**December 23, 2013**

# CFTC Re-Proposes Position Limits for Certain Commodity Futures Contracts and Economically Equivalent Swaps

On November 5, 2013, the Commodity Futures Trading Commission (CFTC) re-proposed speculative position limits relating to certain U.S. exchange-listed physical commodity futures contracts as well as to swaps that reference the specified contracts and contracts settling against the specified contracts that are executed on, or pursuant to, rules of a foreign board of trade (FBOT) providing direct access to U.S. persons (the “Re-Proposed Limits”). The CFTC also re-proposed aggregation standards based upon ownership or control of positions subject to those speculative position limits (the “Re-Proposed Aggregation Rules” and, together with the Re-Proposed Limits, the “Re-Proposed Rules”). The Re-Proposed Limits would replace the speculative position limits that the CFTC adopted on November 18, 2011 (the “Vacated Regulations”), but were vacated by the United States District Court for the District of Columbia, partially on the basis of the CFTC’s failure to determine that speculative position limits were necessary and appropriate to deter excessive speculation. The Re-Proposed Aggregation Rules would replace the aggregation rules the CFTC proposed in May 2012 (the “2012 Aggregation Proposal”). The Re-Proposed Rules are subject to a 60-day comment period.

## Contracts Covered by the New Position Limits

The Re-Proposed Limits would, like the Vacated Regulations, provide position limits for 28 “core” futures contracts, which include contracts for 19 agricultural commodities (including the nine “legacy” futures contracts currently subject to CFTC position limits in CFTC Regulation 150.2 prior to the adoption of the Vacated Rules), five metal commodities and four energy commodities.[1] Other futures contracts, swaps and options on the future contracts or on a related swap (referred to in the regulations, together with the underlying core commodity future, as a “Referenced Contract”) would be included in calculations of a person’s position on a futures-equivalent basis, if they are directly or indirectly linked to, partially or fully settled on, or priced at a fixed differential to (i) the price of the named futures contract or (ii) the price of the same commodity for delivery at the same location specified in the core futures contracts. Also

[1] The “core” agricultural commodity contracts are (1) ICE Futures U.S. Cocoa, (2) ICE Futures U.S. Coffee, (3) Chicago Board of Trade Corn, (4) ICE Futures U.S. Cotton No. 2, (5) Chicago Mercantile Exchange Feeder Cattle, (6) ICE Futures U.S. FCOJ-A, (7) Chicago Mercantile Exchange Lean Hog, (8) Chicago Mercantile Exchange Live Cattle, (9) Chicago Mercantile Exchange Class III Milk, (10) Chicago Board of Trade Oats, (11) Chicago Board of Trade Rough Rice, (12) Chicago Board of Trade Soybeans, (13) Chicago Board of Trade Soybean Meal, (14) Chicago Board of Trade Soybean Oil, (15) ICE Futures U.S. Sugar No. 11, (16) ICE Futures U.S. Sugar No. 16, (17) Chicago Board of Trade Wheat, (18) Minneapolis Grain Exchange Hard Red Spring Wheat and (19) Kansas City Board of Trade Hard Winter Wheat. The core metal futures contracts are (1) Commodity Exchange, Inc. Gold, (2) Commodity Exchange, Inc. Silver; (3) Commodity Exchange, Inc. Copper; (4) New York Mercantile Exchange Palladium and (5) New York Mercantile Exchange Platinum. The core energy commodity futures contracts are (1) New York Mercantile Exchange Light Sweet Crude Oil, (2) New York Mercantile Exchange New York Harbor ULSO, (3) New York Mercantile Exchange RBOB Gasoline Blendstock and (4) New York Mercantile Exchange Henry Hub Natural Gas.

 

included in the position limits are Referenced Contracts executed on, or pursuant to, the rules of an FBOT if members and other participants located in the United States are permitted direct access and such Referenced Contracts settle against any price of any contract listed on a designated contract market or swaps execution facility.

Guarantees of swaps, basis contracts[2] and commodity index contracts[3] would specifically be excluded from the definition of Referenced Contracts and, thus, excluded in determining position limits. The CFTC has stated that it intends to apply position limits to other contracts under its jurisdiction, such as those relating to electricity, in the future.[4] The new position limits would take effect 60 days after publication of the final rule.

