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May 6, 2013

The Honorable Debbie Stabenow
Chairwoman
Senate Committee on Agriculture, Nutrition, and Forestry
328-A Russell Senate Office Building
Washington, DC 20510

The Honorable Thad Cochran
Ranking Member
Senate Committee on Agriculture, Nutrition, and Forestry
328-A Russell Senate Office Building
Washington, DC 20510

Dear Chairwoman Stabenow and Ranking Member Cochran,

The American Cotton Shippers Association ("ACSA") appreciates the opportunity to submit the following comments for consideration by the Senate Agriculture Committee ("Committee") in response to your letter dated March 7, 2013 requesting input on issues related to reauthorization that ACSA would like the Committee to consider during the upcoming process to reauthorize the Commodity Futures Trading Commission ("CFTC"). ACSA is comprised of Merchants, Primary Buyers and Mill Service Agents with members located throughout the cotton belt from coast to coast. ACSA's member firms handle over 80% of the U.S. cotton sold in domestic and foreign markets. The significant market involvement of ACSA members requires that the Association take an active part in promoting the increased use of cotton in the U.S. and throughout the world; establishing with other cotton trade organizations national and international standards for trade; collaborating with producer organizations throughout the cotton belt in formulating farm programs; and cooperating with government agencies in the administration of such programs.

Protection of Customer Collateral

Given recent events surrounding the collapse of two Futures Commission Merchants ("FCMs") and the mismanagement and disappearance of customer collateral, we request that the Committee consider the various market driven proposals to further protect these assets, as they are vital to our member companies and all other market participants seeking to manage risk in the derivatives markets.

Customer Protection Proposal

ACSA commends the efforts of the National Futures Association ("NFA") and the CFTC to improve certain aspects of how customer collateral is treated, although there is one particular issue raised by the CFTC that has caused opposition among our members. Specifically, ACSA strongly believes that the proposed requirement that FCMs maintain a residual amount sufficient to cover on a constant basis the aggregate of customer margin deficits could create liquidity issues and increase costs for FCMs and end-users. Such a decrease in liquidity could be substantial and limit the number and type of transactions FCMs clear, the number of customers they service, and the amount of financing they provide. The proposal would require FCMs to fund their customer segregated and secured accounts with proprietary assets in excess of the aggregated margin deficiencies of all its clients, at a minimum, prior to any margin payments being made to a clearinghouse. The proposal also appears to require executing FCMs to collect collateral for give-ups so that customer positions are fully margined in the event a clearing FCM rejects a trade.

If the proposed residual interest provision were to be finalized, FCMs may be forced to take steps such as over-margining clients, requiring clients to pre-fund their margin requirements, imposing punitive interest rate charges on margin deficit balances, and introducing intra-day margin calls. Such steps would dramatically increase the cost of using futures markets and may force many end-users to decrease or discontinue hedging and risk management practices, which is the reason these markets were created.

The industry has made significant improvements and has little more ability for change under the current regulatory regime. We encourage the Committee and the Congress overall to fully examine the variety of suggested legislative changes that have been offered by the market to create new options for collateral protection for FCMs who choose to offer them and customers who choose to use them. Included in this list is an option for full, individual collateral segregation in an individual custody account (likely requires a change to the Bankruptcy Code) as well as an insurance option. ACSA notes that there is an ongoing study into the cost of various insurance options being conducted, and we look forward to its findings.

End-User Concerns

The CFTC has been working diligently since the passage of Dodd-Frank in July of 2010 and should be commended for the progress they have made thus far. ACSA recognized and supported the need for reform in the over-the-counter (OTC) swaps market and believes that Dodd-Frank provided a foundation for an effective overhaul of this important risk-management market. However, there are various issues that have arisen as part of the implementation process which we believe the Committee should revisit going forward, as they have the ability to drastically affect liquidity in these vital risk-management tools, driving up the costs of energy and agricultural products, and leaving companies more exposed to price volatility, of which decreased liquidity is a contributing factor.

