



**Statement of Charles Conner**

**President and Chief Executive Officer  
National Council of Farmer Cooperatives**

**Testimony before the House Committee on Agriculture**

**Oversight of the Swaps and Futures Markets: Recent Events and  
Impending Regulatory Reforms**

**July 25, 2012**

Chairman Lucas, Ranking Member Peterson, and members of the committee, thank you for the invitation to testify today on the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

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.

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. The ongoing drought across much of the country, which is impacting so many producers so severely, once again illustrates the need for a multilayered risk management strategy in agriculture.

We greatly appreciate the ongoing oversight this committee has provided as the Dodd-Frank rules have been written. Your work in encouraging the Commodity Futures Trading Commission (CFTC) to ensure that the agriculture industry has affordable access to innovative risk management tools once the Act is implemented is commendable. With your continued leadership, agriculture will hopefully avoid being subject to a one size fits all type of regulation intended for Wall Street.

### **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 over-the-counter (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. 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.

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 by entering into another customized hedge via the swap markets.

### **Implementation of the Dodd-Frank Act**

NCFC supports elements of the Dodd-Frank Act that bring more transparency and oversight to the OTC derivatives markets. We also recognize the complexity in crafting rules for the implementation of Dodd-Frank that best fit cooperatives and have had a number of opportunities to express our concerns to the CFTC. With the sheer volume of rules, the challenges in clearly understanding what is contained in those regulations, and the complexity of how they will fit together, NCFC members are now turning their attention to compliance. Our members are doing their best to put into place policies and procedures, but they are finding it a challenge to understand what exactly needs to be done to address the complex regulations.

Our members also have concerns regarding how CFTC will enforce the regulations. Because the regulations will be very complex, we urge CFTC to work closely with industry to ensure clear understanding by all parties.

During the rule writing process, we have worked to ensure that the implementation of the Dodd-Frank Act preserves risk management tools for farmers and their cooperatives, and have advocated for the following:

- Treating agricultural cooperatives as end users because they aggregate the commercial risk of individual farmer-members and are currently treated as such by the CFTC;
- Excluding agricultural cooperatives from the definition of a swap dealer;
- Exempting agricultural cooperatives from mandatory clearing or margining but allowing them to perform either at their discretion; and
- Considering aggregate costs associated with the new regulations and the impact on the agriculture sector.

I am pleased to report that with the recent rulemakings, some of the uncertainty that created concern for farmer cooperatives over the past two years has been resolved. Most significant is the defining of “Swap Dealer.” CFTC provided a definition in the final “entities” rule that will allow farmer cooperatives to provide risk management services to their members and customers without the fear of having to comply with the additional regulatory requirements intended for systemically important institutions. We appreciate the work of the Commission in addressing our concerns, which resulted in significant improvements in the final rule.

While we now know farmer cooperatives will not be treated as swap dealers, there are still many unknowns as to how implementation of the rules will affect cooperatives and their farmer members. Uncertainty over ultimate costs remains an ongoing concern. As you know, agriculture is a high-volume, low-margin industry. Incremental increases in costs, whether passed on from a swap dealer or imposed directly on a cooperative, will trickle down and impact producers. Taken one rule at a time, the costs may not seem unreasonable, but to those who have to absorb or pass on the collective costs of numerous regulations, it is clearly evident those costs are significant.

For example, one “small” change in the proposed conforming amendments rule has to do with additional recording requirements. We are concerned this proposal would not only add swaps to the new recordkeeping requirements, but also extend the new requirements to cash purchase and forward cash contracts entered into by any member of a designated contract market. One NCFC member estimates that installation of recordkeeping systems in all of their facilities would cost over \$6 million dollars. In fact, the necessary investment to put in place and maintain such a system would not only greatly add to the cost of doing business, but would be an extreme compliance burden for the cash grain community (attached are the comments NCFC submitted to CFTC on this issue). We are hopeful CFTC will reconsider this requirement as it finalizes the rule in the coming months.

It is also unclear how other costs will be forced down to end users and impact their ability to hedge. 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. The drought affecting the U.S. has caused corn prices to increase over 50 percent in the last month. While this creates an opportunity for farmers to price more of their crop, (if they haven’t been impacted by the drought), it also causes additional margin calls on the production that has been priced. For farmers to continue to take advantage of selling grain forward during price rallies, cooperatives have to either increase borrowing or look for alternative ways to manage such risk, such as the OTC market. As was the case during the volatile markets in 2008, swaps allow cooperatives to

free up working capital and continue to forward contract with farmers.

