COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 15, 17, 19, 40, 140, 150, and 151

RIN 3038–AD99

Position Limits for Derivatives

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed rule.

SUMMARY: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') is proposing amendments to regulations concerning speculative position limits to conform to the Wall Street Transparency and Accountability Act of 2010 (''Dodd-Frank Act'') amendments to the Commodity Exchange Act (''CEA'' or ''Act''). Among other amendments, the Commission proposes new and amended federal spot month limits for 25 physical commodity derivatives; amended single month and all-months-combined limits for most of the agricultural contracts currently subject to federal limits; new and amended definitions for use throughout the position limits regulations, including a revised definition of ''bona fide hedging transactions or positions'' and a new definition of ''economically equivalent swaps''; amended rules governing exchange-set limit levels and grants of exemptions therefrom; a new streamlined process for bona fide hedging recognitions for purposes of federal limits; new enumerated hedges; and amendments to certain regulatory provisions that would eliminate Form 204, enabling the Commission to leverage cash-market reporting submitted directly to the exchanges.

DATES: Comments must be received on or before April 29, 2020.

ADDRESSES: You may submit comments, identified by ''Position Limits for Derivatives'' and RIN 3038–AD99, by any of the following methods:

- *CFTC Comments Portal: https://comments.cftc.gov.* Select the ''Submit Comments'' link for this rulemaking and follow the instructions on the Public Comment Form.
- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.
- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. To avoid possible delays with mail or in-person deliveries, submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, be accompanied by an English translation. Comments will be posted as received to *https://comments.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (''FOIA''), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission's regulations.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse, or remove any or all submissions from *https://www.comments.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under FOIA.

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SUPPLEMENTARY INFORMATION:

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I. Background

A. Introduction

The Commission has long established and enforced speculative position limits for futures and options on futures contracts on various agricultural commodities as authorized by the CEA.[2] The existing part 150 position limits regulations [3] include three components: (1) The level of the limits, which currently apply to nine agricultural commodity derivatives contracts and set a maximum that restricts the number of speculative positions that a person may hold in the spot month, individual month, and all-months-combined; [4] (2) exemptions for positions that constitute bona fide hedges and for certain other types of transactions; [5] and (3) regulations to determine which accounts and positions a person must aggregate for the purpose of determining compliance with the position limit levels.[6] The existing federal speculative position limits function in parallel to exchange-set limits required by

[1] 17 CFR 145.9.

[2] 7 U.S.C. 1 *et seq.*

[3] 17 CFR part 150. Part 150 of the Commission's regulations establishes federal position limits (that is, position limits established by the Commission, as opposed to exchange-set limits) on nine agricultural contracts. Agricultural contracts refers to the list of commodities contained in the definition of ''commodity'' in CEA section 1a; 7 U.S.C. 1a. This list of agricultural contracts currently includes nine contracts: CBOT Corn (and Mini-Corn) (C), CBOT Oats (O), CBOT Soybeans (and Mini-Soybeans) (S), CBOT Wheat (and Mini-Wheat) (W), CBOT Soybean Oil (SO), CBOT Soybean Meal (SM), MGEX Hard Red Spring Wheat (MWE), CBOT KC Hard Red Winter Wheat (KW), and ICE Cotton No. 2 (CT). *See* 17 CFR 150.2. The position limits on these agricultural contracts are referred to as ''legacy'' limits because these contracts have been subject to federal position limits for decades.

[4] *See* 17 CFR 150.2.

[5] *See* 17 CFR 150.3.

[6] *See* 17 CFR 150.4.

designated contract market (''DCM'') Core Principle 5.[7] Certain contracts are thus subject to both federal and DCM-set limits, whereas others are subject only to DCM-set limits and/or position accountability.

As part of the Dodd-Frank Act, Congress amended the CEA's position limits provisions, which, since 1936, have authorized the Commission (and its predecessor) to impose limits on speculative positions to prevent the harms caused by excessive speculation. As discussed below, the Commission interprets these amendments as, among other things, tasking the Commission with establishing such position limits as it finds are ''necessary'' for the purpose of ''diminishing, eliminating, or preventing'' ''[e]xcessive speculation . . . causing sudden or unreasonable fluctuations or unwarranted changes in . . . price . . .'' [8] The Commission also interprets these amendments as tasking the Commission with establishing position limits on any ''economically equivalent'' swaps.[9]

The Commission previously issued proposed and final rules in 2011 to implement the provisions of the Dodd-Frank Act regarding position limits and the bona fide hedge definition.[10] A September 28, 2012 order of the U.S. District Court for the District of Columbia vacated the 2011 Final Rulemaking, with the exception of the rule's amendments to 17 CFR 150.2.[11]

Subsequently, the Commission proposed position limits regulations in 2013 (''2013 Proposal''), June of 2016 (''2016 Supplemental Proposal''), and again in December of 2016 (''2016 Reproposal'').[12] The 2016 Reproposal would have amended part 150 to, among other things: establish federal position limits for 25 physical commodity futures contracts and for ''economically equivalent'' futures, options on futures, and swaps; revise the existing exemptions from such limits, including for bona fide hedges; and establish a framework for exchanges [13] to recognize certain positions as bona fide hedges, and thus exempt from position limits.

To date, the Commission has not issued any final rulemaking based on the 2013 Proposal, 2016 Supplemental Proposal, or 2016 Reproposal. The 2016 Reproposal generally addressed comments received in response to those prior rulemakings. In a companion proposed rulemaking, the CFTC also proposed, and later adopted in 2016, amendments to rules governing aggregation of positions for purposes of compliance with federal position limits.[14] These aggregation rules currently apply only to the nine agricultural contracts subject to existing federal limits, and going forward would apply to the commodities that would be subject to federal limits under this release.

After reconsidering the prior proposals, including reviewing the comments responding thereto, the Commission is withdrawing from further consideration the 2013 Proposal, the 2016 Supplemental Proposal, and the 2016 Reproposal.[15]

Instead, the Commission is now issuing a new proposal (''2020 Proposal''). The 2020 Proposal is intended to (1) recognize differences across commodities and contracts, including differences in commercial hedging and cash-market reporting practices; (2) focus on derivatives contracts that are critical to price discovery and distribution of the underlying commodity such that the burden of excessive speculation in the derivatives contract may have a particularly acute impact on interstate commerce for that commodity; and (3) reduce duplication and inefficiency by leveraging existing expertise and processes at DCMs. For these general reasons, discussed in turn below, the Commission proposes new regulations, rather than finalizing the 2016 Reproposal.[16]

First, the Commission preliminarily believes that any position limits regime must take into account differences across commodity and contract types. The existing federal position limits regulations apply only to nine contracts, all of which are physically-settled futures on agricultural commodities. Limits on these commodities have been in place for decades, as have the federal program for exemptions from these limits and the federal rules governing DCM-set limits on such commodities. The existing framework is largely a historical remnant of an approach that predates cash-settled futures contracts, let alone swaps, institutional-investor interest in commodity indexes, and highly liquid energy markets. Congress has tasked the Commission with: Establishing such limits as it finds are ''necessary'' for the purpose of preventing the burdens associated with excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in price; and establishing limits on swaps that are ''economically equivalent'' to certain futures contracts. The Commission has preliminarily determined that an approach that is flexible enough to accommodate potential future, unpredictable developments in commercial hedging practices would be well-suited for the current derivatives markets by accommodating differences in commodity types, contract specifications, hedging practices, cash-market trading practices, organizational structures of hedging participants, and liquidity profiles of individual markets.

The Commission proposes to build this flexibility into several parts of the proposed regulations, including: Exchange-set limits and/or accountability, rather than federal limits, outside of the spot month for referenced contracts based on commodities other than the nine legacy agricultural commodities; the ability for exchanges to use more than one formula when setting their own limit levels; an updated formula for federal non-spot month levels on the nine legacy agricultural contracts that is calibrated to recently observed trading activity; a bona fide hedging definition that is broad enough to accommodate common commercial hedging practices, including anticipatory hedging practices such as anticipatory merchandising; a broader range of exchange-granted recognitions for purposes of federal and

[7] 7 U.S.C. 7(d)(5); 17 CFR 38.300.

[8] 7 U.S.C. 6a(a)(1); *see infra* Section III.F. (discussion of the necessity finding).

[9] 7 U.S.C. 6a(a)(5).

[10] Position Limits for Derivatives, 76 FR 4752 (Jan. 26, 2011); Position Limits for Futures and Swaps, 76 FR 71626 (Nov. 18, 2011) (''2011 Final Rulemaking'').

[11] *Int'l Swaps & Derivatives Ass'n* v. *U.S. Commodity Futures Trading Comm'n,* 887 F. Supp. 2d 259 (D.D.C. 2012) (''*ISDA*'').

[12] Position Limits for Derivatives, 78 FR 75680 (Dec. 12, 2013) (2013 Proposal); Position Limits for Derivatives: Certain Exemptions and Guidance, 81 FR 38458 (June 13, 2016) (2016 Supplemental Proposal); and Position Limits for Derivatives, 81 FR 96704 (Dec. 30, 2016) (2016 Reproposal).

[13] Unless indicated otherwise, the use of the term ''exchanges'' throughout this proposal refers to DCMs and Swap Execution Facilities.

[14] Aggregation of Positions, 81 FR 91454 (Dec. 16, 2016) (''Final Aggregation Rulemaking''); *see* 17 CFR 150.4. Under the Final Aggregation Rulemaking, unless an exemption applies, a person's positions must be aggregated with positions for which the person controls trading or for which the person holds a 10 percent or greater ownership interest. The Division of Market Oversight has issued time-limited no-action relief from some of the aggregation requirements contained in that rulemaking. *See* CFTC Letter No. 19–19 (July 31, 2019), *available at https://www.cftc.gov/csl/19-19/download.*

[15] Because the earlier proposals are withdrawn, comments on them will not be part of the administrative record with respect to the current proposal, except where expressly referenced herein. Commenters should resubmit comments relevant to the subject proposal; commenters who wish to reference prior comment letters should cite those prior comment letters as specifically as possible.

[16] The specific proposed new regulations are discussed in detail later in this release.

exchange-set limits that are in line with common commercial hedging practices; the elimination of a restriction for purposes of federal limits on holding positions during the last trading days of the spot month; and broader discretion for market participants to measure risk in the manner most suitable for their business.

Second, the proposal establishes limits on a limited set of commodities for which the Commission preliminarily finds that speculative position limits are necessary.[17] As described below, this necessity finding is based on a combination of factors including: The particular importance of these contracts in the price discovery process for their respective underlying commodities, the fact that they require physical delivery of the underlying commodity, and, in some cases, the commodities' particular importance to the national economy and especially acute economic burdens on interstate commerce that would arise from excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in the price of the commodities underlying these contracts.[18]

Third, the Commission preliminarily believes that there is an opportunity for greater collaboration between the Commission and the exchanges within the statutorily created parallel federal and exchange-set position limit regimes. Given the exchanges' self-regulatory responsibilities, resources, deep knowledge of their markets and trading practices, close interactions with market participants, existing programs for addressing exemption requests, and ability to generally act more quickly than the Commission, the Commission preliminarily believes that cooperation between the Commission and the exchanges on position limits should not only be continued, but enhanced. For example, exchanges are particularly well-positioned to provide the Commission with estimates of deliverable supply, to recommend limit levels for the Commission's consideration, and to help administer the program for recognizing bona fide hedges. Further, given that the Commission is proposing to require exchanges to collect, and provide to the Commission upon request, cash-market information from market participants requesting bona fide hedges, the Commission also proposes to eliminate Form 204, which market participants with bona fide hedging positions in excess of limits currently file each month with the Commission to demonstrate cash-market positions justifying such overages. The Commission preliminarily believes that enhanced collaboration will maintain the Commission's access to information and result in a more efficient administrative process, in part by reducing duplication of efforts. The Commission invites comments on all aspects of this rulemaking.

B. Executive Summary

This executive summary provides an overview of the key components of this proposal. The summary only highlights certain aspects of the proposed regulations and generally uses shorthand to summarize complex topics. The executive summary is neither intended to be a comprehensive recitation of the proposal nor intended to supplement, modify, or replace any interpretive or other language contained herein. Section II of this release includes a more detailed and comprehensive discussion of all of the proposed regulations, and Section V includes the actual regulations.

1. Contracts Subject to Federal Speculative Position Limits

Federal speculative position limits would apply to "referenced contracts," which include: (a) 25 "core referenced futures contracts;" (b) futures and options directly or indirectly linked to a core referenced futures contract; and (c) "economically equivalent swaps."

a. Core Referenced Futures Contracts

Federal speculative position limits would apply to the following 25 physically-settled core referenced futures contracts:

Legacy agricultural (federal limits during and outside the spot month)	Non-legacy agricultural (federal limits only during the spot month)[19]	Metals (federal limits only during the spot month)
CBOT Corn (C)	CBOT Rough Rice (RR)	COMEX Gold (GC).
CBOT Oats (O)	ICE Cocoa (CC)	COMEX Silver (SI)
CBOT Soybeans (S)	ICE Coffee C (KC)	COMEX Copper (HG).
CBOT Wheat (W)	ICE FCOJ–A (OJ)	NYMEX Platinum (PL).
CBOT Soybean Oil (SO)	ICE U.S. Sugar No. 11 (SB)	NYMEX Palladium (PA).
CBOT Soybean Meal (SM)	ICE U.S. Sugar No. 16 (SF)	Energy (federal limits only during the spot month)
MGEX Hard Red Spring Wheat (MWE)	CME Live Cattle (LC)	NYMEX Henry Hub Natural Gas (NG).
ICE Cotton No. 2 (CT)		NYMEX Light Sweet Crude Oil (CL).
CBOT KC Hard Red Winter Wheat (KW)		NYMEX New York Harbor ULSD Heating Oil (HO).
		NYMEX New York Harbor RBOB Gasoline (RB).

b. Futures and Options on Futures Linked to a Core Referenced Futures Contract

Referenced contracts would also include futures and options on futures that are directly or indirectly linked to the price of a core referenced futures contract or to the same commodity underlying the applicable core referenced futures contract for delivery at the same location as specified in that core referenced futures contract. Referenced contracts, however, would not include location basis contracts, commodity index contracts, swap guarantees, and trade options that meet certain requirements.

[17] *See infra* Section III.F.

[18] *See infra* Section III.F.1.

[19] While the Commission is proposing federal non-spot month limits only for the nine legacy agricultural core referenced futures contracts, exchanges would be required to establish, consistent with Commission standards set forth in this proposal, exchange-set position limits and/or position accountability levels in the non-spot months for the non-legacy agricultural, metals, and energy core referenced futures contracts.

c. Economically Equivalent Swaps

Referenced contracts would also include economically equivalent swaps, which would be defined as swaps with ''identical material'' contractual specifications, terms, and conditions to a referenced contract. Swaps in commodities other than natural gas that have identical material specifications, terms, and conditions to a referenced contract, but differences in lot size specifications, notional amounts, or delivery dates diverging by less than *one* calendar day, would still be deemed economically equivalent swaps. Natural gas swaps that have identical material specifications, terms, and conditions to a referenced contract, but differences in lot size specifications, notional amounts, or delivery dates diverging by less than *two* calendar days, would still be deemed economically equivalent swaps.

2. Federal Limit Levels During the Spot Month

Federal spot month limits would apply to referenced contracts on all 25 core referenced futures contracts. The following proposed spot month limit levels, summarized in the table below, are set at or below 25 percent of deliverable supply, as estimated using recent data provided by the DCM listing the core referenced futures contract, and verified by the Commission. The proposed spot month limits would apply on a futures-equivalent basis based on the size of the unit of trading of the relevant core referenced futures contract, and would apply ''separately'' to physically-settled and cash-settled referenced contracts. Therefore, a market participant could net positions across physically-settled referenced contracts, and separately could net positions across cash-settled referenced contracts, but would not be permitted to net cash-settled referenced contracts with physically-settled referenced contracts.

Core referenced futures contract	2020 Proposed spot month limit	Existing federal spot month limit	Existing exchange-set spot month limit
Legacy Agricultural Contracts			
CBOT Corn (C)	1,200	600	600
CBOT Oats (O)	600	600	600
CBOT Soybeans (S)	1,200	600	600
CBOT Soybean Meal (SM)	1,500	720	720
CBOT Soybean Oil (SO)	1,100	540	540
CBOT Wheat (W)	1,200	600	600/500/400/300/220
CBOT KC Hard Red Winter Wheat (KW)	1,200	600	600
MGEX Hard Red Spring Wheat (MWE)	1,200	600	600
ICE Cotton No. 2 (CT)	1,800	300	300
Other Agricultural Contracts			
CME Live Cattle (LC)	[20] 600/300/200	n/a	450/300/200
CBOT Rough Rice (RR)	800	n/a	600/200/250
ICE Cocoa (CC)	4,900	n/a	1,000
ICE Coffee C (KC)	1,700	n/a	500
ICE FCOJ–A (OJ)	2,200	n/a	300
ICE U.S. Sugar No. 11 (SB)	25,800	n/a	5,000
ICE U.S. Sugar No. 16 (SF)	6,400	n/a	n/a
Metals Contracts			
COMEX Gold (GC)	6,000	n/a	3,000
COMEX Silver (SI)	3,000	n/a	1,500
COMEX Copper (HG)	1,000	n/a	1,500
NYMEX Platinum (PL)	500	n/a	500
NYMEX Palladium (PA)	50	n/a	50
Energy Contracts			
NYMEX Henry Hub Natural Gas (NG)	2,000	n/a	1,000
NYMEX Light Sweet Crude Oil (CL)	[21] 6,000/5,000/4,000	n/a	3,000
NYMEX New York Harbor ULSD Heating Oil (HO)	2,000	n/a	1,000
NYMEX New York Harbor RBOB Gasoline (RB)	2,000	n/a	1,000

3. Federal Limit Levels Outside of the Spot Month

Federal limits outside of the spot month would apply only to referenced contracts based on the nine legacy agricultural commodities subject to existing federal limits. All other referenced contracts subject to federal limits would be subject to federal limits only during the spot month, as specified above, and otherwise would only be subject to exchange-set limits and/or position accountability levels outside of the spot month.

[20] The proposed federal spot month limit for Live Cattle would feature a step-down limit similar to the CME's existing Live Cattle step-down exchange set limit. The proposed federal spot month step-down limit is: (1) 600 at the close of trading on the first business day following the first Friday of the contract month; (2) 300 at the close of trading on the business day prior to the last five trading days of the contract month; and (3) 200 at the close of trading on the business day prior to the last two trading days of the contract month.

[21] The proposed federal spot month limit for Light Sweet Crude Oil would feature the following step-down limit: (1) 6,000 contracts as of the close of trading three business days prior to the last trading day of the contract; (2) 5,000 contracts as of the close of trading two business days prior to the last trading day of the contract; and (3) 4,000 contracts as of the close of trading one business day prior to the last trading day of the contract.

The following proposed non-spot month limit levels, summarized in the table below, are set at 10 percent of open interest for the first 50,000 contracts, with an incremental increase of 2.5 percent of open interest thereafter, and would apply on a futures-equivalent basis based on the size of the unit of trading of the relevant core referenced futures contract:

Core referenced futures contract	2020 Proposed single month and all-months combined limit	Existing federal single month and all-months-combined limit	Existing exchange-set single month and all-months-combined limit
CBOT Corn (C)	57,800	33,000	33,000
CBOT Oats (O)	2,000	2,000	2,000
CBOT Soybean (S)	27,300	15,000	15,000
CBOT Soybean Meal (SM)	16,900	6,500	6,500
CBOT Soybean Oil (SO)	17,400	8,000	8,000
CBOT Wheat (W)	19,300	12,000	12,000
CBOT KC HRW Wheat (KW)	12,000	12,000	12,000
MGEX HRS Wheat (MWE)	12,000	12,000	12,000
ICE Cotton No. 2 (CT)	11,900	5,000	5,000

4. Exchange-Set Limits and Exemptions Therefrom

a. Contracts Subject to Federal Limits

An exchange that lists a contract subject to federal limits, as specified above, would be required to set its own limits for such contracts at a level that is no higher than the federal level. Exchanges would be allowed to grant exemptions from their own limits, provided the exemption does not subvert the federal limits framework.[22]

b. Physical Commodity Contracts Not Subject to Federal Limits

For physical commodity contracts not subject to federal limits, an exchange would generally be required to set spot month limits no greater than 25 percent of deliverable supply, but would have flexibility to submit other approaches for review by the Commission, provided the approach results in spot month levels that are ''necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index'' and complies with all other applicable regulations.

Outside of the spot month, such an exchange would have additional flexibility to set either position limits or position accountability levels, provided the levels are ''necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index.'' Non-exclusive Acceptable Practices would provide several examples of formulas that the Commission has determined would meet this standard, but an exchange would have the flexibility to develop other approaches.

Exchanges would be provided flexibility to grant a variety of exemption types, provided that the exchange must take into account whether the exemption would result in a position that would not be in accord with ''sound commercial practices'' in the market for which the exchange is considering the application, and/or would ''exceed an amount that may be established and liquidated in an orderly fashion in that market.''

5. Limits on ''Pre-Existing Positions''

Certain ''Pre-Existing Positions'' that were entered into prior to the effective date of final position limits rules would not be subject to federal limits. Both ''Pre-Enactment Swaps,'' which are swaps entered into prior to the Dodd-Frank Act whose terms have not expired, and ''Transition Period Swaps,'' which are swaps entered into between July 22, 2010 and 60 days after the publication of final position limits rules, would not be subject to federal limits. All other ''Pre-Existing Positions'' that are acquired in good faith prior to the effective date of final position limits rules would be subject to federal limits during, but not outside, the spot month.

6. Substantive Standards for Exemptions From Federal Limits

a. Bona Fide Hedge Recognition

Hedging transactions or positions may continue to exceed federal limits if they satisfy all three elements of the ''general'' bona fide hedging definition: (1) The hedge represents a substitute for transactions or positions made at a later time in a physical marketing channel (''temporary substitute test''); (2) the hedge is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise (''economically appropriate test''); and (3) the hedge arises from the potential change in value of actual or anticipated assets, liabilities, or services (''change in value requirement''). The Commission proposes several changes to the existing bona fide hedging definition, including those described immediately below, and also proposes a streamlined process for granting bona fide hedge recognitions, described further below.

First, for referenced contracts based on the 25 core referenced futures contracts listed in § 150.2(d), the Commission would expand the current list of enumerated bona fide hedges to cover additional hedging practices included in the 2016 Reproposal, as well as hedges of anticipated merchandising.[23] Persons who hold a bona fide hedging transaction or position in accordance with § 150.1 in referenced contracts based on one of the 25 core referenced futures contracts and whose hedging practice is included in the list of enumerated hedges in Appendix A of part 150 would not be required to request prior approval from

[22] In addition, as explained further below, exchanges may choose to participate in the Commission's new proposed streamlined process for reviewing bona fide hedge exemption applications for purposes of federal limits.

[23] The existing definition of ''bona fide hedging transactions and positions'' enumerates the following hedging transactions: (1) Hedges of inventory and cash commodity fixed-price purchase contracts under 1.3(z)(2)(i)(A); (2) hedges of unsold anticipated production under 1.3(z)(2)(i)(B); (3) hedges of cash commodity fixed-price sales contracts under 1.3(z)(2)(ii)(A); (4) certain cross-commodity hedges under 1.3(z)(2)(ii)(B); (5) hedges of unfilled anticipated requirements under 1.3(z)(2)(ii)(C) and (6) hedges of offsetting unfixed price cash commodity sales and purchases under 1.3(z)(2)(iii). The following additional hedging practices are not enumerated in the existing regulation, but are included as enumerated hedges in the 2020 Proposal: (1) Hedges by agents; (2) hedges of anticipated royalties; (3) hedges of services; (4) offsets of commodity trade options; and (5) hedges of anticipated merchandising.

the Commission to hold such bona fide hedge position. That is, such exemptions would be self-effectuating for purposes of federal speculative position limits, so a person would only be required to request the bona fide hedge exemption from the relevant exchange for purposes of exchange-set limits. Transactions or positions that do not fit within one of the enumerated hedges could still be recognized as a bona fide hedge, provided the Commission, or an exchange subject to Commission oversight, recognizes the position as such using one of the processes described below. The Commission would be open to adopting additional enumerated hedges as it becomes more comfortable with evolving hedging practices, particularly in the energy space, and provided the practices comply with the general bona fide hedging definition.

Second, the Commission is clarifying its position on whether and when market participants may measure risk on a gross basis rather than on a net basis in order to provide market participants with greater flexibility. Instead of only being permitted to hedge on a ''net basis'' except in a narrow set of circumstances, market participants would also now be able to hedge positions on a ''gross basis'' in certain circumstances, provided that the participant has done so over time in a consistent manner and is not doing so to evade the federal limits.

Third, market participants would have additional leeway to hold bona fide hedging positions in excess of limits during the last five days of the spot period (or during the time period for the spot month if less than five days). The proposal would not include such a restriction for purposes of federal limits, and would make clear that exchanges continue to have the discretion to adopt such restrictions for purposes of exchange-set limits. The proposal would also include flexible guidance on the circumstances under which exchanges may waive any such limitation for purposes of their own limits.

Finally, the proposal would modify the ''temporary substitute test'' to require that a bona fide hedging transaction or position in a physical commodity must *always,* and not just *normally,* be connected to the production, sale, or use of a physical cash-market commodity. Therefore, a market participant would generally no longer be allowed to treat positions entered into for ''risk management purposes'' [24] as a bona fide hedge, unless the position qualifies as either (i) an offset of a pass-through swap, where the offset reduces price risk attendant to a pass-through swap executed opposite a counterparty for whom the swap qualifies as a bona fide hedge; or (ii) a ''swap offset,'' where the offset is used by a counterparty to reduce price risk attendant to a swap that qualifies as a bona fide hedge and that was previously entered into by that counterparty.

b. Spread Exemption

Transactions or positions may also continue to exceed federal limits if they qualify as a ''spread transaction,'' which includes the following common types of spreads: Calendar spreads, inter-commodity spreads, quality differential spreads, processing spreads (such as energy ''crack'' or soybean ''crush'' spreads), product or by-product differential spreads, or futures-option spreads. Spread exemptions may be granted using the process described below.

c. Financial Distress Exemption

This exemption would allow a market participant to exceed federal limits if necessary to take on the positions and associated risk of another market participant during a potential default or bankruptcy situation. This exemption would be available on a case-by-case basis, depending on the facts and circumstances involved.

d. Conditional Spot Month Limit Exemption in Natural Gas

The rules would allow market participants with cash-settled positions in natural gas to exceed the proposed 2,000 contract spot month limit, provided that the participant exits its spot month positions in the New York Mercantile Exchange (''NYMEX'') Henry Hub (NG) physically-settled natural gas contracts, and provided further that the participant's position in cash-settled natural gas contracts does not exceed 10,000 NYMEX Henry Hub Natural Gas (NG) equivalent-size natural gas contracts per DCM that lists a natural gas referenced contract. Such market participants would be permitted to hold an additional 10,000 contracts in cash-settled natural gas economically equivalent swaps.

[24] The phrase ''risk management'' as used in this instance refers to derivatives positions, typically held by a swap dealer, used to offset a swap position, such as a commodity index swap, with another entity for which that swap is not a bona fide hedge.

7. Process for Requesting Bona Fide Hedge Recognitions and Spread Exemptions

a. Self-Effectuating Enumerated Bona Fide Hedges

For referenced contracts based on any core referenced futures contract listed in § 150.2(d), bona fide hedge recognitions for positions that fall within one of the proposed enumerated hedges, including the proposed anticipatory enumerated hedges, would be self-effectuating for purposes of federal limits, provided the market participant separately applies to the relevant exchange for an exemption from exchange-set limits. Such market participants would no longer be required to file Form 204/304 with the Commission on a monthly basis to demonstrate cash-market positions justifying position limit overages. Instead, the Commission would have access to cash-market information such market participants submit as part of their application to an exchange for an exemption from exchanges-set limits, typically filed on an annual basis.

b. Bona Fide Hedges That Are Not Self-Effectuating

The Commission will consider adding to the proposed list of enumerated hedges at a later time once the Commission becomes more familiar with common commercial hedging practices for referenced contracts subject to federal position limits. Until that time, all bona fide hedging recognitions that are not enumerated in Appendix A of part 150 would be granted pursuant to one of the proposed processes for requesting a non-enumerated bona fide hedge recognition, as explained below.

A market participant seeking to exceed federal limits for a non-enumerated bona fide hedging transaction or position would be able to choose whether to apply directly to the Commission or, alternatively, apply to the applicable exchange using a new proposed streamlined process. If applying directly to the Commission, the market participant would also have to separately apply to the relevant exchange for relief from exchange-set position limits. If applying to an exchange using the new proposed streamlined process, a market participant would be able to file an application with an exchange, generally at least annually, which would be valid both for purposes of federal and exchange-set limits. Under this streamlined process, if the exchange determines to grant a non-enumerated bona fide hedge recognition for purposes of its exchange-set limits, the exchange must notify the Commission and the applicant simultaneously. Then, 10 business days (or two business days in the case of sudden or unforeseen bona fide hedging needs) after the exchange issues such a determination, the market participant could rely on the exchange's determination for purposes of federal limits unless the Commission (and not staff) notifies the market participant otherwise. After the 10 business days expire, the bona fide hedge exemption would be valid both for purposes of federal and exchange position limits and the market participant would be able to take on a position that exceeds federal position limits. Under this streamlined process, during the 10 business day review period, any rejection of an exchange determination would require Commission action. Further, if, for purposes of federal position limits, the Commission determines to reject an application for exemption, the applicant would not be subject to any position limits violation during the period of the Commission's review nor once the Commission has issued its rejection, provided the person reduces the position within a commercially reasonable amount of time, as applicable.

Under the proposal, positions that do not fall within one of the enumerated hedges could thus still be recognized as bona fide hedges, provided the exchange deems the position to comply with the general bona fide hedging definition, and provided that the Commission does not object to such a hedge within the ten-day (or two-day, as appropriate) window.

Requests and approvals to exceed limits would generally have to be obtained in advance of taking on the position, but the proposed rule would allow market participants with sudden or unforeseen hedging needs to file a request for a bona fide hedge exemption within five business days of exceeding the limit. If the Commission rejects the application, the market participant would not be subject to a position limit violation, provided the participant reduces its position within a commercially reasonable amount of time.

Among other changes, market participants would also no longer be required to file Form 204/304 with the Commission on a monthly basis to demonstrate cash-market positions justifying position limit overages.

c. Spread Exemptions

For referenced contracts on any commodity, spread exemptions would be self-effectuating for purposes of federal limits, provided that the position: Falls within one of the categories set forth in the proposed ''spread transaction'' definition,[25] and provided further that the market participant separately applies to the applicable exchange for an exemption from exchange-set limits.

Market participants with a spread position that does not fit within the ''spread transaction'' definition with respect to any of the commodities subject to the proposed federal limits may apply directly to the Commission, and must also separately apply to the applicable exchange.

8. Comment Period and Compliance Date

The public may comment on these rules during a 90-day period that starts after this proposal has been approved by the Commission. Market participants and exchanges would be required to comply with any position limit rules finalized from herein no later than 365 days after publication in the **Federal Register**.

C. Summary of Proposed Amendments

The Commission is proposing revisions to §§ 150.1, 150.2, 150.3, 150.5, and 150.6 and to parts 1, 15, 17, 19, 40, and 140, as well as the addition of §§ 150.8, 150.9, and Appendices A–F to part 150.[26] Most noteworthy, the Commission proposes the following amendments to the foregoing rule sections, each of which, along with all other proposed changes, is discussed in greater detail in Section II of this release. The following summary is not intended to provide a substantive overview of this proposal, but rather is intended to provide a guide to the rule sections that address each topic. Please see the executive summary above for an overview of this proposal organized by topic, rather than by section number.

- The Commission preliminarily finds that federal speculative position limits are necessary for 25 core referenced futures contracts and proposes federal limits on physically-settled and linked cash-settled futures, options on futures, and ''economically equivalent'' swaps for such commodities. The 25 core referenced futures contracts would include the nine ''legacy'' agricultural contracts currently subject to federal limits and 16 additional non-legacy contracts, which would include: seven additional agricultural contracts, four energy contracts, and five metals contracts.[27] Federal spot and non-spot month limits would apply to the nine ''legacy'' agricultural contracts currently subject to federal limits,[28] and only federal spot month limits would apply to the additional 16 non-legacy contracts. Outside of the spot month, these 16 non-legacy contracts would be subject to exchange-set limits and/or accountability levels if listed on an exchange.
- Amendments to § 150.1 would add or revise several definitions for use throughout part 150, including: new definitions of the terms ''core referenced futures contract'' (pertaining to the 25 physically-settled futures contracts explicitly listed in the regulations) and ''referenced contract'' (pertaining to contracts that have certain direct and/or indirect linkages to the core referenced futures contracts, and to ''economically equivalent swaps'') to be used as shorthand to refer to contracts subject to federal limits; a ''spread transaction'' definition; and a definition of ''bona fide hedging transactions or positions'' that is broad enough to accommodate hedging practices in a variety of contract types, including hedging practices that may develop over time.
- Amendments to § 150.2 would list the 25 core referenced futures contracts which, along with any associated referenced contracts, would be subject

[25] The categories are: Calendar spreads, inter-commodity spreads, quality differential spreads, processing spreads (such as energy ''crack'' or soybean ''crush'' spreads), product or by-product differential spreads, and futures-option spreads.

[26] This 2020 Proposal does not propose to amend current § 150.4 dealing with aggregation of positions for purposes of compliance with federal position limits. Section 150.4 was amended in 2016 in a prior rulemaking. *See* Final Aggregation Rulemaking, 81 FR at 91454.

[27] The seven additional agricultural contracts that would be subject to federal spot month limits are CME Live Cattle (LC), CBOT Rough Rice (RR), ICE Cocoa (CC), ICE Coffee C (KC), ICE FCOJ–A (OJ), ICE U.S. Sugar No. 11 (SB), and ICE U.S. Sugar No. 16 (SF). The four energy contracts that would be subject to federal spot month limits are: NYMEX Light Sweet Crude Oil (CL), NYMEX New York Harbor ULSD Heating Oil (HO), NYMEX New York Harbor RBOB Gasoline (RB), and NYMEX Henry Hub Natural Gas (NG). The five metals contracts that would be subject to federal spot month limits are: COMEX Gold (GC), COMEX Silver (SI), COMEX Copper (HG), NYMEX Palladium (PA), and NYMEX Platinum (PL). As discussed below, any contracts for which the Commission is proposing federal limits only during the spot month would be subject to exchange-set limits and/or accountability outside of the spot month.

[28] The Commission currently sets and enforces speculative position limits with respect to certain enumerated agricultural products. The ''enumerated'' agricultural products refer to the list of commodities contained in the definition of ''commodity'' in CEA section 1a; 7 U.S.C. 1a. These agricultural products consist of the following nine currently traded contracts: CBOT Corn (and Mini-Corn) (C), CBOT Oats (O), CBOT Soybeans (and Mini-Soybeans) (S), CBOT Wheat (and Mini-Wheat) (W), CBOT Soybean Oil (SO), CBOT Soybean Meal (SM), MGEX HRS Wheat (MWE), CBOT KC HRW Wheat (KW), and ICE Cotton No. 2 (CT). *See* 17 CFR 150.2.

to federal limits; and specify the proposed federal spot and non-spot month limit levels. Federal spot month limit levels would be set at or below 25 percent of deliverable supply, whereas federal non-spot month limit levels would be set at 10 percent of open interest for the first 50,000 contracts of open interest, with an incremental increase of 2.5 percent of open interest thereafter.

• Amendments to § 150.3 would specify the types of positions for which exemptions from federal position limit requirements may be granted, and would set forth and/or reference the processes for requesting such exemptions, including recognitions of bona fide hedges and exemptions for spread positions, financial distress positions, certain natural gas positions held during the spot month, and pre-enactment and transition period swaps. For all contracts subject to federal limits, bona fide hedge exemptions listed in Appendix A to part 150 as an enumerated bona fide hedge would be self-effectuating for purposes of federal limits. For non-enumerated hedges, market participants must request approval in advance of taking a position that exceeds the federal position limit, except in the case of sudden or unforeseen hedging needs.

• Amendments to § 150.5 would refine the process, and establish non-exclusive methodologies, by which exchanges may set exchange-level limits and grant exemptions therefrom with respect to futures and options on futures, including separate methodologies for contracts subject to federal limits and physical commodity derivatives not subject to federal limits.[29] While the Commission will oversee compliance with federal position limits on swaps, amended § 150.5 would not apply to exchanges with respect to swaps until a later time once exchanges have access to sufficient data to monitor compliance with limits on swaps across exchanges.

• New § 150.9 would establish a streamlined process for addressing requests for bona fide hedging recognitions for purposes of federal limits, leveraging off exchange expertise and resources while affording the Commission an opportunity to intervene as-needed. This process would be used by market participants with non-enumerated positions. Under the proposed rule, market participants could provide one application for a bona fide hedge to a designated contract market or swap execution facility, as applicable, and receive approval of such request for purposes of both exchange-set limits and federal limits.

• New Appendix A to part 150 would contain enumerated hedges, some of which appear in the definition of bona fide hedging transactions and positions in current § 1.3, which would be examples of positions that would comply with the proposed bona fide hedging definition. As the enumerated hedges would be examples of bona fide hedging positions, positions that do not fall within any of the enumerated hedges could still potentially be recognized as bona fide hedging positions, provided the position otherwise complies with the proposed bona fide hedging definition and all other applicable requirements.

• Amendments to part 19 and related provisions would eliminate Form 204, enabling the Commission to leverage cash-market reporting submitted directly to the exchanges under §§ 150.5 and 150.9.

D. The Commission Preliminarily Construes CEA Section 4a(a) To Require the Commission To Make a Necessity Finding Before Establishing Position Limits for Physical Commodities Other Than Excluded Commodities

The Commission is required by *ISDA* to determine whether CEA section 4a(a)(2)(A) requires the Commission to find, before establishing a position limit, that such limit is ''necessary.'' [30] The provision states in relevant part that ''the Commission shall'' establish position limits ''as appropriate'' for contracts in physical commodities other than excluded commodities ''[i]n accordance with the standards set forth in'' the preexisting section 4a(a)(1).[31] That preexisting provision requires the Commission to establish position limits as it ''finds are necessary to diminish, eliminate, or prevent'' certain enumerated burdens on interstate commerce.[32] In the 2011 Final Rulemaking, the Commission interpreted this language as an unambiguous mandate to establish position limits without first finding that such limits are necessary, but with discretion to determine the ''appropriate'' levels for each.[33] In *ISDA,* the U.S. District Court for the District of Columbia disagreed and held that section 4a(a)(2)(A) is ambiguous as to whether the ''standards set forth in paragraph (1)'' include the requirement of an antecedent finding that a position limit is necessary.[34] The court vacated the 2011 Final Rulemaking and directed the Commission to apply its experience and expertise to resolve that ambiguity.[35] The Commission has done so and preliminarily determines that section 4a(a)(2)(A) should be interpreted to require that before establishing position limits, the Commission must determine that limits are necessary.[36] A full legal analysis is set forth *infra* at Section III.F.

The Commission preliminarily finds that position limits are necessary for the 25 core referenced futures contracts, and any associated referenced contracts. This preliminary finding is based on a combination of factors including: The particular importance of these contracts in the price discovery process for their respective underlying commodities, the fact that they require physical delivery of the underlying commodity, and, in some cases, the commodities' particular importance to the national economy and especially acute economic burdens that would arise from excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in the price of the commodities underlying these contracts.

II. Proposed Rules

A. § 150.1—Definitions

Definitions relevant to the existing position limits regime currently appear in both §§ 1.3 and 150.1 of the Commission's regulations.[37] The Commission proposes to update and supplement the definitions in § 150.1, including by moving a revised definition of ''bona fide hedging transactions and positions'' from § 1.3 into § 150.1. The proposed changes are intended, among other things, to conform the definitions to the Dodd-Frank Act amendments to the CEA.[38]

[29] Proposed § 150.5 addresses exchange-set position limits and exemptions therefrom, whereas proposed § 150.3 addresses exemptions from federal limits, and proposed § 150.9 addresses federal limits and acceptance of exchange-granted bona fide hedging recognitions for purposes of federal limits. Exchange rules typically refer to ''exemptions'' in connection with bona fide hedging and spread positions, whereas the Commission uses the nomenclature ''recognition'' with respect to bona fide hedges, and ''exemption'' with respect to spreads.

[30] *ISDA,* 887 F.Supp.2d at 259, 281.

[31] 7 U.S.C. 6a(a)(2)(A).

[32] 7 U.S.C. 6a(a)(1).

[33] 2011 Final Rulemaking, 76 FR at 71626, 71627.

[34] *ISDA,* 887 F.Supp.2d at 279–280.

[35] *Id.* at 281.

[36] *See infra* Section III.F.

[37] 17 CFR 1.3 and 150.1, respectively.

[38] In addition to the amendments described below, the Commission proposes to re-order the defined terms so that they appear in alphabetical order, rather than in a lettered list, so that terms can be more quickly located. Moving forward, any new defined terms would be inserted in alphabetical order, as recommended by the Office of the Federal Register. *See Document Drafting Handbook,* Office of the Federal Register, National Archives and Records Administration, 2–31 (Revision 5, Oct. 2,

Continued

Each proposed defined term is discussed in alphabetical order below.

1. ''Bona Fide Hedging Transactions or Positions''

a. Background

Under CEA section 4a(c)(1), position limits shall not apply to transactions or positions that are ''shown to be bona fide hedging transactions or positions, as such terms shall be defined by the Commission . . . .'' [39] The Dodd-Frank Act directed the Commission, for purposes of implementing CEA section 4a(a)(2), to adopt a definition consistent with CEA section 4a(c)(2).[40] The current definition of ''bona fide hedging transactions and positions,'' which first appeared in § 1.3 of the Commission's regulations in the 1970s,[41] is inconsistent, in certain ways described below, with the revised statutory definition in CEA section 4a(c)(2).

Accordingly, and for the reasons outlined below, the Commission proposes to remove the current bona fide hedging definition from § 1.3 and replace it with an updated bona fide hedging definition that would appear alongside all of the other position limits related definitions in proposed § 150.1.[42] This definition would be applied in determining whether a position is a bona fide hedge that may exceed the proposed federal limits set forth in § 150.2. The Commission's current bona fide hedging definition is described immediately below, followed by a discussion of the proposed new definition. This section of the release describes the substantive standards for bona fide hedges. The process for granting bona fide hedge recognitions is discussed later in this release in connection with proposed §§ 150.3 and 150.9.[43]

b. The Commission's Existing Bona Fide Hedging Definition in § 1.3

Paragraph (1) of the current bona fide hedging definition in § 1.3 contains what is currently labeled the ''general'' bona fide hedging definition, which has five key elements and requires that the position must: (1) ''normally'' represent a substitute for transactions or positions made at a later time in a physical marketing channel (''temporary substitute test''); (2) be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise (''economically appropriate test''); (3) arise from the potential change in value of actual or anticipated assets, liabilities, or services (''change in value requirement''); (4) have a purpose to offset price risks incidental to commercial cash or spot operations (''incidental test''); and (5) be established and liquidated in an orderly manner (''orderly trading requirement'').[44]

Additionally, paragraph (2) currently sets forth a non-exclusive list of four categories of ''enumerated'' hedging transactions that are included in the general bona fide hedging definition in paragraph (1). Market participants thus need not seek recognition from the Commission of such positions as bona fide hedges prior to exceeding limits for such positions; rather, market participants must simply report any such positions on the monthly Form 204, as required by part 19 of the Commission's regulations.[45] The four existing categories of enumerated hedges are: (1) Hedges of ownership or fixed-price cash commodity purchases and hedges of unsold anticipated production; (2) hedges of fixed-price cash commodity sales and hedges of unfilled anticipated requirements; (3) hedges of offsetting unfixed-price cash commodity sales and purchases; and (4) cross-commodity hedges.[46]

Paragraph (3) of the current bona fide hedging definition states that the Commission may recognize non-enumerated bona fide hedging transactions and positions pursuant to a specific request by a market participant using the process described in § 1.47 of the Commission's regulations.[47]

c. Proposed Replacement of the Bona Fide Hedging Definition in § 1.3 With a New Bona Fide Hedging Definition in § 150.1

i. Background

The list of enumerated hedges found in paragraph (2) of the current bona fide hedging definition in § 1.3 was developed at a time when only agricultural commodities were subject to federal limits, has not been updated since 1987,[48] and is likely too narrow to reflect common commercial hedging practices, including for metal and energy contracts. Numerous market and regulatory developments have taken place since then, including, among other things, increased futures trading in the metals and energy markets, the development of the swaps markets, and the shift in trading from pits to electronic platforms. In addition, the CFMA [49] and Dodd-Frank Act introduced various regulatory reforms, including the enactment of position limits core principles.[50] The Commission is thus proposing to update its bona fide hedging definition to better conform to the current state of the law

2017) (stating, ''[i]n sections or paragraphs containing only definitions, we recommend that you do not use paragraph designations if you list the terms in alphabetical order. Begin the definition paragraph with the term that you are defining.'').

[39] 7 U.S.C. 6a(c)(1). While portions of the CEA and proposed § 150.1 respectively refer, and would refer, to the phrase ''bona fide hedging transactions or positions,'' the Commission may use the phrases ''bona fide hedging position,'' ''bona fide hedging definition,'' and ''bona fide hedge'' throughout this section of the release as shorthand to refer to the same.

[40] 7 U.S.C. 6a(c)(2).

[41] *See, e.g.,* Definition of Bona Fide Hedging and Related Reporting Requirements, 42 FR 42748 (Aug. 24, 1977). Previously, the Secretary of Agriculture, pursuant to section 404 of the Commodity Futures Trading Commission Act of 1974 (Pub. L. 93–463), promulgated a definition of bona fide hedging transactions and positions. Hedging Definition, Reports, and Conforming Amendments, 40 FR 11560 (Mar. 12, 1975). That definition, largely reflecting the statutory definition previously in effect, remained in effect until the newly-established Commission defined that term. *Id.*

[42] In a 2018 rulemaking, the Commission amended § 1.3 to replace the sub-paragraphs that had for years been identified with an alphabetic designation for each defined term with an alphabetized list. *See* Definitions, 83 FR 7979 (Feb. 23, 2018). The bona fide hedging definition, therefore, is now a paragraph, located in alphabetical order, in § 1.3, rather than in § 1.3(z). Accordingly, for purposes of clarity and ease of discussion, when discussing the Commission's current version of the bona fide hedging definition, this release will refer to the bona fide hedging definition in § 1.3.

Further, the version of § 1.3 that appears in the Code of Federal Regulations applies only to excluded commodities and is not the version of the bona fide hedging definition currently in effect. The version currently in effect, the substance of which remains as it was amended in 1987, applies to all commodities, not just to excluded commodities. *See* Revision of Federal Speculative Position Limits, 52 FR 38914 (Oct. 20, 1987). While the 2011 Final Rulemaking amended the § 1.3 bona fide hedging definition to apply only to excluded commodities, that rulemaking was vacated, as noted previously, by a September 28, 2012 order of the U.S. District Court for the District of Columbia, with the exception of the rule's amendments to 17 CFR 150.2. Although the 2011 Final Rulemaking was vacated, the 2011 version of the bona fide hedging definition in § 1.3, which applied only to excluded commodities, has not yet been formally removed from the Code of Federal Regulations. The currently-in-effect version of the Commission's bona fide hedging definition thus does not currently appear in the Code of Federal Regulations. The closest to a ''current'' version of the definition is the 2010 version of § 1.3, which, while substantively current, still includes the ''(z)'' denomination that was removed in 2018. The Commission proposes to address the need to formally remove the incorrect version of the bona fide hedging definition as part of this rulemaking.

[43] *See infra* Section II.C.2. (discussion of proposed § 150.3) and Section II.G.3. (discussion of proposed § 150.9).

[44] 17 CFR 1.3.

[45] 17 CFR part 19.

[46] 17 CFR 1.3.

[47] *Id.*

[48] *See* Revision of Federal Speculative Position Limits, 52 FR 38914 (Oct. 20, 1987).

[49] Commodity Futures Modernization Act of 2000, Public Law 106–554, 114 Stat. 2763 (Dec. 21, 2000).

[50] *See* 7 U.S.C. 7(d)(5) and 7 U.S.C. 7b–3(f)(6).

and to better reflect market developments over time.

While one option for doing so could be to expand the list of enumerated hedges to encompass a larger array of hedging strategies, the Commission does not view this alone to be a practical solution. It would be difficult to maintain a list that captures all hedging activity across commodity types, and any list would inherently fail to take into account future changes in industry practices and other developments. The Commission proposes to create a new bona fide hedging definition in proposed § 150.1 that would work in connection with limits on a variety of commodity types and accommodate changing hedging practices over time. The Commission proposes to couple this updated definition with an expanded list of enumerated hedges. While positions that fall within the proposed enumerated hedges, discussed below, would be examples of positions that comply with the bona fide hedging definition, they would certainly not be the only types of positions that could be bona fide hedges. The proposed enumerated hedges are intended to ensure that the framework proposed herein does not reduce any clarity inherent in the existing framework; the proposed enumerated hedges are in no way intended to limit the universe of hedging practices that could otherwise be recognized as bona fide.

The Commission anticipates these proposed modifications would provide a significant degree of flexibility to market participants in terms of how they hedge, and to exchanges in terms of how they evaluate transactions and positions for purposes of their position limit programs, without sacrificing any of the clarity provided by the existing bona fide hedging definition. Further, as described in detail in connection with the discussion of proposed § 150.9 later in this release, the Commission anticipates that allowing the exchanges to process applications for bona fide hedges for purposes of federal limits would be significantly more efficient than the existing processes for exchanges and the Commission.[51] The Commission discusses each element of the proposed bona fide hedging definition below, followed by a discussion of the proposed enumerated hedges. The Commission's intent with this proposal is to acknowledge to the greatest extent possible, consistent with the statutory language, existing bona fide hedging exemptions provided by exchanges.

[51] In this rulemaking, the Commission proposes to allow qualifying exchanges to process requests for non-enumerated bona fide hedge recognitions for purposes of federal limits. *See infra* Section II.G.3. (discussion of proposed § 150.9).

ii. Proposed Bona Fide Hedging Definition for Physical Commodities

The Commission proposes to maintain the general elements currently found in the bona fide hedging definition in § 1.3 that conform to the revised statutory bona fide hedging definition in CEA section 4a(c)(2), and proposes to eliminate the elements that do not. In particular, the Commission proposes to include the updated versions of the temporary substitute test, economically appropriate test, and change in value requirements that are described below, and eliminate the incidental test and orderly trading requirement, which are not included in the revised statutory text. Each of these proposed changes is described below.[52]

(1) Temporary Substitute Test

The language of the temporary substitute test that appears in the Commission's existing bona fide hedging definition is inconsistent in some ways with the language of the temporary substitute test that currently appears in the statute. In particular, the bona fide hedging definition in section 4a(c)(2)(A)(i) of the CEA currently provides, among other things, that a bona fide hedging position ''represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel.'' [53] The Commission's definition currently provides that a bona fide hedging position ''*normally* represent[s] a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel'' (emphasis added).[54] The Dodd-Frank Act amended the temporary substitute language that previously appeared in the statute by removing the word ''normally'' from the phrase ''normally represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel. . . .'' [55] The Commission preliminarily interprets this change as reflecting Congressional direction that a bona fide hedging position in physical commodities must *always* (and not just ''normally'') be in connection with the production, sale, or use of a physical cash-market commodity.[56]

[52] Bona fide hedge recognition is determined based on the particular circumstances of a position or transaction and is not conferred on the basis of the involved market participant alone. Accordingly, while a particular position may qualify as a bona fide hedge for a given market participant, another position held by that same participant may not. Similarly, if a participant holds positions that are recognized as bona fide hedges, and holds other positions that are speculative, only the speculative positions would be subject to position limits.

[53] 7 U.S.C. 6a(c)(2)(A)(i).

[54] 17 CFR 1.3.

[55] 7 U.S.C. 6a(c)(2)(A)(i).

Accordingly, the Commission preliminarily interprets this change to signal that the Commission should cease to recognize ''risk management'' positions as bona fide hedges for physical commodities, unless the position satisfies the pass-through swap/swap offset requirements in section 4a(c)(2)(B) of the CEA, discussed further below.[57] In order to implement that statutory change, the Commission proposes a narrower bona fide hedging definition for physical commodities in proposed § 150.1 that does not include the word ''normally'' currently found in the temporary substitute language in paragraph (1) of the existing § 1.3 bona fide hedging definition.

The practical effect of conforming the temporary substitute test in the regulation to the amended statutory provision would be to prevent market participants from treating positions entered into for risk management purposes as bona fide hedges for contracts subject to federal limits, unless the position qualifies under the pass-through swap provision in CEA section 4a(c)(2)(B).[58] As noted above,

[56] Previously, the Commission stated that, among other things, the inclusion of the word ''normally'' in connection with the pre-Dodd-Frank Act version of the temporary substitute language indicated that the bona fide hedging definition should not be construed to apply only to firms using futures to reduce their exposures to risks in the cash market, and that to qualify as a bona fide hedge, a transaction in the futures market did not necessarily need to be a temporary substitute for a later transaction in the cash market. *See* Clarification of Certain Aspects of the Hedging Definition, 52 FR 27195, 27196 (July 20, 1987). In other words, that 1987 interpretation took the view that a futures position could still qualify as a bona fide hedging position even if it was not in connection with the production, sale, or use of a physical commodity.

[57] 7 U.S.C. 6a(c)(2)(B). In connection with physical commodities, the phrase ''risk management exemption'' has historically been used by Commission staff to refer to non-enumerated bona fide hedge recognitions granted under § 1.47 to allow swap dealers and others to hold agricultural futures positions outside of the spot month in excess of federal limits in order to offset commodity index swap or related exposure, typically opposite an institutional investor for which the swap was not a bona fide hedge. As described below, due to differences in statutory language, the phrase ''risk management exemption'' often has a broader meaning in connection with excluded commodities than with physical commodities. *See infra* Section II.A.1.c.v. (discussion of proposed pass-through language).

[58] 7 U.S.C. 6a(c)(2)(B). *See infra* Section II.A.1.c.v. (discussion of proposed pass-through language). Excluded commodities, as described in further detail below, are not subject to the statutory bona fide hedging definition. Accordingly, the statutory

Continued

the Commission previously viewed positions in physical commodities, entered into for risk management purposes to offset the risk of swaps and other financial instruments and not as substitutes for transactions or positions to be taken in a physical marketing channel, as bona fide hedges. However, given the statutory change, positions that reduce the risk of such swaps and financial instruments would no longer meet the requirements for a bona fide hedging position under CEA section 4a(c)(2) and under proposed § 150.1. As discussed below, any such previously-granted risk management exemptions would generally no longer apply after the effective date of the speculative position limits proposed herein.[59] Further, retaining such exemptions for swap intermediaries, without regard to the purpose of their counterparty's swap, would be inconsistent with the statutory restrictions on pass-through swap offsets, which require that the swap position being offset qualify as a bona fide hedging position.[60] Aside from this change, the Commission is not proposing any other modifications to its existing temporary substitute test.

While the Commission preliminarily interprets the Dodd-Frank amendments to the CEA as constraining the Commission from recognizing as bona fide hedges risk management positions involving physical commodities, the Commission has in part addressed the hedging needs of persons seeking to offset the risk from swap books by proposing the pass-through swap and pass-through swap offset provisions discussed below.

The Commission observes that while ''risk management'' positions would not qualify as bona fide hedges, some other provisions in this proposal may provide flexibility for existing and prospective risk management exemption holders in a manner that comports with the statute. In particular, the Commission anticipates that the proposal to limit the applicability of federal non-spot month limits to the nine legacy agricultural contracts,[61] coupled with the proposed adjustment to non-spot limit levels based on updated open interest numbers for the nine legacy agricultural contracts currently subject to federal limits,[62] may accommodate risk management activity that remains below the proposed levels in a manner that comports with the CEA. Further, to the extent that such activity would be opposite a counterparty for whom the swap is a bona fide hedge, the Commission would encourage intermediaries to consider whether they would qualify under the bona fide hedging position definition for the proposed pass-through swap treatment, which is explicitly authorized by the CEA and discussed in greater detail below.[63] Moreover, while positions entered into for risk management purposes may no longer qualify as bona fide hedges, some may satisfy the proposed requirements for spread exemptions. Finally, consistent with existing industry practice, exchanges may continue to recognize risk management positions for contracts that are not subject to federal limits, including for excluded commodities.

(2) Economically Appropriate Test

The bona fide hedging definitions in section 4a(c)(2)(A)(ii) of the CEA and in existing § 1.3 of the Commission's regulations both provide that a bona fide hedging position must be ''economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise.''[64] The Commission proposes to replicate this standard in the new definition in § 150.1, with one clarification: Consistent with the Commission's longstanding practice regarding what types of risk may be offset by bona fide hedging positions in excess of federal limits,[65] the Commission proposes to make explicit that the word ''risks'' refers to, and is limited to, ''price risk.'' This proposed clarification does not reflect any change in policy, as the Commission has, when defining bona fide hedging, historically focused on transactions that offset price risk.[66]

Commenters have previously requested flexibility for hedges of non-price risk.[67] However, re-interpreting ''risk'' to mean something other than ''price risk'' would make determining whether a particular position is economically appropriate to the reduction of risk too subjective to effectively evaluate. While the Commission or an exchange's staff can objectively evaluate whether a particular derivatives position is an economically appropriate hedge of a price risk arising from an underlying cash-market transaction, including by assessing the correlations between the risk and the derivatives position, it would be more difficult, if not impossible, to objectively determine whether an offset of non-price risk is economically appropriate for the underlying risk. For example, for any given non-price risk, such as political risk, there could be multiple commodities, directions, and contract months which a particular market participant may view as an economically appropriate offset for that risk, and multiple market participants might take different views on which offset is the most effective. Re-interpreting ''risk'' to mean something other than ''price risk'' would introduce an element of subjectivity that would make a federal position limit framework difficult, if not impossible, to administer.

The Commission remains open to receiving new product submissions, and should those submissions include contracts or strategies that are used to hedge something other than price risk, the Commission could at that point evaluate whether to propose regulations that would recognize hedges of risks other than price risk as bona fide hedges.

(3) Change in Value Requirement

The Commission proposes to retain the substance of the change in value requirement in existing § 1.3, with some non-substantive technical modifications, including modifications to correct a typographical error.[68] Aside

restrictions on risk management exemptions that apply to physical commodities subject to federal limits do not apply to excluded commodities.

[59] *See infra* Section II.C.2.g. (discussion of revoking existing risk management exemptions).

[60] *See* 7 U.S.C. 6a(c)(2)(B)(i). The pass-through swap offset language in the proposed bona fide hedging definition is discussed in greater detail below.

[61] *See infra* Section II.B.2.d. (discussion of non-spot month limit levels).

[62] The proposed non-spot month levels for the nine legacy agricultural contracts were calculated using a methodology that, with the exception of CBOT Oats (O), CBOT KC HRW Wheat (KW), and MGEX HRS Wheat (MWE), would result in higher levels than under existing rules and prior proposals. *See infra* Section II.B.2.d (discussion of proposed non-spot month limit levels).

[63] *See infra* Section II.A.1.c.v. (discussion of proposed pass-through language).

[64] 7 U.S.C. 6a(c)(2)(A)(ii) and 17 CFR 1.3.

[65] *See, e.g.,* 2013 Proposal, 78 FR at 75709, 75710.

[66] For example, in promulgating existing § 1.3, the Commission explained that a bona fide hedging position must, among other things, ''be economically appropriate to risk reduction, such risks must arise from operation of a commercial enterprise, and the price fluctuations of the futures contracts used in the transaction must be substantially related to fluctuations of the cash market value of the assets, liabilities or services being hedged.'' Bona Fide Hedging Transactions or Positions, 42 FR 14832, 14833 (Mar. 16, 1977). ''Value'' is generally understood to mean price times quantity. Dodd-Frank added CEA section 4a(c)(2), which copied the economically appropriate test from the Commission's definition in § 1.3. *See also* 2013 Proposal, 78 FR at 75702, 75703 (stating that the ''core of the Commission's approach to defining bona fide hedging over the years has focused on transactions that offset a recognized physical price risk'').

[67] *See, e.g.,* 2016 Reproposal, 81 FR at 96847.

[68] The Commission proposes to replace the phrase ''liabilities which a person owns,'' which appears in the statute erroneously, with ''liabilities which

from the typographical error, the proposed § 150.1 change in value requirement mirrors the Dodd-Frank Act's change in value requirement in CEA section 4a(c)(2)(A)(iii).[69]

(4) Incidental Test and Orderly Trading Requirement

While the Commission proposes to maintain the substance of the three core elements of the existing bona fide hedging definition described above, with some modifications, the Commission also proposes to eliminate two elements contained in the existing § 1.3 definition: The incidental test and orderly trading requirement that currently appear in paragraph (1)(iii) of the § 1.3 bona fide hedging definition.[70]

Notably, Congress eliminated the incidental test from the statutory bona fide hedging definition in CEA section 4a(c)(2).[71] Further, the Commission views the incidental test as redundant because the Commission is proposing to maintain the change in value requirement (value is generally understood to mean price per unit times quantity of units), and the economically appropriate test, which includes the concept of the offset of price risks in the conduct and management of (*i.e.,* incidental to) a commercial enterprise.

The Commission does not view the proposed elimination of the incidental test in the definition that appears in the regulations as a change in policy. The proposed elimination would not result in any changes to the Commission's interpretation of the bona fide hedging definition for physical commodities.

The Commission also preliminarily believes that the orderly trading requirement should be deleted from the definition in the Commission's regulations because the statutory bona fide hedging definition does not include an orderly trading requirement,[72] and because the meaning of ''orderly trading'' is unclear in the context of the over-the counter (''OTC'') swap market and in the context of permitted off-exchange transactions, such as exchange for physicals. The proposed elimination of the orderly trading requirement would also have no bearing on an exchange's ability to impose its own orderly trading requirement. Further, in proposing to eliminate the orderly trading requirement from the definition in the regulations, the Commission is not proposing any amendments or modified interpretations to any other related requirements, including to any of the anti-disruptive trading prohibitions in CEA section 4c(a)(5),[73] or to any other statutory or regulatory provisions.

Taken together, the proposed retention of the updated temporary substitute test, economically appropriate test, and change in value requirement, coupled with the proposed elimination of the incidental test and orderly trading requirement, should reduce uncertainty by eliminating provisions that do not appear in the statute, and by clarifying the language of the remaining provisions. By reducing uncertainty surrounding some parts of the bona fide hedging definition for physical commodities, the Commission anticipates that, as described in greater detail elsewhere in this release, it would be easier going forward for the Commission, exchanges, and market participants to address whether novel trading practices or strategies may qualify as bona fide hedges.

iii. Proposed Enumerated Bona Fide Hedges for Physical Commodities

Federal position limits currently only apply to referenced contracts based on nine legacy agricultural commodities, and, as mentioned above, the bona fide hedging definition in existing § 1.3 includes a list of four categories of enumerated hedges that may be exempt from federal position limits.[74] So as not to reduce any of the clarity provided by the current list of enumerated hedges, the Commission proposes to maintain the existing enumerated hedges, some with modification, and, for the reasons described below, to expand this list. Such enumerated bona fide hedges would be self-effectuating for purposes of federal limits.[75] The Commission also proposes to move the expanded list to proposed Appendix A to part 150 of the Commission's regulations. The Commission preliminarily believes that the list of enumerated hedges should appear in an appendix, rather than be included in the definition, because each enumerated hedge represents just one way, but not the only way, to satisfy the proposed bona fide hedging definition and § 150.3(a)(1).[76] In some places, as described below, the Commission proposes to modify and/or re-organize the language of the current enumerated hedges; such proposed changes are intended only to provide clarifications, and, unless indicated otherwise, are not intended to substantively modify the types of practices currently listed as enumerated hedges. In other places, however, the Commission proposes substantive changes to the existing enumerated hedges, including the elimination of the five-day rule for purposes of federal limits, while allowing exchanges to impose a five-day rule, or similar restrictions, for purposes of exchange-set limits. With the exception of risk management positions previously recognized as bona fide hedges, and assuming all regulatory requirements continue to be satisfied, bona fide hedging recognitions that are currently in effect under the Commission's existing rules, either by virtue of § 1.47 or one of the enumerated hedges currently listed in § 1.3, would be grandfathered once the rules proposed herein are adopted.

When first proposed, the Commission viewed the enumerated bona fide hedges as conforming to the general definition of bona fide hedging ''without further consideration as to the particulars of the case.'' [77] Similarly, the proposed enumerated hedges would reflect fact patterns for which the Commission has preliminarily determined, based on experience over time, that no case-by-case determination, or review of additional details, by the Commission is needed to determine that the position or transaction is a bona fide hedge. This proposal would in no way foreclose the recognition of other hedging practices as bona fide hedges.

The Commission would be open, on a case-by-case basis, to recognizing as bona fide hedges positions or transactions that may fall outside the bounds of these enumerated hedges, but that nevertheless satisfy the proposed

a person owes,'' which the Commission believes was the intended wording. The Commission interprets the word ''owns'' to be a typographical error. A person may owe on a liability, and may anticipate incurring a liability. If a person ''owns'' a liability, such as a debt instrument issued by another, then such person owns an asset. The fact that assets are included in CEA section 4a(c)(2)(A)(iii)(I) further reinforces the Commission's interpretation that the reference to ''owns'' means ''owes.'' The Commission also proposes several other non-substantive modifications in sentence structure to improve clarity.

[69] 7 U.S.C. 6a(c)(2)(A)(iii).

[70] 17 CFR 1.3.

[71] 7 U.S.C. 6a(c)(2).

[72] The orderly trading requirement has been a part of the regulatory definition of bona fide hedging since 1975; *see* Hedging Definition, Reports, and Conforming Amendments, 40 FR 11560 (Mar. 12, 1975). Prior to 1974, the orderly trading requirement was found in the statutory definition of bona fide hedging position; changes to the CEA in 1974 removed the statutory definition from CEA section 4a(3).

[73] 7 U.S.C. 6c(a)(5).

[74] 17 CFR 1.3.

[75] *See infra* Section II.C.2. (discussion of proposed § 150.3) and Section II.G.3. (discussion of proposed § 150.9).

[76] As discussed below, proposed § 150.3(a)(1) would allow a person to exceed position limits for bona fide hedging transactions or positions, as defined in proposed § 150.1.

[77] Bona Fide Hedging Transactions or Positions, 42 FR 14832 (Mar. 16, 1977).

bona fide hedging definition and section 4a(c)(2) of the CEA.[78]

The Commission does not anticipate that moving the list of enumerated hedges from the bona fide hedging definition to an appendix per se would have a substantial impact on market participants who seek clarity regarding bona fide hedges. However, the Commission is open to feedback on this point.

Positions in referenced contracts subject to position limits that meet any of the proposed enumerated hedges would, for purposes of federal limits, meet the bona fide hedging definition in CEA section 4a(c)(2)(A), as well as the Commission's proposed bona fide hedging definition in § 150.1. Any such recognitions would be self-effectuating for purposes of federal limits, provided the market participant separately requests an exemption from the applicable exchange-set limit established pursuant to proposed § 150.5(a). The proposed enumerated hedges are each described below, followed by a discussion of the proposal's treatment of the five-day rule.

(1) Hedges of Unsold Anticipated Production

This hedge is currently enumerated in paragraph (2)(i)(B) of the bona fide hedging definition in § 1.3, and is subject to the five-day rule. The Commission proposes to maintain it as an enumerated hedge, with the modification described below. This enumerated hedge would allow a market participant who anticipates production, but who has not yet produced anything, to enter into a short derivatives position in excess of limits to hedge the anticipated production.

While existing paragraph (2)(i)(B) limits this enumerated hedge to twelve-months' unsold anticipated production, the Commission proposes to remove the twelve-month limitation. The twelve-month limitation may be unsuitable in connection with additional contracts based on agricultural and energy commodities covered by this release, which may have longer growth and/or production cycles than the nine legacy agricultural commodities. Commenters have also previously recommended removing the twelve-month limitation on agricultural production, stating that it is unnecessarily short in comparison to the expected life of investment in production facilities.[79] The Commission preliminarily agrees.

(2) Hedges of Offsetting Unfixed Price Cash Commodity Sales and Purchases

This hedge is currently enumerated in paragraph (2)(iii) of the bona fide hedging definition in § 1.3 and is subject to the five-day rule. The Commission proposes to maintain it as an enumerated hedge, with one proposed modification described below. This enumerated hedge allows a market participant to use commodity derivatives in excess of limits to offset an unfixed price cash commodity purchase coupled with an unfixed price cash commodity sale.

Currently, under paragraph (2)(iii), the cash commodity must be bought and sold at unfixed prices at a basis to different delivery months, meaning the offsetting derivatives transaction would be used to reduce the risk arising from a time differential in the unfixed-price purchase and sale contracts.[80] The Commission proposes to expand this provision to also permit the cash commodity to be bought and sold at unfixed prices at a basis to different commodity derivative contracts in the same commodity, even if the commodity derivative contracts are in the same calendar month. The Commission is proposing this change to allow a commercial enterprise to enter into the described derivatives transactions to reduce the risk arising from either (or both) a location differential[81] or a time differential in unfixed-price purchase and sale contracts in the same cash commodity.

Both an unfixed-price cash commodity purchase and an offsetting unfixed-price cash commodity sale must be in hand in order to be eligible for this enumerated hedge, because having both the unfixed-price sale and purchase in hand would allow for an objective evaluation of the hedge.[82] Absent either the unfixed-price purchase or the unfixed-price sale (or absent both), it would be less clear how the transaction could be classified as a bona fide hedge, that is, a transaction that reduces price risk.[83]

This is not to say that an unfixed-price cash commodity purchase alone, or an unfixed-price cash commodity sale alone, could never be recognized as a bona fide hedge. Rather, an additional facts and circumstances analysis would be warranted in such cases.

Further, upon fixing the price of, or taking delivery on, the purchase contract, the owner of the cash commodity may hold the short derivative leg of the spread as a hedge against a fixed-price purchase or inventory. However, the long derivative leg of the spread would no longer qualify as a bona fide hedging position, since the commercial entity has fixed the price or taken delivery on the purchase contract. Similarly, if the commercial entity first fixed the price of the sales contract, the long derivative leg of the spread may be held as a hedge against a fixed-price sale, but the short derivative leg of the spread would no longer qualify as a bona fide hedging position. Commercial entities in these circumstances thus may have to consider reducing certain positions in order to comply with the regulations proposed herein.

(3) Short Hedges of Anticipated Mineral Royalties

The Commission is proposing a new acceptable practice that is not currently enumerated in § 1.3 for short hedges of anticipated mineral royalties. The Commission previously adopted a similar provision as an enumerated hedge in part 151 in response to a request from commenters.[84] The proposed provision would permit an owner of rights to a future royalty to lock in the price of anticipated mineral production by entering into a short position in excess of limits in a commodity derivative contract to offset the anticipated change in value of mineral royalty rights that are owned by that person and arise out of the production of a mineral commodity

[78] *See infra* Section II.G.3. (discussion of proposed § 150.9).

[79] *See, e.g.,* 2016 Reproposal, 81 FR at 96752.

[80] The Commission stated when it proposed this enumerated hedge, "[i]n particular, a cotton merchant may contract to purchase and sell cotton in the cash market in relation to the futures price in different delivery months for cotton, *i.e.,* a basis purchase and a basis sale. Prior to the time when the price is fixed for each leg of such a cash position, the merchant is subject to a variation in the two futures contracts utilized for price basing. This variation can be offset by purchasing the future on which the sales were based [and] selling the future on which [the] purchases were based." Revision of Federal Speculative Position Limits, 51 FR 31648, 31650 (Sept. 4, 1986).

[81] In the case of reducing the risk of a location differential, and where each of the underlying transactions in separate derivative contracts may be in the same contract month, a position in a basis contract would not be subject to position limits, as discussed in connection with paragraph (3) of the proposed definition of "referenced contract."

[82] For example, in the case of a calendar spread, having both the unfixed-price sale and purchase in hand would set the timeframe for the calendar month spread being used as the hedge.

[83] In 2013, the Commission provided an example regarding this enumerated hedge: "The contemplated derivative positions will offset the risk that the difference in the expected delivery prices of the two unfixed-price cash contracts in the same commodity will change between the time the hedging transaction is entered and the time of fixing of the prices on the purchase and sales cash contracts. Therefore, the contemplated derivative positions are economically appropriate to the reduction of risk." 2013 Proposal, 78 FR at 75715.

[84] *See* 2011 Final Rulemaking, 76 FR at 71646. As noted above, part 151 was subsequently vacated.

(*e.g.,* oil and gas).[85] The Commission preliminarily believes that this remains a common hedging practice, and that positions that satisfy the requirements of this acceptable practice would conform to the general definition of bona fide hedging without further consideration as to the particulars of the case.

The Commission proposes to limit this acceptable practice to mineral royalties; the Commission preliminarily believes that while royalties have been paid for use of land in agricultural production, the Commission has not received any evidence of a need for a bona fide hedge recognition from owners of agricultural production royalties. The Commission requests comment on whether and why such an exemption might be needed for owners of agricultural production or other royalties.

(4) Hedges of Anticipated Services

The Commission is proposing a new enumerated hedge that is not currently enumerated in the § 1.3 bona fide hedging definition for hedges of anticipated services. The Commission previously adopted a similar provision as an enumerated hedge in part 151 in response to a request from commenters.[86] This enumerated hedge would recognize as a bona fide hedge a long or short derivatives position used to hedge the anticipated change in value of receipts or payments due or expected to be due under an executed contract for services arising out of the production, manufacturing, processing, use, or transportation of the commodity underlying the commodity derivative contract.[87] The Commission preliminarily believes that this remains a common hedging practice, and that positions that satisfy the requirements of this acceptable practice would conform to the general definition of bona fide hedging without further consideration as to the particulars of the case.

(5) Cross-Commodity Hedges

Paragraph (2)(iv) of the existing § 1.3 bona fide hedge definition enumerates the offset of cash purchases, sales, or purchases and sales with a commodity derivative other than the commodity that comprised the cash position(s).[88] The Commission proposes to include this hedge in the enumerated hedges and expand its application such that cross-commodity hedges could be used to establish compliance with: Each of the proposed enumerated hedges listed in Appendix A to part 150;[89] and hedges in the proposed pass-through provisions under paragraph (2) of the proposed bona fide hedging definition discussed further below; provided, in each case, that the position satisfies each element of the relevant acceptable practice.[90]

This enumerated hedge is conditioned on the fluctuations in value of the position in the commodity derivative contract or of the underlying cash commodity being ''substantially related''[91] to the fluctuations in value of the actual or anticipated cash position or pass-through swap. To be ''substantially related,'' the derivative and cash market position, which may be in different commodities, should have a reasonable commercial relationship.[92] For example, there is a reasonable commercial relationship between grain sorghum, used as a food grain for humans or as animal feedstock, with corn underlying a derivative. There currently is not a futures contract for grain sorghum grown in the United States listed on a U.S. DCM, so corn represents a substantially related commodity to grain sorghum in the United States.[93] In contrast, there does not appear to be a reasonable commercial relationship between a physical commodity, say copper, and a broad-based stock price index, such as the S&P 500 Index, because these commodities are not reasonable substitutes for each other in that they have very different pricing drivers. That is, the price of a physical commodity is based on supply and demand, whereas the stock price index is based on various individual stock prices for different companies.

(6) Hedges of Inventory and Cash Commodity Fixed-Price Purchase Contracts

Hedges of inventory and cash-commodity fixed-price purchase contracts are included in paragraph (2)(i)(A) of the existing § 1.3 bona fide hedge definition, and the Commission proposes to include them as an enumerated hedge with minor modifications. This proposed enumerated hedge acknowledges that a commercial enterprise is exposed to price risk (*e.g.,* that the market price of the inventory could decrease) if it has obtained inventory in the normal course of business or has entered into a fixed-price spot or forward purchase contract calling for delivery in the physical marketing channel of a cash-market commodity (or a combination of the two), and has not offset that price risk. Any such inventory, or a fixed-price purchase contract, must be on hand, as opposed to a non-fixed purchase contract or an anticipated purchase. To satisfy the requirements of this particular enumerated hedge, a bona fide hedge would be to establish a short position in a commodity derivative contract to offset such price risk. An exchange may require such short position holders to demonstrate the ability to deliver against the short

[85] A short position fixes the price of the anticipated receipts, removing exposure to change in value of the person's share of the production revenue. A person who has issued a royalty, in contrast, has, by definition, agreed to make a payment in exchange for value received or to be received (*e.g.,* the right to extract a mineral). Upon extraction of a mineral and sale at the prevailing cash market price, the issuer of a royalty remits part of the proceeds in satisfaction of the royalty agreement. The issuer of a royalty, therefore, does not have price risk arising from that royalty agreement.

[86] *See* 2011 Final Rulemaking, 76 FR at 71646. As noted above, part 151 was subsequently vacated.

[87] As the Commission previously stated, regarding a proposed hedge for services, ''crop insurance providers and other agents that provide services in the physical marketing channel could qualify for a bona fide hedge of their contracts for services arising out of the production of the commodity underlying a [commodity derivative contract].'' 2013 Proposal, 78 FR at 75716.

[88] For example, existing paragraph (2)(iv) of the bona fide hedging definition recognizes as an enumerated hedge the offset of a cash-market position in one commodity, such as soybeans, through a derivatives position in a different commodity, such as soybean oil or soybean meal.

[89] Specifically, for: (i) Hedges of unsold anticipated production, (ii) hedges of offsetting unfixed-price cash commodity sales and purchases, (iii) hedges of anticipated mineral royalties, (iv) hedges of anticipated services, (v) hedges of inventory and cash commodity fixed-price purchase contracts, (vi) hedges of cash commodity fixed-price sales contracts, (vii) hedges by agents, and (viii) offsets of commodity trade options, a cross-commodity hedge could be used to offset risks arising from a commodity other than the cash commodity underlying the commodity derivatives contract.

[90] For example, an airline that wishes to hedge the price of jet fuel may enter into a swap with a swap dealer. In order to remain flat, the swap dealer may offset that swap with a futures position, for example, in ULSD. Subsequently, the airline may also offset the swap exposure using ULSD futures. In this example, under the pass-through swap language of proposed § 150.1, the airline would be acting as a bona fide hedging swap counterparty and the swap dealer would be acting as a pass-through swap counterparty. In this example, provided each element of the enumerated hedge in paragraph (a)(5) of Appendix A, the pass-through swap provision in § 150.1, and all other regulatory requirements are satisfied, the airline and swap dealer could each exceed limits in ULSD futures to offset their respective swap exposures to jet fuel. *See infra* Section II.A.1.c.v. (discussion of proposed pass-through language).

[91] *See* proposed Appendix A to part 150.

[92] *Id.*

[93] Grain sorghum was previously listed for trading on the Kansas City Board of Trade and Chicago Mercantile Exchange, but because of liquidity issues, grain buyers continued to use the more liquid corn futures contract, which suggests that the basis risk between corn futures and cash sorghum could be successfully managed with the corn futures contract.

position in order to demonstrate a legitimate purpose for holding a position deep into the spot month.[94]

(7) Hedges of Cash Commodity Fixed-Price Sales Contracts

This hedge is enumerated in paragraphs (2)(ii)(A) and (B) of the existing § 1.3 bona fide hedge definition, and the Commission proposes to maintain it as an enumerated hedge. This enumerated hedge acknowledges that a commercial enterprise is exposed to price risk (*i.e.,* that the market price of a commodity might be higher than the price of a fixed-price sales contract for that commodity) if it has entered into a spot or forward fixed-price sales contract calling for delivery in the physical marketing channel of a cash-market commodity, and has not offset that price risk. To satisfy the requirements of this particular enumerated hedge, a bona fide hedge would be to establish a long position in a commodity derivative contract to offset such price risk.

(8) Hedges by Agents

This proposed enumerated hedge is included in paragraph (3) of the existing § 1.3 bona fide hedge definition as an example of a potential non-enumerated bona fide hedge. The Commission proposes to include this example as an enumerated hedge, with non-substantive modifications,[95] because the Commission preliminarily believes that this is a common hedging practice, and that positions which satisfy the requirements of this enumerated hedge would conform to the general definition of bona fide hedging without further consideration as to the particulars of the case. This proposed provision would allow an agent who has the responsibility to trade cash commodities on behalf of another entity for which such positions would qualify as bona fide hedging positions to hedge those cash positions on a long or short basis. For example, an agent may trade on behalf of a farmer or a producer, or a government may wish to contract with a commercial firm to manage the government's cash wheat inventory; in such circumstances, the agent or the commercial firm would not take ownership of the commodity it trades on behalf of the farmer, producer, or government, but would be an agent eligible for an exemption to hedge the risks associated with such cash positions.

(9) Offsets of Commodity Trade Options

The Commission is proposing a new enumerated hedge to recognize certain offsets of commodity trade options as a bona fide hedge. Under this proposed enumerated hedge, a commodity trade option meeting the requirements of § 32.3 [96] of the Commission's regulations [97] may be deemed a cash commodity fixed-price purchase or cash commodity fixed-price sales contract, as the case may be, provided that such option is adjusted on a futures-equivalent basis.[98] Because the Commission proposes to include hedges of cash commodity fixed-price purchase contracts and hedges of cash commodity fixed-price sales contracts as enumerated hedges, the Commission also proposes to include hedges of commodity trade options as an enumerated hedge.

(10) Hedges of Unfilled Anticipated Requirements

This proposed enumerated hedge appears in paragraph (2)(ii)(C) of the existing § 1.3 bona fide hedge definition. The Commission proposes to include it as an enumerated hedge, with modification. To satisfy the requirements of this particular enumerated hedge, a bona fide hedge would be to establish a long position in a commodity derivative contract to offset the expected price risks associated with the anticipated future purchase of the cash-market commodity underlying the commodity derivative contract. Such unfilled anticipated requirements could include requirements for processing, manufacturing, use by that person, or resale by a utility to its customers.[99] Consistent with the existing provision, for purposes of exchange-set limits, exchanges may wish to consider adopting rules providing that during the lesser of the last five days of trading (or such time period for the spot month), such positions must not exceed the person's unfilled anticipated requirements of the underlying cash commodity for that month and for the next succeeding month.[100] Any such quantity limitation may help prevent the use of long futures to source large quantities of the underlying cash commodity. The Commission preliminarily believes that the two-month limitation would allow for an amount of activity that is in line with common commercial hedging practices, without jeopardizing any statutory objectives.

Although existing paragraph (2)(ii)(C) limits this enumerated hedge to twelve-months' unfilled anticipated requirements outside of the spot period, the Commission proposes to remove the twelve-month limitation because commenters have previously stated, and the Commission preliminarily believes, that there is a commercial need to hedge unfilled anticipated requirements for a time period longer than twelve months.[101]

(11) Hedges of Anticipated Merchandising

The Commission is proposing a new enumerated hedge to recognize certain offsets of anticipated purchases or sales as a bona fide hedge. Under this proposed enumerated hedge, a merchant may establish a long or short position in

[94] For example, it would not appear to be economically appropriate to hold a short position in the spot month of a commodity derivative contract against fixed-price purchase contracts that provide for deferred delivery in comparison to the delivery period for the spot month commodity derivative contract. This is because the commodity under the cash contract would not be available for delivery on the commodity derivative contract.

[95] For example, the Commission proposes to replace the phrase ''offsetting cash commodity'' with ''contract's underlying cash commodity'' to use language that is consistent with the other proposed enumerated hedges.

[96] 17 CFR 32.3. In order to qualify for the trade option exemption, § 32.3 requires, among other things, that: (1) The offeror is either (i) an eligible contract participant, as defined in section 1a(18) of the Act, or (ii) offering or entering into the commodity trade option solely for purposes related to its business as a ''producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the'' trade option; and (2) the offeree is offered or entering into the commodity trade option solely for purposes related to its business as ''a producer, processor, or commercial user of, or a merchant handling the commodity that is the subject'' of the commodity trade option.

[97] 17 CFR 32.3.

[98] It may not be possible to compute a futures-equivalent basis for a trade option that does not have a fixed strike price. Thus, under this enumerated hedge, a market participant may not use a trade option as a basis for a bona fide hedging position until a fixed strike price reasonably may be determined. For example, a commodity trade option with a fixed strike price may be converted to a futures-equivalent basis, and, on that futures-equivalent basis, deemed a cash commodity sale contract, in the case of a short call option or long put option, or a cash commodity purchase contract, in the case of a long call option or short put option.

[99] The proposed inclusion of unfilled anticipated requirements for resale by a utility to its customers does not appear in the existing § 1.3 bona fide hedging definition. This provision is analogous to the unfilled anticipated requirements provision of existing paragraph (2)(ii)(C) of the existing bona fide hedging definition, except the commodity is not for use by the same person (that is, the utility), but rather for anticipated use by the utility's customers. This would recognize a bona fide hedging position where a utility is required or encouraged by its public utility commission to hedge.

[100] This is essentially a less-restrictive version of the five-day rule, allowing a participant to hold a position during the end of the spot period if economically appropriate, but only up to two months' worth of anticipated requirements. The two-month quantity limitation has long-appeared in existing § 1.3 as a measure to prevent the sourcing of massive quantities of the underlying in a short time period. 17 CFR 1.3.

[101] *See, e.g.,* 2016 Reproposal, 81 FR at 96751.

a commodity derivative contract to offset the anticipated change in value of the underlying commodity that the merchant anticipates purchasing or selling in the future. To safeguard against misuse, the enumerated hedge would be subject to certain conditions. First, the commodity derivative position must not exceed in quantity twelve months' of purchase or sale requirements of the same commodity that is anticipated to be merchandised. This requirement is intended to ensure that merchants are hedging their anticipated merchandising exposure to the value change of the underlying commodity, while calibrating the anticipated need within a reasonable timeframe and the limitations in physical commodity markets, such as annual production or processing capacity. Unlike in the enumerated hedge for unsold anticipated production, where the Commission is proposing to eliminate the twelve-month limitation, the Commission has preliminarily determined that a twelve-month limitation for anticipatory merchandising is suitable in connection with contracts that are based on anticipated activity on yet-to-be established cash positions due to the uncertainty of forecasting such activity and, all else being equal, the increased risk of excessive speculation on the price of a commodity the longer the time period before the actual need arises.

Second, the Commission is proposing to limit this enumerated hedge to merchants who are in the business of purchasing and selling the underlying commodity that is anticipated to be merchandised, and who can demonstrate that it is their historical practice to do so. Such demonstrated history should include a history of making and taking delivery of the underlying commodity, and a demonstration of an ability to store and move the underlying commodity. The Commission has a longstanding practice of providing exemptive relief to commercial market participants to enable physical commodity markets to continue to be well-functioning markets. The proposed anticipatory merchandising hedge requires that the person be a merchant handling the underlying commodity that is subject to the anticipatory merchandising hedge and that such merchant is entering into the anticipatory merchandising hedge solely for purposes related to its merchandising business. A merchandiser that lacks the requisite history of anticipatory merchandising activity could still potentially receive bona fide hedge recognition under the proposed non-enumerated process, so long as the merchandiser can otherwise show activities in the physical marketing channel, including, for example, arrangements to take or make delivery of the underlying commodity.

