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Commodity Futures Trading Commission

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Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations; Proposed Rule

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 20 and 151

RIN 3038–AC85

Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission ("CFTC" or "Commission") is proposing to implement speculative position limits for futures and option contracts in certain energy commodities. The Commodity Exchange Act of 1936 ("CEA" or "Act") gives the Commission the authority to establish limits on positions to diminish, eliminate or prevent excessive speculation causing sudden or unreasonable fluctuations in the price of a commodity, or unwarranted changes in the price of a commodity. In addition to identifying the affected energy contracts and the position limits that would apply to them, the notice of proposed rulemaking includes provisions relating to exemptions from the position limits for *bona fide* hedging transactions and for certain swap dealer risk management transactions. The notice of proposed rulemaking also sets out an application process that would apply to swap dealers seeking a risk management exemption from the position limits, as well as related definitions and reporting requirements. In addition, the notice of proposed rulemaking includes provisions regarding the aggregation of positions under common ownership for the purpose of applying the limits.

DATES: Comments must be received on or before April 26, 2010.

ADDRESSES: Comments should be submitted to David Stawick, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. Comments also may be sent by facsimile to (202) 418–5521, or by electronic mail to *secretary@cftc.gov.* Reference should be made to "Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations." Comments may also be submitted by connecting to the Federal eRulemaking Portal at *http://www.regulations.gov* and following comment submission instructions.

FOR FURTHER INFORMATION CONTACT: Stephen Sherrod, Acting Director of Surveillance, (202) 418–5452, *ssherrod@cftc.gov,* David P. Van Wagner, Chief Counsel, (202) 418–5481, *dvanwagner@cftc.gov,* Donald Heitman, Senior Special Counsel, (202) 418–5041, *dheitman@cftc.gov,* or Bruce Fekrat, Special Counsel, (202) 418–5578, *bfekrat@cftc.gov,* Division of Market Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581, facsimile number (202) 418–5527.

SUPPLEMENTARY INFORMATION:

I. Overview

The majority of futures and options trading on energy commodities in the United States occurs on the New York Mercantile Exchange ("NYMEX"), a designated contract market ("DCM") that operates as part of the CME Group.[1] Energy commodity trading also takes place on the Intercontinental Exchange ("ICE"), an Atlanta-based exchange that operates as an exempt commercial market ("ECM") and is, as of July 2009, a registered entity with respect to its Henry Financial LD1 Fixed Price natural gas contract.[2] NYMEX currently lists physically-delivered and cash-settled futures contracts (and options on such futures contracts) in crude oil, natural gas, gasoline and heating oil. ICE lists a cash-settled look-alike contract on natural gas, and options thereon, that settles directly to the settlement price of NYMEX's physically-delivered natural gas futures contract.[3]

ICE's Henry Financial LD1 Fixed Price natural gas contract and virtually all NYMEX energy contracts are currently subject to exchange-set spot-month speculative position limits that are in effect for the last three days of trading of the respective contracts. Under an exchange's speculative position limit rules, no trader, whether commercial or noncommercial, may exceed a specified limit unless the trader has requested and received an exemption from the exchange. Outside of a contract's spot month, these energy contracts are subject to exchange all-months-combined and single-month position accountability rules. Under an exchange's position accountability rules, once a trader exceeds an accountability level in terms of outstanding contracts held, the exchange has the right to request supporting justification from the trader for the size of its position, and may order a trader to reduce or not increase its positions further.

As described in detail in section VI of this release, the Commission is proposing to impose all-months-combined, single-month, and spot-month speculative position limits for contracts based on a defined set of energy commodities. Broadly described, the Commission's proposal, for non-spot-month positions, would apply exchange-specific speculative position limits to a set of economically similar contracts that settle in the same manner. In addition, the Commission is proposing to implement and enforce aggregate non-spot-month speculative position limits that would apply across registered entities that list substantially similar energy contracts. As discussed in the Paperwork Reduction Act section of this notice of proposed rulemaking, should the proposed regulations be adopted, the Commission estimates that the total number of traders with significant positions that could be affected by the proposed regulations would be approximately ten.

Particular data concerning the distribution of speculative traders in a market and an analysis of market conditions and variables, including open interest, can support a range of acceptable speculative position limit requirements. The Commission, in structuring the speculative position

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[1] The CME Group is the parent company of four DCMs: NYMEX, the Chicago Board of Trade ("CBOT"), the Chicago Mercantile Exchange ("CME"), and the Commodity Exchange ("COMEX").

[2] Under section 2(h)(7) of the Act, ECM contracts that have been determined by the Commission to be significant price discovery contracts ("SPDCs") are subject to Commission regulation. 7 U.S.C. 2(h)(7). ECMs listing SPDCs ("ECM–SPDCs") are also deemed to be registered entities with self-regulatory responsibilities with respect to such contracts. To date, ICE's Henry Financial LD1 Fixed Price natural gas contract is the first and only ECM contract to have been determined by the Commission to be a SPDC under section 2(h)(7) of the Act. 74 FR 37988 (July 30, 2009).

[3] US-based traders also enter into various energy contracts listed by the ICE Futures Europe Exchange ("ICE Futures Europe"), a London-based exchange. These energy contracts include futures on West Texas Intermediate (WTI) light sweet crude oil, a New York Harbor heating oil futures contract and a New York Harbor unleaded gasoline blendstock futures contract. All of the listed contracts directly cash-settle to the price of NYMEX futures contracts that are physically-settled. ICE Futures Europe is a foreign board of trade ("FBOT") and, unlike NYMEX and ICE, is not registered in any capacity with the Commission. Instead, ICE Futures Europe and its predecessor, the International Petroleum Exchange, have operated in the US since 1999 pursuant to Commission staff no-action relief. CFTC Staff Letter No. 99–69 (November 12, 1999). Since 2008, ICE Futures Europe's no-action relief has been conditioned on, among other things, the requirement that the Exchange implement position limit requirements for its NYMEX-linked contracts that are comparable to the position limits that NYMEX applies to its contracts. CFTC Staff Letter No. 08–09 (June 17, 2008); CFTC Staff Letter No. 08–10 (July 3, 2008). Generally, comparable position limits for FBOT contracts that link to CFTC-regulated contracts serve to ensure the integrity of prices for CFTC-regulated contracts.

limit framework as proposed, has considered its recent and historical actions in setting position limits, its continuous oversight of exchange-set speculative position limit and accountability rules, its experience in administering Commission-set speculative position limits [4] and its observations of energy commodity market conditions and developments, particularly during the past four years. The Commission notes that the proposed Federal speculative position limits on energy contracts would be in addition to, and not a substitute for, a reporting market's existing speculative position limit and accountability requirements. Reporting markets, defined in Commission regulation 15.00 to include DCMs and ECM–SPDCs, are self-regulatory organizations with an independent responsibility for adopting and implementing appropriate position limit and accountability rules.

This notice of proposed rulemaking does not propose regulations that would classify and treat differently passive long-only positions. The Commission does, however, in section VIII of this notice, solicit comment on specific issues related to large, passive long-only positions. In particular, the Commission solicits comments on how to identify and define such positions and whether such positions should, including collectively, be limited in any way.

II. Statutory Background

Speculative position limits have been identified as an effective regulatory tool for mitigating the potential for market disruptions that could result from uncontrolled speculative trading. Section 4a(a) of the Act, 7 U.S.C. 6a(a), which in significant part retains language that was initially adopted in 1936, provides that:

> Excessive speculation in any commodity under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets or derivatives transaction execution facilities, or on electronic trading facilities with respect to a significant price discovery contract causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity.

Accordingly, section 4a(a) of the Act provides the Commission with the following authority:

> For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time * * * proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility, or on an electronic trading facility with respect to a significant price discovery contract, as the Commission finds are necessary to diminish, eliminate, or prevent such burden.

Amendments introduced to the Act by the Futures Trading Act of 1982 supplemented this longstanding statutory framework for Commission-set Federal speculative position limits by explicitly acknowledging the role of the exchanges in setting their own speculative position limits.[5] The 1982 legislation also gave the Commission, under section 4a(5) of the Act, the authority to directly enforce violations of exchange-set, Commission-approved speculative position limits in addition to position limits established directly by the Commission through orders or regulations.[6] Thus, since 1982, the Act's framework explicitly anticipates the concurrent application of Commission and exchange-set speculative position limits. The concurrent application of limits is particularly consistent with an exchange's close knowledge of trading activity on that facility and the Commission's greater capacity for monitoring trading and implementing remedial measures across interconnected commodity futures and option markets.

The Commodity Futures Modernization Act of 2000 ("CFMA") [7] introduced substantial changes to the CEA. Broadly described, the CFMA established a principles-based approach to regulating the futures markets, allowed for the implementation of exchange rules through a certification process without requiring the exchanges to obtain prior Commission approval, and delineated specific designation criteria and core principles with which a DCM must comply to receive and maintain designation. Among these, Core Principle 5 in section 5(d) of the Act provides:

> Position Limitations or Accountability—To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, the board of trade shall adopt position limitations or position accountability for speculators, where necessary and appropriate.

Most recently the CEA was amended by the CFTC Reauthorization Act of 2008.[8] The 2008 legislation amended the CEA by, among other things, adding core principles in new section 2(h)(7) governing SPDCs traded on electronic trading facilities operating in reliance on the exemption in section 2(h)(3) of the Act.[9] The 2008 legislation amended the Act to impose certain self-regulatory responsibilities on ECM–SPDCs through core principles, as did the CFMA with respect to DCMs, including a core principle that requires such facilities to "adopt, where necessary and appropriate, position limitations or position accountability for speculators in significant price discovery contracts * * *" [10] The 2008 legislation also amended section 4a(e) of the Act to incorporate references to ECM–SPDCs, thereby assuring that violation of an ECM–SPDC's position limits, regardless of whether such position limits have been approved by or certified to the Commission, would constitute a violation of the Act that the Commission could independently enforce.

As mentioned above, the CFMA generally replaced the Act's exchange rule approval process with a certification process. On a practical level, this shift has tended to reduce the Commission's ability to more directly shape the specific requirements of exchange-set speculative position limit and accountability rules through approving such rules prior to implementation. In light of this, the Commission's broad authority to independently set position limits under CEA section 4a(a) could be viewed as an increasingly important enabling provision that allows the Commission to take the initiative in acting, when appropriate, to bolster market confidence and curb or prevent excessive speculation that may cause sudden, unwarranted, or unreasonable fluctuations in commodity prices.

III. Federal Speculative Position Limits

A. Historical Background

From the earliest days of federal regulation of the futures markets, Congress made it clear that unchecked speculative positions, even without intent to manipulate the market, can cause price disturbances.[11] To protect

[4] The Commission sets Federal speculative position limits for certain agricultural commodities enumerated in section 1a(4) of the Act. *See* 17 CFR 150.2.

[5] Futures Trading Act of 1982, Pub. L. No. 97–444, 96 Stat. 2299–30 (1983).

[6] Section 4a(5) has since been redesignated as section 4a(e) of the Act. 7 U.S.C. 4a(e).

[7] Commodity Futures Modernization Act of 2000, Appendix E of Public Law No. 106–554, 114 Stat. 2763 (2000).

[8] Food, Conservation and Energy Act of 2008, Public Law No. 110–246, 122 Stat. 1624 (June 18, 2008).

[9] 7 U.S.C. 2(h)(3)–(7).

[10] 7 U.S.C. 2(h)(7)(C)(ii)(IV).

[11] The Congressional finding that excessive speculation can have detrimental consequences even without manipulative intent is consistent with the series of studies and reports made to Congress

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markets from the adverse consequences associated with large speculative positions, Congress expressly authorized the Commodity Exchange Commission ("CEC") [12] to impose speculative position limits prophylactically.[13] The Congressional endorsement of the Commission's prophylactic use of position limits rendered unnecessary a specific finding that an undue burden on interstate commerce had actually occurred. Additionally, Congress closely restricted exemptions from position limits to *bona fide* hedging transactions, initially defined as sales or purchases of futures contracts offset by sales or purchases of the same cash commodity.

In December of 1938, the CEC promulgated the first Federal speculative position limits for futures contracts in grains (then defined as wheat, corn, oats, barley, flaxseed, grain sorghums and rye) after finding that large speculative positions tended to cause sudden and unreasonable fluctuations and changes in the price of grain.[14] At that time, the CEC did not impose limits in the other commodities enumerated in the 1936 Act.

Over the following years, Federal position limits were extended to various other commodities enumerated in the Act. However, no uniform approach regarding speculative position limits was applied to those enumerated commodities. In some cases (*e.g.,* soybeans), a commodity added to the Act's list of enumerated commodities was also added to the roster of commodities subject to Federal speculative position limits. In other cases (*e.g.,* livestock products, butter, and wool), commodities added to the list of enumerated commodities in the Act never became subject to Federal position limits.

In 1974, Congress overhauled the CEA to create the CFTC and simultaneously expanded the new agency's jurisdictional scope beyond the enumerated agricultural commodities to include futures contracts in any commodity. In expanding the CFTC's jurisdiction, Congress reiterated a fundamental precept underlying the Act, namely, to minimize or prevent the harmful effect of uncontrolled speculation.[15] When the Commission came into existence in April 1975, "various contract markets [had] voluntarily placed speculative position limits on 23 contracts involving 17 commodities." [16] At that time, "position limits were in effect for almost all actively traded commodities then under regulation and the limits for positions in about one half of these actively traded commodities had been specified by the contract markets." [17] Initially, the Commission retained the position limits enacted by the CEC, as then in effect, but did not establish position limits for any additional commodities.[18] In the years immediately following, the Commission implemented a few relatively minor changes to position limit regulations, but undertook no significant expansion of Federal speculative position limits.

After the silver futures market crisis during late 1979 to early 1980, commonly referred to as "the Hunt Brothers silver manipulation," [19] the Commission concluded that "[t]he recent events in silver * * * suggest that the capacity of any futures market to absorb large positions in an orderly manner is not unlimited." [20] Accordingly, in 1981 the Commission adopted regulation 1.61, which required all exchanges to adopt and submit for Commission approval speculative position limits in active futures markets for which no exchange or Commission limits were then in effect.[21] Although regulation 1.61 directed the exchanges to implement position limit rules, the pre-CFMA exchange rule approval process, on a practical level, gave the Commission the ability to shape the requirements of exchange-set position limit rules as measures that guarded against excessive speculation in accordance with the purposes and findings of section 4a(a) of the Act.

The next significant development occurred in 1986, when the Commission undertook a comprehensive review of speculative position limit policies, including position limit levels. During the Commission's 1986 reauthorization, the CFTC's Congressional authorizing committees suggested that this subject should be addressed. The Report of the House Agriculture Committee stated:

> [T]he Committee believes that, given the changes in the nature of these markets and the influx of new market participants over the last decade, the Commission should reexamine the current levels of speculative position limits with a view toward elimination of unnecessary impediments to expanded market use.[22]

Subsequently, the Commission reviewed its Federal speculative position limit framework and, in October 1987, adopted final amendments that raised some of the Federal speculative position limits and revised the general structure of the Federal speculative position limit regulations.[23] The amendments introduced in 1987 retained the then current spot-month and individual month position limits but increased the all-months-combined position limits. The revised limits, which had historically been set on a generic commodity basis, established position limits for each contract "according to the individual characteristics of that contract market," particularly "the distribution of speculative position sizes in recent years and recent levels of open interest." [24] In response to a petition by the CBOT, the Commission also established position limits for CBOT soybean oil and soybean meal contracts, which had been subject solely to exchange-set position limits, to provide "consistency with all other agricultural commodities traded at the CBOT." [25]

In 1992, the Commission issued proposed regulations adhering to the principle that speculative position limits should be formulaically adjusted based upon increases in the size of a contract's open interest (in addition to the traditional standard of distribution of speculative traders in a market).[26]

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urging the adoption of measures to restrict speculative trading notwithstanding the absence of "the deliberate purpose of manipulating the market." *See e.g.,* Fluctuations in Wheat Futures, 69th Cong., 1st Sess., Senate Document No. 135 (June 28, 1926).

[12] The CEC is the predecessor of the Commodity Exchange Authority, which is, in turn, the predecessor of the Commission.

[13] Requiring a specific demonstration of the need for position limits is contrary to section 4a(a) of the Act, which provides that the Commission shall set position limits from time to time, among other things, to prevent excessive speculation. 7 U.S.C. 4a(a).

[14] 3 FR 3145 (December 24, 1938).

[15] "The fundamental purpose of the measure is to insure fair practice and honest dealing on the commodity exchanges and to provide a measure of control over those forms of speculative activity which too often demoralize the markets to the injury of producers and consumers and the exchanges themselves." S. Rep. No. 93–1131, 93rd Cong., 2d. Sess. (1974).

[16] 45 FR 79831 (December 2, 1980).

[17] *Id.* at 79832. "Commodity Exchange Authority regulations included limits for wheat, corn, oats, soybeans, cotton, eggs and potatoes. Exchange rules included limits for live cattle, feeder cattle, live hogs, frozen pork bellies, soybean oil, soybean meal, and grain sorghums." (*Id.* n.1)

[18] Pursuant to section 4l of the Commodity Futures Trading Commission Act of 1974, all regulations previously adopted by the Commodity Exchange Authority continued in full force and effect, to the extent they were not inconsistent with the Act, as amended, unless or until terminated, modified or suspended by the Commission. Sec. 205, 88 Stat. 1397 (effective July 18, 1975).

[19] *See, In re* Nelson Bunker Hunt *et al.,* CFTC Docket No. 85–12.

[20] 45 FR 79831, at 79833 (December 2, 1980).

[21] 46 FR 50938 (October 16, 1981).

[22] H.R. Rep. No. 624, 99th Cong., 2d Sess., at 4 (1986).

[23] 52 FR 38914 (October 20, 1987).

[24] *Id.* at 38917, 38919.

[25] Petition for rulemaking of the CBOT, dated July 24, 1986, cited in 52 FR 6814 (March 5, 1987).

[26] 57 FR 12766 (April 13, 1992).

The formula was thereafter "routinely applied … as a matter of administrative practice when reviewing proposed exchange speculative position limits under Commission [regulation] 1.61." [27]

During this same time frame, the Commission began a process that led to the adoption of position accountability rules for contracts that were subject to exchange-set speculative position limits. Beginning in 1991, the Commission approved several exchange rules establishing position accountability provisions in lieu of position limits for certain contracts exhibiting significant trading volume and open interest, a highly liquid underlying cash market and ready opportunities for arbitrage between the cash and futures markets.[28] An exchange's position accountability rules, as opposed to position limits that bar traders from acquiring contracts that quantitatively exceed a specific number of outstanding contracts, require persons holding a certain number of open contracts to report the nature of their positions, trading strategy, and hedging needs to the exchange, upon the exchange's request.

