Testimony of
Thomas J. Erickson, VP Government & Industry Affairs
Bunge North America, Inc.

On behalf of
Commodity Markets Council

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Chairwoman Stabenow, Ranking Member Roberts and Members of the Committee: thank you for convening this hearing to review the implementation of the Dodd-Frank Act. My name is Tom Erickson, Vice President for Government and Industry Affairs for Bunge North America, and I am testifying today on behalf of the Commodity Markets Council ("CMC"). I am also a former Commissioner of the Commodity Future Trading Commission ("CFTC") and am pleased to be here today to share the views of CMC.

CMC is a trade association that brings together commodity exchanges and their industry counterparts. The activities of CMC members include the complete spectrum of commercial end users of all futures markets including energy and agriculture. Specifically, our industry member firms are regular users of the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Kansas City Board of Trade, Minneapolis Grain Exchange and the New York Mercantile Exchange. CMC is well positioned to provide the consensus views of commercial end users of derivatives. Our comments represent the collective view of CMC's members.

Bunge is a member of CMC. Our role as a company in short, is as a middleman – a buffer – in a dynamic marketplace where every farmer wants the highest price possible for his or her production, every consumer wants the lowest price for food and energy, and where competition is intense to serve both the producers and consumer ends of a 7 billion member marketplace. Companies like Bunge exist to intermediate and manage production to meet demand needs. Most agricultural commodities are produced seasonally yet consumed continuously, whereas energy commodities are produced continuously and consumed seasonally. We manage that flow of physical commodity and dynamically hedge it, allowing us to offer higher prices to producers and lower prices to consumers: a key point, because interference with the hedging mechanism introduces risk that must be priced into the chain, negatively affecting both ends and everything between.

Commodity markets and their various forms of regulation have developed over 150 years. CMC and its members support well-regulated markets, and while the financial crisis of 2008 had nothing to do with commodity markets, we recognize the need for the Dodd-Frank Act and support its goals. CMC supports regulation of open and transparent markets free of fraud and manipulation. In turn, that regulation should be efficient and reasonable, not overly prescriptive and complex, as missing the right balance generates market inefficiencies and costs that affect the consumers of energy and agricultural commodities, as well as those finished food, energy and consumer products that derive from the underlying commodities. That being said, the regulatory implementation process has continued to be a source of great concern for CMC members and other commodity market participants. While we commend the CFTC for their rulemaking efforts, the sequencing of the final rules as well as the complexity of the content has stalled industry's ability to fully understand and begin the compliance process.

The CFTC has been working aggressively to implement the regulations required under the Dodd-Frank Act. On this two-year anniversary of the passage of Dodd-Frank, we are at a point in the regulatory process where it is possible to begin to assess the requirements and the benefits and challenges they present. We are not at a point of clarity, however. The law itself is multifaceted and the regulatory implementation process has exponentially increased the complexity to a daunting level. We need to move ahead with a stronger focus on ensuring that neither market integrity nor market function is compromised. Seemingly every rulemaking intended to provide clarity brings with it confusion. The length and complexity of many of the final rules combined with short compliance timelines are making the compliance process nearly impossible for many of our members. For example, the two rules defining "Swap" and "Swap Dealer" totaled nearly 1,200 pages of final rule text.

Commercial participants in the physical commodity market have always fallen squarely inside the CFTC's regulatory authority. Our members are concerned that the implementation of the Dodd Frank has become an exercise of tightening the screws on the already regulated commercial market and its participants at the expense of establishing a regime to regulate markets the CFTC has never previously regulated.

Below is a brief summary of some of the regulations, both proposed and final, that are causes of concern for CMC members.

Issues of Concern

Definition of "Hedging"
Under Dodd-Frank, Congress for the first time created a statutory definition of bona fide hedge transactions. (Section 4a(c)). Yet, it appears the Commission has chosen to use this as mere guidance. Their narrower view of the bona fide hedging rule is most acutely felt in the proposed rules to limit bona fide hedging to five specific transactions called enumerated hedges. The CFTC rules fail to adequately provide what the law clearly states.