The Commission preliminarily believes that anticipated merchandising is a hedging practice commonly used by some commodity market participants, and that merchandisers play an important role in the physical supply chain. Positions which satisfy the requirements of this acceptable practice would thus conform to the general definition of bona fide hedging.

While each of the proposed enumerated hedges described above would be self-effectuating for purposes of federal limits, the Commission and the exchanges would continue to exercise close oversight over such positions to confirm that market participants' claimed exemptions are consistent with their cash-market activity. In particular, because all contracts subject to federal limits would also be subject to exchange-set limits, all traders seeking to exceed federal position limits would have to request an exemption from the relevant exchange for purposes of the exchange limit, regardless of whether the position falls within one of the enumerated hedges. In other words, enumerated bona fide hedge recognitions that are self-effectuating for purposes of federal limits would not be self-effectuating for purposes of exchange limits.

Exchanges have well-established programs for granting exemptions, including, in some cases, experience granting exemptions for anticipatory merchandising for certain traders in markets not currently subject to federal limits. As discussed in greater detail below, proposed § 150.5 [102] would ensure that such programs require, among other things, that: Exemption applications filed with an exchange include sufficient information to enable the exchange to determine, and the Commission to verify, whether the exchange may grant the exemption, including an indication of whether the position qualifies as an enumerated hedge for purposes of federal limits and a description of the applicant's activity in the underlying cash markets; and that the exchange provides the Commission with a monthly report showing the disposition of all exemption applications, including cash market information justifying the exemption. The Commission expects exchanges will be thoughtful and deliberate in granting exemptions, including anticipatory exemptions.

The Commission and the exchanges also have a variety of other tools designed to help prevent misuse of self-effectuating exemptions. For example, market participants who submit an application to an exchange as required under § 150.5 would be subject to the Commission's false statements authority that carries with it substantial penalties under both the CEA and federal criminal statutes.[103] Similarly, the Commission can use surveillance tools, special call authority, rule enforcement reviews, and other formal and informal avenues for obtaining additional information from exchanges and market participants in order to distinguish between true hedging needs and speculative trading masquerading as a bona fide hedge.

In the 2013 Proposal, the Commission previously addressed a petition for exemptive relief for 10 transactions described as bona fide hedging transactions by the Working Group of Commercial Energy Firms (which has since reconstituted itself as the ''Commercial Energy Working Group'') (''BFH Petition'').[104] In the 2013 Proposal, the Commission included examples Nos. 1, 2, 6, 7 (scenario 1), and 8 as being permitted under the proposed definition of bona fide hedging.

With respect to the rules proposed herein, the Commission has preliminarily determined that example #4 (binding, irrevocable bids or offers) and #5 (timing of hedging physical transactions) from the BFH Petition potentially fit within the proposed Appendix A paragraph (a)(11) enumerated hedge of anticipatory merchandising, so long as the transaction complies with each condition of that proposed enumerated hedge.

In addition, as discussed further below, because the Commission is also proposing to eliminate the five-day rule from the enumerated hedges to which the five-day rule currently applies, the Commission has preliminarily determined that example #9 (holding a cross-commodity hedge using a physical delivery contract into the spot month) and #10 (holding a cross-commodity hedge using a physical delivery contract to meet unfilled anticipated

[102] *See infra* Section II.D.4. (discussion of proposed § 150.5).

[103] CEA section 6(c)(2), 7 U.S.C. 9(2); CEA section 9(a)(3), 7 U.S.C. 13(a)(3); CEA section 9(a)(4), 7 U.S.C. 13(a)(4); 18 U.S.C. 1001.

[104] The Working Group BFH Petition is available at *http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgbfhpetition012012.pdf.*

requirements) from the BFH Petition potentially fit within the proposed Appendix A paragraph (a)(5) enumerated hedge, so long as the transaction otherwise complies with the additional conditions of all applicable enumerated hedges and other requirements.

Regarding examples #3 (unpriced physical purchase or sale commitments) and #7 (scenario 2) (use of physical delivery referenced contracts to hedge physical transactions using calendar month average pricing), while the Commission has preliminarily determined that the positions described within those examples do not fit within any of the proposed enumerated hedges, market participants seeking bona fide hedge recognition for such positions may apply for a non-enumerated recognition under proposed §§ 150.3 or 150.9, and a facts and circumstances decision would be made.[105] As included in the request for comment on this section, the Commission requests additional information on the scenarios listed above, particularly for the positions that the Commission preliminarily views as falling outside the proposed list of enumerated hedges.

iv. Elimination of a Federal Five Day Rule

Under the existing bona fide hedging definition in § 1.3, to help protect orderly trading and the integrity of the physical-delivery process, certain enumerated hedging positions in physical-delivery contracts are not recognized as bona fide hedges that may exceed limits when the position is held during the last five days of trading during the spot month. The goal of the five-day rule is to help ensure that only those participants who actually intend to make or take delivery maintain positions toward the end of the spot period.[106] When the Commission adopted the five-day rule, it believed that, as a general matter, there is little commercial need to maintain such positions in the last five days.[107] However, persons wishing to exceed position limits during the five last trading days could submit materials supporting a classification of the position as a bona fide hedge, based on the particular facts and circumstances.[108]

The Commission has viewed the five-day rule as an important way to help ensure that futures and cash-market prices converge and to prevent excessive speculation as a physical-delivery contract nears expiration, thereby protecting the integrity of the delivery process and the price discovery function of the market, and deterring or preventing types of market manipulations such as corners and squeezes. The enumerated hedges currently subject to the five-day rule are either: (i) Anticipatory in nature; or (ii) involve a situation where there is no need to make or take delivery. The Commission has historically questioned the need for such positions in excess of limits to be held into the spot period if the participant has no immediate plans and/or need to make or take delivery in the few remaining days of the spot period.[109]

While the Commission continues to believe that the justifications described above for the existing five-day rule remain valid, the Commission has preliminarily determined that for contracts subject to federal limits, the exchanges, subject to Commission oversight, are better positioned to decide whether to apply the five-day rule in connection with their own exchange-set limits, or whether to apply other tools that may be equally effective. Accordingly, consistent with this proposal's focus on leveraging existing exchange practices and expertise when appropriate, the Commission proposes to eliminate the five-day rule from the enumerated hedges to which the five-day rule currently applies, and instead to afford exchanges with the discretion to apply, and when appropriate, waive the five-day rule (or similar restrictions) for purposes of their own limits.

Allowing for such discretion will afford exchanges flexibility to quickly impose, modify, or waive any such limitation as circumstances dictate. While a strict five day rule may be inappropriate in certain circumstances, including when applied to energy contracts that typically have a shorter spot period than agricultural contracts,[110] the flexible approach allowed for herein may allow for the development and implementation of additional solutions other than a five-day rule that protect convergence while minimizing the impact on market participants. The proposed approach would allow exchanges to design and tailor a variety of limitations to protect convergence during the spot period. For example, in certain circumstances, a smaller quantity restriction, rather than a complete restriction on holding positions in excess of limits during the spot period, may be effective at protecting convergence. Similarly, exchanges currently utilize other tools to achieve similar policy goals, such as by requiring market participants to "step down" the levels of their exemptions as they approach the spot period, or by establishing exchange-set speculative position limits that include a similar step down feature. As proposed § 150.5(a) would require that any exchange-set limits for contracts subject to federal limits must be less than or equal to the federal limit, any exchange application of the five day rule, or a similar restriction, would have the same effect as if administered by the Commission for purposes of federal speculative position limits.

The Commission expects that exchanges would closely scrutinize any participant who requests a recognition during the last five days of the spot period or in the time period for the spot month.

To assist exchanges that wish to establish a five-day rule, or a similar provision, the Commission proposes guidance in paragraph (b) of Appendix B that would set forth circumstances when a position held during the spot period may still qualify as a bona fide hedge. The guidance would provide that a position held during the spot period may still qualify as a bona fide hedging position, provided that, among other things: (1) The position complies with the bona fide hedging definition; and (2) there is an economically appropriate need to maintain such position in excess of federal speculative position limits during the spot period, and that need relates to the purchase or sale of a cash commodity.[111]

In addition, the guidance would provide that the person wishing to exceed federal position limits during the spot period: (1) Intends to make or take delivery during that period; (2) provides materials to the exchange supporting the waiver of the five-day rule; (3)

[105] Similarly, other examples of anticipatory merchandising that have been described to the Commission in response to request for comment on proposed rulemakings on position limits (*i.e.,* the storage hedge and hedges of assets owned or anticipated to be owned) would be the type of transactions that market participants may seek through one of the proposed processes for requesting a non-enumerated bona fide hedge recognition.

[106] Paragraphs (2)(i)(B), (ii)(C), (iii), and (iv) of the existing § 1.3 bona fide hedging definition are subject to some form of the five-day rule.

[107] Definition of Bona Fide Hedging and Related Reporting Requirements, 42 FR 42748, 42750 (Aug. 24, 1977).

[108] *Id.*

[109] *See, e.g.,* 42 FR at 42749.

[110] Energy contracts typically have a three-day spot period, whereas the spot period for agricultural contracts is typically two weeks.

[111] For example, an economically appropriate need for soybeans would mean obtaining soybeans from a reasonable source (considering the marketplace) that is the least expensive, at or near the location required for the purchaser, and that such sourcing does not cause market disruptions or prices to spike.

demonstrates supporting cash-market exposure in-hand that is verified by the exchange; (4) demonstrates that, for short positions, the delivery is feasible, meaning that the person has the ability to deliver against the short position;[112] and (5) demonstrates that, for long positions, the delivery is feasible, meaning that the person has the ability to take delivery at levels that are economically appropriate.[113] This proposed guidance is intended to include a non-exclusive list of considerations for determining whether to waive a five-day rule established at the discretion of an exchange.

v. Guidance on Measuring Risk

In prior proposals involving position limits, the Commission discussed the issue of whether the Commission may recognize as bona fide both ''gross hedging'' and ''net hedging.''[114] Such attempts reflected the Commission's longstanding preference for net hedging, which, although not stated explicitly in prior releases, has been underpinned by a concern that unfettered recognition of gross hedging could potentially allow for the cherry picking of positions in a manner that subverts the position limits rules.[115]

In an effort to clarify its current view on this issue, the Commission proposes guidance in paragraph (a) to Appendix B. The Commission is of the preliminary view that there are myriad ways in which organizations are structured and engage in commercial hedging practices, including the use of multi-line business strategies in certain industries that would be subject to federal limits for the first time under this proposal. Accordingly, the Commission does not propose a one-size-fits-all approach to the manner in which risk is measured across an organization.

The proposed guidance reflects the Commission's historical practice of recognizing positions hedged on a net basis as bona fide;[116] however, as the Commission has also previously allowed, the proposed guidance also may in certain circumstances allow for the recognition of gross hedging as bona fide, provided that: (1) The manner in which the person measures risk is consistent over time and follows a person's regular, historical practice[117] (meaning the person is not switching between net hedging and gross hedging on a selective basis simply to justify an increase in the size of his/her derivatives positions); (2) the person is not measuring risk on a gross basis to evade the limits set forth in proposed § 150.2 and/or the aggregation rules currently set forth in § 150.4; (3) the person is able to demonstrate (1) and (2) to the Commission and/or an exchange upon request; and (4) an exchange that recognizes a particular gross hedging position as a bona fide hedge pursuant to proposed § 150.9 documents the justifications for doing so and maintains records of such justifications in accordance with proposed § 150.9(d).

The Commission continues to believe that a gross hedge may be a bona fide hedge in circumstances where net cash positions do not necessarily measure total risk exposure due to differences in the timing of cash commitments, the location of stocks, and differences in grades or types of the cash commodity.[118] However, the Commission clarifies that these may not be the only circumstances in which gross hedging may be recognized as bona fide. Like the analysis of whether a particular position satisfies the proposed bona fide hedge definition, the analysis of whether gross hedging may be utilized would involve a case-by-case determination made by the Commission and/or by an exchange using its expertise and knowledge of its participants as it considers applications under § 150.9, subject to Commission review and oversight.

The Commission believes that permitting market participants with bona fide hedges to use either or both gross or net hedging will help ensure that market participants are able to hedge efficiently. Large, complex entities may have hedging needs that cannot be efficiently and effectively met with either gross or net hedging. For instance, some firms may hedge on a global basis while others may hedge by trading desk or business line. Some risks that appear offsetting may in fact need to be treated separately where a difference in delivery location or date makes net hedging of those positions inappropriate.

To prevent ''cherry-picking'' when determining whether to gross or net hedge certain risks, hedging entities should have policies and procedures setting out when gross and net hedging is appropriate. Consistent usage of appropriate gross and/or net hedging in line with such policies and procedures can demonstrate compliance with the Commission's regulations. On the other hand, usage of gross or net hedging that is inconsistent with an entity's policies or a change from gross to net hedging (or vice versa) could be an indication that an entity is seeking to evade position limits regulations.

vi. Pass-Through Provisions

As the Commission has noted above, CEA section 4a(c)(2)(B)[119] further contemplates bona fide hedges that by themselves do not meet the criteria of CEA section 4a(c)(2)(A), but that are executed by a pass-through swap counterparty opposite a bona fide hedging swap counterparty, or used by a bona fide hedging swap counterparty to offset its swap exposure that does satisfy CEA section 4a(c)(2)(A).[120] The

[112] That is, the person has inventory on-hand in a deliverable location and in a condition in which the commodity can be used upon delivery.

[113] That is, the delivery comports with the person's demonstrated need for the commodity, and the contract is the cheapest source for that commodity.

[114] *Id.* at 96747.

[115] For example, using gross hedging, a market participant could potentially point to a large long cash position as justification for a bona fide hedge, even though the participant, or an entity with which the participant is required to aggregate, has an equally large short cash position that would result in the participant having no net price risk to hedge as the participant had no price risk exposure to the commodity prior to establishing such derivative position. Instead, the participant created price risk exposure to the commodity by establishing the derivative position.

[116] *See* 2016 Reproposal, 81 FR at 96747 (stating that gross hedging was economically appropriate in circumstances where ''net cash positions do not necessarily measure total risk exposure due to differences in the timing of cash commitments, the location of stocks, and differences in grades or the types of cash commodity.'') *See also* Bona Fide Hedging Transactions or Positions, 42 FR at 14832, 14834 (Mar. 16, 1977) and Definition of Bona Fide Hedging and Related Reporting Requirements, 42 FR 42748, 42750 (Aug. 24, 1977).

[117] This proposed guidance on measuring risk is consistent in many ways with the manner in which the exchanges require their participants to measure and report risk, which is consistent with the Commission's requirements with respect to the reporting of risk. For example, under § 17.00(d), futures commission merchants (''FCMs''), clearing members, and foreign brokers are required to report certain reportable net positions, while under § 17.00(e), such entities may report gross positions in certain circumstances, including if the positions are reported to an exchange or the clearinghouse on a gross basis. 17 CFR 17.00. The Commission's understanding is that certain exchanges generally prefer, but do not require, their participants to report positions on a net basis. For those participants that elect to report positions on a gross basis, such exchanges require such participants to continue reporting that way, particularly through the spot period. The Commission preliminarily believes that such consistency is a strong indicator that the participant is not measuring risk on a gross basis simply to evade regulatory requirements.

[118] *See, e.g.,* Bona Fide Hedging Transactions or Positions, 42 FR at 14834.

[119] 7 U.S.C. 6a(c)(2)(B).

[120] CEA section 4a(c)(2)(B)(i) recognizes as a bona fide hedging position a position that reduces risk attendant to a position resulting from a swap that was executed opposite a counterparty for which the transaction would qualify as a bona fide hedging transaction pursuant to 4a(c)(2)(A). 7 U.S.C. 6a(c)(2)(B)(i). CEA section 4a(c)(2)(B)(ii) further recognizes as bona fide positions that reduce risks attendant to a position resulting from a swap that meets the requirements of 4a(c)(2)(A). 7 U.S.C. 6a(c)(2)(B)(ii).

Commission preliminarily believes that, in affording bona fide hedging recognition to positions used to offset exposure opposite a bona fide hedging swap counterparty, Congress in CEA section 4a(c)(2)(B) intended: (1) To encourage the provision of liquidity to commercial entities that are hedging physical commodity price risk in a manner consistent with the bona fide hedging definition; but also (2) to prohibit risk management positions that are not opposite a bona fide hedging swap counterparty from being recognized as bona fide hedges.[121]

The Commission proposes to implement this pass-through swap language in paragraph (2) of the bona fide hedging definition for physical commodities in proposed § 150.1. Each component of the proposed pass-through swap provision is described in turn below.

Proposed paragraph (2)(i) of the bona fide hedging definition would address a situation where a particular swap qualifies as a bona fide hedge by satisfying the temporary substitute test, economically appropriate test, and change in value requirement under proposed paragraph (1) for one of the counterparties (the ''bona fide hedging swap counterparty''), but not for the other counterparty, and where those bona fides ''pass through'' from the bona fide hedging swap counterparty to the other counterparty (the ''pass-through swap counterparty''). The pass-through swap counterparty could be an entity such as a swap dealer, for example, that provides liquidity to the bona fide hedging swap counterparty.

Under the proposed rule, the pass-through of the bona fides from the bona fide hedging swap counterparty to the pass-through swap counterparty would be contingent on: (1) The pass-through swap counterparty's ability to demonstrate that the pass-through swap is a bona fide hedge upon request from the Commission and/or from an exchange; [122] and (2) the pass-through swap counterparty entering into a futures, option on a futures, or swap position in the same physical commodity as the pass-through swap to offset and reduce the price risk attendant to the pass-through swap.

If the two conditions above are satisfied, then the bona fides of the bona fide hedging swap counterparty ''pass through'' to the pass-through swap counterparty for purposes of recognizing as a bona fide hedge any futures, options on futures, or swap position entered into by the pass-through swap counterparty to offset the pass-through swap (*i.e.* to offset the swap opposite the bona fide hedging swap counterparty). The pass-through swap counterparty could thus exceed federal limits for the bona fide hedge swap opposite the bona fide hedging swap counterparty and for any offsetting futures, options on futures, or swap position in the same physical commodity, even though any such position on its own would not qualify as a bona fide hedge for the pass-through swap counterparty under proposed paragraph (1).

Proposed paragraph (2)(ii) of the bona fide hedging definition would address a situation where a participant who qualifies as a bona fide hedging swap counterparty (*i.e.,* a counterparty with a position in a previously-entered into swap that qualified, at the time the swap was entered into, as a bona fide hedge under paragraph (1)) seeks, at some later time, to offset that bona fide hedge swap position using futures, options on futures, or swaps in excess of limits. Such step might be taken, for example, to respond to a change in the bona fide hedging swap counterparty's risk exposure in the underlying commodity.[123] Proposed paragraph (2)(ii) would allow such a bona fide hedging swap counterparty to use futures, options on futures, or swaps in excess of federal limits to offset the price risk of the previously-entered into swap, even though the offsetting position itself does not qualify for that participant as a bona fide hedge under paragraph (1).

The proposed pass-through exemption under paragraph (2) would only apply to the pass-through swap counterparty's offset of the bona fide hedging swap, and/or to the bona fide hedging swap counterparty's offset of its bona fide hedging swap. Any further offsets would not be eligible for a pass-through exemption under (2) unless the offsets themselves meet the bona fide hedging definition. For instance, if Producer A enters into an OTC swap with Swap Dealer B, and the OTC swap qualifies as a bona fide hedge for Producer A, then Swap Dealer B could be eligible for a pass-through exemption to offset that swap in the futures market. However, if Swap Dealer B offsets its swap opposite Producer A using an OTC swap with Swap Dealer C, Swap Dealer C would not be eligible for a pass-through exemption.

As discussed more fully above, the pass-through swap provision may help mitigate some of the potential impact resulting from the removal of the ''risk management'' exemptions that are currently in effect.[124]

2. ''Commodity Derivative Contract''

The Commission proposes to create the defined term ''commodity derivative contract'' for use throughout part 150 of the Commission's regulations as shorthand for any futures contract, option on a futures contract, or swap in a commodity (other than a security futures product as defined in CEA section 1a(45)).

3. ''Core Referenced Futures Contract''

The Commission proposes to provide a list of 25 futures contracts in proposed § 150.2(d) to which proposed position limit rules would apply. The Commission proposes the term ''core referenced futures contract'' as a short-hand phrase to denote such contracts.[125] As per the ''referenced contract'' definition described below, position limits would also apply to any contract that is directly/indirectly linked to, or that has certain pricing relationships with, a core referenced futures contract.

4. ''Economically Equivalent Swap''

CEA section 4a(a)(5) requires that when the Commission imposes limits on futures and options on futures pursuant to CEA section 4a(a)(2), the Commission also establish limits simultaneously for ''economically equivalent'' swaps ''as appropriate.'' [126]

[121] As described above, the Commission has preliminarily interpreted the revised statutory temporary substitute test as limiting its authority to recognize risk management positions as bona fide hedges unless the position is used to offset exposure opposite a bona fide hedging swap counterparty.

[122] While proposed paragraph (2)(i) of the bona fide hedging definition in § 150.1 would require the pass-through swap counterparty to be able to demonstrate the bona fides of the pass-through swap upon request, the proposed rule would not prescribe the manner by which the pass-through swap counterparty obtains the information needed to support such a demonstration. The pass-through swap counterparty could base such a demonstration on a representation made by the bona fide hedging swap counterparty, and such determination may be made at the time when the parties enter into the swap, or at some later point. For the bona fides to pass-through as described above, the swap position need only qualify as a bona fide hedging position at the time the swap was entered into.

[123] Examples of a change in the bona fide hedging swap counterparty's cash market price risk could include a change in the amount of the commodity that the hedger will be able to deliver due to drought, or conversely, higher than expected yield due to growing conditions.

[124] *See supra* Section II.A.1.c.ii.(1) (discussion of the temporary substitute test).

[125] The selection of the proposed core referenced futures contracts is explained below in the discussion of proposed § 150.2.

[126] CEA section 4a(a)(5); 7 U.S.C. 6a(a)(5). In addition, CEA section 4a(a)(4) separately authorizes, but does not require, the Commission to impose federal limits on swaps that meet certain statutory criteria qualifying them as ''significant price discovery function'' swaps. 7 U.S.C. 6a(a)(4). The Commission reiterates, for the avoidance of

As the statute does not define the term ''economically equivalent,'' the Commission must apply its expertise in construing such term, and, as discussed further below, must do so consistent with the policy goals articulated by Congress, including in CEA sections 4a(a)(2)(C) and 4a(a)(3).

Under the Commission's proposed definition of an ''economically equivalent swap,'' a swap on any referenced contract (including core referenced futures contracts), except for natural gas referenced contracts, would qualify as ''economically equivalent'' with respect to that referenced contract so long as the swap shares identical ''material'' contractual specifications, terms, and conditions with the referenced contract, disregarding any differences with respect to: (i) Lot size or notional amount, (ii) delivery dates diverging by less than one calendar day (if the swap and referenced contract are physically-settled), or (iii) post-trade risk management arrangements.[127] For reasons described further below, natural gas swaps would qualify as economically equivalent with respect to a particular referenced contract under the same circumstances, except that physically-settled swaps with delivery dates diverging by less than *two* calendar days, rather than one calendar day, could qualify as economically equivalent.

In promulgating the position limits framework, Congress instructed the Commission to consider several factors: First, CEA section 4a(a)(3) requires the Commission when establishing federal limits, to the maximum extent practicable, in its discretion, to (i) diminish, eliminate, or prevent excessive speculation; (ii) deter and prevent market manipulation, squeezes, and corners; (iii) ensure sufficient market liquidity for bona fide hedgers; and (iv) ensure that the price discovery function of the underlying market is not disrupted. Second, CEA section 4a(a)(2)(C) requires the Commission to strive to ensure that any limits imposed by the Commission will not cause price discovery in a commodity subject to federal limits to shift to trading on a foreign exchange.

Accordingly, any definition of ''economically equivalent swap'' must consider these statutory objectives. The Commission also recognizes that physical commodity swaps are largely bilaterally negotiated, traded off-exchange (*i.e.,* OTC), and potentially include customized (*i.e.,* ''bespoke'') terms, while futures contracts are exchange traded with standardized terms. As explained further below, due to these differences between swaps and exchange-traded futures and options, the Commission has preliminarily determined that Congress's underlying policy goals in CEA section 4a(a)(2)(C) and (3) are best achieved by proposing a narrow definition of ''economically equivalent swaps,'' compared to the broader definition of ''referenced contract'' the Commission is proposing to apply to look-alike futures and related options.[128]

The Commission's proposed ''referenced contract'' definition in § 150.1 would include ''economically equivalent swaps,'' meaning any economically equivalent swap would be subject to federal limits, and thus would be required to be added to, and could be netted against, as applicable, other referenced contracts in the same commodity for the purpose of determining one's aggregate positions for federal position limit levels.[129] Any swap that is not deemed economically equivalent would not be a referenced contract, and thus could not be netted with referenced contracts nor would be required to be aggregated with any referenced contract for federal position limits purposes. The proposed definition is based on a number of considerations.

First, the proposed definition would support the statutory objectives in CEA section 4a(a)(3)(i) and (ii) by helping to prevent excessive speculation and market manipulation, including corners and squeezes, by: (1) Focusing on swaps that are the most economically equivalent in every significant way to futures or options on futures for which the Commission deems position limits to be necessary;[130] and (2) simultaneously limiting the ability of speculators to obtain excessive positions through netting. Any swap that meets the proposed definition would offer identical risk sensitivity to its associated referenced futures or options on futures contract with respect to the underlying commodity, and thus could be used to effect a manipulation, benefit from a manipulation, or otherwise potentially distort prices in the same or similar manner as the associated futures or options on futures contract.

Because OTC swaps are bilaterally negotiated and customizable, the Commission has preliminarily determined not to propose a more inclusive ''economically equivalent swap'' definition that would encompass additional swaps because such definition could make it easier for market participants to inappropriately net down against their core referenced futures contracts by allowing market participants to structure swaps that do not necessarily offer identical risk or economic exposure or sensitivity. In contrast, the Commission preliminarily believes that this is less of a concern with exchange-traded futures and related options since these instruments have standardized terms and are subject to exchange rules and oversight. As a result, the proposal would generally allow market participants to net certain positions in referenced contracts in the same commodity across economically equivalent swaps, futures, and options on futures, but the proposed economically equivalent swap definition would focus on swaps with identical material terms and conditions in order to reduce the ability of market participants to accumulate large, speculative positions in excess of federal limits by using tangentially-related (*i.e.,* non-identical) swaps to net down such positions.

Second, the proposed definition would address statutory objectives by focusing federal limits on those swaps that pose the greatest threat for facilitating corners and squeezes—that is, those swaps with similar delivery

doubt, that the definitions of ''economically equivalent'' in CEA section 4a(a)(5) and ''significant price discovery function'' in CEA section 4a(a)(4) are separate concepts and that contracts can be economically equivalent without serving a significant price discovery function. *See* 2016 Reproposal, 81 FR at 96736 (the Commission noting that certain commenters may have been confusing the two definitions).

[127] The proposed ''economically equivalent'' language is distinct from the terms ''futures equivalent,'' ''economically appropriate,'' and other similar terms used in the Commission's regulations. For the avoidance of doubt, the Commission's proposed definition of ''economically equivalent swap'' for the purposes of CEA section 4a(a)(5) does not impact the application of any such other terms as they appear in part 20 of the Commission's regulations, in the Commission's proposed bona fide hedge definition, or elsewhere.

[128] The proposed definition of ''referenced contract'' would incorporate cash-settled look-alike futures contracts and related options that are either (i) directly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to, the price of that particular core referenced futures contract; or (ii) directly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to, the price of the same commodity underlying that particular core referenced futures contract for delivery at the same location or locations as specified in that particular core referenced futures contract. *See infra* Section II.A.16. (definition of ''referenced contract''). The proposed definition of ''economically equivalent swap'' would be included as a type of ''referenced contract,'' but, as discussed herein, would include a relatively narrower class of swaps compared to look-alike futures and options contracts, for the reasons discussed below.

[129] *See infra* Section II.B.2.k. (discussion of netting).

[130] *See infra* Section III.F. (necessity finding).

dates and identical material economic terms to futures and options on futures subject to federal limits—while also minimizing market impact and liquidity for bona fide hedgers by not unnecessarily subjecting other swaps to the new federal framework. For example, if the Commission were to adopt an alternative definition of economically equivalent swap that encompassed a broader range of swaps by including delivery dates that diverge by one or more calendar days—perhaps by several days or weeks—a speculator with a large portfolio of swaps may be more likely to be constrained by the applicable position limits and therefore may have an incentive either to minimize its swaps activity, or move its swaps activity to foreign jurisdictions. If there were many similarly situated speculators, the market for such swaps could become less liquid, which in turn could harm liquidity for bona fide hedgers. As a result, the Commission has preliminarily determined that the proposed definition's relatively narrow scope of swaps reasonably balances the factors in CEA section 4a(a)(3)(B)(ii) and (iii) by decreasing the possibility of illiquid markets for bona fide hedgers on the one hand while, on the other hand, focusing on the prevention of market manipulation during the most sensitive period of the spot month as discussed above.

Third, the proposed definition would help prevent regulatory arbitrage and would strengthen international comity. If the Commission proposed a definition that captured a broader range of swaps, U.S.-based swaps activity could potentially migrate to other jurisdictions with a narrower definition, such as the European Union (''EU''). In this regard, the proposed definition is similar in certain ways to the EU definition for OTC contracts that are ''economically equivalent'' to commodity derivatives traded on an EU trading venue.[131] The proposed definition of economically equivalent swaps thus furthers statutory goals, including those set forth in CEA section 4a(a)(2)(C), which requires the Commission to strive to ensure that any federal position limits are ''comparable'' to foreign exchanges and will not cause ''price discovery . . . to shift to trading'' on foreign exchanges.[132] Further, market participants trading in both U.S. and EU markets should find the proposed definition to be familiar, which may help reduce compliance costs for those market participants that already have systems and personnel in place to identify and monitor such swaps.

Each element of the proposed definition, as well as the proposed exclusions from the definition, is described below.

a. Scope of Identical Material Terms

Only ''material'' contractual specifications, terms, and conditions would be relevant to the analysis of whether a particular swap would qualify as an economically equivalent swap. The proposed definition would thus not require that a swap be identical in all respects to a referenced contract in order to be deemed ''economically equivalent.'' ''Material'' specifications, terms, and conditions would be limited to those provisions that drive the economic value of a swap, including with respect to pricing and risk. Examples of ''material'' provisions would include, for example: The underlying commodity, including commodity reference price and grade differentials; maturity or termination dates; settlement type (*e.g.,* cash- versus physically-settled); and, as applicable for physically-delivered swaps, delivery specifications, including commodity quality standards or delivery locations.[133] Because settlement type would be considered to be a material ''contractual specification, term, or condition,'' a cash-settled swap could only be deemed economically equivalent to a cash-settled referenced contract, and a physically-settled swap could only be deemed economically equivalent to a physically-settled referenced contract; however, a cash-settled swap that initially did not qualify as ''economically equivalent'' due to no corresponding cash-settled referenced contract (*i.e.,* no cash-settled look-alike futures contract), could subsequently become an ''economically equivalent swap'' if a cash-settled futures contract market were to develop. In addition, a swap that either references another referenced contract, or incorporates its terms by reference, would be deemed to share identical terms with the referenced contract and therefore would qualify as an economically equivalent swap.[134] Any change in the material terms of such a swap, however, would render the swap no longer economically equivalent for position limits purposes.[135]

In contrast, the Commission generally would consider those swap contractual terms, provisions, or terminology (*e.g.,* ISDA terms and definitions) that are unique to swaps (whether standardized

[131] *See* EU Commission Delegated Regulation (EU) 2017/591, 2017 O.J. (L 87). The applicable European regulations define an OTC derivative to be ''economically equivalent'' when it has ''identical contractual specifications, terms and conditions, excluding different lot size specifications, delivery dates diverging by less than one calendar day and different post trade risk management arrangements.'' While the Commission's proposed definition is similar, the Commission's proposed definition requires ''identical *material*'' terms rather than ''identical'' terms. Further, the Commission's proposed definition excludes different ''lot size specifications or *notional amounts*'' rather than referencing only ''lot size'' since swaps terminology usually refers to ''notional amounts'' rather than to ''lot sizes.''

Both the Commission's definition and the applicable EU regulation are intended to prevent harmful netting. *See* European Securities and Markets Authority, *Draft Regulatory Technical Standards on Methodology for Calculation and the Application of Position Limits for Commodity Derivatives Traded on Trading Venues and Economically Equivalent OTC Contracts,* ESMA/2016/668 at 10 (May 2, 2016), *available at https://www.esma.europa.eu/sites/default/files/library/2016–668_opinion_on_draft_rts_21.pdf* (''[D]rafting the [economically equivalent OTC swap] definition in too wide a fashion carries an even higher risk of enabling circumvention of position limits by creating an ability to net off positions taken in on-venue contracts against only roughly similar OTC positions.'').

The applicable EU regulator, the European Securities and Markets Authority (''ESMA''), recently released a ''consultation paper'' discussing the status of the existing EU position limits regime and specific comments received from market participants. According to ESMA, no commenter, with one exception, supported changing the definition of an economically equivalent swap (referred to as an ''economically equivalent OTC contract'' or ''EEOTC''). ESMA further noted that for some respondents, ''the mere fact that very few EEOTC contracts have been identified is no evidence that the regime is overly restrictive.'' *See* European Securities and Markets Authority, *Consultation Paper MiFID Review Report on Position Limits and Position Management Draft Technical Advice on Weekly Position Reports,* ESMA70–156–1484 at 46, Question 15 (Nov. 5, 2019), *available at https://www.esma.europa.eu/document/consultation-paper-position-limits.*

[132] 7 U.S.C. 6a(a)(2)(C).

[133] When developing its definition of an ''economically equivalent swap,'' the Commission, based on its experience, preliminarily has determined that for a swap to be ''economically equivalent'' to a futures contract, the material contractual specifications, terms, and conditions would need to be identical. In making this determination, the Commission took into account, in regards to the economics of swaps, how a swap and a corresponding futures contract or option on a futures contract react to certain market factors and movements, the pricing variables used in calculating each instrument, the sensitivities of those variables, the ability of a market participant to gain the same type of exposures, and how the exposures move to changes in market conditions.

[134] For example, a cash-settled swap that either settles to the pricing of a corresponding cash-settled referenced contract, or incorporates by reference the terms of such referenced contract, could be deemed to be economically equivalent to the referenced contract.

[135] The Commission preliminarily recognizes that the material swap terms noted above are essential to determining the pricing and risk profile for swaps. However, there may be other contractual terms that also may be important for the counterparties but not necessarily ''material'' for purposes of position limits. For example, as discussed below, certain other terms, such as clearing arrangements or governing law, may not be material for the purpose of determining economic equivalence for federal position limits, but may nonetheless affect pricing and risk or otherwise be important to the counterparties.

or bespoke) not to be material for purposes of determining whether a swap is economically equivalent to a particular referenced contract. For example, swap provisions or terms designating business day or holiday conventions, day count (*e.g.,* 360 or actual), calculation agent, dispute resolution mechanisms, choice of law, or representations and warranties are generally unique to swaps and/or otherwise not material, and therefore would not be dispositive for determining whether a swap is economically equivalent.[136]

The Commission is unable to publish a list of swaps it would deem to be economically equivalent swaps because any such determination would involve a facts and circumstances analysis, and because most commodity swaps are created bilaterally between counterparties and traded OTC. Absent a requirement that market participants identify their economically equivalent swaps to the Commission on a regular basis, the Commission preliminarily believes that market participants are best positioned to determine whether particular swaps share identical material terms with referenced contracts and would therefore qualify as ''economically equivalent'' for purposes of federal position limits. However, the Commission understands that for certain bespoke swaps it may be unclear whether the facts and circumstances would demonstrate whether the swap qualifies as ''economically equivalent'' with respect to a referenced contract.

The Commission emphasizes that under this proposal, market participants would have the discretion to make such determination as long as they make a reasonable, good faith effort in reaching their determination, and that the Commission would not bring any enforcement action for violating the Commission's speculative position limits against such market participants as long as the market participant performed the necessary due diligence and is able to provide sufficient evidence, if requested, to support its reasonable, good faith effort.[137] Because market participants would be provided with discretion in making any ''economically equivalent'' swap determination, the Commission preliminarily anticipates that this flexibility should provide a greater level of certainty to market participants in contrast to the alternative in which market participants would be required to first submit swaps to the Commission staff and wait for feedback.[138]

b. Exclusions From the Definition of ''Economically Equivalent Swap''

As noted above, the Commission's proposed definition would expressly provide that differences in lot size or notional amount, delivery dates diverging by less than one calendar day (or less than two calendar days for natural gas), or post-trade risk management arrangements would not disqualify a swap from being deemed to be ''economically equivalent'' to a particular referenced contract.

i. Delivery Dates Diverging by Less Than One Calendar Day

The proposed definition as it applies to commodities other than natural gas would encompass swaps with delivery dates that diverge by less than one calendar day from that of a referenced contract.[139] As a result, a swap with a delivery date that differs from that of a referenced contract by one calendar day or more would not be deemed to be economically equivalent under the Commission proposal, and such swaps would not be required to be added to, nor permitted to be netted against, any referenced contract when calculating one's compliance with federal position limit levels.[140] The Commission recognizes that while a penultimate contract may be significantly correlated to its corresponding spot-month contract, it does not necessarily offer identical economic or risk exposure to the spot-month contract, and depending on the underlying commodity and market conditions, a market participant may open itself up to material basis risk by moving from the spot-month contract to a penultimate contract. Accordingly, the Commission has preliminarily determined that it would not be appropriate to permit market participants to net such penultimate positions against their core referenced futures contract positions since such positions do not necessarily reflect equivalent economic or risk exposure.

ii. Post-Trade Risk Management

The Commission is specifically excluding differences in post-trade risk management arrangements, such as clearing or margin, in determining whether a swap is economically equivalent. As noted above, many commodity swaps are traded OTC and may be uncleared or cleared at a different clearing house than the corresponding referenced contract.[141] Moreover, since the core referenced futures contracts, along with futures contracts and options on futures in general, are traded on DCMs with vertically integrated clearing houses, as a practical matter, it is impossible for OTC commodity swaps, which historically have been uncleared, to share identical post-trade clearing house or other post-trade risk management arrangements with their associated core referenced futures contracts.

Therefore, if differences in post-trade risk management arrangements were sufficient to exclude a swap from economic equivalence to a core

[136] Commodity swaps, which generally are traded OTC, are less standardized compared to exchange-traded futures and therefore must include these provisions in an ISDA master agreement between counterparties. While certain provisions, for example choice of law, dispute resolution mechanisms, or the general representations made in an ISDA master agreement, may be important considerations for the counterparties, the Commission would not deem such provisions material for purposes of determining economic equivalence under the federal position limits framework for the same reason the Commission would not deem a core referenced futures contract and a look-alike referenced contract to be economically different, even though the look-alike contract may be traded on a different exchange with different contractual representations, governing law, holidays, dispute resolution processes, or other provisions unique to the exchanges. Similarly, with respect to day counts, a swap could designate a day count that is different than the day count used in a referenced contract but adjust relevant swap economic terms (*e.g.,* relevant rates or payments, fees, basis, etc.) to achieve the same economic exposure as the referenced contract. In such a case, the Commission may not find such differences to be material for purposes of determining the swap to be economically equivalent for federal position limits purposes.

[137] As noted below, the Commission reserves the authority under this proposal to determine that a particular swap or class of swaps either is or is not ''economically equivalent'' regardless of a market participant's determination. *See infra* Section II.A.4.d. (discussion of commission determination of economic equivalence). As long as the market participant made its determination, prior to such Commission determination, using reasonable, good faith efforts, the Commission would not take any enforcement action for violating the Commission's position limits regulations if the Commission's determination differs from the market participant's.

[138] As discussed under Section II.A.16. (definition of ''referenced contract''), the Commission proposes to include a list of futures and related options that qualify as referenced contracts because such contracts are standardized and published by exchanges. In contrast, since swaps are largely bilaterally negotiated and OTC traded, a swap could have multiple permutations and any published list of economically equivalent swaps would be unhelpful or incomplete.

[139] This aspect of the proposed definition would be irrelevant for cash-settled swaps since ''delivery date'' applies only to physically-settled swaps.

[140] A swap as so described that is not ''economically equivalent'' would not be subject to a federal speculative position limit under this proposal.

[141] Similar to the Commission's understanding of ''material'' terms, the Commission construes ''post-trade risk management arrangements'' to include various provisions included in standard swap agreements, including, for example: Margin or collateral requirements, including with respect to initial or variation margin; whether a swap is cleared, uncleared, or cleared at a different clearing house than the applicable referenced contract; close-out, netting, and related provisions; and different default or termination events and conditions.

referenced futures contract, then such an exclusion could otherwise render ineffective the Commission's statutory directive under CEA section 4a(a)(5) to include economically equivalent swaps within the federal position limits framework. Accordingly, the Commission has preliminarily determined that differences in post-trade risk management arrangements should not prevent a swap from qualifying as economically equivalent with an otherwise materially identical referenced contract.

iii. Lot Size or Notional Amount

The last exclusion would clarify that differences in lot size or notional amount would not prevent a swap from being deemed to be economically equivalent to its corresponding referenced contract. The Commission's use of ''lot size'' and ''notional amount'' refer to the same general concept—while futures terminology usually employs ''lot size,'' swap terminology usually employs ''notional amount.'' Accordingly, the Commission proposes to use both terms to convey the same general meaning, and in this context does not mean to suggest a substantive difference between the two terms.

c. Economically Equivalent Natural Gas Swaps

Market dynamics in natural gas are unique in several respects including, among other things, that ICE and NYMEX both list high volume contracts, whereas liquidity in other commodities tends to pool at a single DCM. As expiration approaches for natural gas contracts, volume tends to shift from the NYMEX core referenced futures contract (''NG''), which is physically settled, to an ICE contract, which is cash settled. This trend reflects certain market participants' desire for exposure to natural gas prices without having to make or take delivery.[142] NYMEX and ICE also list several ''penultimate'' cash-settled referenced contracts that use the price of the physically-settled NYMEX contract as a reference price for cash settlement on the day before trading in the physically-settled NYMEX contract terminates.[143] In order to recognize the existing natural gas markets, which include active and vibrant markets in penultimate natural gas contracts, the Commission thus proposes a slightly broader economically equivalent swap definition for natural gas so that swaps with delivery dates that diverge by less than two calendar days from an associated referenced contract could still be deemed economically equivalent and would be subject to federal limits. The Commission intends for this change to prevent and disincentivize manipulation and regulatory arbitrage and to prevent volume from shifting away from NG to penultimate natural gas contract futures and/or penultimate swap markets in order to avoid federal position limits.[144]

d. Commission Determination of Economic Equivalence

While the Commission would primarily rely on market participants to determine whether their swaps meet the proposed ''economically equivalent swap'' definition, the Commission is proposing paragraph (3) to the definition to clarify that the Commission may determine on its own initiative that any swap or class of swaps satisfies, or does not satisfy, the economically equivalent definition with respect to any referenced contract or class of referenced contracts. The Commission believes that this provision may provide the ability to offer clarity to the marketplace in cases where uncertainty exists as to whether certain swaps would qualify (or would not qualify) as ''economically equivalent,'' and therefore would be (or would not be) subject to the proposed federal position limits framework. Similarly, where market participants hold divergent views as to whether certain swaps qualify as ''economically equivalent,'' the Commission can ensure that all market participants treat OTC swaps with identical material terms similarly, and also would be able to serve as a backstop in case market participants fail to properly treat economically equivalent swaps as such. As noted above, the Commission would not take any enforcement action with respect to violating the Commission's position limits regulations if the Commission disagrees with a market participant's determination as long as the market participant is able to provide sufficient support to show that it made a reasonable, good faith effort in applying its discretion.[145]

5. ''Eligible Affiliate''

The Commission proposes to create the new defined term ''eligible affiliate,'' which would be used in proposed § 150.2(k), discussed in connection with proposed § 150.2 below. As discussed further in that section of the release, an entity that qualifies as an ''eligible affiliate'' would be permitted to voluntarily aggregate its positions, even though it is eligible for an exemption from aggregation under § 150.4(b).

6. ''Eligible Entity''

The Commission adopted a revised ''eligible entity'' definition in the 2016 Final Aggregation Rulemaking.[146] The Commission is not proposing any further amendments to this definition, but is including that revised definition in this document so that all defined terms are included. As noted above, the Commission is also proposing a non-substantive change to remove the lettering from this and other definitions that appear lettered in existing § 150.1, and to list the definitions in alphabetical order.

7. ''Entity''

The Commission proposes defining ''entity'' to mean ''a 'person' as defined in section 1a of the Act.'' [147] The term, not defined in existing § 150.1, is used throughout proposed part 150 of the Commission's regulations.

8. ''Excluded Commodity''

The phrase ''excluded commodity'' is defined in CEA section 1a(19), but is not defined or used in existing part 150 of the Commission's regulations. The

[142] In part to address historical concerns over the potential for manipulation of physically-settled natural gas contracts during the spot month in order to benefit positions in cash-settled natural gas contracts, the Commission proposes later in this release to allow for a higher ''conditional'' spot month limit in cash-settled natural gas referenced contracts under the condition that market participants seeking to utilize such conditional limit exit any positions in physically-settled natural gas referenced contracts. *See infra* Section II.C.2.e. (proposed conditional spot month limit exemption for natural gas).

[143] Such penultimate contracts include: ICE's Henry Financial Penultimate Fixed Price Futures (PHH) and options on Henry Penultimate Fixed Price (PHE), and NYMEX's Henry Hub Natural Gas Penultimate Financial Futures (NPG).

[144] As noted above, the Commission is proposing a relatively narrow ''economically equivalent swap'' definition in order to prevent market participants from inappropriately netting positions in core referenced futures contracts against swap positions further out on the curve. The Commission preliminarily acknowledges that liquidity could shift to penultimate swaps as a result but believes that, with the exception of natural gas, this concern is mitigated since certain constraints exist that militate against this occurring. First, there may be basis risk between the penultimate swap and the core referenced futures contract. Second, compared to most other contracts, the Commission believes that natural gas has a relatively liquid penultimate futures market that enables a market participant to hedge or set-off its penultimate swap position. Since the constraints described above do not necessarily apply to the natural gas futures markets, the Commission preliminarily believes that liquidity may be incentivized to shift from NG to penultimate natural gas swaps in order to avoid federal position limits in the absence of the Commission's proposed exception for natural gas in the ''economically equivalent swap'' definition.

[145] *See supra* II.A.4.a. (discussing market participants' discretion in determining whether a swap is economically equivalent).

[146] *See* 17 CFR 150.1(d).

[147] 7 U.S.C. 1a(38).

Commission proposes including a definition of ''excluded commodity'' in part 150 that references that term as defined in CEA section 1a(19).[148]

9. ''Futures-Equivalent''

This phrase is currently defined in existing § 150.1(f) and is used throughout existing part 150 of the Commission's regulations to describe the method for converting a position in an option on a futures contract to an economically equivalent amount in a futures contract. The Dodd-Frank Act amendments to CEA section 4a,[149] in part, direct the Commission to apply aggregate federal position limits to physical commodity futures contracts and to swap contracts that are economically equivalent to such physical commodity futures on which the Commission has established limits. In order to aggregate positions in futures, options on futures, and swaps, it is necessary to adjust the position sizes, since such contracts may have varying units of trading (*e.g.,* the amount of a commodity underlying a particular swap contract could be larger than the amount of a commodity underlying a core referenced futures contract). The Commission thus proposes to adjust position sizes to an equivalent position based on the size of the unit of trading of the core referenced futures contract. The phrase ''futures-equivalent'' is used for that purpose throughout the proposed rules, including in connection with the ''referenced contract'' definition in proposed § 150.1. The Commission also proposes broadening this definition to include references to the proposed term ''core referenced futures contracts.''

10. ''Independent Account Controller''

The Commission adopted a revised ''independent account controller'' definition in the 2016 Final Aggregation Rule.[150] The Commission is not proposing any further amendments to this definition, but is including that revised definition in this document so that all defined terms appear together.

11. ''Long Position''

The phrase ''long position'' is currently defined in § 150.1(g) to mean ''a long call option, a short put option or a long underlying futures contract.'' The Commission proposes to update this definition to apply to swaps and to clarify that such positions would be on a futures-equivalent basis. This provision would thus be applicable to options on futures and swaps such that a long position would also include a long futures-equivalent option on futures and a long futures-equivalent swap.

12. ''Physical Commodity''

The Commission proposes to define the term ''physical commodity'' for position limits purposes. Congress used the term ''physical commodity'' in CEA sections 4a(a)(2)(A) and 4a(a)(2)(B) to mean commodities ''other than excluded commodities as defined by the Commission.'' [151] The proposed definition of ''physical commodity'' thus would include both exempt and agricultural commodities, but not excluded commodities.

13. ''Position Accountability''

Existing § 150.5 permits position accountability in lieu of position limits in certain cases, but does not define the term ''position accountability.'' The proposed amendments to § 150.5 would allow exchanges, in some cases, to adopt position accountability levels in lieu of, or in addition to, position limits. The Commission proposes a definition of ''position accountability'' for use throughout proposed § 150.5 as discussed in greater detail in connection with proposed § 150.5 below.

14. ''Pre-Enactment Swap''

The Commission proposes to create the defined term ''pre-enactment swap'' to mean any swap entered into prior to enactment of the Dodd-Frank Act of 2010 (July 21, 2010), the terms of which have not expired as of the date of enactment of that Act. As discussed in connection with proposed § 150.3 later in this release, if acquired in good faith, such swaps would be exempt from federal speculative position limits, although such swaps could not be netted with post-effective date swaps for purposes of complying with spot month speculative position limits.

15. ''Pre-Existing Position''

The Commission proposes to create the defined term ''pre-existing position'' to reference any position in a commodity derivative contract acquired in good faith prior to the effective date of a final federal position limit rulemaking. Proposed § 150.2(g) would set forth the circumstances under which position limits would apply to such positions.

16. ''Referenced Contract''

The nine contracts currently subject to federal limits, which are all physically-settled futures, are all listed in existing § 150.2.[152] As the Commission is proposing to expand the position limits framework to cover certain cash-settled futures and options on futures contracts and certain economically equivalent swaps, the Commission proposes a new defined term, ''referenced contract,'' for use throughout proposed part 150 to refer to contracts that would be subject to federal limits.

The referenced contract definition would thus include: (1) Any core referenced futures contract listed in proposed § 150.2(d); (2) any other contract (futures or option on futures), on a futures-equivalent basis with respect to a particular core referenced futures contract, that is directly or indirectly linked to the price of a core referenced futures contract, or that is directly or indirectly linked to the price of the same commodity underlying a core referenced futures contract (for delivery at the same location(s)); and (3) any economically equivalent swap, on a futures-equivalent basis.

The proposed referenced contract definition would include look-alike futures and options on futures contracts (as well as options or economically equivalent swaps with respect to such look-alike contracts) and contracts of the same commodity but different sizes (*e.g.,* mini contracts). Positions in referenced contracts may in certain circumstances be netted with positions in other referenced contracts. However, to avoid evasion and undermining of the position limits framework, non-referenced contracts on the same commodity could not be used to net down positions in referenced contracts.[153]

a. Cash-Settled Referenced Contracts

Under these proposed provisions, federal limits would apply to all cash-settled futures and options on futures contracts on physical commodities that are linked in some manner, whether directly or indirectly, to physically-settled contracts subject to federal limits, and to any cash settled swaps that are deemed ''economically equivalent swaps'' with respect to a particular cash-settled referenced contract.[154] While the Commission

[148] 7 U.S.C. 1a(19).

[149] Under CEA sections 4a(a)(2) and 4a(a)(5), speculative position limits apply to agricultural and exempt commodity swaps that are ''economically equivalent'' to DCM futures and options on futures contracts. 7 U.S.C. 6a(a)(2) and (5).

[150] *See* 17 CFR 150.1(e).

[151] 7 U.S.C. 6a(a)(2)(A) and (B).

[152] 17 CFR 150.2.

[153] A more detailed discussion of when netting is permitted appears below. *See infra* Section II.B.2.k. (discussion of netting).

[154] For example, ICE's Henry Penultimate Fixed Price Future, which cash-settles directly to

Continued

acknowledges previous comments to the effect that cash-settled contracts are less susceptible to manipulation and thus should not be subject to federal limits, the Commission is of the view that generally speaking, linked cash-settled and physically-settled contracts form one market, and thus should be subject to federal limits. This view is informed by the Commission's experience overseeing derivatives markets, where it has observed that it is common for the same market participant to arbitrage linked cash- and physically-settled contracts, and where it has also observed instances where linked cash-settled and physically-settled contracts have been used together as part of a manipulation.[155] In the Commission's view, cash-settled contracts are generally economically equivalent to physical-delivery contracts in the same commodity. In the absence of position limits, a trader with positions in both the physically-delivered and cash-settled contracts may have increased ability and incentive to manipulate one contract to benefit positions in the other.

The proposal to include futures contracts and options on futures that are ''indirectly linked'' to the core referenced futures contract under the definition of ''referenced contract'' is intended to prevent the evasion of position limits through the creation of an economically equivalent futures contract or option on a future, as applicable, that does not directly reference the price of the core referenced futures contract. Such contracts that settle to the price of a referenced contract but not to the price of a core referenced futures contract, for example, would be indirectly linked to the core referenced futures contract.[156]

On the other hand, an outright derivative contract whose settlement price is based on an index published by a price reporting agency that surveys cash market transaction prices (even if the cash market practice is to price at a differential to a futures contract) would not be directly or indirectly linked to the core referenced futures contract. Similarly, a physical-delivery derivative contract whose settlement price was based on the same underlying commodity at a different delivery location (*e.g.,* a hypothetical physical-delivery futures contract on ultra-low sulfur diesel delivered at L.A. Harbor instead of the NYMEX ultra-low sulfur diesel futures contract delivered in New York Harbor core referenced futures contract) would not be linked, directly or indirectly, to the core referenced futures contract because the price of the physically-delivered L.A. Harbor contract would reflect the L.A. Harbor market price for ultra-low sulfur diesel.

b. Exclusions From the Referenced Contract Definition

While the proposed referenced contract definition would include linked contracts, it would also explicitly exclude certain other types of contracts. Paragraph (3) of the proposed referenced contract definition would explicitly exclude from that definition a location basis contract, a commodity index contract, a swap guarantee, or a trade option that meets the requirements of § 32.3 of this chapter.

First, failing to exclude location basis contracts from the referenced contract definition could enable speculators to net portions of the location basis contract with outright positions in one of the locations comprising the basis contract, which would permit extraordinarily large speculative positions in the outright contract.[157] For example, under the proposed rules, a large outright position in Henry Hub Natural Gas futures could not be netted down against a location basis contract that cash-settles to the difference in price between Gulf Coast Natural Gas and Henry Hub Natural Gas. Absent the proposed exclusion, a market participant could otherwise increase its exposure in the outright contract by using the location basis contract to net down, and then increase further, an outright contract position that would otherwise be restricted by position limits.[158] Further, excluding location basis contracts from the referenced contract definition may allow commercial end-users to more efficiently hedge the cost of commodities at their preferred location.

Similarly, the proposed exclusion of commodity index contracts from the referenced contract definition would help ensure that market participants could not use a position in a commodity index contract to net down an outright position that was a component of the commodity index contract. If the Commission did not exclude commodity index contracts, then speculators would be allowed to take on massive outright positions in referenced contracts, which could lead to excessive speculation.

As noted above, it is common for swap dealers to enter into commodity index contracts with participants for which the contract would not qualify as a bona fide hedging position (*e.g.,* with a pension fund). Failing to exclude commodity index contracts from the referenced contract definition could enable a swap dealer to use positions in commodity index contracts to net down offsetting outright futures positions in the components of the index. This would have the effect of subverting the statutory pass-through swap language in CEA section 4a(c)(2)(B), which is intended to foreclose the recognition of positions entered into for risk management purposes as bona fide hedges unless the swap dealer is entering into positions opposite a counterparty for which the swap position is a bona fide hedge.[159]

In order to clarify the types of contracts that would qualify as location basis contracts and commodity index contracts, and thus would be excluded from the referenced contract definition, the Commission proposes guidance in Appendix C to part 150 of the Commission's regulations. The proposed guidance would include information which would help define the parameters of the terms ''location basis contract'' and ''commodity index contract.'' To the extent a particular contract fits within the proposed guidance, such contract would not be a referenced contract, would not be subject to federal limits, and could not

NYMEX's Henry Hub Natural Gas core referenced futures contract, would be considered a referenced contract under the rules proposed herein.

[155] The Commission has previously found that traders with positions in look-alike cash-settled contracts may have an incentive to manipulate and undermine price discovery in the physical-delivery contracts to which the cash-settled contract is linked. The practice known as ''banging the close'' or ''marking the close'' is one such manipulative practice that the Commission prosecutes and that this proposal seeks to prevent.

[156] As discussed above, the Commission is proposing a definition of ''economically equivalent swap'' that is narrower than the class of futures and options on futures that would be included as referenced contracts. *See supra* Section II.A.4. (discussion of economically equivalent swaps).

[157] *See infra* Section II.B.2.k. (discussion of netting).

[158] While excluding location basis contracts from the referenced contract definition would prevent the circumstance described above, it would also mean that location basis contracts would not be subject to federal limits. The Commission would be comfortable with this outcome because location basis contracts generally demonstrate minimal volatility and are typically significantly less liquid than the core referenced futures contracts, meaning they would be more costly to try to use in a manipulation.

[159] 7 U.S.C. 6a(c)(2)(B). While excluding commodity index contracts from the referenced contract definition would prevent the potentially risky netting circumstance described above, it would also mean that commodity index contracts would not be subject to federal limits. The Commission would be comfortable with this outcome because the commodities comprising the index would themselves be subject to limits, and because commodity index contracts generally tend to exhibit low volatility since they are diversified across many different commodities.

be used to net down positions in referenced contracts.[160]

Second, swap guarantees are explicitly excluded from the proposed referenced contract definition. In connection with further defining the term ''swap'' jointly with the Securities and Exchange Commission in connection with the ''Product Definition Adopting Release,'' [161] the Commission interpreted the term ''swap'' (that is not a ''security-based swap'' or ''mixed swap'') to include a guarantee of such swap, to the extent that a counterparty to a swap position would have recourse to the guarantor in connection with the position.[162] Excluding guarantees of swaps from the definition of referenced contract should help avoid any potential confusion regarding the application of position limits to guarantees of swaps. The Commission understands that swap guarantees generally serve as insurance, and in many cases swap guarantors guarantee the performance of an affiliate in order to entice a counterparty to enter into a swap with such guarantor's affiliate. As a result, the Commission preliminarily believes that swap guarantees neither contribute to excessive speculation, market manipulation, squeezes, or corners nor were contemplated by Congress when Congress articulated its policy goals in CEA sections 4a(a)(1)–(3).[163]

Third, trade options that meet the requirements of § 32.3 would also be excluded from the proposed referenced contract definition. The Commission has traditionally exempted trade options from a number of Commission requirements because they are typically used by end-users to hedge physical risk and thus do not contribute to excessive speculation. Trade options are not subject to position limits under current regulations, and the proposed exclusion of trade options from the referenced contract definition would simply codify existing practice.[164]

[160] *See infra* Section II.B.2.k. (discussion of netting).

[161] *See generally* Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48207 (Aug. 13, 2012) (''Product Definitions Adopting Release'').

[162] *See id.* at 48226.

[163] To the extent that swap guarantees may lower costs for uncleared OTC swaps in particular by incentivizing counterparties to agree to the swap, excluding swap guarantees arguably may improve market liquidity, which is consistent with the CEA's statutory goals in CEA section 4a(a)(3)(B) to ensure sufficient liquidity for bona fide hedgers when establishing its position limit framework.

[164] In the trade options final rule, the Commission stated its belief that federal limits should not apply to trade options, and expressed an intention to address trade options in the context of any final rulemaking on position limits. *See* Trade Options, 81 FR at 14966, 14971 (Mar. 21, 2016).

c. List of Referenced Contracts

In an effort to provide clarity to market participants regarding which exchange-traded contracts are subject to federal limits, the Commission anticipates publishing, and regularly updating, a list of such contracts on its website.[165] The Commission thus proposes to publish a *CFTC Staff Workbook of Commodity Derivative Contracts under the Regulations Regarding Position Limits for Derivatives* along with this release, which would provide a non-exhaustive list of referenced contracts and may be helpful to market participants in determining categories of contracts that would fit within the referenced contract definition. As always, market participants may request clarification from the Commission.

In order to ensure that the list remains up-to-date and accurate, the Commission is proposing changes to certain provisions of part 40 of its regulations which pertain to the collection of position limits information through the filing of product terms and conditions submissions. In particular, under existing rules, including §§ 40.2, 40.3, and 40.4, DCMs and SEFs are required to comply with certain submission requirements related to the listing of certain products. Many of the required submissions must include the product's ''terms and conditions,'' which is defined in § 40.1(j) and which includes, under § 40.1(j)(1)(vii), ''Position limits, position accountability standards, and position reporting requirements.'' The Commission proposes to expand § 40.1(j)(1)(vii), which addresses futures and options on futures, to also include an indication as to whether the contract meets the definition of a referenced contract as defined in § 150.1, and, if so, the name of the core referenced futures contract on which the referenced contract is based. The Commission proposes to also expand § 40.1(j)(2)(vii), which addresses swaps, to include an indication as to whether the contract meets the definition of economically equivalent swap as defined in § 150.1 of this chapter, and, if so, the name of the referenced contract to which the swap is economically equivalent. This information would enable the Commission to maintain on its website, *www.cftc.gov*, an up-to-date list of DCM and SEF contracts subject to federal limits.

[165] As discussed above, the Commission will provide market participants with reasonable, good-faith discretion to determine whether a swap would qualify as economically equivalent for federal position limit purposes. *See supra* Section II.A.4. (discussion of economically equivalent swaps).

17. ''Short Position''

The Commission proposes to expand the existing definition of ''short position,'' currently defined in § 150.1(h), to include swaps and to clarify that any such positions would be measured on a futures-equivalent basis.

18. ''Speculative Position Limit''

The Commission proposes to define the term ''speculative position limit'' for use throughout part 150 of the Commission's regulations to refer to federal or exchange-set limits, net long or net short, including single month, spot month, and all-months-combined limits. This proposed definition is not intended to limit the authority of exchanges to adopt other types of limits that do not meet the ''speculative position limit definition,'' such as a limit on gross long or gross short positions, or a limit on holding or controlling delivery instruments.

19. ''Spot Month,'' ''Single Month,'' and ''All-Months''

The Commission proposes to expand the existing definition of ''spot month'' to account for the fact that the proposed limits would apply to both physically-settled and certain cash-settled contracts, to clarify that the spot month for referenced contracts would be the same period as that of the relevant core referenced futures contract, and to account for variations in spot month conventions that differ by commodity. In particular, for the ICE U.S. Sugar No. 11 (SB) core referenced futures contract, the spot month would mean the period of time beginning at the opening of trading on the second business day following the expiration of the regular option contract traded on the expiring futures contract until the contract expires. For the ICE U.S. Sugar No. 16 (SF) core referenced futures contract, the spot month would mean the period of time beginning on the third-to-last trading day of the contract month until the contract expires. For the CME Live Cattle (LC) core referenced futures contract, the spot month would mean the period of time beginning at the close of trading on the fifth business day of the contract month until the contract expires.

The Commission also proposes to eliminate the existing definitions of ''single month'' and ''all-months'' because the definitions for those terms would be built into the proposed definition of ''speculative position limits'' described above.

20. ''Spread Transaction''

The Commission proposes to incorporate a definition for transactions normally known to the trade as ''spreads,'' which would list the types of transactions that could qualify for spread exemptions for purposes of federal position limits. The proposed list would cover common types of inter-commodity and intra-commodity spreads such as: Calendar spreads; quality differential spreads; processing spreads (such as energy ''crack'' or soybean ''crush'' spreads); product or by-product differential spreads; and futures-options spreads.[166] Separately, under proposed § 150.3(a)(2)(ii), the Commission could determine to exempt any other spread transaction that is not included in the spread transaction definition, but that the Commission has determined is consistent with CEA section 4a(a)(3)(B),[167] and exempted, pursuant to proposed § 150.3(b).

21. ''Swap'' and ''Swap Dealer''

The Commission proposes to incorporate the definitions of ''swap'' and ''swap dealer'' as they are defined in section 1a of the Act and § 1.3 of this chapter.[168]

22. ''Transition Period Swap''

The Commission proposes to create the defined term ''transition period swap'' to mean any swap entered into during the period commencing July 22, 2010 and ending 60 days after the publication of a final federal position limits rulemaking in the **Federal Register,** the terms of which have not expired as of that date. As discussed in connection with proposed § 150.3 later in this release, if acquired in good faith, such swaps would be exempt from federal speculative position limits, although such swaps could not be netted with post-effective date swaps for purposes of complying with spot month speculative position limits.

Finally, the Commission proposes to eliminate existing § 150.1(i), which includes a chart specifying the ''first delivery month of the crop year'' for certain commodities. The crop year definition had been pertinent for purposes of the spread exemption to the individual month limit in current § 150.3(a)(3), which limits spreads to those between individual months in the same crop year and to a level no more than that of the all-months limit. This provision was pertinent at a time when the single month and all months combined limits were different. Now that the current and proposed single month and all months combined limits are the same, and now that the Commission is proposing a new process for granting spread exemptions in § 150.3, this provision is no longer needed.

23. Request for Comment

The Commission requests comment on all aspects of the proposed amendments and additions to the definitions in § 150.1. The Commission also invites comments on the following:

(1) Should the Commission include the enumerated hedges in regulations, rather than in an appendix of acceptable practices? Why or why not?

(2) Should the Commission list any additional common commercial hedging practices as enumerated hedges?

(3) The Commission proposes to eliminate the five day rule on federal position limits, instead allowing exchanges discretion on whether to apply or waive any five day rule or equivalent on their exchange position limits. The Commission believes that the five day rule can be an important way to help ensure that futures and cash market prices converge. As such, should the Commission require that exchanges apply the five day rule to some or all bona fide hedging positions and/or spread exemptions? If so, to which bona fide hedging positions? Should the exchanges retain the ability to waive such five day rule?

(4) The Commission requests comment on the nature of anticipated merchandising exemptions that have been granted by DCMs in connection with the 16 non-legacy commodities or in connection with exemptions from exchange limits in 9 legacy commodities.

(5) To what extent do the enumerated hedges proposed in this release encompass the types of positions discussed in the BFH Petition? Should additional types of positions identified in the BFH Petition, including examples nos. 3 (unpriced physical purchase and sale commitments) and 7 (scenario 2) (use of physical delivery referenced contracts to hedge physical transactions using calendar month averaging pricing), be enumerated as bona fide hedges, after notice and comment?

(6) The Commission requests comment as to whether price risk is attributable to a variety of factors, including political and weather risk, and could therefore allow hedging political, weather, or other risks, or whether price risk is something narrower in the application of bona fide hedging.

(7) While an ''economically equivalent swap'' qualifies as a referenced contract under paragraph (2) of the ''referenced contract'' definition, paragraph (1) of the ''referenced contract'' definition applies a broader test to determine whether futures contracts or options on a futures contract would qualify as a referenced contract. Instead of a separate definition for ''economically equivalent swaps,'' should the same test (*e.g.,* paragraph (1) of the ''referenced contract'' definition) that applies to futures and options on futures for determining status as ''referenced contracts'' also apply to determine whether a swap is an ''economically equivalent swap,'' and therefore a ''referenced contract''? Why or why not?

(8) The Commission is proposing to define ''economically equivalent swap'' in a manner that is generally consistent with the EU's definition, with the exception that a swap must have ''identical *material*'' terms, disregarding differences in lot size or notional amount, delivery dates diverging by less than one calendar day (or for natural gas, by less than two calendar days), or post-trade risk management arrangements. Is this approach either too narrow or too broad? Why or why not?

(9) The Commission requests comment how a market participant subject to both the CFTC's and EU's position limits regimes expects to comply with both regimes for contracts subject to both regimes.

(10) With respect to economically equivalent swaps, the Commission proposes an exception that would capture penultimate swaps only for natural gas contracts, including

[166] For example, trading activity in many commodity derivative markets is concentrated in the nearby contract month, but a hedger may need to offset risk in deferred months where derivative trading activity may be less active. A calendar spread trader could provide liquidity without exposing himself or herself to the price risk inherent in an outright position in a deferred month. Processing spreads can serve a similar function. For example, a soybean processor may seek to hedge his or her processing costs by entering into a ''crush'' spread, *i.e.,* going long soybeans and short soybean meal and oil. A speculator could facilitate the hedger's ability to do such a transaction by entering into a ''reverse crush'' spread (*i.e.,* going short soybeans and long soybean meal and oil). Quality differential spreads, and product or by-product differential spreads, may serve similar liquidity-enhancing functions when spreading a position in an actively traded commodity derivatives market such as CBOT Wheat (W) against a position in another actively traded market, such as MGEX Wheat.

[167] As noted above, CEA section 4a(a)(3)(B) provides that the Commission shall set limits ''to the maximum extent practicable, in its discretion—(i) to diminish, eliminate, or prevent excessive speculation as described under this section; (ii) to deter and prevent market manipulation, squeezes, and corners; (iii) to ensure sufficient market liquidity for bona fide hedgers; and (iv) to ensure that the price discovery function of the underlying market is not disrupted.''

[168] 7 U.S.C. 1a(47) and 1a(49); 17 CFR 1.3.

penultimate swaps on the NYMEX NG core referenced futures contract. Is this exception for such penultimate natural gas swaps appropriate, or should economically equivalent natural gas swaps be treated the same as other economically equivalent swaps? Why or why not?

(11) Should the Commission broaden the definition of ''economically equivalent swap'' to include penultimate referenced contracts for all (or at least a subset of) commodities subject to federal position limits? Why or why not?

(12) The Commission is proposing that a physically-settled swap may qualify as economically equivalent even if its delivery date diverges by less than one calendar day from its corresponding physically-settled referenced contract. Should the Commission include a similar provision for cash-settled swaps where cash-settled swaps could qualify as economically equivalent if their cash settlement price determination diverged from their corresponding cash-settled referenced contract by less than one calendar day?

(13) Under the proposed definition of ''economically equivalent swaps,'' a cash-settled swap that otherwise shares identical material terms with a physically-settled referenced contract (and vice-versa) would not be deemed to be economically equivalent due to the difference in settlement type. Should the Commission consider treating swaps that share identical material terms, other than settlement type (*i.e.,* cash-settled versus physically-settled swaps), to be economically equivalent? Why or why not?

(14) Consistent with the 2016 Reproposal, the Commission is proposing to explicitly exclude swap guarantees from the referenced contract definition.[169] Should the Commission again propose to exclude swap guarantees from the referenced contract definition? Why or why not? If the Commission does exclude swap guarantees, should such exclusion be limited to guarantees for affiliated entities only? Why or why not?

(15) Please indicate if any updates or other modifications are needed to: (1) The proposed list of referenced contracts that would appear in the *CFTC Staff Workbook of Commodity Derivative Contracts Under the Regulations Regarding Position Limits for Derivatives* posted on the Commission's website; [170] or (2) the proposed Appendix D to part 150 list of commodities deemed ''substantially the same'' for purposes of the term ''location basis contract'' as used in the proposed ''referenced contract'' definition.

(16) Should the Commission require exchanges to maintain a list of referenced contracts and location basis contracts listed on their platforms?

(17) The Commission has previously requested, and commenters have previously provided, a list of risks other than price risk for which commercial enterprises commonly need to hedge.[171] Please explain which hedges of non-price risks could be objectively and systematically verified as bona fide hedges by the Commission, and how the Commission would verify that such positions are bona fide hedges, including how the Commission would consistently and definitively quantify and assess whether any such hedges of non-price risks are bona fide hedges that comply with the proposed bona fide hedging definition.

(18) The Commission proposes to define spread transactions to include: Either a calendar spread, intercommodity spread, quality differential spread, processing spread (such as energy ''crack'' or soybean ''crush'' spreads), product or by-product differential spread, or futures-option spread. Are there other types of transactions commonly known to the trade as ''spreads'' that the Commission should include in its spread transaction definition? Please provide any examples or descriptions that will help the Commission determine whether such transactions would be consistent with CEA section 4a(a)(3)(B) and should be included in the definition of spread transaction.

(19) Should the Commission require market participants that trade economically equivalent swaps OTC, rather than on a SEF or DCM, to self-identify and report to the Commission that in their view, such swaps meet the Commission's proposed economically equivalent swap definition?

B. § 150.2—Federal Limit Levels

1. Existing § 150.2

Federal spot month, single month, and all-months-combined position limits currently apply to nine physically-settled futures contracts on agricultural commodities listed in existing § 150.2, and, on a futures-equivalent basis, to options contracts thereon. Existing federal limit levels set forth in § 150.2 [172] apply net long or net short and are as follows:

EXISTING LEGACY AGRICULTURAL CONTRACT FEDERAL SPOT MONTH, SINGLE MONTH, AND ALL-MONTHS-COMBINED LIMIT LEVELS

Contract	Spot month limit	Single month and all-months-combined limit
Chicago Board of Trade (''CBOT'') Corn (C)	600	33,000
CBOT Oats (O)	600	2,000
CBOT Soybeans (S)	600	15,000
CBOT Soybean Meal (SM)	720	6,500
CBOT Soybean Oil (SO)	540	8,000
CBOT Kansas City Hard Red Winter Wheat (KW)	600	12,000
CBOT Wheat (W)	600	12,000
ICE Futures U.S. (''ICE'') Cotton No. 2 (CT)	300	5,000
Minneapolis Grain Exchange (''MGEX'') Hard Red Spring Wheat (MWE)	600	12,000

[169] *See* 2016 Reproposal, 81 FR at 96966.

[170] *Position Limits for Derivatives,* U.S. Commodity Futures Trading Commission website, *available at https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/PositionLimitsforDerivatives/index.htm.*

[171] *See, e.g.,* National Gas Supply Association Comment Letter at 4 (Feb. 28, 2017) in response to 2016 Reproposal (listing operational risk, liquidity risk, credit risk, locational risk, and seasonal risk).

[172] 17 CFR 150.2.

While not explicit in § 150.2, the Commission's practice has been to set spot month limit levels at or below 25 percent of deliverable supply based on DCM estimates of deliverable supply verified by the Commission, and to set limit levels outside of the spot month at 10 percent of open interest for the first 25,000 contracts of open interest, with a marginal increase of 2.5 percent of open interest thereafter.

2. Proposed § 150.2 [173]

a. Contracts Subject to Federal Limits

The Commission proposes to establish federal limits on the 25 core referenced futures contracts listed in proposed § 150.2(d),[174] and on their associated referenced contracts, which would include swaps that qualify as ''economically equivalent swaps.'' [175] The Commission proposes to establish position limits on futures and options on these 25 commodities on the basis that position limits on such contracts are ''necessary.'' A discussion of the necessity finding and the characteristics of the 25 core referenced futures contracts is in Section III.F.

In order to comply with CEA section 4a(a)(5), the Commission also proposes to establish limits on swaps that are ''economically equivalent'' to the above.[176] As discussed above, under the Commission's proposed definition of ''economically equivalent swap'' set forth in § 150.1, a swap would generally qualify as economically equivalent with respect to a particular referenced contract so long as the swap shares identical material contract specifications, terms, and conditions with the referenced contract, disregarding any differences with respect to lot size or notional amount, delivery dates diverging by less than one calendar day, (or for natural gas, by less than two calendar days) or post-trade risk-management arrangements.[177]

As described in greater detail below, the proposed federal limits would apply during all contract months for the nine legacy agricultural commodity contracts and only during the spot month for the 16 other commodity contracts.

Proposed § 150.2(e) would provide that the levels set forth below for the 25 contracts are listed in Appendix E to part 150 of the Commission's regulations and would set the compliance date for such levels at 365 days after publication of final position limits regulations in the **Federal Register**.

b. Proposed Federal Spot Month Limit Levels

Under the rules proposed herein, federal spot month limit levels would apply to all 25 core referenced futures contracts, and any associated referenced contracts.[178] Federal spot month limits for referenced contracts on all 25 commodities are essential for deterring and preventing excessive speculation, manipulation, corners and squeezes.[179] Proposed § 150.2(e) provides that federal spot month levels are set forth in proposed Appendix E to part 150 and are as follows:

Core referenced futures contract	2020 Proposed spot month limit	Existing federal spot month limit	Existing exchange-set spot month limit
Legacy Agricultural Contracts			
CBOT Corn (C)	1,200	600	600
CBOT Oats (O)	600	600	600
CBOT Soybeans (S)	1,200	600	600
CBOT Soybean Meal (SM)	1,500	720	720
CBOT Soybean Oil (SO)	1,100	540	540
CBOT Wheat (W)	1,200	600	[180] 600/500/400/300/220
CBOT KC HRW Wheat (KW)	1,200	600	600

[173] This portion of the release is organized by subject matter, rather than by lettered provision, and will proceed in the following order: (1) Contracts subject to federal limits; (2) proposed spot month limit levels; (3) proposed methodology for setting spot month limit levels; (4) proposed non-spot month limit levels; (5) proposed methodology for setting non-spot month limit levels; (6) subsequent levels; (7) relevant contract month for purposes of referenced contracts; (8) limits on pre-existing positions; (9) limits for positions on foreign boards of trade; (10) anti-evasion provision; (11) netting of positions; (12) eligible affiliates and aggregation; and (13) request for comment.

[174] Proposed § 150.2(d) provides that each core referenced futures contract includes any ''successor'' contracts. An example of a successor contract would be the RBOB Gasoline contract that was listed due to a change in gasoline specifications and that ultimately replaced the Unleaded Gasoline contract. For some time, both contracts were listed for trading to allow open interest to migrate to the new RBOB contract; once trading migrated, the Unleaded Gasoline contract was delisted.

[175] As described above, the proposed term ''referenced contract'' includes: (1) Futures and options on futures contracts that, with respect to a particular core referenced futures contract, are directly or indirectly linked to the price of that core referenced futures contract, or directly or indirectly linked to the price of the same commodity underlying the core referenced futures contract for delivery at the same location; and (2) ''economically equivalent swaps.'' *See* proposed ''referenced contract'' and ''economically equivalent swap'' definitions in 150.1.

[176] CEA section 4a(a)(5); 7 U.S.C. 6a(a)(5).

[177] *See infra* Section II.A.4. (definition of ''economically equivalent swap'').

[178] As described below, federal non-spot month limit levels would only apply to the nine legacy agricultural commodities. The 16 non-legacy commodities would be subject to federal limits during the spot month, and exchange-set limits and/or accountability outside of the spot month. *See infra* Section II.B.2.d. (discussion of proposed non-spot month limit levels).

[179] *See infra* Section III. (Legal Matters).

[180] CBOT's existing exchange-set limit for Wheat (W) is 600 contracts. However, for its May contract month, CBOT has a variable spot limit that is dependent upon the deliverable supply that it publishes from the CBOT's Stocks and Grain report on the Friday preceding the first notice day for the May contract month. In the last five trading days of the expiring futures month in May, the speculative position limit is: (1) 600 contracts if deliverable supplies are at or above 2,400 contracts; (2) 500 contracts if deliverable supplies are between 2,000 and 2,399 contracts; (3) 400 contracts if deliverable supplies are between 1,600 and 1,999 contracts; (4) 300 contracts if deliverable supplies are between 1,200 and 1,599 contracts; and (5) 220 contracts if deliverable supplies are below 1,200 contracts.

[181] The proposed federal spot month limit for CME Live Cattle (LC) would feature a step-down limit similar to the CME's existing Live Cattle (LC) step-down exchange set limit. The proposed federal spot month step down limit is: (1) 600 at the close of trading on the first business day following the first Friday of the contract month; (2) 300 at the close of trading on the business day prior to the last five trading days of the contract month; and (3) 200 at the close of trading on the business day prior to the last two trading days of the contract month.

[182] CME's existing exchange-set limit for Live Cattle (LC) has a step-down spot month limit: (1) 450 at the close of trading on the first business day following the first Friday of the contract month; (2) 300 at the close of trading on the business day prior to the last five trading days of the contract month; and (3) 200 at the close of trading on the business day prior to the last two trading days of the contract month.

[183] CBOT's existing exchange-set spot month limit for Rough Rice (RR) is 600 contracts for all contract months. However, for July and September, there is a step-down limit from 600 contracts. In the last five trading days of the expiring futures month, the speculative position limit for the July futures month steps down to 200 contracts from 600 contracts and the speculative position limit for the September futures month steps down to 250 contracts from 600 contracts.

[184] NYMEX recommends implementing a step-down federal spot position limit for its Light Sweet Crude Oil (CL) futures contract: (1) 6,000 contracts as of the close of trading three business days prior to the last trading day of the contract; (2) 5,000 contracts as of the close of trading two business days prior to the last trading day of the contract; and (3) 4,000 contracts as of the close of trading one business day prior to the last trading day of the contract.

Core referenced futures contract	2020 Proposed spot month limit	Existing federal spot month limit	Existing exchange-set spot month limit
MGEX HRS Wheat (MWE)	1,200	600	600
ICE Cotton No. 2 (CT)	1,800	300	300
Other Agricultural Contracts			
CME Live Cattle (LC)	[181] 600/300/200	n/a	[182] 450/300/200
CBOT Rough Rice (RR)	800	n/a	[183] 600/200/250
ICE Cocoa (CC)	4,900	n/a	1,000
ICE Coffee C (KC)	1,700	n/a	500
ICE FCOJ–A (OJ)	2,200	n/a	300
ICE U.S. Sugar No. 11 (SB)	25,800	n/a	5,000
ICE U.S. Sugar No. 16 (SF)	6,400	n/a	n/a
Metals Contracts			
COMEX Gold (GC)	6,000	n/a	3,000
COMEX Silver (SI)	3,000	n/a	1,500
COMEX Copper (HG)	1,000	n/a	1,500
NYMEX Platinum (PL)	500	n/a	500
NYMEX Palladium (PA)	50	n/a	50
Energy Contracts			
NYMEX Light Sweet Crude Oil (CL)	[184] 6,000/5,000/4,000	n/a	3,000
NYMEX NYH ULSD Heating Oil (HO)	2,000	n/a	1,000
NYMEX NYH RBOB Gasoline (RB)	2,000	n/a	1,000
NYMEX Henry Hub Natural Gas (NG)	2,000	n/a	1,000

Limits for any contract with a proposed limit above 100 contracts would be rounded up to the nearest 100 contracts from the exchange-recommended level and/or from 25 percent of deliverable supply.

c. Process for Calculating Federal Spot Month Limit Levels

The existing federal spot month limit levels on the nine legacy agricultural contracts have remained constant for decades, yet the markets have changed significantly during that time period, including the advent of electronic trading and the implementation of extended trading hours. Further, open interest and trading volume have since reached record levels, and some of the deliverable supply estimates on which the existing federal spot month limits were originally based are now decades out of date. In light of these and other factors, CME Group, ICE, and MGEX recommended federal spot month limit levels for each of their respective core referenced futures contracts, including contracts that would be subject to federal limits for the first time under this proposal.[185] Commission staff reviewed these recommendations and conducted its own analysis of them, including by requesting additional information and by independently assessing the recommended levels using its own experience, observations, and knowledge. The Commission proposes to adopt each of the exchange-recommended levels as federal spot month limit levels.

In setting federal limits, the Commission considers the four policy objectives in CEA section 4a(a)(3)(B). That is, to set limits, to the maximum extent practicable, in its discretion, to: (1) Diminish, eliminate, or prevent excessive speculation; (2) deter and prevent market manipulation, squeezes, and corners; (3) ensure sufficient market liquidity for bona fide hedgers; and (4) ensure that the price discovery function of the underlying market is not disrupted.[186] In setting federal position limit levels, the Commission endeavors to maximize these objectives by setting limits that are low enough to prevent excessive speculation, manipulation, squeezes, and corners that could disrupt price discovery, but high enough so as not to restrict liquidity for bona fide hedgers.

Based on the Commission's experience overseeing federal position limits for decades, and overseeing exchange-set position limits submitted to the Commission pursuant to part 40 of its regulations, the Commission has analyzed and evaluated the information provided by CME Group, ICE, and MGEX, and preliminarily finds that none of the recommended levels considered in preparing this release appear improperly calibrated such that they might hinder liquidity for bona fide hedgers, or invite excessive speculation, manipulation, corners, or squeezes, including activity that could impact price discovery. For these reasons, discussed in turn below, the Commission preliminarily believes that the DCMs' recommended spot month limit levels all further the statutory objectives set forth in CEA section 4a(a)(3)(B).[187]

i. The Proposed Spot Month Limit Levels Are Low Enough To Prevent Excessive Speculation and Protect Price Discovery

All 25 of the exchange-recommended levels are at or below 25 percent of deliverable supply.[188] The Commission has long used deliverable supply as the basis for spot month position limits due to concerns regarding corners, squeezes, and other settlement-period manipulative activity.[189] It would be difficult, in the absence of other factors, for a participant to corner or squeeze a market if the participant holds less than or equal to 25 percent of deliverable supply because, among other things, any

[185] *See* ICE Comment Letter at 8 (May 14, 2019); *MGEX Comment Letter* at 2, 4–8 (Aug. 31, 2018); and *Summary DSE Proposed Limits, CME Group Comment Letter* (Nov. 26, 2019), available at *https://comments.cftc.gov* (comment file for RIN 3038–AD99).

[186] 7 U.S.C. 6a(a)(3)(B).

[187] 7 U.S.C. 6a(a)(3)(B).

[188] The recommended levels range from approximately 7 percent of deliverable supply to 25 percent of deliverable supply.

[189] *See, e.g.,* Revision of Federal Speculative Position Limits and Associated Rules, 64 FR 24038 (May 5, 1999).

potential economic gains resulting from the manipulation may be insufficient to justify the potential costs, including the costs of acquiring, and ultimately offloading, the positions used to effectuate the manipulation.

By restricting positions to a proportion of the deliverable supply of the commodity, the spot month position limits require that no one speculator can hold a position larger than 25 percent of deliverable supply, reducing the possibility that a market participant can use derivatives, including referenced contracts, to affect the price of the cash commodity (and vice versa). Limiting a speculative position based on a percentage of deliverable supply also restricts a speculative trader's ability to establish a leveraged position in cash-settled derivative contracts, reducing that trader's incentive to manipulate the cash settlement price.[190] Further, by proposing levels that are sufficiently low to prevent market manipulation, including corners and squeezes, the proposed levels also help ensure that the price discovery function of the underlying market is not disrupted because markets that are free from corners, squeezes, and other manipulative activity reflect fundamentals of supply and demand rather than artificial pressures.

Each of the exchange-recommended levels is based on a percentage of deliverable supply estimated by the relevant exchange and submitted to the Commission for review.[191] The Commission has closely assessed the estimates, which CME Group, ICE, and MGEX updated with recent data using the methodologies they used during the 2016 Reproposal.[192] The Commission hereby verifies that the estimates submitted by the exchanges are reasonable.