As commercial end users, cooperatives often use swap dealers in utilizing the OTC market to lay off the risk of offering those forward contracts. However, the costs associated with dealers' compliance with capital, margin and other regulatory requirements are still unclear. We will have to wait to see how those costs are passed on to end users and how cost effective the OTC market remains for hedging activities.

Consistent with congressional intent, NCFC supports the CFTC's proposed rules clarifying that it "would not impose margin requirements on non-financial entities," and that "parties would be free to set initial and variation margin requirements in their discretion and any thresholds agreed upon by the parties would be permitted."

However, we are concerned the so-called "Prudential Regulators" margin proposal requires bank swap dealers to collect margin from end-users. As end users, cooperatives use swaps to hedge interest rates, foreign exchange, and energy in addition to agricultural commodities. Often, cooperatives look to their lenders to provide those swaps. Under the proposed rule requiring end users to post margin, costs to businesses will increase as more cash is tied up to maintain those hedges. The additional capital requirements will be syphoned away from activities and investment in cooperatives' primary business ventures. Furthermore, cash for margin is often borrowed from lenders through the use of credit lines. As a result, we could see a situation where a commercial end-user would have to borrow cash from its lender, and pay interest on it, just to give it back to the same lender to hold as margin. Congressional intent was clear on this point—end users were not to be required to post margin. We appreciate the House of Representatives reaffirming this by passing the Business Risk Mitigation and Price Stabilization Act back in March.

Thank you again for the opportunity to testify today before the Committee. We 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.



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August 8, 2011

Mr. David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street NW  
Washington, DC 20581

***RE: Adaptation of Regulations to Incorporate Swaps; Notice of Proposed Rulemaking (Federal Register/Vol. 76, No. 109)***

Dear Mr. Stawick:

On behalf of the more than two million farmers and ranchers who belong to farmer cooperatives, the National Council of Farmer Cooperatives (NCFC) submits the following comments in response to the Commodity Futures Trading Commission's (the Commission) request for comments: *Adaptation of Regulations to Incorporate Swaps; Notice of Proposed Rulemaking*, to amend the Commodity Exchange Act regulations to implement regulatory requirements contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Since 1929, NCFC has been the voice of America's farmer cooperatives. Our members are regional and national farmer cooperatives, which are in turn composed of over 2,500 local farmer cooperatives across the country. NCFC members also include 21 state and regional councils of cooperatives.

America's farmer-owned cooperatives provide a comprehensive array of services for their members. These diverse organizations handle, process and market virtually every type of agricultural commodity produced. They also provide farmers with access to infrastructure necessary to manufacture, distribute and sell a variety of farm inputs. For example, a cooperative may consist of a closely coordinated network to ensure timely and cost-efficient origination, storage, transportation and marketing of grain and oilseeds.

**Proposed Changes to Regulation 1.35**

NCFC is concerned with this proposal because it would not only add swaps to the new recordkeeping requirements, but also would extend the new recordkeeping requirements to cash purchase and forward cash contracts entered into by any member of a designated contract market (DCM).

This would require all farmer cooperatives that are members of DCMs (CME, KCBT, MGE, etc.), and by extension every one of their local facilities, to be bound by this regulation. For example, cooperatives that are members of DCMs have an integrated network of grain elevators to originate and store grain purchased from farmers. As such, the proposed change to 1.35(a) would require those elevators to record, among other things, all oral communications that lead

to execution of cash transactions with farmers. The proposal includes (*proposed additions in italics*):

Included among such records shall be all orders (filled, unfilled, or canceled), trading cards, signature cards, street books, journals, ledgers, canceled checks, copies of confirmations, copies of statements of purchase and sale, and all other records, which have been prepared in the course of its business of dealing in commodity interests and cash commodities, ***and all oral and written communications provided or received concerning quotes, solicitations, bids, offers, instructions, trading, and prices, that lead to the execution of transactions in a commodity interest or cash commodity, whether communicated by telephone, voicemail, facsimile, instant messaging, chat rooms, electronic mail, mobile device or other digital or electronic media. Each transaction record shall be maintained as a separate electronic file identifiable by transaction and counterparty.***

Additionally, all such recorded communications would be required to be maintained for five years.

