

Commodity Futures Trading Commission
Agricultural Advisory Committee

Agriculture and the Dodd-Frank Bill

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Disclaimers

- Dodd-Frank fundamentally restructures US financial regulation, requiring a host of rulemaking actions by multiple agencies
 - The CFTC has 30 interdivisional teams working on various rulemaking proposals
 - The rulemaking efforts are at a very early stage, so any information about the rulemaking efforts is preliminary and subject to change
- The opinions expressed in this presentation do not represent the official views of the Commission, its staff, or even, necessarily, myself

Overview of the Dodd-Frank Bill

Provisions Relating to Agriculture

- Some things remain unchanged under the Dodd-Frank bill
 - Forward contracts are still excluded from CFTC jurisdiction and forward contracting transactions can continue as before, with no change
 - The rules for exchange-traded futures, and options on futures, will not change (contracts for future delivery and options on such contracts are excluded from the “swaps” definition)

Overview of Dodd-Frank Bill

Agriculture Provisions, Continued

- On the other hand, the bill defines “swaps” very broadly and implements major changes for agricultural commodity swaps
 - The broad definition of “swap” in § 721 of the bill covers not only traditional swaps (including “agricultural swaps” and “commodity swaps”), but also “**options of any kind**” (other than options on futures, as just noted)
 - Under § 723 of the bill, “any swap in an agricultural commodity” will be prohibited **when Dodd-Frank takes effect**, unless traded pursuant to an exemption under § 4(c) of the Commodity Exchange Act
 - Section 4(c) exemptions already in effect when Dodd-Frank was enacted are grandfathered until the Commission decides otherwise

Overview of Dodd-Frank Bill

Effective Date

- The Dodd-Frank provisions generally take effect no earlier than 360 days after July 22, 2010
- Some provisions are on a shorter timeline, e.g.
 - Speculative position limits for “exempt commodities,” due in 180 days
 - Speculative position limits for “agricultural commodities,” due in 270 days

Overview of Dodd-Frank Bill

Agriculture Provisions, Continued

- Under § 723 of Dodd-Frank, four types of ongoing agricultural swap transactions will be affected:
 1. OTC agricultural commodity swaps, currently trading under the Part 35 rules, are grandfathered and may continue for now;
 - It is anticipated, however, that post-Dodd-Frank regulatory reforms will substantially revise, or possibly completely replace, Part 35
 2. Exchange-cleared OTC agricultural swaps already trading pursuant to § 4(c) exemptive orders (*e.g.*, CBOT corn and soybean basis swaps and calendar swaps) are also grandfathered and may continue for now;
 - However, any new cleared OTC agricultural swaps would require a new § 4(c) order

Overview of Dodd-Frank Bill

Agriculture Provisions, Continued

3. Agricultural trade options (now defined as swaps) in the **enumerated commodities** (wheat, corn, etc.), trading under the § 32.13(g) **exemption** from the agricultural trade option (ATO) rules, are **not** covered by a § 4(c) order, are **not** grandfathered, and will become illegal, absent a § 4(c) exemption, when Dodd-Frank takes effect
 - Note: the basic § 32.13 ATO rules are effectively moot because no one is currently registered as an agricultural trade option merchant under those rules
4. ATOs in **non-enumerated** agricultural commodities (e.g., coffee, sugar, cocoa), trading under the basic trade option exemption (§ 32.4), are likewise **not** grandfathered and will also become illegal, absent a § 4(c) exemption, when Dodd-Frank takes effect

Agricultural Swaps Rules

- The Agricultural Swaps Rulemaking Team plans to recommend that the Commission propose rules for trading agricultural swaps
 - Any such proposed rules would likely be published in late November
- The rules would be subject to the applicable conditions for a § 4(c) exemption, thus:
 - Agricultural swaps must be found to be "consistent with the public interest;" and
 - **Like all OTC swaps, OTC agricultural swaps could only be bought by "eligible contract participants" (ECPs)**
 - Swaps listed on a designated contract market (DCM) would not be subject to this restriction

