CFTC Approves Proposed Rules on Position Limits

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On Tuesday, November 5, 2013, the Commodity Futures Trading Commission (Commission) proposed new rules on speculative position limits and, separately, on the aggregation of related accounts.[1] These proposals replace the position limit rules that were approved on October 18, 2011, but vacated in US District Court.[2] The following is a brief summary of the proposals. The public will have 60 days from publication to comment in the Federal Register.

I. What are the proposed position limits rules?

The proposed rules would impose speculative position limits in 28 physical commodity contracts—19 agricultural contracts, four energy contracts, and five metals contracts.[3] These limits would apply to futures, options, and their economically equivalent swaps. In accordance with Commission precedent, the limits will apply separately to Spot Month, Single Months and All-Months-Combined.

Spot-Month Limits: Spot-month speculative position limits would apply to the period immediately before delivery obligations arise or cash settlement occurs. As is current practice, the spot-month limits are proposed to be set at 25% of estimated deliverable supply. Cash-settled contracts would have a separate spot-month limit that is five times the size of the spot-month limit for physical delivery contracts.[4] However, due to its historic volatility, the Commission also proposed to require daily reporting of cash market positions for those traders with positions relying upon the higher spot-month limit for cash-settled contracts in natural gas.

Non-Spot-Month Limits: The non-spot-month position limits would apply to positions a trader may have in all contract months combined or in a single contract month. Non-spot limits are proposed to be set using the familiar 10/2.5% formula; 10% of the contract's first 25,000 of open interest, and 2.5 percent of the remainder.[5]

II. What exemptions will apply?

As noted above, there will be a higher spot-month position limit for cash-settled contracts. In addition, the Commission is proposing to include within the hedge exemption some, but not all, of the specific hedging examples previously raised by industry commenters. Finally, the Commission is proposing to make clear that there would also be exemptions for positions established in good faith prior to the effective date of the new limits.

III. What swaps will be "economically equivalent"?

The Commission is proposing that swaps that will be considered to be economically equivalent to a futures contract include: (a) "look-alike" contracts; (b) except for locational basis swaps, swaps with a reference price based on the combination of at least one referenced contract price and another price for the same or substantially the same commodity; (c) inter-commodity spread swaps based on one or more referenced contracts; or (d) swaps priced at a fixed differential to a core referenced futures contract.[6]

IV. What are the proposed changes to the aggregation rules?

The Commission is proposing standards for determining when positions held by two or more related entities must be aggregated under the speculative position limit rules. The proposed aggregation standards generally are similar to the standards proposed in May 2012. However, the Commission is now proposing to permit market participants to apply for relief from aggregation requirements on a case-by-case basis even where one entity is greater than a 50% owner of another but is not consolidated on the balance sheet of its owner. In addition, the proposal would recognize managers of employee benefit plans to be treated as independent account controllers.

V. What is the Commission's legal basis for these rules?

In proposing these rules, the Commission addressed the court decision vacating the original speculative position limit rules finding that Section 4a(a)(2) of the Commodity Exchange Act was ambiguous with respect to whether a Commission finding of necessity was required before it adopted speculative position limits for a specific commodity. The Commission, based upon the legislative history of the Dodd-Frank Act and the Commission's "experience and expertise," determined that Section 4a(a)(2) does not require such a finding, but nevertheless made a generalized finding of necessity.

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[1] The position limits rules were adopted by a 3-1 vote, with Commissioner Scott O'Malia dissenting; the aggregation of accounts rules were adopted unanimously.

[2] See *International Swaps and Derivatives Association v. United States Commodity Futures Trading Commission*, 887 F. Supp. 2d 259 (D.D.C. 2012).

[3] The 28 core contracts are, by category:

(a) nine “legacy” agricultural contracts: (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 US Cotton No.2 (CT), (8) KCBT Hard Winter Wheat (KW), and (9) MGEX Hard Red Spring Wheat (MWE);

(b) 10 “non-legacy” agricultural contracts: (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 US Cocoa (CC), (7) ICE Futures US Coffee C (KC), (8) ICE Futures U.S. FCOJ-A(OJ), (9) ICE Futures US Sugar No. 11 (SB), and (10) ICE Futures US Sugar No. 16 (SF);

(c) four energy contracts: (1) NYMEX Henry Hub Natural Gas (NG), (2) NYMEX Light Sweet Crude Oil (CL), (3) NYMEX RBOB Gasoline (RB), and (4) NYMEX NY Harbor ULSD (HO); and

(d) five metal contracts: (1) COMEX Copper (HG), (2) COMEX Gold (GC), (3) COMEX Silver (SI), (4) NYMEX Palladium (PA), and (5) NYMEX Platinum (PL).

The Commission, however, intends to eventually apply position limits to all physical contracts.

[4] Initial spot-month limits would be based on the spot-month limits currently in place at designated contract markets (DCMs), or on estimates of deliverable supply submitted by a DCM and verified by the Commission. Future limits would be adjusted at least every two years, and would be based on the Commission’s determination of deliverable supply.

[5] Initial non-spot-month limits would be set based on open interest in futures and swaps that are significant price discovery contracts. Future levels would be adjusted at least every two years, and would be based on referenced contract open interest for a calendar year.

[6] See Q&A – Position Limits for Derivatives, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/pl_150_qa.pdf (accessed Nov. 5, 2013).

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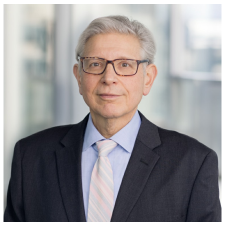

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