### Spot-Month Position Limits

The Re-Proposed Limits, subject to the exceptions discussed below, would prohibit any trader from holding or controlling positions on a net long or net short basis in excess of the specified limit. Spot-month[5] limits for Referenced Contracts will be set at 25 percent of estimated deliverable supply, which is calculated separately for physical-delivery Referenced Contracts and cash-settled Referenced Contracts in the same commodity. A trader may not net across physical-delivery Referenced Contracts and cash-settled Referenced Contracts in the same commodity. Furthermore, under the Re-Proposed Limits' "conditional spot-month limit exemption," the cash-settled spot-month limit for Referenced Contracts in a commodity will be up to five times the level of the cash-settled spot-month limit that would otherwise apply, provided that the trader does not hold or control any position in a physical-delivery spot-month Referenced Contract in the same commodity. Persons claiming the "conditional spot-month limit exemption" would need to file Proposed Form 504 with the CFTC to rely on such exemption.

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2 "Basis contracts" would be defined as a cash-settled commodity derivative agreement based on the difference in (i) the price of a particular core futures contract or a commodity deliverable on a core futures contract and (ii) the commodity deliverable on the same core referenced futures contract or a commodity that the CFTC has determined is substantially the same as the commodity underlying the core commodity futures contract.

3 A commodity index contract is a contract other than a basis contract or spread contract, such as a calendar spread contract or intercommodity spread contract, based on an index comprising commodities that are not the same or substantially the same commodity.

4 See Position Limits for Derivatives, 78 Fed. Reg. 75680 (proposed Dec. 12, 2013) (to be codified at 17 C.F.R. 150 et. seq.), text, between notes 404 and 405.

5 The "spot month" is defined separately for physical-delivery contracts versus cash-settled contract. For physical-delivery commodity derivative contracts, the spot month commences at the period of time beginning at the earlier of the close of trading on the trading day preceding the first day on which delivery notices can be issued to the clearing organization of a contract market, or the close of trading on the trading day preceding the third-to-last trading day, until the contract is no longer listed for trading (or available for transfer, such as through exchange for physical transactions). For cash-settled contracts, "spot month' means the period of time beginning at the earlier of the close of trading on the trading day preceding the period in which the underlying cash-settlement price is calculated, or the close of trading on the trading day preceding the third-to-last trading day, until the contract cash-settlement price is determined and published; provided however, if the cash-settlement price is determined based on prices of a core referenced futures contract during the spot month period for that core referenced futures contract, then the spot month for that cash-settled contract is the same as the spot month for that core referenced futures contract. The spot month would vary by contract.

 

For spot-month position limits, the proposed initial levels would be based on the spot-month position limit levels currently in place at designated contract markets (DCMs) or on a DCM's estimates of deliverable supply if verified by the CFTC. Subsequent levels will be adjusted at least every two years and based on the CFTC's determination of deliverable supply in consultation with DCMs.

### Non-Spot-Month Position Limits

Under the Re-Proposed Limits, the non-spot-month position limits (i.e., limits applied to positions in all contract months combined or in a single contract month) will be set at 10 percent of the open interest for all months listed on a reporting market during the most recent calendar year, up to 25,000 contracts with a marginal increase of 2.5 percent of the open interest thereafter; provided, however, that the minimum levels shall be the greater of (i) the spot month limit and (ii) 1,000 for agricultural commodities and 5,000 in exempt commodities.[6] Unlike the spot-month position limits, a trader may net all positions in Referenced Contracts (i.e., physical-delivery Referenced Contracts and cash-settled Referenced Contracts) for purposes of calculating the non-spot-month position limits.

For non-spot-month position limits (i.e., limits applied to positions in all contract months combined or in a single contract month), proposed initial levels will be set based on open interest in futures and swaps that were significant price discovery contracts for calendar years 2011 and 2012. Subsequent levels will be adjusted at least every two years based on Referenced Contract open interest for a calendar year (i.e., the sum of futures open interest, cleared swaps open interest and uncleared swaps open interest). The CFTC will publish estimates of average open interest on a monthly basis.