A requirement to record all communication leading to a cash purchase or cash forward contract would impose huge regulatory burdens and costs on cooperatives and other businesses and farmers in rural America. In fact, the necessary investment to put in place and maintain such a system would not only greatly add to the cost of doing business, but would be an extreme compliance burden for the cash grain community.

The Commission states these recordkeeping requirements would protect customers from abusive sales practices; protect registrants from risks associated with transactional disputes; allow registrants to follow up more effectively on customer complaints; and preserve evidence that could increase the effectiveness of the Commission's enforcement actions. We do not believe that requiring this additional information to be recorded and maintained is necessary to achieve the stated goals in the cash commodity markets.

Additionally, we do not believe the intent of the Dodd-Frank Act was to subject cash purchases and forward cash contracts to the additional new recordkeeping requirements proposed under regulation 1.35. In fact, cash and forward contracts have been excluded from the definition of a swap in the proposed product definitions rule. Commission Chairman Gary Gensler has highlighted that point on several occasions while testifying before Congress. We believe this proposed regulation, as written to apply to the cash market, is in direct contradiction to that exclusion and to the Congressional intent of the Dodd-Frank Act.

We would be pleased to discuss with the Commission our concerns with proposed regulation 1.35. Thank you taking our views into account as the Commission finalizes rules in the coming months. We appreciate the opportunity to provide input throughout the process of implementation of Title VII of the Dodd-Frank Act.

Sincerely,



Charles F. Conner  
President & CEO

## Charles F. (Chuck) Conner

### *President and CEO National Council of Farmer Cooperatives*

Charles F. (Chuck) Conner became president & CEO of the National Council of Farmer Cooperatives (NCFC) on January 22, 2009. As president of NCFC, Conner will oversee the organization's work to promote and protect the business and public policy interests of America's farmer-owned cooperatives. He will also provide the strategic vision for the trade association as it continues to seek new ways in which to add value for its membership.

Prior to joining NCFC, Conner had served as the Deputy Secretary at the U.S. Department of Agriculture since mid-2005. In this capacity, he was the Chief Operating Officer (COO) overseeing day-to-day operations of the department. Conner interacted directly with President George W. Bush and his senior staff to formulate domestic and international food, trade, security and energy policy. He led development of the Bush Administration's \$300 billion Farm Bill proposal and the strategy to educate and inform industry, constituents and Congress.

From August 2007 to January 2008, Conner served as both USDA Secretary and Deputy Secretary. He played a key role in developing the Administration's immigration policy including important changes to the H2A program.

Conner's experience also includes the assignment of Special Assistant to the President, Executive Office of the President, from October 2001 to May 2005, working on the 2001/2 Farm Bill to develop the strategy behind the transfer of several USDA agency functions to the newly formed Department of Homeland Security.

From May 1997 to October 2001 Conner served as President of the Corn Refiners Association. He also served for 17 years as an advisor to U.S. Senator Richard Lugar of Indiana.

Conner is a graduate of Purdue University, with a Bachelor's of Science degree and is the recipient of Purdue's Distinguished Alumni Award. He and his wife Dru have four children.

Committee on Agriculture  
U.S. House of Representatives  
Required Witness Disclosure Form

House Rules\* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2008.

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Organization you represent (if any): National Council of Farmer Cooperatives (NCFC)

1. Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2008, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:

Source: NONE Amount: \_\_\_\_\_

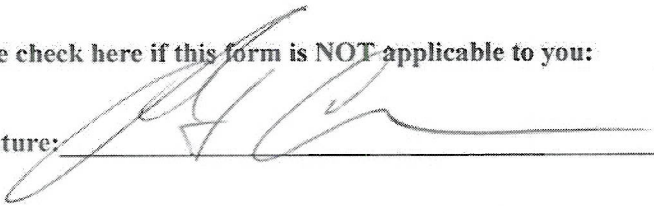
Source: NONE Amount: \_\_\_\_\_

2. If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2008, as well as the source and the amount of each grant or contract:

Source: NONE Amount: \_\_\_\_\_

Source: NONE Amount: \_\_\_\_\_

Please check here if this form is NOT applicable to you: \_\_\_\_\_

Signature:  \_\_\_\_\_

\* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

PLEASE ATTACH DISCLOSURE FORM TO EACH COPY OF TESTIMONY.