In verifying the DCMs' estimates of deliverable supply, the Commission is not endorsing any particular methodology for estimating deliverable supply beyond what is already set forth in Appendix C to part 38 of the Commission's regulations.[193] As circumstances change over time, such DCMs may need to adjust the methodology, assumptions, and allowances that they use to estimate deliverable supply to reflect then current market conditions and other relevant factors.

ii. The Proposed Spot Month Limit Levels are High Enough To Ensure Sufficient Market Liquidity for Bona Fide Hedgers

Section 4a(a)(1) of the CEA addresses ''excessive speculation. . .causing sudden or unreasonable fluctuations or unwarranted [price] changes . . .'' [194] Speculative activity that is not ''excessive'' in this manner is not a focus of section 4a(a)(1). Rather, speculative activity may generate liquidity by enabling market participants with bona fide hedging positions to trade more efficiently. Setting position limits too low could result in reduced liquidity, including for bona fide hedgers. The Commission has not observed, or received any complaints about, a lack of liquidity for bona fide hedgers in the markets for the 25 core referenced futures contracts. In fact, as described later in this release, the 25 core referenced futures contracts represent some of the most liquid markets overseen by the Commission.[195] Market developments that have taken place since federal spot month limits were last amended decades ago, such as electronic trading and expanded trading hours, have likely only contributed to these already liquid markets.[196] Market participants have more opportunities than ever to enter, trade, or exit a position. By proposing to generally increase the existing federal spot month limit levels, and by proposing federal spot month limit levels that are generally equal to or higher than existing exchange-set levels,[197] yet in all cases still low enough to prevent excessive speculation, manipulation, corners and squeezes, the Commission does not expect the proposed limits to result in a reduction in liquidity for bona fide hedgers.

iii. The Proposed Spot Month Limit Levels Fall Within a Range of Acceptable Levels

ICE and MGEX recommended federal spot month limit levels at 25 percent of deliverable supply, while CME Group generally recommended levels below 25 percent of deliverable supply.[198] These

[190] *Id.*

[191] *See ICE Comment Letter* at 8 (May 14, 2019); *MGEX Comment Letter* at 2, 4–8 (Aug. 31, 2018); and *Summary DSE Proposed Limits, CME Group Comment Letter* (Nov. 26, 2019), *available at https://comments.cftc.gov* (comment file for RIN 3038–AD99).CME Group submitted updated estimates of deliverable supply and recommended federal spot month limit levels for CBOT Corn (C), CBOT Oats (O), CBOT Rough Rice (RR), CBOT Soybeans (S), CBOT Soybean Meal (SM), CBOT Soybean Oil (SO), CBOT Wheat (W), and CBOT KC HRW Wheat (KW); COMEX Gold (GC), COMEX Silver (SI), NYMEX Platinum (PL), NYMEX Palladium (PA), and COMEX Copper (HG); and NYMEX Henry Hub Natural Gas (NG), NYMEX Light Sweet Crude Oil (CL), NYMEX NY Harbor ULSD Heating Oil (HO), and NYMEX NY Harbor RBOB Gasoline (RB). ICE submitted updated estimates of deliverable supply and recommended federal spot month limit levels for ICE Cocoa (CC), ICE Coffee C (KC), ICE Cotton No. 2 (CT), ICE FCOJ–A (OJ), ICE U.S. Sugar No. 11 (SB), and ICE U.S. Sugar No. 16 (SF). MGEX submitted an updated deliverable supply estimate and indicated that if the Commission adopted a specific spot month position limit, MGEX believes the federal spot month limit level for MGEX Hard Red Spring Wheat (MWE) should be no less than 1,000 contracts. Commission staff reviewed the exchange submissions and conducted its own research. Commission staff reviewed the data submitted, confirmed that the data submitted accurately reflected the source data, and considered whether the data sources were authoritative. Commission staff considered whether the assumptions made by the exchanges in the submissions were acceptable, or whether alternative assumptions would lead to similar results. In some cases, Commission staff conducted trade source interviews. Commission staff replicated the calculations included in the submissions.

[192] *See* CME Group Comment Letter (Apr. 15, 2016); CME Group Comment Letter (addressing natural gas) (Sept. 15, 2016); CME Group Comment Letter (addressing ULSD) (Sept. 15, 2016); ICE Comment Letter (Apr. 20, 2016); and MGEX Comment Letter (Jul. 13, 2016), available at *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=1772&ctl00_ctl00_cphContentMain_MainContent_gvCommentListChangePage=8_50*. At that time, the Commission reviewed the methodologies that the DCMs used to prepare the estimates, among other things, and verified the deliverable supply estimates as reasonable. *See* 2016 Reproposal, 81 FR at 96754.

[193] 17 CFR part 38, Appendix C.

[194] CEA section 4a(a)(1); 7 U.S.C. 6a(a)(1).

[195] *See infra* Section III.F.

[196] With the exception of CBOT Oats (O), open interest for the legacy agricultural commodities has increased dramatically over the past several decades, some by a factor of four.

[197] While the proposed spot month limit levels are generally higher than the existing federal or exchange-set levels, the proposed federal level for COMEX Copper (HG) is below the existing exchange-set level, the proposed federal level for CBOT Oats (O) is the same as the existing federal and exchange-set level, and the proposed federal levels for NYMEX Platinum (PL) and NYMEX Palladium (PA) are the same as the existing exchange-set levels.

[198] For the following core referenced futures contracts, CME Group recommended spot month levels below 25 percent of deliverable supply: CBOT Corn (C) (9.22% of deliverable supply), CBOT Oats (O) (19.29%), CBOT Soybeans (S) (15.86%), CBOT Soybean Meal (SM) (16.77%), Soybean Oil (SO) (8.31%), CBOT Wheat (W) (9.24%), CBOT KC HRW Wheat (KW) (9.24%), CME Live Cattle (LC) (step-down limits 15.86%–7.93%–5.29%), CBOT Rough Rice (RR) (8.94%), COMEX Gold (GC) (12.72%), COMEX Silver (SI) (12.62%), COMEX Copper (HG) (9.66%), NYMEX Platinum (PL) (13.60%), NYMEX Palladium (PA) (17.18%), NYMEX Light Sweet Crude Oil (CL) (step-down limits 11.16%–9.30%–7.44%), NYMEX NYH ULSD Heating Oil (HO) (10.85%), and NYMEX NYH RBOB Gasoline (RB) (7.41%). CME Group recommended spot month levels at 25 percent of estimated deliverable supply for NYMEX Henry Hub Natural Gas (NG). ICE and MGEX recommended limit levels at 25 percent of estimated deliverable supply for each of their core referenced futures contracts: Cocoa (CC), Coffee C (KC), FCOJ–A (OJ), Cotton No. 2 (CT), U.S. Sugar No. 11 (SB), and U.S. Sugar No. 16 (SF) on ICE, and Hard Red Spring Wheat (MWE) on MGEX. *See ICE Comment Letter* at 1–7 (May 14, 2019); *MGEX Comment Letter* at 2, 4–8 (Aug. 31, 2018); and *Summary DSE Proposed Limits, CME Group Comment Letter* (Nov. 26, 2019), *available at https://comments.cftc.gov* (comment file for RIN 3038–AD99).

distinctions reflect philosophical and other differences among the exchanges and differences between the core referenced futures contracts and their underlying commodities, including a preference on the part of CME Group not to increase existing limit levels applicable to its core referenced futures contracts too drastically.[199] The Commission has previously stated that ''there is a range of acceptable limit levels,'' [200] and continues to believe this is true, both for spot and non-spot month limits. There is no single ''correct'' spot month limit level for a given contract, and it is likely that a number of limit levels within a certain range could effectively address the 4a(a)(3) factors. While the CME Group, ICE, and MGEX recommended levels all fall at different ends of the deliverable supply range, the levels all fall at or below 25 percent of deliverable supply, which is critical for protecting the spot month from excessive speculation, manipulation, corners and squeezes.

iv. The Proposed Spot Month Limit Levels Account for Differences Between Markets

In addition to being high enough to ensure sufficient liquidity, and low enough to prevent excessive speculation and manipulation, the proposed spot month limit levels are also calibrated to further address CEA section 4a(a)(3) by accounting for differences between markets for the core referenced futures contracts and for their underlying commodities.[201]

For the agricultural commodities, the Commission considered a variety of factors in evaluating the exchange-recommended spot month levels, including concentration and composition of market participants, the historical price volatility of the commodity, convergence between the futures and cash market prices at the expiration of the contract, and the Commission's experience observing how the supplies of agricultural commodities are affected by weather (drought, flooding, or optimal growing conditions), storage costs, and delivery mechanisms. In the Commission's view, the exchanges' recommended spot month levels for each of the agricultural contracts would allow for speculators to be present in the market while preventing speculative positions from being so large as to harm convergence and otherwise hinder statutory objectives.

The Commission also considered the delivery mechanisms for the agricultural commodities in assessing the exchange-recommended spot month levels. For example, for the CME Live Cattle (LC) contract, the Commission considered the physical limitation that exists on how many cattle can be processed (inspected, graded, and weighed) at the delivery facilities. CME Group currently has an exchange-set step-down spot month limit, and recommended a federal step-down limit for CME Live Cattle (LC) of 600/300/200 contracts in order to avoid congestion and to foster convergence by gradually reducing the limit levels in a manner that meets the processing capacity of the delivery facilities. The Commission proposes to adopt this step-down limit due to the unique attributes of the CME Live Cattle (LC) contract.

For the metals contracts, which are all listed on NYMEX, the Commission took delivery mechanisms, among other factors, into account in assessing the recommended spot month limit levels. Upon expiration, the long for each metals contract receives the ownership certificate (warrant) for the metal already in the warehouse/depository and can continue to store the metal where it is, load-out the metal, or short a futures contract to sell the ownership certificate. This delivery mechanism, which allows for the resale of the warrant while the metal remains in the warehouse, provides for relatively inexpensive and simple delivery when compared to the delivery mechanisms for other commodity types. Further, metals tend not to spoil and are cheap to store on a per dollar basis compared to other commodities. As metals are generally easier to obtain, store, and sell than other commodity types, it is also potentially cheaper to accomplish a corner or squeeze in metals than in other commodity types. The Commission has previously observed manipulative activity in metals as evidenced by the Hunt Brother silver and Sumitomo copper events. The Commission kept this history in mind in accepting CME Group's recommendation to take a fairly cautious approach with respect to the recommended levels for each metal contract, which are each well below 25 percent of deliverable supply.[202] Commission staff has, however, reviewed each of the metals contracts previously and confirms that these contracts satisfy all regulatory requirements, including the DCM Core Principle 3 requirement that the contracts are not readily susceptible to manipulation.

Additionally, the Commission considered the volatility in the estimated deliverable supply for metals. For the COMEX Copper (HG) contract, the estimated deliverable supply for copper (measured by copper stocks in COMEX-approved warehouses) has experienced considerable volatility during the past decade, resulting in COMEX amending its exchange-set spot month position limit multiple times, decreasing or increasing the limit level to reflect the amount of copper in its approved warehouses.[203] Similarly, volatility in deliverable supplies has been observed for the NYMEX Palladium (PA) contract, where production of palladium from major producers has been declining while demand for palladium by the auto

[199] CME Group has indicated that for its own exchange-set limits, it historically has not typically set the limit at the full 25 percent of deliverable supply when launching a new product, regardless of asset class or commodity. CME Group's recommended spot month limit levels are based on observations regarding the orderliness of liquidations and monitoring for appropriate price convergence. CME Group indicated that the recommended levels reflect a measured approach calibrated to avoid the risk of disruption to its markets, and stated that upon analyzing a reasonable body of data relating to the expirations with the recommended spot month limit levels, CME Group would consider in the future making any recommendations for increases in limits if any additional increases were appropriate. *Summary DSE Proposed Limits,* CME Group Comment Letter (Nov. 26, 2019), *available at https://comments.cftc.gov (comment file for RIN 3038–AD99).*

[200] *See, e.g.,* Revision of Federal Speculative Position Limits, 57 FR at 12766, 12770 (Apr. 13, 1992).

[201] Commenters, including those responding to the 2016 Reproposal, have previously requested that limit levels should be set on a commodity-by-commodity basis to recognize differences among commodities, including differences in liquidity, seasonality, and other economic factors. *See, e.g.,* AQR Capital Management Comment Letter at 12 (Feb. 28, 2017); Copperwood Asset Management Comment Letter at 3 (Feb. 28, 2017); Managed Funds Association, Asset Management Group of the Securities Industry and Financial Markets Association, and the Alternative Investment Management Association Comment Letter at 9–12 (Feb. 28, 2017); and National Grain and Feed Association Comment Letter at 2 (Feb. 28, 2017).

[202] As noted above, CME Group's recommended federal level of 1,000 for COMEX Copper (HG) is below the existing exchange-set level of 1,500, and CME Group's recommended federal levels for NYMEX Platinum (PL) and NYMEX Palladium (PA) are equal to the existing exchange-set levels of 500 and 50, respectively. CME Group recommended federal levels of 6,000 for COMEX Gold (GC) and 3,000 for COMEX Silver (SI), which would represent an increase over the existing exchange-set levels of 3,000 and 1,500, respectively. While CME Group's recommended federal COMEX Gold (GC) and COMEX Silver (SI) levels are higher than the existing exchange-set levels, the recommended levels still represent only approximately 13 percent of deliverable supply each. *Summary DSE Proposed Limits,* CME Group Comment Letter (Nov. 26, 2019), available at *https://comments.cftc.gov* (comment file for RIN 3038–AD99).

[203] The volatility was based on factors such as the bust in the housing market in 2008, the severe recession in the United States in 2009, and high demand for copper exports to China, which has grown continually over the past 20 years.

industry for catalytic converters has increased. This trend in palladium stocks in exchange-approved depositories has been observed since 2014. In a series of amendments, NYMEX reduced its exchange-set spot month limit from 650 contracts to below 200 contracts over time.[204]

The Commission has not observed similar volatility in the deliverable supply estimates for agricultural or energy commodities. Given this history of volatility in deliverable supply estimates for metals, if the Commission were to set limit levels at, rather than below, 25 percent of deliverable supply, and if deliverable supply were to subsequently change drastically, the spot month limit level could end up being well above (or below) 25 percent of deliverable supply, and thus potentially too high (or too low) to further statutory objectives.

For the energy complex, the Commission considered factors such as the underlying infrastructure and connectivity. For example, as of 2017, generally, out of commodities underlying the core referenced futures contracts in energy, natural gas had the most robust infrastructure for moving the commodity, with over 1,600,000 miles of pipeline (including distribution mains, transmission pipelines, and gathering lines) in the United States, compared to only 215,000 miles of pipeline for oil (including crude and product lines).[205] The robust infrastructure for moving natural gas supports CME Group's recommended spot month limit level at 25 percent of estimated deliverable supply for the NYMEX Henry Hub Natural Gas (NG) contract, while comparatively smaller crude oil and crude product pipeline infrastructure support CME Group's recommended spot month limit levels below 25 percent of estimated deliverable supply for the NYMEX Light Sweet Crude Oil (CL) and NYMEX NYH RBOB Gasoline (RB) contracts.

The Commission also considered factors such as the large amounts of liquidity in the cash-settled natural gas referenced contracts relative to the physically settled NYMEX Henry Hub Natural Gas (NG) core referenced futures contract. For that contract, CME Group recommended setting the spot month limit at 25 percent of estimated deliverable supply (2,000 contract spot month limit) with a conditional limit exemption of 10,000 contracts net long or net short conditioned on the participant not holding or controlling any positions during the spot month in the physically-settled NYMEX Henry Hub Natural Gas (NG) core referenced futures contract. Speculators who desire price exposure to natural gas will likely trade in the cash-settled contracts because, generally, they do not have the ability to make or take delivery; trading in the cash-settled contract removes the chance that they may be unable to exit the physically-settled NYMEX Henry Hub Natural Gas (NG) contract and be selected to make or take delivery of natural gas. Thus, speculators are likely to remain out of the NYMEX Henry Hub Natural Gas (NG) contract during the spot month. Since corners and squeezes cannot be effected using cash settled contracts, the Commission proposes a spot month limit set at 25 percent of deliverable supply for the NYMEX Henry Hub Natural Gas (NG) core referenced futures contract.

Further, for certain energy commodities, CME Group recommended step-down limits, including for commodities where delivery constraints could hinder convergence or where market participants otherwise provided feedback that such limits would help maintain orderly markets. In the case of NYMEX Light Sweet Crude Oil (CL), CME Group currently has a single spot-month limit of 3,000 contracts, but is recommending a step down limit that would end at 4,000 contracts (step-down limits of 6,000/5,000/4,000). Historically, as liquidity decreases in the contract, the exchange would have a step down mechanism in its exemptions that it had granted to force market participants to lower their positions to the current 3,000 contract spot month limit. Given the recommended increase to a final step-down limit of 4,000 contracts, the exchange, through feedback from market participants, recommended a step-down spot month limit that would in effect provide the same diminishing effect on positions.

d. Proposed Federal Single Month and All-Months Combined (''Non-Spot Month'') Limit Levels

Under the rules proposed herein, federal non-spot month limits would only apply to the nine agricultural commodities currently subject to federal limits. The 16 additional contracts covered by this proposal would be subject to federal limits only during the spot month, and exchange-set limits and/or accountability requirements outside of the spot month.[206]

The Commission proposes to maintain federal non-spot month limits for the nine legacy agricultural contracts, with the modifications set forth below, because the Commission has observed no reason to eliminate them. These non-spot month limits have been in place for decades, and while the Commission is proposing to modify the limit levels,[207] removing the levels entirely could potentially result in market disruption. In fact, commercial market participants trading the nine legacy agricultural contracts have requested that the Commission maintain federal limits outside the spot month in order to promote market integrity. For the following reasons, however, the Commission is not proposing limits outside the spot month for the other 16 contracts.

[204] *See, e.g.,* NYMEX Submissions Nos. 14–463 (Oct. 31, 2014), 15–145 (Apr. 14, 2015), and 15–377 (Aug. 27, 2015).

[205] *See U.S. Oil and Gas Pipeline Mileage,* Bureau of Transportation Statistics website, *available at www.bts.gov/content/us-oil-and-gas-pipeline-mileage.*

[206] *Market Resources,* ICE Futures website, *available at https://www.theice.com/futures-us/market-resources* (ICE exchange-set position limits); *Position Limits,* CME Group website, *available at https://www.cmegroup.com/market-regulation/position-limits.html*; *Rules and Regulations of the Minneapolis Grain Exchange, Inc.,* MGEX, *available at http://www.mgex.com/documents/Rulebook_051.pdf* (MGEX exchange-set position limits).

[207] *See infra* Section II.B.2.e.

First, corners and squeezes cannot occur outside the spot month when there is no threat of delivery, and there are tools other than federal position limits for deterring and preventing manipulation outside of the spot month.[208] Surveillance at both the exchange and federal level, coupled with exchange-set limits and/or accountability, would continue to offer strong deterrence and protection against manipulation outside of the spot month. In particular, under this proposal, for the 16 contracts that would be subject to federal limits only during the spot month, exchanges would be required to establish either position limit levels or position accountability levels outside of the spot month.[209] Any such accountability and limit levels would be subject to standards established by the Commission including, among other things, that any such levels be ''necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index.'' [210] Exchanges would also be required to submit any rules adopting or modifying such position limit and/or accountability levels to the Commission pursuant to part 40 of the Commission's regulations.[211]

Exchange position accountability establishes a level at which an exchange will ask traders additional questions, including regarding the trader's purpose for the position, and will evaluate existing market conditions. If the position does not raise any concerns, the exchange will allow the trader to exceed the accountability level. If the position raises concerns, the exchange has the authority to instruct the trader not to increase the position further, or to reduce the position. Accountability is a particularly flexible and effective tool because it provides the exchanges with an opportunity to intervene once a position hits a relatively low level, while still affording market participants with the flexibility to establish a large position when warranted by the nature of the position and the condition of the market.

The Commission has decades of experience overseeing accountability levels implemented by exchanges,[212] including for all 16 contracts that would not be subject to federal limits outside of the spot month under this proposal. Such accountability levels apply to all participants on the exchange, whether commercial or non-commercial, and regardless of whether the participant would qualify for an exemption. In the Commission's experience, these levels have functioned as-intended, and the Commission views exchange accountability outside of the spot month as an equally robust, yet more flexible, alternative to federal non-spot month speculative position limits.

Second, applying federal limits during the spot month to referenced contracts based on all 25 core referenced futures contracts, and outside of the spot month only to referenced contracts based on the nine legacy agricultural commodities, furthers statutory goals while minimizing the impact on existing industry practice and leveraging existing exchange-set limits and accountability levels that appear to have functioned well. The Commission thus endeavors to minimize market disruption that could result from eliminating existing federal non-spot month limits on certain agricultural commodities and from adding new non-spot limits on certain metals and energy commodities that have never been subject to federal limits. Layering federal non-spot month limits for the 16 additional contracts on top of existing exchange-set limit/accountability levels may only provide minimal benefits, if any, and would forego the benefits associated with flexible accountability levels, which provide many of the same protections as hard limits but with significantly more flexibility for market participants to exceed the accountability level in cases where the position would not harm the market.

As set forth in proposed § 150.2(e), proposed federal non-spot month levels applicable to referenced contracts based on the nine legacy agricultural contracts are listed in proposed Appendix E and are as follows:

Core referenced futures contract	2020 Proposed single month and all-months combined limit based on new 10/2.5 formula for first 50,000 OI	Existing federal single month and all-months-combined limit	Existing exchange-set single month and all-months-combined limit
CBOT Corn (C)	57,800	33,000	33,000
CBOT Oats (O)	2,000	2,000	2,000
CBOT Soybeans (S)	27,300	15,000	15,000
CBOT Soybean Meal (SM)	16,900	6,500	6,500
CBOT Soybean Oil (SO)	17,400	8,000	8,000
CBOT Wheat (W)	19,300	12,000	12,000
KC HRW Wheat (KW)	12,000	12,000	12,000
MGEX HRS Wheat (MWE)	12,000	12,000	12,000
ICE Cotton No. 2 (CT)	11,900	5,000	5,000

[208] In the case of certain commodities where open interest in the deferred month contracts may be much larger, it may become difficult to exert market power via concentrated futures positions. For example, a participant with a large cash-market position and a large deferred futures position may attempt to move cash markets in order to benefit that deferred futures position. Any attempt to do so could become muted due to general futures market resistance from multiple vested interests present in that deferred futures month (*i.e.,* the overall size of the deferred contracts may be too large for one individual to influence via cash market activity). However, if a large position accumulated over time in a particular deferred month is held into the spot month, it is possible that such positions could form the groundwork for an attempted corner or squeeze in the spot month.

[209] *See infra* Section II.D.4. (discussion of proposed § 150.5).

[210] *Id.*

[211] Under the proposed ''position accountability'' definition in § 150.1, DCM accountability rules would have to require a trader whose position exceeds the accountability level to consent to: (1) Provide information about its position to the DCM; and (2) halt increasing further its position or reduce its position in an orderly manner, in each case as requested by the DCM.

[212] *See, e.g.,* 56 FR 51687 (Oct. 15, 1991) (permitting CME to establish position accountability for certain financial contracts traded on CME), Speculative Position Limits—Exemptions from Commission Rule 1.61, 57 FR 29064 (June 30, 1992) (permitting the use of accountability for trading in energy commodity contracts), and 17 CFR 150.5(e) (2009) (formally recognizing the practice of accountability for contracts that met specified standards).

e. Methodology for Setting Proposed Non-Spot Month Limit Levels

The Commission's practice has been to set non-spot month limit levels for the nine legacy agricultural contracts at 10 percent of the open interest for the first 25,000 contracts and 2.5 percent of the open interest thereafter (the ''10, 2.5 percent formula'').[213] The existing non-spot month limit levels have not been updated to reflect changes in open interest data in over a decade, and the 10, 2.5 percent formula has been used since the 1990s, and was based on the Commission's experience up until that time.[214] The Commission's adoption of the 10, 2.5 percent formula was based on two primary factors: growth in open interest and the size of large traders' positions.[215]

The Commission proposes to maintain the 10, 2.5 percent formula for non-spot limits, with the limited change that the 2.5 percent calculation will be applied to open interest above 50,000 contracts rather than to the current level of 25,000 contracts. The Commission believes that this change is warranted due to the significant overall increase in open interest in these markets, which has roughly doubled since federal limits were set on these markets. The Commission would apply the modified formula to recent open interest data for the periods from July 2017–June 2018 and July 2018–June 2019 of the applicable futures and delta adjusted futures options. The resulting proposed limit levels, set forth in the second column in the table above, would generally be higher than existing limit levels, with the exception of CBOT Oats (O), CBOT KC HRW Wheat (KW), and MGEX HRS Wheat (MWE), where proposed levels would remain at the existing levels.

The Commission continues to believe that a formula based on a percentage of open interest is an appropriate tool for establishing limits outside the spot month. As the Commission stated when it initially proposed to use an open interest formula, taking open interest into account ''will permit speculative position limits to reflect better the changing needs and composition of the futures markets . . .'' [216] Open interest is a measure of market activity that reflects the number of contracts that are ''open'' or live, where each contract of open interest represents both a long and a short position. Relative to contracts with smaller open interest, contracts with larger open interest may be better able to mitigate the disruptive impact of excessive speculation because there may be more activity to oppose, diffuse, or otherwise counter a potential pricing disruption. Limiting positions to a percentage of open interest: (1) Helps ensure that positions are not so large relative to observed market activity that they risk disrupting the market; (2) allows speculators to hold sufficient contracts to provide a healthy level of liquidity for hedgers; and (3) allows for increases in position limits and position sizes as markets expand and become more active.

While the Commission continues to prefer a formula based on a percentage of open interest, market and potential regulatory changes counsel in favor of proposing a slight modification to the existing formula. In particular, as discussed in detail below, open interest has grown, and market composition has changed, significantly since the 1990s. The proposed increase in the open interest portion of the non-spot month limit formula from 25,000 to 50,000 contracts would provide a modest increase in the non-spot month limit of 1,875 contracts (over what the limit would be if the 10, 2.5 percent formula were applied at 25,000 contracts), assuming the underlying commodity futures market has open interest of at least 50,000 contracts. The Commission believes that the amended non-spot month formula would provide a conservative increase in the non-spot month limits for most contracts to better reflect the general increase observed in open interest across futures markets since the late 1990s, as discussed below.

i. Increases in Open Interest

The table below provides data that describes the market environment during the period prior to, and subsequent to, the adoption of the 10, 2.5 percent formula by the Commission in 1999. The data includes futures contracts and the delta-adjusted options on futures open interest.[217] The first column of the table provides the maximum open interest in the nine legacy agricultural contracts over the five year period ending in 1999. The CBOT Corn (C) contract had maximum open interest of approximately 463,000 contracts, and the CBOT Soybeans (S) contract had maximum open interest of approximately 227,000 contracts. The other seven contracts had maximum open interest figures that ranged from less than 20,000 contracts for CBOT Oats (O) to approximately 172,000 for CBOT Soybean Oil (SO). Hence, when adopting the 10, 2.5 percent formula in 1999, the Commission's experience in these markets was of aggregate futures and options on futures open interest well below 500,000 contracts.

TABLE—MAXIMUM FUTURES AND OPTIONS ON FUTURES OPEN INTEREST, 1994–2018

	1994–1999	2000–2004	2005–2009	2010–2014	2015–2018
CBOT Corn (C)	463,386	828,176	1,897,484	2,052,678	2,201,990
ICE Cotton No. 2 (CT)	122,989	140,240	388,336	296,596	344,302

[213] For example, assume a commodity contract has an aggregate open interest of 200,000 contracts over the past 12 month period. Applying the 10, 2.5 percent formula to an aggregate open interest of 200,000 contracts would yield a non-spot month limit of 6,875 contracts. That is, 10 percent of the first 25,000 contracts would equal 2,500 contracts (25,000 contracts × 0.10 = 2,500 contracts). Then add 2.5 percent of the remaining 175,000 of aggregate open interest or 4,375 contracts (175,000 contracts × 0.025 = 4,375 contracts) for a total non-spot month limit of 6,875 contracts (2,500 contracts + 4,375 contracts = 6,875 contracts).

[214] *See, e.g.,* Revision of Federal Speculative Position Limits and Associated Rules, 64 FR at 24038 (May 5, 1999) (increasing deferred-month limit levels based on 10 percent of open interest up to an open interest of 25,000 contracts, with a marginal increase of 2.5 percent thereafter). Prior to 1999, the Commission had given little weight to the size of open interest in the contract in determining the position limit level—instead, the Commission's traditional standard was to set limit levels based on the distribution of speculative traders in the market. *See, e.g.,* 64 FR at 24039; Revision of Federal Speculative Position Limits and Associated Rules, 63 FR at 38525, 38527 (July 17, 1998).

[215] *See* 64 FR at 24038. *See also* 63 FR at 38525, 38527 (The 1998 proposed revisions to non-spot month levels, which were eventually adopted in 1999, were based upon two criteria: ''(1) the distribution of speculative traders in the markets; and (2) the size of open interest.'').

[216] Revision of Federal Speculative Position Limits, 57 FR 12766, 12770 (Apr. 13, 1992). The Commission also stated that providing for a marginal increase was ''based upon the universal observation 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.'' *Id.*

[217] Delta is a ratio comparing the change in the price of an asset (a futures contract) to the corresponding change in the price of its derivative (an option on that futures contract) and has a value that ranges between zero and one. In-the-money call options get closer to 1 as their expiration approaches. At-the-money call options typically have a delta of 0.5, and the delta of out-of-the-money call options approaches 0 as expiration nears. The deeper in-the-money the call option, the closer the delta will be to 1, and the more the option will behave like the underlying asset. Thus, delta-adjusted options on futures will represent the total position of those options as if they were converted to futures.

TABLE—MAXIMUM FUTURES AND OPTIONS ON FUTURES OPEN INTEREST, 1994–2018—Continued

	1994–1999	2000–2004	2005–2009	2010–2014	2015–2018
CBOT Oats (O)	18,879	17,939	16,860	15,375	11,313
CBOT Soybeans (S)	227,379	327,276	672,061	991,258	997,881
CBOT Soybean Meal (SM)	155,658	183,255	241,917	392,265	544,363
CBOT Soybean Oil (SO)	172,424	191,337	328,050	395,743	547,784
CBOT Wheat (W)	163,193	187,181	507,401	576,333	621,750
CBOT Wheat: Kansas City Hard Red Winter (KW)	76,435	87,611	159,332	189,972	311,592
MGEX Wheat: Minneapolis Hard Red Spring (MWE)	24,999	36,155	57,765	68,409	80,635

The table also displays the maximum open interest figures for subsequent periods up to, and including, 2018. The maximum open interest for all of these contracts, except for oats, generally increased over the period.[218] By the 2015–2018 period covered in the last column of the table, five of the contracts had maximum open interest greater than 500,000 contracts. The contracts for CBOT Corn (C), CBOT Soybeans (S), and CBOT Hard Red Winter Wheat (KW) saw maximum open interest increase by a factor of four to five times the maximum open interest during the 1994–1999 period leading up to the Commission's adoption of the 10, 2.5 percent formula in 1999.

ii. Changes in Market Composition

As open interest has increased, the current non-spot limits have become significantly more restrictive over time. In particular, because the 2.5 percent incremental increase applies after the first 25,000 contracts of open interest, limits on commodities with open interest above 25,000 contracts (*i.e.,* all commodities other than oats) continue to increase at a much slower rate of 2.5 percent rather than 10 percent, as for the first 25,000 contracts. This gradual increase was less of a problem in the latter part of the 1990s, for example, when open interest in each of the nine legacy agricultural contracts was below 500,000, and in many cases below 200,000. More recently, however, open interest has grown above 500,000 for a majority of the legacy contracts. The 10, 2.5 percent formula has thus become more restrictive for market participants, including those entities with positions that may not be eligible for a bona fide hedging exemption, but who might otherwise provide valuable liquidity to commercial firms.

This problem has become worse over time because dealers play a much more significant role in the market today than at the time the Commission adopted the 10, 2.5 percent formula. Prior to 1999, the Commission regulated physical commodity markets where the largest participants were often large commercial interests who held short positions. The offsetting positions were often held by small, individual traders, who tended to be long.[219] Several years after the Commission adopted the 10, 2.5 percent formula, the composition of futures market participants changed, as dealers began to enter the physical commodity futures market in larger size. The table below presents data from the Commission's publicly available ''Bank Participation Report'' (''BPR''), as of the December report for 2002–2018.[220] The table displays the number of banks holding reportable positions for the seven futures contracts for which federal limits apply and that were reported in the BPR.[221] The report presents data for every market where five or more banks hold reportable positions. The BPR is based on the same large-trader reporting system database used to generate the Commission's Commitments of Traders (''COT'') report.[222]

No data was reported for the seven futures contracts in December 2002, indicating that fewer than five banks held reportable positions at the time of the report. The December 2003 report shows that five or more banks held reportable positions in four of the commodity futures. The number of banks with reportable positions generally increased in the early to mid-2000s. As described in the Commission's 2008 Staff Report on Commodity Swap Dealers & Index Traders, major changes in the composition of futures markets developed over the 20 years prior to 2008, including an influx of swap dealers (''SDs''), affiliated with banks or other large financial institutions, acting as aggregators or market makers and providing swaps to commercial hedgers and to other market participants.[223] The dealers functioned in the swaps market and also used the futures markets to hedge their exposures. When the Commission adopted the 10, 2.5 percent formula in 1999, it had limited experience with physical commodity derivatives markets in which such banks were significant participants.

TABLE—NUMBER OF REPORTING COMMERCIAL BANKS WITH LONG FUTURES POSITIONS

Year	Corn	Cotton	Soybeans	Soybean meal	Soybean oil	Wheat	Wheat KCBT
2002	NR	NR	NR	NR	NR	NR	NR
2003	5	6	7	NR	NR	5	NR
2004	5	10	7	NR	NR	7	NR
2005	10	8	6	NR	5	9	9
2006	11	11	9	NR	7	14	7
2007	13	8	12	NR	6	14	6
2008	17	13	16	NR	6	14	9

[218] *See infra* Section II.B.2.e.iii. (discussion of proposed non-spot month limit level for CBOT Oats (O)).

[219] Stewart, Blair, *An Analysis of Speculative Trading in Grain Futures,* Technical Bulletin No. 1001, U.S. Department of Agriculture (Oct. 1949).

[220] *Bank Participation Reports,* U.S. Commodity Futures Trading Commission website, *available at https://www.cftc.gov/MarketReports/BankParticipationReports/index.htm* .

[221] The term ''reportable position'' is defined in § 15.00(p) of the Commission's regulations. 17 CFR 15.00(p).

[222] *Commitments of Traders,* U.S. Commodity Futures Trading Commission website, *available at www.cftc.gov/MarketReports/CommitmentsofTraders/index.htm.* There are generally still as many large commercial traders in the markets today as there were in the 1990s.

[223] *Staff Report on Commodity Swap Dealers & Index Traders with Commission Recommendations,* U.S. Commodity Futures Trading Commission (Sept. 2008), *available at https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/cftcstaffreportonswapdealers09.pdf.*

TABLE—NUMBER OF REPORTING COMMERCIAL BANKS WITH LONG FUTURES POSITIONS—Continued

Year	Corn	Cotton	Soybeans	Soybean meal	Soybean oil	Wheat	Wheat KCBT
2009	8	8	8	NR	NR	13	NR
2010	7	7	7	NR	NR	11	NR
2011	10	11	9	5	5	10	NR
2012	8	10	11	6	6	13	5
2013	11	11	13	10	6	11	5
2014	15	12	15	10	9	15	6
2015	12	13	13	12	9	16	9
2016	15	14	15	12	10	15	6
2017	16	13	12	11	9	16	8
2018	16	15	18	15	13	18	12

NR = "Not Reported".

For 2003, the first year in the report with reported data on the futures for these physical commodities, the BPR showed, as displayed in the table below, that the reporting banks held modest positions, totaling 3.4 percent of futures long open interest for wheat and smaller positions in other futures. The positions displayed in the table below increased over the next several years, generally peaking around 2005/2006 as a fraction of the long open interest.

TABLE—PERCENT OF FUTURES LONG OPEN INTEREST HELD BY COMMERCIAL BANKS

Year (Dec.)	Corn	Cotton	Soybeans	Soybean meal	Soybean oil	Wheat	Wheat KCBT
2002	NR	NR	NR	NR	NR	NR	NR
2003	1.5%	1.4%	0.8%	NR	NR	3.4%	NR
2004	7.0	6.5	3.6	NR	NR	14.5	NR
2005	12.5	13.8	8.3	NR	6.8	20.2	5.2
2006	9.4	14.2	7.7	NR	6.7	17.0	6.9
2007	9.2	9.7	6.7	NR	6.5	13.5	5.5
2008	8.9	18.2	10.0	NR	6.4	18.7	7.1
2009	4.3	6.5	3.6	NR	NR	9.3	NR
2010	3.7	2.5	4.7	NR	NR	6.9	NR
2011	4.1	3.3	4.9	1.9	4.4	7.7	NR
2012	4.7	9.9	3.7	5.8	5.5	7.4	3.5
2013	5.3	9.1	4.4	7.0	4.1	6.2	6.4
2014	9.7	10.0	6.3	6.7	6.5	7.7	10.1
2015	8.1	10.1	5.0	5.9	6.4	7.8	4.3
2016	8.1	8.5	7.1	10.7	6.6	7.3	5.2
2017	5.5	9.5	4.3	9.1	7.3	7.7	4.8
2018	5.8	8.3	5.9	9.2	7.6	10.2	7.0

NR = "Not Reported".

iii. Proposed Non-Spot Month Limits for Hard Red Wheat and Oats

The Commission proposes partial wheat parity outside of the spot month: limits for CBOT KC HRW Wheat (KW) and MGEX HRS Wheat (MWE) would be set at 12,000 contracts, while limits for CBOT Wheat (W) would be set at 19,300 contracts. Based on the Commission's experience since 2011 with non-spot month speculative position limit levels at 12,000 for the CBOT KC HRW Wheat (KW) and MGEX HRS Wheat (MWE) core referenced futures contracts, the Commission is proposing to maintain the current non-spot month limit levels for those two contracts, rather than reducing the existing levels to the lower levels that would result from applying the proposed modified 10, 2.5 percent formula.[224] The current 12,000 contract level appears to have functioned well for these contracts, and the Commission sees no market-based reason to reduce the levels.

CBOT KC HRW Wheat (KW) and MGEX HRS Wheat (MWE) are both hard red wheats representing about 60 percent of the wheat grown in the United States[225] and about 80 percent of the wheat grown in Canada.[226] Although the CBOT Wheat (W) contract allows for delivery of hard red wheat, it typically sees deliveries of soft white wheat varieties, which comprises a smaller percentage of the wheat grown in North America. Even though the CBOT Wheat (W) contract has the majority of liquidity among the three wheat contracts as measured by open interest and trading volume, it is the hard red wheats that make up the bulk of wheat crops in North America. Thus, the Commission proposes to maintain the non-spot month limit for the CBOT KC HRW Wheat (KW) contract and MGEX HRS Wheat (MWE) contract at the 12,000 contract level even though both contracts would have a lower non-spot month limit based solely on the open interest formula. The Commission preliminarily believes that maintaining partial parity and the existing non-spot month limits in this manner will benefit the MWE and KW markets since the two species of wheat are similar (*i.e.,* hard red wheat) to one another relative to CBOT Wheat (W), which is soft white

[224] Applying the proposed modified 10, 2.5 percent formula to recent open interest data for these two contracts would result in limit levels of 11,900 and 5,700, respectively.

[225] *Wheat Sector at a Glance,* USDA Economic Research Service, *available at https://www.ers.usda.gov/topics/crops/wheat/wheat-sector-at-a-glance.*

[226] *Estimated Areas, Yield, Production, Average Farm Price and Total Farm Value of Principal Field Crops, In Metric and Imperial Units,* Statistics Canada website, *available at https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3210035901.*

wheat; and as a result, the Commission has preliminarily determined that decreasing the non-spot month levels for MWE could impose liquidity costs on the MWE market and harm bona fide hedgers, which could further harm liquidity for bona fide hedgers in the related KW market.

However, the Commission has determined not to raise the proposed limit levels for CBOT KC HRW Wheat (KW) and MGEX HRS Wheat (MWE) to the proposed 19,300 contract limit level for CBOT Wheat (W) because 19,300 contracts appears to be extraordinarily large in comparison to open interest in the CBOT KC HRW Wheat (KW) and MGEX HRS Wheat (MWE) markets, and the limit levels for both contracts are already larger than a limit level based on the 10, 2.5 percent formula. The Commission is concerned that substantially raising non-spot limits on the KW or MWE contracts could create a greater likelihood of excessive speculation given their smaller overall trading relative to the CBOT Wheat (W) contract. In response to prior proposals, which would have resulted in lower non-spot limits for MWE, MGEX had requested parity among all wheat contracts. In part, MGEX reasoned that intermarket spread trading among the three contracts is vital to their price discovery function.[227] The Commission notes that intermarket spreading is permitted under this proposal.[228] The intermarket spread exemption should address any concerns over the loss of liquidity in spread trades among the three wheat contracts.

Likewise, based on the Commission's experience since 2011 with the current non-spot month speculative position limit of 2,000 contracts for CBOT Oats (O), the Commission is proposing to maintain the current 2,000 contract level rather than reducing it to the lower levels that would result from applying the updated 10, 2.5 formula.[229] The existing 2,000 contract limit for CBOT Oats (O) appears to have functioned well, and the Commission sees no reason to reduce it.

While retaining the existing non-spot month limits for the MWE and KW contracts and for CBOT Oats (O) does break with the proposed non-spot month formula, the Commission has confidence that the existing contract limits should continue to be appropriate for these contracts. Furthermore, even when relying on a single criterion, such as percentage of open interest, the Commission has historically recognized that there can ''result . . . a range of acceptable position limit levels.''[230]

For all of the core referenced contracts, based on decades of experience overseeing exchange-set position limits and administering its own federal position limits regime, the Commission is of the view that the proposed non-spot month limit levels are also low enough to diminish, eliminate, or prevent excessive speculation, and to deter and prevent market manipulation, squeezes, and corners. The Commission has previously studied prior increases in federal non-spot month limits and concluded that the overall impact was modest, and that any changes in market performance were most likely attributable to factors other than changes in the federal position limit rules.[231] The Commission has since gained further experience which supports that conclusion, including by monitoring amendments to position limit levels by exchanges. Further, given the significant increases in open interest and changes in market composition that have occurred since the 1990s, the Commission is comfortable that the proposal to amend the 10, 2.5 percent formula will adequately address each of the policy objectives set forth in CEA section 4a(a)(3).[232]

iv. Conclusion

With the exception of the CBOT KC HRW Wheat (KW), MGEX HRS Wheat (MWE), and CBOT Oats (O) contracts, as noted above, the proposed formula would result in higher non-spot month limit levels than those currently in place. Furthermore, as noted above, under the rules proposed herein, the nine legacy agricultural contracts would be the only contracts subject to limits outside of the spot month. Aside from the CBOT Oats (O) contract, these contracts all have high open interest, and thus their pricing may be less likely to be affected by the trading of large position holders in non-spot months. Further, consistent with the approach proposed herein to leverage existing exchange-level programs and expertise, the proposed federal non-spot month limit levels would serve simply as ceilings—exchanges would remain free to set exchange levels below the federal limit. The exchanges currently have systems and processes in place to monitor and surveil their markets in real time, and have the ability, and regulatory responsibility, to act quickly in the event of a disturbance.[233]

Additionally, exchanges have tools other than position limits for protecting markets. For instance, exchanges can establish position accountability levels well below a position limit level, and can impose liquidity and concentration surcharges to initial margin if they are vertically integrated with a derivatives clearing organization. One reason that the Commission is proposing to update the formula for calculating non-spot month limit levels is that the exchanges may be able in certain circumstances to act much more quickly than the Commission, including quickly altering their own limits and accountability levels based on changing market conditions. Any decrease in an exchange-set limit would effectively lower the federal limit for that contract, as market participants would be required to comply with both federal and exchange-set limits, and as the Commission has the authority to enforce violations of both federal and exchange-set limits.[234]

f. Subsequent Spot and Non-Spot Month Limit Levels

Prior to amending any of the proposed spot or non-spot month levels, if adopted, the Commission would provide for public notice and comment by publishing the proposed levels in the **Federal Register**. Under proposed § 150.2(f), should the Commission wish to rely on exchange estimates of deliverable supply to update spot month speculative limit levels, DCMs would be required to supply to the Commission deliverable supply estimates upon request. Proposed § 150.2(j) would delegate the authority to make such requests to the Director of the Division of Market Oversight.

Recognizing that estimating deliverable supply can be a time and resource consuming process for DCMs and for the Commission, the Commission is not proposing to require

[227] *See* Statement of Layne Carlson, CFTC Agricultural Advisory Committee meeting, Sept. 22, 2015, at 38–44.

[228] *See supra* Section II.A.20. (definition of spread transaction).

[229] Applying the proposed modified 10, 2.5 percent formula to recent open interest data for oats would result in a 700 contract limit level.

[230] Revision of Speculative Position Limits, 57 FR 12770, 12766 (Apr. 13, 1992). *See also* Revision of Speculative Position Limits and Associated Rules, 63 FR at 38525, 38527 (July 17, 1998). *Cf.* 2013 Proposal, 78 FR at 75729 (there may be range of spot month limits that maximize policy objectives).

[231] 64 FR 24038, 24039 (May 5, 1999).

[232] 7 U.S.C. 6a(a)(3)(B).

[233] For example, under DCM Core Principle 4, DCMs are required to ''have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures,'' including ''methods for conducting real-time monitoring of trading'' and ''comprehensive and accurate trade reconstructions.'' 7 U.S.C. 7(d)(4).

[234] *See infra* Section II.D.4.g. (discussion of Commission enforcement of exchange-set limits).

DCMs to submit such estimates on a regular basis; instead, DCMs would be required to submit estimates of deliverable supply if requested by the Commission.[235] DCMs would also have the option of submitting estimates of deliverable supply and/or recommended speculative position limit levels if they wanted the Commission to consider them when setting/adjusting federal limit levels. Any such information would be included in a Commission action proposing changes to the levels. The Commission encourages exchanges to submit such estimates and recommendations voluntarily, as the exchanges are uniquely situated to recommend updated levels due to their knowledge of individual contract markets. When submitting estimates, DCMs would be required under proposed § 150.2(f) to provide a description of the methodology used to derive the estimate, as well as any statistical data supporting the estimate, so that the Commission can verify that the estimate is reasonable. DCMs should consult the guidance regarding estimating deliverable supply set forth in Appendix C to part 38.[236]

g. Relevant Contract Month

Proposed § 150.2(c) clarifies that the spot month and single month for any given referenced contract is determined by the spot month and single month of the core referenced futures contract to which that referenced contract is linked. This requires that referenced contracts be linked to the core referenced futures contract in order to be netted for position limit purposes. For example, for the NYMEX NY Harbor ULSD Heating Oil (HO) futures core referenced futures contract, the spot month period starts at the close of trading three business days prior to the last trading day of the contract. The spot month period for the NYMEX NY Harbor ULSD Financial (MPX) futures referenced contract would thus start at the same time—the close of trading three business days prior to the last trading day of the core referenced futures contract.

h. Limits on ''Pre-Existing Positions''

Under proposed § 150.2(g)(1), other than pre-enactment swaps and transition period swaps as defined in proposed § 150.1, ''pre-existing positions,'' defined in proposed § 150.1 as positions established in good faith prior to the effective date of a final federal position limits rulemaking, would be subject to federal spot month limit levels. This clarification is intended to avoid rendering spot month limits ineffective—failing to apply spot month limits to such pre-existing positions could result in a large, pre-existing position either intentionally or unintentionally causing a disruption to the price discovery function of the core referenced futures contract as positions are rolled into the spot month. The Commission is particularly concerned about protecting the spot month in physical-delivery futures from price distortions or manipulation that would disrupt the hedging and price discovery utility of the futures contract.

Proposed § 150.2(g)(2) would provide that the proposed non-spot month limit levels would not apply to positions acquired in good faith prior to the effective date of such limit, recognizing that pre-existing large positions may have a relatively less disruptive effect outside of the spot month than during the spot month given that physical delivery occurs only during the spot month. However, other than pre-enactment swaps and transition period swaps, any pre-existing positions held outside the spot month would be attributed to such person if the person's position is increased after the effective date of a final federal position limits rulemaking.

i. Positions on Foreign Boards of Trade

CEA section 4a(a)(6) directs the Commission to, among other things, establish limits on the aggregate number of positions in contracts based upon the same underlying commodity that may be held by any person across contracts listed by DCMs, certain contracts traded on a foreign board of trade (''FBOT'') with linkages to a contract traded on a registered entity, and swap contracts that perform or affect a significant price discovery function with respect to regulated entities.[237] Pursuant to that directive, proposed § 150.2(h) would apply the proposed limits to a market participant's aggregate positions in referenced contracts executed on a DCM and on, or pursuant to the rules of, an FBOT, provided that the referenced contracts settle against a price of a contract listed for trading on a DCM or SEF, and that the FBOT makes such contract available in the United States through ''direct access.'' [238] In other words, a market participant's positions in referenced contracts listed on a DCM and on an FBOT registered to provide direct access would collectively have to stay below the federal limit level for the relevant core referenced futures contract. The Commission preliminarily believes that, as proposed, § 150.2(h) would lessen regulatory arbitrage by eliminating a potential loophole whereby a market participant could accumulate positions on certain FBOTs in excess of limits in referenced contracts.[239]

j. Anti-Evasion

Pursuant to the Commission's rulemaking authority in section 8a(5) of the CEA,[240] the Commission proposes § 150.2(i), which is intended to deter and prevent a number of potential methods of evading the position limits proposed herein. The proposed anti-evasion provision is not intended to capture a trading strategy merely because it may result in smaller position size for purposes of position limits, but rather is intended to deter and prevent cases of willful evasion of federal position limits, the specifics of which the Commission may be unable to anticipate. The proposed federal position limit requirements would apply during the spot month for all referenced contracts subject to federal limits and non-spot position limit requirements would only apply for the nine legacy agricultural contracts.

[235] For example, if a contract has problems with pricing convergence between the futures and the cash market, it could be a symptom of a deliverable supply issue in the market. In such a situation, the Commission may request an updated deliverable supply estimate from the relevant DCM to help identify the possible cause of the pricing anomaly.

[236] 17 CFR part 38, Appendix C.

[237] 7 U.S.C. 6a(a)(6).

[238] Commission regulation § 48.2(c) defines ''direct access'' to mean an explicit grant of authority by a foreign board of trade to an identified member or other participant located in the United States to enter trades directly into the trade matching system of the foreign board of trade. 17 CFR 48.2(c).

[239] In addition, CEA section 4(b)(1)(B) prohibits the Commission from permitting an FBOT to provide direct access to its trading system to its participants located in the United States unless the Commission determines, in regards to any FBOT contract that settles against any price of one or more contracts listed for trading on a registered entity, that the FBOT (or its foreign futures authority) adopts position limits that are comparable to the position limits adopted by the registered entity. 7 U.S.C. 6(b)(1)(B). CEA section 4(b)(1)(B) provides that the Commission may not permit a foreign board of trade to provide to the members of the foreign board of trade or other participants located in the United States direct access to the electronic trading and order-matching system of the foreign board of trade with respect to an agreement, contract, or transaction that settles against any price (including the daily or final settlement price) of 1 or more contracts listed for trading on a registered entity, unless the Commission determines that the foreign board of trade (or the foreign futures authority that oversees the foreign board of trade) adopts position limits (including related hedge exemption provisions) for the agreement, contract, or transaction that are comparable to the position limits (including related hedge exemption provisions) adopted by the registered entity for the 1 or more contracts against which the agreement, contract, or transaction traded on the foreign board of trade settles.

[240] 7 U.S.C. 12a(5).

Under this proposed framework, and because the threat of corners and squeezes is the greatest in the spot month, the Commission preliminarily anticipates that it may focus its attention on anti-evasion activity during the spot month.

First, the proposed rule would consider a commodity index contract and/or location basis contract used to willfully circumvent position limits to be a referenced contract subject to federal limits. Because commodity index contracts and location basis contracts are excluded from the proposed ''referenced contract'' definition and thus not subject to federal limits,[241] the Commission intends that proposed § 150.2(i) would close a potential loophole whereby a market participant who has reached its limits could purchase a commodity index contract in a manner that allowed the participant to exceed limits when taking into account the weighting in the component commodities of the index contract. The proposed rule would close a similar potential loophole with respect to location basis contracts.

Second, proposed § 150.2(i) would provide that a bona fide hedge recognition or spread exemption would no longer apply if used to willfully circumvent speculative position limits. This provision is intended to help ensure that bona fide hedge recognitions and spread exemptions are granted and utilized in a manner that comports with the CEA and Commission regulations, and that the ability to obtain a bona fide hedge recognition or spread exemption does not become an avenue for market participants to inappropriately exceed speculative position limits.

Third, a swap contract used to willfully circumvent speculative position limits would be deemed an economically equivalent swap, and thus a referenced contract, even if the swap does not meet the economically equivalent swap definition set forth in proposed § 150.1. This provision is intended to deter and prevent the structuring of a swap in order to willfully evade speculative position limits.

The determination of whether particular conduct is intended to circumvent or evade requires a facts and circumstances analysis. In preliminarily interpreting these anti-evasion rules, the Commission is guided by its interpretations of anti-evasion provisions appearing elsewhere in the Commission's regulations, including the interpretation of the anti-evasion rules that the Commission adopted in its rulemakings to further define the term ''swap'' and to establish a clearing requirement under section 2(h)(1)(A) of the CEA.[242]

Generally, consistent with those interpretations, in evaluating whether conduct constitutes evasion, the Commission would consider, among other things, the extent to which the person lacked a legitimate business purpose for structuring the transaction in that particular manner. For example, an analysis of how a swap was structured could reveal that persons crafted derivatives transactions, structured entities, or conducted themselves in a manner without a legitimate business purpose and with the intent to willfully evade position limits by structuring a swap such that it would not meet the proposed ''economically equivalent swap'' definition. As stated in a prior rulemaking, a person's specific consideration of, for example, costs or regulatory burdens, including the avoidance thereof, is not, in and of itself, dispositive that the person is acting without a legitimate business purpose in a particular case.[243] The Commission will view legitimate business purpose considerations on a case-by-case basis in conjunction with all other relevant facts and circumstances.

Further, as part of its facts and circumstances analysis, the Commission would look at factors such as the historical practices behind the market participant and transaction in question. For example, with respect to § 150.2(i)(3), the Commission would consider whether a market participant has a history of structuring its swaps one way, but then starts structuring its swaps a different way around the time the participant risked exceeding a speculative position limit as a result of its swap position, such as by modifying the delivery date or other material terms and conditions such that the swap no longer meets the definition of an ''economically equivalent swap.''

Consistent with interpretive language in prior rulemakings addressing evasion,[244] when determining whether a particular activity constitutes willful evasion, the Commission will consider the extent to which the activity involves deceit, deception, or other unlawful or illegitimate activity. Although it is likely that fraud, deceit, or unlawful activity will be present where willful evasion has occurred, the Commission does not believe that these factors are a prerequisite to an evasion finding because a position that does not involve fraud, deceit, or unlawful activity could still lack a legitimate business purpose or involve other indicia of evasive activity. The presence or absence of fraud, deceit, or unlawful activity is one fact the Commission will consider when evaluating a person's activity. That said, the proposed anti-evasion provision does require willfulness, *i.e.* ''scienter.'' The Commission will interpret ''willful'' consistent with how the Commission has in the past, that acting either intentionally or with reckless disregard constitutes acting ''willfully.'' [245]

In determining whether a transaction has been entered into or structured willfully to evade position limits, the Commission will not consider the form, label, or written documentation as dispositive. The Commission also is not requiring a pattern of evasive transactions as a prerequisite to prove evasion, although such a pattern may be one factor in analyzing whether evasion has occurred. In instances where one party willfully structures a transaction to evade but the other counterparty does not, proposed § 150.2(i) would apply to the party who willfully structured the transaction to evade.

Finally, entering into transactions that qualify for the forward exclusion from the swap definition shall not be considered evasive. However, in circumstances where a transaction does not, in fact, qualify for the forward exclusion, the transaction may or may not be evasive depending on an analysis of all relevant facts and circumstances.

k. Netting

For the reasons discussed above, the referenced contract definition in proposed § 150.1 includes, among other things, cash-settled contracts that are linked, either directly or indirectly, to a core referenced futures contract; and any ''economically equivalent

[241] *See supra* Section II.A.16.b. (explanation of proposed exclusions from the ''referenced contract'' definition).

[242] *See* Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48207, 48297–48303 (Aug. 13, 2012); Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284, 74317–74319 (Dec. 13, 2012).

[243] *See* Clearing Requirements Determination Under Section 2(h) of the CEA, 77 FR at 74319.

[244] *See* Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48207, 48297–48303 and Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284, 74317–74319.

[245] *See In re Squadrito,* [1990–1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,262 (CFTC Mar. 27, 1992) (adopting definition of ''willful'' in *McLaughlin* v. *Richland Shoe Co.,* 486 U.S. 128 (1987)).

swaps.'' [246] Under proposed § 150.2(a), federal spot month limits would apply to physical-delivery referenced contracts separately from federal spot month limits applied to cash-settled referenced contracts, meaning that during the spot month, positions in physically-settled contracts may not be netted with positions in linked cash-settled contracts. Specifically, all of a trader's positions (long or short) in a given physically-settled referenced contract (across all exchanges and OTC as applicable) [247] are netted and subject to the spot month limit for the relevant commodity, and all of such trader's positions in any cash-settled referenced contracts (across all exchanges and OTC as applicable) linked to such physically-settled core referenced futures contract are netted and independently (rather than collectively along with the physically-settled positions) subject to the federal spot month limit for that commodity.[248] A position in a commodity contract that is not a referenced contract is therefore not subject to federal limits, and, as a consequence, cannot be netted with positions in referenced contracts for purposes of federal limits.[249] For example, a swap that is not a referenced contract because it does not meet the economically equivalent swap definition could not be netted with positions in a referenced contract.

Allowing the netting of linked physically-settled and cash-settled contracts during the spot month could lead to disruptions in the price discovery function of the core referenced futures contract or allow a market participant to manipulate the price of the core referenced futures contract. Absent separate spot month limits for physically-settled and cash-settled contracts, the spot month limit would be rendered ineffective, as a participant could maintain large positions in excess of limits in both the physically-settled contract and the linked cash-settled contract, enabling the participant to disrupt the price discovery function as the contracts go to expiration by taking large opposite positions in the physically-settled core referenced futures and cash-settled referenced contracts, or potentially allowing a participant to effect a corner or squeeze.[250]

Proposed § 150.2(b), which would establish limits outside the spot month, does not use the ''separately'' language. Accordingly, outside of the spot month, participants may net positions in linked physically-settled and cash-settled referenced contracts, because there is no immediate threat of delivery.

Finally, proposed § 150.2(a) and (b) also provide that spot and non-spot limits apply ''net long or net short.'' Consistent with existing § 150.2, this language requires that, both during and outside the spot month, and subject to the provisions governing netting described above, a given participant's long positions in a particular contract be aggregated (including across exchanges and OTC as applicable), and a participant's short positions be aggregated (including across exchanges and OTC as applicable), and those aggregate long and short positons be netted—in other words, it is the net value that is subject to federal limits.

Consistent with current and historical practice, the speculative position limits proposed herein would apply to positions throughout each trading session, including as of the close of each trading session.[251]

l. ''Eligible Affiliates'' and Aggregation

Proposed § 150.2(k) addresses entities that qualify as an ''eligible affiliate'' as defined in proposed § 150.1. Under the proposed definition, an ''eligible affiliate'' includes certain entities that, among other things, are required to aggregate their positions under § 150.4 and that do not claim an exemption from aggregation. There may be certain entities that are eligible for an exemption from aggregation but that prefer to aggregate rather than disaggregate their positions; for example, when aggregation would result in advantageous netting of positions with affiliated entities. Proposed § 150.2(k) is intended to address such a circumstance by making clear that an ''eligible affiliate'' may opt to aggregate its positions even though it is eligible to disaggregate.

m. Request for Comment

The Commission requests comment on all aspects of proposed § 150.2. The Commission also invites comments on the following:

(20) Are there legitimate strategies on which the Commission should offer guidance with respect to the anti-evasion provision?

(21) Should the Commission list by regulation specific factors/circumstances in which it may set spot month limits with other than the at or below 25 percent of deliverable supply formula, and non-spot month limits with other than the modified 10, 2.5 percent formula proposed herein? If so, please provide examples of any such factors, including an explanation of whether and why different formulas make sense for different commodities.

(22) Is the proposed compliance date of twelve months after publication of a final federal position limits rulemaking in the **Federal Register** an appropriate amount of time for compliance? If not, please provide reasons supporting a different timeline. Do market participants support delaying compliance until one year after a DCM has had its new § 150.9 rules approved by the Commission under § 40.5?

(23) The Commission understands that it may be possible for a market participant trading options to start a trading day below the delta-adjusted federal speculative position limit for that option, but end up above such limit as the option becomes in-the-money during the spot month. Should the Commission allow for a one-day grace period with respect to federal position limits for market participants who have exercised options that were out-of-the money on the previous trading day but that become in-the-money during the trading day in the spot month?

(24) Given that the contracts in corn and soybean complex are more liquid than CBOT Oats (O) and the MGEX HRS (MWE) wheat contract, should the Commission employ a higher open interest formula for corn and the soybean complex?

(25) Should the Commission phase-in the proposed increased federal non-spot month limits incrementally over a period of time, rather than implementing the entire increase upon the effective date? Please explain why or why not. If so, please comment on an appropriate phase-in schedule, including whether different

[246] *See supra* Section II.A.16. (discussion of the proposed referenced contract definition).

[247] In practice, the only physically-settled referenced contracts under this proposal would be the 25 core referenced futures contracts, none of which are listed on multiple DCMs, although there could potentially be physically-settled OTC swaps that would satisfy the ''economically equivalent swap'' definition and therefore would also qualify as referenced contracts.

[248] Consistent with CEA section 4a(a)(6), this would include positions across exchanges.

[249] Proposed Appendix C to part 150 provides guidance regarding the referenced contract definition, including that the following types of contracts are not deemed referenced contracts, meaning such contracts are not subject to federal limits and cannot be netted with positions in referenced contracts for purposes of federal limits: Location basis contracts; commodity index contracts; and trade options that meet the requirements of 17 CFR 32.3.

[250] For example, absent such a restriction in the spot month, a trader could stand for 100 percent of deliverable supply during the spot month by holding a large long position in the physical-delivery contract along with an offsetting short position in a cash-settled contract, which effectively would corner the market.

[251] *See, e.g.,* Elimination of Daily Speculative Trading Limits, 44 FR 7124, 7125 (Feb. 6, 1979).

commodities should be subject to different schedules.

(26) The Commission is aware that the non-spot month open interest is skewed to the first new crop (usually December or November) for the nine legacy agricultural contracts. The Commission understands that cotton may be unique because it has an extended harvest period starting in July in the south and working its way north until November. There may be some concern with positions being rolled from the prompt month into deferred contract months causing disruption to the price discovery function of the Cotton futures. Should the Commission consider lowering the single month limit to a percentage of the all months limits for Cotton? If so, what percentage of the all month limit should be used for the single month limit? Please provide a rationale for your percentage.

(27) Should the Commission allow market participants who qualify for the conditional spot month limit in natural gas to net cash-settled natural gas referenced contracts across DCMs? Why or why not?

C. § 150.3—Exemptions From Federal Position Limits

1. Existing §§ 150.3, 1.47, and 1.48

Existing § 150.3(a), which pre-dates the Dodd-Frank Act, lists positions that may, under certain circumstances, exceed federal limits: (1) Bona fide hedging transactions, as defined in the current bona fide hedging definition in § 1.3; and (2) certain spread or arbitrage positions.[252] So that the Commission can effectively oversee the use of such exemptions, existing § 150.3(b) provides that the Commission or certain Commission staff may make special calls to demand certain information from exemption holders, including information regarding positions owned or controlled by that person, trading done pursuant to that exemption, and positions that support the claimed exemption.[253] Existing § 150.3(a) allows for bona fide hedging transactions to exceed federal limits, and the current process for a person to request such recognitions for non-enumerated hedges appears in § 1.47.[254] Under that provision, persons seeking recognition by the Commission of a non-enumerated bona fide hedging transaction or position must file statements with the Commission.[255] Initial statements must be filed with the Commission at least 30 days in advance of exceeding the limit.[256] Similarly, existing § 1.48 sets forth the process for market participants to file an application with the Commission to recognize certain enumerated anticipatory positions as bona fide hedging positions.[257] Under that provision, such recognitions must be requested 10 days in advance of exceeding the limit.[258]

Further, the Commission provides self-effectuating spread exemptions for the nine legacy agricultural contracts currently subject to federal limits, but does not specify a formal process for granting such spread exemptions.[259] The Commission's authority and existing regulation for exempting certain spread positions can be found in section 4a(a)(1) of the Act and existing § 150.3(a)(3) of the Commission's regulations, respectively.[260] In particular, CEA section 4a(a)(1) provides the Commission with authority to exempt from position limits transactions ''normally known to the trade as 'spreads' or 'straddles' or 'arbitrage.' ''

2. Proposed § 150.3

As described elsewhere in this release, the Commission is proposing a new bona fide hedging definition in § 150.1 (described above) and a new streamlined process in proposed § 150.9 for recognizing non-enumerated bona fide hedging positions (described further below). The Commission thus proposes to update § 150.3 to conform to those new proposed provisions. Proposed § 150.3 also includes new exemption types not explicitly listed in existing § 150.3, including: (i) Exemptions for financial distress situations; (ii) conditional exemptions for certain spot month positions in cash-settled natural gas contracts; and (iii) exemptions for pre-enactment swaps and transition period swaps.[261] Proposed § 150.3(b)–(g) respectively address: Requests for relief from position limits submitted directly to the Commission or Commission staff (rather than to an exchange under proposed § 150.9, as discussed further below); previously-granted risk management exemptions to position limits; exemption-related recordkeeping and special-call requirements; the aggregation of accounts; and the delegation of certain authorities to the Director of the Division of Market Oversight.

a. Bona Fide Hedging Positions and Spread Exemptions

The Commission has years of experience granting and monitoring spread exemptions, and enumerated and non-enumerated bona fide hedges, as well as overseeing exchange processes for administering exemptions from exchange-set limits on such contracts. As a result of this experience, the Commission has determined to continue to allow self-effectuating enumerated bona fide hedges and certain spread exemptions for all contracts that would be subject to federal position limits, as explained further below.

i. Bona Fide Hedging Positions

First, under proposed § 150.3(a)(1)(i), bona fide hedge recognitions for positions in referenced contracts that fall within one of the proposed enumerated hedges set forth in proposed Appendix A to part 150, discussed above, would be self-effectuating for purposes of federal position limits. Market participants would thus not be required to request Commission approval prior to exceeding federal position limits in such cases, but would be required to request a bona fide hedge exemption from the relevant exchange for purposes of exchange-set limits established pursuant to proposed § 150.5(a), and submit required cash-market information to the exchange as part of such request.[262] The Commission has also determined to allow the proposed enumerated anticipatory bona fide hedges (some of which are not currently self-effectuating and thus are required to be approved by the Commission under existing § 1.48) to be self-effectuating for purposes of federal limits (and thus would not require prior

[252] 17 CFR 150.3(a).

[253] 17 CFR 150.3(b).

[254] 17 CFR 1.47.

[255] 17 CFR 1.47(a).

[256] 17 CFR 1.47(b).

[257] 17 CFR 1.48.

[258] *Id.*

[259] Since 1938, the Commission (known as the Commodity Exchange Commission in 1938) has recognized the use of spread positions to facilitate liquidity and hedging. Notice of Proposed Order in the Matter of Limits on Position and Daily Trading in Grain for Future Delivery, 3 FR 1408 (June 14, 1938).

[260] *See* 7 U.S.C. 6a(a)(1) and 17 CFR 150.3(a)(3) (providing that the position limits set in § 150.2 may be exceeded to the extent such positions are: Spread or arbitrage positions between single months of a futures contract and/or, on a futures-equivalent basis, options thereon, outside of the spot month, in the same crop year; provided, however, that such spread or arbitrage positions, when combined with any other net positions in the single month, do not exceed the all-months limit set forth in § 150.2.). Although existing § 150.3(a)(3) does not specify a formal process for granting spread exemptions, the Commission is able to monitor traders' gross and net positions using part 17 data, the monthly Form 204, and information from the applicable DCMs to identify any such spread positions.

[261] The Commission revised § 150.3(a) in 2016, relocating the independent account controller aggregation exemption from § 150.3(a)(4) in order to consolidate it with the Commission's aggregation requirements in § 150.4(b)(4). *See* Final Aggregation Rulemaking, 81 FR at 91489–90.

[262] *See infra* Section II.D.4.a. *See also* proposed § 150.5(a)(2)(ii)(A)(1).

Commission approval for such enumerated anticipatory hedges). The Commission may consider expanding the proposed list of enumerated hedges at a later time, after notice and comment, as it gains experience with the new federal position limits framework proposed herein.

Second, under proposed § 150.3(a)(1)(ii), for positions in referenced contracts that do not fit within one of the proposed enumerated hedges in Appendix A, (*i.e.,* non-enumerated bona fide hedges), market participants must request approval from the Commission, or from an exchange, prior to exceeding federal limits. Such exemptions thus would not be self-effectuating and market participants in such cases would have two options for requesting such a non-enumerated bona fide hedge recognition: (1) Apply directly to the Commission in accordance with proposed § 150.3(b) (described below), and separately also apply to an exchange pursuant to exchange rules established under proposed § 150.5(a); [263] or, alternatively (2) apply to an exchange pursuant to proposed § 150.9 for a non-enumerated bona fide hedge recognition that could be valid both for purposes of federal and exchange-set position limit requirements, unless the Commission (and not staff) objects to the exchange's determination within a limited period of time.[264] As discussed elsewhere in this release, market participants relying on enumerated or non-enumerated bona fide hedge recognitions would no longer have to file the monthly Form 204/304 with supporting cash market information.[265]

ii. Spread Exemptions

Under proposed § 150.3(a)(2)(i), spread exemptions for positions in referenced contracts would be self-effectuating, provided that the position fits within one of the types of spreads listed in the spread transaction definition in proposed § 150.1,[266] and provided further that the market participant separately requests a spread exemption from the relevant exchange's limits established pursuant to proposed § 150.5(a).

The Commission anticipates that such spread exemptions might include spreads that are ''legged in,'' that is, carried out in two steps, or alternatively are ''combination trades,'' that is, all components of the spread are executed simultaneously or near simultaneously. The list of spread transactions in proposed § 150.1 reflects the most common types of spread strategies for which the Commission and/or exchanges have previously granted spread exemptions.

Under proposed § 150.3(a)(2)(ii), for all contracts subject to federal limits, if the spread position does not fit within one of the spreads listed in the spread transaction definition in proposed § 150.1, market participants must apply for the spread exemption relief directly from the Commission in accordance with proposed § 150.3(b). The market participant must receive notification of the approved spread exemption under proposed § 150.3(b)(4) before exceeding the federal speculative position limits for that spread position. The Commission may consider expanding the proposed spread transactions definition at a later time, after notice and comment, as it gains experience with the new federal position limits framework proposed herein.

iii. Removal of Existing §§ 1.47, 1.48, and 140.97

Given the proposal set forth in § 150.9, as described in detail below, to allow for a streamlined process for recognizing bona fide hedges for purposes of federal limits,[267] the Commission also proposes to delete existing §§ 1.47 and 1.48. The Commission preliminarily believes that overall, the proposed approach would lead to a more efficient bona fide hedge recognition process. As the Commission proposes to delete §§ 1.47 and 1.48, the Commission also proposes to delete existing § 140.97, which delegates to the Director of the Division of Enforcement or his designee authority regarding requests for classification of positions as bona fide hedges under existing §§ 1.47 and 1.48.[268]

The Commission does not intend the proposed replacement of §§ 1.47 and 1.48 to have any bearing on bona fide hedges previously recognized under those provisions. With the exception of certain recognitions for risk management positions discussed below, positions that were previously recognized as bona fide hedges under §§ 1.47 or 1.48 would continue to be recognized, provided they continue to meet the statutory bona fide hedging definition and all other existing and proposed requirements.

b. Process for Requesting Commission-Provided Relief for Non-Enumerated Bona Fide Hedges and Spread Exemptions

Under the proposed rules, non-enumerated bona fide hedging recognitions may only be granted by the Commission as proposed in § 150.3(b), or under the streamlined process proposed in § 150.9. Further, spread exemptions that do not meet the proposed spread transaction definition may only be granted by the Commission as proposed in § 150.3(b). Under the Commission process in § 150.3(b), a person seeking a bona fide hedge recognition or spread exemption may submit a request to the Commission.

With respect to bona fide hedge recognitions, such request must include: (i) A description of the position in the commodity derivative contract for which the application is submitted, including the name of the underlying commodity and the position size; (ii) information to demonstrate why the position satisfies section 4a(c)(2) of the Act and the definition of bona fide hedging transaction or position in proposed § 150.1, including factual and legal analysis; (iii) a statement concerning the maximum size of all gross positions in derivative contracts for which the application is submitted (in order to provide a view of the true footprint of the position in the market); (iv) information regarding the applicant's activity in the cash markets and the swaps markets for the commodity underlying the position for which the application is submitted; [269] and (v) any other information that may help the Commission determine whether the position meets the requirements of section 4a(c)(2) of the Act and the definition of bona fide hedging transaction or position in § 150.1.[270]

With respect to spread exemptions, such request must include: (i) A description of the spread transaction for which the exemption application is

[263] *See infra* Section II.D.4. (discussion of proposed § 150.5).

[264] *See infra* Section II.G.3. (discussion of proposed § 150.9).

[265] *See infra* Section II.H.2. (discussion of the proposed elimination of Form 204).

[266] *See supra* Section II.A.20. (proposed definition of ''spread transaction'' in § 150.1, which would cover: Calendar spreads; quality differential spreads; processing spreads (such as energy ''crack'' or soybean ''crush'' spreads); product or by-product differential spreads; and futures-options spreads.)

[267] *Id.*

[268] 17 CFR 140.97.

[269] The Commission would expect that applicants would provide cash market data for at least the prior year.

[270] For example, the Commission may, in its discretion, request a description of any positions in other commodity derivative contracts in the same commodity underlying the commodity derivative contract for which the application is submitted. Other commodity derivatives contracts could include other futures, options, and swaps (including over-the-counter swaps) positions held by the applicant.

submitted;[271] (ii) a statement concerning the maximum size of all gross positions in derivative contracts for which the application is submitted; and (iii) any other information that may help the Commission determine whether the position is consistent with section 4a(a)(3)(B) of the Act.

Under proposed § 150.3(b)(2), the Commission, or Commission staff pursuant to delegated authority proposed in § 150.3(g), may request additional information from the requestor and must provide the requestor with ten business days to respond. Under proposed § 150.3(b)(3) and (4), the requestor, however, may not exceed federal position limits unless it receives a notice of approval from the Commission or from Commission staff pursuant to delegated authority proposed in § 150.3(g); *provided however,* that, due to demonstrated sudden or unforeseen increases in its bona fide hedging needs, a person may request a recognition of a bona fide hedging transaction or position within five business days after the person established the position that exceeded the federal speculative position limit.[272]

Under this proposed process, market participants would be encouraged to submit their requests for bona fide hedge recognitions and spread exemptions as early as possible since proposed § 150.3(b) would not set a specific timeframe within which the Commission must make a determination for such requests.

Further, all approved bona fide hedge recognitions and spread exemptions must be renewed if there are any changes to the information submitted as part of the request, or upon request by the Commission or Commission staff.[273] Finally, the Commission (and not staff) may revoke or modify any bona fide hedge recognition or spread exemption at any time if the Commission determines that the bona fide hedge recognition or spread exemption, or portions thereof, are no longer consistent with the applicable statutory and regulatory requirements.[274]

The Commission anticipates that most market participants would utilize the streamlined process set forth in proposed § 150.9 and described below, rather than the process as proposed in § 150.3(b), because exchanges would generally be able to make such determinations more efficiently than Commission staff, and because market participants are likely already familiar with the proposed processes set forth in § 150.9, which is intended to leverage the processes currently in place at the exchanges for addressing requests for exemptions from exchange-set limits. Nevertheless, proposed § 150.3(a)(1) and (2) clarify that market participants may seek relief from federal position limits for non-enumerated bona fide hedges and spread transactions that do not meet the proposed spread transactions definition directly from the Commission. After receiving any approval of a bona fide hedge or spread exemption from the Commission, the market participant would still be required to request a bona fide hedge recognition or spread exemption from the relevant exchange for purposes of exchange-set limits established pursuant to proposed § 150.5(a).

c. Request for Comment

The Commission requests comments on all aspects of proposed § 150.3(a)(1) and (2). The Commission also invites comment on the following:

(28) Out of concern that large demand for delivery against long nearby futures positions may outpace demand on spot cash values, the Commission has previously discussed allowing cash and carry exemptions as spreads on the condition that the exchange ensures that exit points in cash and carry spread exemptions would facilitate an orderly liquidation.[275] Should the Commission allow the granting of cash and carry exemptions under such conditions? If so, please explain why, including how such exemptions would be consistent with the Act and the Commission's regulations. If not, please explain why not, and if other circumstances would be better, including better for preserving convergence, which is essential to properly functioning markets and price discovery. If cash and carry exemptions were allowed, how could an exchange ensure that exit points in cash and carry exemptions facilitate convergence of cash and futures?

d. Financial Distress Exemptions

Proposed § 150.3(a)(3) would allow for a financial distress exemption in certain situations, including the potential default or bankruptcy of a customer or a potential acquisition target. For example, in periods of financial distress, such as a customer default at an FCM or a potential bankruptcy of a market participant, it may be beneficial for a financially-sound market participant to take on the positions and corresponding risk of a less stable market participant, and in doing so, exceed federal speculative position limits. Pursuant to authority delegated under §§ 140.97 and 140.99, Commission staff previously granted exemptions in these types of situations to avoid sudden liquidations required to comply with a position limit.[276] Such sudden liquidations could otherwise potentially hinder statutory objectives, including by reducing liquidity, disrupting price discovery, and/or increasing systemic risk.[277]

The proposed exemption would be available to positions of ''a person, or related persons,'' meaning that a financial distress exemption request should be specific to the circumstances of a particular person, or to persons related to that person, and not a more general request by a large group of unrelated people whose financial distress circumstances may differ from one another. The proposed exemption would be granted on a case by case basis in response to a request submitted pursuant to § 140.99, and would be

[271] The nature of such description would depend on the facts and circumstances, and different details may be required depending on the particular spread.

[272] Where a person requests a bona fide hedge recognition within five business days after they exceed federal position limits, such person would be required to demonstrate that they encountered sudden or unforeseen circumstances that required them to exceed federal position limits before submitting and receiving approval of their bona fide hedge application. These applications submitted after a person has exceeded federal position limits should not be habitual and will be reviewed closely. If the Commission reviews such application and finds that the position does not qualify as a bona fide hedge, then the applicant would be required to bring their position into compliance within a commercially reasonable time, as determined by the Commission in consultation with the applicant and the applicable DCM or SEF. If the applicant brings the position into compliance within a commercially reasonable time, then the applicant will not be considered to have violated the position limits rules. Further, any intentional misstatements to the Commission, including statements to demonstrate why the bona fide hedging needs were sudden and unforeseen, would be a violation of sections 6(c)(2) and 9(a)(2) of the Act.

[273] *See* proposed § 150.3(b)(5). Currently, the Commission does not require automatic updates to bona fide hedge applications, and does not require applications or updates thereto for spread exemptions, which are self-effectuating. Consistent with current practices, under proposed § 150.3(b)(5), the Commission would not require automatic annual updates to bona fide hedge and spread exemption applications; rather, updated applications would only be required if there are changes to information the requestor initially submitted or upon Commission request. This approach is different than the proposed streamlined process in § 150.9, which would require automatic annual updates to such applications, which is more consistent with current exchange practices. *See, e.g.,* CME Rule 559.

[274] This proposed authority to revoke or modify a bona fide hedge recognition or spread exemption would not be delegated to Commission staff.

[275] *See, e.g.,* 2016 Reproposal, 81 FR 96704 at 96833.

[276] *See, e.g.,* CFTC Press Release No. 5551–08, *CFTC Update on Efforts Underway to Oversee Markets,* (Sept. 19, 2008), *available at http://www.cftc.gov/PressRoom/PressReleases/pr5551-08.*

[277] *See* 7 U.S.C. 6a(a)(3).

evaluated based on the specific facts and circumstances of a particular person or related persons. Any such financial distress position would not be a bona fide hedging transaction or position unless it otherwise met the substantive and procedural requirements set forth in proposed §§ 150.1, 150.3, and 150.9, as applicable.

e. Conditional Spot Month Exemption in Natural Gas

Certain natural gas contracts are currently subject to exchange-set limits, but not federal limits.[278] This proposal would apply federal limits to certain natural gas contracts for the first time by including the physically-settled NYMEX Henry Hub Natural Gas (''NYMEX NG'') contract as a core referenced futures contract listed in proposed § 150.2(d). As set forth in proposed Appendix E to part 150, that physically-settled contract, as well as any cash-settled natural gas contract that qualifies as a referenced contract,[279] would be separately subject to a federal spot month limit, net long or net short, of 2,000 NYMEX NG equivalent-size contracts.

Under the referenced contract definition in proposed § 150.1, ICE's cash-settled Henry Hub LD1 contract, ICE's Henry Financial Penultimate Fixed Price Futures, NYMEX's cash-settled Henry Hub Natural Gas Last Day Financial Futures contract, Nodal Exchange's (''Nodal'') cash-settled Henry Hub Monthly Natural Gas contract, and NFX cash-settled Henry Hub Natural Gas Financial Futures contract, for example, would each qualify as a referenced contract subject to federal limits by virtue of being cash-settled to the physically-settled NYMEX NG core referenced futures contract.[280] Any other cash-settled contract that meets the referenced contract definition would also be subject to federal limits, as would an ''economically equivalent swap,'' as defined in proposed § 150.1, with respect to any natural gas referenced contract.

Proposed § 150.3(a)(4) would permit a new federal conditional spot month limit exemption for certain cash-settled natural gas referenced contracts. Under proposed § 150.3(a)(4), market participants seeking to exceed the proposed 2,000 NYMEX NG equivalent-size contract spot month limit for a cash-settled natural gas referenced contract listed on any DCM could receive an exemption that would be capped at 10,000 NYMEX NG equivalent-size contracts net long or net short per DCM, plus an additional 10,000 NYMEX NG futures equivalent size contracts in economically equivalent swaps. A grant of such an exemption would be conditioned on the participant not holding or controlling any positions during the spot month in the physically-settled NYMEX NG core referenced futures contract.[281]

This proposed conditional exemption level of 10,000 contracts per DCM in natural gas would codify into federal regulations the industry practice of an exchange-set conditional limit that is five times the size of the spot month limit that has developed over time, and which the Commission preliminarily believes has functioned well. The practice balances the needs of certain market participants, who may currently hold or control 5,000 contracts in each DCM's cash-settled natural gas futures contracts and prefer a sizeable position in a cash-settled contract in order to obtain the desired exposure without needing to make or take delivery of natural gas, with the policy objectives of the Commission, which has historically had concerns about the possibility of traders attempting to manipulate the physically-settled NYMEX NG contract (*i.e.,* mark-the close) in order to benefit from a larger position in the cash-settled ICE LD1 Natural Gas Swap and/or NYMEX Henry Hub Natural Gas Last Day Financial Futures contract during the spot month as these contracts expired.[282]

NYMEX, ICE, NFX, and Nodal currently have rules in place establishing a conditional spot month limit exemption equivalent to up to 5,000 contracts (in NYMEX-equivalent size) for their respective cash-settled natural gas contracts, provided that the trader does not maintain a position in the physically-settled NYMEX NG contract during the spot month.[283] Together, the ICE, NYMEX, NFX, and Nodal rules allow a trader to hold up to 20,000 (NYMEX-equivalent size) contracts during the spot month combined across ICE, NYMEX, NFX, and Nodal cash-settled natural gas contracts, provided the trader does not hold positions in excess of 5,000

[278] Some examples include natural gas contracts that use the NYMEX NG futures contract as a reference price, such as ICE's Henry Financial Penultimate Fixed Price Futures (PHH), options on Henry Penultimate Fixed Price (PHE), Henry Basis Futures (HEN) and Henry Swing Futures (HHD); NYMEX's E-mini Natural Gas Futures (QG), Henry Hub Natural Gas Last Day Financial Futures (HH), and Henry Hub Natural Gas Financial Calendar Spread (3 Month) Option (G3); and Nasdaq Futures, Inc.'s (''NFX'') Henry Hub Natural Gas Financial Futures (HHQ), and Henry Hub Natural Gas Penultimate Financial Futures (NPQ).

[279] Under the referenced contract definition proposed in § 150.1, cash-settled natural gas referenced contracts are those futures or options contracts, including spreads, that are:

(1) Directly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to, the price of the physically-settled NYMEX NG core referenced futures contract; or

(2) Directly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to, the price of the same commodity underlying the physically-settled NYMEX NG core referenced futures contract for delivery at the same location or locations as specified in the NYMEX NG core referenced futures contract. As proposed, the referenced contract definition does not include a location basis contract, a commodity index contract, or a trade option that meets the requirements of § 32.3 of this chapter. *See* proposed § 150.1.

[280] On November 12, 2019, Nodal announced that it had reached an agreement to acquire the core assets of NFX. *See Nodal Exchange Acquires U.S. Commodities Business of Nasdaq Futures, Inc. (NFX),* Nodal Exchange website (Nov. 12, 2019), *available at https://www.nodalexchange.com/wp-content/uploads/20191112-Nodal-NFX-release-Final.pdf* (press release). The acquisition includes all of NFX's energy complex of futures and options contracts, including NFX's Henry Hub Natural Gas Financial Futures contract. Because that contract will become part of Nodal's offerings, that contract, as well as Nodal's existing Henry Hub Monthly Natural Gas contract, would continue to qualify as referenced contracts under the proposed definition herein, and thus would be subject to federal limits by virtue of being cash-settled to the physically-settled NYMEX NG core referenced futures contract. According to the November 12, 2019 press release, ''Nodal Exchange and Nodal Clear plan to complete the integration of U.S. Power contracts by December 2019. U.S. Natural Gas, Crude Oil and Ferrous Metals contracts could transfer to Nodal as soon as spring 2020.'' *Id.*

[281] While the NYMEX NG is the only natural gas contract included as a core referenced futures contract in this release, the conditional spot month exemption proposed herein would also apply to any other physically-settled natural gas contract that the Commission may in the future designate as a core referenced futures contract, as well as to any physically-delivered contract that is substantially identical to the NYMEX NG and that qualifies as a referenced contract, or that qualifies as an economically equivalent swap.

