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November 18, 2011

# CFTC Adopts Final Position Limit Rules for Futures, Options and Swaps on 28 Physical Commodities

Rising oil and gasoline prices in the spring of 2008 brought calls from many in Congress for the Commodity Futures Trading Commission (CFTC) to impose speculative position limits in futures markets to bring down prices. Despite the dearth of data showing that speculators caused higher prices or that limits would affect prices, the CFTC thereafter held public hearings on, and proposed the imposition of, federal limits on speculation in (certain energy) futures, but not swaps, even if those swap transactions were linked to futures prices. Congress then passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) which, among many other things, expanded the CFTC's position limit authority to include many, but not all, swaps and directed the CFTC to concentrate on speculative position limits on futures and economically equivalent swaps in physical commodities, as found to be necessary and as appropriate. Once granted this new authority, the CFTC abandoned its prior proposal and set out to reconsider the question whether and how to impose speculative limits on futures and swaps on physical commodities.

On January 26, 2011, the CFTC issued a new position limits proposal to establish limits for futures and economically equivalent swaps on 28 agricultural, metals and energy commodities.[1] The CFTC's proposed rules also set forth exemptions from position limits (including a narrow definition of bona fide hedging) and new provisions for aggregating positions of certain parties for position limit compliance purposes. Of the 15,116 comment letters the CFTC received in response to its proposal, only about 100 provided detailed comments and recommendations, and 55 requested that the CFTC either significantly alter or withdraw its proposal.

The CFTC voted 3-2 on October 18, 2011 to adopt final position limit rules, which were published in the Federal Register today.[2] These final rules will be codified at Part 151 of the CFTC's regulations. Although the Part 151 rules will become effective on January 17, 2012, market participants will not be required to comply with the CFTC limits imposed under Part 151 until certain compliance dates that will be triggered by other CFTC actions, which are expected to occur sometime in 2012.

Prior to these Part 151 compliance dates, market participants must continue to comply with the existing CFTC Part 150 position limit regime and any applicable position limits or accountability levels currently imposed by designated contract markets (DCMs). The current CFTC position limits under Part 150 only apply to futures and option contracts in certain agricultural commodities. DCMs have imposed spot-month position limits for futures and options in other physical commodities. Outside of the spot month, DCMs use position accountability levels to protect markets from abuses.[3]

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1 Position Limits for Derivatives, 76 Fed. Reg. 4752 (Jan. 26, 2011).

2 Position Limits for Futures and Swaps, 76 Fed. Reg. 71626 (Nov. 18, 2011).

3 Position accountability rules, unlike hard limits, are flexible tools that DCMs can use to gather information from traders whose positions exceed accountability levels and, if necessary, to require such traders not to further increase their positions.

This client alert summarizes key aspects of the CFTC's final position limits rulemaking and the main features of its new position limit regime under Part 151.

## Why is the CFTC Imposing Position Limits?

One of the most contentious aspects of the CFTC's position limits rulemaking was whether the CFTC had provided an adequate statutory and policy justification, including a sufficient cost-benefit analysis, for imposing new federal position limits. The following questions and answers explore how the CFTC's stated basis for establishing federal limits compares to relevant statutory terms and policy considerations.

### What purposes are the CFTC's position limits intended to serve?

Since 1936, Section 4a of the Commodity Exchange Act (CEA) has required that any CFTC adopted position limits serve the purpose of "diminishing, eliminating, or preventing" excessive speculation "causing sudden or unreasonable fluctuations or unwarranted changes in the price of [a] commodity."[4] In 2010, Congress added three additional goals for limits, which the CFTC must balance "to the maximum extent practicable" along with preventing excessive speculation: 1) "deter[ring] and prevent[ing] market manipulation, squeezes, and corners"; 2) "ensur[ing] sufficient market liquidity for bona fide hedgers"; and 3) "ensur[ing] that the price discovery function of the underlying market is not disrupted."[5]

In the preamble to the final rules, the CFTC acknowledges the statutory objectives that position limits are supposed to serve and also refers to concerns with "large concentrated positions"[6] and the "undue accumulation of large speculative positions owned by a single person or entity,"[7] without linking these concerns to the purposes of limits set out in CEA Section 4a. Dissenting CFTC Commissioner Scott O'Malia observed that the CFTC's new federal position limits "only target large concentrated positions" rather than serving the statutory goals identified above.[8]

### Does the CFTC find that its position limits are *necessary* to achieve any of these objectives?

No, the CFTC does not make a finding that its adopted position limits are necessary. Section 4a(a)(1) states, in relevant part, that the CFTC "shall" fix position limits "*as the [CFTC] finds are necessary* to diminish, eliminate, or prevent" excessive speculation "causing sudden or unreasonable fluctuations or unwarranted changes in the price of [a] commodity."[9] The CFTC, however, asserts that "the Commission is not required … to make an affirmative finding that position limits are necessary to prevent sudden or unreasonable fluctuations in prices."[10] Further, the CFTC insists that it is "not required to find that an undue burden on interstate commerce resulting from excessive speculation exists or is likely to occur" prior to imposing position limits that are meant to diminish, eliminate or prevent the burdens of excessive speculation.[11]

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4 CEA § 4a(a)(1).

5 CEA § 4a(a)(3).

6 *See* 76 Fed. Reg. at 71678.

7 *See id.* at 71653.

8 *See id.* at 71702.

9 CEA § 4a(a)(1) (emphasis added).

10 76 Fed. Reg. at 71627.

11 *Id.*

### Does the CFTC claim that its limits will be *effective* in bringing commodity prices down?

No, the CFTC has not argued that position limits will be effective in lowering commodity prices. Indeed, CFTC Chairman Gary Gensler reaffirmed in his statement in support of the final rule that "[t]he CFTC does not set or regulate prices."[12] Former Commissioner Michael Dunn, who also voted for the rule, issued an opening statement during the CFTC meeting where the final rules were adopted in which he deemed as a "fallacy" the "suggestion by some that once we set position limits on physical commodity derivatives, the price we pay for gas, bread, milk, and other things would inevitably drop, and that volatility in commodities markets would simply cease to exist."[13] Commissioner Dunn further observed that "price volatility exists in markets that have position limits and in markets that do not have position limits."[14]

### What, then, is the CFTC's basis for imposing position limits?

The CFTC contends that it is imposing position limits because "Congress did not give it a choice."[15] According to the CFTC, "[u]nder amended section 4a(a)(2), Congress directed that the CFTC 'shall' establish limits on the amount of positions, as appropriate, that may be held by any person in physical commodity futures and options traded on a DCM."[16] The CFTC asserts that in Section 4a(a)(5) "Congress directed the Commission to establish, concurrently with the limits established under section 4a(a)(2), limits on the amount of positions, as appropriate, that may be held by any person with respect to [economically equivalent swaps]."[17]

