MEMO

TO: MGEX Members and Market Participants

FROM: Athena R. Elias, Associate Corporate Counsel

DATE: July 8, 2014

SUBJECT: Request for Public Comment on CFTC Notice of Proposed Rulemaking on Position Limits for Derivatives

At the end of last year, the Commodity Futures Trading Commission ("CFTC") published the Position Limits for Derivatives Notice of Proposed Rulemaking ("Position Limits NOPR") in the Federal Register.[1]

Due in significant part to industry feedback as to the potential negative impacts of the rulemaking, the CFTC has re-opened the public comment period on the proposal through **August 4, 2014, and has specifically requested comment on the setting of non-spot month limits for the three wheat contracts**. MGEX is drafting a comment letter which will be submitted by the August 4 deadline, and asks for your support in drafting and submitting additional comment letters illustrating the effects the proposed rule and the three different wheat contract limits would have on MGEX market users.[2]

MGEX is issuing this memo as a reference sheet in regards to the Position Limits NOPR and the key wheat equivalence point on which MGEX is focusing its comments, and requests that Members, market participants and any other interested parties submit their own comments to the CFTC as evidence of the various individuals and entities within the industry that would be affected by this change in non-spot position limits.

Rule Summary

The CFTC's Position Limits NOPR sets limits on speculative positions in 28 core commodity contracts and their economically equivalent futures, options and swaps contracts ("referenced contracts"). MGEX Hard Red Spring Wheat is one of the three wheat contracts included as core futures referenced contracts in the rule.

The proposed limits are divided into two categories; spot-month and non-spot month.

Spot-month position limits would initially be based on the spot month position limit levels currently in place, and later would be based on estimates of deliverable supply. Subsequent

[1] Full text of the proposed rule can be found at the following link: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-27200a.pdf

[2] Public comments can be submitted by any of the following methods: online at http://comments.cftc.gov; by mail to Secretary of the Commission, CFTC, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581; or via the Federal eRulemaking Portal at http://www.regulations.gov.

levels would be adjusted at least every two years, and would be based on the CFTC's assessment of a contract market's determination of deliverable supply. Generally, spot-month position limits levels are set at 25% of estimated deliverable supply.

Non-spot month position limits would be based on open interest and would also be adjusted at least every two years. Non-spot month position limits are set using a 10/2.5% formula, meaning 10% of the contracts first 25,000 of open interest and 2.5% thereafter. Open interest used in determining subsequent non-spot month position limits will be the larger of the prior two years annual average of the sum of futures and options open interest, cleared swaps open interest and uncleared swaps open interest on a futures equivalent basis.

The Position Limits NOPR narrows the current definition of a bona fide hedge, and also includes amendments to the current account aggregation standards. Anticipatory hedging is no longer an enumerated or standard form of bona fide hedging under the proposal, and cross hedging becomes much more difficult to use.

Key Points for Comment

Currently, all three domestic wheat contracts are treated equally as to position limits. Under the Position Limits NOPR however, the current HRSW spot-month speculative limit of 600 contracts could drop as a result of lower stocks at delivery locations in prior years. **The current non-spot month MGEX HRSW speculative limit of 12,000 contracts would decrease to just 3,300 contracts**, while the KC HRW limit would decrease to 6,500 contracts, and the CBOT SRW limits would actually increase to 16,200 contracts. **This results in widely different position limits for all three wheat contracts.**

Market Participants have long appreciated the position limit parity among the three wheat contract markets, particularly as it relates to non-spot months. Having the same limits makes cross-hedging and spread trading easy to use as a legitimate risk management tool. In the event position limits are set at different levels for each of the three wheat contracts as proposed in the Position Limits NOPR, price volatility or concentration in one contract may unduly affect the price of the others. Additionally, artificial market disruption among the three wheat contracts could occur through lack of convergence or a change in basis or carry. The value and certainty that parity presents to the marketplace has resulted in historically effective and efficient markets for all wheat contracts. Without it, inequities are introduced into the marketplace which could result in market distortion and arbitrage that bring no value in price discovery or risk mitigation.

The formulaic approach of the NOPR inhibits growth in HRSW just when activity is increasing. This approach is backwards looking, not forward thinking, and simply does not allow for growth or participation by liquidity providers in the same way they can participate in the other wheat contracts.

These comments echo the comments made at the CFTC's June 19 Staff Roundtable on the importance of maintaining equality among the three U.S. wheat markets. Regardless of the level at which these limits are set, parity should be maintained among these three markets. Different limits for the same type (but not necessarily variety) of commodity could dramatically impact the growth or potential for risk mitigating strategies between the contract markets. In the case of wheat, this is particularly critical given the nature of the three differing varieties. Having three varieties provides not only additional opportunities for market participants to reduce risk through spread trades, but also provides opportunity for hedging and risk management by commercial participants between markets in response to domestic or global economic factors.

Conclusion

The CFTC has indicated that specific examples and proposed solutions are most persuasive in public comment letters and as such, MGEX is working to incorporate detail regarding the need for continued parity of position limits among the three wheat contracts into its comment letter.[3] Specifically, that a lack of parity could significantly and negatively impact volume, liquidity and open interest in our market. Further, the proposed changes presented in the Position Limits NOPR offer no evidence there will be an improvement in the price discovery or risk mitigation processes.

MGEX requests that MGEX Members, market participants and all interested parties submit additional public comment letters to the CFTC which highlight concerns and explain the potential impact this proposed rule, if made final as it is currently written, would have on them and on the industry as a whole.

[3] The specific questions open for additional public comment can be found at the following link: http://www.cftc.gov/PressRoom/PressReleases/pr6956-14