Only ECPs Could Buy OTC Swaps

- “Eligible contract participant” (ECP) generally includes large institutional or commercial traders (see § 1a(12) of the Act)
- Agricultural producers seeking to hedge risk might fit within either of two ECP categories:
 - “A corporation, partnership, proprietorship, organization, trust, or other entity” that
 - Has a net worth exceeding \$1 million, and
 - Enters the transaction for hedging purposes
 - An individual with amounts invested on a discretionary basis, the aggregate of which is in excess of \$10 million, or \$5 million if he or she enters the transaction for hedging purposes

Agricultural Swaps Policy Issue

- By requiring a § 4(c) exemption, granted by the CFTC, as a precondition to allowing agricultural swaps to trade, Congress seems to imply that farmers and other persons trading agricultural swaps should be subject to some kind of additional, special protections beyond those available to persons trading swaps in other physical commodities
- This gives rise to a major policy issue for the Commission:

Agricultural Swaps Policy, Continued

- Should OTC agricultural swaps be subject to any special conditions or protections, beyond those that would apply to OTC swaps in other physical commodities, and, if so, what should those protections be?
 - More restrictions on those who can buy?
 - More requirements for those who can sell?
 - Some other type of restrictions or conditions?
- Alternatively, should OTC agricultural swaps be allowed to trade subject to the same terms and conditions as OTC swaps in other physical commodities?

Agricultural Swaps Policy, Continued

- These questions will be addressed in the proposed rules we plan to recommend to the Commission for publication in November
- We hope the AAC members will submit comments on any proposed rules
- In the meantime, if committee members have any preliminary thoughts or suggestions, there's a special agricultural swaps web page on cftc.gov where you can submit comments
- **See the last slide for directions on submitting preliminary comments**

Agricultural Commodity Definition

- The Dodd-Frank agricultural swap provisions apply to “any swap in an agricultural commodity (**as defined by the...Commission**)”
- Therefore, the Commission must also, for the first time ever, publish a definition of the term, “agricultural commodity”
- The Agricultural Swaps Team is also drafting the proposed “agricultural commodity” definition

Agricultural Commodity Definition, Timeline

- The agricultural commodity definition must be final within 180 days after enactment of Dodd-Frank (therefore, proposed rules must be published around mid-October)
- The tight deadline is because Dodd-Frank gives the Commission just 180 days to issue speculative position limits for “exempt commodities”
 - However, under the Act (§ 1a(14)), an “exempt commodity” is a commodity that is neither an “excluded commodity” nor an “agricultural commodity”
 - Since only “excluded commodity” is defined in the Act, the Commission must define “agricultural commodity” in order to establish the boundaries of the universe of exempt commodities to which the position limits will apply

Agricultural Commodity Definition, Terms

- The definition will generally seek to draw a line between:
 - Products that are derived from living organisms and are used for human food, animal feed or natural fiber (covered by the definition); and
 - Plant or animal-based industrial products, such as butanol or denatured ethanol (outside the definition)
- Please be on the lookout for the proposed agricultural commodity definition rules, some time around mid-October, and give us your comments

Speculative Position Limits for Agricultural Commodities

- Dodd-Frank also requires the Commission to issue speculative position limits for agricultural commodities
- These position limits will also apply the “agricultural commodity” definition
- However, as noted above, these limits are on a longer timeline than the limits for “exempt commodities”
 - Agricultural commodity speculative position limits must be issued within 270 days of Dodd-Frank’s enactment
- Again, please be on the lookout for the proposed ag spec limit rules and give us your comments

Accessing the Ag Swaps Web Page

- To submit preliminary comments now (before proposed rules are published), the link to the CFTC's Ag Swaps web page is:
http://www.cftc.gov/LawRegulation/OTCDerivatives/OTC_19_AgSwaps.html
- Alternatively, you can get there by:
 - Go to the CFTC website, cftc.gov
 - Go to the drop down menu under “Law and Regulation”
 - Click on “OTC Derivatives”
 - Under “Rule Writing Process,” click on “See List of Rulemakings”
 - Scroll down the list and click on item XIX, “Ag Swaps”