The CFTC's analysis does not take into account the statutory text "in accordance with the standards set forth in [Section 4a(a)(1)]" which expressly qualifies the "shall" language in Section 4a(a)(2) with respect to imposing limits on physical commodity futures and options.[18] As noted above, one such standard in Section 4a(a)(1) is that the CFTC fix limits "*as the [CFTC] finds are necessary* to diminish, eliminate, or prevent" the burdens of excessive speculation.[19] This "necessary" finding condition in Section 4a(a)(1) is thus imported into Section 4a(a)(2) by virtue of the phrase "in accordance with the standards set forth in [Section 4a(a)(1)]." The imputed "necessary" finding in Section 4a(a)(2) would, in turn, affect the imposition of limits on economically equivalent swaps in Section 4a(a)(5) because Section 4a(a)(5) cross-references (and is triggered by) limits imposed under Section 4a(a)(2).[20]

### Does the CFTC provide any empirical evidence to show that it is establishing appropriate position limits?

No, the CFTC does not provide empirical evidence to demonstrate that the position limits it is imposing are appropriate. Sections 4a(a)(2), (a)(3) and (a)(5) all include the qualification that the CFTC impose position limits "as appropriate." "Appropriate" limits would appear to be those that satisfy the four considerations in Section 4a(a)(3)(B) "to the maximum extent practicable": 1) diminishing, eliminating or preventing excessive speculation; 2) deterring and preventing market manipulation, squeezes and corners; 3) ensuring sufficient market liquidity for bona fide hedgers; and 4) ensuring that the price discovery function of the underlying market is not disrupted. Rather than offer data

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12 *Id.* at 71699.

13 http://cftc.gov/PressRoom/SpeechesTestimony/dunnstatement101811.

14 http://cftc.gov/PressRoom/SpeechesTestimony/dunnstatement101811.

15 76 Fed. Reg. at 71628.

16 *Id.* at 71627.

17 *Id.*

18 *See* CEA § 4a(a)(2).

19 *See* CEA § 4a(a)(1) (emphasis added).

20 *See* CEA § 4a(a)(5).

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to show that its limits are "appropriate," the CFTC repeats the refrain that its limits "will [] protect market participants and the public through maximization … [of] the four objectives set forth in CEA Section 4a(a)(3)(B)."[21] The CFTC also repeatedly contends that, with respect to the market liquidity factor in Section 4a(a)(3)(B), the new federal limits are "sufficiently high" "so as not to affect the[] hedging or speculative activity" of "the majority of market participants."[22]

In his dissent, Commissioner O'Malia — echoing the views of many commenters — stated that the "as appropriate" language entails that "whatever limits the Commission sets are supported by empirical evidence demonstrating that those [limits] would diminish, eliminate, or prevent excessive speculation."[23] Commissioner O'Malia then observed that "in the absence of such evidence … [the CFTC is] unable, at this time, to fulfill the mandate and assure Congress and market participants that any such limits we do establish comply with the statutory objectives of Section 4a(a)(3)."[24] "And to be clear," Commissioner O'Malia further noted, "without empirical data, we cannot assure Congress that the limits we set will not adversely affect the liquidity and price discovery functions of affected markets."[25]

## Which Contracts Will Be Subject to Position Limits?

Although CEA Sections 4a(a)(2) and (a)(5) refer to "physical commodity" futures and swaps, the CFTC's final rules do not impose position limits on all physical commodity futures and swaps. Instead, Part 151 will establish speculative position limits for 28 physical commodity futures contracts — 19 agricultural contracts,[26] five metals contracts[27] and four energy contracts[28] (Core Referenced Futures Contracts) — as well as futures and swaps that are economically equivalent to those contracts (collectively Referenced Contracts). A futures contract, option contract or swap will be considered "economically equivalent" to a Core Referenced Futures Contract if it is:

1) a "look-alike" contract (*i.e.*, a contract that directly or indirectly settles off a Core Referenced Futures Contract or is based on the price of same commodity with the same delivery location as the Core Referenced Futures Contract);

2) a contract with a reference price based on the combination of one or more Referenced Contract prices and one or more prices in the same or substantially the same commodity as that of the Core Referenced Futures Contract (provided that the contract is not a locational basis swap);

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21 *See* 76 Fed. Reg. at 71675.

22 *See id.* at 71668.

23 *Id.* at 71702.

24 *Id.*

25 *Id.*

26 The agricultural contracts are in two groups: "legacy" contracts and "non-legacy" contracts. Legacy contracts are contracts that are currently subject to CFTC position limits. The nine legacy contracts are: (1) CBOT Corn (C); (2) CBOT Oats (O); (3) CBOT Soybeans (S); (4) CBOT Soybean Meal (SM); (5) CBOT Soybean Oil (BO); (6) CBOT Wheat (W); (7) ICE Futures U.S. Cotton No. 2 (CT); (8) KCBT Hard Winter Wheat (KW); and (9) MGEX Hard Red Spring Wheat (MWE).

The non-legacy contracts are: (1) CME Class III Milk (DA); (2) CME Feeder Cattle (FC); (3) CME Lean Hog (LH); (4) CME Live Cattle (LC); (5) CBOT Rough Rice (RR); (6) ICE Futures U.S. Cocoa (CC); (7) ICE Futures U.S. Coffee C (KC); (8) ICE Futures U.S. FCOJ-A (OJ); (9) ICE Futures U.S. Sugar No. 11 (SB); and (10) ICE Futures U.S. Sugar No. 16 (SF).

27 The affected metal contracts are: (1) COMEX Copper (HG); (2) COMEX Gold (GC); (3) COMEX Silver (SI), (4) NYMEX Palladium (PA); and (5) NYMEX Platinum (PL).

28 The affected energy contracts are: (1) NYMEX Henry Hub Natural Gas (NG); (2) NYMEX Light Sweet Crude Oil (CL); (3) NYMEX New York Harbor Gasoline Blendstock (RB); and (4) NYMEX New York Harbor Heating Oil (HO).

3) an intercommodity spread contract with two reference price components, at least one of which is based on a Referenced Contract; or

4) a contract priced at a fixed differential to the price of a Core Referenced Futures Contract or to the price of the same commodity with the same delivery location as the Core Referenced Futures Contract.