Part 1.35 Recordkeeping Requirements

A significant and concerning expansion of current data requirements beyond the scope of Dodd-Frank is related to recordkeeping requirements in Part 1 of Commission regulations. In accordance with Dodd-Frank, the CFTC expanded the futures recordkeeping requirements that existed for certain markets participants to swaps. However, they also significantly expanded the written requirements, as well as created a new requirement to record oral conversations. Compliance costs have already been incredibly substantial now that compliance with the written requirements is mandatory and will only increase once compliance with the oral recording requirement becomes mandatory later this year. Again, the market is searching for a reason and measurable benefit for all of this new information that must be maintained and archived in a particular way. In addition, the rule is vague as to which communications must be retained, so in an abundance of caution, market participants are effectively saving every email, news article, or any other piece of information that might "lead to the execution of a transaction" and soon will have to begin recording every phone call that might "lead to the execution of a transaction." Also, the application of the requirements to members of an exchange seems to have no regulatory rationale and only serves as a disincentive to be a member, something the Commission should encourage. Finally, there has been no sufficient cost benefit analysis to justify the cost figures by CFTC staff. Compliance costs are exponentially higher than they estimate, and in some cases the technology is not even available to market participants. Requests for clarification have not yet been answered, and ACSA will be submitting a written request soon in a continued effort to clarify and hopefully narrow the scope of what must be retained and, therefore, reduce compliance cost.

Real-Time Reporting

Under the real-time reporting rule, end-users have a longer time in which to report trades with other end-users. However, trades that involve a swap dealer or major swap participant must be reported in a much shorter time after execution. Because the rule requires trades between a non-dealer and a swap dealer be reported within the dealer's time limit, swap dealers and major swap participants have limited time to lay off risk before the trade is made public. While the delay may be sufficient for liquid markets, they are not sufficient for illiquid markets and time frames. When a dealer has to report such illiquid trades to the market quickly and the dealer may not be able to lay off the risk of that trade in the prescribed time, the dealer is taking a risk and will charge the counterparty (here, the commercial end-user) for that increased risk if they are willing to execute the trade at all. This increased cost and possible inability to trade in illiquid markets will hurt commercial end-users.

Inter-Affiliate Transactions

Inter-affiliate trades are subject to recordkeeping requirements under Part 45, requiring that the records of inter-affiliate swaps are "full, complete, and systematic." We view this requirement as burdensome and providing very little benefit relative to the increased cost to our members. The information that the Commission is seeking is available through the visibility of market-facing swaps, as they are largely identical. Additionally, these inter-affiliate and market-facing trades are for purposes of hedging or mitigating commercial risk and are documented pursuant to inter-affiliate agreement such that both parties must make payments and deliveries specified, although the transactions may be settled by an intercompany transfer or allocation. The internal documentation is done as necessary for internal purposes, but may not contain all information required or in the format required under Part 45.

With respect to mandatory clearing and the end-user exception, we appreciate the Commission's recent relief providing an exemption for swaps between commonly owned affiliates. The Commission still needs to clarify that swaps entered into by a centralized hedge function of a commercial entity are eligible for the end-user clearing exception when hedging on behalf of the commercial company, whether or not the entity housing the hedge function for the company is by definition a financial entity.

Bona Fide Hedging

Congress provided a definition of a bona fide hedge within Dodd-Frank that the CFTC has unnecessarily narrowed, including related to anticipatory hedging, and has created at least five different definitions in various rules of what constitutes a bona fide hedge. This is nonsensical and creates unnecessary confusion, while disruptive to legitimate risk mitigation practices. We are committed to working with Congress to set clearer direction on bonafide hedges so that transactions that limit economic risks are viewed as bona fide hedges by the CFTC.

In conclusion, the swap reforms in Dodd-Frank were not necessary because of problems in physical commodity markets. Commercial end-users had no role in creating the financial crisis. Given the increased compliance burden that now exists for end-users, ACSA looks forward to working with the Committee as this important process continues and appreciates the invitation to submit comments.

Sincerely,

William E. May
President & CEO