National Grain and Feed Association

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The Honorable Debbie Stabenow	The Honorable Thad Cochran
Chairwoman, Committee on	Ranking Member, Committee on
Agriculture, Nutrition & Forestry	Agriculture, Nutrition & Forestry
U.S. Senate	U.S. Senate
Washington, D.C. 20510	Washington, D.C. 20510

Dear Chairwoman Stabenow and Ranking Member Cochran:

The National Grain and Feed Association (NGFA) is very appreciative of the opportunity to provide input to the committee regarding issues to be considered during reauthorization of the Commodity Futures Trading Commission (CFTC). Our preliminary thoughts and recommendations appear below.

Customer Protection

Companies and individuals that were customers of MF Global Inc.'s futures business continue to deal with the aftermath of parent company MF Global Holdings' bankruptcy and the subsequent liquidation of the futures commission merchant (FCM). Most customers so far have received distributions from the trustee of about 89% of their funds – funds that were supposed to have been segregated and protected. We are hopeful that the remaining 11% of customer funds will be returned to customers, but there is still no assurance of their being made whole. Consequently, we believe that a primary focus of the reauthorization process must continue to be enhancing customer protections with the twin goals of preventing similar occurrences in the future and providing protection to customers in the event of a future FCM insolvency.

Reforms to U.S. Bankruptcy Code – The NGFA believes strongly that reforms to the U.S. bankruptcy code are essential to preserving and codifying customers' rights and protecting customers' assets in the event of future FCM insolvencies. To that end, the NGFA recommends the following statutory changes:

- The bankruptcy code should state clearly that customers always are first in line for distribution of funds, ahead of creditors, and that all proprietary assets including those of affiliates must go to customers first. This would provide clarity to regulators and to the courts in terms of prioritization of claims, an area in which precedent has not been established.

- Part 190 regulations of the CFTC should be incorporated into Subchapter IV of Chapter 7 of the bankruptcy code to harmonize the statutes and remove any interpretative inconsistencies. Generally, the bankruptcy code provides a limited description of the liquidation process of a commodity futures broker. The Commodity Exchange Act and bankruptcy regulations drafted by the CFTC provide much greater and more detailed guidance for the liquidation of a commodity broker or FCM.

- Under current bankruptcy law, powers of a trustee to recover customer funds are limited under so-called "safe harbor" provisions unless actual intent to defraud customers/creditors can be shown. The NGFA strongly recommends that any transaction involving the misappropriation of an FCM's customer property should not be protected under safe harbor provisions, regardless of the intent behind a fund transfer.

- To strengthen commodity customer protection, the CFTC should have a specifically identifiable role in the liquidation of an FCM. The CFTC should have the authority to appoint its own trustee to represent exclusively the interests of commodities customers. In a case like MF Global, in which over 95% of the assets and accounts affected were those of commodities customers, we believe the CFTC's authority should be strengthened and clarified.

- In the MF Global situation, creditor committees were established under the MF Global Holdings Chapter 7 proceeding, but there was no statutory provision under the SIPA liquidation of the MF Global Inc. FCM for establishment of customer committees. The NGFA recommends that the bankruptcy code expressly should authorize the establishment of customer committees to represent FCM customer interests.

We are aware that other organizations also are working toward specific recommendations for changes in the bankruptcy code that will enhance customer protections. The NGFA intends to work cooperatively with such groups to develop consensus reforms that can be moved by Congress expeditiously.

Insurance or Liquidity Protection for Commodity Futures Customers – The NGFA recommends that insurance or insurance-like products should be available to commodity futures customers. Customers and their lenders who finance hedging in commodity markets must have confidence that their funds are safe and protected. We are aware that the Futures Industry Association currently is finalizing a comprehensive analysis of potential products and costs, and we consider it prudent to see that study before recommending a particular structure. We also are aware that the Commodity Customer Coalition recently has completed an online survey of commodity futures customers to gauge interest and input on insurance products. This data also could prove useful in crafting appropriate solutions.

Since the NGFA began working on potential customer protection enhancements early last year, we have been very mindful that most new customer protections will come at a cost – and that, eventually, the cost most likely will be borne by the customer. For that reason, we have taken a deliberate approach to recommending specific new protections, and we respectfully suggest that Congress and all stakeholders adopt a similarly cautious view. On the bright side, since the

collapse of MF Global, significant new operational safeguards that should enhance the safety of customer funds have been put in place on commodity accounts. These enhancements, already in place, should help mitigate costs of insurance or other customer protection efforts.