### Exemptions

#### *Bona Fide Hedging*

The Re-Proposed Limits include an exemption for bona fide hedging activities, but the definition of "bona fide hedging activities" would differ from the traditional "bona fide hedging" definition in Regulation 1.3(z), as well as the definition in the Vacated Rules.

First, as a general requirement, for any position to be considered a bona fide hedging position, (i) the purpose of such position must be to offset price risks incidental to commercial cash operations, and (ii) such position must be established and liquidated in an orderly manner in accordance with sound commercial practices.

Second, the hedge exemption applies separate criteria depending on the type of commodity. For contracts in an excluded commodity (e.g., interest or exchange rate futures),[7] the position would also

[6] An "exempt commodity" is defined as any commodity other than an agricultural commodity or an excluded commodity.

[7] "Excluded commodity" is defined in section 1a(19) of the Commodity Exchange Act as "(i) an interest rate, exchange rate, currency, security, security index, credit risk or measure, debt or equity instrument, index or measure of inflation, or other macroeconomic index or measure; (ii) any other rate, differential, index, or measure of economic or commercial risk, return, or value that is (I) not based in substantial part on the value of a narrow group of commodities not described in clause (i) or (II) based solely on one or more commodities that have no cash market; (iii) any economic or commercial index based on prices, rates, values, or levels that are not within the

 

either (i) be required to be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise and fall within one of the enumerated bona fide hedging exemptions (as described below) or (ii) be recognized as a bona fide hedging position by a DCM or swap execution facility (SEF) consistent with the guidance on risk management exemptions. For hedges in a physical commodity (including swaps that are economically equivalent to futures contracts and direct-access linked FBOT futures contracts that are economically equivalent to futures contracts listed by DCMs), the position would be required to (i) fall within one of the enumerated bona fide hedging exemptions (as described below); (ii) represent a substitute for a position taken or to be taken at a later time in the physical marketing channel; (iii) be economically appropriate to the reduction of risks; and (iv) arise from the potential change in value of assets, liabilities or services the trader has or provides or anticipates having or providing. The bona fide hedging exemption will also apply to positions resulting from a swap that was executed opposite a counterparty for which the swap qualifies for a bona fide hedging exemption.

Third, the particular hedging transaction must fall within one of the enumerated exemptions set forth in the Re-Proposed Limits and must satisfy the particular requirements set forth for each type of hedging transaction, which categories are set forth in Appendix A:

The Re-Proposed Limits would also deem positions entered into to reduce risks related to a "pass-through swap," (i.e., a swap in the same physical commodity opposite a counterparty that would have satisfied the above bona fide hedging requirements) to be a bona fide hedging position other than during the last five days of the spot month.

Persons who are entering into other risk-reducing practices commonly used in the market may, however, request relief from the CFTC. Persons relying on certain of the bona fide hedge exemptions would be required to file Proposed Form 704 or Proposed Form 604 (for pass-through swaps) with the CFTC no later than the date of first use of the exemption or least 10 days in advance of the date on which the trader anticipates exceeding the position limits.

The above exemptions would be similar to those in the Vacated Rules. However, the Re-Proposed Limited do not include the Vacated Rules' exemption to hedge the costs of empty storage capacity.

***Preexisting Positions***

The CFTC proposed two separate pre-existing positions exemptions in the Re-Proposed Limits. One exemption would exempt contracts outside of the spot month acquired in good faith prior to the effective date of the limit. However, those contracts (other than the positions excluded by the next sentence) would be attributed to the trader if the person increases the position after the effective date. The speculative position limits also would not apply positions acquired prior to the enactment of the Dodd-

control of any party to the relevant contract, agreement, or transaction; or (iv) an occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or level of a commodity not described in clause (i)) that is (I) beyond the control of the parties to the relevant contract, agreement, or transaction and (II) associated with a financial, commercial, or economic consequence."

 

Frank Wall Street Reform and Consumer Protection Act or prior to the effectiveness of the Re-Proposed Limits.

