



Commodity Markets Council  
1300 L St., N.W. Suite 1020  
Washington, DC 20005  
Tel 202-842-0400  
Fax 202-789-7223  
www.cmcmarkets.org

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Michael Otten  
Counsel to the Chairman  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

Dear Mr. Otten:

On behalf of the Commodity Markets Council (CMC), I would like to thank you for the opportunity to participate on the Commission's Subcommittee on Convergence.

CMC is a trade association bringing together commodity exchanges with their industry counterparts. The activities of our members represent the complete spectrum of commercial uses all futures markets including agriculture, energy, metals, and financials. Specifically, our industry member firms are regular users of the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Kansas City Board of Trade, Minneapolis Grain Exchange, and New York Mercantile Exchange.

CMC is uniquely positioned to provide the consensus views of commercial end-users of derivatives exchanges and the exchange markets. The financial well-being of the industry depends on the continued competitiveness of US futures exchanges and the smooth functioning of the risk management instruments traded on all regulated exchanges. As such, I look forward to working with you and my fellow Subcommittee members on additional improvements.

In response to your questions, CMC submits our initial comments below. Please note that we combined our responses to Question 2 and 3 into one answer.

***1. In your opinion, which agricultural commodity (or commodities) has experienced the most pronounced convergence problem and why?***

In the energy and cotton markets, CMC is unaware of any pronounced convergence problems at this time. Convergence in CBOT Soybeans and Corn diminished slightly over the last few years, but the problem does not rise to the level seen in the CBOT Wheat markets.

Despite the convergence issues, volume in CBOT grain futures contracts continues to grow. This is strong evidence of market acceptance. It is also evidence of health and utility of the products – the exchange is still the preferred, liquid venue.

CMC remains unconvinced index fund hedge exemptions previously granted by the Commission are having any long-term influence on the price of commodities traded in US markets. To the contrary, all indications thus far from studies done on market performance suggest that index funds are not responsible for high or low commodity prices.

Without empirical evidence supporting the assertion index fund exemptions are distorting market prices, we encourage the Commission to continue its practical approach of placing a moratorium on any new exemption requests, reviewing and studying existing exemptions and their market impact,

and providing the markets with greater information transparency through the development of more detailed reporting of non-traditional hedgers' positions in commodities markets.

2. *What are possible remedies to the convergence problem(s) that you identified in Question 1?*
3. *What are the pros and cons of adopting the remedies that you suggested in Question 2 and for whom?*

CMC is an ardent advocate for any remedy to a convergence problem, in any market, must maintain balance among market participants. Changes in contract design should not leave one group of users at a significant disadvantage against another. In the CBOT Wheat market, all modifications discussed within the industry offer advantages and disadvantages. Bearing in mind the importance of balance, CMC remains unable to recommend a single modification or series of modifications that we regard as a complete solution.

#### **New Delivery Locations**

CMC supports the CBOT's addition of delivery locations, but believes the industry needs more time to evaluate the effectiveness of these changes. Generally, CMC believes exchanges should continually look for viable delivery points. Convergence will be improved, even if only slightly, when more volume is available for delivery at locations that are economically practical.

#### **Increased Storage Charges**

Higher storage charges may marginally improve convergence but would not likely resolve a severe convergence problem. Disadvantages include the possibility of excessively high storage rates disrupting the ability of elevators not included in the delivery mechanism to compete with those within it. If storage rates are set high enough, bidding grain into the delivery mechanism could become a source of consumption of grain, altering normal commercial flows.

#### **Demand Certificates or "Compelled Loadout"**

It is not good policy to recreate the current problem the short hedger has with punitive contract terms imposed in the inverse on the long hedger. A true demand certificate (or compelled loadout) is not a workable tool. It would drastically shift the balance of the current contract in favor of the short hedger at the expense of the long hedger.

#### **Side-by-Side Trading Of Physical-Delivery and Cash-Settled Index Contracts**

CMC recommends further discussion and evaluation of side-by-side trading of physically-delivered and cash-settled index contracts. Trading these contracts side-by-side could give traders greater arbitrage opportunities and increase market acceptance of cash-settled index contracts.

#### **OTC Basis Swaps**

Cleared OTC basis and calendar swaps are similar products which may be important in providing for short hedgers concerned about basis exposure a means to offset that exposure in the OTC market. CMC strongly supports CME's recently approved swaps proposal. National basis swaps may merit consideration for the same reason.

#### **Serial Futures**

In the current wheat markets, the March futures contract attempts to represent the January cash price. With futures contracts expiring every month instead of a few times a year, cash and futures convergence should improve. This proposal could disrupt the roll of

index funds, but with sufficient notice, they will be able to modify their hedging strategies.

Ultimately, the exchange is responsible for maintenance of its contracts, and CMC continues to have strong confidence in the exchange's ability and determination to work with its various constituencies to develop a solution or series of solutions.

We appreciate the opportunity to work with you as you take steps to improve commodity markets for all market users.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael D. Walter". The signature is fluid and cursive, with a prominent initial "M".

MICHAEL D. WALTER  
President

cc: Andrei Kirilenko  
Shirley Wilson