To date, we now have at least five separate definitions of hedging – position limits, end-user exemption, swap dealer, major swap participant and Volcker rule. This creates confusion for the industry.

Inter-Affiliate Swap Transactions
Many firms use a business model through which the number of affiliates within the corporate group that enter into derivatives transactions with third-party dealer counterparties is limited. Rather than having each corporate subsidiary individually transact with dealer counterparties, a single or limited number of corporate entities face dealers. These entities then allocate transactions to those affiliates seeking to mitigate the underlying risk. This allocation is done by way of “inter-affiliate swaps” – swaps between commonly controlled entities. This structure allows the company to more effectively manage corporate risk on an enterprise basis and to secure better pricing on derivatives transactions. The transactions are largely “bookkeeping” in nature, play no role in larger market price discovery, and do not create systemic risk. The CFTC has recognized this and made accommodations in some final rules. We certainly recognize and appreciate this endeavor. We understand, however, that regulators are considering whether to subject inter-affiliate swaps to the same set of requirements that apply to swaps with external dealer counterparties – possibly including margin, clearing, real-time reporting, and other requirements. Doing so would be a mistake and would impose substantial costs on the economy, on consumers and on end-users. There has been no clarity provided by the CFTC on how these transactions will ultimately be viewed. For international companies that span multiple jurisdictions, it will become very complicated if different jurisdictions ask for intra-group transactions to be handled in different ways.

Recording and Recordkeeping Requirements
In a proposed rule described only as conforming amendments, the CFTC has proposed imposing expensive and unprecedented recording and recordkeeping requirements across a broad swath of the cash grain marketplace. The proposal would require all members of a designated contract market (DCM) such as the Chicago Board of Trade, Kansas City Board of Trade, or Minneapolis Grain Exchange to capture and maintain extensive records of all communications related to a commodity transaction. Even country elevators operated by those member firms would be required to record telephone conversations with producers when discussing cash sales or contracts, not to mention cash contract conversations by affiliates in countries around the globe where the technologies envisioned may not even exist.

The proposal presents steep technology and cost challenges to small-town country elevators who deal extensively with producers on the phone when arranging cash sales and forward cash contracts. It also raises competitive concerns because it could create a bifurcated cash marketplace by imposing the requirement on country elevators who are owned by members of DCMs but not on other companies. Who will the producer call to sell his cash grain: the elevator that has to inform him they are recording his phone calls, or the elevator a few miles down the road that is not required to do so?

The CMC believes the proposal may prompt companies who are members of a DCM to reconsider their membership in order to avoid the regulatory burden. This result exposes not only the discriminatory application of the rule, but also highlights the fundamental question within the industry about the proposed rule. Dodd-Frank was intended to address concerns about systemic risks created by an unregulated over-the-counter market. The CFTC's proposed recording and recordkeeping rule does not address any of those concerns. Rather it seems targeted at the cash market and the real commercial trade, neither of which were responsible for the financial crisis and both of which suffered because of that crisis.

Globally, this could affect the utility of the U.S. futures markets to the hedging of global production. Moreover, it could affect the competitive position of U.S. farmers. To the extent competitors and foreign exchange markets can avoid this regulation of the cash market, it will advantage them in the competition for global market share.

Reporting of Daily Positions
Requiring market participants to report daily on their cash market positions as they relate to hedges held in the market is not justified by any corresponding benefit. The physical commodity business is global, operating 24/7. Matching cash and hedge books in this environment will, in practice, lack precision. Many of our U.S. futures markets have become global benchmarks. The obligation imbedded in the rule is parochial and may undermine the U.S. futures markets' value in a global marketplace.