***Financial Distress***

The Re-Proposed Limits would include an exemption for financial distress of a trader or customer. The exemption would not be self-executing and must be requested. This financial distress exemption could apply, for example, in situations involving the potential default or bankruptcy of a customer of the requesting person or persons, an affiliate of the requesting person or persons, or a potential acquisition target of the requesting person or persons.

Exemptions granted under the current rules would expire as of the effective date of the Re-Proposed Limits. Persons receiving exemptions under the Re-Proposed Limits must retain records of their basis and submit to calls from CFTC staff.

## Aggregation of Positions

The Re-Proposed Aggregation Rules, which replace the 2012 Aggregation Proposal, would require the aggregation of positions (i) owned through various entities under common partial ownership or control if those entities are sufficiently related and (ii) held through accounts or pools over which a person holds or controls trading if those accounts or pools have substantially identical trading strategies. However, the CFTC has expanded its exemptions from required aggregation.

The Re-Proposed Aggregation Rules provide that, unless an exemption from aggregation is available, all positions in accounts for which any person by power of attorney or otherwise, directly or indirectly controls the trading or holds a 10 percent or greater ownership or equity interest, must be aggregated with positions held and trading done by such person. The Re-Proposed Aggregation rules also provide that positions or ownership or equity held and trading done by two or more persons acting in concert will be treated as if owned or controlled by a single person. Notwithstanding the exemptions from aggregation set forth in the Re-Proposed Aggregation Rules and discussed below, any person that, by power of attorney or otherwise, holds or controls the trading of positions in more than one account or pool with substantially identical trading strategies, must aggregate all such positions.

The Re-Proposed Aggregation Rules provide the following exemptions from aggregation:

- Commodity Pool Participants. A limited partner, limited member, shareholder or other similar type of pool participant holding positions in which the person by power of attorney or otherwise[8] directly or indirectly has a 10 percent or greater ownership or equity interest in a pooled account or positions is not required to aggregate positions with all other positions owned or controlled by the person except that such person must aggregate the pooled account or positions with all other accounts or positions owned or controlled by such person if such person: is the commodity pool operator (CPO) of such pool

[8] By "ownership" through power of attorney, the CFTC may have intended to provide an exception for control by power of attorney, as specified in the general rule above.

 

   - is a principal or affiliate of the CPO of such pool, unless: the CPO has and enforces written procedures to preclude such person from having access to or receiving data about the positions of the pool
   - the person does not have direct, day-to-day supervisory authority or control over the pool's trading decisions
   - if a principal of the CPO, the person maintains only such minimum control over the CPO as is consistent with its responsibilities as a principal and necessary to fulfill its duty to supervise the trading activities of the pool
   - the CPO makes a notice filing with the CFTC or
   - the person has, by power of attorney or otherwise directly or indirectly, a 25 percent or greater ownership or equity interest in a pool, if the CPO of the pool is exempt from registration as a CPO pursuant to CFTC Regulation 4.13.

- 10-50 Percent Owners. Any person with an ownership or equity interest in an owned entity of 10 percent or greater but not more than 50 percent (other than interest in a pooled account discussed above under Commodity Pool Participants) is not required to aggregate positions of the owned entity with any other accounts or positions such person is required to aggregate if such person and the owned entity: do not have knowledge of the trading decisions of the other
   - trade pursuant to separately developed and independent trading systems
   - have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other[9]
   - do not share employees that control the trading decisions of either
   - do not have risk management systems that permit the sharing of trades or trading strategy
   - make a notice filing with the CFTC.

- 50 Percent or Greater Owners. Any person with a greater than 50 percent ownership or equity interest in an owned entity (other than interest in a pooled account discussed above under Commodity Pool Participants) is not required to aggregate positions, provided that: such person certifies to the CFTC that the owned entity is not required under U.S. generally accepted accounting principles to be, and is not, consolidated on the financial statement of such person

[9] Such procedures must include document routing and other security procedures or security arrangements, including separate physical locations, which would maintain the independence of the two persons activities.