In 1999, the Commission simplified and reorganized its speculative position limit regulations to consolidate requirements for both Commission-set limits and exchange-set limits under regulation 1.61 in part 150 of the Commission's regulations. Regulation 150.5(e), currently, and as initially adopted in 1999, establishes a "trader accountability exemption" [29] and generally codifies the position accountability conditions that initially were imposed as a matter of administrative practice beginning in 1991.[30]

The reorganized rules also included new regulation 150.5(c), which codified the Commission's 1992 formula for calculating Federal speculative position limits based upon open interest, and applied it to exchanges for their use in calculating the levels of exchange-imposed numerical speculative position limits.[31] The formula provided for "combined futures and option speculative position limits for both a single month and for all-months-combined at the level of 10 percent of open interest up to an open interest of 25,000 contracts, with a marginal increase of 2.5% thereafter." [32] In initially proposing to use this formula, the Commission noted that:

> [I]ts large trader data indicates that limits based on open interest as described above should accommodate the normal course of speculative positions in agricultural markets. The levels derived using this method of analysis generally are consistent with the largest exchange-set speculative limits approved by the Commission under Rule 1.61 for contract markets in agricultural commodities at corresponding levels of open interest. However, the Commission, based on its surveillance experience and monitoring of exchange and Federal speculative position limits, is satisfied that the levels indicated by this methodology, although *near the outer bounds* of the levels which have been approved previously, nevertheless will achieve the prophylactic intent of Section [4a] of the Act and Commission Rule 1.61, thereunder [emphasis supplied].[33]

The Commission also emphasized that particular data can result in a range of acceptable speculative position limits, and that based on its experience overseeing exchange-set speculative limits and its direct administration of the Federal limits establishing "a single-month and all-month limits on futures positions combined with option positions on a delta-equivalent basis of no more than ten percent of the combined markets' open interest for contracts with combined open interest below 25,000" was within the range of acceptable speculative position limits.[34] For those markets with combined average open interest greater than 25,000 contracts, the Commission proposed a marginal increase of 2.5% after noting that "the size of the largest individual positions in a market do not continue to grow in proportion with increases in the overall open interest of the market."[35]

As noted above, Core Principle 5, introduced to the Act in 2000 by the CFMA, requires DCMs to implement position limits or position accountability rules for speculators "where necessary and appropriate." In 2001, the Commission established Acceptable Practices for complying with Core Principle 5, set out in Appendix B to part 38 of the Commission's regulations.[36] The Acceptable Practices specifically reference part 150 of the Commission's regulations as providing guidance on how to comply with the requirements of the Core Principle.[37] The CFMA, however, did not change the treatment of the enumerated agricultural commodities, which remained subject to Federal speculative position limits.

In 2005, the Commission increased the all-months-combined Federal speculative position limits and reset the single-month levels to roughly approximate the existing numerical relationship between all-months-combined and single-month levels (*i.e.,* arriving at the single-month limits by setting them at about two-thirds of the relevant all-months-combined limits), based generally on the 1992 open interest formula (as incorporated into regulation 150.5(e)).[38]

In 2008, Congress, in response to high prices and volatility in the energy markets and concerns regarding excessive speculation on unregulated energy exchanges, including ECMs, adopted the CFTC Reauthorization Act of 2008 and amended two CEA provisions aimed at curbing possible manipulation and excessive speculation

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[27] 63 FR 38525 (July 17, 1998).

[28] *See, e.g.,* 56 FR 51687 (October 15, 1991) and 57 FR 29064 (June 30, 1992).

[29] 64 FR 24038, at 24048 (May 5, 1999).

[30] Regulation 150.5(e) provides that, for futures and option contracts that have been listed for trading for at least 12 months, an exchange may submit a position accountability rule, in lieu of a numerical limit, as follows:

"(1) For futures and option contracts on a financial instrument or product having an average open interest of 50,000 contracts and an average daily trading volume of 100,000 contracts and a very highly liquid cash market, an exchange bylaw, regulation or resolution requiring traders to provide information about their position upon request by the exchange;

(2) For futures and option contracts on a financial instrument or product or on an intangible commodity having an average month-end open interest of 50,000 and an average daily volume of 25,000 contracts and a highly liquid cash market, an exchange bylaw, regulation or resolution requiring traders to provide information about their position upon request by the exchange and to consent to halt increasing further a trader's positions if so ordered by the exchange;

(3) For futures and option contracts on a tangible commodity, including but not limited to metals, energy products, or international soft agricultural products having an average month-end open interest of 50,000 contracts and an average daily volume of 5,000 contracts and a liquid cash market, an exchange bylaw, regulation or resolution requiring traders to provide information about their position upon request by the exchange and to consent to halt increasing further a trader's positions if so ordered by the exchange, *provided, however,* such contract markets are not exempt from the requirement of paragraphs (b) or (c) that they adopt an exchange bylaw, regulation or resolution setting a spot month speculative position limit with a level no greater than one quarter of the estimated spot-month deliverable supply * * *" 17 CFR 150.5(e).

Notably, the Commission's concerns regarding spot-month limits were eventually mirrored by the CFMA, which provides in DCM Core Principle 5 (section 5(d)(5) of the Act), that "[t]o reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, the board of trade shall adopt position limitations or position accountability for speculators, where necessary and appropriate."

[31] The formulaic approach, initially developed by Blake Imel, former Acting Director of the Division of Economic Analysis (the Division has since been merged into the Division of Market Oversight), was premised on limiting the concentration of positions in the hands of one or a few traders by requiring a minimum number of distinct market participants.

[32] 64 FR 24038, at 24039 (May 5, 1999).

[33] 57 FR 12766, at 12771 (April 13, 1992).

[34] *Id.* at 12770.

[35] *Id.*

[36] 17 CFR part 38, Appendix B, Core Principle 5(d)(5).

[37] 66 FR 42256 (August 10, 2001).

[38] 70 FR 24705 (May 11, 2005).

in the energy markets. Specifically, the 2008 legislation amended CEA section 4a(e) to give the CFTC enforcement authority over position limits certified by the exchanges and adopted new section 2(h)(7) to apply a position limit and position accountability core principle to ECM–SPDCs.[39] Notably, the legislation also extended the Commission's authority to set Federal speculative position limits, under CEA section 4a(a), to ECM–SPDCs.

B. Statutory Basis and Need for Energy Speculative Position Limits

Energy futures and option contracts have never been subject to CFTC-set speculative position limits. These contracts began to attract significant trading volumes in the early 1980s beginning with NYMEX's New York Harbor No. 2 heating oil futures contract,[40] followed by NYMEX's gasoline futures contract in 1981 and crude oil futures contract in 1983. NYMEX did not initially adopt position limits for heating oil futures contracts. However, with the adoption of Commission regulation 1.61, effective November 16, 1981, each exchange was required to submit for Commission approval speculative position limits for each actively traded futures contract. Thereafter, newly designated contracts (*e.g.,* NYMEX's crude oil futures contract in 1983) were required to be accompanied by exchange speculative position limit rules as a condition of designation.

As noted above, in 1999 the Commission reorganized its speculative position limit regulations to codify its earlier administrative practice of allowing exchanges to adopt position accountability rules in lieu of numerical position limits for positions outside of the spot month. Currently, virtually all of NYMEX's energy futures and option contracts and ICE's single SPDC contract are subject to exchange-set position accountability rules during non-spot months and to hard speculative position limits during spot months.

From 2007 to mid 2008, commodity prices generally, and energy prices in particular, increased significantly and experienced unusual volatility. As a result of this, Commission-regulated energy markets, as well as the over-the-counter ("OTC") energy swap markets over which the Commission has no direct regulatory authority, were the subject of numerous Congressional hearings[41] and formal and informal studies, including a preliminary review by an Interagency Task Force chaired by CFTC staff.[42] In the summer of 2009, the Commission held three days of hearings "to discuss energy position limits and hedge exemptions" ("Energy Hearings").[43] The Commission heard from 26 witnesses, including members of the U.S. House and Senate, swap dealers, money managers, futures market participants (including commercial hedgers), trade associations, exchanges, and consumer advocates.[44] In addition, a total of 5,281 email comments were received (including some 1,200 identical emails from a single commenter).[45]

As with the Congressional hearings and market studies, there were mixed opinions among the Energy Hearing participants as to the causes of the price rises and market volatility. With respect to position limits for energy commodities, a number of witnesses expressed concern over the impact on energy prices of excessive speculation and supported position limits.[46] Others cautioned that such limits could be ineffective, hurt market liquidity or distort the price discovery process if not properly constructed.[47]

As discussed above, section 4a(a) represents an explicit Congressional finding that extreme or abrupt price fluctuations attributable to unchecked speculative positions are harmful to the futures markets and that position limits can be an effective prophylactic regulatory tool to diminish, eliminate or prevent such activity. Accordingly, Congress charged the Commission with responsibility for setting contract position limits in any commodity to prevent or minimize extreme or abrupt price movements resulting from large or concentrated positions. Under the authority granted to it, the Commission may impose speculative position limits without finding an extant undue burden on interstate commerce resulting from excessive speculation.[48] Section 8a(5) of the Act also provides that the Commission may make and promulgate such rules and regulations that in its judgment are reasonably necessary to accomplish any of the purposes of the Act.

Large concentrated positions in the energy futures and option markets can potentially facilitate abrupt price movements and price distortions. The prevention of unreasonable and abrupt price movements that are attributable to large or concentrated speculative positions is a congressionally endorsed regulatory objective. This objective is furthered by position limits, particularly given that the capacity of any reporting market to absorb the establishment and liquidation of large speculative

[39] *See* 7 U.S.C. 2(h)(7)(C)(IV).

[40] The contract was designated in October 1974, but significant volume first developed in 1980.

[41] At the hearings, numerous witnesses expressed concern regarding the impact on energy prices of speculation on commodity futures markets, including particularly the price impact of trading by swap dealers and index funds. Alternatively, many other witnesses expressed the view that fundamental market conditions were the primary driver of prices.

[42] The Task Force included staff representatives from the Departments of Agriculture, Energy and the Treasury, the Board of Governors of the Federal Reserve, the Federal Trade Commission, and the Securities and Exchange Commission. The Task Force looked at the crude oil market between January 2003 and June 2008. The staff members of the various agencies did not find direct causal evidence for the general increase in oil prices between January 2003 and June 2008. Interagency Task Force on Commodity Markets, Interim Report on Crude Oil (July 22, 2008).

[43] Commodity Futures Trading Commission, "CFTC to Hold Three Open Hearings to Discuss Energy Position Limits and Hedge Exemptions," CFTC Release 5681–09 (July 21, 2009).

[44] *See* the following Commission Releases for a listing of agendas and witnesses and related links:

5681–09 (July 21, 2009) *http://www.cftc.gov/newsroom/generalpressreleases/2009/pr5681-09.html;*

5682–09 (July 27, 2009) *http://www.cftc.gov/newsroom/generalpressreleases/2009/pr5682-09.html;*

and 5685–09 (July 31, 2009) *http://www.cftc.gov/newsroom/generalpressreleases/2009/pr5685-09.html.*

[45] Persons wishing to review these comments may contact the Commission's Secretariat at *secretary@cftc.gov.*

[46] "This increase in volatility has been associated with a massive increase in speculative investment in oil futures." Ben Hirst, Senior Vice President and General Counsel for Delta Airlines;
"* * *[S]peculative trading strategies may not always have a benign effect on the markets." Laura Campbell, Assistant Manager of Energy Resources, Memphis Light, Gas & Water, on behalf of The American Public Gas Association; "That ability [to hedge heating fuel costs], however, is now being undermined by an erratic market, questionable investment tactics and purely speculative market forces." Sean Cota, President, Cota & Cota, Inc. Hearings on Energy Position Limits and Hedge Exemptions, July 28, July 29 and August 5, 2009, at the Commodity Futures Trading Commission.

[47] "If [limits] are set too tight, traders who possess important market information and provide crucial liquidity are kept away." Todd E. Petzel. Chief Investment Officer, Offit Capital Advisors; "Simply eliminating or limiting swap dealer hedge exemptions will impair liquidity, have other unintended consequences and would very likely not achieve the stated objective." Donald Casturo, Managing Director, Goldman Sachs & Co.; "Position limits no matter how well meaning create real market migration risk and pushing price discovery of agricultural, energy or metals markets to overseas or other trading venues would be contrary to the purposes of the Act." Mark D. Young, Kirkland & Ellis LLP. Hearings on Energy Position Limits and Hedge Exemptions, July 28, July 29 and August 5, 2009, at the Commodity Futures Trading Commission.

[48] Moreover, the exchanges' independent responsibility to monitor trading and implement position limits and position accountability rules does not detract from or otherwise impair the Commission's broad authority to impose speculative limits.

positions in an orderly manner is related to the relative size of such positions and is not unlimited. Specifically, when large speculative positions are amassed in a contract, or contract month, the potential exists for unreasonable and abrupt price movements should the positions be traded out of or liquidated in a disorderly manner. Concentration of large positions in one or a few traders' accounts can also create the unwarranted appearance of appreciable liquidity and market depth. Trading under such conditions can result in greater volatility than would otherwise prevail if traders' positions were more evenly distributed among market participants.

Furthermore, concurrent trading in economically similar and equivalent energy futures and option contracts on multiple exchanges effectively creates a single but fragmented market for such contracts. Because individual exchanges have knowledge of positions only on their own trading facilities, it is difficult for them to assess the full impact of a trader's positions on the greater market. As such, monitoring and limiting positions through exchange-specific position limits and through the enforcement of exchange position accountability rules, though necessary and beneficial, may not sufficiently guard against potential market disruptions.

For these reasons, the Commission is proposing to establish reporting market-specific Federal speculative position limits for futures and option contracts in certain energy commodities and aggregate position limits that would apply across economically similar contracts, regardless of whether such contracts are listed on a single or on multiple reporting markets, to curb the impact of disruptive excessive speculation.

IV. Exemptions and Account Aggregation

The Commission's current regulatory framework for Federal speculative position limits consists of three elements, (i) the levels of the Commission-set speculative position limits (discussed above), (ii) certain exemptions from the limits (*e.g.,* for hedging, spreading or arbitraged positions), and (iii) the policy on aggregating related accounts for purposes of applying the limits.

Commission regulation 150.3, headed "Exemptions," lists certain types of positions that may be exempted from (and thus may exceed) the Federal speculative position limits delineated in regulation 150.2. In particular, under regulation 150.3(a)(1), *bona fide* hedging transactions, as defined in Commission regulation 1.3(z), may exceed Commission-set position limits.[49] The first two parts of the *bona fide* hedging definition include a general definition of *bona fide* hedging (*see* paragraph (z)(1)) and a listing of certain enumerated hedging transactions in the agricultural commodities that are currently subject to Federal position limits (*see* paragraph (z)(2)). Paragraph (z)(3) of the definition provides flexibility to the Commission in granting exemptions by permitting additional transactions to be recognized as *bona fide* hedging upon a trader's request, made in accordance with the application provisions of Commission regulation 1.47. Regulation 1.47 requires a person seeking a *bona fide* hedge exemption under regulation 1.3(z)(3) to provide the Commission with various information that will, among other things, "demonstrate that the purchases and sales are economically appropriate to the reduction of risk exposure attendant to the conduct and management of a commercial enterprise."[50]

In addition to regulation 150.3(a)(1)'s *bona fide* hedging exemption, regulation 150.3(a) includes two other exemptions from the Federal speculative position limits. Regulation 150.3(a)(3) exempts "spread or arbitrage positions between single months of a futures contract * * * outside of the spot-month, in the same crop year * * *." Subject to various conditions, regulation 150.3(a)(4) exempts positions "[c]arried for an eligible entity as defined in regulation 150.1(d), in the separate account or accounts of an independent account controller, as defined in regulation 150.1(e) * * *." Eligible entities include mutual funds, commodity pool operators and commodity trading advisors. Entities claiming this exemption are required, upon call by the Commission, to provide information supporting their claim that the account controllers for

[49] Commission regulation 1.3(z) provides:

"*Bona fide hedging transactions and positions*—(1) *General definition. Bona fide* hedging transactions and positions shall mean transactions or positions in a contract for future delivery on any contract market, or in a commodity option, where such transactions or positions normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, and where they arise from:

(i) The potential change in the value of assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising,

(ii) The potential change in the value of liabilities which a person owns or anticipates incurring, or

(iii) The potential change in the value of services which a person provides, purchases, or anticipates providing or purchasing.

Notwithstanding the foregoing, no transactions or positions shall be classified as *bona fide* hedging unless their purpose is to offset price risks incidental to commercial cash or spot operations and such positions are established and liquidated in an orderly manner in accordance with sound commercial practices and, for transactions or positions on contract markets subject to trading and position limits in effect pursuant to section 4a of the Act, unless the provisions of paragraphs (z)(2) and (3) of this section and §§ 1.47 and 1.48 of the regulations have been satisfied.

(2) *Enumerated hedging transactions.* The definitions of *bona fide* hedging transactions and positions in paragraph (z)(1) of this section includes, but is not limited to, the following specific transactions and positions:

(i) *Sales* of any commodity for future delivery on a contract market which do not exceed in quantity:

(A) Ownership or fixed-price purchase of the same cash commodity by the same person; and

(B) Twelve months' unsold anticipated production of the same commodity by the same person provided that no such position is maintained in any future during the five last trading days of that future.

(ii) *Purchases* of any commodity for future delivery on a contract market which do not exceed in quantity:

(A) The fixed-price sale of the same cash commodity by the same person;

(B) The quantity equivalent of fixed-price sales of the cash products and by-products of such commodity by the same person; and

(C) Twelve months' unfilled anticipated requirements of the same cash commodity for processing, manufacturing, or feeding by the same person, provided that such transactions and positions in the five last trading days of any one future do not exceed the person's unfilled anticipated requirements of the same cash commodity for that month and for the next succeeding month.

(iii) Offsetting sales and purchases for future delivery on a contract market which do not exceed in quantity that amount of the same cash commodity which has been bought and sold by the same person at unfixed prices basis different delivery months of the contract market, provided that no such position is maintained in any future during the five last trading days of that future.

(iv) Sales and purchases for future delivery described in paragraphs (z)(2)(i), (ii), and (iii) of this section may also be offset other than by the same quantity of the same cash commodity, provided that the fluctuations in value of the position for future delivery are substantially related to the fluctuations in value of the actual or anticipated cash position, and provided that the positions in any one future shall not be maintained during the five last trading days of that future.

(3) *Non-enumerated cases.* Upon specific request made in accordance with § 1.47 of the regulations, the Commission may recognize transactions and positions other than those enumerated in paragraph (z)(2) of this section as *bona fide* hedging in such amount and under such terms and conditions as it may specify in accordance with the provisions of § 1.47. Such transactions and positions may include, but are not limited to, purchases or sales for future delivery on any contract market by an agent who does not own or who has not contracted to sell or purchase the offsetting cash commodity at a fixed price, *provided that* the person is responsible for the merchandising of the cash position which is being offset." 17 CFR 1.3(z).

[50] 17 CFR 1.47(b)(2).

these positions are acting independently.

Also, in order to achieve the intended effect of the Federal speculative position limits, Commission regulation 150.4, headed "Aggregation of positions," requires the Commission and the exchanges to treat multiple accounts subject to common ownership or control as if they are held by a single trader. Such accounts are typically considered to be under a common ownership if one or more traders have a 10% or greater financial interest in the accounts and do not otherwise qualify for an exemption from aggregation, such as the independent account controller exemption discussed above. The aggregation standards are applied in a manner calculated to aggregate related positions. For example, each participant with a 10% or greater financial interest in an account must aggregate the entire position of that account—not just the participant's fractional share—together with other positions that the participant may independently hold. Likewise, a commodity futures or option contract pool comprised of many traders is allowed only to hold positions as if it were a single trader. The Commission also treats positions that are not commonly owned, but are traded pursuant to an express or implied agreement, as a single aggregated position for purposes of applying the Federal speculative position limits. Exceptions to the aggregation standards exist for certain pool participants, such as limited partners and shareholders that cannot exercise control over the positions of the pool.

V. *Bona Fide* Hedge Exemptions

Prior to 1974, the CEA included a limited statutory hedging definition that applied only to agricultural commodities. When the Commission was created in 1974, the Act's definition of commodity was expanded. At that time, Congress was concerned that the limited hedging definition, even if applied to newly regulated commodity futures, would fail to accommodate the commercial risk management needs of market participants that could emerge over time. Accordingly, Congress, in section 404 of the Commodity Futures Trading Commission Act of 1974, repealed the statutory definition and gave the Commission the authority to define *bona fide* hedging.