In the preamble to its final rules, the CFTC explained that it selected the 28 Core Referenced Futures Contracts because such contracts either "have high levels of open interest and significant notional value" or "serve as a reference price for a significant number of cash market transactions."[29] The CFTC further noted that the categories of "economically equivalent" Referenced Contracts were meant to "capture contracts with prices that are or should be closely correlated to the prices of the Core Referenced Futures Contract[s]."[30]

Under the CFTC's final rules, the following contracts explicitly are excluded from the term Referenced Contract and hence will not be subject to CFTC-set position limits: 1) basis contracts (*i.e.*, contracts based on the difference in the price of a commodity (or substantially the same commodity) at different delivery locations) and 2) contracts on diversified commodity indexes.[31] However, a contract on a diversified commodity index will be considered a Referenced Contract and subject to position limits if it is "used to circumvent position limits."[32]

## What Types of Position Limits Will the CFTC Impose on the Referenced Contracts?

Two types of speculative position limits will be imposed on the Referenced Contracts: spot-month limits and non-spot-month limits. Traders will have to comply with both types of limits on an intra-day basis.

### Spot-month Position Limits

Spot-month limits are limits that apply in the last days of trading immediately preceding the delivery period. The length of this trading period (or "spot month") varies depending on the contract. In its final rules, the CFTC has adopted the DCM definitions of spot month for each of the Core Referenced Futures Contracts.[33] Physically-delivered and cash-settled contracts (whether cash-settled futures or swaps) will each have their own spot-month limit set at the same level.[34] Thus, if the spot-month limit for a referenced contract is 1,000 contracts, a trader can hold up to 1,000 contracts long in the physically-delivered contract and up to 1,000 contracts long in the cash-settled contract.

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29 *See* 76 Fed. Reg. at 71629 n. 29.

30 *See id.* at 71630.

31 Final Rule 151.1.

32 *Id.*

33 The DCM definitions of "spot month," codified in Final Rule 151.3, are different for different physical commodities. For energy commodities, like crude oil and natural gas, the spot month is the last three days of trading through the end of the delivery period. For metals commodities, in contrast, the spot month is defined as the period beginning with the first notice day during the delivery month and terminating at the end of the delivery period. For agricultural commodities, there are seven different formulations of spot month: 13 agricultural commodities are subject to the same spot-month definition as the metals commodities and the remaining six agricultural commodities each have their own unique spot-month definition.

34 Final Rule 151.4(a).

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*Methodology for Calculating Spot-month Limits*

Spot-month limits for physically-delivered and cash-settled contracts will be based on 25 percent of estimated deliverable supply for a Core Referenced Futures Contract in the same commodity.[35] The CFTC states that this formula is "consistent with the long-standing Acceptable Practice for [DCM] Core Principle 5, which provides that, for physical-delivery contracts, the spot-month limit should not exceed 25 percent of deliverable supply."[36] In addition, the CFTC notes that "the formula has appeared to work effectively as a prophylactic tool to reduce the threat of corners and squeezes and promote convergence without compromising market liquidity."[37]

In response to commenters' concerns that the CFTC intended to restrict the scope of the term "deliverable supply," the CFTC stated that it was applying its traditional concept of deliverable supply. Under this approach, deliverable supply is "the quantity of the commodity meeting a derivative contract's delivery specifications that can reasonably be expected to be readily available to short traders and saleable by long traders at its market value in normal cash marketing channels at the derivative contract's delivery points during the specified delivery period."[38]

*Effective Dates for Initial and Subsequent Spot-month Limits*

The CFTC will set initial spot-month limits for physically-delivered Core Referenced Futures Contracts at the same levels as are now set by the DCMs with cash-settled Referenced Contracts subject to equivalent limits.[39] Those initial limits have been specified in Appendix A to the final rules and will go into effect 60 days after the term "swap" is further defined in a CFTC/SEC joint rulemaking.[40] Thereafter, spot-month limits will be updated annually for agricultural contracts and every two years for energy and metals contracts, based on the estimates of deliverable supply that DCMs will be required to submit on specific staggered dates for each Core Referenced Futures Contract.[41] Updated limits will be fixed by CFTC order and published on the CFTC's website two months before the limits become effective.[42] The CFTC's final rules allow DCMs to petition the CFTC to update the limits on a more frequent basis if warranted by supply and demand fundamentals.

*Different Approach to Spot-month Limits in Natural Gas Market*

The CFTC's final rules will allow a trader in one type of contract — the NYMEX Henry Hub Natural Gas contract — to hold cash-settled contract positions up to five times the level of the spot-month limit for physically-delivered contracts, set by the CFTC at 1,000 contracts. However, the trader also will be subject to an aggregate five times limit that applies to the trader's total cash-settled and physically delivered contract positions.[43] Thus, assuming the spot-month limit for the physically-delivered contract is 1,000 contracts and the trader holds the maximum directional position in the

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35 *Id.*

36 76 Fed. Reg. at 71634.

37 *Id.*

38 *Id.* at 71633.

39 *Id.* at 71631.

40 Final Rule 151.4(d)(1). The CFTC's final rule simply states that the limits would be effective "60 days after the term 'swap' is further defined under the [Dodd-Frank Act]." Thus, the CFTC does not make clear whether the 60 days will start running from the *publication date* of the CFTC/SEC rulemaking that further defines "swap" or the *effective date* of that rulemaking further defining "swap."

41 Final Rule 151.4(d)(2).

42 Final Rule 151.4(e).

43 Final Rule 151.4(a)(2)(ii).

physically-delivered contract, the trader would have to make sure that trader's cash-settled contract positions on the same side of the market do not exceed four times the limit (*i.e.*, 4,000 contracts). Alternatively, if a trader wanted to hold 1,000 contracts in the physically-delivered contract in one direction, the trader could also hold 5,000 cash-settled contracts in the opposite direction as the physical delivery contract and still comply with the aggregate limit.

The CFTC states that it "has a reasonable basis to believe that the cash-settled market in natural gas is sufficiently different from the cash-settled markets in other physical commodities to warrant a different spot-month methodology."[44] Furthermore, the CFTC contends that "[p]ermitting traders to hold larger positions in natural gas cash-settled contracts near expiration should not materially affect the potential for market abuses, as the current Commission surveillance system serves to detect and prevent market manipulation, squeezes, and corners in the physical-delivery futures contracts as well as market abuses in cash-settled contracts."[45]

### *Interim Final Rule Status of Spot-month Limit Rules for Cash-Settled Contracts and Request for Comments*

The CFTC has adopted its final spot-month limit rules for cash-settled contracts, including the rules applicable to the cash-settled market in natural gas, on an interim basis "in order to solicit additional comments on the appropriate level of spot-month limits for cash-settled contracts."[46] At this time, the CFTC believes that parity should exist in position limits between physically-delivered and cash-settled Referenced Contracts (other than natural gas) because a higher limit in look-alike cash-settled contracts "may provide an incentive to manipulate and undermine price discovery in the underlying physical delivery futures contract."[47] Comments on the CFTC's interim final rules for spot-month limits on cash-settled contracts are due on January 17, 2012.

