Statement of
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NUTRITION & FORESTRY
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Chairwoman Stabenow, Ranking Member Roberts, and members of the Committee, thank you for the invitation to testify today on the role of the over-the-counter (OTC) derivatives market in helping farmer-owned cooperatives and their members manage commodity price risks.

I am Chuck Conner, President and Chief Executive Officer of the National Council of Farmer Cooperatives (NCFC). NCFC represents the nearly 3,000 farmer-owned cooperatives across the country whose members include a majority of our nation's more than 2 million farmers.

I appreciate the opportunity to discuss some of the key issues we see in implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. I also wish to thank Sens. Amy Klobuchar and John Thune for their service as co-chairs of the Congressional Farmer Cooperative Caucus.

Farmer cooperatives – businesses owned, governed and controlled by farmers and ranchers – are an important part of the success of American agriculture. They are a proven tool to help individual family farmers and ranchers through the ups and downs of weather, commodity markets, and technological change. Through their cooperatives, producers are able to improve their income from the marketplace, manage risk, and strengthen their bargaining power, allowing individual producers to compete globally in a way that would be impossible to replicate as individual producers.

In particular, by providing price risk management tools to their farmer-owners, farmer cooperatives help mitigate commercial risk in the production, processing and selling of a broad range of agricultural and food products. America's farmers and ranchers must continue to have access to new and innovative risk management products that enable them to feed, clothe and provide fuel to consumers here at home and around the world. Any regulatory action that could jeopardize access to these tools should be avoided.

As such, we ask that the implementation of the Dodd-Frank Act preserve risk management tools for farmers and their cooperatives. We were please to hear your remarks, Chairwoman Stabenow, and those of Sen. Klobuchar at the March 3rd hearing on Dodd-Frank implementation. You echoed our concern that farmer co-ops will face additional regulations and encouraged the Commodity Futures Trading Commission (CFTC) to ensure the relationship between farmers

and co-ops will be preserved, allowing farmers to have affordable access to risk management tools.

During the rulemaking process, NCFC has advocated for the following:

- Treat agricultural cooperatives as end users because they aggregate the commercial risk of individual farmer-members and are currently treated as such by the CFTC;
- Exclude agricultural cooperatives and Farm Credit System lenders from the definition of a swap dealer; and
- Consider aggregate costs associated with the new regulations and the impact on the agriculture sector.

Cooperatives' Use of the OTC Market

As processors and handlers of commodities and suppliers of farm inputs, farmer cooperatives are commercial end-users of the futures exchanges as well as the OTC derivatives markets. Due to market volatility in recent years, cooperatives are increasingly using OTC products to better manage their exposure by customizing their hedges. This practice increases the effectiveness of risk mitigation and reduces costs to the cooperatives and their farmer-owners.

OTC derivatives are not just used for risk management at the cooperative level, however. They also give the cooperative the ability to provide customized products to farmers and ranchers to help them better manage their risk and returns. Much like a supply cooperative leverages the purchasing power of many individual producers, or a marketing cooperative pools the production volume of hundreds or thousands of growers, a cooperative can aggregate its owner-members' small volume hedges or forward contracts. It can then offset that risk with a futures contract or by entering into another customized hedge via the swap markets.

Some examples include:

- Local grain cooperatives offer farmers a minimum price for future delivery of a specific volume of grain. The local elevator then offsets that risk by entering into a customized swap with an affiliated cooperative in a regional or federated system.

- Cooperatives facilitate hedging for dairy farmers by offering a fixed price for their milk and a swap to hedge their feed purchases.

- Cooperatives offer livestock producers customized contracts at non-exchange traded weights to better match the corresponding number of animal units they have while also reducing producers' financial exposure to daily margin calls.

- Since most individual farmers do not have the demand necessary to warrant a standard 42,000-gallon monthly NYMEX contract, individual farmers can hedge their fuel costs by entering into swaps in 1,000-gallon increments.

While our members could provide greater details on how the above programs work for those sectors, they are all similar in concept and purpose – to hedge the price risk inherent to the production and marketing of agricultural commodities.

Swaps also play a critical role in the ability of cooperatives to provide forward contracts, especially in times of volatile markets. Because commodity swaps are not currently subject to the same margin requirements as the exchanges, cooperatives can use them to free up working capital.

For example, recent movements in grain and oilseed markets have caused a considerable amount of working capital to be used to cover daily margin calls. With the pending increase in the daily price limits on exchange-traded corn futures, those requirements will likely intensify. For farmers to continue to take advantage of selling grain forward during price rallies, cooperatives have to either increase their borrowing from their lenders or look for alternative ways to manage such risk. Using the OTC market has become that alternative. As was the case during the volatile markets in 2008, swaps today allow cooperatives to free up working capital and continue to forward contract with farmers.

Implementation of the Dodd-Frank Act

NCFC believes that as the Dodd-Frank Act is implemented federal regulators must preserve the ability of cooperatives to use the OTC market to manage commercial risks while also allowing them to meet the growing demand from their member-owners for hedging products.

NCFC supports elements of the Dodd-Frank Act that bring more transparency and oversight to the OTC derivatives markets. We also recognize the complexity involved in crafting the implementing rules. Additionally, we have had a number of opportunities to express our concerns to the CFTC. The Commission has been accessible and engaged on our issues.

The uncertainty created by the "definitions" rules is NCFC's greatest concern at this time. While the CFTC has proposed regulations for swaps and swap dealers, it is unclear to us who, and therefore what transactions, will be subjected to those additional regulations. Further, some activities of cooperatives would appear to sweep them into the "swap dealer" category.

The two main issues in the proposed rule are the application of the "interpretive approach for identifying whether a person is a swap dealer," and the very low thresholds on the "de minimis exception." As such CFTC would likely capture a number of entities, including farmer cooperatives, which were never intended to be regulated as swap dealers.

Taking this a step further, some cooperatives are at risk of being designated as swap dealers due to their unique structure. For example, a federated grain or farm supply cooperative is owned by many local cooperatives which are separate business entities. Unlike a traditional corporate structure where risk can be transferred internally, the ability to transfer risk from the local level to the federated cooperative – in this case in the form of a swap – looks to be treated as an external transaction under the draft rules.

Regulating farmer cooperatives as dealers would increase requirements for posting capital and margin on swaps it uses with other dealers to offset the risk of providing risk management products and services. This requirement, combined with the cost of complying with other regulatory requirements intended for large systemically important institutions, could make providing those services to their farmer-members uneconomical. Such action would result in the unintended consequence of increasing risk in the agricultural sector.

We do not believe this is what Congress intended and we urge the committee to once again reiterate that to the CFTC. Furthermore, we do not believe that any member of the committee would want any action taken that would reduce the price and risk management options available to farmers, especially during these highly volatile economic times. Unfortunately, that may well be the consequence of the rulemaking process unless the committee makes its wishes known.

Farmer-owned cooperatives and farmers also would face increased costs and have fewer risk management options if cooperative Farm Credit System lenders are made subject to the Dodd-Frank Act's mandatory clearing requirements or are defined as swap dealers. We are urging CFTC to provide farm credit lenders with an exemption from mandatory clearing and to recognize the swaps they provide to cooperatives in conjunction with loans should not result in them falling under the definition of a swap dealer.

Thank you again for the opportunity to testify today before the Committee. Your leadership and oversight in the implementation of the Dodd-Frank Act is to be commended. We especially appreciate your role in ensuring that farmer cooperatives will continue to be able to effectively hedge commercial risk and support the viability of their members' farms and cooperatively owned facilities. I look forward to answering any questions you may have.

Thank you.