The Commission exercised this authority in 1977 by adopting regulations 1.3(z) and 1.47.[51] Those regulations have remained unchanged since 1977. By the mid 1980s, new concerns had emerged. Under the Commission's definition, *bona fide* hedge transactions "normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel," and are "economically appropriate to the reduction of risks in the conduct of a commercial enterprise."[52] This aspect of the hedging definition proved to be ill fitted to the economic realities of financial futures. Portfolio managers utilize the financial futures markets to add incremental income to managed assets, to manage overall risk, or to rebalance a portfolio. Indeed, futures market positions are often acquired entirely as an alternative to cash market transactions (in view of the lower transaction costs, speed, and minimal price impact), rather than as a temporary substitute for positions that will later be taken in the underlying cash market.

In 1986, in response to concerns raised in testimony regarding the constraints on investment decisions imposed by position limits, the House Committee on Agriculture, in its report accompanying the Commission's 1986 reauthorization legislation, instructed the Commission to reexamine its approach to speculative position limits and its definition of hedging.[53] Specifically, the Committee Report "strongly urge[d] the Commission to undertake a review of its hedging definition * * * and to consider giving certain concepts, uses, and strategies 'non-speculative' treatment * * * whether under the hedging definition or, if appropriate, as a separate category similar to the treatment given certain spread, straddle or arbitrage positions * * *"[54] The Committee Report singled out four categories of trading and positions that the Commission should recognize as non-speculative: (i) "Risk management" trading by portfolio managers as an alternative to the concept of "risk reduction;" (ii) futures positions taken as alternatives to, rather than as temporary substitutes for, cash market positions; (iii) other positions acquired to implement strategies involving the use of financial futures including, but not limited to, asset allocation (altering portfolio exposure in certain areas such as equity and debt), portfolio immunization (curing mismatches between the duration and sensitivity assets and liabilities to ensure that portfolio assets will be sufficient to fund the payment of liabilities), and portfolio duration (altering the average maturity of a portfolio's assets); and (iv) certain options trading, in particular the writing of covered puts and calls.[55]

The Senate Committee on Agriculture, Nutrition and Forestry, in its report on the 1986 CFTC reauthorization legislation, also directed the Commission to reassess its interpretation of *bona fide* hedging.[56] The Commission heeded Congress's recommendation, and its staff issued interpretive statements directing that risk management exemptions be included as speculative position limit exemptions in addition to the existing exemptions for hedging, arbitrage and spreading.[57] The interpretive statements recognized new types of "risk reducing" and "risk shifting" strategies in financial futures (including "dynamic asset allocation strategies") as falling within the *bona fide* hedging category.

The next significant change in trading patterns and practices in derivatives markets involved an influx of new traders into the market seeking exposure to commodities as an asset class through passive, long-term investment in commodity indexes as a way of diversifying portfolios that might otherwise be limited to equities and debt instruments.[58] New market participants included commodity index traders (including pension and endowment funds, as well as individual investors participating in commodity index-based funds or trading programs) and swap dealers seeking to hedge price risk from OTC trading activity (frequently opposite those same commodity index traders).

The development of the OTC swaps industry, over which the Commission generally has no regulatory authority, is related to the exchange-traded futures and options industry in that a swap agreement[59] can either compete with or

[51] 42 FR 42748 (August 24, 1977).

[52] 17 CFR 1.3(z)(1).

[53] House Committee on Agriculture, Futures Trading Act of 1986, H.R. Rep. No. 624, 99th Cong., 2d Sess. 44–46 (1986).

[54] *Id.* at 46.

[55] *Id.*

[56] Senate Committee on Agriculture, Nutrition and Forestry, Futures Trading Act of 1986, S. Rep. No. 291, 99th Cong., 2d Sess. at 21–22 (1986). Specifically, the Senate Committee directed the Commission to consider "whether the concept of prudent risk management [should] be incorporated in the general definition of hedging as an alternative to this risk reduction standard." *Id.*, at 22.

[57] *See,* Clarification of Certain Aspect of the Hedging Definition, 52 FR 27195 (July 20, 1987); Risk Management Exemptions from Speculative Position Limits Approved under Commission Regulation 1.61, 52 FR 34633 (September 14, 1987).

[58] The argument has also been made that commodities act as a general hedge of liability obligations that are linked to inflation.

[59] A swap agreement is typically a privately negotiated exchange of one asset or cash flow for another asset or cash flow. In a commodity swap, at least one of the assets or cash flows is related to the price of one or more commodities.

complement regulated commodity futures and options trading.[60] Market participants often enter into OTC swap agreements because, unlike more standardized futures contracts, they can be customized to match particular hedging or price exposure needs. Swap dealers, often affiliated with a bank or other large financial institution, act as swap counterparties to both commercial firms seeking to hedge price risks and speculators seeking to gain price exposure. Swap dealers, in turn, utilize the more standardized futures markets to manage the residual risk of their swaps book.[61] In addition, some swap dealers also deal directly in the merchandising of physical commodities.

In accordance with the above-discussed Congressional recommendations, market developments, and the Commission's recognition of a risk management exemption for financial futures, beginning in 1991, the Commission staff extended the concept of risk management exemptions from speculative position limits by granting *bona fide* hedge exemptions, in various agricultural futures markets subject to Federal speculative position limits, to a number of swap dealers who were seeking to manage price risks on their books arising from swap dealing activities. The first such hedge exemption involved J. Aron, a large commodity merchandising firm that engaged in commodity related swaps as a part of a commercial line of business. The firm, through an affiliate, wished to enter into an OTC swap transaction with a qualified counterparty (a large pension fund) involving an index based on the returns afforded by investments in exchange-traded futures contracts on certain non-financial commodities meeting specified criteria.[62] The commodities making up the index included contracts in certain agricultural commodities subject to Federal speculative position limits. As a result of the swap, J. Aron would have, in effect, been going short the index. In order to protect itself against this risk, the firm planned to establish a portfolio of long futures positions in the commodities making up the index, in such amounts as would replicate its exposure under the swap transaction. By design, the index did not include contract months that had entered the delivery period and J. Aron, in replicating the index, stated that it would not maintain futures positions based on index-related swap activity into the spot month (when physical commodity markets are most vulnerable to manipulation and attendant price fluctuations). With this risk mitigation strategy, the firm's composite return on its futures portfolio would have offset the net payments that the dealer would have been required to make to the pension fund counterparty.

The futures positions J. Aron required to cover its exposure on the swap agreement's agricultural component would have been in excess of certain Federal speculative position limits. Accordingly, the firm requested, and the staff granted, a hedge exemption for those futures positions, that offset risks directly related to the OTC swap transaction.

Subsequently, the Commission staff granted a number of similar hedge exemptions, pursuant to delegated authority, in other cases where the futures positions clearly offset risks related to swap agreements or similar OTC positions involving both individual commodities and commodity indexes. These non-traditional "hedges" were all subject to specific limitations to protect the marketplace from potential ill effects. The limitations required: (i) The futures positions to offset specific price risk; (ii) the dollar value of the futures positions to be no greater than the dollar value of the underlying risk; and (iii) the futures positions to not be carried into the spot-month.[63]

In 2006, Commission staff issued two no-action letters involving another type of index-based trading.[64] Both cases involved trading that offered investors the opportunity to participate in a broadly-diversified commodity index-based fund or program ("index fund"). The futures positions of these index funds differed from the futures positions taken by the swap dealers who had earlier received exemptions. The swap dealer positions were taken to offset OTC swaps exposure that was directly linked to the price of an index. For that reason, Commission staff granted hedge exemptions to those swap dealer positions. On the other hand, in the index fund positions described in the no-action letters, the price exposure resulted from a promise or obligation to track an index, rather than from holding an OTC swap position whose value was directly linked to the price of an index. Commission staff believed that this difference was significant enough that the index fund positions would not qualify for a hedge exemption. Nevertheless, because the index fund positions represented a legitimate and potentially useful investment strategy, Commission staff granted the index funds no-action relief, subject to certain conditions intended to protect the futures markets from potential ill effects. These conditions required: (i) The positions to be passively managed; (ii) the positions to be unleveraged (so that financial conditions should not trigger rapid liquidations); and (iii) the positions to not be carried into the delivery month.

Prompted by concerns regarding the growing market presence of swap dealers and commodity index traders who use futures markets to manage risks related to OTC trading activity, in June and July of 2008, CFTC staff issued a special call for information from swap dealers and index traders. Based upon information collected from its special call, the Commission published on September 11, 2008, a "Staff Report on Commodity Swap Dealers and Index Traders with Commission Recommendations" (the "September 2008 Report"). Most relevant to the Commission's proposed rulemaking is the Report's recommendation that the Commission consider the elimination of *bona fide* hedge exemptions for swap dealers and the creation of a new, limited risk management exemption for the activities of swap dealers and commodity index traders.[65]

[60] The bilateral contracts that swap dealers create can vary widely, from terms tailored to meet the needs of a specific customer, to relatively standardized contracts.

[61] Because swap agreements can be highly customized, and the liquidity for a particular swap contract can be low, swap dealers may also use other swap agreements and physical market positions, in addition to futures, to offset the residual risks of their swap book.

[62] The commodities comprising such indexes may include the agricultural commodities subject to Federal speculative position limits, as well as energy commodities, metals and world agricultural commodities (*e.g.,* coffee, sugar, and cocoa).

[63] 72 FR 66097, at 66099 (November 27, 2007).

[64] CFTC Letter 06–09 (April 19, 2006); CFTC Letter 06–19 (September 6, 2006).

[65] The Report also made a number of other recommendations for Commission action, including: (1) Removing swap dealers from the commercial category in the Commitments of Traders Reports ("COT Reports") and creating a new swap dealer classification for reporting purposes; (2) Developing and publishing a new periodic supplemental report based on OTC swap dealer activity; (3) Creating a new CFTC Office of Data Collection dedicated to the collection and publication of COT Report data; (4) Establishing more detailed reporting standards for large traders; and (5) Conducting a review of swap dealers' futures trading activity to ensure that it is sufficiently independent of any affiliated commodity research. The Commission has largely addressed the Report's recommendations regarding COT Reports. The Commission has been publishing a new Disaggregated COT Report ("DCOT Report") for twenty-two different physical commodity markets since September 4, 2009 and expanded the DCOT Report to the remaining physical markets on December 4, 2009. The Commission also began publishing on September 4, 2009 a new quarterly report of Index Investment Data which shows for swap dealers and index funds their index

Continued

In March of 2009, the Commission published a "Concept Release on Whether to Eliminate the *Bona Fide* Hedge Exemption for Certain Swap Dealers and Create a New Limited Risk Management Exemption from Speculative Position Limits."[66] The concept release reviewed the underlying statutory and regulatory background, as well as relevant regulatory history and marketplace developments, and posed a number of questions designed to help inform the Commission's decision as to: (i) Whether to proceed with the recommendation to eliminate the *bona fide* hedge exemption for swap dealers and replace it with a conditional limited risk management exemption; and (ii) if so, what form the new limited risk management exemptive regulations should take and how they might be implemented most effectively.

In response, the Commission received letters from 30 commenters, including futures exchanges, agricultural trade associations, financial industry trade associations, money management firms (including swap dealers), other market participants and various other interested parties. The comments were about equally divided between those who favored eliminating the *bona fide* hedge exemption for swap dealers (or restricting the exemption to positions offsetting swap dealers' exposure to traditional commercial market users) and those who favored retaining the swap dealer hedge exemption in its current form, or some variation thereof.[67] Similar views on hedge exemptions were also expressed at the Commission's Energy Hearings in July and August 2009.[68] As discussed below, the proposed regulations would not recognize futures and option transactions offsetting exposure acquired pursuant to swap dealing activity as *bona fide* hedges. Accordingly, swap dealers would not be allowed to seek *bona fide* hedge exemptions for such positions. Instead, however, upon compliance with several conditions including reporting and disclosure obligations, the proposed regulations would allow swap dealers to seek a limited exemption from the proposed speculative position limits for the major energy contracts.

VI. The Proposed Regulations

A. Overview

The proposed regulations seek to implement an integrated speculative position limit framework for exchange listed natural gas, crude oil, heating oil, and gasoline futures and option contracts. In addition to identifying the affected energy contracts with particularity, the proposed regulations would establish aggregate and exchange-specific speculative position limits, including provisions relating to exemptions from the proposed limits and related application and reporting requirements. The proposed regulations provide position limit exemptions for *bona fide* hedging transactions, certain swap dealer risk management transactions, and positions that remain, in their totality, in compliance with the applicable limits once option contracts that comprise a portion of a trader's overall position are delta-adjusted by a demonstrably appropriate risk factor. The proposed regulations key the setting of position limits to deliverable supplies and open interest. In addition, they seek to apply position limits to a set of readily identifiable contracts. By doing so, the proposed regulations intend to establish an objective and administerial process for fixing specific position limits and identifying the contracts to which they apply without relying on the Commission's exercise of discretion.

As discussed in detail below, the proposed spot-month limits generally are a function of the estimated deliverable supply for physically-settled contracts. The logic behind limiting positions based on deliverable supply is readily apparent since, for example, traders with sufficiently large positions can squeeze shorts and thereby distort the price of the deliverable commodity. In contrast, the proposed (non-spot) single-month and all-months-combined position limits would limit positions to a specific percentage of overall trading activity as represented by open interest. As such, the link between open interest and the proposed non-spot-month position limits may not be as readily apparent as the link between spot-month limits and estimated deliverable supply.

To illustrate how a formula based on open interest would restrict the ability of any single trader to disrupt market operations through the acquisition and liquidation of large speculative positions, it may be helpful to consider a framework in which there are no exemptions from position limits and there exists a single contract with an open interest level of 1,000 contracts. With these simplifications in place, a position limit that is set at 10% of open interest, given an assumed open interest level of 1,000 contracts, would be 100 contracts (*i.e.,* 10% of 1,000 contracts). Thus, the position limit, at the assumed open interest level of 1,000 contracts, would mean that there must, at a minimum, be 10 independent long and 10 independent short traders.[69] If there were 9 traders on either side of the market, then at least one trader would necessarily hold more than 100 contracts. That trader would hold such positions in violation of the contract's position limit.

Alternatively, if the position limit is set at a lower percentage of the contract's assumed open interest level of 1,000 contracts, then the minimum number of independent traders needed as market participants would be higher. For example, a position limit that is set at 2.5% of the assumed open interest level of 1,000 contracts would be 25 contracts (*i.e.,* 2.5% of 1,000 contracts). Accordingly, the minimum "size of the trading crowd" under this scenario would be 40 long and 40 short traders (40 traders each with 25 contract positions would equal the given open interest level of 1,000 contracts). Therefore, position limits that are formulaically set as a percentage of open interest can prevent any single trader from acquiring excessive market power if structured properly as one part of a comprehensive speculative position limit framework.

B. Identifying Referenced Energy Contracts

As proposed, the speculative position limits would apply only to referenced energy contracts. Proposed regulation 151.1 defines referenced energy contracts to mean one of four enumerated contracts—the NYMEX Henry Hub natural gas contract, the NYMEX Light Sweet crude oil contract, the NYMEX New York Harbor No. 2 heating oil contract, and the NYMEX New York Harbor gasoline blendstock (RBOB) contract—and in addition, any other contract that is exclusively or partially based on the referenced

investments in commodity markets in terms of notional values and equivalent futures positions. The Commission continues to study the viability of the September 2008 Report's other recommendations regarding the creation of an Office of Data Collection, the establishment of more detailed reporting standards for large traders and a review of the relation of swap dealers' futures trading and commodity research activities. September 2008 Report, at 6.

[66] 74 FR 12282 (March 24, 2009).

[67] The comments are available for review on the Commission's Web site at *http://www.cftc.gov/lawandregulation/federalregister/federalregistercomments/2009/09–004.html.*

[68] Also in August 2009, Commission staff withdrew CFTC Letters 06–09 and 06–19, which had granted staff no-action relief to two index funds (with passively managed positions) from complying with the Federal speculative position limits otherwise applicable to futures and option contracts in wheat, corn and soybeans.

[69] The concept of independence is important because the positions of a group of traders acting pursuant to a common plan would be aggregated as if the positions were traded by a single person.

contracts' commodities and deliverable at locations specified in the proposed regulations. Basis contracts and diversified commodity index futures that are based on such contracts' commodities, however, would not be considered to be referenced energy contracts and, therefore, would not be subject to the proposed speculative position limits.

Basis contracts, as defined in proposed regulation 151.1, are futures or option contracts that are cash settled based on the difference in price of the same commodity (or substantially the same commodity)[70] at different delivery points. These basis contracts have been excluded by the Commission from the speculative position limits because they price the difference between the same commodity in two different locations and not the underlying commodity itself.[71] Similarly, contracts based on diversified commodity indexes, defined in proposed regulation 151.1 as commodity indexes that are comprised of contracts in energy as well as non-energy commodities, are excluded because they may not involve a separate and distinct exposure to the price of a referenced energy contract's commodity.[72]

C. Determining Aggregate All-Months-Combined and Single-Month Position Limits

The current Federal speculative position limits of regulation 150.2 apply only to specific futures contracts (and on a futures-equivalent basis) specific option contracts. Historically, all trading volume in a specific contract tended to migrate to a single contract on a single exchange. Consequently, speculative position limits that applied to a single contract and options thereon effectively applied to a single market. The current speculative position limits of regulation 150.2 for certain agricultural contracts follow this approach.

In 2005, when the Commission last amended the agricultural speculative position limits of regulation 150.2, it codified the Commission's practice of grouping positions in a limited set of contracts on the same exchange with substantially identical terms for the purpose of applying the Federal agricultural speculative position limits.[73] This limited grouping of positions extended only to regular and mini-sized contracts on the same exchange, such as the CBOT Corn and Mini-Corn futures contracts, and did not extend to contracts that were cash settled to physically delivered contracts. At that time and subsequently in 2007 (in a notice of proposed rulemaking that was subsequently withdrawn), the Commission considered but refrained from adopting additional position grouping requirements for the agricultural contracts enumerated in regulation 150.2.[74]

With the advent of look-alike energy contracts that are listed on different registered entities and contracts that are based on other contracts in an attempt to isolate different energy price risks, most prominently contracts traded at NYMEX and ICE, applying a speculative position to a specific energy contract, and its smaller sized counterpart, if any, without consideration of other directly or highly related contracts could result in applying a position limit only to a very limited segment of a broader regulated market. Accordingly, the proposed regulations would, for positions outside the spot month, apply the proposed Federal speculative position limits aggregately on and across reporting markets to capture a broader segment of the open interest that comprises the market for the referenced energy contracts.

Proposed regulation 151.2(b)(1) would establish aggregate all-months-combined and single-month speculative limits for positions held outside the spot month. The proposed framework premises its limits on open interest levels, and would establish speculative position limits aggregately, that is, across contracts of different classes on a single exchange and across all reporting markets listing the same referenced energy contracts. As defined in proposed regulation 151.1, contracts of the same class outside of the spot month include all referenced energy contracts (including option contracts on a futures-equivalent basis) on a single reporting market that are based on the same commodity and settled in the same manner. As proposed, NYMEX's crude oil financial calendar spread option, last day financial futures and options thereon, and light sweet crude oil e-mini contracts, as cash-settled NYMEX contracts, would all be grouped together as contracts of the same class. NYMEX's physically-settled light sweet crude oil contract, however, would be in a different class because the contract is physically-settled as opposed to being a financial futures contract like the contracts listed above. Similarly, ICE's natural gas SPDC, although financially-settled and related to NYMEX's natural gas contracts, would be in a different class because it is on a different exchange. As discussed more fully below, categorizing the referenced energy contracts in this manner allows for the application of aggregate and class-specific speculative position limits and permits for the netting of positions as appropriate.