## Non-spot-month Position Limits

Non-spot-month position limits apply to all Referenced Contracts in a given commodity in all contract months combined or in a single month. Single-month non-spot-month limits and all-months-combined non-spot-month limits will be set at the same level.

### *Methodology for Calculating Non-spot-month Limits*

Non-spot-month limits will be set at 10 percent of aggregate open interest (combined futures, options and swaps open interest in a given commodity) for the first 25,000 contracts and 2.5 percent thereafter for any remaining open interest (10/2.5 percent formula).[48] The CFTC notes that this formula is "consistent with the Commission's historical approach to setting non-spot-month speculative position limits" for certain agricultural commodity futures and options under Part 150.[49] Moreover, the CFTC expects that the formula will yield limits capable of "prevent[ing] a speculative trader from acquiring excessively large positions" while "ensur[ing] sufficient liquidity for bona fide hedgers and avoid[ing] disruption to the price discovery process."[50]

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44 *Id.* at 71635.

45 *Id.* at 71637.

46 *Id.* at 71635.

47 *Id.*

48 Final Rule 151.4(b)(1).

49 76 Fed. Reg. at 71639.

50 *Id.*

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*Effective Dates for Initial and Subsequent Non-spot-month Limits*

The CFTC will impose initial non-spot-month limits (single-month and all-months-combined) by CFTC order within one month of receiving one year of swaps open interest data[51] under the CFTC's new swaps large trader reporting rules, which have not yet gone into effect. (These reporting rules are now scheduled to take effect on November 21, 2011.) The non-spot-month limits will be adjusted every two years by applying the 10/2.5 percent formula to the higher of: 1) the average open interest level in the most recent calendar year or 2) the average open interest level in the most recent two calendar years.[52] The CFTC observed that this "higher of" procedure would provide for generally less restrictive limits than the proposal, which required using the most recent calendar year's open interest.[53] Updated non-spot-month limits will be fixed by CFTC order and published on the CFTC's website two months before they become effective.[54]

*Different Approach to Non-spot-month limits in Legacy Referenced Contracts*

The CFTC's final rules specify a different approach for setting non-spot-month limits in "legacy" agricultural Referenced Contracts that currently are subject to CFTC limits. Rather than apply the open interest formula to those contracts, the CFTC is adopting the increased limit levels proposed by CME based on 2009 open interest data.[55] The CFTC also will ensure parity among wheat contracts by increasing the levels of the limits on wheat at MGEX and KCBT to the level CME proposed for the wheat contract at CBOT.[56] These "legacy" agricultural contract limits are specified in the CFTC's final rules[57] and will go into effect 60 days after the term "swap" is further defined.[58] The CFTC will not reset the limits for legacy agricultural Referenced Contracts under the same bi-annual process it will use for non-legacy Referenced Contracts or under any other regular schedule. Instead, the CFTC only will change the legacy limits following a notice-and-comment rulemaking process that will be initiated at a time of the CFTC's choosing.[59]

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51 Final Rule 151.4(d)(3)(i).

52 Final Rule 151.4(a)(3)(ii).

53 *See* 76 Fed. Reg. at 71641-42.

54 Final Rule 151.4(e).

55 *See* 76 Fed. Reg. at 71642.

56 *See id.*

57 The non-spot-month limits for the legacy agricultural contracts are, respectively:

| Referenced Contract | Position Limit (in contracts) |
|---|---|
| CBOT Corn (C) | 33,000 |
| CBOT Oats (O) | 2,000 |
| CBOT Soybeans (S) | 15,000 |
| CBOT Soybean Meal (SM) | 6,500 |
| CBOT Soybean Oil (BO) | 8,000 |
| CBOT Wheat (W) | 12,000 |
| ICE Futures U.S. Cotton No.2 (CT) | 5,000 |
| KCBT Hard Winter Wheat (KW) | 12,000 |
| MGEX Hard Red Spring Wheat (MW) | 12,000 |

58 Final Rule 151.4(d)(4).

59 *See* 76 Fed. Reg. at 71642.

## How Will Netting Apply to the Position Limits?

Under Part 151, spot-month limits and non-spot-month limits will be subject to different netting provisions.

### Netting in Spot Month

As indicated above, the CFTC is retaining class limits in the spot month for physical-delivery and cash-settled contracts. Traders are permitted to net *within* each class, but may not net across physical-delivery and cash-settled contracts for purposes of determining compliance with spot-month class limits.[60] By way of an example, assume that the spot-month limit (applying separately to physically-delivered and cash-settled contracts) is 100 contracts and a trader holds 50 long cash-settled contracts, 100 short cash-settled contracts and 100 long physically-delivered contracts. The trader could net the long and short cash-settled contract positions, but could not net the resulting cash-settled position of 50 short with the 100 long physically-delivered contracts. The CFTC has explained that the spot-month class limits prevent a trader from "stand[ing] for 100 percent of deliverable supply during the spot month by holding a large long position in the physical-delivery contract along with an offsetting short position in a cash-settled contract, which effectively would corner the market."[61]

### Netting Outside Spot Month

The CFTC has eliminated the proposed non-spot-month class limits that would have applied separately to futures and options, as one contract class, and swaps, as a distinct class. As a result, market participants will be permitted to net futures/options positions against economically equivalent swaps for purposes of determining compliance with non-spot month limits.[62] The CFTC intends to use its large trader surveillance program to monitor for any market abuses arising from the netting of futures and swaps.

## What Exemptions Will Be Available From the Position Limits?

The CFTC's final rules recognize an exemption for bona fide hedges, an exemption for pre-existing positions (*i.e.*, positions established in good faith prior to the effective date of the federal limits imposed under the new rules) and a financial distress exemption.

### Bona Fide Hedging Exemption

The CFTC's final rules codify Dodd-Frank's amended definition of "bona fide hedging" for physical commodity derivatives. That definition essentially recognizes two types of hedging: direct hedging of commercial activity and hedging of swaps that in turn hedge commercial activity.

#### *Direct Hedging of Commercial Activity*

Under the first type of bona fide hedging, a transaction or position in a Referenced Contract must: (1) represent a substitute for subsequent transactions in the physical marketing channel; (2) be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise; and (3) manage price risks associated with specific types of activities in the physical market channel

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60 Final Rule 151.4(c)(1).

