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Reap What You Swap

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I HAVE never purchased a credit-default swap on a collateralized debt obligation. I have never packaged subprime mortgages and sold them to the highest bidder. In fact, I do not even have a home mortgage. I live in the house my grandparents built and passed on to my parents, who eventually passed it on to my husband and me. Someday it will go to my children, when it is their turn.

Still, I am stuck in the middle of this financial overhaul. The Dodd-Frank Wall Street Reform and Consumer Protection Act may be targeted at risk-taking bankers, but the regulations have the potential to change the way I do business on the farm.

I raise mostly wheat and soybeans in northwest Minnesota. Wheat, in particular, is bought and sold in a notoriously volatile market. In February 2008, I sold wheat for $18.69 per bushel. Last month, I was selling it for $3.49 per bushel.

To protect myself from such swings, I use derivatives, or agricultural swaps. I make an arrangement with my local grain elevator or a commodities broker months before my crop is harvested to sell it at a guaranteed price; I have already priced some of the wheat I will raise in 2011 at a decent $7.15 a bushel. Of course, since wildfires in Russia destroyed much of the world’s crop and the country banned the export of grain through December, wheat prices have risen over 45 percent from five weeks ago — a clear sign of how volatile the market can be.

On the purchasing side, I also use derivatives to protect myself from swings in the cost of fertilizer, fuel and other staples. In the past two years, my nitrogen fertilizer has ranged from

$435 to $685 per ton, and my fuel bills are giving me whiplash. While reading through the Dodd-Frank act these past few weeks, I've been wondering: Will the regulations on swaps make it more difficult for me to hedge against market swings in prices for crops and supplies?

According to the language of the law, sometime later this year it will become unlawful to enter into swaps "in excess of such amount as shall be fixed from time to time" by the Commodity Futures Trading Commission. But what will that amount be, and when will we find out? What is meant by "from time to time"?

Luckily, it looks as if the regulations are unlikely to intentionally restrict family farmers like me from trading futures. And the trading commission may carve out special protections for farmers in the next few months as the legislation goes into effect. But that doesn't mean that I'm not worried about the act's unintended consequences.

My biggest worry is what the legislation will do to speculators in the market. These are the traders who buy and sell wheat or corn without taking physical control of the crops. Farmers love speculators when they are buyers, helping push prices higher, and we despise them when they are sellers, driving prices down. Regardless of their position in the market, I am well aware that the system would not function without them — there wouldn't be enough liquidity, or money, in the market.

According to the trading commission, about one-third of the long positions in hard red spring wheat futures, which is what I trade on the Minneapolis Grain Exchange, are owned by speculators. If speculators were driven out of the market, it would be as if I'd lost a third of my customers.

Will speculators continue to provide market liquidity if the legislation ends up increasing margin requirements — the amount of cash an investor must deposit before buying futures — or restricting how much or how often they can trade? Changes like these could do a lot of damage to agricultural markets.

These are the markets I rely on for risk management, to smooth the highs and lows of my purchases and sales. I understand the need for reform, for margin requirements and for speculative limits. No one wants to see a repeat of the Hunt brothers' silver bubble of 1979-80, in which silver prices, driven up by their attempt to corner the market, ultimately crashed and caused widespread panic. But reform must come in small steps and not rapid action.

I hope the Commodity Futures Trading Commission will resist casting the net so wide that it ensnarls those for whom the markets were created: grain buyers and sellers. As rules are developed to translate the act's vague wording, I will be watching to ensure that my risk management strategies remain relevant and affordable. I may not be able to manage Mother Nature, but I can manage my risk with derivatives.

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