In fixing aggregate all-months-combined and single-month position limits across contract classes, that is, for related contracts of different classes on and across the exchanges, the Commission would initially identify the referenced energy contracts that are based on the same commodity but that constitute a distinct class of contracts because, for example, they are cash-settled as opposed to physically-settled, or because they are listed on different reporting markets. The Commission next would calculate each class's average combined futures and delta-adjusted option month-end open interest for all months listed on a reporting market during the most recent calendar year as the first reference point ("class single-exchange gross open interest value").

The proposed regulations would subtract the open interest generated from spread contracts, as defined in regulation 151.1, from the class single-exchange gross open interest value to arrive at a "class single-exchange final open interest value." Proposed regulation 151.1 would define spread contracts as either a calendar spread contract or an inter-commodity spread contract.[75] Open interest generated from

[70] A commodity may be considered "substantially the same," for instance, if it is of the same grade and quality. If a commodity meets an underlying referenced energy contract's deliverable grade and quality specifications, then such commodity presumptively is substantially similar.

[71] It should also be noted that, although a grade may be substantially similar to a referenced energy contract's commodity, this is not sufficient to render a futures or option contract a referenced energy contract. In order to be included as a referenced energy contract, a substantially similar commodity must also be deliverable at a referenced energy contract's delivery point(s).

[72] Examples of diversified commodity indexes include the S&P/Goldman Sachs Commodity Index, the Thomson Reuters/Jefferies CRB Index and the Dow Jones-UBS Commodity Index.

[73] 70 FR 24705 (May 11, 2005).

[74] *See*, 70 FR 12621 (March 15, 2005); 72 FR 65483 (November 21, 2007).

[75] More specifically, proposed regulation 151.1 defines "calendar spread contracts" as contracts that are settled based on the difference between the settlement prices in one expiring month of a referenced energy contract and another month's settlement price for the same referenced energy contract. The proposed regulations would define "inter-commodity spread" contracts as contracts that are based on the price difference between the settlement price of a referenced energy contract and another commodity contract. An example of a calendar spread contract is the NYMEX Crude Oil Calendar Spread Financially Settled Option Contract (WA). This contract represents an option to assume positions in two different NYMEX Light Sweet crude oil futures contracts distinguished by opposite positions in different delivery months. An

Continued

spread contracts, as defined in proposed regulation 151.1, is not included in the class single-exchange final open interest value because spread contracts may be indicative of nominal commodity price exposures. Traders on both sides of spread contracts, as defined by the proposed regulations, hold a single position composed of two highly correlated legs. Therefore, open interest from such contracts may be excluded from the base open interest value that is used to calculate speculative position limits. Although excluded from the class single-exchange final open interest value that, as discussed below, is used to set the aggregate all-months-combined and single-month position limits, such contracts, unlike basis contracts and contracts based on diversified commodity indexes, are nonetheless referenced energy contracts and therefore are attributable to traders for the purposes of determining a trader's compliance with, for example, the proposed single-month speculative position limits.

The following table lists the contracts, grouped by class, which would be used to determine a class's single-exchange final open interest value as described above:

CONTRACT LIST WITHOUT SPREAD CONTRACTS

Class of contract	Contract name	Contract code	Spot-month conversion factor relative to referenced energy contract	Individual month conversion factor relative to referenced energy contract	All months combined conversion factor relative to referenced energy contract
Crude Oil/Physical Delivery/NYMEX	*Light Sweet Crude Oil Futures*	CL	1	1	1
	Light Sweet Crude Oil Option	LO	0	1	1
Crude Oil/Cash-Settled/NYMEX	*Crude Oil Financial Futures*	WS	1	1	1
	Crude Oil Last Day Financial Futures	26	1	1	1
	Crude Oil Option on Calendar Strip	6F	0	1	12
	Crude Oil Option on Quarterly Futures Strip.	6E	0	1	3
	Daily Crude Oil Option	CD	0	1	1
	E-mini Crude Oil Futures	QM	½	½	½
	NYMEX Crude Oil Backwardation/Contango (B/C) Index.	XK	0	⅕	⅕
	NYMEX Crude Oil MACI Index	XC	0	⅕	⅕
	NYMEX Crude Oil Minute-Marker Calendar Month Swap Futures.	4T	1	1	1
	NYMEX Crude Oil Minute-Marker Futures.	6C	1	1	1
	WTI Average Price Option	AO	0	1	1
	WTI Calendar Swap Futures	CS	1	1	1
	WTI Look-Alike Option	LC	0	1	1
Gasoline/Physical Delivery/NYMEX	*RBOB Gasoline Futures*	RB	1	1	1
	RBOB Gasoline Option	OB	0	1	1
Gasoline/Cash-Settled/NYMEX	*E-mini RBOB Gasoline Futures*	QU	½	½	½
	NYMEX RBOB Gasoline Minute-Marker Calendar Month Swap Futures.	5T	1	1	1
	NYMEX RBOB Gasoline Minute-Marker Futures.	6R	1	1	1
	RBOB Gasoline Average Price Option	RA	1	1	1
	RBOB Gasoline BALMO Swap Futures	1D	1	1	1
	RBOB Gasoline Calendar Swap Futures.	RL	1	1	1
	RBOB Gasoline Financial Futures	RT	1	1	1
	RBOB Gasoline Last Day Financial Futures.	27	1	1	1
	RBOB Gasoline Look-Alike European Option.	RF	0	1	1
Heating Oil/Physical Delivery/NYMEX	*Heating Oil Option*	OH	0	1	1
	New York Harbor No. 2 Heating Oil Futures.	HO	1	1	1
Heating Oil/Cash-Settled/NYMEX	*E-mini Heating Oil Futures*	QH	½	½	½
	Heating Oil Average Price Option	AT	1	1	1
	Heating Oil BALMO Swap Futures	1G	1	1	1
	Heating Oil Calendar Swap Futures	MP	1	1	1
	Heating Oil Financial Futures	BH	1	1	1
	Heating Oil Last Day Financial Futures	23	1	1	1
	Heating Oil Look-Alike Option	LB	0	1	1
	NYMEX Heating Oil Minute-Marker Calendar Month Swap Futures.	7T	1	1	1

example of an inter-commodity spread representing the price difference between two referenced commodities would be the NYMEX heating oil crack spread swap futures (HK) contract, which represents the price difference between two referenced energy contracts, the NYMEX New York Harbor No. 2 heating oil futures settlement price minus the NYMEX Light Sweet crude oil futures settlement price. A different example of an inter-commodity spread would be the NYMEX Mars (Argus) vs. WTI spread calendar swap (YX) which represents the Mars midpoint price from Argus Media minus the NYMEX Light Sweet crude oil futures first nearby contract month settlement price.

CONTRACT LIST WITHOUT SPREAD CONTRACTS—Continued

Class of contract	Contract name	Contract code	Spot-month conversion factor relative to referenced energy contract	Individual month conversion factor relative to referenced energy contract	All months combined conversion factor relative to referenced energy contract
	NYMEX Heating Oil Minute-Marker Futures.	6H	1	1	1
Natural Gas/Physical Delivery/NYMEX	*Henry Hub Natural Gas Futures*	NG	1	1	1
	Henry Hub Natural Gas Option	ON	1	1	1
Natural Gas/Cash-Settled/NYMEX	*Daily Natural Gas Option*	KD	0	1	1
	E-mini Henry Hub Natural Gas Penultimate Financial Futures.	NP	1/4	1/4	1/4
	E-mini Natural Gas Futures	QG	1/4	1/4	1/4
	Henry Hub Natural Gas Last Day Financial Futures.	HH	1	1	1
	Henry Hub Natural Gas Last Day Financial Option.	E7	1	1	1
	Henry Hub Natural Gas Look-Alike Option.	LN	1	1	1
	Henry Hub Natural Gas Penultimate Financial Futures.	HP	1	1	1
	Henry Hub Natural Gas Swap Futures	NN	1/4	1/4	1/4
	Natural Gas Option on Calendar Futures Strip.	6J	0	1/4	3
	Natural Gas Option on Summer Futures Strip.	4D	0	1/4	1 3/4
	Natural Gas Option on Winter Futures Strip.	6I	0	1/4	1 1/4
Natural Gas/Cash-Settled/ICE	*Henry Hub Natural Gas Swap*	H	1/4	1/4	1/4

Once a class single-exchange final open interest value is determined, under the proposed regulations, the Commission would sum this value for all related classes on and across all reporting markets to arrive at an "aggregated market open interest value" as a third reference point for each of the four referenced energy contracts. The proposed regulations would establish an all-months-combined aggregate position limit that is fixed by the Commission at 10% of the aggregated open interest value discussed above, up to 25,000 contracts, with a marginal increase of 2.5% thereafter.[76] This proposed formula is similar to the formula provided in current regulation 150.5(c).

The proposed regulations would set the single-month aggregate position limit at two-thirds of the position limit fixed for the all-months-combined aggregate position limit. This means that the aggregate all-months-combined position limit level would be 150% of the aggregate single-month position limit level. As previously discussed, in 2005 the Commission increased the all-months-combined Federal speculative position limits and reset the single-month levels to approximate the then existing ratio between all-months-combined and single-month levels (*i.e.,* arriving at the single-month limits by setting them at about two-thirds of the relevant all-months-combined limits). The proposed regulation's reliance on this approach for determining single non-spot-month limits is therefore consistent with prior Commission determinations.

As proposed, the intent of the aggregate position limits is to permit for the netting of positions in a referenced energy contract's different classes on a single exchange and across the exchanges for the purpose of determining compliance with the aggregate all-months-combined and aggregate single-month speculative position limits. Accordingly, no trader would be permitted to hold net long or net short referenced energy contract positions that, when combined with net long or net short positions in the same referenced energy contract on another exchange, would exceed the aggregate all-months-combined and aggregate single-month speculative position limits.

D. Single-Exchange Limits

In order to prevent the excessive concentration of positions in a particular class of contracts, for each reporting market separately, the proposed regulations would also establish an all-months-combined position limit that would apply specifically to contracts of the same class at the lower of the aggregate position limit for a referenced energy contract or 30% of a class's single exchange final open interest value. Accordingly, for the purpose of applying these exchange and class-specific speculative position limits, netting would only be permitted between contracts of the same class.

For each reporting market separately, the proposed regulations also would establish a single-month position limit for contracts of the same class that would be two-thirds of the all-months-combined position limit fixed for that class of contracts. Thus, the single-month limit on each reporting market for a class of contracts would be no greater than 20% of a class's single exchange final open interest value (*i.e.,* two-thirds of 30% of a class's single exchange final open interest value).

Proposed regulation 151.2 also establishes a minimum position limit for a reporting market of 5,000 contracts or 1% of the aggregated open interest value, whichever is greater. The Commission notes that the 5,000 contract level is consistent with its guidance on acceptable practices for exchanges setting all-months-combined position limits for newly listed energy contracts in current regulation

[76] Proposed regulation 151.2(e)(3) provides that the result of the formula is rounded up to the nearest one hundred to calculate the level of the limit.

150.5(b)(3). Levels set by reference to the 1% of aggregated open interest value and the 5,000 contract limit are intended to give newly listed contracts or contracts with low open interest the opportunity to attract liquidity. The concentration of positions held by a single trader on a particular reporting market, such as a market marker,[77] given the minimal impact that such trading may have on commodity prices, is acceptable because such levels promote innovation and competition.

In addition to the above mentioned position limits, as proposed, a trader's positions in contracts of the same class in a single month on a reporting market, measured on a gross basis, would be limited to no greater than two times the all-months-combined class position limit fixed for that reporting market. A limit on a trader's gross positions in a single month would serve to prevent sudden or unreasonable fluctuations or unwarranted changes in commodity prices that could arise from traders holding large positions that would otherwise net out (*e.g.,* offsetting positions in last trading day and penultimate contracts of the same class for the same month) for the purpose of applying the class single-month position limits.

The following table groups contracts by the classes in which they would be included under the proposed regulations:

CONTRACT LIST WITH SPREAD CONTRACTS

Class of contract	Contract name	Contract code	Spot-month conversion factor relative to referenced energy contract	Individual month conversion factor relative to referenced energy contract	All months combined conversion factor relative to referenced energy contract
Crude Oil/Physical Delivery/NYMEX.	*Light Sweet Crude Oil Futures*	CL	1	1	1
	Light Sweet Crude Oil Option	LO	0	1	1
	Heating Oil Crack Spread Option	HC	−1	−1	−1
	RBOB Gasoline Crack Spread Option	RX	−1	−1	−1
	WTI Calendar Spread Option	WA	1	1	0
Crude Oil/Cash-Settled/NYMEX.	*Crude Oil Financial Calendar Spread Option*	7A	1	1	1
	Crude Oil Financial Futures	WS	1	1	1
	Crude Oil Last Day Financial Futures	26	1	1	1
	Crude Oil Option on Calendar Strip	6F	0	1	12
	Crude Oil Option on Quarterly Futures Strip	6E	0	1	3
	Daily Crude Oil Option	CD	0	1	1
	E-mini Crude Oil Futures	QM	½	½	½
	Gulf Coast No. 2 (Platts) Crack Spread Swap Futures.	RD	−1	−1	−1
	Gulf Coast No. 6 Fuel Oil (Platts) Crack Spread Swap Futures.	MG	−1	−1	−1
	Gulf Coast ULSD (Argus) Crack Spread Swap Futures.	CF	−1	−1	−1
	Gulf Coast ULSD (Platts) Crack Spread Swap Futures.	GY	−1	−1	−1
	Gulf Coast Unl 87 (Argus) Crack Spread Swap Futures.	CK	−1	−1	−1
	Gulf Coast Unl 87 (Platts) Crack Spread BALMO Swap Futures.	1J	−1	−1	−1
	Gulf Coast Unl 87 (Platts) Crack Spread Swap Futures.	RU	−1	−1	−1
	Heating Oil Crack Spread Average Price Option	3W	−1	−1	−1
	Heating Oil Crack Spread BALMO Swap Futures	1H	−1	−1	−1
	Heating Oil Crack Spread Swap Futures	HK	−1	−1	−1
	Mars (Argus) vs. WTI Spread Calendar Swap Futures.	YX	−1	−1	−1
	Mars (Argus) vs. WTI Spread Trade Month Swap Futures.	YV	−1	−1	−1
	New York Harbor Residual Fuel (Platts) Crack Spread Swap Futures.	ML	−1	−1	−1
	New York Ultra Low Sulfur Diesel (ULSD) Crack Spread Swap.	YU	−1	−1	−1
	NYMEX Crude Oil Backwardation/Contango (B/C) Index.	XK	0	⅕	⅕
	NYMEX Crude Oil MACI Index	XC	0	⅕	⅕
	NYMEX Crude Oil Minute-Marker Calendar Month Swap Futures.	4T	1	1	1
	NYMEX Crude Oil Minute-Marker Futures	6C	1	1	1
	RBOB Gasoline Crack Spread Average Price Option.	3Y	−1	−1	−1

[77] A market maker is a trader that quotes both a buy and a sell price in an attempt to profit from the spread.

CONTRACT LIST WITH SPREAD CONTRACTS—Continued

Class of contract	Contract name	Contract code	Spot-month conversion factor relative to referenced energy contract	Individual month conversion factor relative to referenced energy contract	All months combined conversion factor relative to referenced energy contract
	RBOB Gasoline Crack Spread BALMO Swap Futures.	1E	−1	−1	−1
	RBOB Gasoline Crack Spread Swap Futures	RM	−1	−1	−1
	WTI Average Price Option	AO	0	1	1
	WTI Calendar Swap Futures	CS	1	1	1
	WTI Look-Alike Option	LC	0	1	1
	WTS (Argus) vs. WTI Spread Calendar Swap Futures.	FF	−1	−1	−1
	WTS (Argus) vs. WTI Spread Trade Month Swap Futures.	FH	−1	−1	−1
Gasoline/Physical Delivery/NYMEX.	*RBOB Gasoline Futures*	RB	1	1	1
	RBOB Gasoline Option	OB	0	1	1
	RBOB Gasoline Calendar Spread Option	ZA	1	1	0
	RBOB Gasoline Crack Spread Option	RX	0	1	1
Gasoline/Cash-Settled/NYMEX.	*Chicago Unleaded Gasoline (Platts) vs. RBOB Gasoline Spread Swap Futures.*	3C	−1	−1	−1
	E-mini RBOB Gasoline Futures	QU	½	½	½
	Group Three Unleaded Gasoline (Platts) vs. RBOB Spread Swap.	A8	−1	−1	−1
	Gulf Coast Gasoline (OPIS) vs. RBOB Gasoline Spread Swap Futures.	4F	−1	−1	−1
	Gulf Coast Unl 87 (Argus) Up-Down Swap Futures.	UZ	−1	−1	−1
	Gulf Coast Unl 87 (Platts) Up-Down BALMO Swap Futures.	1K	−1	−1	−1
	Gulf Coast Unl 87 (Platts) vs. RBOB Gasoline Spread Swap Futures.	RV	−1	−1	−1
	Los Angeles CARBOB Gasoline (OPIS) Spread Swap Futures.	JL	−1	−1	−1
	New York Harbor Conv. Gasoline (Platts) vs. RBOB Gasoline Swap Futures.	RZ	−1	−1	−1
	NY RBOB (Platts) vs. NYMEX RBOB Gasoline Spread Swap Futures.	RI	−1	−1	−1
	NYMEX RBOB Gasoline Minute-Marker Calendar Month Swap Futures.	5T	1	1	1
	NYMEX RBOB Gasoline Minute-Marker Futures	6R	1	1	1
	RBOB Gasoline Average Price Option	RA	1	1	1
	RBOB Gasoline BALMO Swap Futures	1D	1	1	1
	RBOB Gasoline Calendar Swap Futures	RL	1	1	1
	RBOB Gasoline Crack Spread Average Price Option.	3Y	1	1	1
	RBOB Gasoline Crack Spread BALMO Swap	1E	1	1	1
	RBOB Gasoline Crack Spread Swap Futures	RM	1	1	1
	RBOB Gasoline Financial Futures	RT	1	1	1
	RBOB Gasoline Last Day Financial Futures	27	1	1	1
	RBOB Gasoline Look-Alike European Option	RF	0	1	1
	RBOB Gasoline vs. Heating Oil Swap Futures	RH	1	1	1
Heating Oil/Physical Delivery/NYMEX.	*New York Harbor No. 2 Heating Oil Futures*	HO	1	1	1
	Heating Oil Option	OH	0	1	1
	Heating Oil Calendar Spread Options	FA	1	1	0
	Heating Oil Crack Spread Option	HC	0	1	1
Heating Oil/Cash-Settled/NYMEX.	*Chicago ULSD (Platts) vs. Heating Oil Spread Swap.*	5C	−1	−1	−1
	E-mini Heating Oil Futures	QH	½	½	½
	Group Three ULSD (Platts) vs. Heating Oil Spread Swap Futures.	A6	−1	−1	−1
	Gulf Coast Jet (Argus) Up-Down Swap Futures	JU	−1	−1	−1
	Gulf Coast Jet (OPIS) vs. Heating Oil Spread Swap Futures.	W7	−1	−1	−1
	Gulf Coast Jet (Platts) Up-Down BALMO Swap Futures.	1M	−1	−1	−1
	Gulf Coast Jet (Platts) vs. Heating Oil Spread Swap Futures.	ME	−1	−1	−1
	Gulf Coast Low Sulfur Diesel (LSD) (Platts) Up-Down Spread Swap Futures.	YL	−1	−1	−1
	Gulf Coast ULSD (Argus) Up-Down Swap Futures	US	−1	−1	−1

