn't quantify that. We've done our own regressions and we found regressions on the order of 20 percent or something of the price increase a few months ago and it was related to the exchange rate. The task force I think took the approach of pointing out

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that these are global markets and that global markets trade and flows respond to exchange rates and so in that regard we're on the wrong end of the exchange rate this year.

MR. DUNN: Do you have a follow up?

MR. CHILTON: Yes, I would like to ask Mr. Lehman what's your view of the impact of the devalued dollar on these markets?

MR. LEHMAN: We had it in the slides, Commissioner Chilton, that against the U.S. dollar index it's about 23 percent I think for crude oil, 20 percent for corn, beans, and wheat since 2006, and the U.S. dollar index, the Canadian dollar, the British pound, euro, Japanese yen, Swedish krona, if you look at it against individual currencies, if you look at it against the euro, it's like 37 percent. So it depends on what currency you're looking at. USDA I think has an ag export index that's in the Purdue study and I'm anxious to take a look at that and see what they actually found. The numbers they found are much bigger. They found about a 40-percent impact in

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the Purdue study using this USDA index but I'm not sure what currencies are in that index.

MR. CHILTON: Thank you.

MR. DUNN: Jeff, I think this Ag Advisory Group is anxiously awaiting phase two when you get to the ag commodities in that report and we appreciate you and what the Interagency Task Force is doing and getting our hands on some good empirical data is something that we've longed for for a long time.

I'd like to finish up here asking those members of the Advisory Committee who are still here whether or not you think there is an agricultural commodity bubble and do you have a concern about that. Tom, unfortunately you're the first one I'm looking at, so if I could start with you and go around the table.

MR. COYLE: I'll answer by saying I'm not sure. I can see the level in the case of wheat of new participation but I can also see the level of fundamental inputs. So if I look for corn for instance and I see that we've got

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ethanol, I see that we've got growth around the world from better diets, better consumption, and the U.S. Dollar, it would seem to me that it's somewhat justified. I can say the same thing with soybeans and biofuels and the shift in acres that we keep seeing. So I wish I had a better answer, but I'm not sure. I like the fact that you're looking at the data and I think the data tells you something. We continue to see when we look at the data that we get with the breakout from the supplemental report who's in the market and I think that tells the story. So if you match that up with the fundamental data I think it can lead to a certain conclusion. I had never thought of the idea that you could look at the fact that a market is rallying and then the open interest is not changing which may give you a sense that maybe a bubble does exist, so I may look at that in the future myself.

MR. CRYAN: I agree with Tom that a lot of the fundamentals seem to be shifting and I've written that I think we're at a new plateau on

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commodity prices. As you were saying, the growth in the economies around the world, we've had a very successful decade of growth all over the world and people are eating better and there is just demand for all kinds of raw materials. So there is no question that commodities are up and are bound to stay up and that that would certainly explain the success of commodity investing in recent years. Whether they're going to continue to rise is another question. I think it's certainly possible that we've been in a bubble for the futures for some of these commodities in the last 6 months and that that may be over or not. So it's a question mark but there is no question that the days of $2 corn are over but where it's going to be a year from now I don't know.

MR. DUNN: Jack?

MR. GAINE: I'm particularly unqualified inside the Beltway to speculate on the matter, Mister Commissioner, but if anybody has inside information I'd be delighted to trade on it if they give it to me.

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MR. DUNN: Mr. Green?

MR. GREEN: I feel the same way. It's hard though to deny that at the present value of the dollar that there are not fundamentals on the demand side that are justifying some of the speculative activity, so beyond that I wouldn't venture to guess how far. These people have done an immense amount of examination of that and tried to correlate things and I'd say that they've done a good job of knowledge of what we can find. You have to remember that the market does more than just one thing. One of the things the market is telling farmers and the agricultural community is what should be done in the future, how much planting should be done, et cetera. So it's more than just price discovery. It's also giving signals to the producers of what the next steps are and I think that's an important thing to note here, that as we have drawn stocks in the world marketplace, one of the things it's telling farmers is grow more stuff and so that's a fundamental part of what the market is saying

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today.

MR. DUNN: This is your first meeting here, I believe. Welcome. Leroy?

MR. WATSON: Thank you. I would say that from the derivation of are we in a bubble situation related to market exuberance or irrational application of fundamentals that that would be, no, this is not about Pet Rocks or Dutch tulips. More fundamentally I think the issue of liquidity and probably we ought to be talking about it, what we probably are seeing here is a commodity-driven inflationary move not only in the United States but probably across the world and we probably need to be looking more at what has been happening with all of the reserves of U.S. dollars that have been held by governments around the world and now are they being released in order to prop up prices for both food and energy and other sorts of commodities. So we may be very well seeing a flood of dollars onto the market not only related to domestic issues done by the Federal Reserve but the implicit branch banking which has

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been done by places like China and other countries that have accumulated large dollar reserves and where they might be applying right now or how those might be applying back and forth.

I'm also extremely grateful that Mr. Harris in his slides made the clear statement that there is no evidence of Granger causality so I can pretty be assured that I can walk out of here not in shackles.

MR. DUNN: As the representative of the Grange we appreciate that. Mr. Wellman? And we don't have a soybean causality here.