61 76 Fed. Reg. at 71637.

62 Final Rule 151.4(c)(2).

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(*e.g.*, production of commodity assets).[63] This concept of "bona fide hedging" is narrower than the "bona fide hedging" definition in existing CFTC Rule 1.3(z). In contrast to the new definition, the definition in Rule 1.3(z) — which continues to apply to non-physical commodities (called "excluded commodities" in the statute) — does not require bona fide hedging transactions or positions to represent a substitute for actual cash market transactions. The CFTC rejected commenters' arguments that the CFTC should harmonize the new "bona fide hedging" definition with the broader hedging standards found elsewhere in the CEA, asserting that Congress "included different criteria for bona fide hedging transactions and positions" for position limit purposes.[64]

For this first type of hedging, the CFTC has further narrowed the concept of "bona fide hedging" by requiring not only that a transaction or position meet the three criteria above, but also that the transaction or position qualify as one or more enumerated types of hedging transactions.[65] The CFTC's final rule provides for eight enumerated hedging transactions, including, among others, cross-commodity hedges, anticipated merchandising hedges, anticipated royalty hedges and service hedges.[66] Each enumerated category includes a restriction on holding hedging positions in any physical delivery Referenced Contract during the last five days of trading for agricultural and metals contracts or during the spot month for all other physical delivery contracts. Appendix B to the CFTC's final rules includes fact patterns and analyses to illustrate the enumerated hedging transactions.

During deliberations on the CFTC's final rules, at least four Commissioners expressed concern that the eight enumerated types of hedges might be unduly restrictive. Commissioner Jill Sommers, for one, stated that she "was not comfortable with the notion that a list of eight bona-fide hedging transactions … is sufficiently extensive and specialized to cover the complex needs of today's bona-fide hedgers."[67] In particular, Commissioner Sommers pointed out that the anticipatory merchandising hedge equated "merchandising" with storing a commodity, thereby limiting the concept of merchandising activities in a way that was "needlessly at odds with the statute and with the legitimate needs of hedgers."[68]

In an attempt to address these concerns, the CFTC adopted a special exemption procedure in its final rules. Traders who are engaged in risk-reducing practices commonly used in the market (that do not appear to be specifically enumerated) may petition the CFTC staff or the CFTC for relief from position limits under the CFTC's broad exemptive authority in CEA Section 4a(a)(7).[69] The CFTC has not explained what the petition or request must include or how it would make a determination as to the status of the risk-reducing practice.

### *Hedging of Swaps That in Turn Hedge Commercial Activity ("Pass Through" Exemption)*

A person who does not directly hedge commercial activity, such as a swap dealer, would not need to rely on a hedge exemption to exempt its positions from speculative limits where it nets those positions; once netted, the positions are offset and not counted against the speculative limit. Outside the spot month, a swap dealer would be able to net its swap positions with any futures positions that reduce the risk of the swap because — with the elimination of non-spot-month class limits — netting is permitted across futures and economically equivalent swaps. Similarly, in the spot month,

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63 Final Rule 151.5(a)(1)(i)-(iii).

64 *See* 76 Fed. Reg. at 71644-45.

65 Final Rule 151.5(a)(1)(v).

66 Final Rule 151.5(a)(2).

67 76 Fed. Reg. at 71700.

68 *See id.*

69 Final Rule 151.5(a)(5).

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the swap dealer could net cash-settled swap positions with risk-reducing positions in cash-settled contracts given that netting is permitted within classes (*i.e.*, physically-delivered or cash-settled) for spot-month limit purposes. The only time that a swap dealer would appear to need an exemption is during the spot month when — due to the restriction on netting across classes — the swap dealer would not be able to net cash-settled swap positions against any risk-reducing physically-delivered futures positions.[70]

To address situations where a swap dealer cannot use netting to reduce its exposure against an applicable position limit, the CFTC's new bona fide hedging definition includes a special hedging exemption for persons such as swap dealers.[71] Under the CFTC's final rules, a swap dealer can claim an exemption for: 1) a swap, option or futures position that reduces the risk of a prior swap that was executed against a counterparty who qualifies as a bona fide hedger for that swap (known as the "pass through" swap)[72] and 2) the underlying "pass through" swap. However, the swap dealer can claim an exemption for the "pass through" swap only to the extent that the swap is offset by the swap dealer's risk-reducing positions.[73]

An example can help illustrate how these exemptions work. Assume that, during the spot month, a swap dealer enters into a pass-through swap opposite a bona fide hedger that results in a directional exposure of 100 long cash-settled swap positions in a Referenced Contract. The swap dealer then enters into 95 short physically-delivered futures positions to reduce the risk of the pass-through swap. Due to the restriction on netting across classes in the spot month, the swap dealer would not be able to net its long cash-settled swap positions against its short physically-delivered futures positions. Under the CFTC's final bona fide hedging rules, however, the swap dealer could claim an exemption for the 95 short physically-delivered futures positions because they reduce the risk of the "pass through" swap *and* could claim an exemption for 95 long cash-settled swap positions of the "pass through" swap because that is the amount of the swap being offset. The remaining five long swap positions presumably would be counted against the swap dealer's position limit.

### *Procedural Requirements for Bona Fide Hedge Exemptions*

The CFTC's final rules set forth various procedural requirements for seeking and maintaining bona fide hedging exemptions. Any person who exceeds position limits in reliance on one of the enumerated hedging categories (that does not involve anticipatory hedging) must submit a CFTC Form 404 filing to the CFTC three days after the limit is first exceeded and on a monthly basis thereafter. The 404 filing consists of daily information about the person's cash market and hedging activities.[74]

If a person is relying on an enumerated anticipatory hedging exemption, the person must submit a CFTC Form 404A filing 10 days in advance of the date the person anticipates exceeding the limit. The 404A filing must contain a description of the anticipated cash market activity to be hedged and anticipated hedge positions, data about the person's actual cash market activities and the time period required for the anticipatory hedge. A one-year limitation applies to anticipatory merchandising hedges and anticipatory hedges involving Referenced agricultural contracts.[75]

70 *See* 76 Fed. Reg. at 71647.

71 Final Rule 151.5(a)(1)(iv).

72 Final Rule 151.5(a)(3). This exemption is not available, however, for risk-reducing positions in any physical delivery Referenced Contract during the last five days of trading in an agricultural or metals contract or during the spot month for all other physical delivery contracts, *unless* the "pass through" swap continues to offset the cash market commodity price risk of the bona fide hedging counterparty.