CONTRACT LIST WITH SPREAD CONTRACTS—Continued

Class of contract	Contract name	Contract code	Spot-month conversion factor relative to referenced energy contract	Individual month conversion factor relative to referenced energy contract	All months combined conversion factor relative to referenced energy contract
	Gulf Coast ULSD (OPIS) vs. Heating Oil Spread Swap Futures.	5Q	−1	−1	−1
	Gulf Coast ULSD (Platts) Up-Down Spread Swap Futures.	LT	−1	−1	−1
	Gulf Coast ULSD (Platts) Up-Down Swap Futures	1L	−1	−1	−1
	Heating Oil Arb : NYMEX Heating Oil vs. ICE Gasoil.	HA	1	1	1
	Heating Oil Average Price Option	AT	1	1	1
	Heating Oil BALMO Swap Futures	1G	1	1	1
	Heating Oil Calendar Swap Futures	MP	1	1	1
	Heating Oil Crack Spread Average Price Option	3W	1	1	1
	Heating Oil Crack Spread BALMO Swap Futures	1H	1	1	1
	Heating Oil Crack Spread Swap Futures	HK	1	1	1
	Heating Oil Financial Futures	BH	1	1	1
	Heating Oil Last Day Financial Futures	23	1	1	1
	Heating Oil Look-Alike Option	LB	0	1	1
	Los Angeles CARB Diesel (OPIS) Spread Swap Futures.	KL	−1	−1	−1
	Los Angeles Jet (OPIS) Spread Swap Futures	JS	−1	−1	−1
	Los Angeles Jet Fuel (Platts) vs. Heating Oil Spread Swap Futures.	MQ	−1	−1	−1
	NY Jet Fuel (Argus) vs. Heating Oil Spread Swap Futures.	5U	−1	−1	−1
	NY Jet Fuel (Platts) vs. Heating Oil Swap Futures	1U	−1	−1	−1
	NY ULSD (Platts) vs. NYMEX Heating Oil Spread Swap Futures.	UY	−1	−1	−1
	NYMEX Heating Oil Minute-Marker Calendar Month Swap Futures.	7T	1	1	1
	NYMEX Heating Oil Minute-Marker Futures	6H	1	1	1
	RBOB Gasoline vs. Heating Oil Swap Futures	RH	−1	−1	−1
	ULSD (Argus) vs. Heating Oil Spread Swap Futures.	7Y	−1	−1	−1
Natural Gas/Physical Delivery/NYMEX.	*Henry Hub Natural Gas Futures*	NG	1	1	1
	Henry Hub Natural Gas Option	ON	1	1	1
	Henry Hub Natural Gas Calendar Spread Options	IA	1	1	0
Natural Gas/Cash-Settled/NYMEX.	*Daily Natural Gas Option*	KD	0	1	1
	E-mini Henry Hub Natural Gas Penultimate Financial Futures.	NP	1/4	1/4	1/4
	E-mini Natural Gas Futures	QG	1/4	1/4	1/4
	Henry Hub Natural Gas Last Day Financial Futures.	HH	1	1	1
	Henry Hub Natural Gas Last Day Financial Option	E7	1	1	1
	Henry Hub Natural Gas Look-Alike Option	LN	1	1	1
	Henry Hub Natural Gas Penultimate Financial Futures.	HP	1	1	1
	Henry Hub Natural Gas Swap Futures	NN	1/4	1/4	1/4
	Henry Natural Gas Financial Calendar Spread Option.	G4	1	1	0
	Natural Gas Option on Calendar Futures Strip	6J	0	1/4	3
	Natural Gas Option on Summer Futures Strip	4D	0	1/4	1 3/4
	Natural Gas Option on Winter Futures Strip	6I	0	1/4	1 1/4
Natural Gas/Cash-Settled/ICE.	*Henry Hub Natural Gas Swap*	H	1/4	1/4	1/4

E. Spot-Month Classes of Contracts

An energy contract that is in its spot month, pursuant to industry practice and as defined in proposed regulation 151.1, is a futures contract that is "next to expire during that period of time beginning at 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 registered entity." [78] In practice, the spot-month for the major energy contracts generally is

[78] For a contract that does not allow trading concurrently with the issuance of delivery notices, spot-month means "the futures contract next to expire during that period of time beginning at the close of trading on the third trading day preceding the last trading day." For a contract that cash-settles based on the price of one or more physically-delivered contracts, spot-month means "the period of time that is the spot-month for such physically-delivered contracts." The Commission intends the spot-month for options on futures contracts to be the same period of time as for the underlying futures contract.

three days in duration. In view of the heightened potential for manipulation, corners, squeezes as well as excessive speculation during this concentrated period of time, only those contracts that expire on the same day would be deemed to be contracts of the same class under the proposed regulations. This would mean that, for example, during the spot month, a cash-settled last trading day contract would not be in the same class as a cash-settled penultimate contract. The most significant impact of defining a class of contracts in a narrower manner during the spot-month is to prohibit the netting of spot-month contracts that expire on different days for the purpose of applying the proposed speculative position limits. By way of example, a trader that is 4,000 contracts long in a cash-settled last trading day contract, and 4,000 contracts short in a cash-settled penultimate contract on the same exchange in a referenced energy contract, would be subject to spot-month position limits for each contract and would not be deemed to be holding a flat position. In contrast, outside the spot month, each leg of this spread would be considered to be in the same class and therefore subject to netting for the purpose of applying the proposed class all-months-combined and single-month position limits.

F. Determining and Complying With the Proposed Spot-Month Limits

For physically-delivered contracts, a spot-month position limit would be fixed by the Commission at one-quarter of the estimated deliverable supply for a spot-month class of contracts. This proposed formula is consistent with current regulation 150.5(b) and the Acceptable Practices for Core Principle 5, in Appendix B to part 38, and the Commission's Guideline No. 1, in Appendix A to part 40. Proposed regulation 151.2(d) would require a reporting market listing physically-delivered contracts to submit to the Commission an estimate of deliverable supply for its contracts by December 31st of each calendar year. The Commission, in setting the spot-month limits, would take into consideration the estimates of deliverable supply provided by the reporting markets and would base its own determination of deliverable supply on data submitted by the reporting markets unless the Commission has a basis for questioning the accuracy of the submitted data, in which case the Commission would derive its own estimates of deliverable supply.

For cash-settled contracts based on the prices of physically-delivered futures contracts, the proposed regulations would establish a default spot-month position limit equal to that of the cash-settled contract's physically-delivered counterpart. The proposed regulations would allow a trader to acquire or hold positions in a spot-month class of contracts, pursuant to reporting market rules specifically implemented to address such positions, that is five times greater than the default spot-month limit upon satisfying certain conditions. A trader would be permitted to hold positions under this conditional-spot-month limit only if that trader does not hold a position in any physically-delivered referenced energy contract to which its cash-settled positions are linked in the spot month and satisfies the reporting requirements of proposed regulation 20.00.

Proposed regulation 20.00 sets forth reporting requirements for persons that would acquire positions in a referenced energy contract pursuant to the conditional-spot-month position limit of proposed regulation 151.2(a)(2). Specifically, this regulation would require such persons to file a completed CFTC Form 40 and Part A of new CFTC Form 404. CFTC Form 40, among other things, facilitates the Commission's identification of the persons controlling the trading of an account. Part A of new CFTC Form 404 would collect information on: A trader's spot and forward positions priced in relation to the relevant referenced energy contract or the contract's underlying commodity; the trader's spot and forward positions in contracts priced to a cash market index that includes quotations or prices for spot or forward contracts in the referenced energy contract's underlying commodity; the trader's positions in swaps priced in relation to the referenced energy contract or the contract's underlying commodity; and the trader's positions in other physically or financially settled contracts related to the trader's positions held pursuant to the conditional-spot-month position limit. The collection of this information would facilitate the Commission's surveillance program with respect to detecting and deterring trading activity that may tend to cause sudden or unreasonable fluctuations or unwarranted changes in the prices of the referenced energy contracts and their underlying commodities during the spot-month.

G. Exemptions and Related Requirements

1. *Bona Fide* Hedges

Proposed regulation 151.3(a) would establish three exemptions for the following transactions and positions: (i) *Bona fide* hedging transactions generally consistent with paragraphs (1) and (2) of regulation 1.3(z); (ii) swap dealer risk management transactions outside of the spot-month that are held to offset risks associated with certain swap agreements; and (iii) positions that would be in compliance with the speculative position limits when adjusted by an appropriate contemporaneous risk factor.

As proposed, a reporting market may establish an exemption process for traders holding positions in proprietary accounts that are shown to be *bona fide* hedging positions consistent with, but that may differ from (to the extent such differences are consistent with commercial activity in the physical energy markets), paragraphs (1) and (2) of regulation 1.3(z). As is currently the case for traders seeking exemptions from exchange-set spot-month position limits applicable to the referenced energy contracts, the Commission intends for traders seeking such *bona fide* hedging transactions to apply to a reporting market for exemptions from the applicable spot and non-spot-month limits. The Commission would audit this process to ensure that the reporting markets act appropriately in reviewing and acting on trader *bona fide* hedge exemption requests. In this manner, the Commission would also enable a reporting market to act expeditiously on exemption requests.

Under the proposed regulations, traders holding positions pursuant to a *bona fide* hedge exemption would generally be prohibited from also trading speculatively. If *bona fide* hedging positions outside the spot month exceed twice an otherwise applicable all-months-combined or single-month position limit, then such traders would also be prohibited from holding positions as swap dealers. In contrast, however, traders holding positions in the spot-month pursuant to a *bona fide* hedge exemption would not be prohibited from holding positions speculatively outside the spot month. The intent of this proposed exception is to not affect liquidity generated by speculative trading outside the spot month that would otherwise be prohibited by virtue of a trader's need to invoke a hedge exemption to exceed the lower spot-month position limits.

These "crowding out" provisions would restrict a trader controlling large positions used for hedging from also entering into large speculative positions or large swap dealer risk management positions. The proposed regulations would not impede a trader's ability to engage in *bona fide* hedging in any way, but would limit a trader's ability to acquire swap dealer risk management positions or speculative positions when that trader holds very large positions pursuant to a *bona fide* hedge exemption.

Proposed regulation 20.01 sets forth reporting requirements for persons that would acquire positions pursuant to the *bona fide* hedge exemption of proposed regulation 151.3(a)(1). Specifically, this section would require such persons to file a completed CFTC Form 40 and Part B of new CFTC Form 404. Part B of CFTC Form 404 would collect information on: The quantity of stocks owned of the commodity that underlies the relevant referenced energy contract and its products and by-products; the ownership of shares of an investment vehicle that holds or owns the referenced energy contract or the commodity that underlies the referenced energy contract and its products and by-products; the quantity of fixed price purchase and sale commitments on the relevant referenced energy contract's commodity; and, for anticipatory hedging transactions, annual sales or requirements for the preceding three complete fiscal years and anticipated sales or requirements of such commodity for the period hedged. For cross-hedge positions, traders would be required to report the relevant commercial activity in terms of the actual or anticipated quantity of the cross-hedged commodity, and on a converted basis, equivalent positions in the relevant referenced energy contract. The Commission notes that this proposed data collection is consistent with data currently collected in grain and cotton markets using CFTC Forms 204 and 304, respectively, pursuant to part 19 of the Commission's regulations.

2. Swap Dealers

Swap dealers can perform an important economic function by taking on risks to accommodate the specific hedging and risk management needs of various customers. Swap dealers often are able to aggregate and standardize these otherwise particularized risks, and in turn, enter into commodity futures and option contracts to manage them. Accordingly, under the regulations as proposed, swap dealers may apply to the Commission for an exemption from the proposed speculative position limits for positions held outside of the spot month to manage the risks associated with swap agreements entered into to accommodate swap customers. Proposed regulation 151.1 would define "swap agreement" to have the same meaning as in current Commission regulation 35.1(b)(1).[79] Proposed regulation 151.1 would also define "swap dealer" to mean "any person who, as a significant part of its business, holds itself out as a dealer in swaps, makes a market in swaps, regularly engages in the purchase of swaps and their resale to customers in the ordinary course of a business, or engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps."

The proposed swap dealer exemption would be limited to twice an applicable all-months-combined or single non-spot month speculative position limit. Further, traders would be required to aggregate positions held as swap dealer risk management transactions with net speculative positions for the purpose of determining compliance with the proposed Federal speculative position limits. As with *bona fide* hedgers that hold positions in excess of the proposed limits, swap dealers holding large positions pursuant to the proposed swap dealer exemption would be unable to also take on positions as speculators. In effect, this proposed "crowding out" provision would restrict a trader controlling a large position used for swap risk management from also entering into large speculative positions.

Proposed regulation 1.45 sets forth the application procedure for swap dealers that would seek an exemption from the proposed Commission-set speculative position limits. Specifically, this regulation would require a person to file a completed CFTC Form 40, an initial application and an annual update to certify that the person remains a swap dealer, as defined in proposed regulation 151.1. The exemption would require the applicant to consent to the publication of the fact that such person received a swap dealer exemption from the Commission. Such publication would be made only once a year and would not include the identity of a swap dealer that first received an exemption within the six calendar months preceding a publication. Furthermore, the publication would not include any information that would disclose the specific commodities for which the swap dealer has sought an exemption. In this regard, the Commission reiterates that it will protect all proprietary information in accordance with the Freedom of Information Act and part 145 of the Commission's regulations, headed "Commission Records and Information." In addition, the Commission emphasizes that section 8(a)(1) of the Act strictly prohibits the Commission, unless specifically authorized otherwise by the Act, from making public "data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers."[80]

Proposed regulation 20.02 sets forth reporting requirements for persons who would receive a swap dealer limited risk management exemption pursuant to proposed regulation 151.3(a)(2). Specifically, the proposed regulation would require swap dealers to file monthly a completed Form 404 Part C with the Commission and with any registered entity on which the swap dealer's referenced energy contract positions are listed. The monthly report would include, for each day, swap positions based upon the commodity underlying the referenced energy contracts that are held in proprietary and customer accounts and a summary of dealing and trading activity in swaps based upon the commodity underlying the referenced energy contracts. Furthermore, proposed regulation 20.02 would require the swap dealer to file a supplemental report whenever it establishes a larger position in referenced energy contracts than previously reported. In addition to the above reporting requirements, traders that receive a swap dealer limited risk management exemption must also maintain complete books and records relating to their swap dealing activities (including transaction data) and make such books and records, along with a list of counterparties to customer swap agreements that support and substantiate the need to offset swap agreement risks on reporting markets, available to the Commission upon request.

3. Exemptions for Delta-Adjusted Positions

The Commission understands that option risk factors continuously change with movements in the price of an underlying futures contract. As the price of the underlying futures contract changes, a trader offsetting the risk of an options position through a delta-neutral position in the underlying futures contract may need to adjust the futures position substantially on an intra-day basis to maintain a risk neutral position. As currently defined in regulation 150.1, delta-neutrality is recognized by reference to the previous day's risk factor. Proposed regulations 151.3 and 20.03 would set forth the exemption and reporting requirements for persons whose positions would have exceeded the Federal speculative position limit

[79] 17 CFR 35.1(b)(1).

[80] *See* 7 U.S.C. 12(a)(1).

for a referenced energy contract when adjusted by the previous day's risk factors (deltas), but that would not exceed such a limit when positions are calculated using an appropriate contemporaneous risk factor. The reporting requirements, as proposed, would include the submission of complete position data to demonstrate that such positions remained within an otherwise applicable speculative position limit when adjusted by an appropriate and contemporaneous risk factor.

H. Account Aggregation

Proposed regulation 151.4 would establish account aggregation standards specifically for positions in referenced energy contracts. Under the proposed standards, the Federal position limits in referenced energy contracts would apply to all positions in accounts in which any person, directly or indirectly, has an ownership or equity interest of 10% or greater or, by power of attorney or otherwise, controls trading. Proposed regulation 151.4 includes a limited exemption for positions in pools in which a trader that is a limited partner, shareholder or similar person has an ownership or equity interest of less than 25% unless the trader in fact controls trading that is done by the pool. Proposed regulation 151.4 would also treat positions held by two or more persons acting pursuant to an express or implied agreement or understanding the same as if the positions were held by, or the trading of the positions were done by, a single person. Accordingly, the proposed regulations would aggregate positions in accounts at both the account owner and controller levels.

In contrast to the disaggregation exemptions of current regulations 150.3(a)(4) and 150.4, eligible entities (such as mutual funds, commodity pool operators and commodity trading advisors) and futures commission merchants will not be permitted to disaggregate positions pursuant to the independent account controller framework established in part 150 of the Commission's regulations. The current account disaggregation exceptions for the agricultural contracts enumerated in regulation 150.2, may be incompatible with the proposed Federal speculative position limit framework, however, and used to circumvent its requirements.

The proposed framework sets high position levels that are at the outer bounds of the largest positions held by market participants, permits for the netting of positions across reporting markets and within contracts of the same class and in addition, includes a conditional-spot-month limit for cash-settled contracts and exemptions for *bona fide* hedgers, swap dealers and delta-adjusted positions. Accordingly, an exemption, such as the eligible entity exemption, that would allow traders to establish a series of positions each near a proposed outer bound position limit, without aggregation, may not be appropriate. Instead, proposed regulation 151.4 would establish a clear general account aggregation standard and a clear exception thereto for passive pool participants and similar investors.

VII. The CME Group's Proposal

In a concept paper published in September of 2009, the CME Group suggested an alternative position limit framework that would require each reporting market to set position limits separately without inter-exchange aggregation.[81] The single-month and all-months-combined limits, under the CME's proposal, would apply collectively to physically-delivered contracts and cash-settled contracts on a referenced energy commodity, including spread positions within the same contract. The level of the limits would be based on the collective open interest of the lead month (*i.e.,* the month with the highest level of open interest) in such contracts at that reporting market.

The CME Group also suggested that each reporting market set a single-month limit at 10% of the first 25,000 contracts of that reporting market's open interest with a 5% marginal increase for open interest in excess of 25,000 contracts at that reporting market. The CME Group suggested that the all-months-combined limit be set at 150% of the single-month limit and suggested establishing a flexible concentration limit in deferred-month contracts. Under the CME's proposed approach, a suggested concentration limit of 25% of open interest would be applicable in a single month that has developed liquidity.[82]

With respect to applying aggregate limits, the CME Group suggested that the CFTC establish and enforce an aggregate limit across all reporting markets, conditioned on the CFTC gaining authority to impose limits on OTC trading and on the CFTC developing a means to minimize the impact of potential transfers of trading to foreign jurisdictions or the physical markets. With respect to the aggregation of positions, the CME Group proposed that the aggregation standards of Commission regulation 150.4 apply to the aggregate limits.

By way of comparison, the Commission's proposed limits would apply aggregately across all exchanges that list a referenced energy contract and separately to physically-delivered contracts and cash-settled contracts that are listed by a particular reporting market. The Commission's proposed class-based limits would prevent the establishment of excessively large positions in a single class and, thereby, would reduce the potential for price distortions.

Also, by way of contrast to the CME Group's approach, the level of limits proposed by the Commission would be based on the sum of the open interest in all months, rather than only the lead month's open interest as proposed by the CME. By using the entire open interest, the Commission's proposal would avoid creating an incentive for traders to shift open interest into the lead month in an attempt to increase the level of the limits. Furthermore, rather than considering only a reporting market's open interest, the Commission's proposal would establish limit levels that reflect both aggregated open interest on all reporting markets and open interest on an individual reporting market. This tiered approach would provide an opportunity for small markets to grow, while establishing a prudential all-months limit for a class of contracts of no more than 30% of a reporting market's open interest in a class of contracts as defined in proposed regulation 151.1. The class limit, as proposed by the Commission, would be capped at a formula-determined level based on the open interest in all reporting markets in a referenced energy contract. The 30% level was selected in light of the expected opportunity for arbitrage across classes and the cap was set using the traditional all-months position limit formula in regulation 150.5(c)(2).