[282] As noted above, current exchange rules establish a spot month limit of 1,000 NYMEX equivalent sized contracts. The Commission proposes a federal spot month limit of 2,000 NYMEX equivalent sized contracts based on updated deliverable supply estimates. *See supra* Section II.B.2.b. (2020 proposed spot month limit chart). The proposed conditional spot month limit exemption of 10,000 contracts per exchange is thus five times the proposed federal spot month limit.

[283] *See* ICE Rule 6.20(c), NYMEX Rule 559.F, NFX Rule Chapter V, Section 13(a), and Nodal Rule 6.5.2. The spot month for such contracts is three days. *See also Position Limits,* CMG Group website, *available at https://www.cmegroup.com/market-regulation/position-limits.html* (NYMEX position limits spreadsheet); *Market Resources,* ICE Futures website, *available at https://www.theice.com/futures-us/market-resources* (ICE position limits spreadsheet). NYMEX rules establish an exchange-set spot month limit of 1,000 contracts for its physically-settled NYMEX NG Futures contract and a separate spot month limit of 1,000 contracts for its cash-settled Henry Hub Natural Gas Last Day Financial Futures contract. As the ICE natural gas contract is one quarter the size of the NYMEX contract, ICE's exchange-set natural gas limits are shown in NYMEX equivalents throughout this section of the release. ICE thus has rules in place establishing an exchange-set spot month limit of 4,000 contracts (equivalent to 1,000 NYMEX contracts) for its cash-settled Henry Hub LD1 Fixed Price Futures contract.

contracts on any one DCM, and provided further that the trader does not hold any positions in the physically-settled NYMEX NG contract during the spot month.[284]

The DCMs originally adopted these rules, in consultation with Commission staff, in large part to address historical concerns over the potential for manipulation of physically-settled natural gas contracts during the spot month in order to benefit positions in cash-settled natural gas contracts, and to accommodate certain trading dynamics unique to the natural gas contracts. In particular, in natural gas, open interest tends to decline in the NYMEX NG contract approaching expiration and tends to increase rapidly in the ICE cash-settled Henry Hub LD1 contract. These dynamics suggest that cash-settled natural gas contracts serve an important function for hedgers and speculators who wish to recreate and/or hedge the physically-settled NYMEX NG contract price without being required to make or take delivery.

The condition in proposed § 150.3(a)(4), however, should remove the potential to manipulate the physically-settled natural gas contract in order to benefit a sizeable position in the cash-settled contract. To qualify for the exemption, market participants would not be permitted to hold any spot month positions in the physically-settled contract. This proposed conditional exemption would prevent manipulation by traders with leveraged positions in the cash-settled contracts (in comparison to the level of the limit in the physical-delivery contract) who might otherwise attempt to mark the close or distort physical-delivery prices in the physically-settled contract to benefit their leveraged cash-settled positions. Thus, the exemption would establish a higher conditional limit for the cash-settled contract than for the physical-delivery contract, so long as the cash-settled positions are decoupled from spot-month positions in physical-delivery contracts which set or affect the value of such cash-settled positions.

While the Commission is unaware of any natural gas swaps that would qualify as ''economically equivalent swaps,'' the Commission proposes to apply the conditional exemption to swaps as well, provided that a given market participant's positions in such cash-settled swaps do not exceed 10,000 futures-equivalent contracts and provided that the participant does not hold spot-month positions in physically settled natural gas contracts. Because swaps may generally be fungible across markets, that is, a position may be established on one SEF and offset on another SEF or OTC, the Commission proposes that economically equivalent swap contracts have a conditional spot month limit of 10,000 economically equivalent contracts in total across all SEFs and OTC.

A market participant that sought to hold positions in both the NYMEX NG physically-settled contract and in any cash-settled natural gas contract would not be eligible for the proposed conditional exemption. Such a participant could only hold up to 2,000 contracts net long or net short across exchanges/OTC in physically-settled natural gas referenced contract(s), and another 2,000 contracts net long or net short across exchanges/OTC in cash-settled natural gas contract referenced contract(s).[285]

f. Exemption for Pre-Enactment Swaps and Transition Period Swaps

In order to promote a smooth transition to compliance for swaps not previously subject to federal speculative position limits, proposed § 150.3(a)(5) would provide that federal speculative position limits shall not apply to positions acquired in good faith in any pre-enactment swap or in any transition period swap, in either case as defined by § 150.1.[286] Any swap that meets the proposed economically equivalent swap definition, but that otherwise qualifies as a pre-enactment swap or transition period swap, would thus be exempt from federal speculative position limits. This exemption would be self-effectuating and would not require a market participant to request relief.

In order to further lessen the impact of the proposed federal limits on market participants, for purposes of complying with the proposed federal non-spot month limits, the proposed rule would also allow both pre-enactment swaps and transition period swaps to be netted with commodity derivative contracts acquired more than 60 days after publication of final rules in the **Federal Register**. Any such positions would not be permitted to be netted during the spot month so as to avoid rendering spot month limits ineffective—the Commission is particularly concerned about protecting the spot month in physical-delivery futures from price distortions or manipulation that would disrupt the hedging and price discovery utility of the futures contract.

g. Previously-Granted Risk Management Exemptions

As discussed elsewhere in this release, the Commission previously recognized, as bona fide hedges under § 1.47, certain risk-management positions in physical commodity futures and/or options on futures contracts thereon held outside of the spot month that were used to offset the risk of commodity index swaps and other related exposure, but that did not represent substitutes for transactions or positions to be taken in a physical marketing channel. However, as noted earlier in this release, the Commission interprets Dodd-Frank Act amendments to the CEA as eliminating the Commission's authority to grant such relief unless the position satisfies the pass-through provision in CEA section 4a(c)(2)(B).[287] Accordingly, to ensure consistency with the Dodd-Frank Act, the Commission will not recognize further risk management positions as bona fide hedges, unless the position otherwise satisfies the requirements of the pass-through provisions.[288]

In addition, the Commission proposes in § 150.3(c) that such previously-granted exemptions shall not apply after the effective date of a final federal position limits rulemaking implementing the Dodd-Frank Act. Proposed § 150.3(c) uses the phrase ''positions in financial instruments'' to refer to such commodity index swaps and related exposure and would have the effect of revoking the ability to use previously-granted risk management exemptions once the limits proposed in § 150.2 go into effect.

h. Recordkeeping

Proposed § 150.3(d) establishes recordkeeping requirements for persons who claim any exemptions or relief under proposed § 150.3. Proposed § 150.3(d) should help to ensure that any person who claims any exemption permitted under proposed § 150.3 can demonstrate compliance with the applicable requirements. Under proposed § 150.3(d)(1), any persons

[284] In practice, a majority of the trading in such contracts is on ICE and NYMEX. As noted above, Nodal is acquiring NFX, including its Henry Hub Natural Gas Financial Futures contract.

[285] *See supra* Section II.B.2.k. (discussion of netting).

[286] ''Pre-enactment swap'' would mean any swap entered into prior to enactment of the Dodd-Frank Act of 2010 (July 21, 2010), the terms of which have not expired as of the date of enactment of that Act. ''Transition period swap'' would mean a swap entered into during the period commencing after the enactment of the Dodd-Frank Act of 2010 (July 21, 2010), and ending 60 days after the publication in the **Federal Register** of final amendments to this part implementing section 737 of the Dodd-Frank Act of 2010.

[287] *See supra* Section II.A.1.c.ii.(1). (discussion of the temporary substitute test and risk-management exemptions).

[288] *See supra* Section II.A.1.c.vi. (discussion of proposed pass-through language).

claiming an exemption would be required to keep and maintain complete books and records concerning all details of their related cash, forward, futures, options on futures, and swap positions and transactions, including anticipated requirements, production and royalties, contracts for services, cash commodity products and by-products, cross-commodity hedges, and records of bona fide hedging swap counterparties.

Proposed § 150.3(d)(2) addresses recordkeeping requirements related to the pass-through swap provision in the proposed definition of bona fide hedging transaction or position in proposed § 150.1.[289] Under proposed § 150.3(d)(2), a pass-through swap counterparty, as contemplated by proposed § 150.1, that relies on a representation received from a bona fide hedging swap counterparty that a swap qualifies in good faith as a bona fide hedging position or transaction under proposed § 150.1, would be required to: (i) Maintain any written representation for at least two years following the expiration of the swap; and (ii) furnish the representation to the Commission upon request.

i. Call for Information

The Commission proposes to move existing § 150.3(b), which currently allows the Commission or certain Commission staff to make special calls to demand certain information regarding positions or trading, to proposed § 150.3(e), with some technical modifications. Together with the recordkeeping provision of proposed § 150.3(d), proposed § 150.3(e) should enable the Commission to monitor the use of exemptions from speculative position limits and help to ensure that any person who claims any exemption permitted by proposed § 150.3 can demonstrate compliance with the applicable requirements.

j. Aggregation of Accounts

Proposed § 150.3(f) would clarify that entities required to aggregate under § 150.4 would be considered the same person for purposes of determining whether they are eligible for a bona fide hedge recognition under § 150.3(a)(1).

k. Delegation of Authority

Proposed § 150.3(g) would delegate authority to the Director of the Division of Market Oversight to: Grant financial distress exemptions pursuant to proposed § 150.3(a)(3); request additional information with respect to an exemption request pursuant to proposed § 150.3(b)(2); determine, in consultation with the exchange and applicant, a commercially reasonable amount of time required for a person to bring its position within the federal position limits pursuant to proposed § 150.3(b)(3)(ii)(B); make a determination whether to recognize a position as a bona fide hedging transaction or to grant a spread exemption pursuant to proposed § 150.3(b)(4); and to request that a person submit updated materials or renew their request pursuant to proposed § 150.3(b)(2) or (5). This proposed delegation would enable the Division of Market Oversight to act quickly in the event of financial distress and in the other circumstances described above.

l. Request for Comment

The Commission requests comment on all aspects of proposed § 150.3. In addition, the Commission understands that there may be certain not-for-profit electric and natural gas utilities that have certain public service missions and that are prohibited, by their governing body, risk management policies, or otherwise, from speculating, and that would request relief from federal position limits once federal limits on swaps are implemented. The Commission requests comment on all aspects of the concept of an exemption from part 150 of the Commission's regulations for certain not-for-profit electric and natural gas utility entities that have unique public service missions to provide reliable, affordable energy services to residential, commercial, and industrial customers, and that are prohibited from speculating. In addition, the Commission requests comment on whether the definition of ''economically equivalent swap'' would cover the types of hedging activities such utilities engage in with respect to their OTC swap activity.

The Commission also invites comments on the following:

(29) What are the overarching issues or concerns the Commission should consider regarding a potential exemption from position limits for such not- for-profit electric and natural gas utilities?

(30) Are there certain provisions in part 150 of the Commission's regulations that should apply to such not-for-profit electric and natural gas utilities even if the Commission were to grant such entities an exemption with respect to federal position limits?

(31) Are there other types of entities, similar to the not-for-profit electric and natural gas utilities described above, for which the Commission should also consider granting such exemptive relief by rule, and why?

(32) What types of conditions, restrictions, or criteria should the Commission consider applying with respect to such an exemption?

(33) Should higher position limits in cash-settled natural gas futures be conditioned on the closing of any positions in the physically delivered natural gas contract? Are there characteristics of the natural gas futures markets that weigh in favor of or against the higher conditional limits?

D. § 150.5—Exchange-Set Position Limits and Exemptions Therefrom

1. Background

For the avoidance of confusion, the discussion of § 150.5 that follows addresses exchange-set limits and exemptions therefrom, not federal limits. For a discussion of the proposed processes by which an exemption may be recognized for purposes of federal limits, please see the discussion of proposed § 150.3 above and § 150.9 below.

Under DCM Core Principle 5, DCMs shall adopt for each contract, as is necessary and appropriate, position limitations or position accountability for speculators, and, for any contract subject to a federal position limit, DCMs must establish exchange-set limits for that contract no higher than the federal limit level.[290] Similarly, under SEF Core Principle 6, SEFs that are trading facilities shall adopt for each contract, as is necessary and appropriate, position limitations or position accountability for speculators, and, for any contract subject to a federal position limit, SEFs that are trading facilities must establish exchange-set limits for that contract no higher than the federal limit, and must monitor positions established on or through the SEF for compliance with the limit set by the Commission and the limit, if any, set by the SEF.[291] Beyond these and other statutory and Commission requirements, unless otherwise determined by the Commission, DCM and SEF Core Principle 1 afford DCMs and SEFs ''reasonable discretion'' in establishing the manner in which they comply with the core principles.[292]

The current regulatory provisions governing exchange-set position limits and exemptions therefrom appear in § 150.5.[293] To align § 150.5 with Dodd-

[289] *See supra* Section II.A.1.c.vi. (discussion of proposed pass-through language).

[290] *See* 7 U.S.C. 7(d)(5).

[291] *See* 7 U.S.C. 7b–3(f)(6).

[292] *See* 7 U.S.C. 7(d)(1) and 7 U.S.C. 7b–3(f)(1).

[293] 17 CFR 150.5.

Frank statutory changes [294] and with other changes proposed herein,[295] the Commission proposes a new version of § 150.5. This new proposed § 150.5 would generally afford exchanges the discretion to decide for themselves how best to set limit levels and grant exemptions from such limits in a manner that best reflects their specific markets.

2. Implementation of Exchange-Set Limits on Swaps

With respect to the DCM Core Principle 5 and SEF Core Principle 6 requirements addressing exchange-set limits on swaps, the Commission is preliminarily determining that it is reasonable to delay implementation because requiring compliance would be impracticable, and in some cases impossible, at this time.[296]

The Commission has previously explained why it has proposed to temporarily delay imposition of exchange-set position limits on swaps.[297] The decision to delay imposing exchange-set position limits on swaps is based largely on the lack of exchange access to sufficient data regarding individual market participants' open swap positions, which means that, without action to provide further access to swap data to exchanges, the exchanges cannot effectively monitor swap position limits.

The Commission preliminarily believes that delayed implementation of exchange-set speculative position limits on swaps at this time is not inconsistent with the statutory objectives outlined in section 4a(a)(3) of the CEA: To diminish excessive speculation, to deter market manipulation, to ensure sufficient liquidity for bona fide hedgers, and to ensure that the price discovery function of the underlying market it not disrupted.[298]

Accordingly, while proposed § 150.5 will apply to DCMs and SEFs, the requirements associated with swaps would be enforced at a later time. In other words, exchanges must comply with proposed § 150.5 only with respect to futures and options on futures traded on DCMs, and with respect to swaps at a later time as determined by the Commission.

3. Existing § 150.5

As noted above, existing § 150.5 pre-dates the Dodd-Frank Act and addresses the establishment of DCM-set position limits for all contracts not subject to federal limits under existing § 150.2 (aside from certain major foreign currencies).[299] Existing § 150.5(a) authorizes DCMs to set different limits for different contracts and contract months, and permits DCMs to grant exemptions from DCM-set limits for spreads, straddles, or arbitrage trades.

Existing § 150.5(b) provides a limited set of methodologies for DCMs to use in establishing initial limit levels, including separate maximum limit levels for spot month limits in physical-delivery contracts, spot month limits in cash-settled contracts, non-spot month limits for tangible commodities other than energy, and non-spot month limits for energy products and non-tangible commodities, including financials.[300] Existing § 150.5(c) provides that DCMs may adjust their speculative initial levels as follows: (i) No greater than 25 percent of deliverable supply for adjusted spot month levels in physically-delivered contracts; (ii) ''no greater than necessary to minimize the potential for manipulation or distortion of the contract's or the underlying commodity's price'' for adjusted spot month levels in cash-settled contracts; and (iii) for adjusted non-spot month limit levels, either no greater than 10 percent of open interest, up to 25,000 contracts, with a marginal increase of 2.5 percent thereafter, or based on position sizes customarily held by speculative traders on the DCM.

Existing § 150.5(d) addresses bona fide hedging exemptions from DCM-set limits, including an exemption application process, providing that exchange-set speculative position limits shall not apply to bona fide hedging positions as defined by a DCM in accordance with the definition of bona fide hedging transactions and positions for excluded commodities in § 1.3. Existing § 150.5(d) also addresses factors for consideration by DCMs in recognizing bona fide hedging exemptions (or position accountability), including whether such positions ''are not in accord with sound commercial practices or exceed an amount which may be established and liquidated in an orderly fashion.'' [301]

Existing § 150.5(e) permits DCMs in certain circumstances to submit for Commission approval, as a substitute for the position limits required under § 150.5(a), (b), and (c), a DCM rule requiring traders ''to be accountable for large positions,'' meaning that under certain circumstances, traders must provide information about their position upon request to the exchange, and/or consent to halt increasing further a position if so ordered by the exchange.[302] Among other things, this provision includes open interest and volume-based parameters for determining when DCMs may do so.[303]

Existing § 150.5(f) provides that DCM speculative position limits adopted pursuant to § 150.5 shall not apply to certain positions acquired in good faith prior to the effective date of such limits or to a person that is registered as an FCM or as a floor broker under authority of the CEA except to the extent that transactions made by such person are made on behalf of or for the account or benefit of such person.[304] This provision also provides that in addition to the express exemptions specified in § 150.5, a DCM may propose such other exemptions from the requirements of § 150.5 as are consistent with the purposes of § 150.5, and provides procedures for doing so.[305] Finally, existing § 150.5(g) addresses aggregation of positions for which a person directly or indirectly controls trading.

4. Proposed § 150.5

Pursuant to CEA sections 5(d)(1) and 5h(f)(1), the Commission proposes a new version of § 150.5.[306] Proposed § 150.5 is intended to provide the ability for DCMs and SEFs to set limit levels

[294] While existing § 150.5 on its face only applies to contracts that are not subject to federal limits, DCM Core Principle 5, as amended by Dodd-Frank, and SEF Core Principle 6, establish requirements both for contracts that are, and are not, subject to federal limits. 7 U.S.C. 7(d)(5) and 7 U.S.C. 7b–3(f)(6).

[295] Significant changes proposed herein include the process set forth in proposed § 150.9 and revisions to the bona fide hedging definition proposed in § 150.1.

[296] The Commission has observed in prior releases that courts have upheld relieving regulated entities of their statutory obligations where compliance is impossible or impracticable. 2016 Supplemental Proposal, 81 FR at 38462.

[297] 2016 Supplemental Proposal, 81 FR at 38459–62; 2016 Reproposal, 81 FR at 96784–86.

[298] 7 U.S.C. 6a(a)(3).

[299] Existing § 150.5(a) states that the requirement to set position limits shall not apply to futures or option contract markets on major foreign currencies, for which there is no legal impediment to delivery and for which there exists a highly liquid cash market. 17 CFR 150.5(a).

[300] *See* 17 CFR 150.5(b)(1)–(3) (no greater than one-quarter of the estimated spot month deliverable supply for physical delivery contracts during the spot month; no greater than necessary to minimize the potential for manipulation or distortion of the contract's or the underlying commodity's price for cash-settled contracts during the spot month; no greater than 1,000 contracts for tangible commodities other than energy outside the spot month; and no greater than 5,000 contracts for energy products and nontangible commodities, including financials outside the spot month).

[301] *See* 17 CFR 150.5(d)(1).

[302] 17 CFR 150.5(e).

[303] 17 CFR 150.5(e)(1)–(4).

[304] 17 CFR 150.5(f).

[305] *Id.*

[306] As mentioned above, while proposed § 150.5 will include references to swaps and SEFs, the proposed rule would initially only apply to DCMs, as requirements relating to exchange-set limits on swaps would be phased in at a later time.

and grant exemptions in a manner that best accommodates activity particular to their markets, while promoting compliance with DCM Core Principle 5 and SEF Core Principle 6 and ensuring consistency with other changes proposed herein, including the process for exchanges to administer applications for non-enumerated bona fide hedge exemptions for purposes of federal limits proposed in § 150.9.[307]

Proposed § 150.5 contains two main sub-sections, with each sub-section addressing a different category of contract: (i) Proposed § 150.5(a) would include rules governing exchange-set limits for contracts subject to federal limits; and (ii) proposed § 150.5(b) would include rules governing exchange-set limits for physical commodity contracts that are not subject to federal limits.

As described in further detail below, the proposed provisions addressing exchange-set limits on contracts that are not subject to federal limits reflect a principles-based approach and include acceptable practices that provide for non-exclusive methods of compliance with the principles-based regulations. The Commission would therefore provide exchanges with the ability to set limits and grant exemptions in the manner that most suits their unique markets. Each proposed provision of § 150.5 is described in detail below.

a. Proposed § 150.5(a)—Requirements for Exchange-Set Limits on Commodity Derivative Contracts Subject to Federal Limits Set Forth in § 150.2

Proposed § 150.5(a) would apply to all contracts subject to the federal limits proposed in § 150.2 and, among other things, is intended to help ensure that exchange-set limits do not undermine the federal limits framework. Under proposed § 150.5(a)(1), for any contract subject to a federal limit, DCMs and, ultimately, SEFs, would be required to establish exchange-set limits for such contracts. Consistent with DCM Core Principle 5 and SEF Core Principle 6, the exchange-set limit levels on such contracts, whether cash-settled or physically-settled, and whether during or outside the spot month, would have to be no higher than the level specified for the applicable referenced contract in proposed § 150.2. Exchanges would be free to set position limits that are more stringent than the federal limit for a particular contract, and would also be permitted to adopt position accountability at a level lower than the federal limit, in addition to an exchange-set position limit that is equal to or less than the federal limit.

Proposed § 150.5(a)(2) would permit exchanges to grant exemptions from exchange-set limits established under proposed § 150.5(a)(1) as follows:

First, if such exemptions from exchange-set limits conform to the types of exemptions that may be granted for purposes of federal limits under proposed §§ 150.3(a)(1)(i), 150.3(a)(2)(i), and 150.3(a)(4)–(5) (enumerated bona fide hedge recognitions and spread exemptions that are listed in the spread transaction definition in proposed § 150.1, as well as exempt conditional spot month positions in natural gas and pre-enactment and transition period swaps), then the level of the exemption may exceed the applicable federal position limit under proposed § 150.2. Since the proposed exemptions listed above are self-effectuating for purposes of federal position limit levels, exchanges may grant such exemptions pursuant to proposed § 150.5(a)(2)(i).

Second, if such exemptions from exchange-set limits conform to the exemptions from federal limits that may be granted under proposed §§ 150.3(a)(1)(ii) and 150.3(a)(2)(ii) (respectively, non-enumerated bona fide hedges and spread transactions that are not currently listed in the spread transaction definition in proposed § 150.1), then the level of the exemption may exceed the applicable federal position limit under proposed § 150.2, provided that the exemption for purposes of federal limits is first approved in accordance with proposed § 150.3(b) or § 150.9, as applicable.

Third, if such exemptions conform to the exemptions from federal limits that may be granted under proposed § 150.3(a)(3) (financial distress positions), then the level of the exemption may exceed the applicable federal position limit under proposed § 150.2, provided that the Commission has first issued a letter approving such exemption pursuant to a request submitted under § 140.99.[308]

Finally, for purposes of exchange-set limits only, exchanges may grant exemption types that are not listed in § 150.3(a). However, in such cases, the exemption level would have to be capped at the level of the applicable federal position limit, so as not to undermine the federal limit framework, unless the Commission has first approved such exemption for purposes of federal limits pursuant to § 150.3(b).

Exchanges that wish to offer exemptions from their own limits other than the types listed in proposed § 150.3(a) could also submit rules to the Commission allowing for such exemptions pursuant to part 40. The Commission would carefully review any such exemption types for compliance with applicable standards, including any statutory requirements[309] and Commission-set standards.[310]

Under proposed § 150.5(a)(2)(ii)(A), exchanges that wish to grant exemptions from their own limits would have to require traders to file an application. Aside from the requirements discussed below, including the requirement that the exchange collect cash-market and swaps market information from the applicant, exchanges would have flexibility to establish the application process as they see fit, including adopting protocols to reduce burdens by leveraging existing processes with which their participants are already familiar. For all exemption types, exchanges would have to generally require that such applications be filed in advance of the date such position would be in excess of the limits, but exchanges would be given the discretion to adopt rules allowing traders to file applications within five business days after a trader established such position. Exchanges wishing to grant such retroactive exemptions would have to require market participants to demonstrate circumstances warranting a sudden and unforeseen hedging need.

Proposed § 150.5(a)(2)(ii)(B) would provide that exchanges must require that a trader reapply for the exemption granted under proposed § 150.5(a)(2) at least annually so that the exchange and the Commission can closely monitor exemptions for contracts subject to

[307] To avoid confusion created by the parallel federal and exchange-set position limit frameworks, the Commission clarifies that proposed § 150.5 deals solely with exchange-set position limits and exemptions therefrom, whereas proposed § 150.9 deals solely with federal limits and recognition of exchange-granted exemptions and bona fide hedging determinations for purposes of federal limits.

[308] Under the proposal, requests for exemptions for financial distress positions would be submitted directly to the Commission (or delegated staff) for consideration, and any approval of such exemption would be issued in the form of an exemption letter from the Commission (or delegated staff) pursuant to § 140.99.

[309] For example, an exchange would not be permitted to adopt rules allowing for risk management exemptions in physical commodities because the Commission interprets Dodd-Frank amendments to CEA section 4a(c)(2) as prohibiting risk management exemptions in such commodities. *See supra* Section II.A.1.c.ii.(1). (discussion of the temporary substitute test and risk-management exemptions).

[310] For example, as discussed below, proposed § 150.5(a)(2)(ii)(C) would require that exchanges take into account whether the requested exemption would result in positions that are not in accord with sound commercial practices in the relevant commodity derivative market and/or would not exceed an amount that may be established and liquidated in an orderly fashion in that market.

federal speculative position limits, and to help ensure that the exchange and the Commission remain aware of the trader's activities. Proposed § 150.5(a)(2)(ii)(C) would authorize exchanges to deny, limit, condition, or revoke any exemption request in accordance with exchange rules,[311] and would set forth a principles-based standard for the granting of exemptions that do not conform to the type that the Commission may grant under proposed § 150.3(a). Specifically, exchanges would be required to take into account: (i) Whether the requested exemption from its limits would result in a position that is ''not in accord with sound commercial practices'' in the market in which the DCM is granting the exemption; and (ii) whether the requested exemption would result in a position that would ''exceed an amount that may be established or liquidated in an orderly fashion in that market.'' Exchanges' evaluation of exemption requests against these standards would be a facts and circumstances determination.

Activity may reflect ''sound commercial practice'' for a particular market or market participant but not for another. Similarly, activity may reflect ''sound commercial practice'' outside the spot month but not in the spot month. Further, activity with manipulative intent or effect, or that has the potential or effect of causing price distortion or disruption, would be inconsistent with ''sound commercial practice,'' even if common practice among market participants. While an exemption granted to an individual market participant may reflect ''sound commercial practice'' and may not ''exceed an amount that may be established or liquidated in an orderly fashion in that market,'' the Commission expects exchanges to also evaluate whether the granting of a particular exemption type to multiple participants could have a collective impact on the market in a manner inconsistent with ''sound commercial practice'' or in a manner that could result in a position that would ''exceed an amount that may be established or liquidated in an orderly fashion in that market.''

The Commission understands that the above-described parameters for exemptions from exchange-set limits are generally consistent with current industry practice among DCMs. Bearing in mind that proposed § 150.5(a) would apply to contracts subject to federal limits, the Commission proposes codifying such parameters, as they would establish important, minimum standards needed for exchanges to administer, and the Commission to oversee, a robust program for granting exemptions from exchange-set limits in a manner that does not undermine the federal limits framework. Proposed § 150.5(a) also would afford exchanges the ability to generally oversee their programs for granting exemptions from exchange limits as they see fit, including to establish different application processes and requirements to accommodate the unique characteristics of different contracts.

If adopted, changes proposed herein may result in certain ''pre-existing positions'' being subject to speculative position limits even though the position predated the adoption of such limits.[312] So as not to undermine the federal position limits framework during the spot month, and to minimize disruption outside the spot month, the Commission proposes § 150.5(a)(3), which would require that during the spot month, for contracts subject to federal limits, exchanges must impose limits no larger than federal levels on ''pre-existing positions,'' other than for pre-enactment swaps and transition period swaps.

However, outside the spot month, exchanges would not be required to impose limits on such positions, provided the position is acquired in good faith consistent with the ''pre-existing position'' definition of proposed § 150.1, and provided further that if the person's position is increased after the effective date of the limit, such pre-existing position, other than pre-enactment swaps and transition period swaps, along with the position increased after the effective date, would be attributed to the person. This provision is consistent with the proposed treatment of pre-existing positions for purposes of federal limits set forth in proposed § 150.2(g) and is intended to prevent spot month limits from being rendered ineffective.

Not subjecting pre-existing positions to spot month limits could result in a large, pre-existing position either intentionally or unintentionally causing a disruption as it is rolled into the spot month, and the Commission is particularly concerned about protecting the spot month in physical-delivery futures from corners and squeezes. Outside of the spot month, however, concerns over corners and squeezes may be less acute.[313]

Finally, the Commission seeks a balance between having sufficient information to oversee the exchange-granted exemptions, and not burdening exchanges with excessive periodic reporting requirements. The Commission thus proposes under § 150.5(a)(4) to require one monthly report by each exchange. Certain exchanges already voluntarily file these types of monthly reports with the Commission, and proposed § 150.5(a)(4) would standardize such reports for all exchanges that process applications for bona fide hedges, spread exemptions, and other exemptions for contracts that are subject to federal limits. The proposed report would provide information regarding the disposition of any application to recognize a position as a bona fide hedge (both enumerated and non-enumerated) or to grant a spread or other exemption, including any renewal, revocation of, or modification to the terms and conditions of, a prior recognition or exemption.[314]

As specified under proposed § 150.5(a)(4), the report would provide certain details regarding the bona fide hedging position or spread exemption, including: The effective date and expiration date of any recognition or exemption; any unique identifier assigned to track the application or position; identifying information about the applicant; the derivative contract or positions to which the application pertains; the maximum size of the commodity derivative position that is recognized or exempted by the exchange (including any ''walk-down'' requirements);[315] any size limitations the exchange sets for the position; and a brief narrative summarizing the applicant's relevant cash market activity.

[311] Currently, DCMs review and set exemption levels annually based on the facts and circumstances of a particular exemption and the market conditions at that time. As such, a DCM may decide to deny, limit, condition, or revoke a particular exemption, typically, if the DCM determines that certain conditions have changed and warrant such action. This may happen if, for example, there are droughts, floods, embargoes, trade disputes, or other events that cause shocks to the supply or demand of a particular commodity and thus impact the DCM's disposition of a particular exemption.

[314] In the monthly report, exchanges may elect to list new recognitions or exemptions, and modifications to or revocations of prior recognitions and exemptions each month; alternatively, exchanges may submit cumulative monthly reports listing all active recognitions and exemptions (*i.e.,* including exemptions that are not new or have not changed).

[315] An exchange could determine to recognize as a bona fide hedge or spread exemption all, or a portion, of the commodity derivative position for which an application has been submitted, provided that such determination is made in accordance with the requirements of proposed § 150.5 and is consistent with the Act and the Commission's regulations. In addition, an exchange could require that a bona fide hedging positon or spread position be subject to ''walk-down'' provisions that require the trader to scale down its positions in the spot month in order to reduce market congestion as needed based on the facts and circumstances.

With respect to any unique identifiers to be included in the proposed monthly report, the exchange's assignment of a unique identifier would assist the Commission's tracking process. The unique identifier could apply to each of the bona fide hedge or spread exemption applications that the exchange receives, and, separately, each type of commodity derivative position that the exchange wishes to recognize as a bona fide hedge or spread exemption. Accordingly, the Commission suggests that, as a ''best practice,'' the exchange's procedures for processing bona fide hedging position and spread exemption applications contemplate the assignment of such unique identifiers.

The proposed report would also be required to specify the maximum size and/or size limitations by contract month and/or type of limit (*e.g.,* spot month, single month, or all-months-combined), as applicable.

The proposed monthly report would be a critical element of the Commission's surveillance program by facilitating its ability to track bona fide hedging positions and spread exemptions approved by exchanges. The proposed monthly report would also keep the Commission informed as to the manner in which an exchange is administering its application procedures, the exchange's rationale for permitting large positions, and relevant cash market activity. The Commission expects that exchanges would be able to leverage their current exemption processes and recordkeeping procedures to generate such reports.

In certain instances, information included in the proposed monthly report may prompt the Commission to request records required to be maintained by an exchange. For example, the Commission proposes that, for each derivative position that an exchange wishes to recognize as a bona fide hedge, or any revocation or modification of such recognition or exemption, the report would include a concise summary of the applicant's activity in the cash markets and swaps markets for the commodity underlying the position. The Commission expects that this summary would focus on the facts and circumstances upon which an exchange based its determination to recognize a bona fide hedge, to grant a spread exemption, or to revoke or modify such recognition or exemption. In light of the information provided in the summary, or any other information included in the proposed monthly report regarding the position, the Commission may request the exchange's complete record of the application. The Commission expects that it would only need to request such complete records in the event that it noticed an issue that could cause market disruptions.

Proposed § 150.5(a)(4) would require an exchange, unless instructed otherwise by the Commission, to submit such monthly reports according to the form and manner requirements the Commission specifies. In order to facilitate the processing of such reports, and the analysis of the information contained therein, the Commission would establish reporting and transmission standards. The proposal would also require that such reports be submitted to the Commission using an electronic data format, coding structure, and electronic data transmission procedures approved in writing by the Commission, as specified on its website.[316]

Request for Comment

The Commission requests comment on all aspects of proposed § 150.5(a). The Commission also invites comments on the following:

(34) The Commission has proposed that exchanges submit monthly reports under § 150.5(a)(4). Do exchanges prefer that the Commission specify a particular day each month as a deadline for submitting such monthly reports or do exchanges prefer to have discretion in determining which day to submit such reports?

b. Proposed § 150.5(b)—Requirements and Acceptable Practices for Exchange-Set Limits on Commodity Derivative Contracts in a Physical Commodity That Are Not Subject to the Limits Set Forth in § 150.2

As described elsewhere in this release, the Commission is proposing federal speculative limits on 25 core referenced futures contracts and their respective referenced contracts.[317] DCMs, and, ultimately, SEFs, listing physical commodity contracts for which federal limits do not apply would have to comply with proposed § 150.5(b), which includes a combination of rules and references to acceptable practices.

Under proposed § 150.5(b), for physical commodity derivatives that are not subject to federal limits, whether cash-settled or physically-settled, exchanges would be subject to flexible standards during the product's spot month and non-spot month. During the spot month, under proposed § 150.5(b)(1)(i), exchanges would be required to establish position limits, and such limits would have to be set at a level that is no greater than 25 percent of deliverable supply. As described in detail in connection with the proposed federal spot month limits described above, it would be difficult, in the absence of other factors, for a participant to corner or squeeze a market if the participant holds less than or equal to 25 percent of deliverable supply, and the Commission has long used deliverable supply as the basis for spot month position limits due to concerns regarding corners, squeezes, and other settlement-period manipulative activity.[318]

The Commission recognizes, however, that there may be circumstances where an exchange may not wish to use the 25 percent formula, including, for example, if the contract is cash-settled, does not have a measurable deliverable supply, or if the exchange can demonstrate that a different parameter is better suited for a particular contract or market.[319] Accordingly, the proposal would afford exchanges the ability to submit to the Commission alternative potential methodologies for calculating spot month limit levels required by proposed § 150.5(b)(1), provided that the limits are set at a level that is ''necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index.'' This standard has appeared in existing § 150.5 since its adoption in connection with spot month limits on cash-settled contracts. As noted above, existing § 150.5 includes separate parameters for spot month limits in physical-delivery contracts and for cash-settled contracts, but does not include flexibility for exchanges to consider alternative parameters. In an effort to both simplify the regulation and provide the ability for exchanges to consider multiple parameters that may be better suited for certain products, the Commission proposes the above standard as a principles-based requirement for both cash-settled and physically-settled contracts subject to proposed § 150.5(b).

Outside of the spot month, where, historically, attempts at certain types of market manipulation are generally less of a concern, proposed § 150.5(b)(2)(i) would allow exchanges to choose between position limits or position accountability for physical commodity

[316] The Commission would provide such form and manner instructions on the Forms and Submissions page at *www.cftc.gov*. Such instructions would likely be published in the form of a technical guidebook.

[317] *See infra* Section III.F.

[318] *See supra* Section II.B.2. (discussion of proposed § 150.2).

[319] Guidance for calculating deliverable supply can be found in Appendix C to part 38. 17 CFR part 38, Appendix C.

contracts that are not subject to federal limits. While exchanges would be provided the ability to decide whether to use limit levels or accountability levels for any such contract, under either approach, the exchange would have to set a level that is ''necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index.''

To help exchanges efficiently demonstrate compliance with this standard for physical commodity contracts outside of the spot month, the Commission proposes separate acceptable practices for exchanges that wish to adopt non-spot month position limits and exchanges that wish to adopt non-spot month accountability.[320] For exchanges that choose to adopt non-spot month position limits, rather than position accountability, proposed paragraph (a)(1) to Appendix F of part 150 would set forth non-exclusive acceptable practices. Under that provision, exchanges would be deemed in compliance with proposed § 150.5(b)(2)(i) if they set non-spot limit levels for each contract subject to § 150.5(b) at a level no greater than: (1) The average of historical position sizes held by speculative traders in the contract as a percentage of the contract's open interest;[321] (2) the spot month limit level for the contract; (3) 5,000 contracts (scaled up proportionally to the ratio of the notional quantity per contract to the typical cash market transaction if the notional quantity per contract is smaller than the typical cash market transaction, or scaled down proportionally if the notional quantity per contract is larger than the typical cash market transaction);[322] or (4) 10 percent of open interest in that contract for the most recent calendar year up to 50,000 contracts, with a marginal increase of 2.5 percent of open interest thereafter.[323] When evaluating average position sizes held by speculative traders, the Commission expects exchanges: (i) To be cognizant of speculative positions that are extraordinarily large relative to other speculative positions, and (ii) to not consider any such outliers in their calculations.

These proposed parameters have largely appeared in existing § 150.5 for many years in connection with non-spot month limits, either for initial or subsequent levels.[324] The Commission is of the view that these parameters would be useful, flexible standards to carry forward as acceptable practices. For example, the Commission expects that the 5,000-contract acceptable practice would be a useful benchmark for exchanges because it would allow them to establish limits and demonstrate compliance with Commission regulations in a relatively efficient manner, particularly for new contracts that have yet to establish open interest. Similarly, for purposes of exchange-set limits on physical commodity contracts that are not subject to federal limits, the Commission proposes to maintain the baseline 10, 2.5 percent formula as an acceptable practice. Because these parameters are simply acceptable practices, exchanges may, after evaluation, propose higher non-spot month limits or accountability levels.

Along those lines, the Commission recognizes that other parameters may be preferable and/or just as effective, and would be open to considering alternative parameters submitted pursuant to part 40 of the Commission's regulations, provided, at a minimum, that the parameter complies with § 150.5(b)(2)(i). The Commission encourages exchanges to submit potential new parameters to Commission staff in draft form prior to submitting them under part 40.

For exchanges that choose to adopt position accountability, rather than limits, outside of the spot month, proposed paragraph (a)(2) of Appendix F to part 150 would set forth a non-exclusive acceptable practice that would permit exchanges to comply with proposed § 150.5(b)(2)(i) by adopting rules establishing ''position accountability'' as defined in proposed § 150.1. ''Position accountability'' would mean rules, submitted to the Commission pursuant to part 40, that require traders to, upon request by the exchange, consent to: (i) Provide information to the exchange about their position, including, but not limited to, information about the nature of the their positions, trading strategies, and hedging information; and (ii) halt further increases to their position or to reduce their position in an orderly manner.[325]

Proposed § 150.5(b)(3) addresses a circumstance where multiple exchanges list contracts that are substantially the same, including physically-settled contracts that have the same underlying commodity and delivery location, or cash-settled contracts that are directly or indirectly linked to a physically-settled contract. Under proposed § 150.5(b)(3), exchanges listing contracts that are substantially the same in this manner must either adopt ''comparable'' limits for such contracts, or demonstrate to the Commission how the non-comparable levels comply with the standards set forth in proposed § 150.5(b)(1) and (2). Such a determination also must address how the levels are necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index. Proposed § 150.5(b)(3) would apply equally to cash-settled and physically-settled contracts, and to limits during and outside of the spot month, as

[320] The acceptable practices proposed in Appendix F to part 150 herein reflect non-exclusive methods of compliance. Accordingly, the language of this proposed acceptable practice, along with the other acceptable practices proposed herein, uses the word ''shall'' not to indicate that the acceptable practice is a required method of compliance, but rather to indicate that in order to satisfy the acceptable practice, a market participant must (*i.e.,* shall) establish compliance with that particular acceptable practice.

[321] For example, if speculative traders in a particular contract typically make up 12 percent of open interest in that contract, the exchange could set limit levels no greater than 12 percent of open interest.

[322] For exchanges that choose to adopt a non-spot month limit level of 5,000 contracts, this level assumes that the notional quantity per contract is set at a level that reflects the size of a typical cash market transaction in the underlying commodity. However, if the notional quantity of the contract is larger/smaller than the typical cash market transaction in the underlying commodity, then the DCM must reduce/increase the 5,000 contract non-spot month limit until it is proportional to the notional quantity of the contract relative to the typical cash market transaction. These required adjustments to the 5,000 contract metric are intended to avoid a circumstance where an exchange could allow excessive speculation by setting excessively large notional quantities relative to typical cash-market transaction sizes. For example, if the notional quantity per contract is set at 30,000 units, and the typical observed cash market transaction is 2,500 units, the notional quantity per contract would be 12 times larger than the typical cash market transaction. In that case, the non-spot month limit would need to be 12 times smaller than 5,000 (*i.e.,* at 417 contracts.). Similarly, if the notional quantity per contract is 1,000 contracts, and the typical observed cash market transaction is 2,500 units, the notional quantity per contract would be 2.5 times smaller than the typical cash market transaction. In that case, the non-spot month limit would need to be 2.5 times larger than 5,000, and would need to be set at 12,500 contracts.

[323] In connection with the proposed Appendix F to part 150 acceptable practices, open interest should be calculated by averaging the month-end open positions in a futures contract and its related option contract, on a delta-adjusted basis, for all months listed during the most recent calendar year.

[324] 17 CFR 150.5(b) and (c). Proposed § 150.5(b) would address physical commodity contracts that are not subject to federal limits.

[325] While existing § 150.5(e) includes open-interest and volume-based limitations on the use of accountability, the Commission opts not to include such limitations in this proposal. Under the rules proposed herein, if an exchange submitted a part 40 filing seeking to adopt position accountability, the Commission would determine on a case-by-case basis whether such rules are consistent with the Act and the Commission's regulations. The Commission does not want to use one-size-fits-all volume-based limitations for making such determinations.

applicable.[326] Proposed § 150.5(b)(3) is intended to help ensure that position limits established on one exchange would not jeopardize market integrity or otherwise harm other markets. Further, proposed § 150.5(b)(3) would be consistent with the Commission's proposal to generally apply equivalent federal limits to linked contracts, including linked contracts listed on multiple exchanges.[327]

Finally, under proposed § 150.5(b)(4), exchanges would be permitted to grant exemptions from any limits established under proposed § 150.5(b). As noted, proposed § 150.5(b) would apply to physical commodity contracts not subject to federal limits; thus, exchanges would be given flexibility to grant exemptions in such contracts, including exemptions for both intramarket and intermarket spread positions,[328] as well as other exemption types not explicitly listed in proposed § 150.3.[329] However, such exchanges must require that traders apply for the exemption. In considering any such application, the exchanges would be required to take into account whether the exemption would result in a position that would not be in accord with ''sound commercial practices'' in the market for which the exchange is considering the application, and/or would ''exceed an amount that may be established and liquidated in an orderly fashion in that market.''

While exchanges would be subject to the requirements of § 150.5(a) and (b) described above, such proposed requirements are not intended to limit the discretion of exchanges to utilize other tools to protect their markets. Among other things, an exchange would have the discretion to: impose additional restrictions on a person with a long position in the spot month of a physical-delivery contract who stands for delivery, takes that delivery, then re-establishes a long position; establish limits on the amount of delivery instruments that a person may hold in a physical-delivery contract; and impose such other restrictions as it deems necessary to reduce the potential threat of market manipulation or congestion, to maintain orderly execution of transactions, or for such other purposes consistent with its responsibilities.

c. Proposed § 150.5(c)—Requirements for Security Futures Products

As the Commission has previously noted, security futures products and security options may serve economically equivalent or similar functions to one another.[330] Therefore, when the Commission originally adopted position limits regulations for security futures products in part 41, it set levels that were generally comparable to, although not identical with, the limits that applied to options on individual securities.[331] The Commission has pointed out that security futures products may be at a competitive disadvantage if position limits for security futures products vary too much from those of security options.[332] As a result, the Commission in 2019 adopted amendments to the position limitations and accountability requirements for security futures products, noting that one goal was to provide a level regulatory playing field with security options.[333] Proposed § 150.5(c), therefore, would include a cross-reference clarifying that for security futures products, position limitations and accountability requirements for exchanges are specified in § 41.25.[334] This would allow the Commission to take into account the position limits regime that applies to security options when considering position limits regulations for security futures products.

d. Proposed § 150.5(d)—Rules on Aggregation

As noted earlier in this release, the Commission adopted in 2016 final aggregation rules under § 150.4 that apply to all contracts subject to federal limits. The Commission recognizes that with respect to contracts not subject to federal limits, market participants may find it burdensome if different exchanges adopt different aggregation standards. Accordingly, under proposed § 150.5(d), all DCMs, and, ultimately, SEFs, that list any physical commodity derivatives, regardless of whether the contract is subject to federal limits, would be required to adopt aggregation rules for such contracts that conform to § 150.4.[335] Exchanges that list excluded commodities would be encouraged to also adopt aggregation rules that conform to § 150.4. Aggregation policies that otherwise vary from exchange to exchange would increase the administrative burden on a trader active on multiple exchanges, as well as increase the administrative burden on the Commission in monitoring and enforcing exchange-set position limits.

e. Proposed § 150.5(e)—Requirements for Submissions to the Commission

Proposed § 150.5(e) reflects that, consistent with the definition of ''rule'' in existing § 40.1, any exchange action establishing or modifying exchange-set position limits or exemptions therefrom, or position accountability, in any case pursuant to proposed § 150.5(a), (b), (c), or Appendix F to part 150, would qualify as a ''rule'' and must be submitted to the Commission as such pursuant to part 40 of the Commission's regulations. Such rules would also include, among other things, parameters used for determining position limit levels, and policies and related processes setting forth parameters addressing, among other things, which types of exemptions are permitted, the parameters for the granting of such exemptions, and any exemption application requirements.

[326] For reasons discussed elsewhere in this release, this provision would not apply to natural gas contracts. *See supra* Section II.C.2.e. (discussion of proposed conditional spot month exemption in natural gas).

[327] *See supra* Section II.A.16. (discussion of the proposed referenced contract definition and linked contracts).

[328] The Commission understands an intramarket spread position to be a long position in one or more commodity derivative contracts in a particular commodity, or its products or its by-products, and a short position in one or more commodity derivative contracts in the same, or similar, commodity, or its products or by-products, on the same DCM. The Commission understands an intermarket spread position to be a long (or short) position in one or more commodity derivative contracts in a particular commodity, or its products or its by-products, at a particular DCM and a short (or long) position in one or more commodity derivative contracts in that same, or similar, commodity, or its products or its by-products, away from that particular DCM. For instance, the Commission would consider a spread between CBOT Wheat (W) futures and MGEX HRS Wheat (MWE) futures to be an intermarket spread based on the similarity of the commodities.

[329] As noted above, proposed § 150.3 would allow for several exemption types, including: Bona fide hedging positions; certain spreads; financial distress positions; and conditional spot month limit exemption positions in natural gas.

[330] *See* Position Limits and Position Accountability for Security Futures Products, 83 FR at 36799, 36802 (July 31, 2018).

[331] *Id. See also* Listing Standards and Conditions for Trading Security Futures Products, 66 FR at 55078, 55082 (Nov. 1, 2001) (explaining the Commission's adoption of position limits for security futures products).

[332] *See* 83 FR at 36799, 36802 (July 31, 2018).

[333] *See* Position Limits and Position Accountability for Security Futures Products, 84 FR at 51005, 51009 (Sept. 27, 2019).

[334] *See* 17 CFR 41.25. Rule § 41.25 establishes conditions for the trading of security futures products.

[335] Under § 150.4, unless an exemption applies, a person's positions must be aggregated with positions for which the person controls trading or for which the person holds a 10 percent or greater ownership interest. Commission Regulation § 150.4(b) sets forth several permissible exemptions from aggregation. *See* Final Aggregation Rulemaking, 81 FR at 91454. The Division of Market Oversight has issued time-limited no-action relief from some of the aggregation requirements contained in that rulemaking. *See* CFTC Letter No. 19–19 (July 31, 2019), *available at https://www.cftc.gov/csl/19–19/download.*

Proposed § 150.5(e) further provides that exchanges would be required to review regularly [336] any position limit levels established under proposed § 150.5 to ensure the level continues to comply with the requirements of those sections. For example, in the case of § 150.5(b), exchanges would be expected to ensure the limits comply with the requirement that limits be set ''at a level that is necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index.'' Exchanges would also be required to update such levels as needed, including if the levels no longer comply with the proposed rules.

f. Delegation of Authority to the Director of the Division of Market Oversight

The Commission proposes to delegate its authority, pursuant to proposed § 150.5(a)(4)(ii), to the Director of the Commission's Division of Market Oversight, or such other employee(s) that the Director may designate from time to time, to provide instructions regarding the submission of information required to be reported by exchanges to the Commission on a monthly basis, and to determine the manner, format, coding structure, and electronic data transmission procedures for submitting such information.

g. Commission Enforcement of Exchange-Set Limits

As discussed throughout this release, the framework for exchange-set limits operates in conjunction with the federal position limits framework. The Futures Trading Act of 1982 gave the Commission, under CEA section 4a(5) (since re-designated as section 4a(e)), the authority to directly enforce violations of exchange-set, Commission-approved speculative position limits in addition to position limits established directly by the Commission.[337] Since 2008, it has also been a violation of the Act for any person to violate an exchange position limit rule certified to the Commission by such exchange pursuant to CEA section 5c(c)(1).[338] Thus, under CEA section 4a(e), it is a violation of the Act for any person to violate an exchange position limit rule certified to or approved by the Commission, including to violate any subsequent amendments thereto, and the Commission has the authority to enforce those violations.

h. Request for Comment

The Commission requests comment on all aspects of proposed § 150.5.

E. § 150.6—Scope

Existing § 150.6 provides that nothing in this part shall be construed to affect any provisions of the Act relating to manipulation or corners nor to relieve any contract market or its governing board from responsibility under section 5(4) of the Act to prevent manipulation and corners.[339]

Position limits are meant to diminish, eliminate, or prevent excessive speculation and deter and prevent market manipulation, squeezes, and corners. The Commission stresses that nothing in the proposed revisions to part 150 would impact the anti-disruptive, anti-cornering, and anti-manipulation provisions of the Act and Commission regulations, including but not limited to CEA sections 6(c) or 9(a)(2) regarding manipulation, section 4c(a)(5) regarding disruptive practices including spoofing, or sections 180.1 and 180.2 of the Commission's regulations regarding manipulative and deceptive practices. It may be possible for a trader to manipulate or attempt to manipulate the prices of futures contracts or the underlying commodity with a position that is within the federal position limits. It may also be possible for a trader holding a bona fide hedge recognition from the Commission or an exchange to manipulate or attempt to manipulate the markets. The Commission would not consider it a defense to a charge under the anti-manipulation provisions of the Act or the regulations that a trader's position was within position limits.

Like existing § 150.6, proposed § 150.6 is intended to make clear that fulfillment of specific part 150 requirements alone does not necessarily satisfy other obligations of an exchange. Proposed § 150.6 would provide that part 150 of the Commission's regulations shall only be construed as having an effect on position limits set by the Commission or an exchange including any associated recordkeeping and reporting requirements. Proposed § 150.6 would provide further that nothing in part 150 shall affect any other provisions of the Act or Commission regulations including those relating to actual or attempted manipulation, corners, squeezes, fraudulent or deceptive conduct, or to prohibited transactions. For example, proposed § 150.5 would require DCMs, and, ultimately, SEFs, to impose and enforce exchange-set speculative position limits. The fulfillment of the requirements of § 150.5 alone would not satisfy any other legal obligations under the Act or Commission regulations applicable to exchanges to prevent manipulation and corners. Likewise, a market participant's compliance with position limits or an exemption thereto does not confer any type of safe harbor or good faith defense to a claim that the participant had engaged in an attempted or perfected manipulation.

Further, the proposed amendments are intended to help clarify that § 150.6 applies to: Regulations related to position limits found outside of part 150 of the Commission's regulations (*e.g.,* relevant sections of part 1 and part 19); and recordkeeping and reporting regulations associated with speculative position limits.

F. § 150.8—Severability

The Commission proposes to add new § 150.8 to provide for the severability of individual provisions of part 150. Should any provision(s) of part 150 be declared invalid, including the application thereof to any person or circumstance, § 150.8 would provide that all remaining provisions of part 150 shall not be affected to the extent that such remaining provisions, or the application thereof, can be given effect without the invalid provisions.

G. § 150.9—Process for Recognizing Non-Enumerated Bona Fide Hedging Transactions or Positions With Respect to Federal Speculative Position Limits

1. Background and Overview

For the nine legacy agricultural contracts currently subject to federal position limits, the Commission's current processes for recognizing non-enumerated bona fide hedge positions and certain enumerated anticipatory bona fide hedge positions exist in

[336] An acceptable, regular review regime would consist of both a periodic review and an event-specific review (*e.g.,* in the event of supply and demand shocks such as unanticipated shocks to supply and demand of the underlying commodity, geo-political shocks, and other events that may result in congestion and/or other disruptions). The Commission also expects that exchanges would re-evaluate such levels in the event of unanticipated shocks to the supply or demand of the underlying commodity.

[337] *See* Futures Trading Act of 1982, Public Law 97–444, 96 Stat. 2299–30 (1983).

[338] *See* CFTC Reauthorization Act of 2008, Food, Conservation and Energy Act of 2008, Public Law 110–246, 122 Stat. 1624 (June 18, 2008) (also known as the ''Farm Bill'') (amending CEA section 4a(e), among other things, to assure that a violation of 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). *See also* Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 FR at 4144, 4145 (Jan. 26, 2010) (summarizing the history of the Commission's authority to directly enforce violations of exchange-set speculative position limits).

[339] 17 CFR 150.6.

parallel with exchange processes for granting exemptions from exchange-set limits, as described below. The exchange processes for granting exemptions vary by exchange, and generally do not mirror the Commission's processes. Thus, when requesting certain bona fide hedging position recognitions that are not self-effectuating, market participants must currently comply with the exchanges' processes for exchange-set limits and the Commission's processes for federal limits. Although this disparity is currently only an issue for the nine agricultural futures contracts subject to both federal and exchange-set limits, the parallel approaches may become more inefficient and burdensome once the Commission adopts limits on additional commodities.

Accordingly, the Commission is proposing § 150.9 to establish a separate framework, applicable to proposed referenced contracts in all commodities, whereby a market participant who is seeking a bona fide hedge recognition that is not enumerated in proposed Appendix A can file one application with an exchange to receive a bona fide hedging recognition for purposes of both exchange-set limits and for federal limits.[340] Given the proposal to significantly expand the list of enumerated hedges, the Commission expects the use of the proposed § 150.9 non-enumerated process described below would be rare and exceptional. This separate framework would be independent of, and serve as an alternative to, the Commission's process for reviewing exemption requests under proposed § 150.3. Among other things, proposed § 150.9 would help to streamline the process by which non-enumerated bona fide hedge recognition requests are addressed, minimize disruptions by leveraging existing exchange-level processes with which many market participants are already familiar,[341] and reduce inefficiencies created when market participants are required to comply with different federal and exchange-level processes.

For instance, currently, market participants seeking recognitions of non-enumerated bona fide hedges for the nine legacy agricultural commodities must request recognitions from both the Commission under existing § 1.47, and from the relevant exchange. If the recognition is for an ''enumerated'' hedge under existing § 1.3 (other than anticipatory enumerated hedges), the market participant would not need to file an application with the Commission (as the enumerated hedge has a self-effectuating recognition for purposes of federal limits).

If the exemption is for a ''non-enumerated'' hedge or certain enumerated anticipatory hedges under existing § 1.3, the market participant would need to file an application with the Commission pursuant to §§ 1.47 or 1.48, respectively. In either case, the market participant would also still need to seek an exchange exemption and file a Form 204/304 on a monthly basis with the Commission. As discussed more fully in this section, with respect to bona fide hedges that are not self-effectuating for purposes of federal limits, proposed § 150.9 would permit such a market participant to file a single application with the exchange and relieve the market participant from having to separately file an application and/or monthly cash-market reporting information with the Commission.

The existing Commission and exchange level approaches are described in more detail below, followed by a more detailed discussion of proposed § 150.9.

2. Existing Approaches for Recognizing Bona Fide Hedges

The Commission's authority and existing processes for recognizing bona fide hedges can be found in section 4a(c) of the Act, and §§ 1.3, 1.47, and 1.48 of the Commission's regulations.[342] In particular, CEA section 4a(c)(1) provides that no CFTC rule issued under CEA section 4a(a) applies to ''transactions or positions which are shown to be bona fide hedging transactions or positions.''[343] Further, under the existing definition of ''bona fide hedging transactions and positions'' in § 1.3,[344] paragraph (1) provides the Commission's general definition of bona fide hedging transactions or positions; paragraph (2) provides a list of enumerated bona fide hedging positions that, generally, are self-effectuating, and must be reported (along with supporting cash-market information) to the Commission monthly on Form 204 after the positions are taken;[345] and paragraph (3) provides a procedure for market participants to seek recognition from the Commission for non-enumerated bona fide hedging positions. Under paragraph (3), any person that seeks Commission recognition of a position as a non-enumerated bona fide hedge must submit an application to the Commission in advance of taking on the position, and pursuant to the processes found in § 1.47 (30 days in advance for non-enumerated bona fide hedges) or § 1.48 (10 days in advance for enumerated anticipatory hedges), as applicable.

b. Exchanges' Existing Approach for Granting Bona Fide Hedge Exemptions[346] With Respect to Exchange-Set Limits

Under DCM Core Principle 5,[347] DCMs have, for some time, established exchange-set limits for futures contracts that are subject to federal limits, as well as for contracts that are not. In addition, under existing § 150.5(d), DCMs may grant exemptions to exchange-set position limits for positions that meet the Commission's general definition of bona fide hedging transactions or positions as defined in paragraph (1) of § 1.3.[348] As such, with respect to exchange-set limits, exchanges have adopted processes for handling trader requests for bona fide hedging exemptions, and generally have granted such requests pursuant to exchange rules that incorporate the Commission's existing general definition of bona fide hedging transactions or positions in paragraph (1) of § 1.3.[349] Accordingly, DCMs currently have rules and application forms in place to process applications to exempt bona fide

[340] Alternatively, under the proposed framework, a trader could submit a request directly to the Commission pursuant to proposed § 150.3(b). A trader that submitted such a request directly to the Commission for purposes of federal limits would have to separately request an exemption from the applicable exchange for purposes of exchange-set limits. As discussed earlier in this release, the Commission proposes to separately allow for enumerated hedges and spreads that meet the ''spread transaction'' definition to be self-effectuating. *See supra* Section II.C.2. (discussion of proposed § 150.3).

[341] In particular, the Commission recognizes that, in the energy and metals spaces, market participants are familiar with exchange application processes and are not familiar with the Commission's processes since, currently, there are no federal position limits for those commodities.

[342] *See* 7 U.S.C. 6a(c) and 17 CFR 1.3, 1.47, and 1.48.

[343] 7 U.S.C. 6a(c)(1).

[344] As described above, the Commission proposes to move an amended version of the bona fide hedging definition from § 1.3 to § 150.1. *See supra* Section II.A. (discussion of proposed § 150.1).

[345] As described below, the Commission proposes to eliminate Form 204 and to rely instead on the cash-market information submitted to exchanges pursuant to proposed §§ 150.5 and 150.9. *See infra* Section II.H.3. (discussion of proposed amendments to part 19).

[346] Exchange rules typically refer to ''exemptions'' in connection with bona fide hedging and spread positions, whereas the Commission uses the nomenclature ''recognition'' with respect to bona fide hedges, and ''exemption'' with respect to spreads.

[347] 7 U.S.C. 7(d)(5).

[348] 17 CFR 150.5(d).

[349] *See, e.g.,* CME Rule 559 and ICE Rule 6.29 (addressing position limits and exemptions).

hedging positions with respect to exchange-set position limits.[350]

Separately, under SEF Core Principle 6, currently SEFs are required to adopt, as is necessary and appropriate, position limits or position accountability levels for each swap contract to reduce the potential threat of market manipulation or congestion.[351] For contracts that are subject to a federal position limit, the SEF must set its position limits at a level that is no higher than the federal limit, and must monitor positions established on or through the SEF for compliance with both the Commission's federal limit and the exchange-set limit.[352] Section 37.601 further implements SEF Core Principle 6 and specifies that until such time that SEFs are required to comply with the Commission's position limits regulations, a SEF may refer to the associated guidance and/or acceptable practices set forth in Appendix B to part 37 of the Commission's regulations.[353] Currently, in practice, there are no federal position limits on swaps for which SEFs would be required to establish exchange-set limits.

As noted above, the application processes currently used by exchanges are different than the Commission's processes. In particular, exchanges typically use one application process to grant all exemption types, whereas the Commission has different processes for different exemptions, as explained below. Also, exchanges generally do not require the submission of monthly cash-market information, whereas the Commission has various monthly reporting requirements under Form 204 and part 17 of the Commission's regulations. Finally, exchanges generally require exemption applications to include cash-market information supporting positions that exceed the limits, to be filed annually prior to exceeding a position limit, and to be updated on an annual basis.[354]

The Commission, on the other hand, currently has different processes for permitting enumerated bona fide hedges and for recognizing positions as non-enumerated bona fide hedges. Generally, for bona fide hedges enumerated in paragraph (2) of the bona fide hedge definition in § 1.3, no formal process is required by the Commission. Instead, such enumerated bona fide hedge recognitions are self-effectuating and Commission staff reviews monthly reporting of cash-market positions on existing Form 204 and part 17 position data to monitor such positions. Recognition requests for non-enumerated bona fide hedging positions and for certain enumerated anticipatory bona fide hedge positions, as explained above, must be submitted to the Commission pursuant to the processes in existing §§ 1.47 and 1.48 of the regulations, as applicable.

3. Proposed § 150.9

Under the proposed procedural framework, an exchange's determination to recognize a non-enumerated bona fide hedge in accordance with proposed § 150.9 with respect to exchange-set limits would serve to inform the Commission's own decision as to whether to recognize the exchange's determination for purposes of federal speculative position limits set forth in proposed § 150.2. Among other conditions, the exchange would be required to base its determination on standards that conform to the Commission's own standards for recognizing bona fide hedges for purposes of federal position limits. Further, the exchange's determination with respect to its own position limits and application process would be subject to Commission review and oversight. These requirements would facilitate Commission review and determinations by ensuring that any bona fide hedge recognized by an exchange for purposes of exchange-set limits and in accordance with proposed § 150.9 conforms to the Commission's standards.

For a given referenced contract, proposed § 150.9 would potentially allow a person to exceed federal position limits if the exchange listing the contract has recognized the position as a bona fide hedge with respect to exchange-set limits. Under this framework, the exchange would make such determination with respect to its own speculative position limits, set in accordance with proposed § 150.5(a), and, unless the Commission denies or stays the application within ten business days (or two business days for applications, including retroactive applications, filed due to sudden or unforeseen circumstances), the exemption would be deemed approved for purposes of federal positions limits.

The exchange's exemption would be valid only if the exchange meets the following additional conditions, each described in greater detail below: (1) The exchange maintains rules, approved by the Commission pursuant to § 40.5, that establish application processes for recognizing bona fide hedges in accordance with § 150.9; (2) the exchange meets specified prerequisites for granting such recognitions; (3) the exchange satisfies specified recordkeeping requirements; and (4) the exchange notifies the Commission and the applicant upon determining to recognize a bona fide hedging transaction or position. A person may exceed the applicable federal position limit ten business days (for new and annually renewed exemptions) or two business days (for applications, including retroactive applications, submitted due to sudden and unforeseen circumstances) after the exchange makes its determination, unless the Commission notifies the exchange and the applicant otherwise.

The above-described elements of the proposed approach differ from the regulations proposed in the 2016 Reproposal, which did not require a 10-day Commission review period. The 2016 Reproposal allowed DCMs and SEFs to recognize non-enumerated bona fide hedges for purposes of federal position limits.[355] However, the 2016 Reproposal may not have conformed to the legal limits on what an agency may delegate to persons outside the agency.[356] The 2016 Reproposal

[350] *Id.*

[351] 7 U.S.C. 7b–3(f)(6). The Commission codified Core Principle 6 under § 37.600. 17 CFR 37.600.

[352] *Id.*

[353] 17 CFR 37.601. Under Appendix B to part 37, for Required Transactions, as defined in § 37.9, SEFs may demonstrate compliance with SEF Core Principle 6 by setting and enforcing position limits or position accountability levels only with respect to trading on the SEF's own market. For Permitted Transactions, as defined in § 37.9, SEFs may demonstrate compliance with SEF Core Principle 6 by setting and enforcing position accountability levels or by sending the Commission a list of Permitted Transactions traded on the SEF.

[354] *Id.*

[355] Proposed § 150.9(a)(5) of the 2016 Reproposal provided that an applicant's derivatives position shall be deemed to be recognized as a non-enumerated bona fide hedging position exempt from federal position limits at the time that a designated contract market or swap execution facility notifies an applicant that such designated contract market or swap execution facility will recognize such position as a non-enumerated bona fide hedging position.

[356] In *U.S. Telecom Ass'n* v. *FCC,* the D.C. Circuit held "that, while federal agency officials may subdelegate their decision-making authority to subordinates absent evidence of contrary congressional intent, they may not subdelegate to outside entities—private or sovereign—absent affirmative evidence of authority to do so." *U.S. Telecom Ass'n* v. *FCC,* 359 F.3d 554, 565–68 (D.C. Cir. 2004) (citing *Shook* v. *District of Columbia Fin. Responsibility & Mgmt. Assistance Auth.,* 132 F.3d 775, 783–84 & n. 6 (D.C. Cir.1998); *Nat'l Ass'n of Reg. Util. Comm'rs ("NARUC")* v. *FCC,* 737 F.2d 1095, 1143–44 & n. 41 (D.C. Cir.1984); *Nat'l Park and Conservation Ass'n* v. *Stanton,* 54 F.Supp.2d 7, 18–20 (D.D.C.1999). Nevertheless, the D.C. Circuit recognized three circumstances that the agency may "delegate" its authority to an outside party because they do not involve subdelegation of decision-making authority: (1) Establishing a reasonable condition for granting federal approval; (2) fact gathering; and (3) advice giving. The first instance involves conditioning of obtaining a permit on the approval by an outside entity as an element of its

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delegated to the DCMs and SEFs a significant component of the Commission's authority to recognize bona fide hedges for purposes of federal position limits. Under that proposal, the Commission did not have a substantial role in reviewing the DCMs' or SEFs' recognitions of non-enumerated bona fide hedges for purposes of federal position limits. Upon further reflection, the Commission believes that the 2016 Reproposal may not have retained enough authority with the Commission under case law on sub-delegation of agency decision making authority. Under the new proposed model, the Commission would be informed by the exchanges' determinations to make the Commission's own determination for purposes of federal position limits within a 10-day review period. Accordingly, the Commission would retain its decision-making authority with respect to the federal position limits and provide legal certainty to market participants of their determinations.

Both DCMs and SEFs would be eligible to allow traders to utilize the processes set forth under proposed § 150.9. However, as a practical matter, the Commission expects that upon implementation of § 150.9, the process proposed therein will likely be used primarily by DCMs, rather than by SEFs, given that most economically equivalent swaps that would be subject to federal position limits are expected to be traded OTC and not executed on SEFs.

The Commission emphasizes that proposed § 150.9 is intended to serve as a separate, self-contained process that is related to, but independent of, the proposed regulations governing: (1) The process in proposed § 150.3 for traders to apply directly to the Commission for a bona fide hedge recognition; and (2) exchange processes for establishing exchange-set limits and granting exemptions therefrom in proposed § 150.5. Proposed § 150.9 is intended to serve as a voluntary process exchanges can implement to provide additional flexibility for their market participants seeking non-enumerated bona fide hedges to file one application with an exchange to receive a recognition or exemption for purposes of both exchange-set limits and for federal limits. Proposed § 150.9 is discussed in greater detail below.

Request for Comment

The Commission requests comment on all aspects of proposed § 150.9. The Commission also invites comments on the following:

(35) Considering that the Commission's proposed position limits would apply to OTC economically equivalent swaps, should the Commission develop a mechanism for exchanges to be involved in the review of non-enumerated bona fide hedge applications for OTC economically equivalent swaps?

(36) If so, what, if any, role should exchanges play in the review of non-enumerated bona fide hedge applications for OTC economically equivalent swaps?

a. Proposed § 150.9(a)—Approval of Rules

Under proposed § 150.9(a), the exchange must have rules, adopted pursuant to the rule approval process in § 40.5 of the Commission's regulations, establishing processes and standards in accordance with proposed § 150.9, described below. The Commission would review such rules to ensure that the exchange's standards and processes for recognizing bona fide hedges from its own exchange-set limits conform to the Commission's standards and processes for recognizing bona fide hedges from the federal limits.

b. Proposed § 150.9(b)—Prerequisites for an Exchange To Recognize Non-Enumerated Bona Fide Hedges in Accordance With This Section

This section sets forth conditions that would require an exchange-recognized bona fide hedge to conform to the corresponding definitions or standards the Commission uses in proposed §§ 150.1 and 150.3 for purposes of the federal position limits regime.

An exchange would be required to meet the following prerequisites with respect to recognizing bona fide hedging positions under proposed § 150.9(b): (i) The exchange lists the applicable referenced contract for trading; (ii) the position is consistent with both the definition of bona fide hedging transaction or position in proposed § 150.1 and section 4a(c)(2) of the Act; and (iii) the exchange does not recognize as bona fide hedges any positions that include commodity index contracts and one or more referenced contracts, nor does the exchange grant risk management exemptions for such contracts.[357]

Request for Comment

The Commission requests comment on all aspects of proposed § 150.9. The Commission also invites comments on the following:

(37) Does the proposed compliance date of twelve-months after publication of a final federal position limits rulemaking in the **Federal Register** provide a sufficient amount of time for exchanges to update their exemption application procedures, as needed, and begin reviewing exemption applications in accordance with proposed § 150.9? If not, please provide an alternative longer timeline and reasons supporting a longer timeline.

c. Proposed § 150.9(c)—Application Process

Proposed § 150.9(c) sets forth the information and representations that the exchange, at a minimum, would be required to obtain from applicants as part of the application process for granting bona fide hedges. In this connection, exchanges may rely upon their existing application forms and processes in making such determinations, provided they collect the information outlined below. The Commission believes the information set forth below is sufficient for the exchange to determine, and the Commission to verify, whether a particular transaction or position satisfies the federal definition of bona fide hedging transaction for purposes of federal position limits.

i. Proposed § 150.9(c)(1)—Required Information for Bona Fide Hedging Positions

With respect to bona fide hedging positions in referenced contracts, proposed § 150.9(c)(1) would require that any application include: (i) A description of the position in the commodity derivative contract for which the application is submitted (which would include the name of the underlying commodity and the position size); (ii) information to demonstrate why the position satisfies section 4a(c)(2) of the Act and the definition of bona fide hedging transaction or position in proposed § 150.1, including factual and legal analysis; (iii) a

decision process. The second provides the agency with nondiscretionary information gathering. The third allows a federal agency to turn to an outside entity for advice and policy recommendations, provided the agency makes the final decisions itself. *Id.* at 568. ''An agency may not, however, merely 'rubber-stamp' decisions made by others under the guise of seeking their 'advice,' [ ], nor will vague or inadequate assertions of final reviewing authority save an unlawful subdelegation, [ ].'' *Id.*

[357] The Commission finds that financial products are not substitutes for positions taken or to be taken in a physical marketing channel. Thus, the offset of financial risks arising from financial products would be inconsistent with the definition of bona fide hedging transactions or positions for physical commodities in proposed § 150.1. *See supra* Section II.A.1.c.ii.(1) (discussion of the temporary substitute test and risk-management exemptions).

statement concerning the maximum size of all gross positions in derivative contracts for which the application is submitted (in order to provide a view of the true footprint of the position in the market); (iv) information regarding the applicant's activity in the cash markets for the commodity underlying the position for which the application is submitted; [358] and (v) any other information the exchange requires, in its discretion, to enable the exchange to determine, and the Commission to verify, whether such position should be recognized as a bona fide hedge.[359] These proposed application requirements are similar to current requirements for recognizing a bona fide hedging position under existing §§ 1.47 and 1.48.

Market participants have raised concerns that such requirements, even if administered by the exchanges, would require hedging entities to change internal books and records to track which category of bona fide hedge a position would fall under. The Commission notes that, as part of this current proposal, exchanges would not need to require the identification of a hedging need against a particular identified category. So long as the requesting party satisfies all applicable requirements in proposed § 150.9, including demonstrating with a factual and legal analysis that a position would fit within the bona fide hedge definition, the Commission is not intending to require the hedging party's books and records to identify the particular type of hedge being applied.

ii. Proposed § 150.9(c)(2)—Timing of Application

The Commission does not propose to prescribe timelines (*e.g.,* a specified number of days) for exchanges to review applications because the Commission believes that exchanges are in the best position to determine how to best accommodate the needs of their market participants. Rather, under proposed § 150.9(c)(2), the exchange must separately require that applicants submit their application in advance of exceeding the applicable federal position limit for any given referenced contract. However, an exchange may adopt rules that allow a person to submit a bona fide hedge application within five days after the person has exceeded federal speculative limits if such person exceeds the limits due to sudden or unforeseen increases in its bona fide hedging needs. Where an applicant claims a sudden or unforeseen increase in its bona fide hedging needs, the proposed rules would require exchanges to require that the person provide materials demonstrating that the person exceeded the federal speculative limit due to sudden or unforeseen circumstances. Further, the Commission would caution exchanges that applications submitted after a person has exceeded federal position limits should not be habitual and should be reviewed closely. Finally, if the Commission finds that the position does not qualify as a bona fide hedge, then the applicant would be required to bring its position into compliance, and could face a position limits violation if it does not reduce the position within a commercially reasonable time.

iii. Proposed § 150.9(c)(3)—Renewal of Applications

Under proposed § 150.9(c)(3), the exchange must require that persons with bona fide hedging recognitions in referenced contracts granted pursuant to proposed § 150.9 reapply at least on an annual basis by updating their original application, and receive a notice of approval from the exchange prior to exceeding the applicable position limit.

iv. Proposed § 150.9(c)(4)—Exchange Revocation Authority

Under proposed § 150.9(c)(4), the exchange retains its authority to limit, condition, or revoke, at any time, any recognition previously issued pursuant to proposed § 150.9, for any reason, including if the exchange determines that the recognition is no longer consistent with the bona fide hedge definition in proposed § 150.1 or section 4a(c)(2) of the Act.

Request for Comment

The Commission requests comment on all aspects of proposed § 150.9. The Commission also invites comments on the following:

(38) As described above, the Commission does not propose to prescribe timelines for exchanges to review applications. Please comment on what, if any, timing requirements the Commission should prescribe for exchanges' review of applications pursuant to proposed § 150.9.

(39) Currently, certain exchanges allow for the submission of exemption requests up to five business days after the trader established the position that exceeded the exchange-set limit. Under proposed § 150.9, should exchanges continue to be permitted to recognize bona fide hedges and grant spread exemptions retroactively—up to five days after a trader has established a position that exceeds federal position limits?

d. Proposed § 150.9(d)—Recordkeeping

Proposed § 150.9(d) would set forth recordkeeping requirements for purposes of § 150.9. The required records would form a critical element of the Commission's oversight of the exchanges' application process and such records could be requested by the Commission as needed. Under proposed § 150.9(d), exchanges must maintain complete books and records of all activities relating to the processing and disposition of applications in a manner consistent with the Commission's existing general regulations regarding recordkeeping.[360] Such records must include all information and documents submitted by an applicant in connection with its application; records of oral and written communications between the exchange and the applicant in connection with the application; and information and documents in connection with the exchange's analysis of and action on such application.[361] Exchanges would also be required to maintain any documentation submitted by an applicant after the disposition of an application, including, for example, any reports or updates the applicant filed with the exchange.

Exchanges would be required to store and produce records pursuant to existing § 1.31,[362] and would be subject

[358] The Commission would expect that exchanges would require applicants to provide cash market data for at least the prior year.

[359] Under proposed § 150.9(c)(1)(iv) and (v), exchanges, in their discretion, could request additional information as necessary, including information for cash market data similar to what is required in the Commission's existing Form 204. *See infra* Section II.H.3. (discussion of Form 204 and proposed amendments to part 19). Exchanges could also request a description of any positions in other commodity derivative contracts in the same commodity underlying the commodity derivative contract for which the application is submitted. Other commodity derivatives contracts could include other futures, options, and swaps (including OTC swaps) positions held by the applicant.

[360] Requirements regarding the keeping and inspection of all books and records required to be kept by the Act or the Commission's regulations are found at § 1.31, 17 CFR 1.31. DCMs are already required to maintain records of their business activities in accordance with the requirements of § 1.31 of § 38.951, 17 CFR 38.951.

[361] The Commission does not intend, in proposed § 150.9(d), to create any new obligation for an exchange to record conversations with applicants or their representatives; however, the Commission does expect that an exchange would preserve any written or electronic notes of verbal interactions with such parties.

[362] Consistent with existing § 1.31, the Commission expects that these records would be readily available during the first two years of the required five year recordkeeping period for paper records, and readily accessible for the entire five-year recordkeeping period for electronic records. In addition, the Commission expects that records required to be maintained by an exchange pursuant

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to requests for information pursuant to other applicable Commission regulations, including, for example, existing § 38.5.[363]

Request for Comment

The Commission requests comment on all aspects of proposed § 150.9. The Commission also invites comments on the following:

(40) Do the proposed recordkeeping requirements set forth in § 150.9 comport with existing practice? Are there any ways in which the Commission could streamline the proposed recordkeeping requirements while still maintaining access to sufficient information to carry out its statutory responsibilities?

e. Proposed § 150.9(e)—Process for a Person To Exceed Federal Position Limits

Under proposed § 150.9(e), once an exchange recognizes a bona fide hedge with respect to its own speculative position limits established pursuant to § 150.5(a), a person could rely on such determination for purposes of exceeding federal position limits provided that specified conditions are met, including that the exchange provide the Commission with notice of any approved application as well as a copy of the application and any supporting materials, and the Commission does not object to the exchange's determination. The exchange is only required to provide this notice to the Commission with respect to its initial (and not renewal) determinations for a particular application. Under proposed § 150.9(e), the exchange must provide such notice to the Commission concurrent with the notice provided to the applicant, and, except as provided below, a trader can exceed federal position limits ten business days after the exchange issues the required notification, provided the Commission does not notify the exchange or applicant otherwise.

However, for a person with sudden or unforeseen bona fide hedging needs that has filed an application, pursuant to proposed § 150.9(c)(2)(ii), after they already exceeded federal speculative position limits, the exchange's retroactive approval of such application would be deemed approved by the Commission two business days after the exchange issues the required notification, provided the Commission does not notify the exchange or applicant otherwise. That is, the bona fide hedge recognition would be deemed approved by the Commission two business days after the exchange issues the required notification, unless the Commission notifies the exchange and the applicant otherwise during this two business day timeframe.

Once those ten (or two) business days have passed, the person could rely on the bona fide hedge recognition both for purposes of exchange-set and federal limits, with the certainty that the Commission (and not Commission staff) would only revoke that determination in the limited circumstances set forth in proposed § 150.9(f)(1) and (2) described further below.

However, under proposed § 150.9(e)(5), if, during the ten (or two) business day timeframe, the Commission notifies the exchange and applicant that the Commission (and not staff) has determined to stay the application, the person would not be able to rely on the exchange's approval of the application for purposes of exceeding federal position limits, unless the Commission approves the application after further review.

Separately, under proposed § 150.9(e)(5), the Commission (or Commission staff) may request additional information from the exchange or applicant in order to evaluate the application, and the exchange and applicant would have an opportunity to provide the Commission with any supplemental information requested to continue the application process. Any such request for additional information by the Commission (or staff), however, would not stay or toll the ten (or two) business day application review period.

Further, under proposed § 150.9(e)(6), the applicant would not be subject to any finding of a position limits violation during the Commission's review of the application. Or, if the Commission determines (in the case of retroactive applications) that the bona fide hedge is not approved for purposes of federal limits after a person has already exceeded federal position limits, the Commission would not find that the person has committed a position limits violation so long as the person brings the position into compliance within a commercially reasonable time.

The Commission believes that the ten (or two) business day period to review exchange determinations under proposed § 150.9 would allow the Commission enough time to identify applications that may not comply with the proposed bona fide hedging position definition, while still providing a mechanism whereby market participants may exceed federal position limits pursuant to Commission determinations.

Request for Comment

The Commission requests comment on all aspects of proposed § 150.9. The Commission also invites comments on the following:

(41) The Commission has proposed, in § 150.9(e)(3), a ten business day period for the Commission to review an exchange's determination to recognize a bona fide hedge for purposes of the Commission approving such determination for federal position limits. Please comment on whether the review period is adequate, and if not, please comment on what would be an appropriate amount of time to allow the Commission to review exchange determinations while also providing a timely determination for the applicant.

(42) The Commission has proposed a two business day review period for retroactive applications submitted to exchanges after a person has already exceeded federal position limits. Please comment on whether this time period properly balances the need for the Commission to oversee the administration of federal position limits with the need of hedging parties to have certainty regarding their positions that are already in excess of the federal position limits.

(43) With respect to the Commission's review authority in § 150.9(e)(5), if the Commission stays an application during the ten (or two) business-day review period, the Commission's review, as would be the case for an exchange, would not be bound by any time limitation. Please comment on what, if any, timing requirements the Commission should prescribe for its review of applications pursuant to proposed § 150.9(e)(5).

(44) Please comment on whether the Commission should permit a person to exceed federal position limits during the ten business day period for the Commission's review of an exchange-granted exemption.

(45) Under proposed § 150.9(e), an exchange is only required to notify the Commission of its initial approval of an exemption application (and not any renewal approvals). Should the Commission require that exchanges submit approved renewals of applications to the Commission for review and approval if there are material changes to the facts and circumstances underlying the renewal application?

to this section would be readily accessible during the pendency of any application, and for two years following any disposition that did not recognize a derivative position as a bona fide hedge.

[363] *See* 17 CFR 38.5 (requiring, in general, that upon request by the Commission, a DCM must file responsive information with the Commission, such as information related to its business, or a written demonstration of the DCM's compliance with one or more core principles).

f. Proposed § 150.9(f)—Commission Revocation of an Approved Application

Proposed § 150.9(f) sets forth the limited circumstances under which the Commission would revoke a bona fide hedge recognition granted pursuant to proposed § 150.9. The Commission expects such revocation to be rare, and this authority would not be delegated to Commission staff. First, under proposed § 150.9(f)(1), if an exchange revokes its recognition of a bona fide hedge, then such bona fide hedge would also be deemed revoked for purposes of federal limits.

Second, under proposed § 150.9(f)(2), if the Commission determines that an application that has been approved or deemed approved by the Commission is no longer consistent with the applicable sections of the Act and the Commission's regulations, the Commission shall notify the person and exchange, and, after an opportunity to respond, the Commission can require the person to reduce the derivatives position within a commercially reasonable time, or otherwise come into compliance. In determining a commercially reasonable amount of time, the Commission must consult with the applicable exchange and applicant, and may consider factors including, among others, current market conditions and the protection of price discovery in the market.

The Commission expects that it would only exercise its revocation authority under circumstances where the disposition of an application has resulted, or is likely to result, in price anomalies, threatened manipulation, actual manipulation, market disruptions, or disorderly markets. In addition, the Commission's authority to require a market participant to reduce certain positions in proposed § 150.9(f)(2) would not be subject to the requirements of CEA section 8a(9), that is, the Commission would not be compelled to find that a CEA section 8a(9) emergency condition exists prior to requiring that a market participant reduce certain positions pursuant to proposed § 150.9(f)(2).

If the Commission determines that a person must reduce its position or otherwise bring it into compliance, the Commission would not find that the person has committed a position limit violation so long as the person comes into compliance within the commercially reasonable time identified by the Commission in consultation with the applicable exchange and applicant. The Commission intends for persons to be able to rely on recognitions and exemptions granted pursuant to § 150.9 with the certainty that the exchange decision would only be reversed in very limited circumstances. Any action compelling a market participant to reduce its position pursuant to § 150.9(f)(2) would be a Commission action, and would not be delegated to Commission staff. [364]

g. Proposed § 150.9(g)—Delegation of Authority to the Director of the Division of Market Oversight

The Commission proposes to delegate certain of its authorities under proposed § 150.9 to the Director of the Commission's Division of Market Oversight, or such other employee(s) that the Director may designate from time to time. Proposed § 150.9(g)(1) would delegate the Commission's authority, in § 150.9(e)(5), to request additional information from the exchange and applicant.

The Commission does not propose, however, to delegate its authority, in proposed § 150.9(e)(5) and (6) to stay or reject such application, nor proposed § 150.9(f)(2), to revoke a bona fide hedge recognition granted pursuant to § 150.9 or to require an applicant to reduce its positions or otherwise come into compliance. The Commission believes that if an exchange's disposition of an application raises concerns regarding consistency with the Act, presents novel or complex issues, or requires remediation, then the Commission, and not Commission staff, should make the final determination, after taking into consideration any supplemental information provided by the exchange or the applicant.

As with all authorities delegated by the Commission to staff, the Commission would maintain the authority to consider any matter which has been delegated, including the proposed delegations in §§ 150.3 and 150.9 described above. The Commission will closely monitor staff administration of the proposed processes for granting bona fide hedge recognitions.

H. Part 19 and Related Provisions—Reporting of Cash-Market Positions

1. Background

Key reports currently used for purposes of monitoring compliance with federal position limits include Form 204 [365] and Form 304,[366] known collectively as the ''series '04'' reports. Under existing § 19.01, market participants that hold bona fide hedging positions in excess of limits for the nine commodities currently subject to federal limits must justify such overages by filing the applicable report each month: Form 304 for cotton, and Form 204 for the other commodities.[367] These reports are generally filed after exceeding the limit, show a snapshot of such traders' cash positions on one given day each month, and are used by the Commission to determine whether a trader has sufficient cash positions that justify futures and options on futures positions above the speculative limits.