73 Final Rule 151.5(a)(4).

74 Final Rule 151.5(c).

75 Final Rule 151.5(d).

The CFTC will review these filings and notify the applicant if further information is required or if the transactions or positions are determined not to qualify as bona fide hedging. [76] Persons availing themselves of a bona fide hedging exemption must keep books and records concerning all of their related cash, futures, and swap positions and transactions and make such information available to the CFTC upon request.[77]

Additional requirements apply to traders seeking to take advantage of the "pass through" swap exemption. Like other non-anticipatory bona fide hedgers, any party relying on the "pass through" exemption must make a filing with the CFTC three days after the limit is first exceeded and on a monthly basis thereafter. This filing (called a 404S filing) must include information about the "pass through" swap and the risk-reducing Referenced Contract positions.[78] As part of the recordkeeping requirements, the party seeking the exemption also would be required to maintain a list of bona fide hedging counterparties and make that list available to the CFTC upon request.[79] Finally, the applicant's bona fide hedging counterparty would need to provide a written representation that the swap qualifies as a bona fide hedging transaction and keep records supporting such a representation. Both the representation and related records must be maintained for a period of at least two years following expiration of the swap and be made available to the CFTC upon request.[80]

**Pre-existing Position Exemption**

Positions in Referenced Contracts can exceed non-spot-month limits to the extent that the positions were entered into in good faith prior to the effective date of any CFTC rule or order specifying the non-spot-month limits.[81] However, if a trader's pre-existing positions exceed the limit, the trader cannot increase the directional position that caused the trader to exceed the limit. If a trader's pre-existing positions are below the limit (or if the trader reduced them so they no longer exceed the limit), the trader can increase the trader's positions, but the combined pre-existing and new positions will be counted against the position limit.[82]

Swap positions entered into in good faith prior to the effective date of CFTC-set initial limits will be exempt from both the initial spot-month and non-spot month limits. Such pre-effective date swap positions may be netted against post-effective date swaps and swaptions.[83]

The CFTC clarifies that index funds that "roll" their pre-existing positions after the effective date of a position limit rule do not fall within the scope of the pre-existing position exemptions.[84] By way of an example, assume an index fund establishes a position in good faith prior to the effective date of the CFTC's initial non-spot-month limits and then liquidates and re-establishes (*i.e.* "rolls") that position after the effective date of the non-spot-month limits. Under the CFTC's final rules, the index fund's roll-over position would be treated as a wholly new position and therefore not eligible for the pre-existing position exemption.

76 Final Rule 151.5(e).

77 Final Rule 151.5(h).

78 Final Rule 151.5(f).

79 Final Rule 151.5(h).

80 Final Rule 151.5(i).

81 Final Rule 151.9(a).

82 *See* 76 Fed. Reg. at 71655.

83 Final Rule 151.9(c).

84 76 Fed. Reg. at 71656.

### Financial Distress Exemption

In response to public comments, the CFTC also has adopted an exemption under CEA Section 4a(a)(7) for market participants in financial distress scenarios. Financial distress circumstances are situations involving the potential default or bankruptcy of a customer of the requesting person or persons, affiliate of the requesting person or persons, or potential acquisition target of the requesting person or persons. Persons seeking this exemption must make a request to the CFTC; any exemptions will be granted by CFTC order.[85]

## How Will Positions Be Aggregated for Purposes of Determining Compliance With Position Limits?

The CFTC's final rules adopt a modified version of the existing aggregation standards under its current Part 150 position limit regulations. According to the CFTC, "the primary rationale for the aggregation of positions or accounts is the concern that a single trader, through common ownership or control of multiple accounts, may establish positions in excess of the position limits … and thereby increase the risk of market manipulation or disruption."[86] The CFTC did not contend that the existing Part 150 rules fail to embody this "primary rationale" for aggregation or otherwise explain why it did not retain the existing Part 150 standards in their current form.

### Retention of Current Aggregation Requirements

The final rules retain the current requirement that a person aggregate all of its position holdings as well as the positions in accounts that it controls or owns.[87] As under the current rules, a person is considered to "own" an account when it has a 10 percent or greater ownership or equity interest in the account.[88]

Additionally, the final rules include the existing requirement that the positions of two or more persons be aggregated where the persons are acting pursuant to an express or implied agreement or understanding.[89]

### New "Identical Trading Strategy" Aggregation Requirement

The CFTC's final rules deviate from the existing aggregation policy by adding a new "identical trading strategy" aggregation requirement that applies "notwithstanding any other provision" (including the exemptions set forth below).[90] This "identical trading strategy" rule would require an investor having *any* level of ownership or equity interest in multiple accounts or pools with "identical trading strategies" to aggregate positions in such accounts or pools. The CFTC's final rules and preamble do not make clear whether the person would be required to aggregate its pro rata portion of the positions or all of the positions of the accounts or pools. Also, despite commenters' request for clarification, the CFTC has not provided a definition of "identical trading strategy." The CFTC has indicated that the rule would apply to passively managed index funds and, in a parenthetical, noted that a "long-only position in a given commodity" is an example of an identical trading strategy.[91] According to the CFTC, the aggregation requirement is needed to prevent "a trader [from] acquir[ing] a large long-only position in a given commodity through positions in multiple pools."[92]

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85 Final Rule 151.5(j).

86 76 Fed. Reg. at 71678.

87 Final Rule 151.7(a) & (b).

88 Final Rule 151.7(b).

89 Final Rule 151.7(a).

90 Final Rule 151.7(d).

91 *See* 76 Fed. Reg. at 71654.

92 *Id.*

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## What Exemptions Are Available From Aggregation?

The CFTC's final rules provide for five different aggregation exemptions: 1) an independent account controller exemption, 2) an exemption for futures commission merchants (FCMs) and their separately organized affiliates, 3) exemptions for certain passive participants in commodity pools, 4) an exemption related to the underwriting of securities and 5) an exemption that applies where federal law would restrict information sharing.