As discussed previously, the Commission's proposal first establishes an all-months-combined limit, then sets a single-month limit at two-thirds of the level of that all-months-combined limit. This is the same ratio between limits if first established in a single-month limit, as proposed by the CME, and then multiplied by 150% to arrive at an all-months-combined position limit. This two-thirds ratio, as proposed by the Commission, is therefore the same ratio that is proposed by the CME Group and consistent with the ratio between the single-month limits and the all-month-combined limits in the existing Federal agricultural positions limits which

[81] *See,* "Excessive Speculation and Position Limits in Energy Derivatives Markets," CME Group, at page 10, *http://www.cmegroup.com/company/files/PositionLimitsWhitePaper.pdf.*

[82] The concept paper did not specify a method to determine when a contract month had developed liquidity.

range from a low of 61% to a high of 77%. The table below provides a comparison of position limits as they would be set under the proposed Commission and CME Group approaches to establishing speculative position limits:

PROPOSED FEDERAL SPECULATIVE POSITION LIMITS FOR REFERENCED ENERGY CONTRACTS

Referenced energy contract	Class of contract	All-months-combined (AMC) average open interest (January 2008–December 2008)	AMC limit	Single-month limit
NYMEX Light Sweet Crude Oil	NYMEX Physical Delivery	2,881,901	98,100	65,400
	NYMEX Cash-Settled	963,871	98,100	65,400
	Aggregate Limit	3,845,772	98,100	65,400
NYMEX New York Harbor Gasoline Blendstock (RBOB).	NYMEX Physical Delivery	252,564	9,000	6,000
	NYMEX Cash-Settled	29,306	8,800	5,900
	Aggregate Limit	281,870	9,000	6,000
NYMEX New York Harbor No. 2 Heating Oil.	NYMEX Physical Delivery	254,442	10,100	6,800
	NYMEX Cash-Settled	73,996	10,100	6,800
	Aggregate Limit	328,438	10,100	6,800
NYMEX Henry Hub Natural Gas	NYMEX Physical Delivery	1,236,257	132,700	88,500
	NYMEX Cash-Settled	3,088,239	132,700	88,500
	ICE Cash-Settled	904,754	132,700	88,500
	Aggregate Limit	5,229,250	132,700	88,500

PROPOSED ENERGY SPECULATIVE LIMITS BY CME GROUP

Reference energy contract	Exchange	Average lead month open interest January 2008–December 2008)	All-months-combined limit	Single-month limit
NYMEX Light Sweet Crude Oil	NYMEX	841,607	65,000	43,400
NYMEX New York Harbor Gasoline Blendstock (RBOB).	NYMEX	107,439	10,000	6,700
NYMEX New York Harbor No. 2 Heating Oil.	NYMEX	98,977	9,300	6,200
NYMEX Henry Hub Natural Gas	NYMEX	505,220	39,800	26,600
	ICE	124,860	11,300	7,500

VIII. Request for Comment

The Commission requests comment on all aspects of this proposal, and particularly requests comments on the following issues and responses to the following questions:

1. Are Federal speculative position limits for energy contracts traded on reporting markets necessary to “diminish, eliminate, or prevent” the burdens on interstate commerce that may result from position concentrations in such contracts?

2. Are there methods other than Federal speculative position limits that should be utilized to diminish, eliminate, or prevent such burdens?

3. How should the Commission evaluate the potential effect of Federal speculative position limits on the liquidity, market efficiency and price discovery capabilities of referenced energy contracts in determining whether to establish position limits for such contracts?

4. Under the class approach to grouping contracts as discussed herein, how should contracts that do not cash settle to the price of a single contract, but settle to the average price of a sub-group of contracts within a class be treated during the spot month for the purposes of enforcing the proposed speculative position limits?

5. Under proposed regulation 151.2(b)(1)(i), the Commission would establish an all-months-combined aggregate position limit equal to 10% of the average combined futures and option contract open interest aggregated across all reporting markets for the most recent calendar year up to 25,000 contracts, with a marginal increase of 2.5% of open interest thereafter. As an alternative to this approach to an all-months-combined aggregate position limit, the Commission requests comment on whether an additional increment with a marginal increase larger than 2.5% would be adequate to prevent excessive speculation in the referenced energy contracts. An additional increment would permit traders to hold larger positions relative to total open positions in the referenced energy contracts, in comparison to the proposed formula. For example, the Commission could fix the all-months-combined aggregate position limit at 10% of the prior year’s average open interest up to 25,000 contracts, with a marginal increase of 5% up to 300,000 contracts and a marginal increase of 2.5% thereafter. Assuming the prior year’s average open interest equaled 300,000 contracts, an all-months-combined aggregate position limit would be fixed at 9,400 contracts under the proposed rule and 16,300 contracts under the alternative.

6. Should customary position sizes held by speculative traders be a factor in moderating the limit levels proposed by the Commission? In this connection, the Commission notes that current regulation 150.5(c) states contract markets may adjust their speculative

limit levels "based on position sizes customarily held by speculative traders on the contract market, which shall not be extraordinarily large relative to total open positions in the contract * * *"

7. Reporting markets that list referenced energy contracts, as defined by the proposed regulations, would continue to be responsible for maintaining their own position limits (so long as they are not higher than the limits fixed by the Commission) or position accountability rules. The Commission seeks comment on whether it should issue acceptable practices that adopt formal guidelines and procedures for implementing position accountability rules.

8. Proposed regulation 151.3(a)(2) would establish a swap dealer risk management exemption whereby swap dealers would be granted a position limit exemption for positions that are held to offset risks associated with customer initiated swap agreements that are linked to a referenced energy contract but that do not qualify as *bona fide* hedge positions. The swap dealer risk management exemption would be capped at twice the size of any otherwise applicable all-months-combined or single non-spot-month position limit. The Commission seeks comment on any alternatives to this proposed approach. The Commission seeks particular comment on the feasibility of a "look-through" exemption for swap dealers such that dealers would receive exemptions for positions offsetting risks resulting from swap agreements opposite counterparties who would have been entitled to a hedge exemption if they had hedged their exposure directly in the futures markets. How viable is such an approach given the Commission's lack of regulatory authority over the OTC swap markets?

9. Proposed regulation 20.02 would require swap dealers to file with the Commission certain information in connection with their risk management exemptions to ensure that the Commission can adequately assess their need for an exemption. The Commission invites comment on whether these requirements are sufficient. In the alternative, should the Commission limit these filing requirements, and instead rely upon its regulation 18.05 special call authority to assess the merit of swap dealer risk management exemption requests?

10. The Commission's proposed part 151 regulations for referenced energy contracts would set forth a comprehensive regime of position limit, exemption and aggregation requirements that would operate separately from the current position limit, exemption and aggregation requirements for agricultural contracts set forth in part 150 of the Commission's regulations. While proposed part 151 borrows many features of part 150, there are notable distinctions between the two, including their methods of position limit calculation and treatment of positions held by swap dealers. The Commission seeks comment on what, if any, of the distinctive features of the position limit framework proposed herein, such as aggregate position limits and the swap dealer limited risk management exemption, should be applied to the agricultural commodities listed in part 150 of the Commission's regulations.

11. The Commission is considering establishing speculative position limits for contracts based on other physical commodities with finite supply such as precious metal and soft agricultural commodity contracts. The Commission invites comment on which aspects of the current speculative position limit framework for the agricultural commodity contracts and the framework proposed herein for the major energy commodity contracts (such as proposed position limits based on a percentage of open interest and the proposed exemptions from the speculative position limits) are most relevant to contracts based on other physical commodities with finite supply such as precious metal and soft agricultural commodity contracts.

12. As discussed previously, the Commission has followed a policy since 2008 of conditioning FBOT no-action relief on the requirement that FBOTs with contracts that link to CFTC-regulated contracts have position limits that are comparable to the position limits applicable to CFTC-regulated contracts. If the Commission adopts the proposed rulemaking, should it continue, or modify in any way, this policy to address FBOT contracts that would be linked to any referenced energy contract as defined by the proposed regulations?

13. The Commission notes that Congress is currently considering legislation that would revise the Commission's section 4a(a) position limit authority to extend beyond positions in reporting market contracts to reach positions in OTC derivative instruments and FBOT contracts. Under some of these revisions, the Commission would be authorized to set limits for positions held in OTC derivative instruments and FBOT contracts.[83] The Commission seeks comment on how it should take this pending legislation into account in proposing Federal speculative position limits.

14. Under proposed regulation 151.2, the Commission would set spot-month and all-months-combined position limits annually.

a. Should spot-month position limits be set on a more frequent basis given the potential for disruptions in deliverable supplies for referenced energy contracts?

b. Should the Commission establish, by using a rolling-average of open interest instead of a simple average for example, all-months-combined position limits on a more frequent basis? If so, what reasons would support such action?

15. Concerns have been raised about the impact of large, passive, and unleveraged long-only positions on the futures markets. Instead of using the futures markets for risk transference, traders that own such positions treat commodity futures contracts as distinct assets that can be held for an appreciable duration. This notice of rulemaking does not propose regulations that would categorize such positions for the purpose of applying different regulatory standards. Rather, the owners of such positions are treated as other investors that would be subject to the proposed speculative position limits.

a. Should the Commission propose regulations to limit the positions of passive long traders?

b. If so, what criteria should the Commission employ to identify and define such traders and positions?

c. Assuming that passive long traders can properly be identified and defined, how and to what extent should the Commission limit their participation in the futures markets?

d. If passive long positions should be limited in the aggregate, would it be feasible for the Commission to apportion market space amongst various traders that wish to establish passive long positions?

e. What unintended consequences are likely to result from the Commission's implementation of passive long position limits?

16. The proposed definition of referenced energy contract, diversified commodity index, and contracts of the same class are intended to be simple definitions that readily identify the affected contracts through an objective and administerial process without

[83] *See, e.g.,* the Over-the-Counter Derivatives Markets Act of 2009 (OCDMA), H.R. 3795, 111th Congress, 1st Session (2009). OCDMA would also abolish the DTEF, ECM and ECM–SPDC market categories.

relying on the Commission's exercise of discretion.

a. Is the proposed definition of contracts of the same class for spot and non-spot months sufficiently inclusive?

b. Is it appropriate to define contracts of the same class during spot months to only include contracts that expire on the same day?

c. Should diversified commodity indexes be defined with greater particularity?

17. Under the proposed regulations, a swap dealer seeking a risk management exemption would apply directly to the Commission for the exemption. Should such exemptions be processed by the reporting markets as would be the case with *bona fide* hedge exemptions under the proposed regulations?

18. In implementing initial spot-month speculative position limits, if the notice of proposed rulemaking is finalized, should the Commission:

a. Issue special calls for information to the reporting markets to assess the size of a contract's deliverable supply;

b. Use the levels that are currently used by the exchanges; or

c. Undertake an independent calculation of deliverable supply without substantial reliance on exchange estimates?

IX. Related Matters

A. Cost Benefit Analysis

Section 15(a) of the Act requires the Commission to consider the costs and benefits of its actions before issuing new regulations under the Act. Section 15(a) does not require the Commission to quantify the costs and benefits of new regulations or to determine whether the benefits of adopted regulations outweigh their costs. Rather, section 15(a) requires the Commission to consider the cost and benefits of the subject regulations. Section 15(a) further specifies that the costs and benefits of new regulations shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of the market for listed derivatives; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may, in its discretion, give greater weight to any one of the five enumerated areas of concern and may, in its discretion, determine that, notwithstanding its costs, a particular regulation is necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

The proposed regulatory framework for positions in the referenced energy contracts, as defined by the proposed regulations, would impose certain compliance costs on Commission-regulated exchanges and traders that hold large positions in the referenced energy contracts. In addition to the compliance costs that are directly related to the proposed regulations, the proposed position limits and their concomitant limitation on trading activity could impose certain general but significant costs. The proposed position limits could cause unintended consequences by decreasing liquidity in the markets for the referenced energy contracts, impairing the price discovery process in these markets, and pushing large positions to trading venues over which the Commission has no direct regulatory authority.

Based on data received by the Commission's large trader reporting system, the Commission believes the proposed position limits would accommodate the normal course of speculative positions in markets for the referenced energy contracts. Commission data indicates that possibly ten traders, including traders that hold positions pursuant to exchange-approved *bona fide* hedge exemptions, could be affected by the proposed limits. For the reasons discussed below, the Commission anticipates that the compliance costs associated with the proposed limits and their impact on the efficiency of the markets for the referenced energy contracts would be minimal.

The proposed spot-month position limits, although applicable to a class of contracts and across reporting markets, are consistent with current exchange-set spot-month position limits that have been implemented and enforced by NYMEX and ICE pursuant to DCM and ECM–SPDC core principles and Commission guidance. In addition, both NYMEX and ICE implement position accountability rules for positions outside the spot month and routinely monitor and solicit reports from large traders. The affected exchanges and large traders therefore are accustomed to an existing compliance system for large positions and the processing of hedge and spread exemptions from exchange-set spot-month position limits. In addition, a significant portion of the affected traders are currently subject to the Commission's large trader reporting system and should have compliance systems in place to accommodate any new potential regulatory requirements. For these reasons, the compliance costs associated with the proposed limits should be minimal.

Section 4a(a) has identified excessive speculation that causes unwarranted fluctuations in the price of a commodity as an undue burden on commerce. Accordingly section 4a(a) of the Act gives the Commission the ability to establish a position limit framework as a prophylactic measure against sudden or unreasonable price fluctuations or unwarranted price changes in accordance with the purposes and findings of the Act. The Congressional endorsement of the Commission's prophylactic use of speculative position limits extends to any commodity and does not require a specific finding of an extant undue burden on interstate commerce.

A primary intent of the proposed position limit framework is to prevent a single trader or several traders from acquiring large or concentrated positions that may cause unwarranted, sudden or unreasonable fluctuations in the price of energy commodities. The Commission is concerned that concentrated positions at or near the proposed limits may directly lead to market disruptions causing unwarranted, sudden or unreasonable fluctuations in the price of energy commodities.

Another concern regarding the existence of large speculative positions is the possibility for disruption across markets or trading platforms listing similar or linked products. Because individual markets have knowledge of positions only on their own trading platforms, it is difficult for them to assess the full impact of a trader's activities. In recognition of this, the proposed framework also would apply to trading done in linked and economically similar contracts across markets. The Commission notes that it has the unique capacity for monitoring trading and implementing remedial measures across interconnected futures and option markets in the referenced energy contracts. The position limits, as proposed, are purposefully set at the outer bounds of the levels that speculators are likely to acquire in order to avoid disrupting or interfering with beneficial trading activity. Still, the proposed regulations are intended to fully achieve the prophylactic purpose of section 4a(a) of the Act.

B. The Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601 *et seq.,* requires that agencies consider the impact of their regulations on small businesses. The requirements related to the proposed amendments fall mainly on registered entities, exchanges, futures commission merchants, clearing members, foreign brokers, and large traders. The Commission has previously determined that exchanges, futures commission merchants and large traders are not "small entities" for the purposes of the RFA.[84] Similarly, clearing members, foreign brokers and traders would be subject to the proposed regulations only if carrying or holding large positions. Accordingly, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the actions proposed to be taken herein would not have a significant economic impact on a substantial number of small entities.

C. Paperwork Reduction Act

Certain provisions of the proposed regulations would result in new collection of information requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA"). The Commission therefore is submitting this proposal to the Office of Management and Budget ("OMB"), along with proposed new CFTC Form 404, for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11.

The title for this proposed collection of information is "Regulation 1.45 and Parts 20 and 151—Position Limit Framework For Referenced Energy Contracts" (OMB control number 3038–NEW).

If adopted, responses to this collection of information would be mandatory. The Commission will protect proprietary information according to the Freedom of Information Act and 17 CFR part 145, headed "Commission Records and Information." In addition, the Commission emphasizes that section 8(a)(1) of the Act strictly prohibits the Commission, unless specifically authorized by the Act, from making public "data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers." [85]

Under the proposed regulations, reporting markets listing, and market participants trading, the referenced energy contracts would be subject to the position limit framework established by proposed part 151 and the application and reporting requirements of proposed regulation 1.45 and part 20. Proposed regulation 1.45 sets forth the application procedure for swap dealers that would seek an exemption from the proposed Commission-set Federal speculative position limits for referenced energy contracts. Proposed part 20 would require similar reports from persons holding large positions under the proposed conditional-spot-month position limit, as *bona fide* hedgers, as swap dealers, and as traders with certain delta-adjusted positions. The Commission estimates that affected traders, as a result of their diversified business structure, would be subject to most or all of the requirements and exemptions of proposed regulation 1.45 and parts 20 and 151.

Should the proposed regulations be adopted, the total number of traders that would be subject to the regulations is estimated at 10, with each providing an estimated 20 reports to the Commission at an estimated compliance time of four hours per response. Accordingly, the Commission estimates the aggregate annual burden that would be imposed by the regulations, as proposed, to be 800 hours. The Commission specifically notes that the estimated annual burden provided on the affected exchanges and traders is in addition to, and does not include, costs incurred from compliance with other regulatory and operational requirements. The Commission invites the public and other Federal agencies to comment on any aspect of the reporting and recordkeeping burdens discussed above.

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

You may submit your comments directly to the Office of Information and Regulatory Affairs, by fax at (202) 395–6566 or by e-mail at *OIRA-submissions@omb.eop.gov*. Please provide the Commission with a copy of your comments so that we can summarize all written comments and address them in any subsequent notice of rulemaking. Refer to the Addresses section of this notice for comment submission instructions to the Commission. You may obtain a copy of the supporting statements for the collection of information discussed above by visiting RegInfo.gov. OMB is required to make a decision concerning the collection of information between 30 to 60 days after publication of this notice. Consequently, a comment to OMB is most assured of being fully considered if received by OMB (and the Commission) within 30 days after the publication of this notice of proposed rulemaking.

List of Subjects

17 CFR Part 1

Brokers, Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

17 CFR Part 20

Commodity futures, Reporting and recordkeeping requirements.

17 CFR Part 151

Position limits, *Bona fide* hedge positions, Spread exemptions, Energy commodities.

In consideration of the foregoing, pursuant to the authority contained in the Commodity Exchange Act, the Commission hereby proposes to amend chapter I of title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24, as amended by Title XIII of the Food, Conservation and Energy Act of 2008, Pub. L. No. 110–246, 122 Stat. 1624 (June 18, 2008).

2. Add § 1.45 in part 1 to read as follows:

§ 1.45. Application for a swap dealer exemption.

(a) Persons seeking an exemption from the speculative position limits established by the Commission for referenced energy contracts under § 151.2 of this chapter, pursuant to an exemption for swap dealers under § 151.3(a)(2) of this chapter, shall:

(1) File an initial application for an exemption and, thereafter, update such application annually, as the Commission shall require;

(2) Provide as part of the application, all information required by the Commission, including but not limited to:

(i) A completed Form 40 along with the information required under § 18.04 of this chapter;

(ii) A certification that the person is a swap dealer as defined in § 151.1 of this chapter; and

[84] 47 FR 18618 (April 30, 1982).

[85] 7 U.S.C. 12(a)(1).

(iii) Specific consent to having their name published on the Commission's Web site (*http://www.cftc.gov*) as having received a swap dealer exemption from the speculative position limits; *provided however,* that such list shall be published no more than once annually, that no publication of the name of a swap dealer shall be made earlier than six calendar months following the date on which the exemption was granted, and that such publication shall not disclose the related commodities in which the person is swap dealer or any other information provided by the swap dealer to the Commission that would be inconsistent with section 8(a)(1) of the Act; and

(3) Comply with the reporting requirements of § 20.02 of this chapter.

(b) *Form, manner and time of filing.*

(1) An application under paragraph (a) of this section shall be submitted in the format and in the manner and within the time specified by the Commission.

(2) The Commission hereby delegates, until such time as the Commission orders otherwise, to the Director of the Division of Market Oversight and to such members of the Commission's staff acting under the Director's direction as the Director may designate, the authority to specify the format, manner and time period for applications to be submitted under paragraph (a) of this section. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

3. Add part 20 to read as follows:

PART 20—REPORTS IN CONNECTION WITH POSITIONS IN REFERENCED ENERGY CONTRACTS

Sec.