2. Proposed Elimination of Form 204 and Cash-Reporting Elements of Form 304

For the reasons set forth below, the Commission proposes to eliminate Form 204 and Parts I and II of existing Form 304, which requests information on cash-market positions for cotton akin to the information requested in Form 204.[368]

First, the Commission would no longer need the cash-market information currently reported on Forms 204 and 304 because the exchanges would collect, and make available to the Commission, cash-market information needed to assess whether any such position is a bona fide hedge.[369] Further, the Commission would continue to have access to information, including cash-market information, by issuing special calls relating to positions exceeding limits.

Second, Form 204 as currently constituted would be inadequate for the

[364] None of the provisions in proposed § 150.9 would compromise the Commission's emergency authorities under CEA section 8a(9), including the Commission's authority to fix ''limits that may apply to a market position acquired in good faith prior to the effective date of the Commission's action.'' CEA section 8a(9). 7 U.S.C. 12a(9).

[365] *CFTC Form 204: Statement of Cash Positions in Grains, Soybeans, Soybean Oil, and Soybean Meal,* U.S. Commodity Futures Trading Commission website, *available at https://www.cftc.gov/sites/default/files/idc/groups/public/@forms/documents/file/cftcform204.pdf* (existing Form 204).

[366] *CFTC Form 304: Statement of Cash Positions in Cotton,* U.S. Commodity Futures Trading Commission website, *available at http://www.cftc.gov/ucm/groups/public/@forms/documents/file/cftcform304.pdf* (existing Form 204). Parts I and II of Form 304 address fixed-price cash positions used to justify cotton positions in excess of federal limits. As described below, Part III of Form 304 addresses unfixed-price cotton ''on-call'' information, which is not used to justify cotton positions in excess of limits, but rather to allow the Commission to prepare its weekly cotton on-call report.

[367] 17 CFR 19.01.

[368] Proposed amendments to Part III of the Form 304, which addresses cotton on-call, are discussed below.

[369] The cash-market reporting regime discussed in this section of the release only pertains to bona fide hedges, not to spread exemptions, because the Commission has not traditionally relied on cash-market information when reviewing requests for spread exemptions.

reporting of cash-market positions relating to certain energy contracts which would be subject to federal limits for the first time under this proposal. For example, when compared to agricultural contracts, energy contracts generally expire more frequently, have a shorter delivery cycle, and have significantly more product grades. The information required by Form 204, as well as the timing and procedures for its filing, reflects the way agricultural contracts trade, but is inadequate for purposes of reporting cash-market information involving energy contracts.

While the Commission considered proposing to modify Form 204 to cover energy and metal contracts, the Commission has opted instead to propose a more streamlined approach to cash-market reporting that reduces duplication between the Commission and the exchanges. In particular, to obtain information with respect to cash market positions, the Commission proposes to leverage the cash-market information reported to the exchanges, with some modifications. When granting exemptions from their own limits, exchanges do not use a monthly cash-market reporting framework akin to Form 204. Instead, exchanges generally require market participants who wish to exceed exchange-set limits, including for bona fide hedging positions, to submit an annual exemption application form in advance of exceeding the limit.[370] Such applications are typically updated annually and generally include a month-by-month breakdown of cash-market positions for the previous year supporting any position-limits overages during that period.[371]

To ensure that the Commission continues to have access to the same information on cash-market positions that is already provided to exchanges, the Commission proposes several reporting and recordkeeping requirements in §§ 150.3, 150.5, and 150.9, as discussed above.[372] First, exchanges would be required to collect applications, updated at least on an annual basis, for purposes of granting bona fide hedge recognitions from exchange-set limits for contracts subject to federal limits,[373] and for recognizing bona fide hedging positions for purposes of federal limits.[374] Among other things, such applications would be required to include: (1) Information regarding the applicant's activity in the cash markets for the underlying commodity; and (2) any other information to enable the exchange to determine, and the Commission to verify, whether the exchange may recognize such position as a bona fide hedge.[375] Second, consistent with existing industry practice for certain exchanges, exchanges would be required to file monthly reports to the Commission showing, among other things, for all bona fide hedges (whether enumerated or non-enumerated), a concise summary of the applicant's activity in the cash markets.[376]

Collectively, these proposed §§ 150.5 and 150.9 rules would provide the Commission with monthly information about all recognitions and exemptions granted for purposes of contracts subject to federal limits, including cash-market information supporting the applications, and annual information regarding all month-by-month cash-market positions used to support a bona fide hedging recognition. These reports would help the Commission verify that any person who claims a bona fide hedging position can demonstrate satisfaction of the relevant requirements. This information would also help the Commission perform market surveillance in order to detect and deter manipulation and abusive trading practices in physical commodity markets.

While the Commission would no longer receive the monthly snapshot data currently included on Form 204, the Commission would have broad access, at any time, to the cash-market information described above, as well as any other data or information exchanges collect as part of their application processes.[377] This would include any updated application forms and periodic reports that exchanges may require applicants to file regarding their positions. To the extent that the Commission observes market activity or positions that warrant further investigation, § 150.9 would also provide the Commission with access to any supporting or related records the exchanges would be required to maintain.[378]

Furthermore, the proposed changes would not impact the Commission's existing provisions for gathering information through special calls relating to positions exceeding limits and/or to reportable positions. Accordingly, as discussed further below, the Commission proposes that all persons exceeding the proposed limits set forth in § 150.2, as well as all persons holding or controlling reportable positions pursuant to § 15.00(p)(1), must file any pertinent information as instructed in a special call.[379]

Finally, the Commission understands that the exchanges maintain regular dialogue with their participants regarding cash-market positions, and that it is common for exchange surveillance staff to make informal inquiries of market participants, including if the exchange has questions about market events or a participant's use of an exemption. The Commission encourages exchanges to continue this practice. Similarly, the Commission anticipates that its own staff would engage in dialogue with market participants, either through the use of informal conversations or, in limited circumstances, via special call authority.

For market participants who are accustomed to filing Form 204s with information supporting classification as a federally enumerated hedging position, the proposed elimination of Form 204 would result in a slight change in practice. Under the proposed rules, such participants' bona fide hedge recognitions could still be self-effectuating for purposes of federal limits, provided the market participant also separately applies for a bona fide hedge exemption from exchange-set limits established pursuant to proposed § 150.5(a), and provided further that the participant submits the requisite cash-market information to the exchange as required by proposed § 150.5(a)(2)(ii)(A)(*1*).

[370] *See, e.g.,* ICE Rule 6.29 and CME Rule 559.

[371] For certain physically-delivered agricultural contracts, some exchanges may require that spot month exemption applications be renewed several times a year for each spot month, rather than annually.

[372] As discussed earlier in this release, proposed § 150.9 also includes reporting and recordkeeping requirements pertaining to spread exemptions. Those requirements will not be discussed again in this section of the release, which addresses cash-market reporting in connection with bona fide hedges. This section of the release focuses on the cash-market reporting requirements in § 150.9 that pertain to bona fide hedges.

[373] *See* proposed § 150.5(a)(2)(ii)(A)*(1).*

[374] As discussed above in connection with proposed § 150.9, market participants who wish to request a bona fide hedge recognition under § 150.9 would not be required to file such applications with both the exchange and the Commission. They would only file the applications with the exchange, which would then be subject to recordkeeping requirements in proposed § 150.9(d), as well as proposed §§ 150.5 and 150.9 requirements to provide certain information to the Commission on a monthly basis and upon demand.

[375] *See* proposed § 150.9(c)(1)(iv)–(v).

[376] *See* proposed § 150.5(a)(4).

[377] *See, e.g.,* proposed § 150.9(d) (requiring that all such records, including cash-market information submitted to the exchange, be kept in accordance with the requirements of § 1.31) and proposed § 19.00(b) (requiring, among other things, all persons exceeding speculative limits who have received a special call to file any pertinent information as specified in the call).

[378] *See* proposed § 150.9(d).

[379] *See* proposed § 19.00(b).

3. Proposed Changes to Parts 15 and 19 To Implement the Proposed Elimination of Form 204 and Portions of Form 304

The market and large-trader reporting rules are contained in parts 15 through 21 of the Commission's regulations. Collectively, these reporting rules effectuate the Commission's market and financial surveillance programs by enabling the Commission to gather information concerning the size and composition of the commodity derivative markets and to monitor and enforce any established speculative position limits, among other regulatory goals.

To effectuate the proposed elimination of Form 204 and the cash-market reporting components of Form 304, the Commission proposes corresponding amendments to certain provisions in parts 15 and 19. These amendments would eliminate: (i) Existing § 19.00(a)(1), which requires persons holding reportable positions which constitute bona fide hedging positions to file a Form 204; and (ii) existing § 19.01, which, among other things, sets forth the cash-market information required on Forms 204 and 304.[380] Based on the proposed elimination of existing § 19.00(a)(1) and Form 204, the Commission also proposes to remove related provisions from: (i) The ''reportable position'' definition in § 15.00(p); (ii) the list of ''persons required to report'' in § 15.01; and (iii) the list of reporting forms in § 15.02.

4. Special Calls

Notwithstanding the proposed elimination of Form 204, the Commission does not propose to make any significant substantive changes to information requirements relating to positions exceeding limits and/or to reportable positions. Accordingly, in proposed § 19.00(b), the Commission proposes that all persons exceeding the proposed limits set forth in § 150.2, as well as all persons holding or controlling reportable positions pursuant to § 15.00(p)(1), must file any pertinent information as instructed in a special call. This proposed provision is similar to existing § 19.00(a)(3), but would require any such person to file the information as instructed in the special call, rather than to file a series '04 report.[381]

The Commission also proposes to add language to existing § 15.01(d) to clarify that persons who have received a special call are deemed ''persons required to report'' as defined in § 15.01.[382] The Commission proposes this change to clarify an existing requirement found in § 19.00(a)(3), which requires persons holding or controlling positions that are reportable pursuant to § 15.00(p)(1) who have received a special call to respond.[383] The proposed changes to part 19 operate in tandem with the proposed additional language for § 15.01(d) to reiterate the Commission's existing special call authority without creating any new substantive reporting obligations. Finally, proposed § 19.03 would delegate authority to issue such special calls to the Director of the Division of Enforcement, and proposed § 19.03(b) would delegate to the Director of the Division of Enforcement the authority in proposed § 19.00(b) to provide instructions or to determine the format, coding structure, and electronic data transmission procedures for submitting data records and any other information required under part 19.

5. Form 304 Cotton On-Call Reporting

With the proposed elimination of the cash-market reporting elements of Form 304 as described above, Form 304 would be used exclusively to collect the information needed to publish the Commission's weekly cotton on call report, which shows the quantity of unfixed-price cash cotton purchases and sales that are outstanding against each cotton futures month.[384] The requirements pertaining to that report would remain in proposed §§ 19.00(a) and 19.02, with minor modifications to existing provisions. The Commission proposes to update cross references (including to renumber § 19.00(a)(2) as § 19.00(a)) and to clarify and update the procedures and timing for the submission of Form 304. In particular, proposed § 19.02(b) would require that each Form 304 report be made weekly, dated as of the close of business on Friday, and filed not later than 9 a.m. Eastern Time on the third business day following that Friday using the format, coding structure, and electronic data transmission procedures approved in writing by the Commission. The Commission also proposes some modifications to the Form 304 itself, including conforming and technical changes to the organization, instructions, and required identifying information.[385]

Request for Comment

The Commission requests comment on all aspects of the proposed amendments to Part 19 and related provisions. The Commission also invites comments on the following:

(46) To what extent, and for what purpose, do market participants and others rely on the information contained in the Commission's weekly cotton on-call report?

(47) Does publication of the cotton on-call report create any informational advantages or disadvantages, and/or otherwise impact competition in any way?

(48) Should the Commission stop publishing the cotton on-call report, but continue to collect, for internal use only, the information required in Part III of Form 304 (Unfixed-Price Cotton ''On Call'')?

(49) Alternatively, should the Commission stop publishing the cotton on-call report and also eliminate the Form 304 altogether, including Part III?

6. Proposed Technical Changes to Part 17

Part 17 of the Commission's regulations addresses reports by reporting markets, FCMs, clearing members, and foreign brokers.[386] The Commission proposes to amend existing § 17.00(b), which addresses information to be furnished by FCMs, clearing members, and foreign brokers, to delete certain provisions related to aggregation, because those provisions have become duplicative of aggregation provisions that were adopted in § 150.4 in the 2016 Final Aggregation Rulemaking.[387] The Commission also proposes to add a new provision, § 17.03(i), which delegates certain authority under § 17.00(b) to the Director of the Office of Data and Technology.[388]

[380] 17 CFR 19.01.

[381] 17 CFR 19.00(a)(3).

[382] 17 CFR 15.01.

[383] 17 CFR 19.00(a)(3).

[384] *Cotton On-Call,* U.S. Commodity Futures Trading Commission website, *available at https://www.cftc.gov/MarketReports/CottonOnCall/index.htm* (weekly report).

[385] Among other things, the proposed changes to the instructions would clarify that traders must identify themselves on Form 304 using their Public Trader Identification Number, in lieu of the CFTC Code Number required on previous versions of Form 304. This proposed change would help Commission staff to connect the various reports filed by the same market participants. This release includes a representation of the proposed Form 304, which would be submitted in an electronic format published pursuant to the proposed rules, either via the Commission's web portal or via XML-based, secure FTP transmission.

[386] 17 CFR part 17.

[387] *See* Final Aggregation Rulemaking. Specifically, the Commission proposes to delete paragraphs (1), (2), and (3) from § 17.00(b). 17 CFR 17.00(b).

[388] Under § 150.4(e)(2), which was adopted in the 2016 Final Aggregation Rulemaking, the Director of the Division of Market Oversight is delegated authority to, among other things, provide instructions relating to the format, coding structure, and electronic data transmission procedures for submitting certain data records. 17 CFR 150.4(e)(2). A subsequent rulemaking changed this delegation

Continued

I. Removal of Part 151

Finally, the Commission is proposing to remove and reserve part 151 in response to its *vacatur* by the U.S. District Court for the District of Columbia,[389] as well as in light of the proposed revisions to part 150 that conform part 150 to the amendments made to the CEA section 4a by the Dodd-Frank Act.

III. Legal Matters

A. Introduction

Section 737 (a)(4) of the Dodd-Frank Act,[390] codified as section 4a(a)(2)(A) of the Commodity Exchange Act,[391] states in relevant part that ''the Commission shall'' establish position limits for contracts in physical commodities other than excluded commodities ''[i]n accordance with the standards set forth in'' section 4a(a)(1), which primarily contains the Commission's preexisting authority to establish such position limits as it ''finds are necessary.'' [392] In connection with the 2011 Final Rulemaking, the Commission determined that section 4a(a)(2)(A) is an unambiguous mandate to establish position limits for all physical commodities. In *ISDA,*[393] however, the U.S. District Court for the District of Columbia held that the term ''standards set forth in paragraph (1)'' is ambiguous as to whether it includes the requirement under section 4a(a)(1) that before the Commission establishes a position limit, it must first find it ''necessary'' to do so. The court therefore vacated the 2011 Final Rulemaking and directed the Commission to determine, in light of the Commission's ''experience and expertise'' '' and the ''competing interests at stake,'' whether section 4a(a)(2)(A) requires the Commission to make a necessity finding before establishing the relevant limits, or if section 4a(a)(2)(A) is a mandate from Congress to do so without that antecedent finding.

Following the court's order, the Commission subsequently determined that the ''standards set forth in paragraph (1)'' do not include the requirement in that paragraph that the Commission find position limits ''necessary.'' [394] Rather, the Commission determined, ''the standards set forth in paragraph (1)'' refer only to what the Commission called the ''aggregation standard'' and the ''flexibility standard.'' [395] The ''aggregation standard'' referred to directions under section 4a(a)(1)(A) that in determining whether any person has exceeded an applicable position limit, the Commission must aggregate the positions a party controls directly or indirectly, or held by two persons acting in concert ''the same as if the positions were held by, or the trading were done by, a single person.'' [396] The ''flexibility standard'' referred to the statement in section 4a(a)(1)(A) that ''[n]othing in this section shall be construed to prohibit'' the Commission from fixing different limits for different commodities, markets, futures, delivery months, numbers of days remaining on the contract, or for buying and selling operations.[397]

The Commission here preliminarily reaches a different conclusion. In light of its experience with and expertise in position limits and the competing interests at stake, the Commission now determines that it should interpret ''the standards set forth in paragraph (1)'' to include the traditional necessity and aggregation standards. The Commission also preliminarily determines that the ''flexibility standard'' is not an accurate way of describing the statute's lack of a prohibition on differential limits, and therefore is not included in ''the standards set forth in paragraph (1)'' with which position limits must accord. However, even if that were not so, the Commission would still preliminarily determine that ''the standards set forth in paragraph (1)'' should be interpreted to include necessity.

B. Key Statutory Provisions

The Commission's authority to establish position limits dates back to the Commodity Exchange Act of 1936.[398] The relevant CEA language, now codified in its present form as section 4a(a)(1), states, among other things that 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 such contracts'' as the Commission ''finds are necessary to diminish, eliminate, or prevent such burden.'' Thus, the Commission's original authority to establish a position limit required it first to find that it was necessary to do so. Section 4a(a)(1) also includes what the Commission has referred to as the aggregation and flexibility standards.

Section 4a(a)(2)(A) provides, in relevant part, that ''[i]n accordance with the standards set forth in paragraph (1) of this subsection,'' *i.e.,* paragraph 4a(a)(1) discussed above, the Commission shall, by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a DCM. This direction applies only to physical commodities other than excluded commodities. Paragraph 4a(a)(2)(B) states that the limits for exempt physical commodities ''required'' under subparagraph (A) ''shall'' be established within 180 days, and for agricultural commodities the limits ''required'' under subparagraph (A) ''shall'' be established within 270 days. Paragraph 4a(a)(2)(C) establishes as a ''goal'' that the Commission ''shall strive to ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits'' and that any limits imposed by the Commission not cause price discovery to shift to foreign boards of trade.

Next, paragraph 4a(a)(3) establishes certain requirements for position limits set pursuant to paragraph 4a(a)(2). It directs that when the Commission establishes ''the limits required in paragraph (2),'' it shall, ''as appropriate,'' set limits on the number of positions that may be held in the spot month, each other month, and the aggregate number of positions that may be held by any person for all months; and ''to the extent practicable, in its discretion'' the Commission shall fashion the limits to (i) ''diminish, eliminate, or prevent excessive speculation as described under this section;'' (ii) ''deter and prevent market manipulation, squeezes, and corners;'' (iii) ''ensure sufficient market liquidity for bona fide hedgers;'' and (iv) ''ensure that the price discovery function of the underlying market is not disrupted.''

Paragraph 4a(a)(5) adds a further requirement that when the Commission establishes limits under paragraph 4a(a)(2), the Commission must establish limits on the amount of positions, ''as appropriate,'' on swaps that are ''economically equivalent'' to futures

of authority from the Director of the Division of Market Oversight to the Director of the Office of Data and Technology, with the concurrence of the Director of the Division of Enforcement. *See* 82 FR at 28763 (June 26, 2017). The proposed addition of § 17.03(i) would conform § 17.03 to that change in delegation.

[389] *See supra* note 11 and accompanying discussion.

[390] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, § 737(a)(4), Public Law 111–203, 124 Stat. 1376, 1723 (July 21, 2010).

[391] 7 U.S.C. 6a(a)(2)(A).

[392] 7 U.S.C. 6a(a)(1).

[393] 887 F. Supp.2d 259.

[394] *See, e.g.,* 2013 Proposal, 78 FR at 75680, 75684.

[395] *See, e.g., id.*

[396] 7 U.S.C. 6a(a)(1).

[397] *Id.*

[398] Public Law 74–675 § 5, 49 Stat. 1491, 1492 (June 15, 1936).

and options contracts subject to paragraph 4a(a)(2).

C. Ambiguity of Section 4a With Respect to Necessity Finding

The district court held that section 4a(a)(2) is ambiguous as to whether, before the Commission establishes a position limit, it must first find that a limit is ''necessary.'' The court found the phrase ''[i]n accordance with the standards set forth in paragraph (1) of this subsection'' unclear as to whether it includes the proviso in paragraph (1) that position limits be established only ''as the Commission finds are necessary.'' [399] The court noted that, by some definitions of ''standard,'' a requirement that position limits be ''necessary'' could qualify.[400]

The district court found the ambiguity compounded by the phrase ''as appropriate'' in sections 4a(a)(2)(A), 4a(a)(3), and 4a(a)(5).[401] It was unclear to the court whether this phrase gives the Commission discretion not to impose position limits at all if it finds them not appropriate, or if the discretion extends only to determining ''appropriate'' levels at which to set the limits.[402] Neither the grammar of the relevant provisions nor the available legislative history resolved these issues to the court's satisfaction.[403] In sum, ''the Dodd-Frank amendments do not constitute a clear and unambiguous mandate to set position limits.'' [404] The court therefore directed the Commission to resolve the ambiguity, not by ''rest[ing] simply on its parsing of the statutory language,'' but by ''bring[ing] its experience and expertise to bear in light of the competing interests at stake.'' [405]

D. Resolution of Ambiguity

The Commission has applied its experience and expertise in light of the competing interests at stake and preliminarily determined that paragraph 4a(a)(2) should be interpreted as incorporating the requirement of paragraph 4a(a)(1) that position limits be established only ''as the Commission finds are necessary.'' This is based on a number of considerations.

First, while the Commission has previously taken the position that necessity does not fall within the definition of the word ''standard,'' that view relied on only one of the many dictionary definitions of ''standard,'' [406] and the Commission now believes it was an overly narrow interpretation. The word ''standard'' is used in different ways in different contexts, and many reasonable definitions would encompass ''necessity.'' [407] In legal contexts, ''necessity'' is routinely called a ''standard.'' [408] The Commission preliminarily believes that the more natural reading of ''standard'' in section 4a(a)(2)(A) does include the requirement of a necessity finding.

Second, and relatedly, the Commission believes the term ''standard'' is a less natural fit for the language in subparagraph 4a(a)(1) that the Commission has previously called the ''flexibility standard.'' The sentence provides that ''[n]othing in this section shall be construed to prohibit the Commission from fixing different trading or position limits for different'' contracts or situations.[409] Typically a legal standard constrains an agency's discretion.[410] But nothing in the so-called ''flexibility'' language constrains the Commission at all. In other words, the express lack of any prohibition of differential limits under section 4a(a)(1) is better understood as the absence of any standard.[411] And if flexibility is not a standard, then necessity must be, because section 4a(a)(2)(A) refers to ''standards,'' plural.

Third, the requirement that position limits be ''appropriate'' is an additional ground to interpret the statute as lacking an across-the board-mandate. In the past, the Commission has taken the view that the word ''appropriate'' as used in section 4a(a)(2)(A)—and in sections 4a(a)(3) and 4a(a)(5) in connection with position limits established pursuant to section 4a(a)(2)(A)—refers to position limit levels but not to the determination of whether to establish a limit.[412] However, the Supreme Court has opined in the context of the Clean Air Act that ''[n]o regulation is 'appropriate' if it does significantly more harm than good.'' [413] That was not a CEA case, but the Commission finds the Court's reasoning persuasive in this context.

It is reasonable to interpret the direction to set a position limit ''as appropriate'' to mean that in a given context, it may be that no position limit is justified. Under an across-the-board mandate, however, the Commission would be compelled to impose some limit even if any level of position limit would do significantly more harm than good, including with respect to the public interests Congress set forth in section 4a(a)(1) itself and elsewhere in section 4a and the CEA generally.[414] The Commission does not believe that is the best reading of section 4a(a)(2)(A). Rather, Congress's use of ''appropriate'' in that section and elsewhere in the Dodd-Frank amendments is more consistent with a directive that the

[399] *ISDA,* 887 F.Supp.2d at 274.

[400] *Id.*

[401] *Id.* at 276–278.

[402] *Id.*

[403] *Id.*

[404] *Id.* at 280.

[405] *Id.* at 281.

[406] *ISDA,* Defendant Commodity Futures Trading Commission's Cross-Motion for Summary Judgment at 24–25, (quoting definition of ''standard'' as ''something set up and established by authority as a rule for the measure of quantity, weight, extent, value, or quality'' from *Merriam-Webster's Collegiate Dictionary* 1216 (11th ed. 2011)).

[407] *Black's Law Dictionary* 1624 (10th ed. 2014) (''A criterion for measuring acceptability, quality, or accuracy.''); *The American Heritage Dictionary of the English Language* (5th ed. 2011) (''A degree or level of requirement, excellence, or attainment.''); *New Oxford American Dictionary* 1699 (3rd ed. 2010) (''an idea or thing used as a measure, norm, or model in comparative evaluations''); *The Random House Unabridged Dictionary* 1857 (2d ed. 1993) (''rule or principle that is used as a basis for judgment''); XVI *The Oxford English Dictionary* 505 (2d ed. 1989) (''A rule, principle, or means of judgment or estimation; a criterion, measure.'').

[408] *Home Buyers Warranty Corp.* v. *Hanna,* 750 F.3d 427, 435 (4th Cir. 2014) (applying a '' 'necessity' standard'' under Fed. R. Civ. P. 19(a)(1)(A)); *United States* v. *Cartagena,* 593 F.3d 104, 111 n.4 (1st Cir. 2010) (discussing a ''necessity standard'' under the Omnibus Crime Control and Safe Streets Act of 1968); *Fones4All Corp.* v. *F.C.C.,* 550 F.3d 811, 820 (9th Cir. 2008) (applying a ''necessity standard'' under the Telecommunications Act of 1996); *Swonger* v. *Surface Transp. Bd.,* 265 F.3d 1135, 1141–42 (10th Cir. 2001) (applying a ''necessity standard'' under transportation law); *see also Minnesota* v. *Mille Lacs Band of Chippewa Indians,* 526 U.S. 172, 205 (1999) (''conservation necessity standard''); *Int'l Union, United Auto., Aerospace & Agr. Implement Workers of Am., UAW* v. *Johnson Controls, Inc.,* 499 U.S. 187, 198 (1991) (''business necessity standard'').

[409] 7 U.S.C. 6a(a)(1)(A).

[410] *See, e.g., OSU Student Alliance* v. *Ray,* 699 F.3d 1053, 1064 (9th Cir. 2012) (holding that the First Amendment was violated by enforcement of a rule that ''created no standards to cabin discretion''); *Lenis* v. *U.S. Attorney General,* 525 F.3d 1291, 1294 (11th Cir. 2008) (dismissing petition for review where agency procedural regulation ''specifie[d] no standards for a court to use to cabin'' the agency's discretion); *Tamenut* v. *Mukasey,* 521 F.3d 1000, 1004 (8th Cir. 2008); *Drake* v. *FAA,* 291 F.3d 59, 71 (D.C. Cir. 2002) (similar).

[411] *Tamenut* v. *Mukasey,* 521 F.3d 1000, 1004 (8th Cir. 2008) (explaining that a statute placing ''no constraints on the [agency's] discretion . . . specifie[d] no standards''); *United States* v. *Gonzalez-Aparicio,* 663 F.3d 419, 435 (9th Cir. 2011) (Tashima, J., dissenting) (''If we can pick whatever standard suits us, free from the direction of binding principles, then there is no standard at all.''); *Downs* v. *Am. Emp. Ins. Co.,* 423 F.2d 1160, 1163 (5th Cir. 1970) (''best judgment is no standard at all'').

[412] *E.g., ISDA,* Commission Appellate Brief at 37–38.

[413] *Michigan* v. *EPA,* 135 S.Ct. 2699, 2707 (2015). Because *Michigan* was not a CEA case, the Commission does not mean to imply that *Michigan* would be controlling or compels any particular result in determining when a position limit is appropriate. To the contrary, the court in *ISDA* held that the CEA is ambiguous in that regard. The Commission merely finds the Supreme Court's discussion in *Michigan* useful in reasonably resolving that ambiguity.

[414] 7 U.S.C. 5, 6a(a)(2)(C) and (a)(3)(B).

Commission consider all relevant factors and, on that basis, set an appropriate limit level—or no limit at all, if to establish one would contravene the public interests Congress articulated in section 4a(a)(1) and the CEA generally. That is also better policy. To be clear, this does not mean the Commission must conduct a formal cost-benefit analysis in which each advantage and disadvantage is assigned a monetary value. To the contrary, the Commission retains broad discretion to decide how to determine whether a position limit is appropriate.[415]

Fourth, mandatory federal position limits for all physical commodities would be a sea change in derivatives regulation, and the Commission does not believe it should infer that Congress would have acted so dramatically without speaking clearly and unequivocally.[416] It is important to understand the reach of the proposition that the Commission must impose position limits for every physical commodity. The Commission estimates, based on information from the Commission's surveillance system, that currently there are over 1,200 contracts on physical commodities listed on DCMs. Some of these contracts have little or no active trading.[417] Absent clearer statutory language than is present in the statute, the Commission does not believe it should interpret the statute as though Congress had concerns about or even considered each and every one of the similar number of contracts listed at the time of Dodd-Frank. In a similar vein, the Commission previously has cited Senate Subcommittee's staff studies of potential excessive speculation that preceded the enactment of section 4a(a)(2).[418] But those studies covered only a few commodities—oil, natural gas, and wheat.[419] While these studies demonstrate that Senate subcommittee's concern with potential excessive speculation, the Commission does not believe it should interpret a statute by extrapolating from one Senate subcommittee's interest in three specific commodities to a requirement to impose limits on all of the many hundreds of physical futures contracts listed on exchanges, where Congress as a whole has not said so unambiguously.

DCMs also regularly create new contracts. If Congress intended federal position limits to apply to all physical commodity contracts, the Commission would expect there to be a provision directing it to establish position limits on a continuous basis. There is no such provision—and Congress directed the Commission to complete its position-limits rulemaking within 270 days.[420] The only other relevant provision is the preexisting and broadly discretionary requirement that the Commission make an assessment ''from time to time.'' That structure is inconsistent, both as a statutory and policy matter, with an across-the-board mandate.

Fifth, the Commission believes as a matter of policy judgment that requiring a necessity finding better carries out the purposes of section 4a. As Congress presumably was aware, position limits create costs as well as potential benefits.

The Commission has recognized, and Congress also presumably understood, that there are costs even for well-crafted position limits. As discussed below in the Commission's consideration of costs and benefits, market participants must monitor their positions and have safeguards in place to ensure compliance with limits. In addition to compliance costs, position limits may constrain some economically beneficial uses of derivatives, because a limit calculated to prevent excessive speculation or to restrict opportunities for manipulation may, in some circumstances, affect speculation that is desirable. While the Commission has designed limits to avoid interference with normal trading, certain negative effects cannot be ruled out.

For example, to interpret section 4a(a)(2) as a mandate even where unnecessary could pose risks to liquidity and hedging. Well-calibrated position limits can protect liquidity by checking excessive speculation, but unnecessary limits can have the opposite effect by drawing capital out of markets. Indeed, the liquidity of a futures contract, upon which hedging depends, is directly related to the amount of speculation that takes place. Speculators contribute valuable liquidity to commodity markets, and section 4a(a)(1) identified ''*excessive* speculation''—not all speculation—as ''an undue burden on interstate commerce.'' To needlessly reduce liquidity, impair price discovery, and make hedging more difficult for commodity end-users without sufficient beneficial effects on interstate commerce is unsound policy, as Congress has defined the policy. If Congress had drafted the statute unambiguously to reflect the judgment that these costs of position limits are justified in all instances, the Commission of course would follow it. Without such clarity, the Commission does not believe it should interpret the statute to impose those costs regardless of whether and to what extent doing so advances Congress' stated goals.

Sixth, while Congress has deemed position limits an effective tool, it is sound regulatory policy for the Commission to apply its experience and expertise to determine whether economic conditions with respect to a given commodity at a given point in time render it likely that position limits will achieve positive outcomes. A mandate without the requirement of a necessity finding would eliminate the Commission's expertise and experience from the process and could lead to position limits that do not have significantly positive effects, or even position limits that are counterproductive. Necessity findings may also enhance public confidence that position limits in place are necessary to their statutory purposes, potentially improving public confidence in the markets themselves. It is therefore sound policy to construe the statute in a way that requires the Commission to make a necessity finding before establishing position limits.[421]

Finally, also as a matter of policy, the Commission's approach will prevent market participants from suffering the costs of statutory ambiguity. Mandating position limits across all products would automatically impose costs on market participants regardless of whether doing so fulfills the purpose of section 4a. The associated compliance costs remain as long as those limits are in place. Reading a mandate into section 4a would exchange regulatory convenience, with or without any public benefit, for long-term burdens on market participants. The Commission does not believe that ambiguity should

[415] 135 S.Ct. at 2707, 2711.

[416] *E.g., Whiteman* v. *American Trucking Assns., Inc.,* 531 U.S. 457, 468 (2000) (Congress . . . does not alter the fundamental details of a regulatory scheme in vague terms. . . .''); *EEOC* v. *Staten Island Sav. Bank,* 207 F.3d 144, (2d Cir. 2000) (''we are reluctant to infer . . . a mandate for radical change absent a clearer legislative command''); *Canup* v. *Chipman-Union, Inc.,* 123 F.3d 1440, (11th Cir. 1997) (''We would expect Congress to speak more clearly if it intended such a radical change. . . .'').

[417] *See, e.g., Daily Agricultural Volume and Open Interest,* CME Group website, *available at https://www.cmegroup.com/market-data/volume-open-interest/agriculture-commodities-volume.html* (tables of daily trading volume and open interest for CME futures contracts).

[418] *E.g.,* 2013 Proposal, 78 FR at 75787 nn.122–124; *ISDA,* Brief for Appellant Commodity Futures Trading Commission at 14–15.

[419] *Id.*

[420] 7 U.S.C. 6a(a)(2)(B).

[421] The Commission also does not believe that establishing and enforcing position limits for all contracts on physical commodities, regardless of their importance to the price or delivery process of the underlying commodities or to the economy more broadly, would be a productive use of the public resources Congress has appropriated to the Commission.

be resolved reflexively in a manner that shifts costs to market participants. Rather, the Commission believes that where an agency has discretion to choose from among reasonable alternative interpretations, it should not impose costs without a strong justification, which in this context would be lacking without a necessity finding.

E. Evaluation of Considerations Relied Upon by the Commission in Previous Interpretation of Paragraph 4a(a)(2)

As noted above, the Commission previously has identified a number of considerations it believed supported interpreting paragraph 4a(a)(2) to mandate position limits for all physical commodities other than excluded commodities, without the need for a necessity finding. Although the Administrative Procedure Act does not require the Commission to rebut those previous points, the Commission believes it is useful to discuss them. While certain of these considerations could support such an interpretation, the Commission is no longer persuaded that, on balance, they support interpreting paragraph 4a(a)(2) as an across-the-board mandate. Considerations on which the Commission previously relied include the following:

1. When Congress enacted paragraph 4a(a)(2), the text of what previously was paragraph 4a(a),[422] already provided that the Commission ''shall . . . proclaim and fix'' position limits ''as the Commission finds are necessary'' to diminish, eliminate, or prevent the burdens on commerce associated with excessive speculation. This directive applied—and still applies—to all exchange-traded commodities, including the physical commodities that are the subject of paragraph 4a(a)(2). The Commission has previously reasoned that if paragraph 4a(a)(2) were not a mandate to establish position limits *without* such a necessity finding, it would be a nullity.[423] That is, the Commission already had the *authority* to issue position limits, so 4a(a)(2) would add nothing were it not a mandate. The Commission is no longer convinced that is correct.

Whereas the Commission's preexisting authority under the predecessor to paragraph 4a(a)(1) directed the Commission to establish position limits ''from time to time,'' new paragraph 4a(a)(2) directed the Commission to consider position limits promptly within two specified time limits after Congress passed the Dodd-Frank Act. That is a new directive, and it is consistent with maintaining the requirement for, and preserving the benefits of, a necessity finding. This interpretation is also consistent with the Commission's belief that Congress would not have intended a drastic mandate without a clear statement to that effect. This interpretation is likewise consistent with Congress' addition of swaps to the Commission's jurisdiction—it makes sense to direct the Commission to give prompt consideration to whether position limits are necessary at the same time Congress was expanding the Commission's oversight responsibilities to new markets, and the Commission believes that is sound policy to ensure that the regime works well as a whole. Rather than leave it to the Commission's preexisting discretion to set limits ''from time to time,'' it is reasonable to believe that Congress found it important for the Commission to focus on this issue at a time certain.

In addition, paragraph 4a(a)(2) triggers other requirements added to section 4a(a) by Dodd-Frank and not included in paragraph 4a(a)(1). For example, as described above, paragraph 4a(a)(3)(B) identifies objectives the Commission is required to pursue in establishing position limits, including three, set forth in subparagraphs 4a(a)(3)(B)(ii)–(iv), that are not explicitly mentioned in paragraph 4a(a)(1). The Commission previously opined that paragraph 4a(a)(5), which directs the Commission to establish, position limits on swaps ''economically equivalent'' to futures subject to new position limits, would add nothing to paragraph 4a(a)(1), because if there were no mandate. The Commission no longer finds that reasoning persuasive. Paragraph 4a(a)(5) goes beyond paragraph 4a(a)(1), because it separately requires that *when* the Commission imposes limits on futures pursuant to paragraph 4a(a)(2), it also does so on economically equivalent swaps. Without that text, the Commission would have no such obligation to issue both types of limits at the same time.

2. The Commission has also previously been influenced by the requirements of paragraph 4a(a)(3), which directs the Commission, ''as appropriate'' when setting limits, to establish them for the spot month, each other month, and all months; and sets forth four policy objectives the Commission must pursue ''to the maximum extent practicable.''[424] The Commission described these as ''constraints'' and found it ''unlikely'' that Congress intended to place new constraints on the Commission's preexisting authority to establish position limits, given the background of the amendments and in particular the studies that preceded their enactment.[425] However, on further consideration of this statutory language, the Commission does not interpret that language as a set of constraints in the sense of directing the Commission to make less use of limits or to impose higher limits than in the past. Rather, it focuses the Commission's decision process by identifying relevant objectives and directing the Commission to achieve them to the maximum extent practicable. Requiring the Commission to prioritize, to the extent practicable, preventing excessive speculation and manipulation, ensuring liquidity, and avoiding disruption of price discovery is reasonable regardless of whether there is an across-the-board mandate.

In past releases the Commission has also suggested that it is unclear why Congress would have imposed the decisional ''constraints'' of paragraph 4a(a)(3) ''with respect to physical commodities but not excluded commodities or others'' unless this provision was enacted as part of a mandate to impose limits without a necessity finding.[426] However, all of these relevant amendments pertain only to physical commodities other than excluded commodities. The Congressional studies that preceded the enactment of paragraph 4a(a)(2) demonstrated concern specifically with problems in markets for physical commodities such as oil and natural gas.[427] It therefore is not surprising that Congress enacted provisions specifically addressing limits for physical commodities and not others, whether or not Congress intended a necessity finding. Those physical commodities were the focus of Congress' concern.

3. The Commission has previously stated that the time requirements for establishing limits set forth in subparagraph 4a(a)(2)(B) are inconsistent with a necessity finding because, based on past experience, necessity findings for individual commodity markets cannot be made

[422] 7 U.S.C. 6a(a).

[423] *E.g.,* 2016 Reproposal, 81 FR at 96715, 96716 (discussing comments on past releases); 2013 Proposal, 78 FR at 75684.

[424] 7 U.S.C. 6a(a)(3).

[425] *E.g.,* 2016 Reproposal, 81 FR at 96716 (discussing comments on earlier releases).

[426] *Id.*

[427] *See, e.g.,* 2013 Proposal, 78 FR at 75682 and nn.24–26 (describing Congressional studies).

within the specified time periods.[428] However, the fact that many decades ago a number of months may have elapsed between proposals and final position limits does not mean that much time was necessary then or is necessary now. There are a number of possible reasons, such as limits on agency resources and why the agency took that amount of time. It is not a like-to-like comparison, because the agencies acting many decades ago were not acting pursuant to a mandate. The speed with which an agency could or would enact discretionary position limits is not necessarily a good proxy for how long would be required under a mandate.[429] There is accordingly no inconsistency, and thus the deadlines do not necessarily imply that Congress intended to eliminate a necessity finding for limits under paragraph 4a(a)(2).

4. The Commission previously has stated that Congress appears to have modeled the text of paragraph 4a(a)(2) on the text of the Commission's 1981 rule requiring exchanges to set speculative position limits for all contracts.[430] The Commission has further stated that the 1981 rule treated aggregation and flexibility as ''standards,'' and Congress therefore likely did the same in paragraph 4a(a)(2).[431] The Commission no longer agrees with that description or that reasoning.

Under the 1981 rule, former section 1.61(a) of the Commission's regulations required exchanges to adopt position limits for all contracts listed to trade.[432] The rule also established requirements similar to the current statutory aggregation requirements: Section 1.61(a) required that limits apply to positions a person may either ''hold'' or ''control,''[433] section 1.61(g) established more detailed aggregation requirements.[434] Section 1.61(a)(1) contained language the Commission has called the ''flexibility standard,'' *i.e.,* that ''nothing'' in section 1.61 ''shall be construed to prohibit a contract market from fixing different and separate position limits for different types of futures contracts based on the same commodity, different position limits for different futures, or for different delivery months, or from exempting positions which are normally known in the trade as 'spreads, straddles or arbitrage' or from fixing limits which apply to such positions which are different from limits fixed for other positions.''[435] Section 1.61(d)(1) of the rule required every exchange to submit information to the Commission demonstrating that it had ''complied with the purpose and standards set forth in paragraph (a).''[436] In the 2013 and 2016 proposals, the Commission concluded that the cross-reference to the ''standards set forth in paragraph (a)'' meant both the aggregation and flexibility language, because both of those sets of language appear in paragraph (a). By contrast, paragraph (a) did not include a requirement for a necessity finding, since the 1981 rule required position limits on all actively traded contracts.[437]

On further review, the Commission does not find this reasoning persuasive. The ''flexibility'' language gave the exchange unfettered discretion to set different limits for different kinds of positions—there was expressly ''nothing'' in that language to limit the exchange's discretion.[438] In other words, there is nothing in that flexibility text with which to ''comply,'' so it cannot be part of what section 1.61(d)(1) referenced as a ''standard'' for which compliance must be demonstrated.

As discussed above, ''standard'' is an ill-fitting label for this lack of a prohibition. Indeed, the 1981 release and associated 1980 NPRM did use the word ''standard'' to refer to certain language directing and constraining the discretion of the exchanges, a much more natural use of that word. For example, the preambles to both releases called requirements to aggregate certain holdings ''aggregation standards.''[439] And, in both the 1980 NPRM (in the preamble) and the 1981 Final Rule (in rule text), the Commission used the word ''standard'' to describe factors, such as position sizes customarily held by speculative traders, that exchanges were required to consider in setting the level of position limits.[440]

Although the wording of the 1981 rule and paragraph 4a(a)(2) have similarities, there are also differences. These differences weaken the inference that Congress intended the statute to hew closely to the rule. There is no legislative history articulating any relationship between the two. And even if Congress in Dodd-Frank did borrow concepts from the 1981 rule, there is little reason to infer that Congress was borrowing the precise meaning of any individual word—much less that the use of ''standards'' includes what ''nothing in this section shall be construed to prohibit . . . .''

5. In past releases the Commission has also observed that, in 1983, as part of the Futures Trading Act of 1982, Public Law 96–444, 96 Stat. 2294 (1983), Congress added a provision to the CEA making it a violation of the Act to violate exchange-set position limits, thus, in effect, ratifying the Commission's 1981 rule.[441] The Commission reasoned that this history supports the possibility that Congress could reasonably have followed an across-the-board approach here.[442] But while that may be so, the Commission today does not find that mere possibility helpful in interpreting the ambiguous term ''standards,'' because there is no evidence that Congress in 1982 considered the lack of a prohibition on different position limit levels in the rule to be a ''standard.'' By extension, the Futures Trading Act does not bear on the Commission's preliminary interpretation of ''standards'' in section 4a(a)(2)(A) today.

6. In briefs in the *ISDA* case, the Commission pointed out that CEA paragraphs 4a(a)(2)(B) and 4a(a)(3) repeatedly use the word ''required'' in connection with position limits established pursuant to paragraph 4a(a)(2), implying that the Commission is required to establish those limits regardless of whether it finds them to be necessary.[443] But that is not the only way to interpret the word ''required.'' Position limits are required under certain circumstances even if there is no across-the-board mandate—*i.e.,* when the Commission finds that they are ''necessary.'' Under the Commission's current preliminary interpretation, the Commission was required to assess within a specified timeframe if position limits were ''necessary'' and, if so, section 4a(a)(2) states that the Commission ''shall'' establish them.

[428] *E.g.,* 2016 Reproposal, 81 FR at 96708; 2013 Proposal, 78 FR at 75682, 75683.

[429] The Commission's reasoning in this respect has also assumed that a necessity finding means a granular market-by-market study of whether position limits will be useful for a given contract. As explained below, however, the Commission here preliminarily determines that such an analysis is not required. Under the Commission's current preliminary interpretation of the necessity finding requirement, it would have been plausible to complete the required findings under the deadlines Congress established.

[430] *E.g.,* 2013 Proposal, 78 FR at 75683, 75684.

[431] *Id.*

[432] Establishment of Speculative Position Limits, 46 FR at 50945 (Oct. 16, 1981).

[433] *Id.*

[434] *Id.* at 50946.

[435] *Id.* at 50945.

[436] *Id.*

[437] *Id.*

[438] 46 FR at 50945 (section 1.61(a)(1)).

[439] *Id.* at 50943; Speculative Position Limits, 45 FR at 79834.

[440] 46 FR at 50945 (in section 1.61(a)(2)); 45 FR at 79833, 79834.

[441] *See, e.g.,* 2016 Reproposal, 81 FR at 96709, 96710.

[442] *Id.* at 96710.

[443] *E.g., ISDA,* Brief for Appellant Commodity Futures Trading Commission at 26–27.

Thus, the word ''required'' in paragraphs 4a(a)(2)(B) and 4a(a)(3) leaves open the question of whether paragraph 4a(a)(2) itself requires position limits for all physical commodity contracts or, on the other hand, only requires them where the Commission finds them necessary under the standards of paragraph 4a(a)(1). The use of the word ''required'' in paragraphs 4a(a)(2)(B) and 4a(a)(3) therefore does not resolve the ambiguity in the statute. For the same reason, the evolution of the statutory language during the legislative process, during which the word ''may'' was changed to ''shall'' in a number of places, also does not resolve the ambiguity.[444]

7. The Commission has pointed out that section 719 of the Dodd-Frank Act required the Commission to ''conduct a study of the effects (if any) of the position limits imposed'' pursuant to paragraph 4a(a)(2) and report the results to Congress within twelve months after the imposition of limits.[445] The Commission has suggested that Congress would not have required such a study if paragraph 4a(a)(2) left the Commission with discretion to find that limits were unnecessary so that there would be nothing for the Commission to study and report on to Congress.[446] However, while the study requirement implies that Congress perhaps anticipated that at least some limits would be imposed pursuant to paragraph 4a(a)(2), it leaves open the question of whether Congress mandated limits for every physical commodity without the need for a necessity finding. In addition, the phrase ''the effects (if any)'' language does not imply that Congress expected position limits on all physical commodities. This language simply recognizes that new position limits could be imposed, but have no demonstrable effects.

8. In past releases and court filings, the Commission has stated that the legislative history of section 4a, as amended by the Dodd-Frank Act, supports the conclusion that paragraph 4a(a)(2) requires the establishment of position limits for all physical commodities whether or not the Commission finds them necessary to achieve the objectives of the statute.[447] However, the most relevant legislative history, taken as a whole, does not resolve the ambiguity in the statutory language or compel the conclusion that Congress intended to drop the necessity finding requirement when it enacted paragraph 4a(a)(2) as part of the Dodd-Frank Act.

The language of paragraph 4a(a)(2) derives from section 6(a) of a bill, the Derivatives Markets Transparency and Accountability Act of 2009, H.R. 977 (111th Cong.), which was approved by the House Committee on Agriculture in February of 2009.[448] The committee report on this bill included explanatory language stating that the relevant provision required the Commission to set position limits ''for all physical commodities other than excluded commodities.'' [449] However, H.R. 977 was never approved by the full House of Representatives.[450]

The relevant language concerning position limits was incorporated into the House of Representatives version of what became the Dodd-Frank Act, H.R. 4173 (111th Cong.), as part of a floor amendment that was introduced by the chairman of the Committee on Agriculture.[451] In explaining the amendment's language regarding position limits, the chairman stated that it ''strengthens confidence in position limits on physically deliverable commodities as a way to prevent excessive speculation trading'' but did not specify that limits would be required for all physical commodities without the need for a necessity finding.[452] The House of Representatives language regarding position limits was ultimately incorporated into the Dodd-Frank Act by a conference committee. However, the explanatory statement in the Conference report states, with respect to position limits, only that the act's ''regulatory framework outlines provisions for: . . . [p]osition limits on swaps contracts that perform or affect a significant price discovery function and requirements to aggregate limits across markets.'' [453]

In subsequent floor debate, the chairman of the House Agriculture Committee alluded to position limits provisions deriving from earlier bills reported by that committee, but did not describe them with specificity.[454] In the Senate, the chairman of the Senate Committee on Agriculture, Nutrition, and Forestry stated that the conference bill would ''grant broad authority to the Commodity Futures Trading Commission to once and for all set aggregate position limits across all markets on non-commercial market participants.'' [455] The statement that the bill would grant ''authority'' to set position limits implies an exercise of judgement by the Commission in determining whether to set particular limits.[456] Thus, this legislative history is itself ambiguous on the question of whether federal position limits are now mandatory on all physical commodities in the absence of a finding of necessity.

Looking at legislative history in more general terms, the Commission, in past releases, has pointed out that the enactment of paragraph 4a(a)(2) followed congressional investigations in the late 1990s and early 2000s that concluded that excessive speculation accounted for volatility and prices increases in the markets for a number of commodities.[457] However, while the history of congressional investigations supports the conclusion that Congress intended the Commission to take action with respect to position limits, it does not resolve the specific interpretive issue of whether the ''[i]n accordance with the standards set forth in paragraph (1)'' language that was ultimately enacted by Congress incorporates a necessity finding. As discussed above, the congressional investigations focused on only a few commodities, which weakens the inference that Congress considered the question of what speculative positions to limit a closed question.

Overall, in past releases the Commission has expressed the view that construing section 4a as an ''integrated whole'' leads to the conclusion that paragraph 4a(a)(2) does not require a

[444] *See, e.g.,* 2013 Proposal, 78 FR at 75684, 75685 (discussing evolution of statutory language as supporting mandate).

[445] *See, e.g., id.* at 75684.

[446] *See, e.g., id.*

[447] *See, e.g.,* 2016 Reproposal, 81 FR at 96709.

[448] *See* H.R. Rep. 111–385 part 1 at 4 (Dec. 19, 2009).

[449] *Id.* at 19.

[450] *See Actions—H.R.977—111th Congress (2009–2010) Derivatives Markets Transparency and Accountability Act of 2009,* Congress website, *available at https://www.congress.gov/bill/111th-congress/house-bill/977/all-actions?overview=closed#tabs* (bill history).

[451] 155 Cong. Rec. H14682, H14692 (daily ed. Dec. 10, 2009).

[452] *Id.* at H14705.

[453] Dodd-Frank Wall Street Reform and Consumer Protection Act, Conference Report to Accompany H.R. 4173 at 969 (H.R. Rep. 111–517 June 29, 2010).

[454] He stated, ''This conference report includes the tools we authorized [in response to concerns about excessive speculation] and the direction to the CFTC to mitigate outrageous price spikes we saw 2 years ago.'' 156 Cong. Rec. H5245 (daily ed. June 30, 2010).

[455] 156 Cong. Rec. S5919 (daily ed. July 15, 2010).

[456] In addition, the remainder of the Senate chairman's floor statement with regard to position limits focused on volatility and price discovery problems arising from the use of commodity swaps, implying that her reference to setting position limits ''across all markets'' refers to Dodd-Frank's extension of position limits authority to swaps markets. 156 Cong. Rec. at S5919–20 (daily ed. July 15, 2010).

[457] *See, e.g.,* 2016 Reproposal, 81 FR at 96711–96713.

necessity finding.[458] However, for reasons explained above, the Commission preliminarily believes that the better interpretation is that prior to imposing position limits, it must make a finding that the position limits are necessary.

F. Necessity Finding

The Commission preliminarily finds that federal speculative position limits are necessary for the 25 core referenced futures contracts, and any associated referenced contracts. This preliminary finding is based on a combination of factors including: The particular importance of these contracts in the price discovery process for their respective underlying commodities; the fact that they require physical delivery of the underlying commodity; and, in some cases, the especially acute economic burdens that would arise from excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in the price of the commodities underlying these contracts. The Commission has preliminarily determined that the benefit of advancing the statutory goal of preventing those undue burdens with respect to these commodities in interstate commerce justifies the potential burdens or negative consequences associated with establishing these targeted position limits.[459]

1. Meaning of ''Necessary'' Under Section 4a(a)(1)

Section 4a(a)(1) of the Act contains a congressional finding that ''[e]xcessive speculation . . . causing sudden or unreasonable fluctuations or unwarranted changes in . . . price . . . is an undue and unnecessary burden on interstate commerce in such commodity.''[460] For the purpose of ''diminishing, eliminating, or preventing'' that burden, section 4a(a)(1) tasks the Commission with establishing such position limits as it finds are ''necessary.''[461] The Commission's analysis, therefore, proceeds on the basis of these legislative findings that excessive speculation threatens negative consequences for interstate commerce and the accompanying proposition that position limits are an effective tool to diminish, eliminate, or prevent the undue and unnecessary burdens Congress has targeted in the statute.[462] The Commission will therefore determine whether position limits are necessary for a given contract, in light of those premises, considering facts and circumstances and economic factors.

The statute does not define ''necessary.'' In legal contexts, the term can have ''a spectrum of meanings.''[463] ''At one end, it may 'import an absolute physical necessity, so strong, that one thing, to which another may be termed necessary, cannot exist without that other;' at the opposite, it may simply mean 'no more than that one thing is convenient, or useful, or essential to another.' ''[464] The Commission does not believe Congress intended either end of this spectrum in section 4a(a)(1). On one hand, ''necessary'' in this context cannot mean that position limits must be the only means capable of addressing the burdens associated with excessive speculation. The Act contains numerous provisions designed to prevent, diminish, or eliminate price disruptions or distortions or unreasonable volatility. For example, the Commission's anti-manipulation authority is designed to stop, redress, and deter intentional acts that may give rise to uneconomic prices or unreasonable volatility.[465] Other examples include prohibitions on disruptive trading practices,[466] certain core principles for contract markets,[467] and the Commission's emergency powers.[468]

Yet the Commission is directed by section 4a(a)(1) not only to impose position limits to diminish or eliminate sudden and unwarranted fluctuations in price caused by excessive speculation once those other protections have failed, it is directed to establish position limits as necessary to ''prevent'' those burdens on interstate commerce from arising in the first place. It makes little sense to suppose that Congress meant for the Commission to ''prevent'' unreasonable fluctuations or unwarranted price changes caused by excessive speculation only after they have already begun to occur, or when the Commission can somehow predict with confidence that the Act's other tools will be absolutely ineffective.[469] The Act uses the word ''necessary'' in a number of places to authorize measures it is highly unlikely Congress meant to apply only where the relevant policy goals will otherwise certainly fail.[470]

On the other hand, the Commission also does not believe that Congress intended position limits where they are merely ''useful'' or ''convenient.'' As explained above, Congress has already determined that position limits are useful in preventing undue burdens on interstate commerce associated with excessive speculation, but requires the Commission to make the further finding that they are also necessary. A ''convenience'' standard would be similarly toothless.

Rather than accepting either extreme, the Commission preliminarily interprets that sections 4a(a)(1) and 4a(a)(2) direct the Commission to establish position

[458] *See, e.g.,* 2016 Reproposal, 81 FR at 96713, 96714.

[459] As discussed, the Commission is not proposing non-spot-month limits apart from the legacy agricultural contracts. Non-spot-month prices serve as references for cash-market transactions much less frequently than spot-month prices. Accordingly, the burdens of excessive speculation in non-spot-months on commodities in interstate commerce would be substantially less than the burdens of excessive speculation in spot-months. It is also not possible to execute a corner or squeeze in non-spot-months. And because there generally are fewer market participants in non-spot-months, holders of large speculative positions may play a more important role in providing liquidity to bona fide hedgers.

[460] 7 U.S.C. 6a(a)(1).

[461] 7 U.S.C. 6a(a)(1).

[462] It is not the Commission's role to determine if these findings are correct. *See Public Citizen* v. *FTC,* 869 F.2d 1541, 1557 (D.C. Cir. 1989) (''[A]gencies surely do not have inherent authority to second-guess Congress' calculations.''); *see also* 46 FR at 50938, 50940 (''Section 4a(1) [now 4a(a)(1)] represents an express Congressional finding that excessive speculation is harmful to the market, and a finding that speculative limits are an effective prophylactic measure.'').

[463] *Jewell* v. *Life Ins. Co. of N. Am.,* 508 F.3d 1303, 1310 (10th Cir. 2007).

[464] *Jewell* v. *Life Ins. Co. of N. Am.,* 508 F.3d 1303, 1310 (10th Cir. 2007); *see also Black's Law Dictionary* 1227 (3d ed. 1933) (''As used in jurisprudence, the word 'necessary' does not always import an actual physical necessity, so strong that one thing, to which another may be termed 'necessary,' cannot exist without the other. . . . To employ the means *necessary* to an end is generally understood as employing any means calculated to produce the end, and not as being confined to those single means without which the end would be entirely unattainable.'' (citing *McCullouch* v. *Maryland,* 4 Wheat. 216, 4 L. Ed. 579 (1819)).

[465] 7 U.S.C. 9(1), 9(3), 13(a)(2).

[466] 7 U.S.C. 6c(a).

[467] 7 U.S.C. 7(d).

[468] 7 U.S.C. 12a(9).

[469] *See Nat. Res. Def. Council, Inc.* v. *Thomas,* 838 F.2d 1224, 1236–37 (D.C. Cir. 1988) (''[A] measure may be 'necessary' even though acceptable alternatives have not been exhausted.''); *F.T.C.* v. *Rockefeller,* 591 F.2d 182, 188 (2d Cir. 1979) (rejecting ''the notion that 'necessary' means that the [Federal Trade Commission] must pursue all other 'reasonably available alternatives''' before undertaking the measure at issue). Indeed, where the Commission considers setting such prophylactic limits, it is unlikely to be knowable whether position limits will be the only effective tool. The existence of other tools to prevent unwarranted volatility and price changes may be relevant, but cannot be dispositive in all cases.

[470] *See, e.g.,* 7 U.S.C. 2(h)(4)(A) (empowering the Commission to prescribe rules ''as determined by the Commission to be necessary to prevent evasions of the mandatory clearing requirements''); 7 U.S.C. 2(h)(4)(B)(iii) (requiring that the Commission ''shall'' take such actions ''as the Commission determines to be necessary'' when it finds that certain swaps subject to the clearing requirement are not listed by any derivatives clearing organization); 7 U.S.C. 21(e) (subjecting registered persons to such ''rules and regulations as the Commission may find necessary to protect the public interest and promote just and equitable principles of trade.'').

limits where the Commission finds, based on the relevant facts and circumstances, that position limits would be an efficient mechanism to advance the congressional goal of preventing undue burdens on interstate commerce in the given underlying commodity caused by excessive speculation. For example, it may be that for a given commodity, volatility in derivatives markets would be unlikely to cause high levels of sudden or unreasonable fluctuations or unwarranted changes in the price of the underlying commodity and would have little overall impact on the national economy/interstate commerce. Under those circumstances, the Commission may find that position limits are unnecessary. There are, however, also contract markets in which volatility would be highly likely to cause sudden or unreasonable fluctuations or unwarranted changes in the price of the underlying commodity or have significantly negative effects on the broader economy. Even if such disruptions would be unlikely due to the characteristics of an individual market, the Commission may nevertheless determine that position limits are necessary as a prophylactic measure given the potential magnitude or impact of the event.[471]

Most commodities lie somewhere in between, with varying degrees of linkage between derivative contracts and cash-market prices, and differences in importance to the overall economy. There is no mathematical formula to make this determination, though the Commission will consider relevant data where it is available. The Commission must instead exercise its judgment in light of facts and circumstances, including its experience and expertise, to determine what limits are economically justified.[472] In all instances, the Commission will consider the applicable costs and benefits as required under section 15(a) of the Act.[473] With this interpretation of ''necessary'' in mind, the Commission below explains its selection of the 25 core referenced futures contracts, and any associated referenced contracts. Going forward, the Commission will make this assessment ''from time to time'' as required under section 4a(a)(1).

The Commission recognizes that this approach differs from that taken in earlier necessity findings. For example, when the Commission's predecessor agency, the Commodity Exchange Commission (''CEC''), established position limits, it would publish them in the **Federal Register** along with necessity findings that were generally conclusory recitations of the statutory language.[474] The published basis would be a recitation that trading of a given commodity for future delivery by a person who holds or controls a net position in excess of a given amount tends to cause sudden or unreasonable fluctuations or changes in the price of that commodity, not warranted by changes in the conditions of supply and demand.[475] Apart from that, the CEC typically would refer to a public hearing, but provide no specifics of the evidence presented or what the CEC found persuasive.[476] The CEC variously imposed limits one commodity at a time, or for several commodities at once.[477]

In 1981, the Commission issued a rule directing all exchanges to establish position limits for each contract not already subject to federal limits, and for which delivery months were listed to trade.[478] There, as here, the Commission explained that section 4a(a)(1) represents an ''express Congressional finding that excessive speculation is harmful to the market, and a finding that speculative limits are an effective prophylactic measure.''[479] The Commission observed that all futures markets share the salient characteristics that make position limits a useful tool to prevent the potential burdens of excessive speculation. Specifically, ''it appears 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.''[480]

In 2013, the Commission proposed a necessity finding applicable to all physical commodities, and then reproposed it in 2016. In that finding, the Commission discussed incidents in which the Hunt family in 1979 and 1980 accumulated unusually large silver positions, and in which Amaranth Advisors L.L.C. in 2006 accumulated unusually large natural gas positions.[481] The Commission preliminarily determined that the size of those positions contributed to unwarranted volatility and price changes in those respective markets, which imposed undue burdens on interstate commerce, and that position limits could have prevented this.[482] The Commission here preliminarily finds those parts of the 2013 and 2016 proposed necessity finding to be beside the point, because Congress has already determined that excessive speculation can place undue burdens on interstate commerce in a commodity, and that position limits can diminish, eliminate, or prevent those burdens. In 2013 and 2016, the Commission also considered numerous studies concerning position limits.[483] To the extent that those studies merely examined whether or not position limits are an effective tool, the Commission here does not find them directly relevant, again because Congress has already determined that position limits can be effective to diminish, eliminate, or prevent sudden or unreasonable fluctuations or unwarranted changes in commodity prices.[484]

In the 2013 and 2016 necessity findings, the Commission stated again that ''all markets in physical commodities'' are susceptible to the burdens of excessive speculation because all such markets have a finite ability to absorb the establishment and liquidation of large speculative positions in an orderly manner.[485] The

[471] The Commission will also be mindful that the undue burdens Congress tasked the Commission with diminishing, eliminating, or preventing would not generally be borne exclusively by speculators or other participants in futures and swaps markets, but instead the public at large or a certain industry or sector of the economy. In a given context, the Commission may find that this factor supports a finding that position limits are necessary.

[472] The Commission is well positioned to select from among all commodities within the scope of 4a(a)(1) and (2)(A), from its ongoing regulatory activities, including but not limited to market surveillance and product review.

[473] 7 U.S.C. 19(a).

[474] *See, e.g.,* Limits on Position and Daily Trading in Soybeans for Future Delivery, 16 FR at 8107 (Aug. 16, 1951); Findings of Fact, Conclusions, and Order in the Matter of Limits on Position and Daily Trading in Cotton for Future Delivery, 5 FR at 3198 (Aug. 28, 1940); In re Limits on Position and Daily Trading in Wheat, Corn, Oats, Barley, Rye, and Flaxseed, for Future Delivery, 3 FR at 3146, 3147 (Dec. 24, 1938).

[475] *See, e.g.,* Limits on Position and Daily Trading in Soybeans for Future Delivery, 16 FR at 8107 (Aug. 16, 1951); Findings of Fact, Conclusions, and Order in the Matter of Limits on Position and Daily Trading in Cotton for Future Delivery, 5 FR at 3198 (Aug. 28, 1940); In re Limits on Position and Daily Trading in Wheat, Corn, Oats, Barley, Rye, and Flaxseed, for Future Delivery, 3 FR at 3146, 3147 (Dec. 24, 1938).

[476] The records available from the National Archives during this period are sparse.

[477] *Compare* 5 FR at 3198 (cotton) *with* 3 FR at 3146, 3147 (six types of grain).

[478] 46 FR at 50945.

[479] *Id.* at 50938, 50940. Section 4a(a)(1) was at the time numbered 4a(1).

[480] 46 FR at 50940 (Oct. 16, 1981). The Commission based this finding in part upon then-recent events in the silver market, an apparent reference to the corner and squeeze perpetrated by members of the Hunt family in 1979 and 1980.

[481] 2013 Proposal, 78 FR at 75686, 75693.

[482] *Id.* at 75691, 75193.

[483] *See* 2016 Reproposal, 81 FR at 96894, 96924.

[484] In any event, the Commission found those studies inconclusive. 2016 Reproposal, 81 FR at 96723.

[485] 2016 Reproposal, 81 FR at 96722; *see also* *Corn Products Refining Co.* v. *Benson,* 232 F.2d 554,

Continued

Commission here, however, preliminarily determines that this characteristic is not sufficient to support a finding that position limits are ''necessary'' for all physical commodities, within the meaning of section 4a(a)(1). Congress has already determined that excessive speculation can give rise to unwarranted burdens on interstate commerce and that position limits can be an effective tool to eliminate, diminish, or prevent those burdens. Yet the statute directs the Commission to establish position limits only when they are ''necessary.'' In that context, the Commission considers it unlikely that Congress intended the Commission to find that position limits are ''necessary'' even where facts and circumstances show the significant potential that they will cause disproportionate negative consequences for markets, market participants, or the commodity end users they are intended to protect. Similarly, because the Commission has preliminarily determined that section 4a(a)(2) does not mandate federal speculative position limits for all physical commodities,[486] it cannot be that federal position limits are ''necessary'' for all physical commodities, within the meaning of section 4a(a)(1), on the basis of a property shared by all of them, *i.e.,* a limited capacity to absorb the establishment and liquidation of large speculative positions in an orderly fashion.

The Commission requests comments on all aspects of this interpretation of the requirement in section 4a(a)(1) of a necessity finding.

2. Necessity Findings as to the 25 Core Referenced Futures Contracts

As noted above, the proposed rule would impose federal position limits on: 25 core referenced futures contracts, including 16 agricultural products, five metals products, and four energy products; any futures or options on futures directly or indirectly linked to the core referenced futures contracts; and any economically equivalent swaps. As discussed above, the Commission's necessity analysis proceeds on the basis of certain propositions reflected in the text of section 4a(a)(1): First, that excessive speculation in derivatives markets can cause sudden or unreasonable fluctuations or unwarranted changes in the price of an underlying commodity, *i.e.,* fluctuations not attributable to the forces of supply of and demand for that underlying commodity; second, that such price fluctuations and changes are an undue and unnecessary burden on interstate commerce in that commodity, and; third, that position limits can diminish, eliminate, or prevent that burden. With those propositions established by Congress, the Commission's task is to make the further determination of whether it is necessary to use position limits, Congress's prescribed tool to address those burdens on interstate commerce, in light of the facts and circumstances. Unlike prior preliminary necessity findings which focused on evidence of excessive speculation in just wheat and natural gas, this necessity finding addresses all 25 core referenced futures contracts and focuses on two interrelated factors: (1) The importance of the derivatives markets to the underlying cash markets, including whether they call for physical delivery of the underlying commodity; and (2) the importance of the cash markets underlying the referenced futures contracts to the national economy. The Commission will apply the relevant facts and circumstances holistically rather than formulaically, in light of its experience and expertise.

With respect to the first factor, the markets for the 25 core referenced futures contracts are large in terms of notional value and open interest, and are critically important to the underlying cash markets. These derivatives markets enable food processors, farmers, mining operations, utilities, textile merchants, confectioners, and others to hedge the risks associated with volatile changes in price that are the hallmark of cash commodity markets.

Futures markets were established to allow industries that are vital to the U.S. economy and critical to the American public to accurately manage future receipts, expenses, and financial obligations with a high level of certainty. In general, futures markets perform valuable functions for society such as ''price discovery'' and by allowing counterparties to transfer price risk to their counterparty. The risk transfer function that the futures markets facilitate allows someone to hedge against price movements by establishing a price for a commodity for a time in the future. Prices in derivatives markets can inform the cash market prices of, for example, energy used in homes, cars, factories, and hospitals. More than 90 percent of Fortune 500 companies use derivatives to manage risk, and over 50 percent of all companies use derivatives in physical commodity markets such as the 25 core referenced futures contracts.[487]

The 25 core referenced futures contracts are vital for establishing reliable commodity prices and enabling the beneficial risk transfer between buyers and sellers of commodities, allowing participants to hedge risk and undertake planning with greater certainty. By providing a highly efficient marketplace for participants to offset risks, the 25 core referenced futures contracts attract a broad range of participants, including farmers, ranchers, producers, utilities, retailers, investors, banking institutions, and others. These participants hedge production costs and delivery prices so that, among other things, consumers can always find plenty of food at reliable prices on the grocery store shelves.

Futures prices are used for pricing of cash market transactions but also serve as economic signals that help various members of society plan. These signals help farmers decide which crops to plant as well as assist producers to decide how to implement their production processes given the anticipated costs of various inputs and the anticipated prices of any anticipated finished products, and they serve similar functions in other areas of the economy. For the commodities that are the subject of this necessity finding, the Commission preliminarily has determined that there is a significant amount of participation in these commodity markets, both directly and indirectly, through price discovery signals.[488]

Two key features of the 25 core referenced futures contracts are the role they play in the price discovery process for their respective underlying commodities and the fact that they

560 (1956) (finding it ''obvious that transactions in such vast amounts as those involved here might cause 'sudden or unreasonable fluctuations in the price' of corn and hence be an undue and unnecessary burden on interstate commerce'' (alteration omitted)).

[486] *See supra* Section III.D.

[487] ISDA Survey of the Derivatives Usage by the World's Largest Companies 2009. It has also been estimated that the use of commercial derivatives added 1.1 percent to the size of the U.S. economy between 2003 and 2012. *See* Apanard Prabha et al., *Deriving the Economic Impact of Derivatives,* (Mar. 2014), *available at http://assets1b.milkeninstitute.org/assets/Publication/ResearchReport/PDF/Derivatives-Report.pdf.*

[488] The Commission observes that there has been much written in the academic literature about price discovery of the 25 core referenced futures contracts. This demonstrates the importance of the commodities underlying such contracts in our society. The Commission's Office of the Chief Economist conducted a preliminary search on the JSTOR and Science Direct academic research databases for journal articles that contain the key words: Price Discovery <Commodity Name> Futures. While the articles made varying conclusions regarding aspects of the futures markets, and in some cases position limits, almost all articles agreed that the futures markets in general are important for facilitating price discovery within their respective markets.

require physical delivery of the underlying commodity. Price discovery is the process by which markets, through the interaction of buyers and sellers, produce prices that are used to value underlying futures contracts that allow society to infer the value of underlying physical commodities. Adjustments in futures market requirements and valuations by a diverse array of futures market participants, each with different perspectives and access to supply and demand information, can result in adjustments to the pricing of the commodities underlying the futures contract. The futures markets are generally the first to react to such price-moving information, and price movements in the futures markets reflect a judgment of what is likely to happen in the future in the underlying cash markets. The 25 core referenced futures contracts were selected in part because they generally serve as reference prices for a large number of cash-market transactions, and the Commission knows from large trader reporting that there is a significant presence of commercial traders in these contracts, many of whom may be using the contracts for hedging and price discovery purposes.

For example, a grain elevator may use the futures markets as a benchmark for the price it offers local farmers at harvest. In return, farmers look to futures prices to determine for themselves whether they are getting fair value for their crops. The physical delivery mechanism further links the cash and futures markets, with cash and futures prices expected to converge at settlement of the futures contract.[489] In addition to facilitating price convergence, the physical delivery mechanism allows the 25 core referenced futures contracts to be an alternative means of obtaining or selling the underlying commodity for market participants. While most physically-settled futures contracts are rolled-over or unwound and are not ultimately settled using the physical delivery mechanism, because the futures contracts have standardized terms and conditions that reflect the cash market commodity, participants can reasonably expect that the commodity sold or purchased will meet their needs.[490] This physical delivery and price discovery process contributes to the complexity of the markets for the 25 core referenced futures contracts. If these markets function properly, American producers and consumers enjoy reliable commodity prices. Excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in the price of those commodities could, in some cases, have far reaching consequences for the U.S. economy by interfering with proper market functioning.

The cash markets underlying the 25 core referenced futures contracts are to varying degrees vitally important to the U.S. economy, driving job growth, stimulating economic activity, and reducing trade deficits while impacting everyone from consumers to automobile manufacturers and farmers to financial institutions. These 25 cash markets include some of the largest cash markets in the world, contributing together, along with related industries, approximately 5 percent to the U.S. gross domestic product (''GDP'') directly and a further 10 percent indirectly.[491] As described in detail below, the cash markets underlying the 25 core referenced futures contracts are critical to consumers, producers, and, in some cases, the overall economy.

By ''excessive speculation,'' the Commission here refers to the accumulation of speculative positions of a size that threaten to cause the ills Congress addressed in Section 4a—sudden or unreasonable fluctuations or unwarranted changes in the price of the underlying commodity. These potentially violent price moves in the futures markets could impact producers such as utilities, farmers, ranchers, and other hedging market participants. Such unwarranted volatility could result in significant costs and price movements, compromising budgeting and planning, making it difficult for producers to manage the costs of farmlands and oil refineries, and impacting retailers' ability to provide reliable prices to consumers for everything from cereal to gasoline. To be clear, volatility is sometimes warranted in the sense that it reflects legitimate forces of supply and demand, which can sometimes change very quickly. The purpose of this proposed rule is not to constrain those legitimate price movements. Instead, the Commission's purpose is to prevent volatility caused by excessive speculation, which Congress has deemed a potential burden on interstate commerce.

Further, excessive speculation in the futures market could result in price uncertainty in the cash market, which in turn could cause periods of surplus or shortage that would not have occurred if prices were more reliable. Properly functioning futures markets free from excessive speculation are essential for hedging the volatility in cash markets for these commodities that are the result of real supply and demand. Specific attributes of the cash and derivatives markets for these 25 commodities are discussed below.

3. Agricultural Commodities

Futures contracts on the 16 agricultural commodities are essential tools for hedging against price moves of these widely grown crops, and are key instruments in helping to smooth out volatility and to ensure that prices remain reliable and that food remains on the shelves. These agricultural futures contracts are used by grain elevators, farmers, merchants, and others and are particularly important because prices in the underlying cash markets swing regularly depending on factors such as crop conditions, weather, shipping issues, and political events.

Settlement prices of futures contracts are made available to the public by exchanges in a process known as ''price discovery.'' To be an effective hedge for cash market prices, futures contracts should converge to the spot price at expiration of the futures contract. Otherwise, positions in a futures contract will be a less effective tool to hedge price risk in the cash market since the futures positions will less than perfectly offset cash market positions. Convergence is so important for the 16 agricultural contracts that exchanges have deliveries occurring during the spot month, unlike for the energy commodities covered by this proposal.[492] This delivery mechanism helps to force convergence because shorts who can deliver cheaper than the futures prices may do so, and longs can stand in for delivery if it's cheaper to

[489] Futures contracts are traded for settlement at a date in the future. At a contract's delivery month and date, a commodity cash market price and its futures price converge, allowing an efficient transfer of physical commodities between buyers and sellers of the futures contract.

[490] Standardized terms and conditions for physically-settled futures contracts typically include delivery quantities, qualities, sizes, grades and locations for delivery that are commonly used in the commodity cash market.

[491] *See* The Bureau of Economic Analysis, U.S. Department of Commerce, Interactive Access to Industry Economic Accounts Data: GDP by Industry (Historical) that includes GDP contributions by U.S. Farms, Oil & Gas extraction, pipeline transportation, petroleum and coal products, utilities, mining and support activities, primary and fabricated metal products and finance in securities, commodity contracts and investments.

[492] For energy contracts, physical delivery of the underlying commodity does not occur during the spot month. This allows time to schedule pipeline deliveries and so forth. Instead, a shipping certificate (a financial instrument claim to the physical product), not the underlying commodity, is the delivery instrument that is exchanged at expiration of the futures contract.

obtain the underlying through the futures market than the cash market. The Commission does not collect information on all cash market transactions. Nevertheless, the Commission understands that futures prices are often used by counterparties to settle many cash-market transactions due to approximate convergence of the futures contract price to the cash-market price at expiration.

Agricultural futures markets are some of the most active, and open interest on agricultural futures have some of the highest notional value. The CBOT Corn (C) and CBOT Soybean (S) contracts, for example, trade over 350,000 and 200,000 contracts respectively per day.[493] Outstanding futures and options notional values range anywhere from approximately $ 71 billion for CBOT Corn (C) to approximately $ 70 million for CBOT Oats (O), with the other core referenced futures contracts on agricultural commodities all falling somewhere in between.[494]

The American agricultural market, including markets for the commodities underlying the 16 agricultural core referenced contracts, is foundational to the U.S. economy. Agricultural, food, and related industries contributed $ 1.053 trillion to the U.S. economy in 2017, representing 5.4 percent of U.S. GDP.[495] In 2017, agriculture provided 21.6 million full and part time jobs, or 11 percent of total U.S. employment.[496] Agriculture's contribution to international trade is also sizeable. For fiscal year 2019, it was projected that agricultural exports would exceed $ 137 billion, with imports at $ 129 billion for a net balance of trade of $ 8 billion.[497] This balance of trade is good for the nation and for American farmers. The U.S. commodity futures markets have provided risk mitigation and pricing that reflects the economic value of the underlying commodity to farmers, ranchers, and producers.

The 16 agricultural core referenced futures contracts[498] are key drivers to the success of the American agricultural industry. The commodities underlying these markets are used in a variety of consumer products including: Ingredients in animal feeds for production of meat and dairy (soybean meal and corn); margarine, shortening, paints, adhesives, and fertilizer (soybean oil); home furnishings and apparel (cotton); and food staples (corn, soybeans, wheat, oats, frozen orange juice, cattle, rough rice, cocoa, coffee, and sugar).

The cash markets underlying the 16 agricultural core referenced futures contracts help create jobs and stimulate economic activity. The soybean meal market alone has an implied value to the U.S. economy through animal agriculture which contributed more than 1.8 million American jobs,[499] and wheat remains the largest produced food grain in the United States, with planted acreage, production, and farm receipts ranking third after corn and soybeans.[500] The United States is the world's largest producer of beef, and also produced 327,000 metric tons of frozen orange juice in 2018.[501] Total economic activity stimulated by the cotton crop is estimated at over $ 75 billion.[502] Many of these markets are also significant export commodities, helping to reduce the trade deficit. The United States exports between 10 and 20 percent of its corn crop and 47 percent of its soybean crop, generating tens of billions of dollars in annual economic output.[503]

Many of these agricultural commodities are also crucial to rural areas. In Arkansas alone, which ranks first among rice-producing states, the annual rice crop contributes $1.3 billion to the state's economy and accounts for tens of thousands of jobs to an industry that contributes more than $35 billion to the U.S. economy on an annual basis.[504] Similarly, the U.S. meat and poultry industry, which includes cattle, accounts for $1.02 trillion in total economic output equaling 5.6 percent of GDP, and is responsible for 5.4 million jobs.[505] Coffee-related economic activity comprises 1.6 percent of total U.S. GDP,[506] and U.S. sugar producers generate nearly $20 billion per year for the U.S. economy, supporting 142,000 jobs in 22 states.[507] Even some of the smaller agricultural markets have a noteworthy economic impact.[508] For example, oats are planted on over 2.6 million acres in the United States, with the total U.S. supply in the order of 182 million bushels,[509] and in 2010 the United States exported chocolate and chocolate-type confectionary products worth $799 million to more than 50 countries around the world.[510]

4. Metal Commodities

The core referenced futures contracts on metal commodities play an important role in the price discovery process and are some of the most active and valuable in terms of notional value.

[493] CME Group website, *available at https://www.cmegroup.com/trading/products/#pageNumber=1&sortAsc=false&sortField=oi.*

[494] Notional values here and throughout this section of the release are derived from CFTC internal data obtained from the Commitments of Traders Reports. Notional value means the U.S. dollar value of both long and short contracts without adjusting for delta in options. Data is as of June 30, 2019.

[495] *What is Agriculture's Share of the Overall U.S. Economy,* USDA Economic Research Services, *available at https://www.ers.usda.gov/data-products/chart-gallery/gallery/chart-detail/?chartId=58270.*

[496] *Ag and Food Sales and the Economy,* USDA Economic Research Services, *available at https://www.ers.usda.gov/data-products/ag-and-food-statistics-charting-the-essentials/ag-and-food-sectors-and-the-economy.*

[497] *Outlook for U.S. Agricultural Trade,* USDA Economic Research Services, *available at https://www.ers.usda.gov/topics/international-markets-us-trade/us-agricultural-trade/outlook-for-us-agricultural-trade.*

[498] The 16 agricultural core referenced futures contracts are: CBOT Corn (C), CBOT Oats (O), CBOT Soybeans (S), CBOT Soybean Meal (SM), CBOT Soybean Oil (SO), CBOT Wheat (W), CBOT KC HRW Wheat (KW), ICE Cotton No. 2 (CT), MGEX HRS Wheat (MWE), CBOT Rough Rice (RR), CME Live Cattle (LC), ICE Cocoa (CC), ICE Coffee C (KC), ICE FCOJ–A (OJ), ICE U.S. Sugar No. 11 (SB), and ICE U.S. Sugar No. 16 (SF).

[499] Decision Innovation Solutions, *2018 Soybean Meal Demand Assessment,* United Soybean Board, *available at https://www.unitedsoybean.org/wp-content/uploads/LOW-RES-FY2018-Soybean-Meal-Demand-Analysis-1.pdf.*

[500] *Wheat Sector at a Glance,* USDA Economic Research Service, *available at https://www.ers.usda.gov/topics/crops/wheat/wheat-sector-at-a-glance.*

[501] *Cattle & Beef Sector at a Glance,* USDA Economic Research Service, *available at https://www.ers.usda.gov/topics/animal-products/cattle-beef/sector-at-a-glance.*

[502] *World of Cotton,* National Cotton Council of America, *available at http://www.cotton.org/econ/world/index.cfm.*

[503] *Feedgrains Sector at a Glance,* USDA Economic Research Service, *available at https://www.ers.usda.gov/topics/crops/corn-and-other-feedgrains/feedgrains-sector-at-a-glance.*

[504] *Where is Rice Grown,* Think Rice website, *available at http://www.thinkrice.com/on-the-farm/where-is-rice-grown.*

[505] *The United States Meat Industry at a Glance,* North American Meat Institute website, *available at https://www.meatinstitute.org/index.php?ht=d/sp/i/47465/pid/47465.*

[506] *The Economic Impact of the Coffee Industry,* National Coffee Association, *available at http://www.ncausa.org/Industry-Resources/Economic-Impact.*

[507] *U.S. Sugar Industry,* The Sugar Association, *available at https://www.sugar.org/about/us-industry.* While Sugar No. 11 (SB) is primarily an international benchmark, the contract is still used for price discovery and hedging within the United States and has significantly more open interest and daily volume than the domestic Sugar No. 16 (SF). As a pair, these two contracts are crucial tools for risk management and for ensuring reliable pricing, with much of the price discovery occurring in the higher-volume Sugar No. 11 (SB) contract.

[508] Although the macroeconomic impact of these markets is smaller, the Commission reiterates that it has selected the 25 core referenced futures contracts also based on the importance of derivatives in these commodities to cash-market pricing.

[509] *Feed Outlook: May 2019,* USDA Economic Research Service, *available at https://www.ers.usda.gov/publications/pub-details/?pubid=93094.*

[510] *Economic Profile of the U.S. Chocolate Industry,* World Cocoa Foundation, *available at https://www.worldcocoafoundation.org/wp-content/uploads/Economic_Profile_of_the_US_Chocolate_Industry_2011.pdf.*

The Gold (GC) contract, for example, trades the equivalent of nearly 27 million ounces and 170,000 contracts daily. [511] Outstanding futures and options notional values range from approximately $234 billion in the case of Gold (GC), to approximately $2.34 billion in the case of Palladium (PA), with the other metals core referenced futures contracts all falling somewhere in between.[512] Metals futures are used by a diverse array of commercial end-users to hedge their operations, including mining companies, merchants and refiners.

The underlying commodities are also important to the U.S. economy. In 2018, U.S. mines produced $82.2 billion of raw materials, including the commodities underlying the five metals core referenced futures contracts: COMEX Gold (GC), COMEX Silver (SI), COMEX Copper (HG), NYMEX Platinum (PL), and NYMEX Palladium (PA).[513] U.S. mines produced 6.6 million ounces of gold in 2018 worth around $9.24 billion as of July 1, 2019, and the United States holds the largest official gold reserves of any country, worth around $366 billion and representing 75 percent of the value of total U.S. foreign reserves.[514] U.S. silver refineries produced around 52.5 million ounces of silver worth around $800 million in 2018 at current prices.[515]

Major industries, including steel, aerospace, and electronics, process and transform these materials, creating about $3.02 trillion in value-added products.[516] The five metals commodities are key components of these products, including for use in: Batteries, solar panels, water purification systems, electronics, and chemical refining (silver); jewelry, electronics, and as a store of value (gold); building construction, transportation equipment, and industrial machinery (copper); automobile catalysts for diesel engines and in chemical, electric, medical and biomedical applications, and petroleum refining (platinum); and automobile catalysts for gasoline engines and in dental and medical applications (palladium). A disruption in any of these markets would impact highly important and sensitive industries, including those critical to national security, and would also impact the price of consumer products.