Position Aggregation
The Final Rule on Position Limits for Futures and Swaps required aggregation of positions between commonly owned entities based solely on ownership and deleted a proposed exemption from aggregation for non-financial entities with a lack of justification. CMC along with the Working Group of Commercial Energy Firms submitted a petition to request changes to the final rule. We appreciate the CFTC's response to the petition, which advanced a proposed rule to include control over trading as a factor in determining aggregation. The proposal, however, uses ownership as its foundation and limits the relief to ownership interests up to a level of 50 percent. While these proposed changes are constructive, it would still materially impair the operation of the commercial markets and incur significant costs. Control of trading activity should be the determining factor for aggregation, not the ownership interest because the purpose of the aggregation provision is to ensure that position limits are not circumvented by multiple entities trading in concert. If there is not common control, trading in concert should not occur.

Failure to revise the proposed rule will force commercial firms to evaluate their corporate structure for reasons unrelated to real world economics. For those who must aggregate, there will be a cost of designing, testing and implementing systems to aggregate and ensure compliance intraday, as well as additional unquantifiable costs of future potential violations, in the unintended area of antitrust.

Swap Dealers
Possibly the most important rule regulators have passed in the derivatives area is a joint rule between the CFTC and SEC which defines who will be regulated as a "Swap Dealer." Reading the Treasury proposal for financial regulatory reform and the testimony from various Administration officials leading up to the passage of Dodd-Frank, it is abundantly clear that the idea was that *"All OTC derivatives dealers and all other firms whose activities in those markets*

create large exposures to counterparties should be subject to a robust and appropriate regime of prudential supervision and regulation. " ["Financial Regulatory Reform: A New Foundation", US Dept of Treasury]. Testimony from CFTC Chairman Gensler before this Committee in 2009 reflected the belief that this dealer regulation should be targeted to a few firms:

> …There are "**about 15 or 20 (dealers) around the globe that make up 99 percent of the market for over-the-counter derivatives**." He referred to those that should be regulated as the "derivative dealers that are making markets. We all know their names. I will not name them here, but the large financial institutions."

According to the final rule, the CFTC estimates 125 entities will be required to register, and CMC believes that number to be much higher.

Among those being wrongly captured by the expansive definition are many commercial firms who operate diversified businesses in the energy and agricultural sector due to their role in both the buy and sell side of the physical markets. These firms transact in swaps ancillary to their physical business, but many would be caught in the final definition of Swap Dealer. As entities that have no experience being subject to regulatory capital requirements, this is certain to drive many of them from markets where they are lowering their own costs, as well as those of their customers. There will be a drying up of liquidity, particularly in smaller, more esoteric markets where the profit margins are not there for the large banks and the only entities willing to trade are those with physical market risk. By regulating these entities as Swap Dealers, the cost of hedging in the commercial space will go up. The question is how much? And at what regulatory benefit?

A Physical Commodity Market Conundrum: The Impact of Unknown Definitions

Throughout the implementation of Dodd-Frank the CMC has been a consistent critic of the sequencing of the rules relating to swaps. The reason is simple: commercial companies who buy and sell physical commodities and their products never envisioned that their use of derivatives might compel registration as a swap dealer. Therefore, definitions were the most important element of the rulemaking process to begin assessing registration risk or opportunity. In fact, even with last week's final rule defining a swap, the physical commodity market still has no final clarity. The Commission has asked for additional comment on "trade options" and "volumetric optionality." Further, the end-user community does not yet know the extent to which capital or margin requirements will attach to their activities or how to correlate swap transactions into futures equivalents. In the end, knowing the mechanics and requirements of registration are less important than knowing the underlying definitions at the outset.

For these reasons, CMC members are struggling. Commercial agriculture and energy firms are only now able to begin to assess what activities may trigger registration and the consequent regulatory requirements. Therefore, the industry will need relief from the 60-day compliance deadline.

In sum, the CMC understands and respects the difficult challenge the Commission has had in implementing Dodd-Frank. That said, CMC believes the Commission's rules relating to physical commodity markets and their primary commercial users routinely fail to adequately consider impacts to the underlying functions of the markets – price discovery and risk management. The objective should not be to discourage hedging, but rather to create a market and regulatory environment that maintains market integrity while promoting the economic benefits of risk management. We look forward to continuing our work with the Commission in this endeavor.

Thank you for this opportunity to testify. I look forward to your questions.