It is important to note that the solution on insurance to protect customers is not necessarily a government solution or a legislated solution. It may be that some form of privately provided product is more cost-effective and more appropriate. The NGFA has taken no formal view at this point on any specific structure. We advise strongly that data from the above-referenced efforts should be carefully considered prior to making such an important decision.

Fully Segregated Customer Accounts/Pilot Program – Currently, the Commodity Exchange Act and U.S. bankruptcy code provide for *pro rata* distribution of all customer property that was held by a failed futures commission merchant (FCM). After eighteen months, former customers of MF Global have received back only 89% of their supposedly safe segregated funds through distributions from the trustee, with no assurance that they ever will receive 100% of their funds. This is unacceptable, including to lenders who finance hedging of customers who use exchange-traded futures and options. Restoring the confidence not only of customers, but also of their lenders, is critically important. To that end, the NGFA has recommended establishment of an *optional* fully-segregated account structure to be offered and utilized by mutual agreement of customers and their FCMs.

Creation of a fully-segregated account structure necessarily would result in some additional costs that likely would be borne by customers that utilize such accounts. It is likely that some customers would opt for the added protections despite extra costs, while other customers might be unwilling or unable to bear those extra costs. For that reason, we propose that the full-segregation option be utilized on a voluntary basis at the agreement of an FCM and its individual customers.

We suggest that a pilot program involving a limited number of commodity futures customers, FCMs, and lenders, along with regulators, would be a useful means of testing the mechanics and identifying the viability and true costs of a full-segregation structure. The NGFA does not recommend legislative action to establish a full-segregation account structure, but support for a pilot to test concepts would be constructive.

High Frequency Trading

Increasingly, traditional customers of agricultural futures markets are concerned about the impacts of high-frequency trading. Especially immediately preceding and following release of important crop and stocks reports by the U.S. Department of Agriculture, we believe high-frequency trading has caused and magnified volatile market swings. These disruptions have led many hedgers who use futures markets to avoid futures markets at such times. Concerns also have been raised about the impact of high-frequency trading on order fills for traditional hedgers.

It may be that regulatory action by the CFTC is the more appropriate way to address high-frequency trading issues. Should high-frequency traders be required to register with the Commission? Should such traders be required to post margin even if no positions are held at

day's end? Are there other measures that should be considered to help ensure that high-frequency trading does not disrupt futures markets in ways that render them less useful to hedgers managing business risk? The NGFA suggests that these kinds of questions should be part of the conversation during reauthorization.

CFTC's Customer Protection Proposal

The CFTC currently is evaluating comments submitted with regard to a proposed rule issued November 14, 2012, that seeks to bolster futures customer protections – a laudable goal. However, two very troublesome provisions in the proposed rule would have the effect of dramatically changing the way business has been conducted in futures markets for decades. The NGFA believes the two provisions would have the perverse impacts of significantly ***increasing*** futures customer risk in the event of future FCM failures.

One provision concerns the timing of when an FCM is required to take a capital charge for undermargined accounts. The other would change the manner and timing of FCMs' calculation of residual interest for futures accounts. The NGFA believes that either provision, if contained in a final rule as originally proposed, would have the chilling effect of forcing FCMs to require pre-margining of hedge accounts – and perhaps also intra-day margining. The practical end result would be that futures customers would be required to send much more money to their FCMs in anticipation of market moves that might never happen. Some customers likely would simply exit futures markets in favor of lower-cost risk management alternatives. Clearly, the proposals would put a much greater amount of customer funds at risk when the next FCM fails. If this rule had been in place when MF Global failed, perhaps twice as much customer money would have been missing and a correspondingly larger amount still would not be returned to customers.

Discussions with the Commission have not resolved these issues to date. It is difficult to understand the reason for such a dramatic change in the CFTC's stance after decades of consistent interpretation. However, if the Commission believes its hands are tied due to provisions of the Commodity Exchange Act, Congressional action may be needed to clarify the matter.

We look forward to working with the committee on these and other matters during the reauthorization process. Please do not hesitate to contact the NGFA with any questions.

Sincerely,

Diana Klemme, Chair
Risk Management Committee

John Heck, Chair
Finance & Administration Committee