Authority: 7 U.S.C. 1a, 2, 2a, 4, 6a, 6c, 6f, 6g, 6i, 6k, 6m, 6n, 7, 7a, 12a, 19 and 21, as amended by Title XIII of the Food, Conservation and Energy Act of 2008, Public Law 110–246, 122 Stat. 1624 (June 18, 2008).

§ 20.00 Conditional-spot-month position limit.

(a) *Information required.* All persons that acquire positions in a referenced energy contract pursuant to the conditional-spot-month position limit of § 151.2(a)(2) of this chapter shall submit to the Commission a Form 40 and provide the information required under § 18.04 of this chapter.

(b) *Additional cash and derivatives position data.* All persons subject to paragraph (a) of this section shall also submit the following position data, net long or short, on Part A of Form 404:

(1) The trader's cash positions in contracts priced at a fixed price differential (including a zero differential) to the referenced energy contract or the contract's underlying commodity;

(2) The trader's cash positions in contracts priced to a cash market index that includes quotations or prices for spot or forward contracts in the referenced energy contract's underlying commodity;

(3) The trader's positions in cleared or bilateral swap agreements with a fixed price differential (including zero) to the referenced energy contract or the contract's underlying commodity; and

(4) Positions in any other physically or financially settled contracts that are economically related to the trader's positions that are acquired pursuant to the conditional-spot-month position limit.

§ 20.01 Bona fide hedging.

(a) *Information required.* All persons that acquire positions in a referenced energy contract pursuant to the *bona fide* hedge exemption of § 151.3(a)(1) of this chapter shall submit to the Commission a Form 40 and provide the information required under § 18.04 of this chapter.

(b) *Additional information on cash market activities.* All persons subject to paragraph (a) of this section shall also submit the following information on Part B of Form 404:

(1) The quantity of stocks owned of the commodity that underlies a referenced energy contract and its products and by-products;

(2) The quantity of fixed price purchase commitments open in such commodity and its products and by-products;

(3) The quantity of fixed price sale commitments open in such commodity and its products and by-products;

(4) For unsold anticipated commercial services or output directly connected to producing, transporting, refining, merchandising, marketing, or processing a commodity underlying a referenced energy contract:

(i) Annual sales of such services or output for the three complete fiscal years preceding the current fiscal year; and

(ii) Anticipated sales of such services or output for the period hedged; and

(5) For unfilled anticipated requirements:

(i) Annual requirements of such commodity for the three complete fiscal years preceding the current fiscal year; and

(ii) Anticipated requirements of such commodity for the period hedged.

(6) The shares of an investment vehicle, including, but not limited to, exchange-traded funds, registered investment companies, commodity pools and private investment companies, that holds or owns a referenced energy contract or the commodity that underlies a referenced energy contract and its products and by-products.

(c) *Conversion methodology.* Persons engaged in the hedging of commercial activity that does not involve the same quantity or commodity as the quantity or commodity associated with positions in referenced energy contracts shall furnish this information both in terms of the actual quantity and commodity used in the trader's normal course of business and in terms of the referenced energy contracts that are sold or purchased. In addition, such persons shall explain the methodology used for determining the ratio of conversion between the actual or anticipated cash positions and the trader's positions in referenced energy contracts.

§ 20.02 Reports from swap dealers.

(a) *Initial reports.* Persons who have received a swap dealer exemption pursuant to § 151.3(a)(2) of this chapter from the speculative position limits established by the Commission for referenced energy contracts under § 151.2 of this chapter shall provide on Part C of Form 404 to the Commission, and to any registered entity on which the swap dealer's referenced energy contract positions are listed, a monthly report including:

(1) Swap positions based upon the commodity underlying the referenced energy contracts separately for proprietary and customer accounts on a daily basis; and

(2) A daily summary of dealing and trading activity in swaps based upon the commodity underlying the referenced energy contracts.

(b) *Supplemental reports.* Whenever the risk management requirements of a swap dealer require it to increase its positions in referenced energy contracts from levels justified by information provided in its initial application under § 1.45 of this chapter or the swap dealer's most recent report submitted under this section, the swap dealer shall file, on the business day following the date on which such positions were acquired, a supplemental report in compliance with the requirements of paragraph (a) of this section that supports the increase in position levels.

(c) *Recordkeeping.* Traders that receive a swap dealer exemption under § 151.3(a)(2) of this chapter shall maintain complete books and records relating to their swap dealing activities (including transactional data) and make such books and records, along with a list of counterparties to customer swap agreements that support and substantiate the need to offset swap agreement risks on reporting markets, available to the Commission upon request.

§ 20.03 Delta-adjusted positions.

(a) *Information required.* All persons with referenced energy contract positions in excess of the position limits of § 151.2 of this chapter that acquire such positions in reliance on § 151.3(a)(3) of this chapter shall submit to the Commission a Form 40 and provide the information required under § 18.04 of this chapter.

(b) *Additional information.* In addition, such persons shall provide the following on Part D of Form 404:

(1) A certification that their positions, in whole or in part, are in excess of the applicable limits as a result of the application of a futures-equivalent calculation that adjusts option positions by the previous day's risk factor, or delta coefficient; and

(2) Complete position data that demonstrates that the application of a contemporaneous risk factor, or delta coefficient, renders the trader compliant with the position limits of § 151.2 of this chapter on an adjusted basis.

§ 20.04 Form, manner and time of filing.

Unless otherwise instructed in this part or by the Commission or its designee, the Forms and information required to be filed under this part shall be submitted at such time and in a form and manner specified by the Commission. The Commission hereby delegates, until such time as the Commission orders otherwise, to the Director of the Division of Market Oversight and to such members of the Commission's staff acting under the Director's direction as the Director may designate, the authority to specify the format, manner and time period within which the Forms and information required to be filed under this part shall be submitted to the Commission. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

4. Add part 151 to read as follows:

PART 151—FEDERAL SPECULATIVE POSITION LIMITS FOR REFERENCED ENERGY CONTRACTS

Authority: 7 U.S.C. 1a, 2, 2a, 4, 6a, 6c, 6f, 6g, 6i, 6k, 6m, 6n, 7, 7a, 12a, 19 and 21, as amended by Title XIII of the Food, Conservation and Energy Act of 2008, Public Law 110–246, 122 Stat. 1624 (June 18, 2008).

§ 151.1 Definitions.

As used in this part—

Basis contract means a futures or option contract that is cash settled based on the difference in price of the same commodity (or substantially the same commodity) at different delivery points;

Calendar spread contract means a futures or option contract that represents the difference between the settlement prices in one month of a referenced energy contract and another month's settlement price for the same referenced energy contract;

Contracts of the same class mean referenced energy contracts (including option contracts on a futures-equivalent basis) on a single reporting market that are based on the same commodity and delivered in the same manner (cash-settled or physically-delivered), *provided however,* that during their spot month, contracts shall be considered contracts of the same class if, in addition, such contracts expire on the same trading day;

Diversified commodity index means a commodity index with price components that include energy as well as non-energy commodities, *provided however,* that futures and option contracts based on a diversified commodity index that incorporates the price of a commodity underlying a referenced energy contract's commodity which are used to circumvent the speculative position limits, shall be considered to be referenced energy contracts for the purpose of applying the position limits of § 151.2 of this chapter;

Inter-commodity spread contract means a futures or option contract that is based on the price difference between a referenced energy contract and another commodity contract;

Referenced energy contract means a physically-delivered or cash-settled futures or option contract, other than a basis contract or contract on a diversified commodity index, that is a:

(1) New York Mercantile Exchange Henry Hub natural gas contract (NG), or any other natural gas contract that is exclusively or partially based on a trading unit of 10,000 million British thermal units (mmBtu) of natural gas delivered at the Henry Hub pipeline interchange in Erath, Louisiana;

(2) New York Mercantile Exchange Light Sweet crude oil contract (CL), or any other crude oil contract that is exclusively or partially based on a trading unit of 1,000 U.S. barrels of light sweet crude oil delivered at the Cushing crude oil storage complex in Cushing, Oklahoma;

(3) New York Mercantile Exchange New York Harbor No. 2 heating oil contract (HO), or any other heating oil contract that is exclusively or partially based on a trading unit of 1,000 U.S. barrels of No. 2 fuel oil delivered at an ex-shore facility in New York Harbor;

(4) New York Mercantile Exchange New York Harbor gasoline blendstock (RBOB) contract, or any other gasoline contract that is exclusively or partially based on a trading unit of 1,000 U.S. barrels of reformulated gasoline blendstock for oxygen blend delivered at an ex-shore facility in New York Harbor; or

(5) Fraction or multiple of the contracts described in paragraphs (1) through (4) of this section, so that when viewed on a fractional basis or as a multiple, such contract is based on the same commodity in equivalent trading units;

Reporting market means a reporting market as defined in § 15.00 of this chapter;

Spot month means:

(1) For a contract that allows trading concurrently with the issuance of delivery notices, the futures contract next to expire during that period of time beginning at 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 registered entity;

(2) For a contract that does not allow trading concurrently with the issuance of delivery notices, the futures contract next to expire during that period of time beginning at the close of trading on the third trading day preceding the last trading day; or

(3) For a contract that cash-settles based on the price of one or more physically-delivered contracts, the period of time that is the spot-month for such physically-delivered contracts;

Spread contract means either a calendar spread contract or an inter-commodity spread contract;

Swap agreement means a swap agreement as defined in § 35.1(b)(1) of this chapter;

Swap dealer means, solely for the purposes of this part and § 1.45 and part 20 of this chapter, any person who, as a significant part of its business, holds itself out as a dealer in swaps, makes a market in swaps, regularly engages in the purchase of swaps and their resale to customers in the ordinary course of a business, or engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps;

Unless specifically defined otherwise, the terms defined in § 150.1 of this chapter shall have the same meaning as they do in that section.

§ 151.2 Position limits for referenced energy contracts.

(a) *Spot-month position limits.* Except as otherwise authorized in § 151.3, no person may hold or control positions in contracts of the same class when such positions, net long or net short, are in excess of:

(1) For physically-delivered contracts, a *spot-month position limit,* fixed by the Commission at one-quarter of the estimated spot-month deliverable supply; or

(2) For contracts that cash settle based on prices of physically-delivered contracts, a *conditional-spot-month position limit,* fixed by the Commission at one-quarter of the estimated spot-month deliverable supply, *provided that,* a trader may, if permitted by reporting market rules adopted to implement this paragraph, acquire or hold spot-month positions equal to the product of the above specified level and the spot-month multiplier of five if the trader does not hold positions in spot-month physically-delivered referenced energy contracts and the trader complies with the reporting requirements of part 20 of this chapter.

(b) *All-months-combined and single-month limits.* Except as otherwise authorized in § 151.3, no person may hold or control positions in a referenced energy contract when such positions, net long or net short, are in excess of:

(1) *Aggregate position limits:*

(i) *An all-months-combined aggregate position limit,* across reporting markets, fixed by the Commission at 10% of the open interest of that referenced energy contract aggregated across all reporting markets up to an open interest level of 25,000 contracts with a marginal increase of 2.5% of aggregated open interest thereafter; or

(ii) *A single-month aggregate position limit* that is two-thirds of the position limit fixed pursuant to paragraph (b)(1)(i) of this section.

(2) *Reporting market position limits:*

(i) For a reporting market, *an all-months-combined position limit* for contracts of the same class that is the lower of the aggregate position limit for a referenced energy contract under paragraph (b)(1)(i) of this section or, for contracts of the same class, 30% of a class's average combined futures and delta-adjusted option month-end open interest for the most recent calendar year on that reporting market; or

(ii) For a reporting market, *a single-month position limit* for contracts of the same class that is two-thirds of the position limit fixed pursuant to paragraph (b)(2)(i) of this section, *provided however,* that such positions shall not be greater than two times the level of the position limit fixed pursuant to paragraph (b)(2)(i) of this section on a gross basis.

(c) *Minimum position limit.* The position limits of § 151.2(b)(2)(i) shall be replaced by an all-months-combined position limit, fixed by the Commission at the greater of 5,000 contracts or 1% of the open interest aggregated across all reporting markets, if the resulting position limit calculated under this paragraph is higher than an otherwise applicable position limit.

(d) *Deliverable supply.*

(1) Reporting markets listing physically-delivered referenced energy contracts are required to submit to the Commission an estimate of deliverable supply by the 31st of December of each calendar year.

(2) The estimate submitted under paragraph (d)(1) of this section shall be accompanied by a description of the methodology used to derive the estimate along with any statistical data supporting the reporting market's estimate of deliverable supply.

(3) The Commission shall base its fixing of spot-month position limits on the estimate provided under paragraph (d)(1) of this section unless the Commission determines to rely on its own estimate of deliverable supply.

(4) The Commission may base its initial fixing of spot-month position limits solely on its own estimates of deliverable supply.

(e) *Calculation of limits for the purposes of this section.*

(1) For the purpose of calculating positions under this section, referenced energy option contracts that do not settle into futures contracts shall be included in any calculation on a futures-equivalent basis and treated as futures contracts under the provisions of this section.

(2) Open interest shall be calculated by combining the month-end futures open interest and the open interest in its related option contract, on a delta-adjusted basis, for all months listed on a reporting market during the most recent calendar year.

(3) In determining or calculating all levels and limits under this section, a resulting number shall be rounded up to the nearest hundred.

(4) For the purpose of calculating position limits under this section, referenced energy contracts that are spread contracts, as defined by § 151.1, shall be excluded from any calculation of open interest.

(f) *Administrative process for fixing and publishing position limits.*

(1) The Commission shall fix the spot-month position limits (and estimates of deliverable supply) and the all-months-combined position limits under § 151.2, aggregately across all reporting markets and separately for each reporting market, by January 31st of each calendar year, *provided that,* the initial fixing of position limits may occur on a different date.

(2) The Commission hereby delegates, until such time as the Commission orders otherwise, to the Director of the Division of Market Oversight and to such members of the Commission's staff acting under the Director's direction as the Director may designate, the authority to fix the position limits to be established pursuant to paragraph (f)(1) of this section. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

(3) The fixed position limits shall be published on the Commission's Web site (*http://www.cftc.gov*) and shall become effective on the 1st day of March immediately following the fixing date (or 30 complete calendar days following an initial fixing of position limits under this part if such fixing is on a date other than the 31st of January) and shall remain effective until the last day of the immediately following February.

§ 151.3 Exemptions for referenced energy contracts.

(a) *Positions that may exceed limits.* The position limits set forth in § 151.2 may be exceeded to the extent that such positions are:

(1) Upon application to a reporting market for an exemption, positions (other than positions that are held to offset risks associated with swap agreements under paragraph (a)(2) of this section) held in a proprietary account (as defined in § 1.3(y) of this chapter) shown to be *bona fide* hedging transactions, as defined and approved

by a reporting market in a manner consistent with, but that may differ from (to the extent that such differences are consistent with commercial activity in the physical energy markets), §§ 1.3(z)(1) and (2) of this chapter, *provided that:*

(i) Traders holding positions outside the spot month, and traders holding spot-month positions with respect to spot-month positions only, that are greater than or equal to a position limit set under § 151.2 pursuant to a *bona fide* hedge exemption shall not also hold or control positions speculatively; and

(ii) Traders holding positions that are greater than or equal to twice a position limit set under to § 151.2 pursuant to a *bona fide* hedge exemption shall not also hold or control positions pursuant to an exemption under paragraph (a)(2) of this section;

(2) Upon application under § 1.45 of this chapter, swap dealer risk management transactions outside of the spot month that are held to offset risks associated with swap agreements, which are entered into to accommodate swap customers and are either directly linked to the referenced energy contracts or the fluctuations in value of the swap agreements are substantially related to the fluctuations in the value of the referenced energy contracts, and which do not exceed twice the applicable speculative position limits in all-months-combined or in any single non-spot-month, *provided that* traders holding positions under this paragraph shall not also hold or control positions speculatively when such the trader's total positions are greater than or equal to a position limit set under to § 151.2; or

(3) Subsequently demonstrated, in a report to be filed on the calendar day following the acquisition of such positions pursuant to part 20 of this chapter, to be below an applicable position limit once option contracts that are a part of a trader's overall position are adjusted by a contemporaneous risk factor or delta coefficient for such options.

(b) *Other exemptions.* The position limits set forth in § 151.2 of this chapter may be exceeded to the extent that such positions remain open and were entered into in good faith prior to the effective date of any rule, regulation, or order that specifies a limit.

(c) *Call for information.* Upon call by the Commission, the Director of the Division of Market Oversight or the Director's designee, any reporting market issuing, or any person claiming, an exemption from speculative position limits under this section must provide to the Commission such information as specified in the call relating to the positions owned or controlled by that person, trading done pursuant to the claimed exemption, the futures, options, over-the-counter, or cash market positions that support the claim of exemption, and the relevant business relationships supporting a claim of exemption.

§ 151.4 Aggregation of positions.

(a) *Positions to be aggregated.* The position limits set forth in § 151.2 of this chapter shall apply to:

(1) All positions in accounts in which any person, directly or indirectly, has an ownership or equity interest of 10% or greater or, by power of attorney or otherwise, controls trading; or

(2) Positions held by two or more persons acting pursuant to an expressed or implied agreement or understanding the same as if the positions were held by, or the trading of the positions were done by, a single person.

(b) *Positions in pools.* Positions in pools in which a trader that is a limited partner, shareholder or similar person has an ownership or equity interest of less than 25% need not be aggregated with other positions of the trader unless such person, by power of attorney or otherwise, controls trading that is done by the pool.

Issued by the Commission this 14th day of January 2010, in Washington, DC.

David Stawick,

Secretary of the Commission.

Note: The following appendix will not appear in the Code of Federal Regulations.

Appendix Statements

Statement of Gary Gensler Chairman, Commodity Futures Trading Commission Meeting of the Commodity Futures Trading Commission

The CFTC is charged with a significant responsibility to ensure the fair, open and efficient functioning of futures markets. Our duty is to protect both market participants and the American public from fraud, manipulation and other abuses. Central to these responsibilities is our duty to protect the public from the undue burdens of excessive speculation that may arise, including those from concentration in the marketplace.

The CFTC does not set or regulate prices. Rather, the Commission is directed to ensure that commodity markets are fair and orderly. It is for that reason that I support the staff's recommended rulemaking regarding position limits in the energy markets and exemptions for swap dealer risk management transactions.

The CFTC is directed in its original 1936 statute to set position limits to protect against the burdens of excessive speculation, including those caused by large concentrated positions. In that law—the Commodity Exchange Act (CEA)—Congress said that the CFTC "shall" impose limits on trading and positions as necessary to eliminate, diminish or prevent the undue burdens that may come as a result of excessive speculation. We are directed by statute to act in this regard to protect the American public.

A transparent and consistent playing field for all physical commodity futures should be the foundation of our regulations. Thus, position limits should be applied consistently to all markets and trading platforms and exemptions to them also should be consistent and well-defined.

While we currently set and enforce position limits on certain agriculture products, we do not for energy markets. Though there are some differences between energy markets and agricultural markets, those distinctions do not suggest to me that the federal government should set position limits on one and not the other.

When the CFTC set position limits in the past, the agency sought to ensure that the markets were made up of a broad group of market participants with a diversity of views. At the core of our obligations is promoting market integrity, which the agency has historically interpreted to include ensuring markets do not become too concentrated.

Position limits help to protect the markets both in times of clear skies and when there is a storm on the horizon. In 1981, the Commission said that "the capacity of any contract market to absorb the establishment and liquidation of large speculative positions in an orderly manner is related to the relative size of such positions, *i.e.,* the capacity of the market is not unlimited." I believe this is still true today.