MR. WELLMAN: It's been mentioned already that the stocks -- ratios on wheat, corn, and soybeans are at record or near record lows. I would agree that the fundamentals point toward these higher prices. Many grain producers have invested funds for years to try to develop markets and to create more demand for our products which in return would create higher prices and I think we've done some of that and I think that's happened.

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My concern is that as we have done that, now we look at the higher prices and everybody is looking at how do we fix this problem. I'm not exactly sure that it's a problem for producers if that is an accurate price discovery. Then the second concern I have is is there still a functional, affordable tool for producers to use for risk management and I think that's a serious question that we don't have an answer to yet. Recently there has not been. But what can be done to correct that situation I think there have been good steps by the CFTC to address those issues. And I think another point that has been brought up here is all the information isn't out there yet and it isn't accessible to everyone who needs the information. So I believe that further disclosure of who the market participants are and what their positions are is very important so we can move forward. Thank you.

MR. DUNN: Mr. Nicosia?

MR. NICOSIA: You asked the question are we in a speculative bubble. I would say, no,

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we're probably not in a speculative bubble but there is no doubt that we are under the bullish influences of prices that would be higher than they otherwise would be. What people have said is correct, the fundamentals have warranted higher prices in almost all commodities whether they've been part of index and/or not. Those ones that are not part of indexes are absolutely influenced by the pull of acres away from those that are so there is a causality between them and not just the index funds.

However, when you look at it, again I think all the work that's been done may be good but it's looking at the wrong thing. It's not a question of whether index money causes higher prices, it is whether the index money has caused prices to be higher than they would have been, so it's not just the flow of the money that causes that. It was an interesting thing to hear about the swap dealers being short in the oil market and if they didn't have that billion barrels on the long side to offset those swap dealer shorts,

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where would the swap dealers have found buyers and if so at what price level if we removed all that index money? And the argument that you go through convergence in he oil market, we've just dropped $25 and then convergence is going to take the place just the same at $120 as it was going to be at $140 because the market, when you look at it the level of balance at delivery time, it's moving through and it's setting off a benchmark price and not anything else, again just the bullish influences causing oil prices to be higher.

When you look at where we were 5 to 10 years ago on the CRB and you look at where we are today and you track that against the total amount of money that has come into our marketplace from index funds, they go straight up together, as the money has grown so has the CRB gone straight up with it. Sure, some of that is explainable by the demand factors that we've talked about here, but at the same time if you ask USDA or any other statistical analysis to run regressions based on fundamentals they will get higher prices but not

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nearly as high as the prices that we've just seen in any of the commodities.

So again what I would really encourage the economists to do and Jeff to do is to go back and look at what the incremental increase is, not whether the total increase or whether any of the increase as far as the money flow causes invokes the incremental difference between the two. So I think that there's no doubt that we're having bullish influences but, no, I would not call it a bubble.

MR. DUNN: Thank you, Joe. Are there any final remarks from my fellow Commissioners? Commissioner Sommers?

MS. SOMMERS: I just want to say thank you to everybody. This has been a great discussion today and I've learned a lot about some of these different issues and I appreciate you being here.

MR. DUNN: Commissioner Chilton?

MR. CHILTON: I just want to thank everybody for being here and being patient and

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thank you for the presentations, and particularly want to thank your staff and Mr. Juzenas for his great bubble presentation. Thank you, sir.

MR. DUNN: Commissioner Lukken?

MR. LUKKEN: I just want to echo the Commissioners and thank everybody for participating today, and Mike's staff and Mike for leading a great meeting here today. It was very educational for me in particular on the issue of convergence, just to express the urgency of trying to resolve this issue as quickly as we can. The CME seems to be on top of this and we'll continue to work with you to make sure that this happens quickly and in a timeframe that people can use in order to hedge these products. So thank you very much, Mike.

MR. DUNN: Thank you, Mister Chairman. I'd like to announce that we will hold the record open for a 2-week period for anybody on the Commission or the folks who are listening or here in the audience here today who want to put in any remarks, a little too late for the question side,

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that you might have. I too want to thank all of the participants for what I consider an excellent meeting and I also appreciate all of you who I have worked with since the April roundtable meeting. I know you people have put a lot of time in it. The agricultural exchanges, I truly appreciate your responsiveness to the Commission and to the industry as a whole to try to grapple with some of these problems that are really having a great of upheaval in the countryside.

I want to thank the CFTC staff, both the staff here who worked so hard in making sure that the accommodations are here and that everything worked so well as it did. I don't think we had any microphone problems today except when Commissioner Lukken had to keep turning my mike on for me. That's one of his side jobs that he has. But also a special thanks to the Chicago staff and the Division of Marketing Oversight who I have worked to closely with in getting information in a period of time when they're doing a lot of extra work and with the 1805 requests that you've heard

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about they have been just absolutely tremendous in working not only with me but with the exchanges and with constituency groups who have come in to talk to them. I know that the Farm Bureau and others have gone there and I've gotten great and glowing reports on how helpful that staff has been.

Finally I'd like to thank my fellow Commissioners for their support in putting this together and having what I think is a very successful meeting, but I do think that we are under a very, very short window of opportunity to get ahold of this issue of convergence to ensure that the marketplace works orderly and we can get back to relying on the futures and options markets for price discovery and risk mitigation. Thank you all.

(Whereupon, at 3:50 p.m., the PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

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