The underlying metals markets also create jobs and contribute to GDP. Over 20,000 people were employed in U.S. gold and copper mines and mills in 2017 and 2018, metal ore mining contributed $54.5 billion to U.S. GDP in 2015, and the global copper mining industry drives more than 45 percent of the world's GDP, either on a direct basis or through the use of products that facilitate other industries.[517]

The gold and silver markets are especially important because they serve as financial assets and a store of value for individual and institutional investors, including in times of economic or political uncertainty. Several exchange-traded funds (''ETFs'') that are important instruments for U.S. retail and institutional investors also hold significant quantities of these metals to back their shares. A disruption to any of these metals markets would thus not only impact producers and retailers, but also potentially retail and institutional investors. The iShares Silver Trust ETF, for example, holds around 323.3 million ounces of silver worth $4.93 billion, and the largest U.S. listed gold-backed ETF holds around 25.5 million ounces to back its shares worth around $35.7 billion.[518] Platinum and palladium ETFs are worth hundreds of millions of dollars as well.[519]

5. Energy Commodities

The energy core referenced futures markets are crucial tools for hedging price risk for commodities which can be highly volatile due to changes in weather, economic health, demand-related price swings, and pipeline and supply availability or disruptions. These futures contracts are used by some of the largest refiners, exploration and production companies, distributors, and by other key players in the energy industry, and are some of the most widely traded and valuable contracts in the world in terms of notional value. The NYMEX Light Sweet Crude Oil (CL) contract, for example, is the world's most liquid and actively traded crude oil contract, trading nearly 1.2 million contracts a day, and the NYMEX Henry Hub Natural Gas (NG) contract trades 400,000 contracts daily.[520] Futures and option notional values range from $ 53 billion in the case of NYMEX NY Harbor RBOB Gasoline (RB) and NYMEX NY Harbor ULSD Heating Oil (HO), to $ 498 billion for NYMEX Light Sweet Crude Oil (CL).[521]

Some of the energy core referenced futures contracts also serve as key benchmarks for use in pricing cash-market and other transactions. NYMEX NY Harbor RBOB Gasoline (RB) is the main benchmark used for pricing gasoline in the U.S. petroleum products market, a huge physical market with total U.S. refinery capacity of approximately 9.5 million barrels per day of gasoline.[522] Similarly, the NYMEX NY Harbor ULSD Heating Oil (HO) contract is the main benchmark used for pricing the distillate products market, which includes diesel fuel, heating oil, and jet fuel. [523]

The U.S. energy markets are some of the most important and complex in the world, contributing over $ 1.3 trillion to the U.S. economy.[524] Crude oil, heating oil, gasoline, and natural gas, the commodities underlying the four energy core reference futures contracts,[525] are key contributors to job growth and GDP. In 2015, the natural gas and oil industries supported 10.3 million jobs directly and indirectly, accounting for 5.6 percent of total U.S. employment, and generating $ 714 billion in wages to

[511] *Gold Futures Quotes,* CME Group website, *available at https://www.cmegroup.com/trading/metals/precious/gold_quotes_globex.html.*

[512] Calculations based on data submitted to the Commission pursuant to part 16 of the Commission's regulations.

[513] *Mineral Commodity Summaries 2019,* U.S. Geological Survey, *available at http://prd-wret.s3-us-west-2.amazonaws.com/assets/palladium/production/atoms/files/mcs2019_all.pdf.*

[514] *CPM Gold Yearbook 2019,* CPM Group, *available at https://www.cpmgroup.com/store/cpm-gold-yearbook-2019; Goldhub,* World Gold Council, *available at https://www.gold.org/goldhub.*

[515] *World Silver Survey 2019,* The Silver Institute, *available at https://www.silverinstitute.org/wp-content/uploads/2019/04/WSS2019V3.pdf.*

[516] *Id.*

[517] Creamer, Martin, *Global Mining Derives 45%-Plus of World GDP,* Mining Weekly (July. 4, 2012), *available at https://www.miningweekly.com/print-version/global-mining-drives-45-plus-of-world-gdp-cutifani-2012-07-04.* Platinum and palladium mine production in 2018 was less substantial, worth $114 million and $695 million, respectively (All such valuations throughout this release are at current prices as of July 2, 2019.). *See* Bloxham, Lucy, *et al., Pgm Market Report May 2019,* Johnson Matthey, *available at http://www.platinum.matthey.com/documents/new-item/pgm%20market%20reports/pgm_market_report_may_19.pdf.* However, derivatives contracts in those commodities do play a role in price discovery.

[518] *Historical Data,* SPDR Gold Shares, *available at http://www.spdrgoldshares.com/usa/historical-data.* Data as of July 1, 2019.

[519] *iShares Silver Trust Fund,* iShares, *available at https://www.ishares.com/us/products/239855/ishares-silver-trust-fund/1521942788811.ajax?fileType=xls&fileName=iShares-Silver-Trust_fund&dataType=fund, https://www.aberdeenstandardetfs.us/institutional/us/en-us/products/product/etfs-physical-platinum-shares-pplt-arca#15.*

[520] Calculations based on data submitted to the Commission pursuant to part 16 of the Commission's regulations.

[521] Calculations based on data submitted to the Commission pursuant to part 16 of the Commission's regulations.

[522] CME Comment letter dated April 24, 2015 at 79.

[523] *Id.* at 136.

[524] *Natural Gas and Oil National Factsheet,* API Energy, *available at https://www.api.org/~/media/Files/Policy/Jobs/National-Factsheet.pdf.*

[525] The four energy core referenced futures contracts are: NYMEX Light Sweet Crude Oil (CL), NYMEX NY Harbor ULSD Heating Oil (HO), NYMEX NY Harbor RBOB Gasoline (RB), and NYMEX Henry Hub Natural Gas (NG).

account for 6.7 percent of national income.[526] Crude oil alone, which is a key component in making gasoline, contributes 7.6 percent of total U.S. GDP. RBOB gasoline, which is a byproduct of crude oil that is used as fuel for vehicles and appliances, contributes $ 35.5 billion in income and $57 billion in economic activity.[527] ULSD comprises all on-highway diesel fuel consumed in the United States, and is also commonly used as heating oil.[528]

Natural gas is similarly important, serving nearly 69 million homes, 185,400 factories, and 5.5 million businesses such as hotels, restaurants, hospitals, schools, and supermarkets. More than 2.5 million miles of pipeline transport natural gas to more than 178 million Americans.[529] Natural gas is also a key input for electricity generation and comprises more than one quarter of all primary energy used in the United States. [530] U.S. agricultural producers also rely on an affordable, dependable supply of natural gas, as fertilizer used to grow crops is composed almost entirely of natural gas components.

6. Consistency With Commodity Indices

The criteria underlying the Commission's necessity finding is consistent with the criteria used by several widely tracked third party commodity index providers in determining the composition of their indices. Bloomberg selects commodities for its Bloomberg Commodity Index that in its view are ''sufficiently significant to the world economy to merit consideration,'' that are ''tradeable through a qualifying related futures contract'' and that generally are the ''subject of at least one futures contract that trades on a U.S. exchange.'' [531] Similarly, S&P's GSCI index is, among other things, ''designed to reflect the relative significance of each of the constituent commodities to the world economy.'' [532] Applying these criteria, Bloomberg and S&P have deemed eligible for inclusion in their indices lists of commodities that overlap significantly with the Commission's proposed list of 25 core referenced futures contracts. Independent index providers thus appear to have arrived at similar conclusions to the Commission's preliminary necessity finding regarding the relative importance of certain commodity markets.

7. Conclusion

This proposal only sets limits for referenced contracts for which a DCM currently lists a physically-settled core referenced futures contract. As discussed above, there are currently over 1,200 contracts on physical commodities listed on DCMs, and there are physical commodities other than those underlying the 25 core referenced futures contracts that are important to the national economy, including, for example, steel, butter, uranium, aluminum, lead, random length lumber, and ethanol. However, unlike the 25 core referenced futures contracts, the derivatives markets for those commodities are not as large as the markets for the 25 core referenced futures contracts and/or play a less significant role in the price discovery process.

For example, the futures contracts on steel, butter, and uranium were not included as core referenced futures contracts because they are cash-settled contracts that settle to a third party index. Among the agricultural commodity futures listed on CME that are cash-settled only to an index are: class III milk, feeder cattle, and lean hogs. All three of these were included in the 2011 Final Rulemaking. Because there are no physically-settled futures contracts on these commodities, these cash-settled contracts would not qualify as referenced contracts are would not be subject to the proposed rule. While the futures contracts on aluminum, lead, random length lumber, and ethanol are physically settled contracts, their open interest and trading volume is lower than that of the CBOT Oats contract, which is the smallest market included among the 25 core referenced futures contracts as measured by open interest and volume. In that regard, based on FIA end of month open interest data and 12-month total trading volume data for December 2019, CBOT Oats had end of month open interest of 4,720 contracts and 12-month total trading volume ending in December 2019 of 162,682 round turn contracts.[533] In comparison, the end of month December 2019 open interest and 12-month total trading volume ending in December 2019 for the other commodity futures contracts that were not selected to be included as core referenced futures contracts were as follows: COMEX Aluminum (267 OI/ 2,721 Vol), COMEX Lead (0 OI/0 Vol), CME Random Length Lumber (3,275 OI/ 11,893 Vol), and CBOT Ethanol (708 OI/ 2,686 Vol.). It would be impracticable for the Commission to analyze in comprehensive fashion all contracts that have either feature, so the Commission has chosen commodities for which the underlying and derivatives markets both play important economic roles, including the potential for especially acute burdens on a given commodity in interstate commerce that would arise from excessive speculation in derivatives markets. Line drawing of this nature is inherently inexact, and the Commission will revisit these and other contracts ''from time to time'' as the statute requires.[534] Depending on facts and circumstances, including the Commission's experience administering the proposed limits with respect to the 25 core referenced futures contracts, the Commission may determine that additional limits are necessary within the meaning of section 4a(a)(1).

As discussed in the cost benefit consideration below, the Commission's proposed limits are not without costs, and there are potential burdens or negative consequences associated with establishing the proposed limits.[535] In particular, if the levels are set too high, there is a greater risk of excessive speculation that could harm market participants and the public. If the levels are set too low, transaction costs may rise and liquidity could be reduced.[536] Nevertheless, the Commission preliminarily believes that the specific proposed limits applicable to the 25 core referenced futures contracts would

[526] *Natural Gas and Oil National Factsheet,* API Energy, *available at https://www.api.org/~/media/Files/Policy/Jobs/National-Factsheet.pdf;* PricewaterhouseCoopers, *Impacts of the Natural Gas and Oil Industry on the US Economy in 2015,* API Energy, *available at https://www.api.org/~/media/Files/Policy/Jobs/Oil-and-Gas-2015-Economic-Impacts-Final-Cover-07-17-2017.pdf.*

[527] PricewaterhouseCoopers, *Impacts of the Natural Gas and Oil Industry on the US Economy in 2015,* API Energy, at 12, *available at https://www.api.org/~/media/Files/Policy/Jobs/Oil-and-Gas-2015-Economic-Impacts-Final-Cover-07-17-2017.pdf.*

[528] CME Comment Letter dated April 24, 2015 at 135.

[529] *Natural Gas: The Facts,* American Gas Association, *available at https://www.aga.org/globalassets/2019-natural-gas-factsts-updated.pdf.*

[530] *Id.*

[531] *The Bloomberg Commodity Index Methodology,* Bloomberg, at 17 (Dec. 2018) *available at https://data.bloomberglp.com/professional/sites/10/BCOM-Methodology-December-2019.pdf.* The list of commodities that Bloomberg deems eligible for inclusion in its index overlaps significantly with the Commission's proposed list of 25 core referenced futures contracts.

[532] *S&P GSCI Methodology,* S&P Dow Jones Indices, at 8 (Oct. 2019) *available at https://us.spindices.com/documents/methodologies/methodology-sp-gsci.pdf?force_download=true.*

[533] FIA notes that volume for exchange-traded futures is measured by the number of contracts traded on a round-trip basis to avoid double-counting. Furthermore, FIA notes that open interest for exchange-traded futures is measured by the number of contracts outstanding at the end of the month.

[534] CEA section 4a(a)(1).

[535] *See infra* Section IV.A. (discussion of cost-benefit considerations for the proposed changes).

[536] *See infra* Section IV.A.2.a. (cost-benefit discussion of market liquidity and integrity).

limit such potential costs, and that the significant benefits associated with advancing the statutory goal of preventing the undue burdens associated with excessive speculation in these commodities justify the potential costs associated with establishing the proposed limits.

G. Request for Comment

The Commission requests comment on all aspects of the proposed necessity finding. The Commission also invites comments on the following:

(50) Does the proposed necessity finding take into account the relevant factors to ascertain whether position limits would be necessary on a core referenced futures contract?

(51) Does the proposed necessity finding base its analysis on the correct levels of trading volume and open interest? If not, what would be a more appropriate minimum level of trading volume and/or open interest upon which to evaluate whether federal position limits are necessary to prevent excessive speculation?

(52) Are there particular attributes of any of the 25 proposed core referenced futures contracts that the Commission should consider when determining whether federal position limits are or are not necessary for that particular product?

IV. Related Matters

A. Cost-Benefit Considerations

1. Introduction

Section 15(a) of the Commodity Exchange Act (''CEA'' or ''Act'') requires the Commodity Futures Trading Commission (''Commission'') to consider the costs and benefits of its actions before promulgating a regulation under the CEA.[537] Section 15(a) further specifies that the costs and benefits 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 futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations (collectively, the ''section 15(a) factors'').[538]

The Commission interprets section 15(a) to require the Commission to consider only those costs and benefits of its proposed changes that are attributable to the Commission's discretionary determinations (*i.e.,* changes that are not otherwise required by statute) compared to the existing status quo requirements. For this purpose, the status quo requirements include the CEA's statutory requirements as well as any applicable Commission regulations that are consistent with the CEA.[539] As a result, any proposed changes to the Commission's regulations that are required by the CEA or other applicable statutes would not be deemed to be a discretionary change for purposes of discussing related costs and benefits.

The Commission anticipates that the proposed position limits regulations will affect market participants differently depending on their business model and scale of participation in the commodity contracts that are covered by the proposal.[540] The Commission also anticipates that the proposal may result in ''programmatic'' costs to some market participants. Generally, affected market participants may incur increased costs associated with developing or revising, implementing, and maintaining compliance functions and procedures. Such costs might include those related to the monitoring of positions in the relevant referenced contracts; related filing, reporting, and recordkeeping requirements, and the costs of changes to information technology systems.

The Commission has preliminarily determined that it is not feasible to quantify the costs or benefits with reasonable precision and instead has identified and considered the costs and benefits qualitatively.[541] The Commission believes that for many of the costs and benefits that quantification is not feasible with reasonable precision because doing so would require understanding all market participants' business models, operating models, cost structures, and hedging strategies, including an evaluation of the potential alternative hedging or business strategies that could be adopted under the proposal. Further, while Congress has tasked the Commission with establishing such position limits as the Commission finds are ''necessary,'' some of the benefits, such as mitigating or eliminating manipulation or excessive speculation, may be very difficult or infeasible to quantify. These benefits, moreover, would likely manifest over time and be distributed over the entire market.

In light of these limitations, to inform its consideration of costs and benefits of the proposed regulations, the Commission in its discretion relies on: (1) Its experience and expertise in regulating the derivatives markets; (2) information gathered through public comment letters[542] and meetings with a broad range of market participants; and (3) certain Commission data, such as the Commission's Large Trader Reporting System and data reported to swap data repositories.

In addition to the specific questions included throughout the discussion below, the Commission generally requests comment on all aspects of its consideration of costs and benefits, including: Identification and assessment of any costs and benefits not discussed herein; data and any other information to assist or otherwise inform the Commission's ability to quantify or qualify the costs and benefits of the proposed rules; and substantiating data, statistics, and any other information to support positions posited by commenters with respect to the Commission's consideration of costs and benefits.

The Commission preliminarily considers the benefits and costs discussed below in the context of international markets, because market participants and exchanges subject to the Commission's jurisdiction for purposes of position limits may be organized outside of the United States; some industry leaders typically conduct operations both within and outside the United States; and market participants may follow substantially similar business practices wherever located.

[537] 7 U.S.C. 19(a).

[538] *Id.*

[539] This cost-benefit consideration section is divided into seven parts, including this introductory section, each discussing their respective baseline benchmarks with respect to any applicable CEA or regulatory provisions.

[540] For example, the proposal could result in increased costs to market participants who may need to adjust their trading and hedging strategies to ensure that their aggregate positions do not exceed federal position limits, particularly those who will be subject to federal position limits for the first time (*i.e.,* those who may trade contracts for which there are currently no federal limits). On the other hand, existing costs could decrease for those existing traders whose positions would fall below the new proposed limits and therefore would not be forced to adjust their trading strategies and/or apply for exemptions from the limits, particularly if the Commission's proposal improves market liquidity or other metrics of market health. Similarly, for those market participants who would become subject to the federal position limits, general costs would be lower to the extent such market participants can leverage their existing compliance infrastructure in connection with existing exchange position limit regimes relative to those market participants that do not currently have such systems.

[541] With respect to the Commission's analysis under its discussion of its obligations under the Paperwork Reduction Act (''PRA''), the Commission has endeavored to quantify certain costs and other burdens imposed on market participants related to collections of information as defined by the PRA. *See generally* Section IV.B. (discussing the Commission's PRA determinations).

[542] While the general themes contained in comments submitted in response to prior proposals informed this rulemaking, the Commission is withdrawing the 2013 Proposal, the 2016 Supplemental Proposal, and the 2016 Reproposal. *See supra* Section I.A.

Where the Commission does not specifically refer to matters of location, the discussion of benefits and costs below refers to the effects of this proposal on all activity subject to the proposed regulations, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with or effect on U.S. commerce under CEA section 2(i).[543]

The Commission will identify and discuss the costs and benefits organized conceptually by topic, and certain topics may generally correspond with a specific proposed regulatory section. The Commission's discussion is organized as follows: (1) The scope of the commodity derivative contracts that would be subject to the proposed position limits framework, including with respect to the 25 proposed core referenced futures contracts and the proposed definitions of ''referenced contract'' and ''economically equivalent swaps;'' (2) the proposed federal position limit levels (proposed § 150.2); (3) the proposed federal bona fide hedging definition (proposed § 150.1) and other Commission exemptions from federal position limits (proposed § 150.3); (4) proposed streamlined process for the Commission and exchanges to recognize bona fide hedges and to grant exemptions for purposes of federal position limits (proposed §§ 150.3 and 150.9) and related reporting changes to part 19 of the Commission's regulations; (5) the proposed exchange-set position limits framework and exchange-granted exemptions thereto (proposed § 150.5); and (6) the section 15(a) factors.

2. ''Necessity Finding'' and Scope of Referenced Futures Contracts Subject to Proposed Federal Position Limit Levels

Federal spot and non-spot month limits currently apply to futures and options on futures on the nine legacy agricultural commodities.[544] The Commission's proposal would expand the scope of commodity derivative contracts currently subject to the Commission's existing federal position limits framework[545] so that federal spot-month limits would apply to futures and options on futures on 16 additional physical commodities, for a total of 25 physical commodities.[546]

The Commission has preliminarily interpreted CEA section 4a to require that the Commission must make an antecedent ''necessity'' finding that establishing federal position limits is ''necessary'' to diminish, eliminate, or prevent certain burdens on interstate commerce with respect to the physical commodities in question.[547] As the statute does not define the term ''necessary,'' the Commission must apply its expertise in construing such term, and, as discussed further below, must do so consistent with the policy goals articulated by Congress, including in CEA sections 4a(a)(2)(C) and 4a(a)(3), as noted throughout this discussion of the Commission's cost-benefit considerations.[548] As discussed in greater detail in the preamble, the Commission proposes to establish position limits on futures and options on futures for these 25 commodities on the basis that position limits on such contracts are ''necessary.'' In determining to include the proposed 25 core referenced futures contracts within the proposed federal position limit framework, the Commission considered the effects that these contracts have on the underlying commodity, especially with respect to price discovery; the fact that they require physical delivery of the underlying commodity and therefore may be more affected by manipulation such as corners and squeezes compared to cash-settled contracts; and, in some cases, the especially acute economic burdens on interstate commerce that could arise from excessive speculation in these contracts causing sudden or unreasonable fluctuations or unwarranted changes in the price of the commodities underlying these contracts.[549]

More specifically, the 25 core referenced futures contracts were selected because they: (i) Physically settle, (ii) have high levels of open interest[550] and significant notional value of open interest,[551] (iii) serve as a reference price for a significant number of swaps and/or cash market transactions, and/or (iv) have, in most cases, relatively higher average trading volumes.[552] These factors reflect the important and varying degrees of linkage between the derivatives markets and the underlying cash markets. The Commission preliminarily acknowledges that there is no mathematical formula that would be dispositive, though the Commission has considered relevant data where it is available.

As a result, the Commission preliminarily has concluded that it must exercise its judgment in light of facts and circumstances, including its experience and expertise, to determine whether federal position limit levels are economically justified. For example, based on its general experience, the Commission preliminarily recognizes that contracts that physically settle can, in certain circumstances during the spot month, be at risk of corners and squeezes, which could distort pricing and resource allocation, make it more costly to implement hedge strategies, and harm the underlying cash market. Similarly, certain contracts with higher

[543] 7 U.S.C. 2(i).

[544] The nine legacy agricultural contracts currently subject to federal spot and non-spot month limits are: CBOT Corn (C), CBOT Oats (O), CBOT Soybeans (S), CBOT Wheat (W), CBOT Soybean Oil (SO), CBOT Soybean Meal (SM), MGEX Hard Red Spring Wheat (MWE), ICE Cotton No. 2 (CT), and CBOT KC Hard Red Winter Wheat (KW).

[545] 17 CFR 150.2. Because the Commission has not yet implemented the Dodd-Frank Act's amendments to the CEA regarding position limits, except with respect to aggregation (*see generally* Final Aggregation Rulemaking, 81 FR at 91454) and the vacated 2011 Position Limits Rulemaking's amendments to 17 CFR 150.2 (*see International Swaps and Derivatives Association* v. *United States Commodity Futures Trading Commission,* 887 F. Supp. 2d 259 (D.D.C. 2012)), the baseline or status quo consists of the provisions of the CEA relating to position limits immediately prior to effectiveness of the Dodd-Frank Act amendments to the CEA and the relevant provisions of existing parts 1, 15, 17, 19, 37, 38, 140, and 150 of the Commission's regulations, subject to the aforementioned exceptions.

[546] The 16 proposed new products that would be subject to federal spot month limits would include seven agricultural (CME Live Cattle (LC), CBOT Rough Rice (RR), ICE Cocoa (CC), ICE Coffee C (KC), ICE FCOJ–A (OJ), ICE U.S. Sugar No. 11 (SB), and ICE U.S. Sugar No. 16 (SF)), four energy (NYMEX Light Sweet Crude Oil (CL), NYMEX New York Harbor ULSD Heating Oil (HO), NYMEX New York Harbor RBOB Gasoline (RB), NYMEX Henry Hub Natural Gas (NG)), and five metals (COMEX Gold (GC), COMEX Silver (SI), COMEX Copper (HG), NYMEX Palladium (PA), and NYMEX Platinum (PL)) contracts.

[547] *See supra* Section III.F. (discussion of the necessity finding).

[548] In promulgating the position limits framework, Congress instructed the Commission to consider several factors: First, CEA section 4a(a)(3) requires the Commission when establishing position limits, to the maximum extent practicable, in its discretion, to (i) diminish, eliminate, or prevent excessive speculation; (ii) deter and prevent market manipulation, squeezes, and corners; (iii) ensure sufficient market liquidity for bona fide hedgers; and (iv) ensure that the price discovery function of the underlying market is not disrupted. Second, CEA section 4a(a)(2)(C) requires the Commission to strive to ensure that any limits imposed by the Commission will not cause price discovery in a commodity subject to position limits to shift to trading on a foreign exchange.

[549] *See supra* Section III.F. (discussion of the necessity finding).

[550] Open interest for this purpose includes the sum of open contracts, as defined in § 1.3 of the Commission's regulations, in futures contracts and in futures option contracts converted to a futures-equivalent amount, as defined in current § 150.1(f) of the Commission's regulations. *See* 17 CFR 1.3 and 150.1(f).

[551] Notional value of open interest for this purpose is open interest multiplied by the unit of trading for the relevant futures contract multiplied by the price of that futures contract.

[552] A combination of higher average trading volumes and open interest is an indicator of a contract's market liquidity. Higher trading volumes make it more likely that the cost of transactions is lower with narrower bid-ask spreads.

open interest and/or trading volume are more likely to serve as benchmarks and/or references for pricing cash market and other transactions, meaning a distortion of the price of any such contract could potentially impact underlying cash markets that are important to interstate commerce.[553]

As discussed in more detail in connection with proposed § 150.2 below, the Commission preliminarily believes that establishing federal position limits at the proposed levels for the proposed 25 core referenced futures contracts and related referenced contracts would result in several benefits, including a reduction in the probability of excessive speculation and market manipulation (*e.g.,* squeezes and corners) and the attendant harms to price discovery that may result. The Commission acknowledges, in connection with establishing federal position limit levels under proposed § 150.2 (discussed below), that position limits, especially if set too low, could adversely affect market liquidity and increase transaction costs, especially for bona fide hedgers, which ultimately might be passed on to the general public. However, the Commission is also cognizant that setting position limit levels too high may result in an increase in the possibility of excessive speculation and the harms that may result, such as sudden or unreasonable fluctuations or unwarranted changes in the price of the commodities underlying these contracts.

For purposes of this discussion, rather than discussing the general potential benefits and costs of the federal position limit framework, the Commission will instead focus on the benefits and costs resulting from the Commission's proposed necessity finding with respect to the 25 core referenced futures contracts.[554] The Commission will address potential benefits and costs of its approach with respect to: (1) The liquidity and integrity of the futures and related options markets and (2) market participants and exchanges.

a. Potential Impact of the Scope of the Commission's Necessity Finding on Market Liquidity and Integrity

The Commission has preliminarily determined that the 25 contracts that the Commission proposes to include in its necessity finding are among the most liquid physical commodity contracts, as measured by open interest and/or trading volume, and therefore, imposing positions limits on these contracts may impose costs on market participants by constraining liquidity. However, the Commission believes that the potential harmful effect on liquidity will be muted, as a result of the generally high levels of open interest and trading volumes of the respective 25 core referenced futures contracts.[555]

The Commission has preliminarily determined that, as a general matter, focusing on the 25 proposed core referenced futures contracts may benefit market integrity since these contracts generally are amongst the largest physically-settled contracts with respect to relative levels of open interest and/or trading volumes. As a result, the Commission preliminarily believes that excessive speculation or potential market manipulation in such contracts would be more likely to affect more market participants and therefore potentially more likely to cause an undue and unnecessary burden (*e.g.,* potential harm to market integrity or liquidity) on interstate commerce. Because each proposed core referenced futures contract is physically-settled, as opposed to cash-settled, the proposal focuses on preventing corners and squeezes in those contracts where such market manipulation could cause significant harm in the price discovery process for their respective underlying commodities.[556]

While the Commission recognizes that market participants may engage in market manipulation through cash-settled futures and options on futures, the Commission preliminarily has determined that focusing on the physically-settled core referenced futures contracts will benefit market integrity by reducing the risk of corners and squeezes in particular. In addition, not imposing position limits on additional commodities may foster non-excessive speculation, leading to better prices and more efficient resource allocation in these commodities. This may ultimately benefit commercial end users and possibly be passed on to the general public in the form of better pricing. As noted above, the scope of the Commission's necessity finding with respect to the 25 proposed core referenced futures contracts will allow the Commission to focus on those contracts that, in general, the Commission preliminarily recognizes as having particular importance in the price discovery process for their respective underlying commodities as well as potentially acute economic burdens that would arise from excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in the commodity prices underlying these contracts.

To the extent the Commission does not include additional commodities in its necessity finding, the Commission's approach may also introduce additional costs in the form of loss of certain benefits associated with the proposed federal position limits framework, such as stronger prevention of market manipulation, such as corners and squeezes. Accordingly, the greater the potential benefits of the proposed federal position limits framework in general, the greater the potential cost in the reduction in market integrity in general from not including other possible commodities within the federal position limits framework (only to the extent any such additional commodities would be found to be ''necessary'' for purposes of CEA section 4a). Nonetheless, some of the potential harms to market integrity associated with not including additional commodities within the federal position limits framework could be mitigated to an extent by exchanges, which can use tools other than position limits, such as margin requirements or position accountability at lower levels than potential federal limits, to defend against certain market behavior. Similarly, for those contracts that would not be subject to the proposal, exchange-set position limits alternatively may achieve the same benefits discussed in connection with the proposed federal position limits.

b. Potential Impact of the Scope of the Commission's Necessity Finding on Market Participants and Exchanges

The Commission acknowledges that the federal position limits proposed herein could impose certain administrative, logistical, technological, and financial burdens on exchanges and market participants, especially with respect to developing or expanding compliance systems and the adoption of monitoring policies. However, the

[553] *See supra* Section III.F. (discussion of the necessity finding).

[554] *See supra* Section III.F. (discussion of the necessity finding).

[555] The contracts that would be subject to the Commission's proposal generally have higher trading volumes and open interest, which tend to have greater liquidity, including relatively narrower bid-ask spreads and relatively smaller price impacts from larger transaction sizes. Further, all other factors being equal, markets for contracts that are more illiquid tend to be more concentrated, so that a position limit on such contracts might reduce open interest on one side of the market, because a large trader would face the potential of being capped out by a position limit. For this reason, among others, the contracts to which the federal position limits in existing § 150.2 apply include some of the most liquid physical-delivery futures contracts.

[556] The Commission must also make this determination in light of its limited available resources and responsibility to allocate taxpayer resources in an efficient manner to meet the goals of section 4a(a)(1), and the CEA generally.

Commission preliminarily believes that its approach to delaying the effective date by 365 days from publication of any final rule in the **Federal Register** should mitigate compliance costs by permitting the update and build out of technological and compliance systems more gradually. It may also reduce the burdens on market participants not previously subject to position limits, who will have a longer period of time to determine whether they may qualify for certain bona fide hedging recognitions or other exemptions, and to possibly alter their trading or hedging strategies.[557] Further, the delayed effective date will reduce the burdens on exchanges, market participants, and the Commission by providing each with more time to resolve technological and other challenges for compliance with the new regulations. In turn, the Commission preliminarily anticipates that the extra time provided by the delayed effective date will result in more robust systems for market oversight, which should better facilitate the implementation of the Commission's position limits framework and avoid unnecessary market disruptions while exchanges and market participants prepare for its implementation. However, the longer the proposed delay in the proposal's effective date, the longer it will take to realize the benefits identified above.

3. Federal Position Limit Levels (Proposed § 150.2)

a. General Approach

Existing § 150.2 establishes position limit levels that apply net long or net short to futures and futures-equivalent options contracts on nine legacy physically-settled agricultural contracts.[558] The Commission has previously set separate federal position limits for: (i) The spot month, and (ii) the single month and all-months combined limit levels (*i.e.,* ''non-spot months'').[559] For the existing spot month federal limit levels, the contract levels are based on 25 percent, or lower, of the estimated deliverable supply (''EDS'').[560] For the existing single month and all-months combined limit levels, the levels are set at 10 percent of open interest for the first 25,000 contracts of open interest, with a marginal increase of 2.5 percent of open interest thereafter (the ''10, 2.5 percent formula'').

Proposed § 150.2 would revise and expand the current federal position limits framework as follows: First, for spot month levels, proposed § 150.2 would (i) cover 16 additional physically-settled futures and related options contracts, based on the Commission's existing approach of establishing limit levels at 25 percent or lower of EDS, for a total of 25 core referenced futures contracts subject to federal spot month limits (*i.e.,* the nine legacy agricultural contracts plus the proposed 16 additional contracts);[561] and (ii) update the existing spot month levels for the nine legacy agricultural contracts based on revised EDS.[562]

Second, for non-spot month levels, proposed § 150.2 would revise the 10, 2.5 percent formula so that (i) the incremental 2.5 percent increase takes effect after 50,000 contracts of open interest, rather than after 25,000 contracts under the existing rule (the ''marginal threshold level''), and (ii) the limit levels will be calculated by applying the updated 10, 2.5 percent formula to open interest data for the periods from July 2017–June 2018 and July 2018–June 2019 of the applicable futures and delta adjusted futures options.[563]

Third, the proposed position limits framework would expand to cover (i) any cash-settled futures and related options contracts directly or indirectly linked to any of the 25 proposed physically-settled core referenced futures contracts as well as (ii) any economically equivalent swaps.

For spot month positions, the proposed position limits would apply separately, net long or short, to cash-settled contracts and to physically-settled contracts in the same commodity. This would result in a separate net long/short position for each category so that cash-settled contracts in a particular commodity would be netted with other cash-settled contracts in that commodity, and physically-settled contracts in a given commodity would be netted with other physically-settled contracts in that commodity; a cash-settled contract and a physically-settled contract would not net with one another. Outside the spot month, cash and physically-settled contracts in the same commodity would be netted together to determine a single net long/short position.

Fourth, proposed § 150.2 would subject certain pre-existing positions to federal position limits during the spot month but would grandfather certain pre-existing positions outside the spot month.

In setting the federal position limit levels, the Commission seeks to advance the enumerated statutory objectives with respect to position limits in CEA section 4a(a)(3)(B).[564] The Commission recognizes that relatively high limit levels may be more likely to support some of the statutory goals and less likely to advance others. For instance, a relatively higher limit level may be more likely to benefit market liquidity for hedgers or ensure that the price discovery of the underlying market is not disrupted, but may be less likely to benefit market integrity by being less effective at diminishing, eliminating, or preventing excessive speculation or at deterring and preventing market manipulation, corners, and squeezes. In particular, setting relatively high federal position limit levels may result in excessively large speculative positions and/or increased volatility, especially during speculative showdowns, which may cause some market participants to retreat from the commodities markets due to perceived decreases in market integrity. In turn, fewer market participants may result in lower liquidity levels for hedgers and harm to

[557] Commenters on prior proposals have requested a sufficient phase-in period. *See, e.g.,* 2016 Reproposal, 81 FR at 96815 (implementation timeline).

[558] The nine legacy agricultural contracts currently subject to federal spot and non-spot month limits are: CBOT Corn (C), CBOT Oats (O), CBOT Soybeans (S), CBOT Wheat (W), CBOT Soybean Oil (SO), CBOT Soybean Meal (SM), MGEX Hard Red Spring Wheat (MWE), ICE Cotton No. 2 (CT), and CBOT KC Hard Red Winter Wheat (KW).

[559] For clarity, limits for single and all-months combined apply separately. However, the Commission previously has applied the same limit levels to the single month and all-months combined. Accordingly, the Commission will discuss the single and all-months limits, *i.e.,* the non-spot month limits, together.

[560] *See supra* Section II.B.1—Existing § 150.2 (discussing that establishing spot month levels at 25 percent or less of EDS is consistent with past Commission practices).

[561] The 16 proposed new products that would be subject to federal spot month limits would include seven agricultural (CME Live Cattle (LC), CBOT Rough Rice (RR), ICE Cocoa (CC), ICE Coffee C (KC), ICE FCOJ–A (OJ), ICE U.S. Sugar No. 11 (SB), and ICE U.S. Sugar No. 16 (SF)), four energy (NYMEX Light Sweet Crude Oil (CL), NYMEX NY Harbor ULSD Heating Oil (HO), NYMEX NY Harbor RBOB Gasoline (RB), and NYMEX Henry Hub Natural Gas (NG)), and five metals (COMEX Gold (GC), COMEX Silver (SI), COMEX Copper (HG), NYMEX Palladium (PA), and NYMEX Platinum (PL)) contracts.

[562] The proposal would maintain the current spot month limits on CBOT Oats (O).

[563] As discussed below, for most of the legacy agricultural commodities, this would result in a higher non-spot month limit. However, the Commission is not proposing to change the non-spot month limits for either CBOT Oats (O) or MGEX Hard Red Spring Wheat (MWE) based on the revised open interest since this would result in a reduction of non-spot month limits from 2,000 to 700 contracts for CBOT Oats (O) and 12,000 to 5,700 contracts for MGEX HRS Wheat (MWE). Similarly, the Commission also proposed to maintain the current non-spot month limit for CBOT KC Hard Red Winter Wheat (KW).

[564] *See supra* Section II.B.2.c. (for further discussion regarding the CEA's statutory objectives for the federal position limits framework).

the price discovery function in the underlying markets.

Conversely, setting a relatively lower federal limit level may be more likely to diminish, eliminate, or prevent excessive speculation, but may also limit the availability of certain hedging strategies, adversely affect levels of liquidity, and increase transaction costs.[565] Additionally, setting federal position limits too low may cause non-excessive speculation to exit a market, which could reduce liquidity, cause ''choppy'' [566] prices and reduced market efficiency, and increase option premia to compensate for the more volatile prices. The Commission in its discretion has nevertheless endeavored to set federal limit levels, to the maximum extent practicable, to benefit the statutory goals identified by Congress.

As discussed above, the contracts that would be subject to the proposed federal limits are currently subject to either federal- or exchange-set limits (or both). To the extent that the proposed federal position limit levels are higher than the existing federal position limit levels for either the spot or non-spot month, market participants currently trading these contracts could engage in additional trading under the proposed federal limits in proposed § 150.2 that otherwise would be prohibited under existing § 150.2.[567] On the other hand, to the extent an exchange-set limit level would be lower than its proposed corresponding federal limit, the proposed federal limit would not affect market participants since market participants would be required to comply with the lower exchange-set limit level (to the extent that the exchanges maintain their current levels).[568]

b. Spot Month Levels

The Commission proposes to maintain 25 percent of EDS as a ceiling for federal limits. Based on the Commission's experience overseeing federal position limits for decades and overseeing exchange-set position limits submitted to the Commission pursuant to part 40 of the Commission's regulations, none of the proposed levels listed in Appendix E of part 150 of the Commission's regulations appears to be so low as to reduce liquidity for bona fide hedgers or disrupt price discovery function of the underlying market, or so high as to invite excessive speculation, manipulation, corners, or squeezes because, among other things, any potential economic gains resulting from the manipulation may be insufficient to justify the potential costs, including the costs of acquiring, and ultimately offloading, the positions used to effect the manipulation.

c. Levels Outside of the Spot Month

i. The 10, 2.5 Percent Formula

The Commission preliminarily has determined that the existing 10, 2.5 percent formula generally has functioned well for the existing nine legacy agricultural contracts and has successfully benefited the markets by taking into account the competing goals of facilitating both liquidity formation and price discovery while also protecting the markets from harmful market manipulation and excessive speculation. However, since the existing limit levels are based on open interest levels from 2009 (except for CBOT Oats (O), CBOT Soybeans (S), and ICE Cotton No. 2 (CT), for which existing levels are based on the respective open interest from 1999), the Commission is proposing to revise the levels based on the periods from July 2017–June 2018 and July 2018–June 2019 to reflect the general increases in open interest and trading volume that have occurred over time in the nine legacy agricultural contracts (other than CBOT Oats (O), MGEX HRS Wheat (MWE), and CBOT KC HRW Wheat (KW)).[569] Since the proposed increase for most of the federal non-spot position limits is predicated on the increase in open interest and trading volume, as reflected in the revised data reviewed by the Commission, the Commission preliminarily believes that its proposal may enhance, or at least should maintain, general liquidity, which the Commission preliminarily believes may benefit those with bona fide hedging positions, and commercial end users in general. On the other hand, the Commission understands that many market participants, especially commercial end users, generally believe that the existing non-spot month levels for the nine legacy agricultural commodities function well, including promoting liquidity and facilitating bona fide hedging in the respective markets. As a result, the Commission's proposal may increase the risk of excessive speculation without achieving any concomitant benefits of increased liquidity for bona fide hedgers compared to the status quo.

The Commission also preliminarily recognizes that there could be potential costs to keeping the existing 10, 2.5 percent formula (even if revised to reflect current open interest levels) compared to alternative formulae that would result in even higher federal position limit levels. First, while the 10, 2.5 percent formula may have reflected ''normal'' observed market activity through 1999 when the Commission adopted it, it no longer reflects current open interest figures. When adopting the 10, 2.5 percent formula in 1999, the Commission's experience in these markets reflected aggregate futures and options open interest well below 500,000 contracts, which no longer reflects market reality.[570] As the nine legacy agricultural contracts (with the exception of CBOT Oats (O)) all have open interest well above 25,000

[565] For example, relatively lower federal limits may adversely affect potential hedgers by reducing liquidity. In the case of reduced liquidity, a potential hedger may face unfavorable spreads and prices, in which case the hedger must choose either to delay implementing its hedging strategy and hope for more favorable spreads in the near future or to choose immediate execution (to the extent possible) at a less favorable price.

[566] ''Choppy'' prices often refers to illiquidity in a market where transacted prices bounce between the bid and the ask prices. Market efficiency may be harmed in the sense that transacted prices might need to be adjusted for the bid-ask bounce to determine the fundamental value of the underlying contract.

[567] For the spot month, all the legacy agricultural contracts other than CBOT Oats (O) would have higher federal levels. For the non-spot months, all the legacy agricultural contracts other than CBOT Oats (O), MGEX HRS Wheat (MWE), and CBOT KC HRW Wheat (KW), would have higher federal levels.

[568] While the Commission proposes to generally either increase or maintain the federal position limits for both the spot-months and non-spot months compared to existing federal limits, where applicable, and exchange limits, the proposed federal level for COMEX Copper (HG) would be below the existing exchange-set level. Accordingly, market participants may have to change their trading behavior with respect to COMEX Copper (HG), which could impose compliance and transaction costs on these traders, to the extent their existing trading would violate the proposed lower federal limit levels.

[569] For most of the legacy agricultural commodities, this would result in a higher non-spot month limit. However, the Commission is not proposing to change the non-spot month limits for either CBOT Oats (O) or MGEX HRS Wheat (MWE) based on the revised open interest since this would result in a reduction of non-spot month limits from 2,000 to 700 contracts for CBOT Oats (O) and 12,000 to 5,700 contracts for MGEX HRS Wheat (MWE). Similarly, the Commission also proposed to maintain the current non-spot month limit for CBOT KC HRW Wheat (KW). *See supra* Section II.B.2.e. —Methodology for Setting Proposed Non-Spot Month Limit Levels for further discussion.

[570] *See* 64 FR at 24038, 24039 (May 5, 1999). As discussed in the preamble, the data show that by the 2015–2018 period, five of the nine legacy agricultural contracts had maximum open interest greater than 500,000 contracts. The contracts for CBOT Corn (C), CBOT Soybeans (S), and CBOT KC HRW Wheat (KW) saw increased maximum open interest by a factor of four to five times the maximum open interest during the years leading up to the Commission's adoption of the 10, 2.5 percent formula in 1999. Similarly, the contracts for CBOT Soybean Meal (SM), CBOT Soybean Oil (SO), CBOT Wheat (W), and MGEX HRS Wheat (MWE) saw increased maximum open interest by a factor of three to four times. *See supra* Section II.B.2.e. —Methodology for Setting Proposed Non-Spot Month Limit Levels for further discussion.

contracts, and in some cases above 500,000 contracts, the existing formula may act as a negative constraint on liquidity formation relative to the higher proposed formula. Further, if open interest continues to increase over time, the Commission anticipates that the existing 10, 2.5 percent formula could impose even greater marginal costs on bona fide hedgers by potentially constraining liquidity formation (*i.e.,* as the open interest of a commodity contract increase, a greater relative proportion of the commodity's open interest is subject to the 2.5 percent limit level rather than the initial 10 percent limit). In turn, this may increase costs to commercial firms, which may be passed to the public in the form of higher prices.

Further, to the extent there may be certain liquidity constrains, the Commission has determined that this potential concern could be mitigated, at least in part, by the Commission's proposed change to increase the marginal threshold level from 25,000 contracts to 50,000 contracts, which the Commission preliminarily believes should provide a conservative increase in the non-spot month limits for most contracts to better reflect the general increase observed in open interest across futures markets. The Commission acknowledges that the marginal threshold level could be increased above 50,000 contracts, but notes that each increase of 25,000 contracts in the marginal threshold level would only increase the permitted non-spot month level by 1,875 contracts (*i.e.,* (10% of 25,000 contracts)—(2.5% of 25,000 contracts) = 1,875 contracts). The Commission has observed based on current data that this proposed change could benefit several market participants per legacy agricultural commodity who otherwise would bump up against the all-months and/or single month limits with based on the status quo threshold of 25,000 contracts. As a result, the Commission preliminarily has determined that changing the marginal threshold level could result in marginal benefits and costs for many of the legacy agricultural commodities, but the Commission acknowledges the proposed change is relatively minor compared to revising the existing 10, 2.5 percent formula based on updated open interest data.

Second, the Commission preliminarily recognizes that an alternative formula that allows for higher non-spot limits, compared to the existing 10, 2.5 percent formula, could benefit liquidity and market efficiency by creating a framework that is more conducive to the larger liquidity providers that have entered the market over time.[571] Compared to when the Commission first adopted the 10, 2.5 percent formula, today there exist relatively more large non-commercial traders, such as banks, managed money traders, and swap dealers, which generally hold long positions and act as aggregators or market makers that provide liquidity to short positions (*e.g.,* commercial hedgers).[572] These dealers also function in the swaps market and use the futures market to hedge their exposures. Accordingly, to the extent that larger non-commercial market makers and liquidity providers have entered the market—particularly to the extent they are able to take offsetting positions to commercial short interests—a hypothetical alternative formula that would permit higher non-spot month limits might provide greater market liquidity, and possibly increased market efficiency, by allowing for greater market-making activities.[573]

However, the Commission believes that any purported benefits related to a hypothetical alternative formula that would allow for higher non-spot limits would be minimal at best. Specifically, bona fide hedgers and end users generally have not requested a revised formula to allow for significantly higher non-spot limits. Similarly, liquidity providers would still be able to maintain, and possibly increase, market making activities under the Commission's proposal since the non-spot month limits will generally still increase under the existing 10, 2.5 percent formula to reflect the increase in open interest. Further, to the extent that the Commission's proposal to eliminate the risk management exemption could theoretically force liquidity providers to reduce their trading activities, the Commission preliminarily believes that certain liquidity-providing activity of the existing risk management exemption holders may still be permitted under the Commission's proposal, either as a result of the proposed swap pass-through provision or because of the general increase in limits based on the revised open interest levels.[574] The Commission also preliminarily recognizes an additional benefit to market integrity of the current proposal compared to a hypothetical alternative formula: While the Commission believes that the proposed pass-through swap provision is narrowly-tailored to enable liquidity providers to continue providing liquidity to bona fide hedgers, in contrast, an alternative formula that would allow higher limit levels for all market participants would also permit increased excessive speculation and increase the probability of market manipulation or harm the underlying price discovery function.

Additionally, some have voiced general concern that permitting increased federal non-spot month limits in the nine legacy agricultural contracts (at any level), especially in connection with commodity indices, could disrupt price discovery and result in a lack of convergence between futures and cash prices, resulting in increased costs to end users, which ultimately could be borne by the public. The Commission has not seen data demonstrating this causal connection, but acknowledges arguments to that effect.[575]

Third, if the Commission's proposed non-spot position limits would be too

[571] *See supra* Section II.B.2.e.—Methodology for Setting Proposed Non-Spot Month Limit Levels for further discussion.

[572] *Id.*

[573] For example, the Commission is aware of several market makers that either have left particular commodity markets, or reduced their market making activities. *See, e.g.,* McFarlane, Sarah, *Major Oil Traders Don't See Banks Returning to the Commodity Markets They Left,* The Wall Street Journal (Mar. 28, 2017), *available at https://www.wsj.com/articles/major-oil-traders-dont-see-banks-returning-to-the-commodity-markets-they-left-1490715761?mg=prod/com*-wsj (describing how ''Morgan Stanley sold its oil trading and storage business . . . and J.P. Morgan unloaded its physical commodities business . . . .''); Decambre, Mark, *Goldman Said to Plan Cuts to Commodity Trading Desk: WSJ,* MarketWatch website (Feb. 5, 2019), *https://www.marketwatch.com/story/goldman-said-to-plan-cuts-to-commodity-trading-desk-wsj-2019-02-05* (describing how Goldman Sachs ''plans on making cuts within its commodity trading platform. . . .'').

[574] *See supra* Section II.A.1.c.v. (preamble discussion of pass-through swap provision); *see infra* Section IV.A.4.b.i.(2).

[575] As discussed in preamble Section II.B.2.e.—Methodology for Setting Proposed Non-Spot Month Limit Levels, one of the concerns that prompted the 2008 moratorium on granting risk management exemptions was a lack of convergence between futures and cash prices in wheat. Some at the time hypothesized that perhaps commodity index trading was a contributing factor to the lack of convergence, and, some have argued that this could harm price discovery since traders holding these positions may not react to market fundamentals, thereby exacerbating any problems with convergence. However, the Commission has determined for various reasons that risk management exemptions did not lead to the lack of convergence since the Commission understands that many commodity index traders vacate contracts before the spot month and therefore would not influence converge between the spot and futures price at expiration of the contract. Further, the risk-management exemptions granted prior to 2008 remain in effect, yet the Commission is unaware of any significant convergence problems relating to commodity index traders at this time. Additionally, there did not appear to be any convergence problems between the period when Commission staff initially granted risk management exemptions and 2007. Instead, the Commission believes that the convergence issues that started to occur around 2007 were due to the contract specification underpricing the option to store wheat for the long futures holder making the expiring futures price more valuable than spot wheat.

high for a commodity, the proposal might be less effective in deterring excessive speculation and market manipulation for that commodity's market. Conversely, if the Commission's proposed position limit levels would be too low for a commodity, the proposal could unduly constrain liquidity for bona fide hedgers or result in a diminished price discovery function for that commodity's underlying market. In either case, the Commission would view these as costs imposed on market participants. However, to the extent the Commission's proposed non-spot limit levels could be too high, the Commission preliminarily believes these costs could be mitigated because exchanges would be able to establish lower non-spot month levels.[576] Moreover, these concerns may be mitigated further to the extent that exchanges use other tools for protecting markets aside from position limits, such as establishing accountability levels below federal position limit levels or imposing liquidity and concentration surcharges to initial margin if vertically integrated with a derivatives clearing organization. Further, as discussed below, the Commission is proposing to maintain current non-spot limit levels for CBOT Oats (O), MGEX HRS Wheat (MWE), and CBOT KC HRW Wheat (KW), which otherwise would be lower based on current open interest levels for these contracts.

ii. Exceptions to the Proposed 10, 2.5 Percent Formula for CBOT Oats (O), MGEX Hard Red Spring Wheat (MWE), and CBOT Kansas City Hard Red Winter Wheat (KW)

Based on the Commission's experience since 2011 with non-spot month speculative position limit levels for MGEX HRS Wheat (''MWE'') and CBOT KC HRW Wheat (''KW'') core referenced futures contracts, the Commission is proposing to maintain the proposed limit levels for MWE and KW at the existing level of 12,000 contracts rather than reducing them to the lower level that would result from applying the proposed updated 10, 2.5 percent formula. Maintaining the status quo for the MWE and KW non-spot month limit levels would result in partial wheat parity between those two wheat contracts, but not with CBOT Wheat (''W''), which would increase to 19,300 contracts. The Commission preliminarily believes that this will benefit the MWE and KW markets since the two species of wheat are similar to one another; accordingly, decreasing the non-spot month levels for MWE could impose liquidity costs on the MWE market and harm bona fide hedgers, which could further harm liquidity or bona fide hedgers in the KW market. On the other hand, the Commission has determined not to raise the proposed limit levels for either KW or MWE to the limit level for W since the non-spot month level appears to be extraordinarily large in comparison to open interest in KW and MWE markets, and the limit level for the MWE contract is already larger than the limit level would be based on the 10, 2.5 percent formula. While W is a potential substitute for KW and MWE, it is not similar to the same extent that MWE and KW are to one another, and so the Commission has preliminarily determined that this is a reasonable compromise to maintain liquidity and price discovery while not unnecessarily inviting excessive speculation or potential market manipulation in the MWE and KW markets.

Likewise, based on the Commission's experience since 2011 with the non-spot month speculative position limit for CBOT Oats (O), the Commission is proposing the limit level at the current 2,000 contract level rather than reducing it to the lower level that would result from applying the updated 10, 2.5 formula based on current open interest. The Commission has preliminarily determined that there is no evidence of potential market manipulation or excessive speculation, and so there would be no perceived benefit to reducing the non-spot month limit for the CBOT Oats (O) contract, while reducing the level could impose liquidity costs.

d. Core Referenced Futures Contracts and Linked Referenced Contracts; Netting

The definitions of the terms ''core referenced futures contract'' and ''referenced contract'' set the scope of contracts to which federal position limits apply. As discussed below, by applying the federal position limits to ''referenced contracts,'' the Commission's proposal would expand the federal position limits beyond the proposed 25 physically-settled ''core referenced futures contracts'' listed in proposed Appendix E to part 150 by also including any cash-settled ''referenced contracts'' linked thereto as well as swaps that meet the proposed ''economically equivalent swap'' definition and thus qualify as ''referenced contracts.''[577]

i. Referenced Contracts

The Commission preliminarily has determined that including futures contracts and options thereon that are ''directly'' or ''indirectly linked'' to the core referenced contracts, including cash-settled contracts, under the proposed definition of ''referenced contract'' would help prevent the evasion of federal position limits—especially during the spot month—through the creation of a financially equivalent contract that references the price of a core referenced futures contract. The Commission preliminarily has determined that this will benefit market integrity and potentially reduce costs to market participants that otherwise could result from market manipulation.

The Commission also recognizes that including cash-settled contracts within the proposed federal position limits framework may impose additional compliance costs on market participants and exchanges. Further, the proposed federal position limits—especially outside the spot month—may not provide the benefits discussed above with respect to market integrity and manipulation because there is no physical delivery outside the spot month and therefore there is reduced concern for corners and squeezes. However, to the extent that there is manipulation of such non-spot, cash-settled contracts, the Commission's authority to regulate and oversee futures and related options markets (other than through establishing federal position

[576] On the other hand, relying on exchanges may have potential costs because exchanges may have conflicting interests and therefore may not establish position limit (or accountability) levels lower than the proposed federal limits. For example, exchanges may not be incentivized to lower their limits due to competitive concerns with another exchange, or due to influence from a large customer. Conversely, exchange and Commission interests may be aligned to the extent that exchanges do have a countervailing interest to protect their markets from manipulation and price distortion: If market participants lose confidence in the contract as a tool for hedging, they will look for alternatives, possibly migrating to another product on a different exchange. The Commission is aware of at least one instance in which exchanges adopted spot-month position limits and/or adopted a lower exchange-set limit for particular futures contracts as a result of excessive manipulation and potential market manipulation. Similarly, exchanges remain subject to their core principle obligations to prevent manipulation, and the Commission conducts general market oversight through its own surveillance program. Accordingly, the Commission acknowledges such concerns about conflicting exchange incentives, but preliminarily believes that such concerns are mitigated for the foregoing reasons.

[577] As discussed in the preamble, the proposed position limits framework would also apply to physically-settled swaps that qualify as economically equivalent swaps. However, the Commission preliminarily believes that physically-settled economically equivalent swaps would be few in number.

limits) may also be effective in uncovering or preventing manipulation, especially in the non-spot cash markets, and may result in relatively lower compliance costs incurred by market participants. Similarly, the Commission preliminarily acknowledges that exchange oversight could provide the same benefit to market oversight and prevention of market manipulation, but with lower costs imposed on market participants—given the exchanges' deep familiarity with their own markets and their ability to tailor a response to a particular market disruption—compared to federal position limits.

The proposed ''referenced contract'' definition would also include ''economically equivalent swaps,'' and for the reasons discussed below would include a narrower set of swaps compared to the set of futures and options thereon that would be, under the proposed ''referenced contract'' definition, captured as either ''directly'' or ''indirectly linked'' to a core referenced futures contract.[578]

ii. Netting

The Commission proposes to permit market participants to net positions outside the spot month in linked physically-settled and cash-settled referenced contracts, but during the spot month market participants would not be able to net their positions in cash-settled referenced contracts against their positions in physically-settled referenced contracts. The Commission preliminarily believes that its proposal would benefit liquidity formation and bona fide hedgers outside the spot months since the proposed netting rules would facilitate the management of risk on a portfolio basis for liquidity providers and market makers. In turn, improved liquidity may benefit bona fide hedgers and other end users by facilitating their hedging strategies and reducing related transaction costs (*e.g.,* improving execution timing and reducing bid-ask spreads). On the other hand, the Commission recognizes that allowing such netting could increase transaction costs and harm market integrity by allowing for a greater possibility of market manipulation since market participants and speculators would be able to maintain larger gross positions outside the spot month. However, the Commission preliminarily has determined that such potential costs may be mitigated since concerns about corners and squeezes generally are less acute outside the spot month given there is no physical delivery involved, and because there are tools other than federal position limits for preventing and deterring other types of manipulation, including banging the close, such as exchange-set limits and accountability and surveillance both at the exchange and federal level. Moreover, prohibiting the netting of physical and cash positions during the spot month should benefit bona fide hedgers as well as price discovery of the underlying markets since market makers and speculators would not be able to maintain a relatively large position in the physical markets by netting it against its positions in the cash markets.[579] While this may increase compliance and transaction costs for speculators, it might benefit some bona fide hedgers and end users. It might also impose costs on exchanges, including increased surveillance and compliance costs and lost fees related to the trading that such market makers or speculators otherwise might engage in absent federal position limits or with the ability to their net physical and cash positions.

iii. Exclusions From the ''Referenced Contract'' Definition

First, while the proposed ''referenced contract'' definition would include linked contracts, it would explicitly exclude location basis contracts, which are contracts that reflect the difference between two delivery locations or quality grades of the same commodity.[580] The Commission preliminarily believes that excluding location basis contracts from the ''referenced contract'' definition would benefit market integrity by preventing a trader from obtaining an extraordinarily large speculative position in the commodity underlying the referenced contract. Otherwise, absent the proposed exclusion, a market participant could increase its exposure in the commodity underlying the referenced contract by using the location basis contract to net down against its position in a referenced contract, and then further increase its position in the referenced contract that would otherwise by restricted by position limits. Similarly, the Commission preliminarily believes that this would reduce hedging costs for hedgers and commercial end-users, as they would be able to more efficiently hedge the cost of commodities at their preferred location without the risk of possibly hitting a position limits ceiling or incur compliance costs related to applying for a bona fide hedge related to such position.

Excluding location basis contracts from the ''referenced contract'' definition also could impose costs for market participants that wish to trade location basis contracts since, as noted, such contracts would not be subject to federal limits and thus could be more easily subject to manipulation by a market participant that obtained an excessively large position. However, the Commission preliminarily believes such costs are mitigated because location basis contracts generally demonstrate less volatility and are less liquid than the core referenced futures contracts, meaning the Commission believes that it would be an inefficient method of manipulation (*i.e.,* too costly to implement and therefore, the Commission believes that the probability of manipulation is low). Further, excluding location basis contracts from the ''referenced contract'' definition is consistent with existing market practice since the market treats a contract on one grade or delivery location of a commodity as different from another grade or delivery location. Accordingly, to the extent that the proposal is consistent with current market practice, any benefits or costs already may have been realized.

Second, the Commission preliminarily has concluded that excluding commodity indices from the ''referenced contract'' definition would benefit market integrity by preventing speculators from using a commodity index contract to net down an outright position in a referenced contract that is a component of the commodity index contract, which would allow the speculator to take on large outright positions in the referenced contracts and therefore result in increased speculation, undermining the federal

[578] *See infra* Section IV.A.3.d.iv. (discussion of economically equivalent swaps).

[579] Otherwise, a participant could maintain large, offsetting positions in excess of limits in both the physically-settled and cash-settled contract, which might harm market integrity and price discovery and undermine the federal position limits framework. For example, absent such a restriction in the spot month, a trader could stand for over 100 percent of deliverable supply during the spot month by holding a large long position in the physical-delivery contract along with an offsetting short position in a cash-settled contract, which effectively would corner the market.

[580] The term ''location basis contract'' generally means a derivative that is cash-settled based on the difference in price, directly or indirectly, of (1) a core referenced futures contract; and (2) the same commodity underlying a particular core referenced futures contract at a different delivery location than that of the core referenced futures contract. For clarity, a core referenced futures contract may have specifications that include multiple delivery points or different grades (*i.e.,* the delivery price may be determined to be at par, a fixed discount to par, or a premium to par, depending on the grade or quality). The above discussion regarding location basis contracts is referring to delivery locations or quality grades other than those contemplated by the applicable core referenced futures contract.

position limits framework.[581] However, the Commission preliminarily believes that its proposed exclusion could impose costs on market participants that trade commodity indices since, as noted, such contracts would not be subject to federal limits and thus could be more easily subject to manipulation by a market participant that obtained an excessively large position. The Commission preliminarily believes such costs would be mitigated because the commodities comprising the index would themselves be subject to limits, and because commodity index contracts generally tend to exhibit low volatility since they are diversified across many different commodities. Further, the Commission believes that it is possible that excluding commodity indices from the definition of ''referenced contracts'' could result in some trading shifting to commodity indices contracts, which may reduce liquidity in exchange-listed core referenced futures contracts, harm pre-trade transparency and the price discovery process in the futures markets, and further depress open interest (as volumes shift to index positions, which would not count toward open interest calculations). However, the Commission believes that the probability of this occurring is low because the Commission preliminarily believes that using indices is an inefficient means of obtaining exposure to a certain commodity.

Under certain circumstances, a participant that has reached the applicable position limit could use a commodity index to purchase and weight a commodity index contract, which is otherwise excluded from the ''referenced contract'' definition and therefore from federal position limits, in a manner that would allow the participant to exceed limits of the applicable referenced contract (*i.e.,* the participant could be long outright in a referenced contract, purchase a commodity index contract that includes the applicable referenced contract as a component, and short the remaining components of the index. The Commission observes that these short positions would be subject to the proposed federal limits, so there would be a ceiling on this strategy and, in addition, it would be costly to potential manipulators because margin would have to be posted and exchanged to retain the positions. In this circumstance, excluding commodity indices from the ''referenced contract'' definition could impose costs on market integrity. However, the Commission preliminarily believes any related costs should be mitigated because proposed § 150.2 would include anti-evasion language that would deem such commodity index contract to be a referenced contract subject to federal limits. Also, analogous costs could apply to the discussion above regarding location basis contracts and such proposed anti-evasion provision would similarly cover location basis contracts.[582]

iv. Economically Equivalent Swaps

The existing federal position limits framework does not include limit levels on swaps. The Dodd-Frank Act added CEA section 4a(a)(5), which requires that when the Commission imposes position limits on futures and options on futures pursuant to CEA section 4a(a)(2), the Commission also establish limits simultaneously for ''economically equivalent'' swaps ''as appropriate.''[583] As the statute does not define the term ''economically equivalent,'' the Commission will apply its expertise in construing such term consistent with the policy goals articulated by Congress, including in CEA sections 4a(a)(2)(C) and 4a(a)(3) as discussed below.

Specifically, under the Commission's proposed definition of ''economically equivalent swap'' set forth in proposed § 150.1, a swap would generally qualify as economically equivalent with respect to a particular referenced contract so long as the swap shares ''identical material'' contract specifications, terms, and conditions with the referenced contract, disregarding any differences with respect to lot size or notional amount, delivery dates diverging by less than one calendar day (other than for natural gas referenced contracts),[584] or post-trade risk-management arrangements.[585] As discussed further below, the Commission explains that the definition of ''economically equivalent swaps'' is relatively narrow, especially compared to the definition of ''referenced contract'' as applied to cash-settled look-alike contracts.

The Commission preliminarily believes that the proposed definition of ''economically equivalent swaps'' would benefit (1) market integrity by protecting against excessive speculation and potential manipulation and (2) market liquidity by not favoring OTC or foreign markets over domestic markets. However, as discussed below, exchanges would be subject to delayed compliance with respect to the proposed § 150.5 requirements regarding exchange-set speculative position limits on swaps until such time that exchanges have access to sufficient data to monitor for limits on swaps across exchanges; as a result, exchange-set limits would not need to include, nor would exchanges be required to oversee, compliance with exchange-set position limits on swaps until such time.

(1) Benefits and Costs Related to Market Integrity

The Commission preliminarily believes that the proposed definition will benefit market integrity in two ways. First, the proposed definition would protect against excessive speculation and potential market manipulation by limiting the ability of speculators to obtain excessive positions through netting. For example, a more inclusive ''economically equivalent'' definition that would encompass additional swaps (*e.g.,* swaps that may differ in their ''material'' terms or physical swaps with delivery dates that

[581] Further, the Commission believes that prohibiting the netting of a commodity index position with a referenced contract is required by its interpretation of the Dodd-Frank Act's amendments to the CEA's definition of ''bona fide hedging transaction or position.'' The Commission interprets the amended CEA definition to eliminate the Commission's ability to recognize risk management positions as bona fide hedges or transactions. *See infra* Section IV.A.4.—Bona Fide Hedging and Spread and Other Exemptions from Federal Position Limits (proposed §§ 150.1 and 150.3) for further discussion. In this regard, the Commission has observed that it is common for swap dealers to enter into commodity index contracts with participants for which the contract would not qualify as a bona fide hedging position (*e.g.,* with a pension fund). Failing to exclude commodity index contracts from the ''referenced contract'' definition could enable a swap dealer to use positions in commodity index contracts as a risk management hedge by netting down its offsetting outright futures positions in the components of the index. Permitting this type of risk management hedge would subvert the statutory pass-through swap language in CEA section 4a(c)(2)(B), which the Commission interprets as prohibiting the recognition of positions entered into for risk management purposes as bona fide hedges unless the swap dealer is entering into positions opposite a counterparty for which the swap position is a bona fide hedge.

[582] Similarly, the proposed anti-evasion provision would also provide that a spread exemption would no longer apply.

[583] CEA section 4a(a)(5); 7 U.S.C. 6a(a)(5). In addition, CEA section 4a(a)(4) separately authorizes, but does not require, the Commission to impose federal limits on swaps that meet certain statutory criteria qualifying them as ''significant price discovery function'' swaps. 7 U.S.C. 6a(a)(4). The Commission reiterates, for the avoidance of doubt, that the definitions of ''economically equivalent'' in CEA section 4a(a)(5) and ''significant price discovery function'' in CEA section 4a(a)(4) are separate concepts and that contracts can be economically equivalent without serving a significant price discovery function.

[584] As discussed below, the proposed definition of ''economically equivalent swaps'' with respect to natural gas referenced contracts would contain the same terms, except that it would include delivery dates diverging by less than two calendar days.

[585] *See supra* Section II.A.4. (for further discussion regarding the Commission's proposed definition of ''economically equivalent swap'').

diverge by one day or more) could make it easier for market participants to inappropriately net down against their referenced contracts by allowing market participants to structure swaps that do not necessarily offer identical risk or economic exposure or sensitivity. In such a case, a market participant could enter into an OTC swap with a maturity that differs by days or even weeks in order to net down this position against its position in a referenced contract, enabling it to hold an even greater position in the referenced contract.

Similarly, requiring ''economically equivalent swaps'' to share all material terms with their corresponding referenced contracts benefits market integrity by preventing market participants from escaping the position limits framework merely by altering non-material terms, such as holiday conventions. On the other hand, the Commission recognizes that such a narrow definition could impose costs on the marketplace by possibly permitting excessive speculation since market participants would not be subject to federal position limits if they were to enter into swaps that may have different material terms (*e.g.,* penultimate swaps) [586] but may nonetheless be sufficiently correlated to their corresponding referenced contract. In this case, it is possible that there may be potential for excessive speculation, market manipulation such as squeezes and corners, insufficient market liquidity for bona fide hedgers, or disruption to the price discovery function. Nonetheless, to the extent that swaps currently are not subject to federal position limit levels, such potential costs would remain unchanged compared to the status quo.

Second, the relatively narrow proposed definition benefits market integrity, and reduces associated compliance and implementation costs, by permitting exchanges, market participants, and the Commission to focus resources on those swaps that pose the greatest threat for facilitating corners and squeezes—that is, those swaps with substantially identical delivery dates and material economic terms to futures and options on futures subject to federal position limits. While swaps that have different material terms than their corresponding referenced contracts, including different delivery dates, may potentially be used for engaging in market manipulation, the proposed definition would benefit market integrity by allowing exchanges and the Commission to focus on the most sensitive period of the spot month, including with respect to the Commission's and exchanges' various surveillance and enforcement functions. To the extent market participants would be able to use swaps that would not be covered by the proposed definition to effect market manipulation, such potential costs would not differ from the status quo since no swaps are currently covered by federal position limits. The Commission however acknowledges that its narrow definition may increase this cost, as fewer swaps will be covered under the limits.

Further, the proposal to delay compliance with respect to exchange-set limits on swaps will benefit exchanges by facilitating exchanges' ability to establish surveillance and compliance systems. As noted above, exchanges currently lack sufficient data regarding individual market participants' open swap positions, which means that requiring exchanges to establish oversight over participants' positions currently could impose substantial costs and also may be impractical to achieve. As a result, the Commission has preliminarily determined that allowing exchanges delayed compliance with respect to swaps would reduce unnecessary costs. Nonetheless, the Commission's preliminary determination to permit exchanges to delay implementing federal position limits on swaps could incentivize market participants to leave the futures markets and instead transact in economically-equivalent swaps, which could reduce liquidity in the futures and related options markets, although the Commission recognizes that this concern should be mitigated by the reality that the Commission would still oversee and enforce federal position limits on economically equivalent swaps.

Additionally, while futures and related options are subject to clearing and exchange oversight, economically equivalent swaps may be transacted bilaterally off-exchange (*i.e.,* OTC swaps). As a result, it is relatively easy to create customized OTC swaps that may be highly correlated to a referenced contract, which would allow the market participant to create an exposure in the underlying commodity similar to the referenced contract's exposure. Due to the relatively narrow proposed ''economically equivalent swap'' definition, the Commission preliminarily believes that it would not be difficult for market participants to avoid federal position limits by entering into such OTC swaps.[587] While such swaps may not be perfectly correlated to their corresponding referenced contracts, market participants may find this risk acceptable in order to avoid federal position limits. An increase in OTC swaps at the expense of futures and options contracts may impose costs on market integrity due to lack of exchange oversight. If liquidity were to move from futures exchanges to the OTC swaps markets, non-dealer commercial entities may face increased transaction costs and widening spreads, as swap dealers gain market power in the OTC market relative to centralized exchange trading. The Commission is unable to quantify the costs of these potential harms. However, while the Commission acknowledges these potential costs, such costs to those contracts that already have limits on them already may have been realized in the marketplace because swaps are not subject to federal position limits under the status quo.

Lastly, under this proposal, market participants would be able to determine whether a particular swap satisfies the definition of ''economically equivalent swap,'' as long as market participants make a reasonable, good faith effort in reaching their determination and are able to provide sufficient evidence, if requested, to support a reasonable, good faith effort. The Commission preliminarily anticipates that this flexibility will benefit market integrity by providing a greater level of certainty to market participants in contrast to the alternative in which market participants would be required to first submit swaps to the Commission staff and wait for feedback or approval. On the other hand, the Commission also recognizes that not having the Commission explicitly opine on whether a swap would qualify as economically equivalent could cause market participants to avoid entering into such swaps. In turn, this could lead to less efficient hedging strategies if the market participant is forced to turn to the futures markets (*e.g.,* a market participant may choose to transact in the OTC swaps markets for various reasons, including liquidity, margin requirements, or simply better familiarity with ISDA and swap processes over exchange-traded futures). However, as noted below, the Commission reserves the right to declare

[586] Or, in the case of natural gas referenced contracts, which would potentially include penultimate swaps as economically equivalent swaps, a swap with a maturity of less than one day away from the penultimate swap. *See infra* Section IV.A.3.d.iv.(3) (discussion of natural gas swaps).

[587] In contrast, since futures and options on futures contracts are created by exchanges and submitted to the Commission for either self-certification or approval under part 40 of the Commission's regulations, a market participant would not be able to customize an exchange-traded futures or options on futures contract.

whether a swap or class of swaps is or is not economically equivalent, and a market participant could petition, or request informally, that the Commission make such a determination, although the Commission acknowledges that there could be costs associated with this, including delayed timing and monetary costs.

Further, the Commission recognizes that requiring market participants to conduct reasonable due diligence and maintain related records also could impose new compliance costs. Additionally, the Commission recognizes that certain market participants could assert that an OTC swap is (or is not) ''economically equivalent'' depending upon whether such determination benefits the market participant. In such a case, market participants could theoretically subvert the intent of the federal position limits framework, although the Commission preliminarily believes that such potential costs would be mitigated due to its surveillance functions and the proposal to reserve the authority to declare that a particular swap or class of swaps either would or would not qualify as economically equivalent.

(2) The Proposed Definition Could Increase Benefits or Costs Related to Market Liquidity

First, the proposed definition could benefit market liquidity by being, in general, less disruptive to the swaps markets, which in turn may reduce the potential for disruption for the price discovery function compared to an alternative in which the Commission would proposed a broader definition. For example, if the Commission were to adopt an alternative to its proposed ''economically equivalent swap'' definition that encompassed a broader range of swaps by including, for example, delivery dates that diverge by one or more calendar days—perhaps by several days or weeks—a speculator with a large portfolio of swaps could more easily bump up against the applicable position limits and therefore would have a strong incentive either to reduce its swaps activity or move its swaps activity to foreign jurisdictions. If there were many similarly situated speculators, the market for such swaps could become less liquid, which in turn could harm liquidity for bona fide hedgers as large liquidity providers could move to other markets.

Second, the proposed definition could benefit market liquidity by being sufficiently narrow to reduce incentives for liquidity providers to move to foreign jurisdictions, such as the European Union (''EU'').[588] Additionally, the Commission preliminarily believes that proposing a definition similar to that used by the EU will benefit international comity.[589] Further, since market participants trading in both U.S. and EU markets would find the proposed definition to be familiar, it may help reduce compliance costs for those market participants that already have systems and personnel in place to identify and monitor such swaps.

(3) The Proposed Definition Could Create Benefits or Costs Related to Market Liquidity for the Natural Gas Market

As discussed in greater detail in the preamble, the Commission recognizes that the market dynamics in natural gas are unique in several respects, including the fact that unlike with respect to other core referenced futures contracts, for natural gas relatively liquid spot-month and penultimate cash-settled futures exist. As a result, the Commission believes that creating an exception to the proposed ''economically equivalent swap'' definition for natural gas would benefit market liquidity by not unnecessarily favoring existing penultimate contracts over spot contracts. The Commission is especially sensitive to potential market manipulation in the natural gas markets since market participants—to a significantly greater extent compared to the other core referenced futures contracts that are included in the proposal—regularly trade in both the physically-settled core referenced futures contract and the cash-settled look-alike referenced contracts. Accordingly, the Commission preliminarily has concluded that a slightly broader definition of ''economically equivalent swap'' would uniquely benefit the natural gas markets by helping to deter and prevent manipulation of a physically-settled contract to benefit a related cash-settled contract.

e. Pre-Existing Positions

Proposed § 150.2(g) would impose federal limits on ''pre-existing positions''—other than pre-enactment swaps and transition period swaps—during the spot month, while non-spot month pre-existing positions would not be subject to position limits as long as (i) the position was acquired in good faith consistent with the ''pre-existing position'' definition in proposed § 150.1;[590] and (ii) such position would be attributed to the person if the position increases after the limit's effective date.

The Commission believes that this approach would benefit market integrity since pre-existing positions (other than pre-enactment and transition period swaps) that exceed spot-month limits could result in market or price disruptions as positions are rolled into the spot month.[591] However, the Commission acknowledges that the proposed ''good-faith'' standard also could impose certain costs on market integrity since an inherently subjective ''good faith'' standard could result in disparate treatment of traders by a

[588] In this regard, the proposed definition is similar in certain ways to the EU definition for OTC contracts that are ''economically equivalent'' to commodity derivatives traded on an EU trading venue. The applicable European regulations define an OTC derivative to be ''economically equivalent'' when it has ''identical contractual specifications, terms and conditions, excluding different lot size specifications, delivery dates diverging by less than one calendar day and different post trade risk management arrangements.'' While the Commission's proposed definition is similar, the Commission's proposed definition requires ''identical *material*'' terms rather than simply ''identical'' terms. Further, the Commission's proposed definition excludes different ''lot size specifications or *notional amounts*'' rather than referencing only ''lot size'' since swaps terminology usually refers to ''notional amounts'' rather than to ''lot sizes.'' *See* EU Commission Delegated Regulation (EU) 2017/591, 2017 O.J. (L 87).

[589] Both the Commission's definition and the applicable EU regulation are intended to prevent harmful netting. *See* European Securities and Markets Authority, *Draft Regulatory Technical Standards on Methodology for Calculation and the Application of Position Limits for Commodity Derivatives Traded on Trading Venues and Economically Equivalent OTC Contracts,* ESMA/2016/668 at 10 (May 2, 2016), *available at https://www.esma.europa.eu/sites/default/files/library/2016-668_opinion_on_draft_rts_21.pdf* (''[D]rafting the [economically equivalent OTC swap] definition in too wide a fashion carries an even higher risk of enabling circumvention of position limits by creating an ability to net off positions taken in on-venue contracts against only roughly similar OTC positions.'')

The applicable EU regulator, the European Securities and Markets Authority (''ESMA''), recently released a ''consultation paper'' discussing the status of the existing EU position limits regime and specific comments received from market participants. According to ESMA, no commenter, with one exception, supported changing the definition of an economically equivalent swap (referred to as an ''economically equivalent OTC contract'' or ''EEOTC''). ESMA further noted that for some respondents, ''the mere fact that very few EEOTC contracts have been identified is no evidence that the regime is overly restrictive.'' *See* European Securities and Markets Authority, *Consultation Paper MiFID Review Report on Position Limits and Position Management Draft Technical Advice on Weekly Position Reports,* ESMA70–156–1484 at 46, Question 15 (Nov. 5, 2019), *available at https://www.esma.europa.eu/document/consultation-paper-position-limits*.

[590] Proposed § 150.1 would define ''pre-existing position'' to mean ''any position in a commodity derivative contract acquired in good faith prior to the effective date'' of any applicable position limit.

[591] The Commission is particularly concerned about protecting the spot month in physical-delivery futures from corners and squeezes.

particular exchange or across exchanges seeking a competitive advantage with one another and could impose trading costs on those traders given less advantageous treatment. For example, the Commission acknowledges that since it has given discretion to an exchange in interpreting this ''good faith'' standard, an exchange may be more liberal with concluding that a large trader or influential exchange member obtained a position in ''good faith.'' As a result, the proposal could potentially harm market integrity and/or increase transaction costs if an exchange were to benefit certain market participants compared to other market participants that receive relatively less advantageous treatment. However, the Commission believes the risk of any unscrupulous trader or exchange is mitigated since exchanges continue to be subject to Commission oversight and to DCM Core Principles 4 (''prevention of market disruption'') and 12 (''protection of markets and market participants''), among others, and since proposed § 150.2(g)(2) also would require that exchanges must attribute the position to the trader if its position increases after the position limit's effective date.

4. Bona Fide Hedging and Spread and Other Exemptions From Federal Position Limits (Proposed §§ 150.1 and 150.3)

a. Background

The proposal provides for several exemptions that, subject to certain conditions, would permit a trader to exceed the applicable federal position limit set forth under proposed § 150.2. Specifically, proposed § 150.3 would generally maintain, with certain modifications discussed below, the two existing federal exemptions for bona fide hedging positions and spread positions, and would include new federal exemptions for certain conditional spot month positions in natural gas, certain financial distress positions, and pre-enactment and transition period swaps. Proposed § 150.1 would set forth the proposed definitions for ''bona fide hedging transactions or positions'' and for ''spread transactions.'' [592]

b. Bona Fide Hedging Definition; Enumerated Bona Fide Hedges; and Guidance on Measuring Risk

The Commission is proposing several amendments related to bona fide hedges. First, the Commission is proposing to include a revised definition of ''bona fide hedging transactions or positions'' in § 150.1 to conform to the statutory bona fide hedge definition in CEA section 4a(c) as Congress amended it in the Dodd-Frank Act. As discussed in greater detail in the preamble, the Commission proposes to (1) revise the temporary substitute test, consistent with the Commission's understanding of the Dodd-Frank Act's amendments to section 4a of the CEA, to no longer recognize as bona fide hedges certain risk management positions; (2) revise the economically appropriate test to make explicit that the position must be economically appropriate to the reduction of ''price risk''; and (3) eliminate the incidental test and orderly trading requirement, which Dodd-Frank removed from section 4a of the CEA. The Commission preliminarily believes that these changes include non-discretionary changes that are required by Congress's amendments to section 4a of the CEA. The Commission also proposes to revise the bona fide hedge definition to conform to the CEA's statutory definition, which permits certain pass-through offsets.[593]

Second, the Commission would maintain the distinction between enumerated and non-enumerated bona fide hedges but would (1) move the currently-enumerated hedges in the existing definition of ''bona fide hedging transactions and positions'' currently found in Commission regulation § 1.3 to proposed Appendix A in part 150 that will serve as examples of positions that would comply with the proposed bona fide hedging definition; and (2) propose to make all existing enumerated bona fide hedges as well as additional enumerated hedges to be self-effectuating for federal position limit purposes, without the need for prior Commission approval. In contrast, the existing enumerated anticipatory bona fide hedges are not currently self-effectuating and require market participants to apply to the Commission for recognition.

Third, the Commission is proposing guidance with respect to whether an entity may measure risk on a net or gross basis for purposes of determining its bona fide hedge positions.

The Commission expects these proposed modifications will provide market participants with the ability to hedge, and exchanges with the ability to recognize hedges, in a manner that is consistent with common commercial hedging practices, reducing compliance costs and increase the benefits associated with sound risk management practices.

i. Bona Fide Hedging Definition

(1) Elimination of Risk Management Exemptions; Addition of the Proposed Pass-Through Swap Exemption

First, the Commission has preliminarily determined that eliminating the risk-management exemption in physical commodity derivatives subject to federal speculative position limits, unless the position satisfies the pass-through/swap offset requirements in section 4a(c)(2)(B) of the CEA discussed further below, is consistent with Congressional and statutory intent, as evidenced by the Dodd-Frank Act's amendments to the bona fide hedging definition in CEA section 4a(c)(2).[594] Accordingly, once the proposed federal limit levels go into effect, market participants with positions that do not otherwise satisfy

[592] This discussion sometimes refers to the ''bona fide hedging transactions or positions'' definition as ''bona fide hedges,'' ''bona fide hedging,'' or ''bona fide hedge positions.'' For the purpose of this discussion, the terms have the same meaning.

[593] As discussed in Section II.A.—§ 150.1—Definitions of the preamble, the existing definition of ''bona fide hedging transactions and positions'' currently appears in § 1.3 of the Commission's regulations; the proposal would move the revised definition to proposed § 150.1.

[594] *See supra* Section II.A.1.c.ii.(1). The existing bona fide hedging definition in § 1.3 requires that a position must ''normally'' represent a substitute for transactions or positions made at a later time in a physical marketing channel (*i.e.,* the ''temporary substitute test''). The Dodd-Frank Act amended the temporary substitute language that previously appeared in the statute by removing the word ''normally'' from the phrase normally represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel.'' 7 U.S.C. 6a(c)(2)(A). The Commission preliminarily interprets this change as reflecting Congressional direction that a bona fide hedging position in physical commodities must *always* (and not just ''normally'') be in connection with the production, sale, or use of a physical cash-market commodity.

Previously, the Commission stated that, among other things, the inclusion of the word ''normally'' in connection with the pre-Dodd-Frank version of the temporary substitute language indicated that the bona fide hedging definition should not be construed to apply only to firms using futures to reduce their exposures to risks in the cash market, and that to qualify as a bona fide hedge, a transaction in the futures market did not need to be a temporary substitute for a later transaction in the cash market. *See* Clarification of Certain Aspects of the Hedging Definition, 52 FR at 27195, 27196 (Jul. 20, 1987). In other words, that 1987 interpretation took the view that a futures position could still qualify as a bona fide hedging position even if it was not in connection with the production, sale, or use of a physical commodity. Accordingly, based on the Commission's preliminary interpretation of the revised statutory definition of bona fide hedging in CEA section 4a(c)(2), risk-management hedges would not be recognized under the Commission's proposed bona fide hedging definition.

the proposed bona fide hedging definition or qualify for an exemption would no longer be able to rely on recognition of such risk-reducing techniques as bona fide hedges. Absent other factors, market participants who have, or have requested, a risk management exemption under the existing definition may resort to less effective hedging strategies resulting in, for example, increased costs for liquidity providers due to increased basis risk and/or decreased market efficiency due to higher transaction (*i.e.,* hedging) costs. Moreover, absent other factors, by excluding risk management positions from the bona fide hedge definition (other than those positions that would meet the pass-through/swap offset requirement in the proposed bona fide hedge definition, discussed further below), the proposed definition may affect the overall level of liquidity in the market since dealers who approach or exceed the federal position limit may decide to pull back on providing liquidity, including to bona fide hedgers.

On the other hand, the Commission believes that these potential costs could be mitigated for several reasons. First, the proposed bona fide hedging definition, consistent with the Dodd-Frank Act's changes to CEA section 4a(c)(2), would permit the recognition as bona fide hedges of futures and options on futures positions that offset pass-through swaps entered into by dealers and other liquidity providers (the ''pass-through swap counterparty'') [595] opposite bona fide hedging swap counterparties (the ''bona fide hedge counterparty''), as long as: (1) The pass-through swap counterparty can demonstrate, upon request from the Commission and/or from an exchange, that the pass-through swap qualifies as a bona fide hedge for the bona fide hedge counterparty; and (2) the pass-through swap counterparty enters into a futures or option on a futures position or a swap position, in each case in the same physical commodity as the pass-through swap to offset and reduce the price risk attendant to the pass-through swap.[596] Accordingly, a subset of risk management exemption holders could continue to benefit from an exemption, and potential counterparties could benefit from the liquidity they provide, as long as the position being offset qualifies as a bona fide hedge for the counterparty.

The Commission preliminarily has determined that any resulting costs or benefits related to the proposed pass-through swap exemption are a result of Congress's amendments to CEA section 4a(c) rather than the Commission's discretionary action. On the other hand, the Commission's discretionary action to require the pass-through swap counterparty to create and maintain records to demonstrate the bona fides of the pass-through swap would cause the swap counterparty to incur marginal recordkeeping costs.[597]

The proposed pass-through swap provision, consistent with the Dodd-Frank Act's changes to CEA section 4a(c)(2), also would address a situation where a participant who qualifies as a bona fide hedging swap counterparty (*i.e.,* a participant with a position in a previously-entered into swap that qualified, at the time the swap was entered into, as a bona fide hedging position under the proposed definition) seeks, at some later time, to offset that swap position.[598] Such step might be taken, for example, to respond to a change in the participant's risk exposure in the underlying commodity. As a result, a participant could use futures or options on futures in excess of federal position limits to offset the price risk of a previously-entered into swap, which would allow the participant to exceed federal limits using either new futures or options on futures or swap positions that reduce the risk of the original swap.

The Commission expects the pass-through swap provision to facilitate dynamic hedging by market participants. The Commission recognizes that a significant number of market participants use dynamic hedging to more effectively manage their portfolio risks. Therefore, this provision may increase operational efficiency. In addition, by permitting dynamic hedging, a greater number of dealers should be better able to provide liquidity to the market, as these dealers will be able to more effectively manage their risks by entering into pass-through swaps with bona fide hedgers as counterparties. Moreover, market participants are not precluded from using swaps that are not ''economically equivalent swap'' for such risk management purposes since swaps that are not deemed to be ''economically equivalent'' to a referenced contract would not be subject to the Commission's proposed position limits framework.

The Commission preliminarily observes that market participants may not need to rely on the proposed pass-through swap provision to the extent such parties employ swaps that qualify as ''economically equivalent swaps,'' since such market participants may be able to net such swaps against the corresponding futures or options on futures. As a result, the Commission preliminarily anticipates that the proposed pass-through swap provision would benefit those bona fide hedgers and pass-through swap counterparties that use swaps that would not qualify as economically equivalent under the Commission's proposal. To the extent market participants use swaps that would qualify as economically equivalent swaps, or could shift their trading strategies to use such swaps without incurring additional costs, the Commission preliminarily believes that the elimination of the risk management position would not necessarily result in market participants incurring costs or limiting their trading since they would be able to net the positions in economically equivalent swaps with their futures and options on futures positions, or with other economically equivalent swaps.