 

- such person and the owned entity: do not have knowledge of the trading decisions of the other
- trade pursuant to separately developed and independent trading systems
- have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other[10]
- do not share employees that control the trading decisions of either
- do not have risk management systems that permit the sharing of trades or trading strategy
- demonstrate to the CFTC that procedures are in place that are reasonably effective to prevent coordinated trading decisions
- each representative (if any) of the person on the owned entity's board of directors (or equivalent governance body) certifies that he or she does not control the trading decisions of the owned entity
- such person certifies to the CFTC that either all of the owned entity's positions qualify as bona fide hedging transactions or the owned entity's positions that do not so qualify do not exceed 20 percent of any position limit currently in effect, and such person agrees to notify the CFTC if the certification becomes untrue and provide additional account information as requested
- the CFTC finds, in its discretion, that such person has satisfied the above conditions
- such person, when first requesting disaggregation makes a notice filing with the CFTC.

- Independent Account Controllers. An "eligible entity"[11] is not required to aggregate the eligible entity's positions with its client positions or accounts carried by an authorized" independent account controller,"[12] except for spot-month physical-delivery Referenced Contracts, if the entity makes a notice filing with the CFTC. However, if the independent account controller is affiliated with such

[10] See footnote 7 above.

[11] An "eligible entity" means a commodity pool operator; the operator of a trading vehicle which is excluded, or which itself has qualified for exclusion from the definition of the term ''pool'' or ''commodity pool operator,'' respectively, under § 4.5 of this chapter; the limited partner, limited member or shareholder in a commodity pool the operator of which is exempt from registration under § 4.13 of this chapter; a commodity trading advisor; a bank or trust company; a savings association; an insurance company; or the separately organized affiliates of any of the above entities.

[12] An "independent account controller" is a person who (i) is specifically authorized by an eligible entity (such as a CPO, whether registered or exempt, or a commodity trading advisor (CTA)), (ii) is subject to only such minimum control as is consistent with the eligible entity's fiduciary responsibility to fulfill its supervisory duties, (iii) trades independently of the eligible entity, (iv) has no knowledge of trading decisions by any other account controller and (v) is registered as an FCM, introducing broker, a CTA, an associated person of the above or is the general partner of a pool, the CPO of which is exempt under Regulation 4.13.

 

eligible entity or another independent account controller, each of the affiliated entities must: have and enforce written procedures[13] to preclude the affiliated entities from having knowledge of, gaining access to, or receiving data about, trades of the other

- trade such accounts pursuant to separately developed and independent trading systems
- market such trading systems separately
- solicit funds for such trading by separate disclosure documents that meet the standards of Regulation 4.24 or Regulation 4.34, if required.

- Information Sharing Restriction. A person is not required to aggregate positions with an owned entity if the sharing of information necessary to determine aggregate positions creates reasonable risk of violating federal, state or foreign law or regulation.[14]

- Higher-Tier Entities. If an owned entity has made a notice filing with the CFTC pursuant to other exemptions from aggregation, any person with an ownership or equity interest of 10 percent or greater in the owned entity need not file a separate notice identifying the same positions and accounts previously identified in the notice filing of the owned entity, provided that such person: complies with the conditions applicable to the exemption specified in the owned entity's notice filing, other than the filing requirements
  - does not otherwise control trading of the accounts or positions
  - provides account information to the CFTC as requested.

Additional aggregation exemptions apply, subject to further conditions specified in the rule, to futures commission merchants for positions held in discretionary accounts controlled by other persons, positions held by underwriters that are only owned as part of underwriters carrying out their underwriter functions, and registered broker-dealers who own securities only as part of their broker or dealer functions.

### DCM and SEF Rules

DCMs and SEFs are also required to set position limits for referenced contracts at levels no greater than those established under CFTC regulations. DCMs and SEFs may set accountability levels instead of position limits for contracts that are not Referenced Contracts, contracts relating to a major foreign currency, excluded commodities that are indexes or measures of inflation or another macroeconomic

[13] Such procedures must include document routing and other procedures or security arrangements, including separate physical locations, which would maintain the independence of their activities; provided, however, that such procedures may provide for the disclosure of information which is reasonably necessary for an entity to maintain the level of control consistent with its fiduciary responsibilities to the managed positions and accounts and necessary to fulfill its duty to supervise diligently the trading done on its behalf.