### Retention of Independent Account Controller Exemption "Largely as Currently in Effect"

The CFTC states that it is "retain[ing] the [independent account controller] exemption largely as currently in effect" in response to comments that strongly opposed its proposed elimination.[93] Under existing Part 150, the independent account controller exemption allows an "eligible entity to disaggregate positions "carried for [the] eligible entity" "in the separate account or accounts of an independent account controller" (IAC) outside the spot month.[94] An "eligible entity" is defined as: 1) a commodity pool operator (CPO), commodity trading advisor, bank or trust company, savings association, or an insurance company, among others[95]; 2) which authorizes an independent account controller independently to control all the trading decisions for positions it holds directly or indirectly, or on its behalf, but without its day-to-day direction; and 3) which maintains only such minimum control over the independent account controller as is consistent with its fiduciary responsibilities and necessary to fulfill its duty to supervise diligently the trading done on its behalf.[96]

For decades, eligible entities have relied on the IAC exemption as a means of disaggregating on the basis of independence of trading control. The historical understanding of the IAC exemption — as Commissioner O'Malia noted in his dissent — is that it even extends to providing relief from the 10 percent ownership aggregation standard (where trading control is independent).[97] For example, an eligible entity with a 10 percent or greater ownership interest in an independently controlled entity could use the IAC exemption to disaggregate the owned entity's positions from the eligible entity's positions. Because the current IAC exemption is self-effectuating, the CFTC has not had to issue any decision approving any market participants' interpretation and use of the IAC exemption.

The wording of the new IAC exemption under Part 151 differs from that of the current IAC exemption. Per the new IAC exemption, "an eligible entity need not aggregate its positions with the eligible entity's client positions or accounts carried by an independent account controller … except for the spot month in physical-delivery Referenced Contracts."[98] The CFTC states that the language of the new IAC exemption makes explicit the CFTC's "long-standing position that the IAC exemption is limited to client positions, that is, only to the extent one trades professionally for others can one avail

93 76 Fed. Reg. at 71652.

94 17 C.F.R. § 150.3(a)(4).

95 The list of entities also includes the operator of a trading vehicle which is excluded or who itself has qualified for exclusion from the definition of the term "pool" or commodity pool operator," respectively, under CFTC Regulation 4.5; the limited partner or shareholder in a commodity pool the operator of which is exempt from registration under CFTC Regulation 4.13; and the separately organized affiliates of any of the enumerated entities.

96 17 C.F.R. § 150.1(d).

97 *See* 76 Fed. Reg. at 71704.

98 Final Rule 151.7(f). Similarly, the "eligible entity" definition under Part 151 differs from the "eligible entity" definition in Part 150 in the following respects: 1) the Part 151 definition refers to the "eligible entity's client positions or accounts" whereas the Part 150 definition refers to "positions it holds directly or indirectly, or on its behalf"; 2) the Part 151 definition refers to the "eligible entity's fiduciary responsibilities to the managed positions and accounts" whereas the Part 150 definition refers to "its fiduciary responsibilities" without any qualification; and 3) the Part 151 definition does not include "savings association" in the list of potential eligible entities.

him or herself of this IAC exemption."[99] Thus, under the new IAC exemption, eligible entities can disaggregate their client positions held by an IAC. The CFTC also clarifies that the "IAC exemption does not extend to proprietary positions in accounts which a trader owns."[100]

### Retention of FCM and Passive Pool Participant Exemptions

Aside from the IAC exemption, the CFTC's final rules include two other provisions granting disaggregation relief on the basis of independent trading control: an exemption for futures commission merchants (FCMs) and their affiliates and exemptions for certain passive pool participants, both of which also are found in Part 150. The FCM exemption allows an FCM or its separately organized affiliates to disaggregate positions in discretionary accounts or customer trading program accounts if a trader other than the FCM or the affiliate directs trading in such accounts and the FCM or the affiliate maintains only a minimum level of supervision over such accounts.[101]

In the commodity pool context, a pool participant with a 10 percent or greater ownership or equity interest in a pool is allowed to disaggregate the pooled accounts or positions from the participant's other positions unless the participant also is: 1) a principal or affiliate of a CPO with knowledge of and/or control over trading, 2) the CPO or 3) a 25 percent or greater shareholder in a commodity pool the operator of which is exempt from registration under CFTC Regulation 4.13. A principal or affiliate of a CPO with a 10 percent or greater interest in the pool can be exempted from aggregation if the principal or affiliate does not have knowledge of or control over the pool's trading decisions.[102]

### New Exemptions Related to Underwriting of Securities and Federal Law Information Sharing Restrictions

The CFTC has created two new, limited exemptions that would allow for the disaggregation of commonly owned entities, though not on the basis of independent trading control. Final Rule 151.7(g) [Exemption for Underwriting] states that a "person need not aggregate the positions or accounts of an owned entity if the ownership interest is based on [the underwriting of securities]." Under Rule 151.7(i) [Exemption for Federal Law Information Sharing Restriction], "a person is not subject to … aggregation requirements … if the sharing of information associated with such aggregation would cause either person to violate federal law or regulations." The exemption in 151.7(i) is worded broadly enough to apply to situations where a person would otherwise be forced to aggregate with an entity in which it has a 10 percent or greater ownership or equity interest.

The CFTC has decided not to expand the scope of disaggregation relief to owners of non-financial entities and/or financial entities on the basis that the owned entity is independently controlled and managed.[103]

## How Does a Party Obtain an Exemption From Aggregation?

Historically, exemptions from aggregation like the independent account controller exemption were self-effectuating. The CFTC has elected to change this practice under the final rules for certain exemptions. A person seeking to rely upon the passive pool participant exemption for principals or affiliates of CPOs, the IAC exemption or the federal law information sharing restriction exemption must file a notice with the CFTC. The notice filing, which will be effective upon submission, must set forth the circumstances

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99 76 Fed. Reg. at 71652.

100 *Id.*

101 Final Rule 151.7(e).

102 Final Rule 151.7(c).

103 *See* 76 Fed. Reg. at 71654.

warranting disaggregation and a certification that the relevant conditions are met.[104] For the federal law information sharing restriction exemption, a person also is required to submit an opinion of counsel that the sharing of information would cause a violation of federal law or regulations.[105]

## What Other Position Thresholds Does the CFTC Establish?

The CFTC's final rules adopt a position visibility reporting regime that will apply to traders who hold or control positions (including bona fide hedge positions) that equal or exceed CFTC-set position visibility levels for energy and metal Referenced Contracts.[106] These levels have been specified in the final rules[107] and represent approximately 50 percent to 60 percent of the projected aggregate position limits for Referenced Contracts, with the exception of lower levels used for natural gas and crude oil.[108]

Traders equaling or exceeding a visibility level in any single month (including the spot month) or all months combined will be required to submit 401 and 404 filings to the CFTC within 10 business days of the last day of the quarter in which the trader exceeded a visibility level. Information reported in such filings would include the dates on which the trader held or controlled a position that equaled or exceeded a visibility level, gross long and gross short positions separately for futures, options and swaps (cleared and uncleared), and cash market commodity data.[109]

The CFTC expects that the position visibility reports will provide it with a better understanding of trading activity in the physical commodity futures and swaps market and, accordingly, will enable the CFTC to more effectively enforce position limits and/or adjust the position limit framework as needed.[110] The position visibility rule will become effective 60 days after the term "swap" is further defined.[111]

## How Do the Final Rules Affect Designated Contract Market and Swap Execution Facility Position Limits and Position Accountability Levels?