Second, for the nine legacy agricultural contracts, the proposal would generally set federal non-spot month limit levels higher than existing non-spot limits, which may enable additional dealer activity described above.[599] The remaining 16 core referenced futures contracts would be subject to existing exchange-set limits or accountability outside of the spot month, which does not represent a change from the status quo under existing or proposed § 150.5. The proposed higher levels with respect to the nine legacy agricultural contracts and the exchanges' flexible accountability regimes with respect to the proposes new 16 core referenced futures contract should mitigate at least some potential costs related to the

[595] Such pass-through swap counterparties are typically swap dealers providing liquidity to bona fide hedgers.

[596] *See* paragraph (2)(i) of the proposed bona fide hedging definition. Of course, if the pass-through swap qualifies as an ''economically appropriate swap,'' then the pass-through swap counterparty would not need to rely on the proposed pass-through swap provision since it may be able to offset its long (or short) position in the economically equivalent swap with the corresponding short (or long) position in the futures or option on futures position or on the opposite side of another economically equivalent swap.

[597] To the extent that the pass-through swap counterparty is a swap dealer or major swap participant, they already may be subject to similar recordkeeping requirements under § 1.31 and part 23 of the Commission's regulations. As a result, such costs may already have been realized.

[598] *See* paragraph (2)(ii) of the proposed bona fide hedging transactions or positions definition.

[599] Proposed § 150.2 generally would increase position limits for non-spot months for contracts that currently are subject to the federal position limits framework other than for CBOT Oats (O), CBOT KC HRW Wheat (KW), and MGEX HRS Wheat (MWE), for which the Commission would maintain existing levels.

prohibition on recognizing risk management positions as bona fide hedges.

Third, the proposal may improve market competitiveness and reduce transaction costs. As noted above, existing holders of the risk management exemption, and the levels permitted thereunder, are currently confidential, and the Commission is no longer granting new risk management exemptions to potential new liquidity providers. Accordingly, by eliminating the risk management exemption, the Commission's proposal would benefit the public and strengthen market integrity by improving market transparency since certain dealers would no longer be able to maintain the grandfathered risk management exemption while other dealer lack this ability under the status quo. While the Commission believes that the risk management exemption may allow dealers to more effectively provide market making activities, which benefits market liquidity and ultimately leads to lower prices for end-users, as noted above, the potential costs resulting from removing the risk management exemption may be mitigated by the revised position limit levels that reflect current EDS for spot month levels and current open interest and trading volume for non-spot month levels. Therefore, the Commission believes that existing risk management exemption holders should be able to continue providing liquidity to bona fide hedgers, but acknowledges that some may not to the same degree as under the exemption; however, the Commission believes that any potential harm to liquidity should be mitigated.

Further, the proposed spot month and non-spot month levels, which generally will be higher than the status quo, together with the elimination of the risk management exemptions that benefit only certain dealers, might enable new liquidity providers to enter the markets on a level playing field with the existing risk management exemption holders. With the possibility of additional liquidity providers, the proposed framework may strengthen market integrity by decreasing concentration risk potentially posed by too few market makers. However, the benefits to market liquidity the Commission describes above may be muted since this analysis is predicated, in part, on the understanding that dealers are the predominant large traders. Data in the Commission's Supplementary COT and its underlying data indicate that risk-management exemption holders are not the only large participants in these markets—large commercial firms also hold large positions in such commodities.

(2) Limiting ''Risk'' to ''Price'' Risk; Elimination of the Incidental Test and Orderly Trading Requirement

As discussed in the preamble, the proposed bona fide hedging definition's ''economically appropriate test'' would clarify that only hedges that offset *price* risks could be recognized as bona fide hedging transactions or positions. The Commission does not believe that this clarification would impose any new costs or benefits, as it is consistent with both the existing bona fide hedging definition[600] as well as the Commission's longstanding policy.[601] Nonetheless, the Commission realizes that hedging occurs for more types of risks than price (*e.g.,* volumetric hedging). Therefore, the Commission recognizes that by expressly limiting the bona fide hedge exemption to hedging only price risk, certain market participants may not be able to receive a bona fide hedging recognition, and for certain dealers, this may limit their ability to provide liquidity to the market because without being able to rely on bona fide hedging status, their trading activity would cause them to otherwise exceed federal limits.

The Commission further would implement Congress's Dodd-Frank Act amendments that eliminated the statutory bona fide hedge definition's incidental test and orderly trading requirement by proposing to make the same changes to the Commission's regulations. As discussed in the preamble, the Commission preliminarily believes that these proposed changes do not represent a change in policy or regulatory requirement. As a result, the Commission does not identify any costs or benefits related to these proposed changes.

[600] The existing bona fide hedging definition in § 1.3 provides that 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. (emphasis added). Accordingly, the proposed definition would merely move this requirement to the proposed definition's revised ''economically appropriate test'' requirement.

[601] For example, in promulgating existing § 1.3, the Commission explained that a bona fide hedging position must, among other things, ''be economically appropriate to risk reduction, such risks must arise from operation of a commercial enterprise, and the price fluctuations of the futures contracts used in the transaction must be substantially related to fluctuations of the cash market value of the assets, liabilities or services being hedged.'' Bona Fide Hedging Transactions or Positions, 42 FR at 14832, 14833 (Mar. 16, 1977). Dodd-Frank added CEA section 4a(c)(2), which copied the ''economically appropriate test'' from the Commission's definition in § 1.3. *See also* 2013 Proposal, 78 FR at 75702, 75703.

ii. Proposed Enumerated Bona Fide Hedges

The Commission proposes enumerated bona fide hedges in Appendix A to part 150 of the Commission's regulations to provide a list bona fide hedges that would include: (i) The existing enumerated hedges; and (ii) additional enumerated bona fide hedges. The Commission reinforces that hedging practices not otherwise listed may still be deemed, on a case-by-case basis, to comply with the proposed bona fide hedging definition (*i.e.,* non-enumerated bona fide hedges). As discussed further below, the proposed enumerated bona fide hedges in Appendix A would be ''self-effectuating'' for purposes of federal position limits levels, which are expected to reduce delays and compliance costs associated with requesting an exemption.

Additionally, as part of the Commission's proposal, the exchanges would have discretion to determine, for purposes of their own exchange-granted bona fide hedges, whether any of the proposed enumerated bona fide hedges in proposed Appendix A to part 150 of the Commission's regulations would be permitted to be maintained during the lesser of the last five days of trading or the time period for the spot month in such contract (the ''five-day rule''), and the Commission's proposal otherwise would not require any of the enumerated bona fide hedges to be subject to the five-day rule for purposes of federal position limits. Instead, the Commission expects exchanges to make their own determinations with respect to exchange-set limits as to whether it is appropriate to apply the five-day rule for a particular bona fide hedge type and commodity contract. The Commission has preliminarily determined that exchanges are well-informed with respect to their respective markets and well-positioned to make a determination with respect to imposing the five-day rule in connection with recognizing bona fide hedges for their respective commodity contracts. In general, the Commission believes that, on the one hand, limiting a trader's ability to establish a position in this manner by requiring the five-day rule could result in increased costs related to operational inefficiencies, as a trader may believe that this is the most opportune time to hedge. On the other hand, the Commission believes that price convergence may be particularly sensitive to potential market manipulation or excessive speculation during this period. Accordingly, the Commission preliminarily believes that the proposal to not impose the five-day rule with respect to any of the enumerated bona fide hedges for federal purposes but instead rely on exchange's determination with respect to exchange-granted exemptions would help to better optimize these considerations. The Commission notes a potential cost for market integrity if exchanges fail to implement a five-day rule in order to encourage additional trading in order to increase profit, which could harm price convergence. However, the Commission believes this concern is mitigated since exchanges also have an economic incentive to ensure that price convergence occurs with their respective contracts since commercial end-users would be less willing to use such contracts for hedging purposes if price convergence would fail to occur in such contracts as they may generally desire to hedge cash market prices with futures contracts.

iii. Guidance for Measuring Risk on a Gross or Net Basis

The Commission proposes guidance in paragraph (a) of Appendix B to part 150 on whether positions may be hedged on either a gross or net basis. Under the proposed guidance, among other things, a trader may measure risk on a gross basis if it would be consistent with the trader's historical practice and is not intended to evade applicable limits. The key cost associated with allowing gross hedging is that it may provide opportunity for hidden speculative trading.[602]

Such risk is mitigated to a certain extent by the guidance's provisos that the trader does not switch between net hedging and gross hedging in order to evade limits and that the DCM documents justifications for allowing gross hedging and maintains any relevant records in accordance with proposed § 150.9(d).[603] However, the Commission also recognizes that there are myriad of ways in which organizations are structured and engage in commercial hedging practices, including the use of multi-line business strategies in certain industries that would be subject to federal position limits for the first time under this proposal and for which net hedging could impose significant costs or be operationally unfeasible.

c. Spread Exemptions

Under existing § 150.3, certain spread exemptions are self-effectuating. Specifically, existing § 150.3 allows for ''spread or arbitrage positions'' that are ''between single months of a futures contract and/or, on a futures-equivalent basis, options thereon, outside of the spot month, in the same crop year; provided, however, that such spread or arbitrage positions, when combined with any other net positions in the single month, do not exceed the all-months limit set forth in § 150.2.''[604] Proposed §§ 150.1 and 150.3 would amend the existing spread position exemption for federal limits by (i) listing specific spread transactions that may be granted; and (ii) other than for the listed spread positions, which would be self-effectuating, requiring a person to apply for spread exemptions directly with the Commission pursuant to proposed § 150.3.[605] In addition, the proposed rule would permit spread exemptions outside the same crop year and/or during the spot month.[606]

In connection with the spread exemption provisions, the Commission is relaxing the prohibition for contracts during the same crop year and/or the spot month so that exchanges are able to exempt spreads outside the same crop year and/or during the spot month. There may be benefits that result from permitting these types of spread exemptions. For example, the Commission believes that permitting spread exemptions not in the same crop year or during the spot month may potentially improve price discovery as well as provide market participants with the ability to use strategies involving spread positions, which may reduce hedging costs.

As in the intermarket wheat example discussed below, the proposed spread relief not limited to the same crop year month may better link prices between two markets (*e.g.,* the price of MGEX wheat futures and the price of CBOT wheat futures). Put another way, permitting spread exemptions outside the same crop year may enable pricing in two different but related markets for substitute goods to be more highly correlated, which, in this example, benefits market participants with a price exposure to the underlying protein content in wheat generally, rather than that of a particular commodity.

However, the Commission also recognizes certain potential costs to permitting spread exemptions during the spot month, particularly to extend into the last five days of trading. This feature could raise the risk of allowing participants in the market at a time in the contract where only those interested in making or taking delivery should be present. When a contract goes into expiration, open interest and trading volume naturally decrease as traders not interested in making or taking delivery roll their positions into deferred calendar months. The presence of large spread positions so close to the expiration of a futures contract, which positions are normally tied to large liquidity providers, may actually lead to disruptions in the price discovery function of the contract by disrupting the futures/cash price convergence. This could lead to increased transaction costs and harm the hedging utility for end-users of the futures contract, which could lead to higher costs passed on to consumers. However, the Commission preliminarily believes that these concerns would be mitigated as exchanges would continue to apply their expertise in overseeing and maintaining the integrity of their markets. For example, an exchange could refuse to grant a spread exemption if the exchange believed it would harm its markets, require a participant to reduce its positions, or implement a five-day-rule for spread exemptions, as discussed above.[607]

Generally, the Commission preliminarily finds that, by allowing speculators to execute intermarket and intramarket spreads as proposed, speculators would be able to hold a greater amount of open interest in

[602] For example, using gross hedging, a market participant could potentially point to a large long cash position as justification for a bona fide hedge, even though the participant, or an entity with which the participant is required to aggregate, has an equally large short cash position that would result in the participant having no net price risk to hedge as the participant had no price risk exposure to the commodity prior to establishing such derivative position. Instead, the participant created price risk exposure to the commodity by establishing the derivative position.

[603] Under proposed § 150.3(b)(2) and (e) and proposed § 150.9(e)(5), and (g), the Commission would have access to any information related to the applicable exemption request.

[604] 17 CFR 150.3. CEA section 4a(a)(1) provides the Commission with authority to exempt from position limits transactions ''normally known to the trade'' as ''spreads'' or ''straddles'' or ''arbitrage'' or to fix limits for such transactions or positions different from limits fixed for other transactions or positions.

[605] The proposed ''spread transactions'' definition would list the most common types of spread positions, including: Calendar spreads, intercommodity spreads, quality differential spreads, processing spreads (such as energy ''crack'' or soybean ''crush'' spreads), product or by-product differential spreads, and futures-options spreads. Proposed § 150.3(b) also would permit market participants to apply to the Commission for other spread transactions.

[606] As discussed under proposed § 150.3, spread exemptions identified in the proposed ''spread transaction'' definition in proposed § 150.1 would be self-effectuating similar to the status quo and would not represent a change to the status quo baseline. The related costs and benefits, particularly with respect to requesting exemptions with respect to spreads other than those identified in the proposed ''spread transaction'' definition, are discussed under the respective sections below.

[607] *See supra* Section IV.A.4.b.ii. (discussion of the five-day rule).

underlying contract(s), and therefore, bona fide hedgers may benefit from any increase in market liquidity. Spread exemptions may also lead to better price continuity and price discovery if market participants who seek to provide liquidity (for example, through entry of resting orders for spread trades between different contracts) receive a spread exemption, and thus would not otherwise be constrained by a position limit.

For clarity, the Commission has identified the following two examples of spread positions that could benefit from the proposed spread exemption:

- Reverse crush spread in soybeans on the CBOT subject to an intermarket spread exemption. In the case where soybeans are processed into two different products, soybean meal and soybean oil, the crush spread is the difference between the combined value of the products and the value of soybeans. There are two actors in this scenario: the speculator and the soybean processor. The spread's value approximates the profit margin from actually crushing (or mashing) soybeans into meal and oil. The soybean processor may want to lock in the spread value as part of its hedging strategy, establishing a long position in soybean futures and short positions in soybean oil futures and soybean meal futures, as substitutes for the processor's expected cash market transactions (the long position hedges the purchase of the anticipated inputs for processing and the short position hedges the sale of the anticipated soybean meal and oil products). On the other side of the processor's crush spread, a speculator takes a short position in soybean futures against long positions in soybean meal futures and soybean oil futures. The soybean processor may be able to lock in a higher crush spread because of liquidity provided by such a speculator who may need to rely upon a spread exemption. In this example, the speculator is accepting basis risk represented by the crush spread, and the speculator is providing liquidity to the soybean processor. The crush spread positions may result in greater correlation between the futures prices of soybeans on the one hand and those of soybean oil and soybean meal on the other hand, which means that prices for all three products may move up or down together in a more correlated manner.
- Wheat spread subject to intermarket spread exemptions. There are two actors in this scenario: the speculator and the wheat farmer. In this example, a farmer growing hard wheat would like to reduce the price risk of her crop by shorting a MGEX wheat futures. There, however, may be no hedger, such as a mill, that is immediately available to trade at a desirable price for the farmer. There may be a speculator willing to offer liquidity to the hedger; however, the speculator may wish to reduce the risk of an outright long position in MGEX wheat futures through establishing a short position in CBOT wheat futures (soft wheat). Such a speculator, who otherwise would have been constrained by a position limit at MGEX and/or CBOT, may seek exemptions from MGEX and CBOT for an intermarket spread, that is, for a long position in MGEX wheat futures and a short position in CBOT wheat futures of the same maturity. As a result of the exchanges granting an intermarket spread exemption to such a speculator, who otherwise may be constrained by limits, the farmer might be able to transact at a higher price for hard wheat than might have existed absent the intermarket spread exemptions. Under this example, the speculator is accepting basis risk between hard wheat and soft wheat, reducing the risk of a position on one exchange by establishing a position on another exchange, and potentially providing liquidity to a hedger. Further, spread transactions may aid in price discovery regarding the relative protein content for each of the hard and soft wheat contracts.

d. Conditional Spot Month Exemption Positions in Natural Gas

Proposed § 150.3(a)(4) would provide a new federal conditional spot month limit exemption position for cash-settled natural gas contracts that would permit traders to acquire positions up to 10,000 NYMEX Henry Hub Natural Gas (NG) equivalent-size contracts (the federal spot month limit in proposed § 150.2 for NYMEX Henry Hub Natural Gas (NG) referenced contracts is otherwise 2,000 contracts in the aggregate across all one's net positions) per exchange that lists the relevant natural gas cash-settled referenced contracts, along with an additional futures-adjusted 10,000 contracts of cash-settled economically equivalent swaps, as long as such person does not also hold positions in the physically-settled natural gas referenced contract.[608] NYMEX, ICE, Nasdaq Futures, and Nodal currently have rules in place establishing a conditional spot month limit exemption equivalent to up to 5,000 contracts in NYMEX-equivalent size. By proposing to include the conditional exemption for purposes of federal limits on natural gas contracts, the Commission reduces the incentive and ability for a market participant to manipulate a large physically-settled position to benefit a linked cash-settled position.

Further, the Commission has heeded natural gas traders' concerns about disrupting market practices and harming liquidity in the cash-settled contract, which could increase the cost of hedging and possibly prevent convergence between the physical delivery futures and cash markets.[609] While a trader with a position in the physical-delivery natural gas contract may incur costs associated with liquidating that position in order to meet the conditions of the federal exemption, such costs are incurred outside of the proposal, as the trader would have to do so as a condition of the exchange-level exemption under current exchange rules.[610]

e. Financial Distress Exemption

Proposed § 150.3(a)(3) would provide an exemption for certain financial distress circumstances, including the default of a customer, affiliate, or acquisition target of the requesting entity that may require the requesting entity to take on, in short order, the positions of another entity. In codifying the Commission's historical practice, the proposed rule accommodates transfers of positions from financially distressed firms to financially secure firms. The disorderly liquidation of a position threatens price impacts that may harm the efficiency and price discovery function of markets, and the proposal would make it less likely that positions will be prematurely or needlessly liquidated. The Commission has determined that costs related to filing and recordkeeping are likely to be minimal. The Commission cannot accurately estimate how often this exemption may be invoked because emergency or distressed market situations are unpredictable and dependent on a variety of firm and market-specific factors as well as general macroeconomic indicators.[611] The Commission, nevertheless, believes that emergency or distressed market situations that might trigger the need for this exemption will be infrequent, and that codifying this historical practice

[608] The NYMEX Henry Hub Natural Gas (NG) contract is the only natural gas contract included as a core referenced futures contract under this proposal.

[609] *See* 2016 Reproposal, 81 FR at 96862, 96863.

[610] *See* ICE Rule 6.20(c) and NYMEX Rule 559.F. *See, e.g.,* NASDAQ Futures Rule ch. v, section 13(a)(ii) and Nodal Exchange Rulebook Appendix C (equivalent rules of NASDAQ and Nodal exchanges).

[611] *See* 2016 Reproposal, 81 FR at 96862, 96863.

will add transparency to the Commission's oversight responsibilities.

f. Pre-Enactment and Transition Period Swaps Exemption

Proposed § 150.3(a)(5) would also provide an exemption from position limits for positions acquired in good faith in any ''pre-enactment swap,'' or in any ''transition period swap,'' in either case as defined in proposed § 150.1. A person relying on this exemption may net such positions with post-effective date commodity derivative contracts for the purpose of complying with any non-spot-month speculative positions limits, but may not net against spot month positions. This exemption would be self-effectuating, and the Commission preliminarily believes that proposed § 150.3(a)(5) would benefit both individual market participants by lessening the impact of the proposed federal limits, and market liquidity in general as liquidity providers initially would not be forced to reduce or exit their positions.

The proposal would benefit price discovery and convergence by prohibiting large traders seeking to roll their positions into the spot month from netting down positions in the spot-month against their pre-enactment swap or transition period swap. The Commission acknowledges that, on its face, including a ''good-faith'' requirement in the proposed § 150.3(a)(5) could hypothetically diminish market integrity since determining whether a trader has acted in ''good faith'' is inherently subjective and could result in disparate treatment among traders, where certain traders may assert a more aggressive position in order to seek a competitive advantage over others. The Commission believes the risk of any such unscrupulous trader or exchange is mitigated since exchanges would still be subject to Commission oversight and to DCM Core Principles 4 (''prevention of market disruption'') and 12 (''protection of markets and market participants''), among others. The Commission has determined that market participants who voluntarily employ this exemption also will incur negligible recordkeeping costs.

5. Process for the Commission or Exchanges To Grant Exemptions and Bona Fide Hedge Recognitions for Purposes of Federal Limits (Proposed §§ 150.3 and 150.9) and Related Changes to Part 19 of the Commission's Regulations

Existing §§ 1.47 and 1.48 set forth the process for market participants to apply to the Commission for recognition of certain bona fide hedges for purposes of federal limits, and existing § 150.3 sets forth a list of spread exemptions a person can rely on for purposes of federal limits. However, under existing Commission practices, spread exemptions and certain enumerated bona fide hedges are generally self-effectuating and do not require market participants to apply to the Commission for purposes of federal position limits, although market participants are required to file Form 204 monthly reports[612] to justify certain position limit overages. Further, for those bona fide hedges for which market participants are required to apply to the Commission, existing regulations and market practice require market participants to apply both to the Commission for purposes of federal limits and also to the relevant exchanges for purposes of exchange-set limits. The Commission has preliminarily determined that this dual application process creates inefficiencies for market participants.

Proposed §§ 150.3 and 150.9, taken together, would make several changes to the process of acquiring bona fide hedge recognitions and spread exemptions for federal position limits purposes. Proposed §§ 150.3 and 150.9 would maintain certain elements of the status quo while also adopting certain changes to facilitate the exemption process.[613]

First, with respect to the proposed enumerated bona fide hedges, proposed § 150.3 would maintain the status quo by providing that those enumerated bona fide hedges that currently are self-effectuating for the nine legacy agricultural contracts would remain self-effectuating for the nine legacy agricultural contracts for purposes of federal position limits.[614] Similarly, the enumerated bona fide hedges for the proposed additional 16 contracts that would be newly subject to federal position limits (*i.e.,* those contracts other than the nine legacy agricultural contracts) also would be self-effectuating for purposes of federal position limits.

Second, for recognition of any non-enumerated bona fide hedge in connection with any referenced contract, market participants would be required to apply either directly to the Commission under proposed § 150.3 or through an exchange that adheres to certain requirements under proposed § 150.9. The Commission notes that existing regulations require market participants to apply to the Commission for recognition of non-enumerated bona fide hedges, and so the Commission's proposal does not represent a change to the status quo in this respect for the nine legacy agricultural contracts.

Third, proposed § 150.3 would maintain the status quo by providing that the most common spread exemptions for the nine legacy agricultural contracts would remain self-effectuating. Similarly, these common spread exemptions also would be self-effectuating for the proposed additional 16 contracts that would be newly subject to federal position limits. These common spread exemptions would be listed in the proposed ''spread transaction'' definition under proposed § 150.1.[615]

Fourth, for any spread exemption not listed in the proposed ''spread transaction'' definition, market participants would be required to apply directly to the Commission under proposed § 150.3. There would be no exception for the nine legacy agricultural products nor would market participants be permitted to apply through an exchange under proposed § 150.9 for these types of spread exemptions.[616]

The Commission anticipates that most—if not all—market participants would utilize the exchange-centric process set forth in proposed § 150.9 with respect to applying for recognition of non-enumerated bona fide hedges rather than apply directly to the Commission under proposed § 150.3 because market participants are likely already familiar with the proposed processes set forth in § 150.9, which is intended to leverage the processes currently in place at the exchanges for addressing requests bona fide hedge recognitions from exchange-set limits. In the sections below, the Commission will discuss the costs and benefits related to both processes.

[612] In the case of cotton, market participants currently file the relevant portions of Form 304.

[613] In this section the Commission discusses the costs and benefits related to the *application* process for these exemptions and bona fide hedge recognitions. For a discussion of the costs and benefits related to the scope of the exemptions and bona fide hedge recognitions, *see supra* Section IV.A.5.a.iv.

[614] Under the status quo, market participants must apply to the Commission for recognition of certain enumerated anticipatory bona fide hedges. The Commission's proposal also would make these enumerated anticipatory bona fide hedges self-effectuating for the nine legacy agricultural contracts.

[615] The proposed ''spread transaction'' definition would include a calendar spread, intercommodity spread, quality differential spread, processing spread (such as energy ''crack'' or soybean ''crush'' spreads), product or by-product differential spread, or futures-option spread.

[616] As discussed below, the proposal would also eliminate the Form 204 and the equivalent portions of the Form 304.

a. Process for Requesting Exemptions and Bona Fide Hedge Recognitions Directly From the Commission (Proposed § 150.3)

Under existing §§ 1.47 and 1.48, and existing § 150.3, the processes for obtaining a recognition of a bona fide hedge or for relying on a spread exemption, are similar in some respects and different in other respects than the proposed approach. Existing §§ 1.47 and 1.48 require market participants seeking recognition of non-enumerated bona fide hedges and enumerated anticipatory bona fide hedges, respectively, for federal position limits to apply directly to the Commission for prior approval.

In contrast, existing non-anticipatory enumerated bona fide hedges and spread exemptions are self-effectuating, which means that market participants are not required to submit any information to the Commission for prior approval, although such market participants must subsequently file Form 204 or Form 304 each month in order to describe their cash market positions and justify their bona fide hedge position. There currently is no codified federal process related to financial distress exemptions or natural gas conditional spot month exemptions.

For those market participants that would choose to apply directly to the Commission for recognition of non-enumerated bona fide hedges or spread exemptions not included in the proposed ''spread transaction'' definition, which in each case would not be self-effectuating under the proposal, proposed § 150.3 would provide a process for the Commission to review and approve requests. Under proposed § 150.3, any person seeking Commission recognition of these types of bona fide hedges or a spread exemptions (as opposed to applying to using the exchange-centric process under proposed § 150.9 described below) would be required to submit a request directly to the Commission and to provide information similar to what is currently required under existing §§ 1.47 and 1.48.[617]

i. Existing Bona Fide Hedges That Currently Require Prior Submission to the Commission Under Existing §§ 1.47 and 1.48 for the Nine Legacy Agricultural Contracts

Under the proposal, the Commission would maintain the distinction between enumerated bona fide hedges and non-enumerated bona fide hedges under proposed § 150.3: (1) Enumerated bona fide hedges would continue to be self-effectuating; (2) enumerated anticipatory bona fide hedges would become self-effectuating so market participants would no longer need to apply to the Commission; and (3) non-enumerated bona fide hedges would still require market participants to apply for recognition. Market participants that choose to apply directly to the Commission for a bona fide hedge recognition (*i.e.,* for non-enumerated bona fide hedges) would be subject to an application process that generally is similar to what the Commission currently administers for the non-enumerated bona fide hedges and the enumerated anticipatory bona fide hedges.[618] With respect to enumerated anticipatory bona fide hedges for the nine legacy contracts, for which market participants currently are required to apply to the Commission for recognition for federal position limit purposes, the Commission preliminarily anticipates that the proposal would benefit market participants by making such hedges self-effectuating.[619] As a result, market participants will no longer be required to spend time and resources applying to the Commission. Further, for these enumerated anticipatory hedges, existing § 1.48 requires market participants to submit either an initial or supplemental application to the Commission 10 days prior to entering into the bona fide hedge that would cause the hedger to exceed federal position limits.[620] Under existing § 1.48, market participants could proceed with their proposed bona fide hedges if the Commission does not notify a market participants otherwise within the specific 10-day period. Because bona fide hedgers could implement enumerated anticipatory bona fide hedges without waiting the requisite 10 days, they may be able to implement their hedging strategy more efficiently with reduced cost and risk. The Commission acknowledges that making such bona fide hedges easier to obtain could increase the possibility of excess speculation since anticipatory exemptions are theoretically more difficult to substantiate compared to the other existing enumerated bona fide hedges. However, the Commission has gained significant experience over the years with bona fide hedging practices in general and with enumerated anticipatory bona fide hedging practices in particular, and the Commission preliminarily has determined that making such hedges self-effectuating should not increase the risk of excessive speculation or market manipulation compared to the status quo.

For non-enumerated bona fide hedges, existing § 1.47 requires market participants to submit (i) initial applications to the Commission 30 days prior to the date the market participant would exceed the applicable position limits and (ii) supplemental applications (*i.e.,* applications for a market participant that desire to exceed the bona fide hedge amount provided in the person's previous Commission filing) 10 days prior for Commission approval, and market participants can proceed with their proposed bona fide hedges if the Commission does not intervene within the specific time (*e.g.,* either 10 days or 30 days).

Proposed § 150.3 would similarly require market participants seeking recognition of a non-enumerated bona fide hedge for any of the proposed 25 core referenced futures contracts to apply to the Commission prior to exceeding federal position limits, but proposed § 150.3 would not prescribe a certain time period by which a bona fide hedger must apply or by which the

[617] For bona fide hedges and spread exemptions, this information would include: (i) A description of the position in the commodity derivative contract for which the application is submitted, including the name of the underlying commodity and the position size; (ii) information to demonstrate why the position meets the applicable requirements for a bona fide hedge or spread transaction; (iii) a statement concerning the maximum size of all gross positions in derivative contracts for which the application is submitted; (iv) for bona fide hedges, information regarding the applicant's activity in the cash markets and swaps markets for the commodity underlying the position for which the application is submitted; and (v) any other information that may help the Commission determine whether the position meets the applicable requirements for a bona fide hedge position or spread transaction.

[618] As noted above, under the existing framework market participants are not required to apply for any type of bona fide hedge recognition or spread exemption from the Commission for any of the proposed additional 16 contracts that would be newly subject to federal position limits (*i.e.,* those contracts other than the nine legacy agricultural contracts); rather, under the existing framework, such market participants must apply to the exchanges for bona fide hedge recognitions or exemptions for purposes of exchange-set position limits. Accordingly, to the extent that market participants would not need to apply to the Commission in connection with any of the proposed additional 16 contracts, the Commission's proposal would not impose additional costs or benefits compared to the status quo.

[619] As noted above, since market participants do not need to apply to the Commission for bona fide hedge recognition for any of the proposed additional 16 contracts that would be newly subject to federal position limits, the Commission's proposal would not result in any additional costs or benefits to the extent such bona fide hedge recognitions would be self-effectuating.

[620] Under the Commission's existing regulations, non-anticipatory enumerated bona fide hedges are self-effectuating, and market participants do not have to file any applications for recognition under existing Commission regulations. However, bona fide hedgers must file with the Commission monthly Form 204 (or Form 304 in connection with ICE Cotton No. 2 (CT)) reports discussing their underlying cash positions in order to substantiate their bona fide hedge positions.

Commission must respond. The Commission preliminarily anticipates that the proposal would benefit bona fide hedgers by enabling them in many cases to generally implement their hedging strategies sooner than the existing 30-day or 10-day waiting period, in which case the Commission believes hedging-related costs would decrease. However, the Commission believes that there could also be circumstances in which the overall process could take longer than the existing timelines under § 1.47, which could increase hedging related costs if a bona fide hedger is compelled to wait longer, compared to existing Commission practices, before executing its hedging strategy.

On the other hand, the Commission also recognizes that there could be potential costs to bona fide hedgers if under the proposal they are forced either to enter into less effective bona fide hedges or to wait to implement their hedging strategy, as a result of the potential uncertainty that could result from proposed § 150.3 not requiring the Commission to respond within a certain amount of time. The Commission believes this concern is mitigated to the extent market participants utilize the proposed § 150.3 process that would permit a market participant that demonstrates a ''sudden or unforeseen'' increase in its bona fide hedging needs to enter into a bona fide hedge without first obtaining the Commission's prior approval, as long as the market participant submits a retroactive application to the Commission within five business days of exceeding the applicable position limit. The Commission preliminarily believes this ''five-business day retroactive exemption'' would benefit bona fide hedgers compared to existing §§ 1.47 and 1.48, which requires Commission prior approval, since hedgers that would qualify to exercise the five-business day retroactive exemption are also likely facing more acute hedging needs—with potentially commensurate costs if required to wait. This provision would also leverage, for federal position limit purposes, existing exchange practices for granting retroactive exemptions from exchange-set limits.

On the other hand, the proposed five-business day retroactive exemption could harm market liquidity and bona fide hedgers if the applicable exchange or the Commission were to not approve of the retroactive request, and the Commission subsequently required liquidation of the position in question. As a result, such possibility could cause market participants to either enter into smaller bona fide hedge positions than they otherwise would or cause the bona fide hedger to delay entering into its hedge, in either case potentially causing bona fide hedgers to incur increased hedging costs.

However, the Commission preliminarily believes this concern is partially mitigated since proposed § 150.3 would require the purported bona fide hedger to exit its position in a ''commercially reasonable time,'' which the Commission believes should partially mitigate any costs incurred by the market participant compared to either an alternative that would require the bona fide hedger to exit its position immediately, or the status quo where the market participant either is unable to enter into a hedge at all without Commission prior approval.

ii. Spread Exemptions and Non-Enumerated Bona Fide Hedges

Proposed § 150.3 would impose a new requirement for market participants to (1) apply either directly to the Commission pursuant to proposed § 150.3 or to an exchange pursuant to proposed § 150.9 for any non-enumerated bona fide hedge; and (2) to apply directly to the Commission pursuant to proposed § 150.3 for any spread exemptions not identified in the proposed ''spread transaction'' definition for any of the proposed 25 core referenced futures contracts.[621] As noted above, common spread exemptions (*i.e.,* those identified in the proposed definition of ''spread transaction'' in proposed § 150.1) would remain self-effectuating for the nine legacy agricultural products and also would be self-effectuating for the 16 proposed core referenced futures contracts.[622] Unlike non-enumerated bona fide hedges, for which market participants could apply directly to the Commission under proposed § 150.3 or through an exchange under proposed § 150.9, for spread exemptions not identified in the proposed ''spread transaction'' definition, market participants would be required to apply directly to the Commission under proposed § 150.3.

As noted above, proposed § 150.3 also would maintain the status quo and continue to require any non-enumerated bona fide hedge in one of the nine legacy agricultural products to receive prior approval, and similarly would require prior approval for such non-enumerated bona fide hedges for the proposed additional 16 contracts that would be newly subject to federal position limits.[623] The Commission anticipates that there will be no change to the status quo baseline with respect to the most common spread exemptions since these exemptions would be self-effecting for purposes of federal position limits.

To the extent market participants would be required to obtain prior approval for a non-enumerated bona fide hedge or spread exemption for any of the additional 16 contracts that would be newly subject to federal position limits, the Commission recognizes that proposed § 150.3 would impose costs on market participants who will now be required to spend time and resources submitting applications to the Commission (for certain spread exemptions) or to either the Commission or an exchange (for non-enumerated bona fide hedges) for prior approval for federal position limit purposes.[624] Further, compared to the status quo in which the proposed new 16 contracts are not subject to federal position limits, the proposed process could increase uncertainty since market participants would be required to seek prior approval and wait up to 10 days. As a result, such uncertainty could cause market participants to either enter into smaller spread or bona fide hedging positions or do so at a later time. In either case, this could cause market participants to incur additional costs and/or implement less efficient hedging strategies. However, the Commission preliminarily believes that proposed § 150.3's framework would be familiar to market participants that currently apply to the Commission for bona fide exemptions for the nine legacy agricultural products, which should serve to reduce costs for some market participants associated with obtaining recognition of a bona fide hedge or spread exemption from the Commission for federal limits for those market

[621] As discussed below, for spread exemptions not identified in the proposed ''spread transaction'' definition in proposed § 150.3, market participants would be required to apply directly to the Commission under proposed § 150.3 and would not be able to apply under proposed § 150.9.

[622] Existing § 150.3(a)(2) does not specify a formal process for granting either spread exemptions or non-anticipatory enumerated bona fide hedges that are consistent with CEA section 4a(a)(1), so in practice spread exemptions and non-anticipatory enumerated bona fide hedges have been self-effectuating.

[623] The Commission discusses the costs and benefits related to the proposed process for non-enumerated bona fide hedge recognitions with respect to the nine legacy agricultural products in the above section.

[624] The Commission's Paperwork Reduction Act analysis identifies some of these information collection burdens in greater specificity. *See supra* Section IV.A.4.c. (discussing in greater detail the cost and benefits related to spread exemptions).

participants.[625] The Commission also preliminarily believes that this analysis also would apply to the nine legacy agricultural contracts for spread exemptions that are not listed in the proposed ''spread transaction'' definition and therefore also would require market participants to apply to the Commission for these types of spread exemptions for the first time for the nine legacy agricultural products. However, because the Commission preliminarily has determined that most spread transactions would be self-effectuating (especially for the nine legacy agricultural contracts based on the Commission's experience), the Commission believes that the proposal would impose only small costs with respect to spread exemptions for both the nine legacy agricultural contracts as well as the proposed additional 16 contracts that would be newly subject to federal position limits.

While the Commission has years of experience granting and monitoring spread exemptions and enumerated and non-enumerated bona fide hedges for the nine legacy agricultural contracts, as well as overseeing exchange processes for administering exemptions from exchange-set limits on such commodities, the Commission does not have the same level of experience or comfort administering bona fide hedge recognitions and spread exemptions for the additional 16 contracts that would be subject to the proposed federal position limits and the new proposed exemption processes for the first time. Accordingly, the Commission preliminarily recognizes that permitting enumerated bona fide hedges and spread recognitions identified in the proposed ''spread transaction'' definition for these additional 16 contracts might not provide the purported benefits, or could result in increased costs, compared to the Commission's experience with the nine legacy agricultural products.

The Commission also preliminarily believes that the proposal will benefit market participants by providing market participants the option to choose the process for applying for a non-enumerated bona fide hedge (*i.e.,* either directly with the Commission or, alternatively, through the exchange-centric process discussed under proposed § 150.9 below) for the additional 16 contracts that would be newly subject to federal position limits that would be more efficient given the market participants unique facts, circumstances, and experience.[626] If a market participant chooses to apply through an exchange for federal position limits pursuant to proposed § 150.9, the market participant would also receive the added benefit of not being required to also submit another application directly to the Commission. The Commission anticipates that most market participants would apply directly to exchanges for non-enumerated bona fide hedges, pursuant to the proposed streamlined process § 150.9, as explained below, in which case the Commission believes that most market participants would incur the costs and benefits discussed thereunder. The Commission also preliminarily believes that this analysis also would apply with respect to non-enumerated bona fide hedges for the nine legacy agricultural contracts.

iii. Exemption-Related Recordkeeping

Proposed § 150.3(d) would require persons who avail themselves of any of the foregoing exemptions to maintain complete books and records relating to the subject position, and to make such records available to the Commission upon request under proposed § 150.3(e). These requirements would benefit market integrity by providing the Commission with the necessary information to monitor the use of exemptions from speculative position limits and help to ensure that any person who claims any exemption permitted by proposed § 150.3 can demonstrate compliance with the applicable requirements. The Commission does not expect these requirements to impose significant new costs on market participants, as these requirements are in line with existing Commission and exchange-level recordkeeping obligations.

iv. Exemption Renewals

Consistent with existing §§ 1.47 and 1.48, with respect to any Commission-recognized bona fide hedge or Commission-granted spread exemption pursuant to proposed § 150.3, the Commission would not require a market participant to reapply annually for bona fide hedges.[627] The Commission preliminarily believes that this will reduce burdens on market participants but also recognizes that not requiring market participants to annually reapply ostensibly could harm market integrity since the Commission would not directly receive updated information with respect to particular bona fide hedgers or exemption holders prior to the trader excessing the applicable federal limits.

However, the Commission preliminarily believes that any potential harm would be mitigated since the Commission, unlike exchanges, has access to aggregate market data, including positions held by individual market participants. Further, proposed § 150.3 would require a market participant to submit a new application if any information changes, or upon the Commission's request. On the other hand, market participants would benefit by not being required to annually submit new applications, which the Commission preliminarily believes will reduce compliance costs.

v. Exemptions for Financial Distress and Conditional Natural Gas Positions

Proposed § 150.3 would codify the Commission's existing informal practice with respect to exemptions for financial distress and conditional spot month limit exemption positions in natural gas. The same costs and benefits described above with respect to applications for bona fide hedge recognitions and spread exemptions would also apply. However, to the extent the Commission currently allows exemptions related to financial distress, the Commission preliminarily has determined that the costs and benefits with respect to the related application process already may be recognized by market participants.

[625] The Commission preliminarily anticipates that the proposed application process in § 150.3(b) could slightly reduce compliance-related costs, compared to the status quo application process to the Commission under existing §§ 1.47 and 1.48, because proposed § 150.3 would provide a single, standardized process for all bona fide hedge and spread exemption requests that is slightly less complex—and more clearly laid out in the proposed regulations—than the Commission's existing application processes. Nonetheless, since the Commission anticipates that most market participants would apply directly to exchanges for bona fide hedges and spread exemptions when provided the option under proposed § 150.9, the Commission believes that most market participants would incur the costs and benefits discussed thereunder.

[626] As noted above, market participants seeking spread exemptions not listed in the proposed ''spread transaction'' definition in proposed § 150.1 would be required to apply directly with the Commission under proposed § 150.3 and would not be permitted to apply under proposed § 150.9. The Commission preliminarily recognizes that these types of spread exemptions are difficult to analyze compared to either the spread exemptions identified in proposed § 150.1 or bona fide hedges in general. Accordingly, the Commission preliminarily has determined to require market participants to apply directly to the Commission. Further, compared to the spread exemptions identified in proposed § 150.1, the Commission anticipates relatively few requests, and so does not believe the proposed application requirement will impose a large aggregate burden across market participants.

[627] As discussed below, with respect to exchange-set limits under proposed § 150.5 or the exchange process for federal limits under proposed § 150.9, market participants would be required to annually reapply to exchanges.

b. Process for Market Participants To Apply to an Exchange for Non-Enumerated Bona Fide Hedge Recognitions for Purposes of Federal Limits (Proposed § 150.9) and Related Changes to Part 19 of the Commission's Regulations

Proposed § 150.9 would provide a framework whereby a market participant could avoid the existing dual application process described above and, instead, file one application with an exchange to receive a non-enumerated bona fide hedging recognition, which as discussed previously would not be self-effectuating for purposes of federal position limits. Under this process, a person would be allowed to exceed the federal limit levels following an exchange's review and approval of an application for a bona fide hedge recognition or spread exemption, provided that the Commission during its review does not notify the exchange otherwise within a certain period of time thereafter. Market participants who do not elect to use the process in proposed § 150.9 for purposes of federal position limits would be required to request relief both directly from the Commission under proposed § 150.3, as discussed above, and also apply to the relevant exchange, consistent with existing practices.[628]

i. Proposed § 150.9—Establishment of General Exchange Process

Pursuant to proposed § 150.9, exchanges that elect to process these applications would be required to file new rules or rule amendments with the Commission under § 40.5 of the Commission's regulations and obtain from applicants all information to enable the exchange to determine, and the Commission to verify, that the facts and circumstances support a non-enumerated bona fide hedge recognition. The Commission initially believes that exchanges' existing practices generally are consistent with the requirements of proposed § 150.9, and therefore exchanges would only incur marginal costs, if any, to modify their existing practices to comply. Similarly, the Commission preliminarily anticipates that establishing uniform, standardized exemption processes across exchanges would benefit market participants by reducing compliance costs. On the other hand, the Commission recognizes that exchanges that wish to participate in the processing of applications with the Commission under proposed § 150.9 would be required to expend resources to establish a process consistent with the Commission's proposal. However, to the extent exchanges have similar procedures, such benefits and costs may already have been realized by market participants and exchanges.

The Commission preliminarily believes that there are significant benefits to the proposed § 150.9 process that would be largely realized by market participants. The Commission preliminarily has determined that the use of a single application to process both exchange and federal position limits will benefit market participants and exchanges by simplifying and streamlining the process. For applicants seeking recognition of a non-enumerated bona fide hedge, proposed § 150.9 should reduce duplicative efforts because applicants would be saved the expense of applying in parallel to both an exchange and the Commission for relief from exchange-set position limits and federal position limits, respectively. Because many exchanges already possess similar application processes with which market participants are likely accustomed, compliance costs should be decreased in the form of reduced application-production time by market participants and reduced response time by exchanges.

As discussed above, in connection with the recognition of bona fide hedges for federal position limit purposes, current practices set forth in existing §§ 1.47 and 1.48 require market participants to differentiate between (i) enumerated non-anticipatory bona fide hedges that are self-effectuating, and (ii) enumerated anticipatory bona fide hedges and non-enumerated bona fide hedges for which market participants must apply to the Commission for prior approval. Under the proposal, the Commission would no longer distinguish among different types of enumerated bona fide hedges (*e.g.,* anticipatory versus non-anticipatory enumerated bona fide hedges), and therefore, would not require exchanges to have separate processes for enumerated anticipatory positions under proposed § 150.9 for the nine legacy agricultural contracts. The Commission's proposal would also eliminate the requirement for bona fide hedgers to file Form 204 or Form 304, as applicable, with respect to any bona fide hedge, whether enumerated or non-enumerated.[629] The Commission preliminarily expects this to benefit market participants by providing a more efficient and less complex process that is consistent with existing practices at the exchange-level.

On the other hand, the Commission recognizes proposed § 150.9 would impose new costs related to non-enumerated bona fide hedges for the additional 16 contracts that would be newly subject to federal position limits. Under the proposal, market participants would now be required to submit applications to receive prior approval for federal position limits purposes. However, since the Commission preliminarily understands that exchanges already require market participants to submit applications and receive prior approval under exchange-set limits for all types of bona fide hedges, the Commission does not believe proposed § 150.9 would impose any additional incremental costs on market participants beyond those already incurred under exchanges' existing processes. Accordingly, the Commission preliminarily believes that any costs already may have been realized by market participants.

Further, the Commission preliminarily believes that employing a concurrent process with exchanges to oversee the non-enumerated bona fide hedges that would not be self-effectuating for federal position limits purposes would benefit market integrity by ensuring that market participants are appropriately relying on such bona fide hedges and not entering into such positions in order to attempt to manipulate the market or evade position limits. However, to the extent that exchange oversight, consistent with Commission standards and DCM core principles, already exists, such benefits may already be realized.

ii. Proposed § 150.9—Exchange Expertise, Market Integrity, and Commission Oversight

For non-enumerated bona fide hedge recognitions that would require the Commission's prior approval, the proposal would provide a framework that utilizes existing exchange resources and expertise so that fair access and liquidity are promoted at the same time market manipulations, squeezes, corners, and any other conduct that would disrupt markets are deterred and prevented. Proposed § 150.9 would build on existing exchange processes, which the Commission preliminarily

[628] As noted above, the Commission preliminarily anticipates that most, if not all, market participants will use proposed § 150.9, rather than proposed § 150.3, where permitted.

[629] *See infra* Section II.H.3. (discussion of proposed changes to part 19 eliminating Form 204 and portions of Form 304).

believes would strengthen the ability of the Commission and exchanges to monitor markets and trading strategies while reducing burdens on both the exchanges, which would administer the process, and market participants, who would utilize the process. For example, exchanges are familiar with their market participants' commercial needs, practices, and trading strategies, and already evaluate hedging strategies in connection with setting and enforcing exchange-set position limits; accordingly, exchanges should be able to readily identify bona fide hedges.[630]

For these reasons, the Commission has preliminarily determined that allowing market participants to apply through an exchange under proposed § 150.9, rather than directly to the Commission as required under existing § 1.47, is likely to be more efficient than if the Commission itself initially had to review and approve all applications. The Commission preliminarily considers the increased efficiency in processing applications under proposed § 150.9 as a benefit to bona fide hedgers and liquidity providers. By having the availability of the exchange's analysis and view of the markets, the Commission would be better informed in its review of the market participant and its application, which in turn may further benefit market participants in the form of administrative efficiency and regulatory consistency. However, the Commission recognizes additional costs for exchanges required to create and submit these real-time notices. To the extent exchanges already provide similar notice to the Commission or to market participants, or otherwise are required to notify the Commission under certain circumstances, such benefits and costs already may have been realized.

On the other hand, to the extent exchanges would become more involved with respect to review and oversight of market participants' bona fide hedges and spread exemptions, exchanges could incur additional costs. However, as noted, the Commission believes most of the costs have been realized by exchanges under current market practice.

At the same time, the Commission also preliminarily recognizes that this aspect of the proposal could potentially harm market integrity. Absent other provisions, since exchanges profit from increased activity, an exchange could hypothetically seek a competitive advantage by offering excessively permissive exemptions, which could allow certain market participants to utilize non-enumerated bona fide hedge recognitions to engage in excessive speculation or to manipulate market prices. If an exchange engaged in such activity, other market participants would likely face greater costs through increased transaction fees, including forgoing trading opportunities resulting from market prices moving against market participants and/or preventing the market participant from executing at its desired prices, which may also further lead to inefficient hedging. However, the Commission preliminarily believes that these hypothetical costs are unfounded since under proposed § 150.9 the Commission would review the applications submitted by market participants for bona fide hedge recognitions and spread exemptions; the Commission emphasizes that proposed § 150.9 is not providing exchanges with an ability to recognize a bona fide hedge or grant an exemption for federal position limit purposes in lieu of a Commission review. Rather, proposed § 150.9(e) and (f) would require an exchange to provide the Commission with notice of the disposition of any application for purposes of exchange limits concurrently with the notice the exchange would provide to the applicant, and the Commission would have 10 business days to make its determination for federal position limits purposes (although, in connection with ''sudden or unforeseen increases'' in bona fide hedging needs, as discussed in connection with proposed § 150.3, proposed § 150.9 would require the Commission to make its determination within two business days).

On the other hand, the Commission also recognizes that there could be potential costs to bona fide hedgers if under the proposal they are forced to wait up to 10 business days for the Commission to complete its review after the exchange's initial review—especially compared to the status quo for the 16 commodities that would be subject to federal limits for the first time under this release and currently are not required to receive the Commission's prior approval. As a result, the Commission preliminarily recognizes that a market participant could incur costs by waiting during the 10 business day period or be required to enter into a less efficient hedge, which would harm liquidity. However, the Commission believes this concern is mitigated since proposed § 150.9, similar to proposed § 150.3, would permit a market participant that demonstrates a ''sudden or unforeseen'' increase in its bona fide hedging needs to enter into a bona fide hedge without first obtaining the Commission's prior approval, as long as the market participant submits a retroactive application to the Commission within five business days of exceeding the applicable position limit. In turn, the Commission would only have two business days (as opposed to the default 10 business days) to complete its review for federal purposes. The Commission preliminarily believes this ''five-business day retroactive exemption'' would benefit bona fide hedgers compared to existing § 1.47, which requires Commission prior approval, since hedgers that would qualify to exercise the five-business day retroactive exemption are also likely facing more acute hedging needs—with potentially commensurate costs if required to wait. This provision would also leverage, for federal position limit purposes, existing exchange practices for granting retroactive exemptions from exchange-set limits.

On the other hand, the proposed five-business day retroactive exemption could harm market liquidity and bona fide hedgers since the Commission would be able to require a market participant to exit its position if the exchange or the Commission does not approve of the retroactive request, and such uncertainty could cause market participants to either enter into smaller bona fide hedge positions than it otherwise would or could cause the bona fide hedger to delay entering into its hedge, in either case potentially causing bona fide hedgers to incur increased hedging costs. However, the Commission preliminarily believes this concern is partially mitigated since proposed § 150.9 would require the purported bona fide hedger to exit its position in a ''commercially reasonable time,'' which the Commission believes should partially mitigate any costs incurred by the market participant compared to either an alternative that would require the bona fide hedger to exit its position immediately, or the status quo where the market participant either is unable to enter into a hedge at all without Commission approval.

While existing § 1.47 does not require market participants to annually reapply for certain bona fide hedges, proposed § 150.9 would require market participants to reapply at least annually with exchanges for purposes of federal position limits. The Commission recognizes that requiring market participants to reapply annually could impose additional costs on those that are not currently required to do so. However, the Commission believes that this is consistent with industry practice

[630] For a discussion on the history of exemptions, *see* 2013 Proposal, 78 FR at 75703–75706.

with respect to exchange-set limits and that market participants are familiar with exchanges' exemption processes, which should reduce related costs.[631] Further, the Commission preliminarily believes that market integrity would be strengthened by ensuring that exchanges receive updated trader information that may be relevant to the exchange's oversight.[632] However, to the extent any of these benefits and costs reflect current market practice, they already may have been realized by exchanges and market participants.

In addition, the proposed exchange-to-Commission monthly report in proposed § 150.5(a)(4) would further detail the exchange's disposition of a market participant's application for recognition of a bona fide hedge position or spread exemption as well as the related position(s) in the underlying cash markets and swaps markets. The Commission believes that such reports would provide greater transparency by facilitating the tracking of these positions by the Commission and would further assist the Commission in ensuring that a market participant's activities conform to the exchange's rules and to the CEA. The combination of the ''real-time'' exchange notification and exchanges' provision of monthly reports to the Commission under proposed §§ 150.9(e)(1) and 150.5(a)(4), respectively, would provide the Commission with enhanced surveillance tools on both a ''real-time'' and a monthly basis to ensure compliance with the requirements of this proposal. The Commission anticipates additional costs for exchanges required to create and submit monthly reports because the proposed rules would require exchanges to compile the necessary information in the form and manner required by the Commission. However, to the extent exchanges already provide similar notice to the Commission, or otherwise are required to notify the Commission under certain circumstances, such benefits and costs already may have been realized

iii. Proposed 150.9(d)—Recordkeeping

Proposed § 150.9(d) would require exchanges to maintain complete books and records of all activities relating to the processing and disposition of any applications, including applicants' submission materials, exchange notes, and determination documents.[633] The Commission preliminarily believes that this will benefit market integrity and Commission oversight by ensuring that pertinent records will be readily accessible, as needed by the Commission. However, the Commission acknowledges that such requirements would impose costs on exchanges. Nonetheless, to the extent that exchanges are already required to maintain similar records, such costs and benefits already may be realized.[634]

iv. Proposed § 150.9 (g)—Commission Revocation of Previously-Approved Applications

The Commission preliminarily acknowledges that there may be costs to market participants if the Commission revokes the hedge recognition for federal purposes under proposed § 150.9(f). Specifically, market participants could incur costs to unwind trades or reduce positions if the Commission required the market participant to do so under proposed § 150.9(f)(2).

However, the potential cost to market participants would be mitigated under proposed § 150.9(f) since the Commission would provide a commercially reasonable time for a person to come back into compliance with the federal position limits, which the Commission believes should mitigate transaction costs to exit the position and allow a market participant the opportunity to potentially execute other hedging strategies.

v. Proposed § 150.9—Commodity Indexes and Risk Management Exemptions

Proposed § 150.9(b) would prohibit exchanges from recognizing as a bona fide hedge with respect to commodity index contracts. The Commission recognizes that this proposed prohibition could alter trading strategies that currently use commodity index contracts as part of an entity's risk management program. Although there likely would be a cost to change risk management strategies for entities that currently rely on a bona fide hedge recognition for positions in commodity index contracts, as discussed above, the Commission believes that such financial products are not substitutes for positions in a physical market and therefore do not satisfy the statutory requirement for a bona fide hedge under section 4a(c)(2) of the Act.[635] In addition, the Commission further posits that this cost may be reduced or mitigated by the proposed increased in federal position limit levels set forth in proposed § 150.2 or by the implementation of the pass-through swap provision of the proposed bona fide hedge definition.[636]

c. Request for Comment

(48) The Commission requests comment on its considerations of the benefits and costs of proposed § 150.3 and § 150.9. Are there additional benefits or costs that the Commission should consider? Has the Commission misidentified any benefits or costs? Commenters are encouraged to include both quantitative and qualitative assessments of these benefits and costs, as well as data or other information to support such assessments.

(49) The Commission requests comment on whether a Commission-administered process, such as the process in proposed § 150.3, would promote more consistent and efficient decision-making. Commenters are encouraged to include both quantitative and qualitative assessments, as well as data or other information to support such assessments.

(50) The Commission recognizes there exist alternatives to proposed § 150.9. These include such alternatives as: (1) Not permitting exchanges to administer any process to recognize bona fide hedging transactions or positions or grant exempt spread positions for purposes of federal limits; or (2) maintaining the status quo. The Commission requests comment on whether an alternative to what is proposed would result in a superior cost-benefit profile, with support for any such position.

[631] *See infra* Section IV.A.6. (discussing proposed § 150.5).

[632] In contrast, the Commission, unlike exchanges, has access to aggregate market data, including positions held by individual market participants, and so the Commission has preliminarily determined that requiring market participants to apply annually under proposed § 150.3, absent any changes to their application, would not benefit market integrity to the same extent.

[633] Moreover, consistent with existing § 1.31, the Commission expects that these records would be readily accessible until the termination, maturity, or expiration date of the bona fide hedge recognition or exempt spread position and during the first two years of the subsequent, five-year retention period.

[634] The Commission believes that exchanges that process applications for recognition of bona fide hedging transactions or positions and/or spread exemptions currently maintain records of such applications as required pursuant to other existing Commission regulations, including existing § 1.31. The Commission, however, also believes that proposed § 150.9(d) may impose additional recordkeeping obligations on such exchanges. The Commission estimates that each exchange electing to administer the proposed process would likely incur a *de minimis* cost annually to retain records for each proposed process compared to the status quo. *See generally* Section IV.B. (discussing the Commission's PRA determinations).

[635] *See supra* Section III.F.6. (discussion of commodity indices); *see supra* Section IV.A.4.b.i.(1). (discussion of elimination of the risk management exemption).

[636] *See supra* Section IV.A.4.b.i.(1). (discussion of the pass-through swap exemption).

d. Related Changes to Part 19 of the Commission's Regulations Regarding the Provision of Information by Market Participants

Under existing regulations, the Commission relies on Form 204 [637] and Form 304,[638] known collectively as the ''series '04'' reports, to monitor for compliance with federal position limits. Under existing part 19, market participants that hold bona fide hedging positions in excess of federal limits for the nine legacy agricultural contracts currently subject to federal limits under existing § 150.2 must justify such overages by filing the applicable report (Form 304 for cotton and Form 204 for the other eight legacy commodities) each month.[639] The Commission uses these reports to determine whether a trader has sufficient cash positions that justify futures and options on futures positions above the speculative limits.

As discussed above, with respect to bona fide hedging positions, the Commission is proposing a streamlined approach under proposed § 150.9 to cash-market reporting that reduces duplication between the Commission and the exchanges. Generally, the Commission is proposing amendments to part 19 and related provisions in part 15 that would: (i) Eliminate Form 204; and (ii) amend the Form 304, in each case to remove any cash-market reporting requirements. Under this proposal, the Commission would instead rely on cash-market reporting submitted directly to the exchanges, pursuant to proposed §§ 150.5 and 150.9,[640] or request cash-market information through a special call.

The proposed cash-market and swap-market reporting elements of §§ 150.5 and 150.9 discussed above are largely consistent with current market practices with respect to exchange-set limits and thus should not result in any new costs. The proposed elimination of Form 204 and the cash-market reporting segments of the Form 304 would eliminate a reporting burden and the costs associated thereto for market participants. Instead, market participants would realize significant benefits by being able to submit cash market reporting to one entity—the exchanges—instead of having to comply with duplicative reporting requirements between the Commission and applicable exchange, or implement new Commission processes for reporting cash market data for market participants who will be newly subject to position limits.[641] Further, market participants are generally already familiar with exchange processes for reporting and recognizing bona fide hedging exemptions, which is an added benefit, especially for market participants that would be newly subject to federal position limits.

Further, the proposed changes would not impact the Commission's existing provisions for gathering information through special calls relating to positions exceeding limits and/or to reportable positions. Accordingly, as discussed above, the Commission proposes that all persons exceeding the proposed limits set forth in proposed § 150.2, as well as all persons holding or controlling reportable positions pursuant to existing § 15.00(p)(1), must file any pertinent information as instructed in a special call.[642] This proposed provision is similar to existing § 19.00(a)(3), but would require any such person to file the information as instructed in the special call, rather than to file a series '04 report.[643] The Commission preliminarily believes that relying on its special call authority is less burdensome for market participants than the existing Forms 204 and 304 reporting costs, as special calls are discretionary requests for information whereas the series '04 reporting requirements are a monthly, recurring reporting burden for market participants.

6. Exchange-Set Position Limits (Proposed § 150.5)

a. Introduction

Existing § 150.5 addresses exchange-set position limits on contracts not subject to federal limits under existing § 150.2, and sets forth different standards for DCMs to apply in setting limit levels depending on whether the DCM is establishing limit levels: (1) On an initial or subsequent basis; (2) for cash-settled or physically-settled contracts; and (3) during or outside the spot month.

In contrast, for physical commodity derivatives, proposed § 150.5(a) and (b) would (1) expand existing § 150.5's framework to also cover contracts subject to federal limits under § 150.2; (2) simplify the existing standards that DCMs apply when establishing exchange-set position limits; and (3) provide non-exclusive acceptable practices for compliance with those standards.[644] Additionally, proposed § 150.5(d) would require DCMs to adopt aggregation rules that conform to existing § 150.4.[645]

b. Physical Commodity Derivative Contracts Subject to Federal Position Limits Under § 150.5 (Proposed § 150.5(a))

i. Exchange-Set Position Limits and Related Exemption Process

For contracts subject to federal limits under § 150.2, proposed § 150.5(a)(1) would require DCMs to establish exchange-set limits no higher than the level set by the Commission. This is not a new requirement, and merely restates the applicable requirement in DCM Core Principle 5.[646]

Proposed § 150.5(a)(2) would authorize DCMs to grant exemptions from such limits and is generally consistent with current industry practice. The Commission has

[637] *CFTC Form 204: Statement of Cash Positions in Grains, Soybeans, Soybean Oil, and Soybean Meal,* U.S. Commodity Futures Trading Commission website, *available at https://www.cftc.gov/sites/default/files/idc/groups/public/@forms/documents/file/cftcform204.pdf* (existing Form 204).

[638] *CFTC Form 304: Statement of Cash Positions in Cotton,* U.S. Commodity Futures Trading Commission website, *available at http://www.cftc.gov/ucm/groups/public/@forms/documents/file/cftcform304.pdf* (existing Form 204). Parts I and II of Form 304 address fixed-price cash positions used to justify cotton positions in excess of federal limits. As described below, Part III of Form 304 addresses unfixed price cotton ''on-call'' information, which is not used to justify cotton positions in excess of limits, but rather to allow the Commission to prepare its weekly cotton on-call report.

[639] 17 CFR 19.01.

[640] *See supra* Section II.G.3. (discussion of proposed § 150.9). As discussed above, leveraging existing exchange application processes should avoid duplicative Commission and exchange procedures and increase the speed by which position limit exemption applications are addressed. While the Commission would recognize spread exemptions based on exchanges' application processes that satisfy the requirements in proposed § 150.9, for purposes of federal limits, the cash-market reporting regime discussed in this section of the release only pertains to bona fide hedges, not to spread exemptions, because the Commission has not traditionally relied on cash-market information when reviewing requests for spread exemptions.

[641] The Commission has noted that certain commodity markets will be subject to federal position limits for the first time. In addition, the existing Form 204 would be inadequate for reporting of cash-market positions relating to certain energy contracts that would be subject to federal limits for the first time under this proposal.

[642] *See* proposed § 19.00(b).

[643] 17 CFR 19.00(a)(3).

[644] *See* 17 CFR 150.2. Existing § 150.5 addresses only contracts *not* subject to federal limits under existing § 150.2 (aside from certain major foreign currency contracts). To avoid confusion created by the parallel federal and exchange-set position limit frameworks, the Commission clarifies that proposed § 150.5 deals solely with exchange-set position limits and exemptions therefrom, whereas proposed § 150.9 deals solely with the process for purposes of federal limits.

[645] *See* 17 CFR 150.4.

[646] *See* Commission regulation § 38.300 (restating DCMs' statutory obligations under the CEA § 5(d)(5), 7 U.S.C. 7(d)(5)). Accordingly, the Commission will not discuss any costs or benefits related to this proposed change since it merely reflects an existing regulatory and statutory obligation.

preliminarily determined that codifying such practice would establish important, minimum standards needed for DCMs to administer—and the Commission to oversee—an effective and efficient program for granting exemptions to exchange-set limits in a manner that does not undermine the federal limits framework.[647] In particular, proposed § 150.5(a)(2) would protect market integrity and prevent exchange-granted exemptions from undermining the federal limits framework by requiring DCMs to either conform their exemptions to the type the Commission would grant under proposed §§ 150.3 or 150.9, or to cap the exemption at the applicable federal limit level and to assess whether an exemption request would result in a position that is ''not in accord with sound commercial practices'' or would ''exceed an amount that may be established or liquidated in an orderly fashion in that market.''

Absent other factors, this element of the proposal could potentially increase compliance costs for traders since each DCM could establish different exemption-related rules and practices. However, to the extent that rules and procedures currently differ across exchanges, any compliance-related costs and benefits for traders may already be realized. Similarly, absent other provisions, a DCM could hypothetically seek a competitive advantage by offering excessively permissive exemptions, which could allow certain market participants to utilize exemptions in establishing sufficiently large positions to engage in excessive speculation and to manipulate market prices. However, proposed § 150.5(a)(2) would mitigate these risks by requiring that exemptions that do not conform to the types the Commission may grant under proposed § 150.3 could not exceed proposed § 150.2's applicable federal limit unless the Commission has first approved such exemption. Moreover, before a DCM could permit a new exemption category, proposed § 150.5(e) would require a DCM to submit rules to the Commission allowing for such exemptions, allowing the Commission to ensure that the proposed exemption type would be consistent with applicable requirements, including with the requirement that any resulting positions would be ''in accord with sound commercial practices'' and may be ''established and liquidated in an orderly fashion.''

Proposed § 150.5(a)(2) additionally would require traders to re-apply to the exchange at least annually for the exchange-level exemption. The Commission recognizes that requiring traders to re-apply annually could impose additional costs on traders that are not currently required to do so. However, the Commission believes this is industry practice among existing market participants, who are likely already familiar with DCMs' exemption processes.[648] This familiarity should reduce related costs, and the proposal should strengthen market integrity by ensuring that DCMs receive updated information related to a particular exemption.

Proposed § 150.5(a)(2) also would require a DCM to provide the Commission with certain monthly reports regarding the disposition of any exemption application, including the recognition of any position as a bona fide hedge, the exemption of any spread transaction or other position, the revocation or modification or previously granted recognitions or exemptions, or the rejection of any application, as well as certain related information similar to the information that applicants must provide the Commission under proposed § 150.3 or an exchange under proposed § 150.9, including underlying cash-market and swap-market information related to bona fide hedge positions. The Commission generally recognizes that this monthly reporting requirement could impose additional costs on exchanges, although the Commission also preliminarily has determined that it would assist with its oversight functions and therefore benefit market integrity. The Commission discusses this proposed requirement in greater detail in its discussion of proposed § 150.9.[649]

Further, while existing § 150.5(d) does not explicitly address whether traders should request an exemption prior to taking on its position, proposed § 150.5(a)(2), in contrast, would explicitly authorize (but not require) DCMs to permit traders to file a retroactive exemption request due to ''demonstrated sudden or unforeseen increases in its bona fide hedging needs,'' but only within five business days after the trade and as long as the trader provides a supporting explanation.[650] As noted above, these provisions are largely consistent with existing market practice, and to this extent, the benefits and costs already may have been realized by DCMs and market participants.

ii. Pre-Existing Positions

Proposed § 150.5(a)(3) would require DCMs to impose exchange-set position limits on ''pre-existing positions,'' other than pre-enactment swaps and transition period swaps, during the spot month, but not outside of the spot month, as long as any position outside of the spot month: (i) Was acquired in good faith consistent with the ''pre-existing position'' definition in proposed § 150.1;[651] and (ii) would be attributed to the person if the position increases after the limit's effective date. The Commission believes that this approach would benefit market integrity since pre-existing positions that exceed spot-month limits could result in market or price disruptions as positions are rolled into the spot month.[652] However, the Commission acknowledges that, on its face, including a ''good-faith'' requirement in the proposed ''pre-existing position'' definition could hypothetically diminish market integrity since determining whether a trader has acted in ''good faith'' is inherently subjective and could result in disparate treatment of traders by a particular exchange or across exchanges seeking a competitive advantage with one another. For example, with respect to a particular large or influential exchange member, an exchange could, in order to maintain the business relationship, be incentivized to be more liberal with its conclusion that the member obtained its position in ''good faith,'' or could be more liberal in

[647] This proposed standard is substantively consistent with current market practice. *See, e.g.,* CME Rule 559 (providing that CME will consider, among other things, the ''applicant's business needs and financial status, as well as whether the positions can be established and liquidated in an orderly manner . . .'') and ICE Rule 6.29 (requiring a statement that the applicant's ''positions will be initiated and liquidated in an orderly manner . . .''). This proposed standard is also substantively similar to existing § 150.5's standard and is not intended to be materially different. *See* existing § 150.5(d)(1) (an exemption may be limited if it would not be ''in accord with sound commercial practices or exceed an amount which may be established and liquidated in orderly fashion.'') 17 CFR 150.5(d)(1).

[648] As noted above, the Commission believes this requirement is consistent with current market practice. *See, e.g.,* CME Rule 559 and ICE Rule 6.29. While ICE Rule 6.29 merely requires a trader to ''submit to [ICE Exchange] a written request'' without specifying how often a trader must reapply, the Commission understands from informal discussions between Commission staff and ICE that traders must generally submit annual updates.

[649] *See supra* Section IV.A.5.b.ii. (discussion of monthly exchange-to-Commission report in proposed § 150.5(a)).

[650] Certain exchanges currently allow for the submission of exemption requests up to five business days after the trader established the position that exceeded a limit in certain circumstances. *See, e.g.,* CME Rule 559 and ICE's ''Guidance on Position Limits'' (Mar. 2018).

[651] Proposed § 150.1 would define ''pre-existing position'' to mean ''any position in a commodity derivative contract acquired in good faith prior to the effective date'' of any applicable position limit.

[652] The Commission is particularly concerned about protecting the spot month in physical-delivery futures from corners and squeezes.

general in order to gain a competitive advantage. The Commission believes the risk of any such unscrupulous trader or exchange is mitigated since exchanges would still be subject to Commission oversight and to DCM Core Principles 4 (''prevention of market disruption'') and 12 (''protection of markets and market participants''), among others, and since proposed § 150.5(a)(3) also would require that exchanges must attribute the position to the trader if its position increases after the position limit's effective date.

c. Physical Commodity Derivative Contracts Not Yet Subject to Federal Position Limits Under § 150.2 (Proposed § 150.5(b))

i. Spot Month Limits and Related Acceptable Practices

For cash-settled contracts during the spot month, existing § 150.5 sets forth the following qualitative standard: exchange-set limits should be ''no greater than necessary to minimize the potential for market manipulation or distortion of the contract's or underling commodity's price.'' However, for physically-settled contracts, existing § 150.5 provides a one-size-fits-all parameter that exchange limits must be no greater than 25 percent of EDS.

In contrast, the proposed standard for setting spot month limit levels for physical commodity derivative contracts not subject to federal position limits set forth in proposed § 150.5(b)(1) would not distinguish between cash-settled and physically-settled contracts, and instead would require DCMs to apply the existing § 150.5 qualitative standard to both.[653] The Commission also proposes a related, non-exclusive acceptable practice that would deem exchange-set position limits for both cash-settled and physically-settled contracts subject to proposed § 150.5(b) to be in compliance if the limits are no higher than 25 percent of the spot-month EDS.

Applying the existing § 150.5 qualitative standard and non-exclusive acceptable practice in proposed 150.5(b)(1), rather than a one-size-fits-all regulation, to both cash-settled and physically-settled contracts during the spot month is expected to enhance market integrity by permitting a DCM to establish a more tailored, product-specific approach by applying other parameters that may take into account the unique liquidity and other characteristics of the particular market and contract, which is not possible under the one-size-fits-all 25 percent EDS parameter set forth in existing § 150.5. While the Commission recognizes that the existing 25 percent EDS parameter has generally worked well, the Commission also recognizes that there may be circumstances where other parameters may be preferable and just as effective, if not more, including, for example, if the contract is cash-settled or does not have a reasonably accurate measurable deliverable supply, or if the DCM can demonstrate that a different parameter would better promote market integrity or efficiency for a particular contract or market.

On the other hand, the Commission recognizes that proposed § 150.5(b)(1) could adversely affect market integrity by theoretically allowing DCMs to establish excessively high position limits in order to gain a competitive advantage, which also could harm the integrity of other markets that offer similar products.[654] However, the Commission believes these potential risks would be mitigated since (i) proposed § 150.5(e) would require DCMs to submit proposed position limits to the Commission, which would review those rules for compliance with § 150.5(b), including to ensure that the proposed limits are ''in accord with sound commercial practices'' and that they may be ''established and liquidated in an orderly fashion''; and (ii) proposed § 150.5(b)(3) would require DCMs to adopt position limits for any new contract at a ''comparable'' level to existing contracts that are substantially similar (*i.e.,* ''look-alike contracts'') on other exchanges unless the Commission approves otherwise. Moreover, this latter requirement also may reduce the amount of time and effort needed for the DCM and Commission staff to assess proposed limits for any new contract that competes with another DCM's existing contract.

ii. Non-Spot Month Limits/Accountability Levels and Related Acceptable Practices

Existing § 150.5 provides one-size-fits-all levels for non-spot month contracts and allows for position accountability after a contract's initial listing only for those contracts that satisfy certain trading thresholds.[655] In contrast, for contracts outside the spot-month, proposed § 150.5(b)(2) would require DCMs to establish either position limits or position accountability levels that satisfy the same proposed qualitative standard discussed above for spot-month contracts.[656] For DCMs that establish position limits, the Commission proposes related acceptable practices that would provide non-exclusive parameters that are generally consistent with existing § 150.5's parameters for non-spot month contracts.[657] For DCMs that establish

[653] Proposed § 150.5(b)(1) would require DCMs to establish position limits for spot-month contracts at a level that is ''necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index.'' Existing § 150.5 also distinguishes between ''levels at designation'' and ''adjustments to levels,'' although each category similarly incorporates the qualitative standard for cash-settled contracts and the 25-percent metric for physically-settled contracts. Proposed § 150.5(b) would eliminate this distinction. The Commission intends the proposed § 150.5(b)(1) standard to be substantively the same as the existing § 150.5 standard for cash-settled contracts, except that under proposed § 150.5(b)(1), the standard would apply to physically-settled contracts.

[654] Since the existing § 150.5 framework already applies the proposed qualitative standard to cash-settled spot-month contracts, any new risks resulting from the proposed standard would occur only with respect to physically-settled contracts, which are currently subject to the one-size-fits-all 25-percent EDS parameter under the existing framework.

[655] As noted above, in establishing the specific metric, existing § 150.5 distinguishes between ''levels at designation'' and ''adjustments to [subsequent] levels.'' Proposed § 150.5(b)(2) would eliminate this distinction and apply the qualitative standard for all non-spot month position limit and accountability levels.

[656] DCM Core Principle 5 requires DCMs to establish either position limits or accountability for speculators. *See* Commission regulation § 38.300 (restating DCMs' statutory obligations under the CEA § 5(d)(5)). Accordingly, inasmuch as proposed § 150.5(b)(2) would require DCMs to establish position limits or accountability, the proposal does not represent a change to the status quo baseline requirements.

[657] Specifically, the acceptable practices proposed in Appendix F to part 150 would provide that DCMs would be deemed to comply with the proposed § 150.5(b)(2)(i) qualitative standard if they establish non-spot limit levels no greater than any one of the following: (1) Based on the average of historical positions sizes held by speculative traders in the contract as a percentage of open interest in that contract; (2) the spot month limit level for that contract; (3) 5,000 contracts (scaled up proportionally to the ratio of the notional quantity per contract to the typical cash market transaction if the notional quantity per contract is smaller than the typical cash market transaction, or scaled down proportionally if the notional quantity per contract is larger than the typical cash market transaction); or (4) 10 percent of open interest in that contract for the most recent calendar year up to 50,000 contracts, with a marginal increase of 2.5 percent of open interest thereafter.

These proposed parameters have largely appeared in existing § 150.5 for many years in connection with non-spot month limits, either for levels at designation, or for subsequent levels, with certain revisions. For example, while existing § 150.5(b)(3) has provided a limit of 5,000 contracts for energy products, existing § 150.5(b)(2) provides a limit of 1,000 contracts for physical commodities other than energy products. The proposed acceptable practice parameters would create a uniform standard of 5,000 contracts for all physical commodities. The Commission expects that the 5,000 contract acceptable practice, for example, would be a useful rule of thumb for exchanges because it would allow them to establish limits and demonstrate compliance with Commission regulations in a relatively efficient manner, particularly for new contracts that have yet to establish open interest. The spot month limit level under item (2) above position accountability, § 150.1's proposed definition of ''position accountability'' would provide that a trader must reduce its position upon a DCM's request, which is generally consistent with existing § 150.5's framework, but would not distinguish between trading volume or contract type, like existing § 150.5. While DCMs would be provided the ability to decide whether to use limit levels or accountability levels for any such contract, under either approach, the DCM would have to set a level that is ''necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index.''

Proposed § 150.5(b)(2) would benefit market efficiency by authorizing DCMs to determine whether position limits or accountability would be best-suited outside of the spot month based on the DCM's knowledge of its markets. For example, position accountability could improve liquidity compared to position limits since liquidity providers may be more willing or able to participate in markets that do not have hard limits. As discussed above, DCMs are well-positioned to understand their respective markets, and best practices in one market may differ in another market, including due to different market participants or liquidity characteristics of the underlying commodities. For DCMs that choose to establish position limits, the Commission believes that applying the proposed § 150.5 qualitative standard to contracts outside the spot-month would benefit market integrity by permitting a DCM to establish a more tailored, product-specific approach by applying other tools that may take into account the unique liquidity and other characteristics of the particular market and contract, which is not possible under the existing § 150.5 specific parameters for non-spot month contracts. While the Commission recognizes that the existing parameters may have been well-suited to market dynamics when initially promulgated, the Commission also recognizes that open interest may have changed for certain contracts subject to proposed § 150.5(b), and open interest will likely continue to change in the future (*e.g.,* as new contracts may be introduced and as supply and/or demand may change for underlying commodities). In cases where open interest has not increased, the exchange may not need to change existing limit levels. But, for contracts where open interest have increased, the exchange would be able to raise its limits to facilitate liquidity consistent with an orderly market. However, the Commission reiterates that the specific parameters in the proposed acceptable practices are merely non-exclusive examples, and an exchange would be able to establish higher (or lower) limits, provided the exchange submits its proposed limits to the Commission under proposed § 150.5(e) and explains how its proposed limits satisfy the proposed qualitative standard and are otherwise consistent with all applicable requirements.

The Commission, however, recognizes that proposed § 150.5(b)(2) could adversely affect market integrity by potentially allowing DCMs to establish position accountability levels rather than position limits, regardless of whether the contract exceeds the volume-based thresholds provided in existing § 150.5. However, proposed § 150.5(e) would require DCMs to submit any proposed position accountability rules to the Commission for review, and the Commission would determine on a case-by-case basis whether such rules satisfy regulatory requirements, including the proposed qualitative standard. Similarly, in order to gain a competitive advantage, DCMs could theoretically set excessively high accountability (or position limit) levels, which also could potentially adversely affect markets with similar products. However, the Commission believes these risks would be mitigated since (i) proposed § 150.5(e) would require DCMs to submit proposed position accountability (or limits) to the Commission, which would review those rules for compliance with § 150.5(b), including to ensure that the exchange's proposed accountability levels (or limits) are ''necessary and appropriate to reduce the potential threat of market manipulation or price distortion'' of the contract or underlying commodity; and (ii) proposed § 150.5(b)(3) would require DCMs to adopt position limits for any new contract at a ''comparable'' level to existing contracts that are substantially similar on other exchanges unless the Commission approves otherwise.

iii. Exchange-Set Limits on Economically Equivalent Swaps

As discussed above, swaps that would qualify as ''economically equivalent swaps'' would become subject to the federal position limits framework. However, the Commission is proposing to allow exchanges to delay compliance—including enforcing position limits—with respect to exchange-set limits on economically equivalent swaps. The proposed delayed compliance would benefit the swaps markets by permitting SEFs and DCMs that list economically equivalent swaps more time to establish surveillance and compliance systems; as noted in the preamble, such exchanges currently lack sufficient data regarding individual market participants' open swap positions, which means that requiring exchanges to establish oversight over participants' positions currently would impose substantial costs and would be currently impracticable.

Nonetheless, the Commission's preliminary determination to permit exchanges to delay implementing federal position limits on swaps could incentivize market participants to leave the futures markets and instead transact in economically equivalent swaps, which could reduce liquidity in the futures and related options markets, which could also increase transaction and hedging costs. Delaying position limits on swaps therefore could harm market participants, especially end-users that do not transact in swaps, if many participants were to shift trading from the futures to the swaps markets. In turn, end-users could pass on some of these increased costs to the public at large.[658] However, the Commission believes that these concerns would be mitigated to the extent the Commission would still oversee and enforce federal position limits even if the exchanges would not be required to do so.

d. Position Aggregation

Proposed § 150.5(d) would require all DCMs that list physical commodity derivative contracts to apply aggregation rules that conform to existing § 150.4, regardless of whether the contract is subject to federal position limits under § 150.2.[659] The Commission believes

would be a new parameter for non-spot month contracts.

[658] On the other hand, the Commission has not seen any shifting of liquidity to the swaps markets—or general attempts at market manipulation or evasion of federal position limits—with respect to the nine legacy core referenced futures contracts, even though swaps currently are not subject to federal or exchange position limits.

[659] The Commission adopted final aggregation rules in 2016 under existing § 150.4, which applies to contracts subject to federal limits under § 150.2. *See* Final Aggregation Rulemaking, 81 FR at 91454. Under the Final Aggregation Rulemaking, unless an exemption applies, a person's positions must be aggregated with positions for which the person controls trading or for which the person holds a 10 percent or greater ownership interest. The Division of Market Oversight has issued time-limited no-action relief from some of the aggregation requirements contained in that rulemaking. *See* CFTC Letter No. 19–19 (July 31, 2019), *available at https://www.cftc.gov/csl/19-19/download.* Commission regulation § 150.4(b) sets forth several permissible exemptions from aggregation.

proposed § 150.5(d) would benefit market integrity in several ways. First, a harmonized approach to aggregation across exchanges that list physical commodity derivative contracts would prevent confusion that could result from divergent standards between federal limits under § 150.2 and exchange-set limits under § 150.5(b). As a result, proposed § 150.5(d) would provide uniformity, consistency, and reduced administrative burdens for traders who are active on multiple trading venues and/or trade similar physical contracts, regardless of whether the contracts are subject to § 150.2's federal position limits. Second, a harmonized aggregation policy eliminates the potential for DCMs to use excessively permissive aggregation policies as a competitive advantage, which would impair the effectiveness of the Commission's aggregation policy and limits framework. Third, since, for contracts subject to federal limits, proposed § 150.5(a) would require DCMs to set position limits at a level not higher than that set by the Commission under proposed § 150.2, differing aggregation standards could effectively lead to an exchange-set limit that is higher than that set by the Commission. Accordingly, harmonizing aggregation standards reinforces the efficacy and intended purpose of proposed §§ 150.2 and 150.5 and existing § 150.4 by eliminating DCMs' ability to circumvent the applicable federal aggregation and position limits rules.

To the extent a DCM currently is not applying the federal aggregation rules in existing § 150.4, or similar exchange-based rules, proposed § 150.5(d) could impose costs with respect to market participants trading referenced contracts for the proposed new 16 commodities that would become subject to federal position limits for the first time. Market participants would be required to update their trading and compliance systems to ensure they comply with the new aggregation rules.

e. Request for Comment

(51) The Commission requests comment on all aspects of the Commission's cost-benefit discussion of the proposal.

7. Section 15(a) Factors [660]

a. Protection of Market Participants and the Public

A chief purpose of speculative position limits is to preserve the integrity of derivatives markets for the benefit of commercial interests, producers, and other end- users that use these markets to hedge risk and of consumers that consume the underlying commodities. The Commission preliminarily believes that the proposed position limits regime would operate to deter excessive speculation and manipulation, such as squeezes and corners, which might impair the contract's price discovery function and liquidity for hedgers—and ultimately, would protect the integrity and utility of the commodity markets for the benefit of both producers and consumers.

At this time, the Commission is proposing to include the proposed 25 core referenced futures contracts within the proposed federal position limit framework. In selecting the proposed 25 core referenced contracts, the Commission, in accordance with its necessity analysis, considered the effects that these contracts have on the underlying commodity, especially with respect to price discovery; the fact that they require physical delivery of the underlying commodity; and, in some cases, the potentially acute economic burdens on interstate commerce that could arise from excessive speculation in these contracts causing sudden or unreasonable fluctuations or unwarranted changes in the price of the commodities underlying these contracts.[661]

Of particular importance are the proposed position limits during the spot month period because the Commission preliminarily believes that deterring and preventing manipulative behaviors, such as corners and squeezes, is more urgent during this period. The proposed spot month position limits are designed, among other things, to deter and prevent corners and squeezes as well as promote a more orderly liquidation process at expiration. By restricting derivatives positions to a proportion of the deliverable supply of the commodity, the spot month position limits reduce the possibility that a market participant can use derivatives, including referenced contracts, to affect the price of the cash commodity (and vice versa). Limiting a speculative position based on a percentage of deliverable supply also restricts a speculative trader's ability to establish a leveraged position in cash-settled derivative contracts, diminishing that trader's incentive to manipulate the cash settlement price. As the Commission has determined in the preamble, the Commission has concluded that excessive speculation or manipulation may cause sudden or unreasonable fluctuations or unwarranted changes in the price of the commodities underlying these contracts.[662] In this way, the Commission preliminarily believes that the proposed limits would benefit market participants that seek to hedge the spot price of a commodity at expiration, and benefit consumers who would be able to purchase underlying commodities for which prices are determined by fundamentals of supply and demand, rather than influenced by excessive speculation, manipulation, or other undue and unnecessary burdens on interstate commerce.

The Commission preliminarily believes that the proposed Commission and exchange-centric processes for granting exemptions from federal limits, including non-enumerated bona fide hedging recognitions, would help ensure the hedging utility of the futures market for commercial end-users. First, the proposal to allow exchanges to leverage existing processes and their knowledge of their own markets, including participant positions and activities, along with their knowledge of the underlying commodity cash market, should allow for more timely review of exemption applications than if the Commission were to conduct such initial application reviews. This benefits the public by allowing producers and end-users of a commodity to more efficiently and predictably hedge their price risks, thus controlling costs that might be passed on to the public. Second, exchanges may be better-suited than the Commission to leverage their knowledge of their own markets, including participant positions and activities, along with their knowledge of the underlying commodity cash market, in order to recognize whether an applicant qualifies for an exemption and what the level for that exemption should be. This benefits market participants and the public by helping assure that exemption levels are set in a manner that meets the risk management needs of the applicant without negatively impacting the futures and cash market for that commodity. Third, allowing for exchange-granted spread exemptions could improve liquidity in all months

[660] The discussion here covers the proposed amendments that the Commission has identified as being relevant to the areas set out in section 15(a) of the CEA: (i) Protection of market participants and the public; (ii) efficiency, competitiveness, and financial integrity of futures markets; (iii) price discovery; (iv) sound risk management practices; and (v) other public interest considerations. For proposed amendments that are not specifically addressed, the Commission has not identified any effects.