The futures exchanges also have obligations with regard to the setting of position limits. As was explored in our summer hearings, though, the Commodity Futures Modernization Act (CFMA) changed the exchanges' obligations. They have to comply with a core principal that speaks to protecting against manipulation or congestion, "especially during trading in the delivery month." These core principles do not explicitly require the exchanges to set position limits to guard against the burdens of excessive speculation. The CEA, in section 4a, though, left the obligations of the CFTC unchanged with regard to setting position limits to protect against the possible burdens of excessive speculation. Our governing statute importantly distinguishes between these two distinct, but sometimes related, public policy goals—protecting against manipulation and protecting against possible burdens of excessive speculation. The CFMA clearly established that the exchanges had to address the first while the CFTC had a broader mandate to address both. Though the CFTC had in 1992 first allowed exchanges to establish accountability regimes, it was only in 2001 that they did so in lieu of position limits in the energy markets.

The past eight years have provided further evidence as to the difference. Accountability levels are regularly and repeatedly exceeded. In fact, they are neither stop signs nor even yield signs for market participants. As reviewed at our summer hearings, in the 12 months between July 2008 and June 2009, accountability levels for individual months were exceeded in the four main energy contracts by 69 different traders, some exceeding the levels during every trading day in the period.

The staff recommendation builds upon the Commission's experience and previous guidance in setting position limits, particularly for agricultural commodities.

• Limits are set across the same contract month groupings: All-months-combined (AMC); single-month; and spot-month.
• Limits apply to aggregate positions in futures and options combined.
• There are exemptions for bona fide hedging transactions involving commodity inventory hedges and anticipatory purchases or sales of the commodity.

In addition, the proposed energy limits incorporate CFTC guidance to exchanges in setting speculative position limits:

• The basic formula for the level of the all-months-combined limit is the same—10% of the first 25,000 contracts of open interest plus 2.5% of open interest over 25,000 contracts.
• The approach to setting the level of the spot-month limit in the physical delivery contracts is the same—25% of the estimated deliverable supply.

The proposed energy Federal limits builds upon the Commission's experience in several ways:

• The proposed energy limits would be responsive to the size of the market and administratively reset on an annual basis, rather than remaining unchanged until a new rule is issued.
• The proposal extends contract aggregation by applying all-months-combined and single-month energy speculative position limits both to classes of contracts (all physical delivery or cash settled contracts in a commodity at a reporting market) and to positions held across all reporting markets.
• The proposed energy limits aggregate positions at the owner level rather than permitting disaggregation for independent account controllers.

I believe that the staff recommendation is a measured and balanced approach to setting position limits in the energy markets.

In addition to resetting position limits in the energy futures and options markets, the proposed rulemaking both addresses exemptions for *bona fide* hedgers and establishes a consistent framework for certain swap dealer risk management exemptions. The Commission and the exchanges currently grant relief from agriculture and energy position limits to swap dealers on a case-by-case basis via staff no-action letters or similar methods at the exchanges. The proposed rule would, for the first time, bring uniformity to swap dealer exemptions. Swap dealers would be required to file an exemption application and update the application annually. Exempted swap dealers also would be required to provide monthly reports of their actual risk management needs and maintain records that demonstrate their net risk management needs. The CFTC would publicly disclose the names of swap dealers that have filed for an exemption after a six-month delay.

This rule proposal is one step in a very important process. Our vote on the proposed rulemaking begins a 90-day public comment period. Many important questions are listed in the proposal, and we are all very interested to hear from the public on these significant issues.

I look forward to hearing from hedgers and speculators, dealers and exchanges and other market participants and economists regarding the proposal and how and if it would improve the functioning of the markets. I am also interested in hearing any changes that they may suggest.

As we vote to on a proposed rulemaking to set position limits in the energy futures and options markets, we also are working with Congress to bring comprehensive regulatory reform to the over-the-counter derivatives markets. I was pleased that the House included in the recently passed financial reform legislation enhanced authority for the CFTC to set aggregate position limits for over-the-counter derivatives contracts when they perform or affect a significant price discovery function with respect to regulated entities. While Congress continues to work on regulatory reform, it is important that the Commission continue its work under current authority to consider setting energy position limits. The CFTC is working in parallel with the legislative process.

I thank the staff and my fellow Commissioners for all of the preparation that went into the recommended rulemaking. I will now entertain a motion that the Commission issue a proposed rule to set position limits for futures and option contracts in the major energy markets and establish consistent, uniform exemptions for certain swap dealer risk management transactions.

Statement of Commissioner Michael V. Dunn Regarding the Notice of Proposed Rulemaking for Speculative Position Limits for Referenced Energy Contracts

Today I am voting to release the proposed notice of rulemaking entitled Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations. My vote to release this proposed rule should in no way be construed as an agreement with the opinions expressed in the proposal or to the approach advocated in setting these proposed position limits. Despite my serious reservations, I have agreed to the release of this proposal so that the public at-large has ample opportunity to voice their opinions and concerns on this topic.

At the close of the Commission's position limits hearings on August 5, 2009, I stated that:

[T]he CFTC does not have the authority to set speculative position limits in all of the venues that may be affected by excessive speculation, specifically over-the-counter markets (OTC) and on foreign boards of trade (FBOT). Unilateral Commission action in only the markets we currently regulate may not have the desired effect of reigning in excessive speculation in the futures market. Without similar steps in the OTC markets and on FBOTs, those seeking to evade the limits we set could simply move to venues outside our authority.

I believe this is still true today, and that forging ahead on a position limits regime for political expediency is not the course of action that this agency needs or one that promotes the health and integrity of the futures industry in the United States. The simple announcement of our hearings several months ago caused business to migrate to OTC markets and FBOTs currently outside our purview. This is an unacceptable consequence of regulation and is, I fear, a sign of things to come if this agency does not take a coordinated approach to bringing sensible regulation to the futures markets.

I think it needs to be made clear that the Proposed Position Limits do not set trading limitations on any particular class of investor, including passively managed long-only index funds. The Proposed Position Limits' sole objective is to prevent excessive speculation by a single entity. I would be very interested to hear from the public on whether this incremental approach best addresses the market wide concerns raised by those who participated in our hearings last summer.

I would like to reiterate that my vote to release this document should in no way be construed as an agreement of any kind to final rules setting federal speculative position limits on energy contracts. My commitment remains to accept comments and information during the next few months with an open mind, and to work with my fellow Commissioners to ensure that we have a functioning futures industry.

Statement of Commissioner Jill Sommers Regarding the Notice of Proposed Rulemaking for Speculative Position Limits for Referenced Energy Contracts

Dissenting

The Commission and its predecessors have grappled with the complex issues surrounding federal speculative position limits for many years in connection with transactions based on agricultural commodities. As prices rose across the board in virtually all commodities throughout 2007 and 2008, the Commission focused its attention on possible causes, including the influx of new traders into the markets, in particular swap dealers hedging the risk resulting from over-the-counter (OTC) business and traders seeking exposure to commodities as an asset class through passive, long-term investment in exchange traded funds (ETFs) and commodity index funds. Concerns were raised in numerous Congressional hearings that excessive speculation in both exchange-traded and OTC markets was to blame for rising prices, particularly in the energy sector. The Commission held three days of hearings in July and August of 2009 to discuss a number of different approaches and has received continuous feedback from the industry for the past several months. We now have before us a proposal from staff which would implement federal speculative position limits for futures and options contracts in certain energy commodities.

I dissent from issuing the proposal for the following reasons. I am concerned that hard positions limits may be imposed on exchange trading without similar limits in place for

OTC markets. Legislation giving us the authority to impose OTC limits may be enacted this year, but the timing and final form of such legislation is unknown. While I wholeheartedly support efforts to enhance our authority in this area, I am concerned that forging ahead with federal limits in a piecemeal fashion is unwise. I am especially concerned that doing so will have the perverse effect of driving portions of the market away from centralized trading and clearing at the very time we are urging all standardized OTC activity to be traded on-exchange or cleared. Likewise, I am concerned that, without global standards, trading will move to other financial centers around the world. A report issued by the United Kingdom's Financial Services Authority and HM Treasury last month urges caution in introducing a position limits regime. *See Financial Services Authority & HM Treasury, Reforming OTC Derivative Markets, A UK Perspective at 31–35 (Dec. 2009).* Clearly, more work is needed to achieve a uniform approach.

A delay in promulgating position limits will not leave the markets unprotected. The proposal before us "sets high position levels that are at the outer bounds of the largest positions held by market participants." Proposal at 59. Exchange position limits and accountability rules remain in place and will continue to trigger the first line of defense against potential market manipulations or other disruptions. Even if the proposed federal limits were enacted, exchanges would be obligated to begin monitoring positions on their markets well before traders reach the federal limits. Aggressive use of the Commission's surveillance authority in partnership with the exchanges should be sufficient to closely monitor and protect the integrity of the markets.

Finally, the proposal makes no distinction between passive ETF and index traders and speculators. While the proposal does seek comment on the feasibility of categorizing such traders differently, I am discouraged that we are no closer to an answer than we were prior to our 2009 hearings, the numerous Congressional hearings that focused on index trading, and the Commission's extensive collection of index investment data since June 2008, which it now publishes on a quarterly basis. There is no doubt that passive long-only investors do not behave as typical speculative traders. They have a unique footprint in the markets. If the data demonstrates that passive long traders are disrupting the markets, through the rolling of their positions or otherwise, the Commission should make an affirmative finding and tailor a solution that addresses the problem.

It is also my hope that if the Commission adopts the limits included in the proposal, that it also promulgate federal limits for all other commodities with a finite supply, such as metals and the agricultural commodities not currently subject to federal limits. The rationale given for the current proposal applies equally to contracts in those commodities. Another inconsistency that would result if the Commission adopts the proposed rulemaking is that swap dealers would continue to receive bona fide hedge exemptions for positions related to agricultural commodities subject to federal limits, but the new proposed risk management exemption regime would apply to positions related to the four energy commodities included in the proposal. A uniform policy would benefit not only the Commission and market participants from an operational efficiency standpoint, but would also enhance transparency by eliminating needless complexities in the process.

Statement of Commissioner Bart Chilton Regarding the Notice of Proposed Rulemaking for Speculative Position Limits for Referenced Energy Contracts

"*Moving Forward*"

During the last decade, while traditional hedgers and speculators increased their use of the futures markets, many new non-traditional participants entered the arena, bringing with them capital and a wealth of innovative approaches to trading. The trend helped fuel the economic engine of our democracy—a good and positive outcome. As markets and market participants evolve, the Commission has an inherent responsibility to examine the impact, as well as to proactively anticipate the potential impact, of changing dynamics on those markets we are entrusted to oversee.

There is certainly no consensus about the potential and net impact of new non-traditional speculators on commodity markets. Did the massive passives—very large traders who have no interest in the underlying physical commodity and have, in general, a fairly inactive long trading strategy—contribute to $147 barrel oil in 2008? Some say there is no impact on markets, others (like researchers at MIT, Rice and Princeton—and a new study out this week from Lincoln University of Missouri) absolutely disagree.

Regardless, what is important to remember is that having an impact is not equivalent to manipulation (or other abuse) under current law, rule or regulation; it is not per se negative. However, any conduct that potentially can distress markets, that has the propensity to create artificiality in the markets, needs to be understood and curbed as necessary.

The Commodity Exchange Act (CEA) has as its fundamental purpose the deterrence and prevention of fraud, market abuse and manipulation. To accomplish our mission requires vigilance and thoughtful consideration of the potential for market aberrations. It requires agile, balanced and prudent action in a timely manner—not usually the mark of government. Our role in striking the right balance with regard to the massive passives and other new dynamics in the futures industry requires that we not merely review and respond, but that we anticipate, deter and prevent.

That is why I support moving forward on the energy proposal before the Commission. This proposal strikes a reasonable balance. Simply put, it seeks to impose mandatory hard cap position limits. Doing so is not the mark of wild-eyed overzealous regulators. In fact, the position limits called for in the proposal are similar to limits already in effect for agricultural commodities. This proposal simply seeks to expand such mandatory hard cap position limits to four heavily traded energy contracts.

Specifically, the energy proposal would establish four different hard cap mandatory speculative position limits. They are: An exchange-specific spot-month limit; a single month limit; an all-months-combined limit; and an all-encompassing, cumulative U.S. exchange position limit for substantially similar-traded contracts. These limits would be dynamic in that they would be responsive to the size of the market and subject to annual recalculation by the Commission.

While I have been a staunch advocate for strong position limits, the levels set for the limits, in my opinion, actually err on the high side. The proposed limits will certainly be seen by some as higher than appropriate. However, should the limits prove inadequate, the agency can, and I hope will, recalibrate to ratchet them down or even increase them as deemed appropriate. The most important thing is to establish a thoughtful position limit system.

Furthermore, while the proposed limits err on the high side, such levels would still ensure that the very largest traders' positions, those with the greatest potential for causing market-contortions, would be limited. Moreover, if limits were set too low, there would be a possibility that trading migration could take place, transferring traders to over-the-counter markets or overseas exchanges. This is particularly noteworthy because Congress has yet to pass regulatory reform legislation that would grant the CFTC authority to properly regulate the over-the-counter markets—markets that are currently dark in that there is not government regulation or oversight. Hundreds of trillions of dollars are traded in these dark markets and they can influence the price that consumers pay for everything from gasoline, to a loaf of bread, to a home mortgage. Passage of such legislation to provide regulators with authority in this area is critically needed, and soon.

In addition to position limits, the proposal contains a mechanism to consider certain exemptions to those limits. I have suggested that any exemptions should be approved by the CFTC, targeted for legitimate business purposes, verifiable and transparent. This proposal meets all four of those criteria.

Traders hedging commercial risks, *i.e.* those who have inventory or have an interest in the underlying physical commodity, would qualify for a bona fide hedging exemption from the proposed speculative position limits upon application to the exchange. The CFTC would audit the use of this exemption to ensure its consistency with our rules and regulations. Importantly, no longer included in this class of traders would be swap dealers who establish positions to offset the financial risk of customer initiated swap positions. Instead, those traders could apply directly to the CFTC for a limited risk management exemption for positions held outside of the spot month. Swap dealers who receive this exemption from the CFTC would be subject to rigorous and regular reporting requirements to verify and qualify their need for the exemption. Currently, neither the names nor the numbers of such exemptions are available to the public. Under the proposal, in order to increase transparency, the CFTC would make public the identities of those who receive exemptions.

Finally, the proposal seeks comment from the public on the question of expanding position limits to the metals complex and to soft agricultural commodities. While I am pleased that this question is at least posited through the proposed rule, I am extremely disappointed that metals are not a part of this proposal as I have sought. In essence, failure to include a proposed rule relative to metals such as gold and silver prevents the inclusion of metals in the final rule covering position limits in energy. As a result of the omission, CFTC attorneys have opined that should the Commission wish to establish position limits in metals as a result of public comment, the agency would have to undertake an entirely separate rulemaking. I strongly support thoughtful position limits in the metals complex. I have advocated for their inclusion in this proposal with each of my colleagues and staff, and regret the lack of consensus that remains. It is my sincere hope and expectation that the upcoming hearing on position limits with regard to metals will enable us to move more expeditiously on a parallel regulatory process for metals.

I thank everyone involved in conceiving and designing this thoughtful proposal with regard to energy. We seek comment, for an ample period of 90 days, on not only the overall proposal, but also specifically on the question of expanding the concept to the metals and soft agricultural commodities and on the question of imposing separate position limits for the massive passives as a class of investors. I look forward to the comments and ultimately to putting a sensible position limit system in place.

Concurring Statement of Commissioner Scott D. O'Malia

Regarding the Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations

I concur on the release of the **Federal Register** notice of proposed Federal speculative position limits for certain energy commodities because I think it is important that the Commission receive comments on the proposal. I encourage our market participants, the public, and anyone with an interest in the markets to inform the Commission about the impact of the proposed limits or other limits, meaning limits as currently proposed, or potentially lower limits as a result of this rulemaking or future rulemaking.

Notwithstanding my concurrence on the release for comments, I have many concerns regarding the proposal's effectiveness and justification. Keeping in mind the importance of maintaining the market's fundamental purpose of allowing customers to hedge commercial risk, I question the utility of rules that either present any potential for circumventing CFTC authority or make energy markets less transparent or liquid.

The Proposed Limits Could Result in Less U.S. Regulatory Oversight

I question the effectiveness of these regulatory changes, especially as Congress is considering a much broader and comprehensive financial reform package. I remain particularly concerned with the impact of enacting the proposed position limits on the regulated exchanges, while the Commission lacks the regulatory authority to impose limits equitably upon all similar energy transactions, including over-the-counter transactions. As we work to increase transparency in these markets, the proposed position limits may undermine our efforts by allowing participants to turn to the less regulated and less transparent over-the-counter markets, which would be detrimental to the markets and to the public.

Status Quo for Index and Speculative Investors

Earlier this year, the Commission held hearings and heard testimony from witnesses who were frustrated with recent prices and volatility in commodity markets. Some advocated that the Commission immediately impose position limits as a solution. This created high expectations that any Commission proposal would impose limitations on passive index and speculative investors. The release states that no more than ten trading entities would be affected and most of those would likely be entitled to a *bona fide* hedge exemption. This means that few, if any, passive index and speculative investors will be significantly impacted by the proposed position limits. The proposed position limits will not change the investing behavior of passive index investors, so long as they remain under the limits or utilize the over-the-counter markets over which the Commission has limited authority. The Commission would benefit from receiving information on the impact, if any, the proposed position limits might have on the trading strategies of passive index investors going forward. In addition, the Commission should endeavor to improve its understanding of the impacts of passive index investors rolling over their position on a monthly basis to determine what, if any, action is required.

Concerns About Effectiveness and Necessity

This proposal makes a case for the statutory justification for the CFTC to impose position limits under Section 4a(a) of the Act. However, the proposal fails to make a compelling argument that the proposed position limits, which only target large concentrated positions, would dampen price distortions or curb excessive speculation. In large part, the lack of a compelling justification may be due to the CFTC's own research and the Interagency Task Force on Commodity Market's conclusion that the rise in oil prices was largely attributable to fundamental supply and demand factors, which is also supported by independent analysis. In addition, the fact that the proposed position limits are modeled on the agricultural commodities position limits forces us to examine whether those agriculture limits were effective in preventing the price spikes in 2007 and 2008. Despite federal position limits, contracts such as wheat, corn, soybeans, and cotton contracts were not spared record setting price increases.

Missed Opportunity for Transparency

The proposed position limits provide swap dealers with twice the single and all-months combined levels. This is a divergence from the current practice of providing swap dealers with a hedge exemption for commercial risk taken on over-the-counter transactions. I question whether the Commission has missed an opportunity to consider an alternative approach to provide swap dealers with a "look through" exemption, meaning swap dealers would receive a *bona fide* hedge exemption for business related to counterparties who would have been entitled to a hedge exemption if the counterparties had used the futures markets. In exchange for this "look through" exemption, swap dealers would provide the Commission with their customer's over-the-counter position data. That data would allow the Commission to determine whether customers are attempting to circumvent the position limits. I would be interested to receive comments on whether the Commission should impose this "look through" exemption, rather than the swap dealer exemption in the proposed rule. In addition, I am interested to know what types of data could be made available under a "look through" exemption. While I am aware that the proposed rule contains a provision for "look through" recordkeeping, meaning data would be provided only upon Commission request, this would not provide the same transparency as the above.

Position Limits Must Not Hinder Commercial Risk Management

If position limits are implemented, the Commission must ensure that such limits do not affect market liquidity and thus hinder the market's fundamental purpose of allowing commercial hedgers to manage risk. This is true for position limits on energy products or for any other commodity.

In light of the many questions and concerns I have, I look forward to receiving comments from market participants, the public, and anyone with an interest in the markets that would be impacted by the proposed position limits.

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