The CFTC's final rules set forth requirements and acceptable practices for DCMs and SEFs with respect to establishing position limits and position accountability levels on contracts executed pursuant

104 Final Rule 151.7(h).

105 Final Rule 151.7(i).

106 Final Rule 151.6(a).

107 The visibility levels for the Referenced Contracts are, respectively:

| Contract | Visibility Level |
|---|---|
| Commodity Exchange, Inc. Copper (HG) | 8,500 |
| Commodity Exchange, Inc. Gold (GC) | 30,000 |
| Commodity Exchange, Inc. Silver (SI) | 8,500 |
| NYMEX Palladium (PA) | 1,500 |
| NYMEX Platinum (PL) | 2,000 |
| NYMEX Light Sweet Crude Oil (CL) | 50,000 |
| NYMEX Henry Hub Natural Gas (NG) | 50,000 |
| NYMEX New York Harbor Gasoline Blendstock (RB) | 10,000 |
| NYMEX New York Harbor No. 2 Heating Oil (HO) | 16,000 |

108 76 Fed. Reg. at 71673.

109 Final Rule 151.6(b) & (c).

110 *See* 76 Fed. Reg. at 71673-73.

111 Final Rule 151.6(f).

to their rules. Additionally, the CFTC's final rules specify the aggregation provisions and bona fide hedging and other exemptions that DCMs and SEFs are to apply in their position limit and position accountability regimes.

### DCM and SEF Position Limits on Referenced Contracts

For Referenced Contracts covered by the CFTC's final rules, DCMs and SEFs will be required to impose spot-month and non-spot-month limits at levels no greater than the corresponding federal limit.[112] The CFTC's asserted basis for this requirement is, in part, that Core Principle 5 for DCMs and SEFs, respectively, requires DCMs and SEFs to set and enforce speculative position limits at a level no higher than those established by the CFTC.[113] Although the CFTC will not administer the position limits imposed by DCMs and SEFs, it stated in its release that it retains the authority to enforce compliance with those limits.[114]

### DCM and SEF Position Limits on Non-Referenced Contracts

For Non-Referenced Contracts — *i.e.*, contracts on physical commodities not covered in the rulemaking and contracts on excluded commodities — the CFTC's rules state that "it shall be an acceptable practice" for DCMs and SEFs to adopt spot-month limits using the 25 percent estimated deliverable supply formula and to adopt non-spot-month limits using the 10/2.5 percent open interest formula.[115] In the case of new contracts, the CFTC's rules indicate that an "acceptable practice" for DCMs and SEFs is setting non-spot-month limits at 1,000 for physical commodities other than energy and at 5,000 for all other commodities.[116] The CFTC claims that "requiring that DCMs (and SEFs by extension) establish position limits for all physical commodity contracts" is "consistent with the congressional mandate [to the CFTC] to establish position limits on all DCM physical commodity contracts."[117] Nowhere in the release does the CFTC specifically identify a statutory basis for requiring (or, through an "acceptable practice," strongly encouraging) DCMs and SEFs to impose position limits or accountability levels on excluded commodities.

### DCM and SEF Position Accountability Levels for Certain Non-Referenced Contracts

The CFTC's final rules state that "it shall be an acceptable practice" for DCMs and SEFs to adopt position accountability levels in lieu of position limits for the following Non-Referenced Contracts: 1) contracts on agricultural and exempt commodities (outside of the 28 specified in the CFTC's final rules) that meet certain open interest, volume and liquidity thresholds (although limits must be imposed on such contracts during the spot month); 2) contracts on a major foreign currency for which there is no legal impediment to delivery and for which there exists a highly liquid cash market; 3) contracts on an excluded commodity that is an index or measure of inflation, or other macroeconomic index or measure; and 4) contracts on an excluded commodity that meets the definition of § 1a(19) (ii), (iii), or (iv) of CEA.[118] If a trader exceeds the position accountability level set by a DCM or SEF,

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112 Final Rule 151.11(a)(1) & (b)(1).

113 *See* 76 Fed. Reg. at 71659.

114 *Id.*

115 Final Rule 151.11(a)(2) & (b)(2).

116 Final Rule 151.11(b)(3).

117 76 Fed. Reg. at 71660.

118 Final Rule 151.11(c).

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the trader would be required to provide information about the trader's position and to consent to halt increasing further a trader's position upon request by the exchange.[119]

**Aggregation Provisions and Bona Fide Hedging and Other Exemptions for DCM and SEF Position Limit and Position Accountability Regimes**

The CFTC's final rules also require DCMs and SEFs to apply certain aggregation standards and bona fide hedging and other exemptions in administering their position limit and position accountability regimes. Under Final Rule 151.11(e), any DCM or SEF position limits or accountability rules shall be subject to the CFTC's account aggregation standards in Rule 151.7. DCMs and SEFs also would have to ensure that they do not apply any position limits or accountability levels to physical commodity derivative positions that would meet the definition of "bona fide hedging" used in administering federal limits or, for excluded commodities, positions that would be exempt under the current definition of "bona fide hedging" in Rule 1.3(z).[120] The CFTC's final rules further state that DCM and SEF "speculative position limits shall not apply to": pre-existing positions, spread or arbitrage positions (provided that such positions are outside of the spot month for physical-delivery contracts) or any person registered as an FCM or floor broker (except to the extent that transactions made by such person are made on behalf of or for the account or benefit of such person).[121]

**Effective Date for DCM and SEF Position Limits and Accountability Levels**

The final rules pertaining to the DCM and SEF position limit regimes will become effective 60 days after the CFTC and SEC adopt final joint rules further defining the term "swap."[122] However, DCM and SEF non-spot-month limits for non-legacy Referenced Contracts shall not be effective until the CFTC establishes federal non-spot-month limits for such contracts by subsequent order, which will not be adopted for at least one year. In the interim, "it shall be an acceptable practice" for DCMs and SEFs to either: 1) retain existing non-spot-month position limits or accountability rules or 2) establish non-spot-month limits or accountability rules "based on open interest in the same contract or economically equivalent contracts."[123]

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119 *Id.*

120 Final Rule 151.11(f)(1).

121 Final Rule 151.11(g).

122 Final Rule 151.11(i).

123 Final Rule 151.11(j).

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