[14] The entity must provide a written memorandum of law (which may be prepared by an employee of the entity or its affiliates) which explains the legal basis for determining that information sharing creates a reasonable risk that the entity could violate federal, state or foreign law.

 

index or measure, and certain other specified excluded commodities.  DCMs and SEFs will be permitted to grant additional exemptions upon application to the CFTC.

 

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## Appendix A

## Enumerated Hedge Exemptions

- Hedges of Inventory and Cash Commodity Purchase Contracts. Short positions in commodity derivative contracts that do not exceed in quantity ownership or fixed-price purchase contracts in the contract's underlying cash commodity by the hedger.

- Hedges of Cash Commodity Sales Contracts. Long positions in commodity derivative contracts that do not exceed in quantity the fixed-price sales contracts in the contract's underlying cash commodity by the hedger and the quantity equivalent of fixed-price sales contracts of the cash products and by-products of such commodity by the hedger.

- Hedges of Unfilled Anticipated Requirements. Provided that such positions in a physical-delivery commodity derivative contract, during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract, do not exceed the person's unfilled anticipated requirements of the same cash commodity for that month and for the next succeeding month: (i) long positions in commodity derivative contracts that do not exceed in quantity unfilled anticipated requirements of the same cash commodity and that do not exceed 12 months for an agricultural commodity, for processing, manufacturing, or use by the same person; and (ii) long positions in commodity derivative contracts that do not exceed in quantity unfilled anticipated requirements of the same cash commodity for resale by a utility that is required or encouraged to hedge by its public utility commission on behalf of its customers' anticipated use.

- Hedges by Agents. Long or short positions in commodity derivative contracts by an agent who does not own or has not contracted to sell or purchase the offsetting cash commodity at a fixed price, provided that the agent is responsible for merchandising the cash positions that are being offset in commodity derivative contracts and the agent has a contractual arrangement with the person who owns the commodity or holds the cash market commitment being offset.

- Hedges of Unsold Anticipated Production. Short positions in commodity derivative contracts that do not exceed in quantity unsold anticipated production of the same commodity, and that do not exceed 12 months of production for an agricultural commodity, by the same person; provided that no such position is maintained in any physical-delivery commodity derivative contract during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract.

- Hedges of Offsetting Unfixed-Price Cash Commodity Sales and Purchases. Short and long positions in commodity derivative contracts that do not exceed in quantity that amount of the same cash commodity that has been bought and sold by the same person at unfixed prices: (i) basis different delivery months in the same commodity derivative contract; or (ii) basis different commodity derivative contracts in the same commodity, regardless of whether the commodity derivative contracts are in the same calendar month; provided that no such position is maintained in any physical-delivery commodity derivative contract during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract.

- Hedges of Anticipated Royalties. Short positions in commodity derivative contracts offset by the anticipated change in value of mineral royalty rights that are owned by the same person, provided that the royalty rights arise out of the production of the commodity underlying the commodity derivative contract, provided further that no such position is maintained in any physical-delivery commodity derivative contract during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract.

- Hedges of Services. Short or long positions in commodity derivative contracts offset by the anticipated change in value of receipts or payments due or expected to be due under an executed contract for services held by the same person, provided further that the contract for services arises out of the production, manufacturing, processing, use, or transportation of the commodity underlying the commodity derivative contract, and which may not exceed one year for agricultural commodities; provided further that no such position is maintained in any physical-delivery commodity derivative contract during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract.

- Cross-Commodity Hedges. Positions in commodity derivative contracts described above “may also be used to offset the risks arising from a commodity other than the same cash commodity underlying a commodity derivative contract, provided that the fluctuations in value of the position in the commodity derivative contract, or the commodity underlying the commodity derivative contract, are substantially related to the fluctuations in value of the actual or anticipated cash position or pass-through swap and provided further that no such position is maintained in any physical-delivery commodity derivative contract during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract.”[15]

If a particular hedging transaction does not fall within one of the enumerated exemptions set forth above, a person engaged in risk-reducing practices may request an interpretative letter from the CFTC concerning the applicability of the bona fide hedging position exemption or seek exemptive relief from the CFTC under the Commodity Exchange Act.

 