[661] *See supra* Section III.F.2. (discussion of the necessity findings as to the 25 core referenced futures contacts).

[662] *See supra* Section III.F. (discussion of the necessity finding).

for a listed contract or across commodities, benefitting hedgers by providing tighter bid-ask spreads for out-right trades. Furthermore, traders using spreads can arbitrage price discrepancies between calendar months within the same commodity contract or price discrepancies between commodities, helping ensure that futures prices more accurately reflect the underlying market fundamentals for a commodity. Lastly, the Commission would review each application for bona fide hedge recognitions or spread exemptions (other than those bona fide hedges and spread exemptions that would be self-effectuating under the Commission's proposal), but the proposal would allow the Commission to also leverage the exchange's knowledge and experience of its own markets and market participants discussed above.

The Commission also understands that there are costs to market participants and the public to setting the levels that are too high or too low. If the levels are set too high, there's greater risk of excessive speculation, which may harm market participants and the public. Further, to the extent that the proposed limits are set at such a level that even without these proposed exemptions, the probability of nearing or breaching such levels may be negligible for most market participants, benefits associated with such exemptions may be reduced.

Conversely, if the limits are set too low, transaction costs for market participants who are near or above the limit would rise as they transact in other instruments with higher transaction costs to obtain their desired level of speculative positions. Additionally, limits that are too low could incentivize speculators to leave the market and not be available to provide liquidity for hedgers, resulting in ''choppy'' prices. It is also possible for limits that are set too low to harm market efficiency because the views of some speculators might not be reflected fully in the price formation process.

In setting the proposed limit levels, the Commission considered these factors in order to implement to the maximum extent practicable, as it finds necessary in its discretion, to apply the position limits framework articulated in CEA section 4a(a) to set federal position limits to protect market integrity and price discovery, thereby benefiting market participants and the public.

b. Efficiency, Competitiveness, and Financial Integrity of Futures Markets

Position limits help to prevent market manipulation or excessive speculation that may unduly influence prices at the expense of the efficiency and integrity of markets. The proposed expansion of the federal position limits regime to 25 core referenced futures contracts (*e.g.,* the existing nine legacy agricultural contracts and the 16 proposed new contracts) enhances the buffer against excessive speculation historically afforded to the nine legacy agricultural contracts exclusively, improving the financial integrity of those markets. Moreover, the proposed limits in proposed § 150.2 may promote market competitiveness by preventing a trader from gaining too much market power in the respective markets.

Also, in the absence of position limits, market participants may be deterred from participating in a futures market if they perceive that there is a participant with an unusually large speculative position exerting what they believe is unreasonable market power. A lack of participation may harm liquidity, and consequently, may harm market efficiency.

On the other hand, traders who find position limits overly constraining may seek to trade in substitute instruments—such as futures contracts or swaps that are similar to or correlated with (but not otherwise deemed to be a referenced contract), forward contracts, or trade options—in order to meet their demand for speculative instruments. These traders may also decide to not trade beyond the federal speculative position limit. Trading in substitute instruments may be less effective than trading in referenced contracts and, thus, may raise the transaction costs for such traders. In these circumstances, futures prices might not fully reflect all the speculative demand to hold the futures contract, because substitute instruments may not fully influence prices the same way that trading directly in the futures contract does. Thus, market efficiency might be harmed.

The Commission preliminarily believes that focusing on the proposed 25 core referenced futures contracts, which generally have high levels of open interest and trading volume and/or have been subject to existing federal position limits for many years, should in general be less disruptive for the derivatives markets that it regulates, which in turn may reduce the potential for disruption for the price discovery function of the underlying commodity markets as compared to including less liquid contracts (of course, only to the extent that the Commission would be able to make the requisite necessity finding for such contracts).

Finally, the Commission preliminarily believes that the proposal to cease recognizing certain risk management positions as bona fide hedges, coupled with the proposed increased non-spot month limit levels for the nine legacy agricultural contracts, will foster competition among swap dealers by subjecting all market participants, including all swap dealers, to the same non-spot month limit rather than to an inconsistent patchwork of staff-granted exemptions. Accommodating risk management activity by additional entities with higher limit levels may also help lessen the concentration risk potentially posed by a few commodity index traders holding exemptions that are not available to competing market participants.

c. Price Discovery

Market manipulation or excessive speculation may result in artificial prices. Position limits may help to prevent the price discovery function of the underlying commodity markets from being disrupted. Also, in the absence of position limits, market participants might elect to trade less as a result of a perception that the market pricing is unfair as a consequence of what they perceive is the exercise of too much market power by a larger speculator. Reduced liquidity may have a negative impact on price discovery.

On the other hand, imposing position limits raises the concerns that liquidity and price discovery may be diminished, because certain market segments, *i.e.,* speculative traders, are restricted. For certain commodities, the Commission proposes to set the levels of position limits at increased levels, to avoid harming liquidity that may be provided by speculators that would establish large positions, while restricting speculators from establishing extraordinarily large positions. The Commission further preliminarily believes that the bona fide hedging recognition and exemption processes will foster liquidity and potentially improve price discovery by making it easier for market participants to have their bona fide hedging recognitions and spread exemptions granted.

In addition, position limits serve as a prophylactic measure that reduces market volatility due to a participant otherwise engaging in large trades that induce price impacts that interrupt price discovery. In particular, spot month position limits make it more difficult to mark the close of a futures contract to possibly benefit other contracts that settle on the closing futures price. Marking the close harms markets by spoiling convergence between futures prices and spot prices at expiration and damaging price discovery.

d. Sound Risk Management Practices

Proposed exemptions for bona fide hedges help to ensure that market participants with positions that are hedging legitimate commercial needs are recognized as hedgers under the Commission's speculative position limits regime. This promotes sound risk management practices. In addition, the Commission has crafted the proposed rules to ensure sufficient market liquidity for bona fide hedgers to the maximum extent practicable, *e.g.,* through the proposals to: (1) Create a bona fide hedging definition that is broad enough to accommodate common commercial hedging practices, including anticipatory hedging, for a variety of commodity types; (2) maintain the status quo with respect to existing bona fide hedge recognitions and spread exemptions that would remain self-effectuating and make additional bona fide hedges self-effectuating (*i.e.,* certain anticipatory hedging); (3) provide additional ability for a streamlined process where market participants can make a single submission to an exchange in which the exchange and Commission would each review applications for non-enumerated bona fide hedge recognitions for purposes of federal and exchange-set limits that are in line with commercial hedging practices; and (4) to allow for a conditional spot month limit exemption in natural gas.

To the extent that monitoring for position limits requires market participants to create internal risk limits and evaluate position size in relation to the market, position limits may also provide an incentive for market participants to engage in sound risk management practices. Further, sound risk management practices would be promoted by the proposal to allow for market participants to measure risk in the manner most suitable for their business (*i.e.,* net versus gross hedging practices), rather than having to conform their hedging programs to a one-size-fits-all standard that may not be suitable for their risk management needs. Finally, the proposal to increase non-spot month limit levels for the nine legacy agricultural contracts to levels that reflect observed levels of trading activity, based on recent data reviewed by the Commission, should allow swap dealers, liquidity providers, market makers, and others who have risk management needs, but who are not hedging a physical commercial, to soundly manage their risks.

e. Other Public Interest

The Commission has not identified any additional public interest considerations related to the costs and benefits of this 2020 Proposal.

f. Request for Comment

(52) The Commission requests comment on all aspects of the Commission's discussion of the 15(a) factors for this proposal.

B. Paperwork Reduction Act

1. Overview

Certain provisions of the proposed rule on position limits for derivatives would amend or impose new ''collection of information'' requirements as that term is defined under the Paperwork Reduction Act (''PRA'').[663] An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number from the Office of Management and Budget (''OMB''). The proposed rule would modify the following existing collections of information previously approved by OMB and for which the Commodity Futures Trading Commission (''Commission'') has received control numbers: (i) OMB control number 3038–0009 (Large Trader Reports), which generally covers Commission regulations in parts 15 through 21; (ii) OMB control number 3038–0013 (Aggregation of Positions), which covers Commission regulations in part 150;[664] and (iii) OMB control number 3038–0093 (Provisions Common to Registered Entities), which covers Commission regulations in part 40.

Certain provisions of the proposed rule would impose new collection of information requirements under the PRA. As a result, the Commission is proposing to revise OMB control numbers 3038–0009, 3038–0013, and 3038–0093 and is submitting this proposal to OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11.

2. Commission Reorganization of OMB Control Numbers 3038–0009 and 3038–0013

The Commission is proposing two non-substantive changes so that all collections of information related solely to the Commission's position limit requirements are consolidated under one OMB control number.[665] First, the Commission would transfer collections of information under part 19 (Reports by Persons Holding Bona Fide Hedge Positions and By Merchants and Dealers in Cotton) related to position limit requirements from OMB control number 3038–0009 to OMB control number 3038–0013. Second, the modified OMB control number 3038–0013 would be renamed as ''Position Limits.'' This renaming change is non-substantive and would allow for all collections of information related to the federal position limits requirements, including exemptions from speculative position limits and related large trader reporting, to be housed in one collection.

One collection would make it easier for market participants to know where to find the relevant position limits PRA burdens. If the proposed rule is finalized, the remaining collections of information under OMB control number 3038–0009 would cover reports by various entities under parts 15, 17, and 21[666] of the Commission's regulations, while OMB control number 3038–0013 would hold collections of information arising from parts 19 and 150.

As discussed in section 3 below, this non-substantive reorganization would result in: (i) A decreased burden estimate under control number 3038–0009 due to the transfer of the collection of information arising from obligations in part 19, and (ii) a corresponding increase of the amended part 19 burdens under control number 3038–0013. However, as discussed further below, the collection of information and burden hours arising from proposed part 19 that would be transferred to OMB control number 3038–0013 would be less than the existing burden estimate under OMB control number 3038–0009 since the Commission's proposal would amend existing part 19 by eliminating existing Form 204 and certain parts of Form 304 and the reporting burdens related thereto. As a result, market participants would see a net reduction of collections of information and burden hours under revised part 19.

[663] 44 U.S.C. 3501 *et seq.*

[664] Currently, OMB control number 3038–0013 is titled ''Aggregation of Positions.'' The Commission proposes to rename the OMB control number ''Position Limits'' to better reflect the nature of the information collections covered by that OMB control number.

[665] The Commission notes that certain collections of information under OMB control number 3038–0093 relate to several Commission regulations in addition to the Commission's proposed position limits framework. As a result, the collections of information discussed herein under this OMB control number 3038–0093 will not be consolidated under OMB control number 3038–0013.

[666] As noted above, OMB control number 3038–0009 generally covers Commission regulations in parts 15 through 21. However, it does not cover §§ 16.02, 17.01, 18.04, or 18.05, which are under OMB control number 3038–0103. Final Rule. 78 FR 69178 at 69200 (Nov. 18, 2013) (transferring §§ 16.02, 17.01, 18.04, and 18.05 to OMB Control Number 3038–0103).

3. Collections of Information

The proposed rule would amend existing regulations, and create new regulations, concerning speculative position limits. Among other amendments, the Commission's proposed rule would include: (1) New and amended federal spot month limits for the proposed 25 physical commodity derivatives; (2) amended federal non-spot limits for the nine legacy agricultural commodities contracts currently subject to federal position limits; (3) amended rules governing exchange-set limit levels and grants of exemptions therefrom; (4) an amended process for requesting certain spread exemptions and non-enumerated bona fide hedge recognitions for purposes of federal position limits directly from the Commission; (5) a new exchange-administered process for recognizing non-enumerated bona fide hedge positions from federal limit requirements; and (6) amendments to part 19 and related provisions that would eliminate certain reporting obligations that require traders to submit a Form 204 and Parts I and II of Form 304.

Specifically, this proposal would amend parts 15, 17, 19, 40, and 150 of the Commission's regulations to implement the proposed federal position limits framework. The proposal would also transfer an amended version of the ''bona fide hedging transactions or positions'' definition from existing § 1.3 to proposed § 150.1, and remove §§ 1.47, 1.48, and 140.97. The Commission's proposal would revise existing collections of information covered by OMB control number 3038–0009 by amending part 19, along with conforming changes to part 15, in order to narrow the scope of who is required to report under part 19.[667]

Furthermore, the proposed rule's amendments to part 150 would revise existing collections of information covered by OMB control number 3038–0013, including new reporting and recordkeeping requirements related to the application and request for relief from federal position limit requirements submitted to designated contract markets (''DCMs'') and swap execution facilities (''SEFs'') (collectively, ''exchanges''). Finally, the proposed rule would also amend part 40 to incorporate a new reporting obligation into the definition of ''terms and conditions'' in § 40.1(j) and result in a revised existing collection of information covered by OMB control number 3038–0093.

a. OMB Control Number 3038–0009—Large Trader Reports; Part 19—Reports by Persons Holding Bona Fide Hedge Positions and by Merchants and Dealers in Cotton

Under OMB control number 3038–0009, the Commission currently estimates that the collections of information related to existing part 19, including Form 204 and Form 304, collectively known as the ''Series '04'' reports, have a combined annual burden hours of 1,553 hours. Under existing part 19, market participants that hold *bona fide* hedging positions in excess of position limits for the nine legacy agricultural commodity contracts currently subject to federal limits must file a monthly report on Form 204 (or Parts I and II of Form 304 for cotton). These reports show a snapshot of traders' cash positions on one given day each month, and are used by the Commission to determine whether a trader has sufficient cash positions to justify futures and options on futures positions above the applicable federal position limits in existing § 150.2.

The Commission's proposal would amend part 19 to remove these reporting obligations associated with Form 204 and Parts I and II of Form 304. As discussed under proposed § 150.9 below, the Commission preliminarily has determined that it may eliminate these forms and still receive adequate information to carry out its market and financial surveillance programs since its proposed amendments to §§ 150.5 and 150.9 would also enable the Commission to obtain the necessary information from the exchanges. To effect these changes to traders' reporting obligations, the Commission would eliminate (i) existing § 19.00(a)(1), which requires the applicable persons to file a Form 204; and (ii) existing § 19.01, which among other things, sets forth the cash-market information required to be submitted on the Forms 204 and 304.[668] The Commission would maintain Part III of Form 304, which requests information on unfixed-price ''on call'' purchases and sales of cotton and which the Commission utilizes to prepare its weekly cotton on-call report.[669] The Commission would also maintain its existing special call authority under part 19.

The supporting statement for the current active information collection request for part 19 under OMB control number 3038–0009[670] states that in 2014: (i) 135 reportable traders filed the Series '04 reports (*i.e.,* Form 204 and Form 304 in the aggregate), (ii) totaling 3,105 Series '04 reports, for a total of (iii) 1,553 burden hours.[671] However, based on more current and recent 2019 submission data, the Commission is revising its existing estimates slightly higher for the Series '04 reports under part 19:

- *Form 204:* 50 monthly reports, for an annual total of 600 reports (50 monthly reports × 12 months = 600 total annual reports) and 300 annual burden hours (600 annual Form 204s submitted × 0.5 hours per report = 300 aggregate annual burden hours for all Form 204s).
- *Form 304:* 55 weekly reports, for an annual total of 2,860 reports (55 weekly reports × 52 weeks = 2,860 total annual reports) and 1,430 annual burden hours (2,860 annual Form 304s submitted × 0.5 hours per report = 1,430 aggregate annual burden hours for all Form 304s).

Accordingly, based on the above revised estimates the Commission would revise its estimate of the current collections of information under existing part 19 to reflect that approximately 105 reportable traders[672] file a total of 3,460 responses annually[673] resulting in an aggregate annual burden of 1,730 hours.[674][675] The

[667] As noted above, the Commission would accomplish this by eliminating existing From 204 and Parts I and II of Form 304. Additionally, proposed changes to part 17, covered by OMB control number 3038–0009, would make conforming amendments to remove certain duplicative provisions and associated information collections related to aggregation of positions, which are in current § 150.4. These conforming changes would not impact the burden estimates of OMB control number 3038–0009.

[668] As noted above, the proposed amendments to part 19 affect certain provisions of part 15 and § 17.00. Based on the proposed elimination of Form 204 and Parts I and II of Form 304, the Commission proposes conforming technical changes to remove related reporting provisions from (i) the ''reportable position'' definition in § 15.00(p); (ii) the list of ''persons required to report'' in § 15.01; and (iii) the list of reporting forms in § 15.02. These proposed conforming amendments to part 15 would not impact the existing burden estimates.

[669] The Commission is proposing a technical change to Part III of Form 304 to require traders to identify themselves on the Form 304 using their Public Trader Identification Number, in lieu of the CFTC Code Number required on previous versions of the Form 304. However, the Commission preliminarily has determined that this would not result in any change to its existing PRA estimates with respect to the collections of information related to Part III of Form 304.

[670] *See* ICR Reference No: 201906–3038–008.

[671] 3,105 Series '04 submissions × 0.5 hours per submission = 1,553 aggregate burden hours for all submissions. The Commission notes that it has preliminarily estimated that it takes approximately 20 minutes to complete a Form 204 or 304. However, in order to err conservatively, the Commission now uses a figure of 30 minutes.

[672] 55 Form 304 reports + 50 Form 205 reports = 105 reportable traders.

[673] 2,860 Form 304s + 600 Form 204s = 3,460 total annual Series '04 reports.

[674] 3,460 Series '04 reports × 0.5 hours per report = 1,730 annual aggregate burden hours.

[675] These revised estimates result in an increased estimate under existing part 19 of 355 Series '04

Continued

Commission's proposal would reduce the current OMB control number 3038–0009 by these revised burden estimates under part 19 as they would be transferred to OMB control number 3038–0013.

With respect to the overall collections of information that would be transferred to OMB control number 3038–0013 based on the Commission's revised part 19 estimate, the Commission estimates that the Commission's proposal would reduce the collections of information in part 19 by 600 reports [676] and by 300 annual aggregate burden hours since the Commission's proposal would eliminate Form 204, as discussed above.[677] The Commission does not expect a change in the number of reportable traders that would be required to file Part III of Form 304.[678] Thus, the Commission continues to expect approximately 55 weekly Form 304 reports, for an annual total of 2,860 reports [679] for an aggregate total of 1,430 burden hours, which information collection burdens would be transferred to OMB control number 3038–0013.[680]

In addition, the Commission would maintain its authority to issue special calls for information to any person claiming an exemption from speculative federal position limits. While the position limits framework will expand to traders in the proposed twenty-five commodities (an increase from the existing nine legacy agricultural products), the position limit levels themselves will also be higher. The higher position limit levels would result in a smaller universe of traders who may exceed the position limits and thus be subject to a special call for information on their large position(s). Taking into account the higher limits and smaller universe of traders who would likely exceed the position limits, the Commission estimates that it is likely to issue a special call for information to 4 reportable traders. The Commission preliminarily estimates that it would take approximately 5 hours to respond to a special call. The Commission therefore estimates that industry would incur a total of 20 aggregate annual burden hours.[681]

b. OMB Control Number 3038–0013—Aggregation of Positions (To Be Renamed ''Position Limits'')

i. Introduction; Bona Fide Hedge Recognition and Exemption Process

The Commission is proposing to amend the existing process for market participants to apply to obtain an exemption or recognition of a bona fide hedge position. Currently, the ''bona fide hedging transaction or position'' definition appears in existing § 1.3. Under existing §§ 1.47 and 1.48, a market participant must apply directly to the Commission to obtain a bona fide hedge recognition in accordance with § 1.3 for federal position limit purposes.

Proposed §§ 150.3 and 150.9 would establish an amended process for obtaining a bona fide hedge exemption or recognition, which includes: (i) A new bona fide hedging definition in § 150.1, (ii) a new process administered by the exchanges in proposed § 150.9 for recognizing non-enumerated bona fide hedging positions for federal limit requirements, and (iii) an amended process to apply directly to the Commission for certain spread exemptions or for recognition of non-enumerated bona fide hedging positions. Proposed § 150.3 also would include new exemption types not explicitly listed in existing § 150.3.

The Commission has previously estimated the combined annual burden hours for submitting applications under both §§ 1.47 and 1.48 to be 42 hours.[682] The Commission's proposal would maintain the existing process where market participants may apply directly to the Commission, although the Commission expects market participants to predominantly rely on the exchange-administered process to obtain recognition of their non-enumerated bona fide hedging positions for purposes of federal position limit requirements. Enumerated bona fide hedge positions would remain self-effectuating, which means that market participants would not need to apply to the Commission for purposes of federal position limits, although market participants would still need to apply to an exchange for recognition of bona fide hedge positions for purposes of exchange-set position limits. The Commission forms this expectation on the fact that all the contracts that will now be subject to federal position limits are already subject to exchange-set limits. Thus, most market participants are likely to already be familiar with an exchange-administered process, as is being proposed under § 150.9. Familiarity with an exchange-administered process will result in operational efficiencies, such as completing one application for non-enumerated bona fide hedge requests for both federal and exchange-set limits and thus a reduced burden on market participants.

As previously discussed, the proposal would move the ''bona fide hedge transaction or position'' definition to proposed § 150.1, and amend the definition to, among other things, remove the distinction between different types of enumerated bona fide hedge positions so that anticipatory enumerated bona fide hedges would be self-effectuating like other non-anticipatory enumerated bona fide hedges. The proposal would maintain the distinction between enumerated and non-enumerated bona fide hedges, and market participants would be required to apply for recognition of non-enumerated bona fide hedge positions either directly from the Commission pursuant to proposed § 150.3 or indirectly through an exchange-centric process under § 150.9.[683] The Commission does not preliminarily believe that this amendment will have any PRA impacts since it is maintaining the status quo in which most enumerated bona fide hedges are self-effectuating while requiring traders to apply to the Commission for recognition

reports submitted by traders (3,460 estimated Series '04 reports − 3,105 submissions from the Commission's previous estimate = an increase of 355 response difference); an increase of 177 aggregate burden hours across all respondents (1,730 aggregate burden hours − 1,553 aggregate burden hours from the Commission's previous estimate = an increase of 177 aggregate burden hours); and a decrease of 30 respondent traders (105 respondents − 135 respondents from the Commission's previous estimate = a decrease of 30 respondents).

[676] 50 monthly Form 204 reports × 12 months = 600 total annual reports.

[677] 600 Form 204 reports × 0.5 burden hours per report = 300 aggregate annual burden hours.

[678] Since the Commission's proposal would eliminate Parts I and II of Form 304, proposed Form 304 would only refer to existing Part III of that form.

[679] 55 weekly Form 304 reports × 52 weeks = 2,860 total annual Form 304 reports.

[680] 2,860 Form 304 reports × 0.5 burden hours per report = 1,430 aggregate annual burden hours.

[681] 4 possible reportable traders × 5 hours each = 20 aggregate annual burden hours.

[682] The supporting statement for a previous information collection request, ICR Reference No: 201808–3038–003, for OMB control number 3038–0013, estimated that seven respondents would file the §§ 1.47 and 1.48 submissions, and that each respondent would file two submissions for a total of 14 annual submissions, requiring 3 hours per response, for a total of 42 burden hours for all respondents.

[683] Currently, in order to determine whether a futures, an option on a futures, or a swap position qualifies as a bona fide hedge, either (1) the position in question must qualify as an enumerated bona fide hedge, as defined in existing § 1.3, or (2) the trader must file a statement with the Commission, pursuant to existing § 1.47 (for non-enumerated bona fide hedges) and/or existing § 1.48 (for enumerated anticipatory bona fide hedges). The revised definition would be accompanied by an expanded list of enumerated bona fide hedges that would appear in acceptable practices, rather than in the definition. The Commission additionally proposes to include an additional enumerated bona fide hedge for anticipatory merchandizing, which would be self-effectuating like the other enumerated hedges. Under the existing framework, anticipatory merchandizing is considered to be a non-enumerated bona fide hedge. The Commission preliminarily does not expect this change to have any PRA impacts.

of non-enumerated bona fide hedge positions.

ii. § 150.2 Speculative Limits

Under proposed § 150.2(f), upon request from the Commission, DCMs listing a core referenced futures contract would be required to supply to the Commission deliverable supply estimates for each core referenced futures contract listed at that DCM. DCMs would only be required to submit estimates if requested to do so by the Commission on an as-needed basis. When submitting estimates, DCMs would be required to provide a description of the methodology used to derive the estimate, as well as any statistical data supporting the estimate. Appendix C to part 38 sets forth guidance regarding estimating deliverable supply.

Submitting deliverable supply estimates upon demand from the Commission for contracts subject to federal limits would be a new reporting obligation for DCMs. The Commission estimates that six DCMs would be required to submit initial deliverable supply estimates. The Commission estimates that it would request each DCM that lists a core referenced futures contract to file one initial report for each core reference futures contract it lists on its market. Such requests from the Commission would result in one initial submission for each of the proposed twenty-five core referenced futures contracts.[684] The Commission further estimates that it will take 20 hours to complete and file each report for a total annual burden of 500 hours for all respondents.[685] Accordingly, the proposed changes to § 150.2(f) would result in an initial, one-time increase to the current burden estimates of OMB control number 3038–0013 by an increase of 25 submissions across six respondent DCMs for the initial number of submissions for the twenty-five core referenced futures contracts and an initial, one-time burden of 500 hours.

iii. § 150.3 Exemptions From Federal Position Limit Requirements

Market participants may currently apply directly to the Commission for recognition of certain bona fide hedges under the process set forth in existing §§ 1.47 and 1.48. There is no existing process that is codified under the Commission's regulations for spread exemptions or other exemptions included under proposed § 150.3.

Proposed § 150.3 would specify the circumstances in which a trader could exceed federal position limits.[686] With respect to non-enumerated bona fide hedge recognitions and spread exemptions not identified in the proposed ''spread transaction'' definition in proposed § 150.1, proposed § 150.3(b) would provide a process for market participants to request such bona fide hedge recognitions or spread exemptions directly from the Commission (as previously noted, both enumerated bona fide hedges and spread exemptions identified in the proposed ''spread transaction'' definition would be self-effectuating and would not require a market participant to submit a request). Proposed § 150.3(b), (d), and (e) set forth exemption-related reporting and recordkeeping requirements that impact the current burden estimates in OMB control number 3038–0013.[687] The proposed collection of information is necessary for the Commission to determine whether to recognize a trader's position as a bona fide hedge exempted from position limit requirements.

Proposed § 150.3(b) establishes application filing requirements and recordkeeping and reporting requirements that are similar to existing requirements for bona fide hedge recognitions under existing §§ 1.47 and 1.48. Although these requirements in proposed § 150.3 would be new for market participants seeking spread exemptions (which are currently self-effectuating), the proposed filing, recordkeeping, and reporting requirements in § 150.3(b) are otherwise familiar to market participants that have requested certain bona fide hedging recognitions from the Commission under existing regulations.

The Commission estimates that very few or no traders would request recognition of a non-enumerated bona fide hedge, and those traders that do would likely prefer the exchange-administered process in proposed § 150.9 (discussed further below) rather than apply directly to the Commission under proposed § 150.3(b). Similarly, the Commission estimates that very few or no traders would submit a request for a spread exemption since the Commission preliminarily has determined that the most common spread exemptions are included in the proposed ''spread transaction'' definition and therefore would be self-effectuating and would not need approval for purposes of federal position limits. The Commission expects that traders are likely to rely on the § 150.3(b) process when dealing with a spread transaction or non-enumerated bona fide hedge position that poses a novel or complex question under the Commission's rules. Particularly when the exchanges have not recognized that type of practice as a non-enumerated bona fide hedge previously, the Commission expects market participants to seek more regulatory clarity under proposed § 150.3(b). In the event a trader submits such request under proposed § 150.3, the Commission estimates that traders would file one request per year for a total of one annual request for all respondents. The Commission further estimates that in such situation, it would take 20 hours to complete and file each report, for a total of 20 aggregate annual burden hours for all traders.

Proposed § 150.3(d) establishes recordkeeping requirements for persons who claim any exemptions or relief under proposed § 150.3. Proposed § 150.3(d) should help to ensure that if any person claims any exemption permitted under proposed § 150.3 such exemption holder can demonstrate compliance with the applicable requirements as follows:

First, under proposed § 150.3(d)(1), any person claiming an exemption would be required to keep and maintain complete books and records concerning certain details.[688] Proposed § 150.3(d)(1)

[684] In 2018, the DCMs submitted deliverable supply estimates for all the commodities that would be subject to federal position limits. Thus, the Commission expects that the exchanges would be able to leverage these recent estimates to minimize the burden of the initial submission under the Commission's proposal.

[685] 20 initial hours × 25 core referenced futures contracts = 500 one-time, aggregate burden hours. While there is an initial annual submission, the Commission does not expect to require the exchanges to resubmit the supply estimates on an annual basis.

[686] Proposed § 150.3(b) would include (1) recognitions of bona fide hedges under proposed § 150.3(b); (2) spread exemptions under proposed § 150.3(b); (3) financial distress positions a person could request from the Commission under § 140.99; and (4) exemptions for certain natural gas positions held during the spot month. Proposed § 150.3(b) would also exempt pre-enactment and transition period swaps. The enumerated bona fide hedge recognitions and spread exemptions identified in the proposed ''spread transaction'' definition in proposed § 150.1 would be self-effectuating.

[687] Proposed § 150.3(f) clarifies the implications on entities required to aggregate accounts under § 150.4, and § 150.3(g) provides for delegation of certain authorities to the Director of the Division of Market Oversight. The proposed changes to §§ 150.3(f) and 150.3(g) do not impact the current estimates for these OMB control numbers. Also, the proposal reminds persons of the relief provisions in § 140.99, covered by OMB control number 3038–0049, which does not impact the burden estimates.

[688] The requirement would include all details of related cash, forward, futures, options, and swap positions and transactions, including anticipated requirements, production and royalties, contracts for services, cash commodity products and by-

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would establish recordkeeping requirements for any person relying on an exemption granted directly from the Commission. The Commission estimates that very few or no traders would claim an exemption directly from the Commission. In the event a trader requests an exemption, the Commission estimates that the trader would create one record per exemption per year for a total of one annual record for all respondents. The Commission further estimates that it will take one hour to comply with the recordkeeping requirement of § 150.3(d)(1) for a total of one aggregate annual burden hour for all traders.

Second, under proposed § 150.3(d)(2), a pass-through swap counterparty, as defined by proposed § 150.1, that relies on a representation received from a bona fide hedging swap counterparty that the swap qualifies in good faith as a ''bona fide hedging position or transaction,'' as defined under proposed § 150.1, would be required to: (i) Maintain any written representation for at least two years following the expiration of the swap; and (ii) furnish the representation to the Commission upon demand. Proposed § 150.3(d)(2) would create a new recordkeeping obligation for certain persons relying on the proposed pass-through swap representations, and the Commission estimates that 425 traders would be requested to maintain the required records. The Commission estimates that each trader would maintain one record per year for a total of 425 aggregate annual records for all respondents. The Commission further estimates that it will take one hour to comply with the recordkeeping requirement of § 150.3(d) for a total of one annual burden hour for each trader and 425 aggregate annual burden hours for all traders.

The Commission proposes to move existing § 150.3(b), which currently allows the Commission or certain Commission staff to make special calls to demand certain information regarding persons claiming exemptions, to proposed § 150.3(e), with some modifications to include swaps.[689] Together with the recordkeeping provision of proposed § 150.3(d), proposed § 150.3(e) should enable the Commission to monitor the use of exemptions from speculative position limits and help to ensure that any person who claims any exemption permitted by proposed § 150.3 can demonstrate compliance with the applicable requirements. The Commission's existing collection under existing § 150.3 estimated that the Commission issues two special calls per year for information related to exemptions, and that each response to a special call for information takes 3 burden hours to complete. This includes two burden hours to fulfill reporting requirements and 1 burden hour related to recordkeeping for an aggregate total for all respondents of six annual burden hours, broken down into four aggregate annual burden hours for reporting and two aggregate annual burden hours for recordkeeping.[690]

The Commission estimates that proposed § 150.3(e) would impose information collection burdens related to special calls by the Commission on approximately 18 additional respondents, for an estimated 20 special calls per year.[691] The Commission estimates that these 20 market participants would provide one submission per year to respond to the special call for a total of 20 annual submissions for all respondents. The Commission estimates it would take a market participant approximately 10 hours to complete a response to a special call. Therefore, the Commission estimates responses to special calls for information will take an aggregate total of 200 burden hours for all traders.[692] The Commission notes that it is also maintaining its special call authority for reporting requirements under proposed part 19 discussed above.

iv. § 150.5 Exchange Set Limits and Exemptions

Amendments to § 150.5 would refine the process, and establish non-exclusive methodologies, by which exchanges may set exchange-level limits and grant exemptions therefrom, including separate methodologies for setting limit levels for contracts subject to federal limits (§ 150.5(a)), physical commodity derivatives not subject to federal limits (§ 150.5(b)), and excluded commodity contracts (§ 150.5(c)).[693] In compliance with part 40 of the Commission's regulations, exchanges currently have policies and procedures in place to address exemptions from exchange set limits through their rulebooks. If the proposal is adopted, the Commission expects that the exchanges would accordingly update their rulebooks, both to conform to proposed new requirements and to incorporate the additional contracts that will be subject to federal position limits into their process for setting exchange-level limits and exemptions therefrom.

The collections of information related to amended rulebooks under part 40 are covered by OMB control number 3038–0093. Separately, the collections of information related to applications for exemptions from exchange-set limits are covered by OMB control number 3038–0013.

Under proposed § 150.5(a)(1), for any contract subject to a federal limit, DCMs and, ultimately, SEFs, would be required to establish exchange-set limits for such contracts. Under proposed § 150.5(a)(2), exchanges that wish to grant exemptions from exchange-set limits on commodity derivative contracts subject to federal limits would have to require traders to file an application to show a request for a bona fide hedge recognition or exemption conforms to a type that may be granted under proposed § 150.3(a)(1)–(4). Exchanges would have to require that such exchange-set limit exemption applications be filed in advance of the date such position would be in excess of the limits, but exchanges would be given the discretion to adopt rules allowing traders to file applications within five business days after a trader took on such position. Proposed § 150.5(a)(2) would also provide that exchanges must require that the trader reapply for the exemption at least annually. Proposed § 150.5(a)(4) would require each exchange to provide a monthly report showing the disposition of any exemption application, including the recognition of any position as a bona fide hedge, the exemption of any spread transaction, the renewal, revocation, or modification of a previously granted

products, cross-commodity hedges, and a record of bona fide hedging swap counterparties.

[689] Proposed § 150.3(e) would refer to commodity derivative contracts, whereas current § 150.3(b) refers to futures and options. The proposed change would result in the inclusion of swaps.

[690] The special call authority under part 19 and the proposed special call authority discussed under § 150.3 would be similar in nature; however, part 19 would apply to special calls regarding bona fide hedge recognitions and related underlying cash market positions while the special calls under proposed § 150.3 would apply to the other exemptions under proposed § 150.3.

[691] 2 respondents subject to special calls under existing § 150.3 + 18 additional respondents under proposed § 150.3 = 20 total respondents. The Commission estimates, at least during the initial implementation period, that it is likely to issue more special calls for information to monitor compliance with position limits, particularly in the commodity markets that will now be subject to federal position limits for the first time.

[692] 20 special calls × 10 burden hours per call = 200 total burden hours.

[693] Proposed § 150.5 addresses exchange-set position limits and exemptions therefrom, whereas proposed § 150.9 addresses federal limits and an exchange-administered process for purposes of federal limits where an applicant may apply through an exchange to the Commission for recognition of an non-enumerated bona fide hedge for purposes of federal position limits.

recognition or exemption, or the rejection of any application.[694]

These proposed collections of information related to exemptions from exchange-set limits are necessary to ensure that such exchange-set limits comply with Commission regulations, including that exchange limits are no higher than the applicable federal level; to establish minimum standards needed for exchanges to administer the exchange's position limits framework; and to enable the Commission to oversee an exchange's exemptions process to ensure it does not undermine the federal position limits framework. In addition, the Commission would use the information to confirm that exemptions are granted and renewed in accordance with the types of exemptions that may be granted under proposed § 150.3(a)(1)–(4).

The Commission estimates under proposed § 150.5(a) that 425 traders would submit applications to claim spread exemptions and bona fide hedge recognitions from exchange-set position limits on commodity derivatives contracts subject to federal limits set forth in § 150.2. The Commission estimates that each trader on average would submit one application to an exchange each year for a total of 425 applications for all respondents. The Commission further estimates that it will take 2 hours to complete and file each application for a total of 2 annual burden hours for each trader and 850 aggregate burden hours for all traders.[695]

The Commission estimates under proposed § 150.5(a)(4) that six exchanges would provide monthly reports for a total of 72 monthly reports for all exchanges.[696] The Commission further estimates that it will take 5 hours to complete and file each monthly report for a total of 60 annual burden hours for each exchange and 360 annual burden hours for all exchanges.[697]

Proposed § 150.5(b) would require exchanges, for physical commodity derivatives that are not subject to federal limits to set limits during the spot month and to set either limits or accountability outside of the spot month. Under proposed § 150.5(b)(3), where multiple exchanges list contracts that are substantially the same, including physically-settled contracts that have the same underlying commodity and delivery location, or cash-settled contracts that are directly or indirectly linked to a physically-settled contract, the exchange must either adopt ''comparable'' limits for such contracts, or demonstrate to the Commission how the non-comparable levels comply with the standards set forth in proposed § 150.5(b)(1) and (2). Such a determination also must address how the levels are necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index. Proposed § 150.5(b)(3) is intended to help ensure that position limits established on one exchange would not jeopardize market integrity or otherwise harm other markets. This provision may also improve the efficiency with which exchanges adopt limits on newly-listed contracts that compete with an existing contract listed on another exchange and help reduce the amount of time and effort needed for Commission staff to assess the new limit levels. Further, proposed § 150.5(b)(3) would be consistent with the Commission's proposal to generally apply equivalent federal limits to linked contracts, including linked contracts listed on multiple exchanges.

The Commission estimates that under proposed § 150.5(b)(3), six exchanges would make submissions to demonstrate to the Commission how the non-comparable levels comply with the standards set forth in proposed § 150.5(b)(1) and (2). The Commission estimates that each exchange on average would make 3 submissions each year for a total of 18 submissions for all exchanges. The Commission further estimates that it will take 10 hours to complete and file each submission for a total of 18 annual burden hours for each exchange and 180 burden hours for all exchanges.[698]

Proposed § 150.5(b)(4) would permit exchanges to grant exemptions from any exchange limit established for physical commodity contracts not subject to federal limits. To grant such exemptions, exchanges must require traders to file an application to show whether the requested exemption from exchange-set limits would be in accord with sound commercial practices in the relevant commodity derivative market and/or that may be established and liquidated in an orderly fashion in that market. This proposed collection of information is necessary to confirm that any exemptions granted from exchange limits on physical commodity contracts not subject to federal limits do not pose a threat of market manipulation or congestion, and maintains orderly execution of transactions. The Commission estimates that 200 traders would submit one application each year and that each application would take approximately two hours to complete, for an aggregate total of 400 burden hours per year for all traders.

Proposed § 150.5(e) reflects that, consistent with the definition of ''rule'' in existing § 40.1, any exchange action establishing or modifying position limits or exemptions therefrom, or position accountability, in any case pursuant to proposed § 150.5(a), (b), (c), or Appendix F to part 150, would qualify as a ''rule'' and must be submitted to the Commission pursuant to part 40 of the Commission's regulations. Proposed § 150.5(e) further provides that exchanges would be required to review regularly any position limit levels established under proposed § 150.5 to ensure the level continues to comply with the requirements of those sections. The Commission estimates under proposed § 150.5(e) that six exchanges would submit revised rulebooks to satisfy their compliance obligations under part 40.

[694] Additionally, each report should include the following details: (A) The date of disposition; (B) The effective date of the disposition; (C) The expiration date of any recognition or exemption; (D) Any unique identifier(s) the designated contract market or swap execution facility may assign to track the application, or the specific type of recognition or exemption; (E) If the application is for an enumerated bona fide hedging transaction or position, the name of the enumerated bona fide hedging transaction or position listed in Appendix A to this part; (F) If the application is for a spread transaction listed in the spread transaction definition in § 150.1, the name of the spread transaction as it is listed in § 150.1; (G) The identity of the applicant; (H) The listed commodity derivative contract or position(s) to which the application pertains; (I) The underlying cash commodity; (J) The maximum size of the commodity derivative position that is recognized by the designated contract market or swap execution facility as a bona fide hedging transaction or position, specified by contract month and by the type of limit as spot month, single month, or all-months-combined, as applicable; (K) Any size limitations or conditions established for a spread exemption or other exemption; and (L) For bona fide hedging transactions or positions, a concise summary of the applicant's activity in the cash markets and swaps markets for the commodity underlying the commodity derivative position for which the application was submitted.

[695] To increase efficiency and reduce duplicative efforts, the proposed rule would permit an exchange to have a single process in place that would allow market participants to request non-enumerated bona fide hedge recognitions from both federal and exchange-set position limits at the same time. The Commission believes that under a single process, the estimated burdens under proposed § 150.5(a) discussed in this section for exemptions from exchange-set limits will include the burdens under the federal limit exemption process for non-enumerated bona fide hedges under proposed § 150.9 discussed below.

[696] 6 exchanges × 12 months = 72 total monthly reports per year.

[697] 5 hours per monthly report × 12 months = 60 hours per year for each exchange. 60 annual hours × 6 exchanges = 360 aggregate annual hours for all exchanges.

[698] 18 estimated annual submissions × 10 burden hours per submission = 180 aggregate annual burden hours.

The Commission estimates that each exchange on average would make 1 initial revision of its rulebook to reflect the new position limit framework for a total of 6 applications for all exchanges. The Commission further estimates that it will take 30 hours to revise a rulebook for a total of 30 annual burden hours for each exchange and 180 burden hours for all exchanges.[699]

This proposed collection of information is necessary to ensure that the exchanges' rulebooks reflect the most up to date rules and requirements in compliance with the proposed position limits framework. The information would be used to confirm that exchanges are complying with their requirements to regularly review any position limit levels established under proposed § 150.5.

v. § 150.9 Exchange Process for Bona Fide Hedge Recognitions From Federal Limits

Proposed § 150.9 would establish a new streamlined process in which a trader could apply through an exchange to request a non-enumerated bona fide hedging recognition from federal position limits. As part of the process, proposed § 150.9 would create certain recordkeeping and reporting obligations on the market participant and the exchange, including: (i) An application to request non-enumerated bona fide hedge recognitions, which the trader would submit to the exchange and which the exchange would subsequently provide to the Commission if the exchange approves the application for purposes of exchange-set limits; (ii) a notification to the Commission and the applicant of the exchange's determination for purposes of exchange limits regarding the trader's request for recognition of a bona fide hedge or spread exemption; (iii) and a requirement to maintain full, complete and systematic records for Commission review of the exchange's decisions. The Commission believes that the exchanges that will elect to process applications for non-enumerated bona fide hedging exemptions under proposed § 150.9(a) already have similar processes for the review and disposition of such exemption applications in place through their rulebooks for purposes of exchange-set position limits.

Accordingly, the estimated burden on an exchange to comply with the proposed rule will be less burdensome because the exchanges may leverage their existing policies and procedures to comply with the proposed rule. The Commission estimates that six exchanges would elect to process applications for non-enumerated bona fide hedge recognitions that would satisfy the federal position limit requirements under proposed § 150.9, and would be required to file amended rulebooks pursuant to part 40 of the Commission's regulations. The Commission bases its estimate on the number of exchanges that have submitted similar rules to the Commission in the past.

Proposed § 150.9(c) would require a trader to submit an application with sufficient information to enable the exchange to determine whether it should recognize a position as a bona fide hedge for purposes of federal position limits. Each applicant would need to reapply for its non-enumerated bona fide hedge recognition at least on an annual basis by updating its original application. The Commission expects that traders would benefit from the exchange-administered framework established under proposed § 150.9 because traders may submit one application to obtain a non-enumerated bona fide hedge recognition for purposes of both exchange-set and federal limits, as opposed to submitting separate applications to the Commission for federal position limit purposes and separate applications to an exchange for exchange limit purposes.[700]

Accordingly, the estimated burden for traders requesting non-enumerated bona fide hedge recognitions from exchange-set limits under § 150.5(a) would subsume the burden estimates in connection with proposed § 150.9 for requesting non-enumerated bona fide hedge recognition's from federal limits since the Commission preliminarily believes exchanges would combine the two processes (*i.e.,* any trader who applies through an exchange under proposed § 150.9 for a non-enumerated bona fide hedge for federal position limits purposes also would be deemed to be applying at the same time under proposed § 150.5(a) for exchange position limits purposes and thus it would not be appropriate to distinguish between the two for PRA purposes). Accordingly, the Commission preliminarily anticipates that 6 exchanges each would receive only one application for a non-enumerated bona fide hedge recognition under proposed § 150.9 for a total of six aggregate annual applications for all exchanges; however, as noted above, this amount is included in the Commission's estimate in connection with proposed § 150.5(a).[701] Specifically, as discussed above in connection with proposed § 150.5(a), the Commission estimates under proposed §§ 150.5(a) and 150.9(a) that 425 traders would submit applications to claim exemptions and/or bona fide hedge recognitions for contracts subject to federal position limits as set forth in § 150.2.[702]

Proposed § 150.9(d) would require exchanges to keep full, complete, and systematic records, including all pertinent data and memoranda, of all activities relating to the processing of such applications and the disposition thereof. In addition, as provided for in proposed § 150.9(g), the Commission may, in its discretion, at any time, review the designated contract market's records retained pursuant to proposed § 150.9(d). The proposed recordkeeping requirement is necessary for the Commission to review the exchanges' processes, retention of records, and

[699] 6 initial applications × 30 burden hours = 180 initial aggregate burden hours.

[700] The Commission believes the collections of information set forth above are necessary for the exchange to process requests for recognition of non-enumerated bona fide hedges for purposes of both exchange-set position limits and federal position limits. The information would be used by the exchange to determine, and the Commission to review and verify, whether the facts and circumstances demonstrate it is appropriate to recognize a position as a non-enumerated bona fide hedging transaction or position.

[701] As discussed above, the process and estimated burdens under proposed § 150.9 would not apply to § 150.5(b) because proposed § 150.5(b) applies to those physical commodity contracts that are not subject to federal limits (as opposed to proposed § 150.5(a), which applies to those contracts subject to federal limits). As a result, a trader that would use the process established under § 150.5(b) for exchange-set limits would not need to apply under proposed § 150.9 since the traders would not need a bona fide hedge recognition or an exemption from federal position limits.

[702] As discussed in connection with proposed § 150.5(a) above, the Commission estimates that each trader on average would make one application each year for a total of 425 applications across all exchanges. The Commission further estimates that, for proposed §§ 150.5(a) and 150.9(a), taken together, it will take two hours to complete and file each application for a total of two annual burden hours for each trader and 850 aggregate annual burden hours for all traders. (425 annual applications × 2 burden hours per application = 850 aggregate annual burden hours). The Commission preliminarily anticipates that compared to proposed § 150.5(a), fewer traders will apply under proposed § 150.9 since proposed § 150.9 applies only to non-enumerated bona fide hedge recognitions for federal purposes. In comparison, while proposed § 150.5 would encompass these same applications for non-enumerated bona fide hedge recognitions (but for the purpose of exchange-set limits), proposed § 150.5(a) also would include enumerated bona fide hedge applications along with spread exemption requests. The Commission's estimate of 850 aggregate annual burden hours encompasses all such requests from all traders. However, for the sake of clarity, the Commission preliminarily anticipates that 6 exchanges each would receive one application per year for a non-enumerated bona fide hedge under proposed § 150.9 (for a total of six applications across all exchanges); as noted, this burden is included in the Commission's estimate of 425 annual applications in connection with its estimate under proposed § 150.5(a).

compliance with requirements established and implemented under this section.

Proposed § 150.9(d) would create a new recordkeeping obligation consistent with the standards in existing § 1.31.[703] The Commission estimates that six exchanges would each create one record in connection with proposed § 150.9 each year for a total of six annual records for all respondents. The Commission further estimates that it will take five hours to comply with the proposed recordkeeping requirement of § 150.9(d) for a total of five annual burden hours for each exchange and 30 aggregate annual burden hours across all exchanges.

Proposed § 150.9(f) would allow the Commission to inspect such books and records.[704] In the event the Commission exercises its authority to inspect such books and records, it estimates that the Commission would make an inspection to two exchanges per year and each exchange would incur four hours to make its books and records available to the Commission for review for a total of 8 aggregate annual burden hours for the two estimated respondent exchanges.[705]

Under proposed § 150.9(e), an exchange would need to provide an applicant and the Commission with notice of any approved application of an exchange's determination to recognize bona fide hedges and grant spread exemptions with respect to its own position limits for purposes of exceeding the federal position limits. The proposed notification requirement is necessary to inform the Commission of the details of the type of bona fide hedge recognitions or spread exemptions being granted. The information would be used to keep the Commission informed as to the manner in which an exchange administers its application procedures, and the exchange's rationale for permitting large positions.

The Commission estimates that under proposed § 150.9(e), 6 exchanges would submit notifications of approved application of an exchange's determination to recognize non-enumerated bona fide hedges for purposes of exceeding the federal position limits. The Commission estimates that each exchange on average would make 2 notifications: one notification each to the applicant trader and to the Commission each year for a total of 12 notices for all exchanges. The Commission further estimates that it will take 0.5 hours to complete and file each notification for a total of one annual burden hour for each exchange and six burden hours for all exchanges.[706]

c. OMB Control Number 3038–0093—Provisions Common to Registered Entities

1. § 150.9(a)

Under proposed § 150.9(a), exchanges that would like for their market participants to be able to exceed federal position limits based on a non-enumerated bona fide hedge recognition granted by the exchange with respect to its own limits must have rules, adopted pursuant to the rule approval process in § 40.5 of the Commission's regulations, establishing processes consistent with the provisions of proposed § 150.9. The proposed collection of information is necessary to capture the new non-enumerated bona fide hedge process in the exchanges' rulebook, which is subject to Commission approval. The information would be used to assess the process put in place by each exchange submitting amended rulebooks.

The Commission has previously estimated the combined annual burden hours for both §§ 40.5 and 40.6 to be 7,000 hours.[707] If the proposed rule is adopted, the Commission estimates that six exchanges would make one initial § 40.5 rule filings per year for a total of six one-time initial submissions for all exchanges. The Commission further estimates that the exchanges would employ a combination of in-house and outside legal and compliance counsel to update existing rulebooks and it will take 25 hours to complete and file each rule for a total 25 one-time burden hours for each exchange and 150 one-time burden hours for all exchanges.

2. Request for Comments on Collection

The Commission invites the public and other Federal agencies to comment on any aspect of the proposed information collection requirements 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 proposed to be collected; and (iv) minimize the burden of the proposed collections of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology.

Those desiring to submit comments on the proposed information collection requirements should submit them directly to the Office of Information and Regulatory Affairs, OMB, by fax at (202) 395–6566, or by email at *OIRAsubmissions@omb.eop.gov*. Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rule preamble. Refer to the **ADDRESSES** section of this notice of proposed rulemaking for comment submission instructions to the Commission. A copy of the supporting statements for the collection of information discussed above may be obtained by visiting *http://www.RegInfo.gov*. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment is best assured of having its full effect if OMB receives it within 30 days of publication.

C. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") requires that agencies consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the

[703] Consistent with existing § 1.31, the Commission expects that these records would be readily available during the first two years of the required five year recordkeeping period for paper records, and readily accessible for the entire five-year recordkeeping period for electronic records. In addition, the Commission expects that records required to be maintained by an exchange pursuant to this section would be readily accessible during the pendency of any application, and for two years following any disposition that did not recognize a derivative position as a bona fide hedge.

[704] Proposed § 150.9(g)(1) provides the Commission's authority to, at its discretion, and at any time, review the exchange's processes, retention of records, and compliance with requirements established and implemented under this section. Under proposed § 150.9(g)(2), if the Commission determines additional information is required to conduct its review, pursuant to proposed § 150.9(g)(1), then it would notify the exchange and the relevant market participant of any issues identified and provide them with ten business days to provide supplemental information.

[705] 2 exchanges per year subject to a Commission inspection × 4 hours per inspection request = 8 aggregate annual burden hours for all exchanges.

[706] 12 notices for all exchanges × 0.5 hours per notice = six (6) total burden hours across all exchanges.

[707] The supporting statement for the current active information collection request, ICR Reference No: 201503–3038–002, for OMB control number 3038–0013, estimated that seven respondents would file the §§ 1.47 and 1.48 reports, and that each respondent would file two reports for a total of 14 annual responses, requiring three hour per response, for a total of 42 burden hours for all respondents.

impact.[708] A regulatory flexibility analysis or certification typically is required for ''any rule for which the agency publishes a general notice of proposed rulemaking pursuant to'' the notice-and-comment provisions of the Administrative Procedure Act, 5 U.S.C. 553(b).[709] The requirements related to the proposed amendments fall mainly on registered entities, exchanges, FCMs, swap dealers, clearing members, foreign brokers, and large traders. The Commission has previously determined that registered DCMs, FCMs, swap dealers, major swap participants, eligible contract participants, SEFs, clearing members, foreign brokers and large traders are not small entities for purposes of the RFA.[710]

Further, while the requirements under this rulemaking may impact nonfinancial end users, the Commission notes that position limits levels apply only to large traders. Accordingly, the Chairman, on behalf of the Commission, hereby certifies, on behalf of the Commission, 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. The Chairman made the same certification in the 2013 Proposal,[711] the 2016 Supplemental Proposal,[712] and the 2016 Reproposal.[713]

D. Antitrust Considerations

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of the Act, and the policies and purposes of the Act, in issuing any order or adopting any Commission rule or regulation (including any exemption under section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of the Act.[714]

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requests comment on whether the proposed rule implicates any other specific public interest to be protected by the antitrust laws.

The Commission has considered the proposed rules to determine whether they are anticompetitive and has preliminarily determined that the proposed rules could, in some circumstances, be anticompetitive because position limits at low levels are, to some degree, inherently anticompetitive. A more established DCM that already lists, or is first to list, a core referenced futures contract (an ''incumbent DCM'') has a competitive advantage over smaller DCMs seeking to expand or future entrant DCMs (collectively ''entrant DCMs''), even in the absence of position limits, because ''liquidity attracts liquidity.'' That is, a market participant seeking to execute a single transaction or, for that matter, establish a large position would, other things being equal, gravitate toward a more established facility that successfully lists a contract with relatively consistent volume and transparent pricing—where there is likely to be someone willing to take the other side of a trade. This is especially true if the market participant is already clearing other products with the incumbent DCM. This would tend to protect the incumbent DCM's contract and reinforce the advantage of an incumbent DCM, which has to do less to keep and attract customers and should be able to keep more of the profits from trading volume. That is, the status of incumbency by itself may to some extent create a barrier to entry for an entrant DCM where the presence of a counterparty at the desired price is less assured. Position limits at low levels, especially in the non-spot month, may exacerbate the situation. If a market participant establishes a futures position on an incumbent DCM and then reaches the federal limit level on the incumbent DCM, it becomes even less likely that the market participant will migrate to an entrant DCM, because the federal limit would still apply and prevents the market participant from increasing its aggregate futures position where ever located. Higher volume may permit an incumbent DCM to charge lower transaction fees than an entrant DCM; the price concession that a market participant might have to absorb to establish a large position may be lower on an incumbent DCM than an entrant DCM. Both of these factors would inform a DCM's decision regarding where to set the levels for its own exchange-set limits. Moreover, the incumbent DCM can use other tools to defend its advantage such as the implementation of new technologies, the use of various fees/charges and the application of exemptions to federal limits. The Commission preliminarily believes that the relatively high limit levels that the Commission proposes today do not at this time establish a barrier to entry or competitive restraint likely to facilitate anticompetitive effects in any relevant antitrust market for contract trading. This is because the limit levels that the Commission proposes today are based on recent data regarding deliverable supply and open interest. However, if the size of the relevant markets continues on an upward trend and the Commission does not adjust federal limit levels commensurately, limit levels that become stale over time could facilitate anticompetitive effects. The Commission requests comment on whether and in what circumstances adopting the proposed rules could be anticompetitive.

The Commission has also preliminarily determined that the proposed rules serve the regulatory purpose of the Act ''to deter and prevent price manipulation or any other disruptions to market integrity.'' [715] The Commission proposes to implement the rules pursuant to section 4a(a) of the CEA, which articulates additional policies and purposes.[716]

The Commission has identified the following less anticompetitive means: Requiring derivatives clearing organizations (''DCOs'') to impose initial margin surcharges for position limits. This would be less anticompetitive because initial margin surcharges would still allow a large speculator to accumulate a futures position on another DCM if the speculator so desired while protecting against the price impact from a large price change against the speculator who would otherwise be forced to offload a position due to position limits. The Commission requests comment on whether there are other less anticompetitive means of achieving the relevant purposes of the Act. The Commission is not required to

[708] 44 U.S.C. 601 *et seq.*

[709] 5 U.S.C. 601(2), 603–05.

[710] *See* Policy Statement and Establishment of Definitions of ''Small Entities'' for Purposes of the Regulatory Flexibility Act, 47 FR 18618–19, Apr. 30, 1982 (DCMs, FCMs, and large traders) (''RFA Small Entities Definitions''); Opting Out of Segregation, 66 FR 20740–43, Apr. 25, 2001 (eligible contract participants); Position Limits for Futures and Swaps; Final Rule and Interim Final Rule, 76 FR 71626, 71680, Nov. 18, 2011 (clearing members); Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476, 33548, Jun. 4, 2013 (SEFs); A New Regulatory Framework for Clearing Organizations, 66 FR 45604, 45609, Aug. 29, 2001 (DCOs); Registration of Swap Dealers and Major Swap Participants, 77 FR 2613, Jan. 19, 2012, (swap dealers and major swap participants); and Special Calls, 72 FR 50209, Aug. 31, 2007 (foreign brokers).

[711] *See* 2013 Proposal, 78 FR at 75784.

[712] *See* 2016 Supplemental Proposal, 81 FR at 38499.

[713] *See* 2016 Reproposal, 81 FR at 96894.

[714] 7 U.S.C. 19(b).

[715] Section 3(b) of the CEA, 7 U.S.C. 5(b).

[716] 7 U.S.C. 7a(a) (burdens on interstate commerce; trading or position limits).

follow the least anticompetitive course of action.

The Commission has examined whether requiring DCOs to impose initial margin surcharges for position limits in lieu of imposing position limits is feasible and has preliminarily determined that is not because it could be inconsistent with a relevant provision of the CEA and would require the Commission to revise its current regulations in part 39 to be more prescriptive and less principles-based. Thus, the Commission has preliminarily determined not to adopt this less anticompetitive means. Under section 5b(c)(2)(A)(ii) of the CEA [717] and the corresponding provision of the Commission's current regulations, a registered DCO has ''reasonable discretion in establishing the manner by which it complies with each core principle.'' [718] Moreover, the Commission's regulations already require DCOs to ''establish initial margin requirements that are commensurate with the risks of each product and portfolio, including any unusual characteristics of, or risks associated with, particular products or portfolios . . .,'' [719] which would include large positions. DCOs are also already required to use models that take into account concentration, minimum liquidation time, and other risk factors inherent in large positions, and the Commission reviews these models.[720] Finally, Congress has required that the Commission establish position limits ''as the Commission finds are necessary.'' [721] The Commission requests comment on its feasibility analysis.

List of Subjects

17 CFR Part 1

Agricultural commodity, Agriculture, Brokers, Committees, Commodity futures, Conflicts of interest, Consumer protection, Definitions, Designated contract markets, Directors, Major swap participants, Minimum financial requirements for intermediaries, Reporting and recordkeeping requirements, Swap dealers, Swaps.

17 CFR Part 15

Brokers, Commodity futures, Reporting and recordkeeping requirements, Swaps.

17 CFR Part 17

Brokers, Commodity futures, Reporting and recordkeeping requirements, Swaps.

17 CFR Part 19

Commodity futures, Cottons, Grains, Reporting and recordkeeping requirements, Swaps.

17 CFR Part 40

Commodity futures, Reporting and recordkeeping requirements, Procedural rules.

17 CFR Part 140

Authority delegations (Government agencies), Conflict of interests, Organizations and functions (Government agencies).

17 CFR Part 150

Bona fide hedging, Commodity futures, Cotton, Grains, Position limits, Referenced Contracts, Swaps.

17 CFR Part 151

Bona fide hedging, Commodity futures, Cotton, Grains, Position limits, Referenced Contracts, Swaps.

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR chapter I as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

■ 1. The authority citation for part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a–1, 7a–2, 7b, 7b–3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24 (2012).

§ 1.3 [Amended]

■ 2. In § 1.3, remove the definition of the term ''bona fide hedging transactions and positions for excluded commodities.''

§ 1.47 [Removed and Reserved]

■ 3. Remove and reserve § 1.47.

§ 1.48 [Removed and Reserved]

■ 4. Remove and reserve § 1.48.

PART 15—REPORTS—GENERAL PROVISIONS

■ 5. The authority citation for part 15 continues to read as follows:

Authority: 7 U.S.C. 2, 5, 6a, 6c, 6f, 6g, 6i, 6k, 6m, 6n, 7, 7a, 9, 12a, 19, and 21, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

■ 6. In § 15.00, revise paragraph (p)(1) to read as follows:

§ 15.00 Definitions of terms used in parts 15 to 19, and 21 of this chapter.

* * * * *

(p) * * *

(1) For reports specified in parts 17 and 18 and in § 19.00(a) and (b) of this chapter, any open contract position that at the close of the market on any business day equals or exceeds the quantity specified in § 15.03 in either:

(i) Any one futures of any commodity on any one reporting market, excluding futures contracts against which notices of delivery have been stopped by a trader or issued by the clearing organization of the reporting market; or

(ii) Long or short put or call options that exercise into the same future of any commodity, or other long or short put or call commodity options that have identical expirations and exercise into the same commodity, on any one reporting market.

* * * * *

■ 7. In § 15.01, revise paragraph (d) to read as follows:

§ 15.01 Persons required to report.

* * * * *

(d) Persons, as specified in part 19 of this chapter, who:

(1) Are merchants or dealers of cotton holding or controlling positions for future delivery in cotton that equal or exceed the amount set forth in § 15.03; or

(2) Are persons who have received a special call from the Commission or its designee under § 19.00(b) of this chapter.

* * * * *

■ 8. Revise § 15.02 to read as follows:

§ 15.02 Reporting forms.

Forms on which to report may be obtained from any office of the Commission or via *https://www.cftc.gov.* Listed below are the forms to be used for the filing of reports. To determine who shall file these forms, refer to the Commission rule listed in the column opposite the form number.

Form No.	Title	Rule
40	Statement of Reporting Trader	18.04

[717] 7 U.S.C. 7a–1(c)(2)(A)(ii).

[718] 17 CFR 39.10(b).

[719] 17 CFR 39.13(g)(2)(i).

[720] *See generally* 17 CFR 39.13.

[721] *See supra* Section III.F. (discussion of the necessity finding).

Form No.	Title	Rule
71	Identification of Omnibus Accounts and Sub-accounts	17.01
101	Positions of Special Accounts	17.00
102	Identification of Special Accounts, Volume Threshold Accounts, and Consolidated Accounts	17.01
304	Statement of Cash Positions for Unfixed-Price Cotton "On Call"	19.00

(Approved by the Office of Management and Budget under control numbers 3038–0007, 3038–0009, 3038–0013, and 3038–0103.)

PART 17—REPORTS BY REPORTING MARKETS, FUTURES COMMISSION MERCHANTS, CLEARING MEMBERS, AND FOREIGN BROKERS

■ 9. The authority citation for part 17 continues to read as follows:

Authority: 7 U.S.C. 2, 6a, 6c, 6d, 6f, 6g, 6i, 6t, 7, 7a, and 12a.

■ 10. In § 17.00, revise paragraph (b) introductory text to read as follows:

§ 17.00 Information to be furnished by futures commission merchants, clearing members and foreign brokers.

* * * * *

(b) *Interest in or control of several accounts.* Except as otherwise instructed by the Commission or its designee and as specifically provided in § 150.4 of this chapter, if any person holds or has a financial interest in or controls more than one account, all such accounts shall be considered by the futures commission merchant, clearing member, or foreign broker as a single account for the purpose of determining special account status and for reporting purposes.

* * * * *

■ 11. In § 17.03, add paragraph (i) to read as follows:

§ 17.03 Delegation of authority to the Director of the Office of Data and Technology or the Director of the Division of Market Oversight.

* * * * *

(i) Pursuant to § 17.00(b), and as specifically provided in § 150.4 of this chapter, the authority shall be designated to the Director of the Office of Data and Technology to instruct a futures commission merchant, clearing member, or foreign broker to consider otherwise than as a single account for the purpose of determining special account status and for reporting purposes all accounts one person holds or controls, or in which the person has a financial interest.

■ 12. Revise part 19 to read as follows:

PART 19—REPORTS BY PERSONS HOLDING REPORTABLE POSITIONS IN EXCESS OF POSITION LIMITS, AND BY MERCHANTS AND DEALERS IN COTTON

Authority: 7 U.S.C. 6g, 6c(b), 6i, and 12a(5).

§ 19.00 Who shall furnish information.

(a) *Persons filing cotton on call reports.* Merchants and dealers of cotton holding or controlling positions for future delivery in cotton that are reportable pursuant to § 15.00(p)(1)(i) of this chapter shall file CFTC Form 304.

(b) *Persons responding to a special call.* All persons:

(1) Exceeding speculative position limits under § 150.2 of this chapter; or

(2) Holding or controlling positions for future delivery that are reportable pursuant to § 15.00(p)(1) of this chapter and who have received a special call from the Commission or its designee shall file any pertinent information as instructed in the special call. Filings in response to a special call shall be made within one business day of receipt of the special call unless otherwise specified in the call. Such filing shall be transmitted using the format, coding structure, and electronic data submission procedures approved in writing by the Commission.

§ 19.01 [Reserved]

§ 19.02 Reports pertaining to cotton on call purchases and sales.

(a) *Information required.* Persons required to file CFTC Form 304 reports under § 19.00(a) shall file CFTC Form 304 reports showing the quantity of call cotton bought or sold on which the price has not been fixed, together with the respective futures on which the purchase or sale is based. As used herein, call cotton refers to spot cotton bought or sold, or contracted for purchase or sale at a price to be fixed later based upon a specified future.

(b) *Time and place of filing reports.* Each CFTC Form 304 report shall be made weekly, dated as of the close of business on Friday, and filed not later than 9 a.m. Eastern Time on the third business day following that Friday using the format, coding structure, and electronic data transmission procedures approved in writing by the Commission.

§ 19.03 Delegation of authority to the Director of the Division of Enforcement.

(a) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Enforcement, or such other employee or employees as the Director may designate from time to time, the authority in § 19.00(b) to issue special calls.

(b) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Enforcement, or such other employee or employees as the Director may designate from time to time, the authority in § 19.00(b) to provide instructions or to determine the format, coding structure, and electronic data transmission procedures for submitting data records and any other information required under this part.

(c) The Director of the Division of Enforcement may submit to the Commission for its consideration any matter which has been delegated in this section.

(d) Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

§§ 19.04–19.10 [Reserved]

Appendix A to Part 19—Form 304

BILLING CODE 6351–01–P

CFTC FORM 304

Statement of Cash Positions for Unfixed-Price Cotton "On Call"

NOTICE: Failure to file a report required by the Commodity Exchange Act ("CEA" or the "Act")[1] and the regulations thereunder,[2] or the filing of a report with the Commodity Futures Trading Commission ("CFTC" or "Commission") that includes a false, misleading, or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both.

PRIVACY ACT NOTICE

The Commission's authority for soliciting this information is granted in sections 4i and 8 of the CEA and related regulations (*see, e.g.*, 17 CFR 19.02). The information solicited from entities and individuals engaged in activities covered by the CEA is required to be provided to the CFTC, and failure to comply may result in the imposition of criminal or administrative sanctions (*see, e.g.*, 7 U.S.C. 9 and 13a-1, and/or 18 U.S.C. 1001). The information requested is used by the Commission to prepare its cotton on-call report. The requested information may be used by the Commission in the conduct of investigations and litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to contract markets to meet responsibilities assigned to them by law. The information will be maintained in, and any additional disclosures will be made in accordance with, the CFTC System of Records Notices, available on *www.cftc.gov*.

[1] 7 U.S.C. 1, *et seq*.

[2] Unless otherwise noted, the rules and regulations referenced in this notice are found in chapter I of title 17 of the Code of Federal Regulations; 17 CFR chapter I.

BACKGROUND & INSTRUCTIONS

Applicable Regulations:

- 17 CFR 19.00(a) specifies who shall file Form 304.
- 17 CFR 19.02(a) specifies the information required on Form 304.
- 17 CFR 19.02(b) specifies the frequency (weekly), the report date (close of business on Friday), and the time (9 a.m. Eastern Time on the third business day following that Friday) and manner, for filing the Form 304.

Please follow the instructions below to generate and submit the required filing. Relevant regulations are cited in parentheses () for reference. Unless the context requires otherwise, the terms used herein shall have the same meaning as ascribed in parts 15 to 21 of the Commission's regulations.

Complete Form 304 as follows:

The trader identification fields should be completed by all filers. This Form 304 requires traders to identify themselves using their Public Trader Identification Number, in lieu of the CFTC Code Number required on previous versions of the Form 304. This number is provided to traders who have previously filed Forms 40 or 102 with the Commission. Traders may contact the Commission to obtain this number if it is unknown. If a trader has a National Futures Association Identification Number ("NFA ID") and/or a Legal Entity Identifier ("LEI"), the trader should also identify itself using those numbers. Form 304 requires traders to identify the name of the reporting trader or firm and the contact information (including full name, address, phone number, and email address) for a natural person the Commission may contact regarding the submitted Form 304.

Merchants and dealers of cotton shall report on Form 304. Report in hundreds of 500-lb. bales unfixed-price cotton "on-call" pursuant to § 19.02(a) of the Commission's regulations. Include under "Call Purchases" stocks on hand for which price has not yet been fixed. For each listed stock, report the delivery month, delivery year, quantity of call purchases, and quantity of call sales.

The signature/authorization page shall be completed by all filers. This page shall include the name and position of the natural person filing Form 304 as well as the name of the reporting trader represented by that person. The trader certifying this Form 304 on the signature/authorization page should note that filing a report that includes a false, misleading, or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both.

Submitting Form 304: Once completed, please submit this form to the Commission pursuant to the instructions on *www.cftc.gov* or as otherwise directed by Commission staff. If submission attempts fail, the reporting trader shall contact the Commission at *techsupport@cftc.gov* for further technical support.

Please be advised that pursuant to 5 CFR 1320.5(b)(2)(i), you are not required to respond to this collection of information unless it displays a currently valid OMB control number.

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Public Trader ID No. [provided by CFTC]	OMB No. 3038-0013

COMMODITY FUTURES TRADING COMMISSION
FORM 304
STATEMENT OF CASH POSITIONS FOR UNFIXED-PRICE COTTON "ON-CALL"

Identifying Information			
Identification Codes:			
NFA ID	Legal Entity Identifier (LEI)		
Name of Reporting Trader or Firm:			
Name of Person to Contact Regarding This Form:			
First Name	Middle Name	Last Name	Suffix
Contact Information:			
Address	Phone Number	Email Address	

NOTICE: Failure to file a report required by the Commodity Exchange Act ("CEA" or the "Act") and the regulations thereunder, or the filing of a report with the Commodity Futures Trading Commission ("CFTC" or "Commission") that includes a false, misleading or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both. Please be advised that pursuant to 5 CFR 1320.5(b)(2)(i), you are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Unfixed-price Cotton "on-call" pursuant to § 19.02(a); include under "Call Purchases" stocks on hand for which price has not yet been fixed. Report in hundreds of bales (500-lb. bales).

Delivery Month	Delivery Year	Call Purchases ('00 bales)	Call Sales ('00 bales)

CFTC Form 304 (XX-XX)
Previous Editions Obsolete

Please sign/authenticate the Form 304 prior to submitting.

Signature/ Electronic Authentication:

☐ By checking this box and submitting this form (or by clicking "submit," "send," or any other analogous transmission command if transmitting electronically), I certify that I am duly authorized by the reporting trader identified below to provide the information and representations submitted on this Form 304, and that to the best of my knowledge the information and representations made herein are true and correct.

Reporting Trader Authorized Representative (Name and Position):

____________________ (Name)

____________________ (Position)

Submitted on behalf of:

____________________ (Reporting Trader Name)

Date of Submission: ____________________

CFTC Form 304 (XX-XX)
Previous Editions Obsolete

Form 304, Example – July 2017 Call purchases of 200 bales and sales of 1,800 bales; October Call purchases of 6,600 bales and sales of 8,000 bales.

Unfixed-price Cotton “on-call” pursuant to § 19.02(a); include under “Call Purchases” stocks on hand for which price has not yet been fixed. Report in hundreds of bales (500-lb. bales).			
Delivery Month	Delivery Year	Call Purchases ('00 bales)	Call Sales ('00 bales)
July	2017	2	18
October	2017	66	80

BILLING CODE 6351–01–C

PART 40—PROVISIONS COMMON TO REGISTERED ENTITIES

■ 13. The authority citation for part 40 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 7, 7a, 8 and 12, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Pub. L. 111–203, 124 Stat. 1376 (2010).

■ 14. In § 40.1, revise paragraphs (j)(1)(vii) and (j)(2)(vii) to read as follows:

§ 40.1 Definitions.

* * * * *

(j) * * *

(1) * * *

(vii) Speculative position limits, position accountability standards, and position reporting requirements, including an indication as to whether the contract meets the definition of a referenced contract as defined in § 150.1 of this chapter, and, if so, the name of the core referenced futures contract on which the referenced contract is based.

* * * * *

(2) * * *

(vii) Speculative position limits, position accountability standards, and position reporting requirements, including an indication as to whether the contract meets the definition of economically equivalent swap as defined in § 150.1 of this chapter, and, if so, the name of the referenced contract to which the swap is economically equivalent.

* * * * *

PART 140—ORGANIZATION, FUNCTIONS, AND PROCEDURES OF THE COMMISSION

■ 15. The authority citation for part 140 continues to read as follows:

Authority: 7 U.S.C. 2(a)(12), 12a, 13(c), 13(d), 13(e), and 16(b).

§ 140.97 [Removed and Reserved]

■ 16. Remove and reserve § 140.97.

PART 150—LIMITS ON POSITIONS

■ 17. The authority citation for part 150 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6c, 6f, 6g, 6t, 12a, and 19, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

■ 18. Revise § 150.1 to read as follows:

§ 150.1 Definitions.

As used in this part—

Bona fide hedging transactions or positions means a position in commodity derivative contracts in a physical commodity, where:

(1) Such position:

(i) Represents a substitute for transactions made or to be made, or positions taken or to be taken, at a later time in a physical marketing channel;

(ii) Is economically appropriate to the reduction of price risks in the conduct and management of a commercial enterprise; and

(iii) Arises from the potential change in the value of—

(A) Assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;

(B) Liabilities which a person owes or anticipates incurring; or

(C) Services that a person provides or purchases, or anticipates providing or purchasing; or

(2) Such position qualifies as:

(i) *Pass-through swap and pass-through swap offset pair.* Paired positions of a pass-through swap and a pass-through swap offset, where:

(A) The pass-through swap is a swap position entered into by one person for which the swap would qualify as a bona fide hedging transaction or position pursuant to paragraph (1) of this definition (the bona fide hedging swap counterparty) that is opposite another person (the pass-through swap counterparty); and

(B) The pass-through swap offset is a futures, option on a futures, or swap position entered into by the pass-through swap counterparty in the same physical commodity as the pass-through swap, and which reduces the pass-through swap counterparty's price risks attendant to that pass-through swap; and provided that the pass-through swap counterparty is able to demonstrate upon request that the pass-through swap qualifies as a bona fide hedging transaction or position pursuant to paragraph (1) of this definition; or

(ii) *Offsets of a bona fide hedger's qualifying swap position.* A futures, option on a futures, or swap position entered into by a bona fide hedging swap counterparty that reduces price risks attendant to a previously-entered-into swap position that qualified as a bona fide hedging transaction or position at the time it was entered into for that counterparty pursuant to paragraph (1) of this definition.

Commodity derivative contract means any futures, option on a futures, or swap contract in a commodity (other than a security futures product as defined in section 1a(45) of the Act).

Core referenced futures contract means a futures contract that is listed in § 150.2(d).

Economically equivalent swap means, with respect to a particular referenced contract, any swap that has identical material contractual specifications, terms, and conditions to such referenced contract.

(1) Other than as provided in paragraph (2) of this definition, for the purpose of determining whether a swap is an economically equivalent swap with respect to a particular referenced contract, the swap shall not be deemed to lack identical material contractual specifications, terms, and conditions due to different lot size specifications or notional amounts, delivery dates diverging by less than one calendar day, or different post-trade risk management arrangements.

(2) With respect to any natural gas referenced contract, for the purpose of determining whether a swap is an economically equivalent swap to such referenced contract, the swap shall not be deemed to lack identical material contractual specifications, terms, and conditions due to different lot size specifications or notional amounts, delivery dates diverging by less than two calendar days, or different post-trade risk management arrangements.

(3) With respect to any referenced contract or class of referenced contracts, the Commission may make a determination that any swap or class of swaps satisfies, or does not satisfy, this economically equivalent swap definition.

Eligible affiliate means an entity with respect to which another person:

(1) Directly or indirectly holds either:

(i) A majority of the equity securities of such entity, or

(ii) The right to receive upon dissolution of, or the contribution of, a majority of the capital of such entity;

(2) Reports its financial statements on a consolidated basis under Generally Accepted Accounting Principles or International Financial Reporting Standards, and such consolidated financial statements include the financial results of such entity; and

(3) Is required to aggregate the positions of such entity under § 150.4 and does not claim an exemption from aggregation for such entity.

Eligible entity [1] means a commodity pool operator; the operator of a trading

[1] The definition of the term eligible entity was amended by the Commission in a final rule published on December 16, 2016 (81 FR at 91454, 91489). Aside from proposing to remove the lettering from each of the defined terms and to display them in alphabetical order, the definition of

Continued

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

(1) Which authorizes an independent account controller independently to control all trading decisions with respect to the eligible entity's client positions and accounts that the independent account controller holds directly or indirectly, or on the eligible entity's behalf, but without the eligible entity's day-to-day direction; and

(2) Which maintains:

(i) Only such minimum control over the independent account controller as is consistent with its fiduciary responsibilities to the managed positions and accounts, and necessary to fulfill its duty to supervise diligently the trading done on its behalf; or

(ii) If a limited partner, limited member or shareholder of a commodity pool the operator of which is exempt from registration under § 4.13 of this chapter, only such limited control as is consistent with its status.

Entity means a ''person'' as defined in section 1a of the Act.

Excluded commodity means an ''excluded commodity'' as defined in section 1a of the Act.

Futures-equivalent means:

(1) An option contract, whether an option on a future or an option that is a swap, which has been adjusted by an economically reasonable and analytically supported risk factor, or delta coefficient, for that option computed as of the previous day's close or the current day's close or contemporaneously during the trading day, and converted to an economically equivalent amount of an open position in a core referenced futures contract, *provided however,* if a participant's position exceeds speculative position limits as a result of an option assignment, that participant is allowed one business day to liquidate the excess position without being considered in violation of the limits;

(2) A futures contract which has been converted to an economically equivalent amount of an open position in a core referenced futures contract; and

(3) A swap which has been converted to an economically equivalent amount of an open position in a core referenced futures contract.

Independent account controller [2] means a person:

(1) Who specifically is authorized by an eligible entity, as defined in this section, independently to control trading decisions on behalf of, but without the day-to-day direction of, the eligible entity;

(2) Over whose trading the eligible entity maintains only such minimum control as is consistent with its fiduciary responsibilities for managed positions and accounts to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations which may be incumbent upon the eligible entity to fulfill;

(3) Who trades independently of the eligible entity and of any other independent account controller trading for the eligible entity;

(4) Who has no knowledge of trading decisions by any other independent account controller; and

(5) Who is:

(i) Registered as a futures commission merchant, an introducing broker, a commodity trading advisor, or an associated person of any such registrant, or

(ii) A general partner, managing member or manager of a commodity pool the operator of which is excluded from registration under § 4.5(a)(4) of this chapter or § 4.13 of this chapter, *provided that* such general partner, managing member or manager complies with the requirements of § 150.4(c).

Long position means, on a futures-equivalent basis, a long call option, a short put option, a long underlying futures contract, or a swap position that is equivalent to a long futures contract.

Physical commodity means any agricultural commodity as that term is defined in § 1.3 of this chapter or any exempt commodity as that term is defined in section 1a of the Act.

Position accountability means any bylaw, rule, regulation, or resolution that is submitted to the Commission pursuant to part 40 of this chapter in lieu of, or along with, a speculative position limit, and that requires a trader whose position exceeds the accountability level to consent to: (1) Provide information about its position to the designated contract market or swap execution facility; and (2) halt increasing further its position or reduce its position in an orderly manner, in each case as requested by the designated contract market or swap execution facility.

Pre-enactment swap means any swap entered into prior to enactment of the Dodd-Frank Act of 2010 (July 21, 2010), the terms of which have not expired as of the date of enactment of that Act.

Pre-existing position means any position in a commodity derivative contract acquired in good faith prior to the effective date of any bylaw, rule, regulation, or resolution that specifies a speculative position limit level or a subsequent change to that level.

Referenced contract means:

(1) A core referenced futures contract listed in § 150.2(d) or, on a futures-equivalent basis with respect to a particular core referenced futures contract, a futures contract or options on a futures contract, including a spread, that is either:

(i) Directly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to, the price of that particular core referenced futures contract; or

(ii) Directly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to, the price of the same commodity underlying that particular core referenced futures contract for delivery at the same location or locations as specified in that particular core referenced futures contract; or

(2) On a futures-equivalent basis, an economically equivalent swap.

(3) The definition of referenced contract does not include a location basis contract, a commodity index contract, any guarantee of a swap, or a trade option that meets the requirements of § 32.3 of this chapter.

Short position means, on a futures-equivalent basis, a short call option, a long put option, a short underlying futures contract, or a swap position that is equivalent to a short futures contract.

Speculative position limit means the maximum position, either net long or net short, in a commodity derivative contract that may be held or controlled by one person, absent an exemption, whether such limits are adopted for combined positions in all commodity derivative contracts in a particular commodity, including the spot month future and all single month futures (the spot month and all single month futures, cumulatively, ''all-months-combined''), positions in a single month of commodity derivative contracts in a particular commodity other than the spot month future (''single month''), or

the term eligible entity would not be further amended by this proposal and is included solely to maintain the continuity of this definitions section.

[2] The definition of the term independent account controller was amended by the Commission in a final rule published on December 16, 2016 (81 FR at 91454, 91489). This term would not be further amended by this proposal and is included solely to maintain the continuity of this definitions section.

positions in the spot month of commodity derivative contacts in a particular commodity. Such a limit may be established under federal regulations or rules of a designated contract market or swap execution facility. For referenced contracts other than core referenced futures contracts, single month means the same period as that of the relevant core referenced futures contract.

Spot month means:

(1) For physical-delivery core referenced futures contracts, the period of time beginning at the earlier of the close of business on the trading day preceding the first day on which delivery notices can be issued by the clearing organization of a contract market, or the close of business on the trading day preceding the third-to-last trading day, until the contract expires, except as follows:

(i) For *ICE Futures U.S. Sugar No. 11* (SB) core referenced futures contract, the spot month means the period of time beginning at the opening of trading on the second business day following the expiration of the regular option contract traded on the expiring futures contract until the contract expires;

(ii) For *ICE Futures U.S. Sugar No. 16* (SF) core referenced futures contract, the spot month means the period of time beginning on the third-to-last trading day of the contract month until the contract expires;

(iii) For *Chicago Mercantile Exchange Live Cattle* (LC) core referenced futures contract, the spot month means the period of time beginning at the close of trading on the fifth business day of the contract month until the contract expires;

(2) For referenced contracts other than core referenced futures contracts, the spot month means the same period as that of the relevant core referenced futures contract.

Spread transaction means either a calendar spread, intercommodity spread, quality differential spread, processing spread, product or by-product differential spread, or futures-option spread.

Swap means ''swap'' as that term is defined in section 1a of the Act and as further defined in § 1.3 of this chapter.

Swap dealer means ''swap dealer'' as that term is defined in section 1a of the Act and as further defined in § 1.3 of this chapter.

Transition period swap means a swap entered into during the period commencing after the enactment of the Dodd-Frank Act of 2010 (July 21, 2010), and ending 60 days after the publication in the **Federal Register** of final amendments to this part implementing section 737 of the Dodd-Frank Act of 2010.

■ 19. Revise § 150.2 to read as follows:

§ 150.2 Federal speculative position limits.

(a) *Spot month speculative position limits.* For physical-delivery referenced contracts and, separately, for cash-settled referenced contracts, no person may hold or control positions in the spot month, net long or net short, in excess of the levels specified by the Commission.

(b) *Single month and all-months-combined speculative position limits.* For any referenced contract, no person may hold or control positions in a single month or in all-months-combined (including the spot month), net long or net short, in excess of the levels specified by the Commission.

(c) *Relevant contract month.* For purposes of this part, for referenced contracts other than core referenced futures contracts, the spot month and any single month shall be the same as those of the relevant core referenced futures contract.

(d) *Core referenced futures contracts.* Federal speculative position limits apply to referenced contracts based on the following core referenced futures contracts:

TABLE 1 TO PARAGRAPH (d)—CORE REFERENCED FUTURES CONTRACTS

Commodity type	*Designated contract market*	*Core referenced futures contract* [1]
Legacy Agricultural		
	Chicago Board of Trade	
		Corn (C).
		Oats (O).
		Soybeans (S).
		Soybean Meal (SM).
		Soybean Oil (SO).
		Wheat (W).
		Hard Winter Wheat (KW).
	ICE Futures U.S.	
		Cotton No. 2 (CT).
	Minneapolis Grain Exchange	
		Hard Red Spring Wheat (MWE).
Other Agricultural		
	Chicago Board of Trade	
		Rough Rice (RR).
	Chicago Mercantile Exchange	
		Live Cattle (LC).
	ICE Futures U.S.	
		Cocoa (CC).
		Coffee C (KC).
		FCOJ–A (OJ).
		U.S. Sugar No. 11 (SB).
		U.S. Sugar No. 16 (SF).
Energy		
	New York Mercantile Exchange	
		Light Sweet Crude Oil (CL).
		NY Harbor ULSD (HO).
		RBOB Gasoline (RB).
		Henry Hub Natural Gas (NG).
Metals		
	Commodity Exchange, Inc.	
		Gold (GC).

TABLE 1 TO PARAGRAPH (d)—CORE REFERENCED FUTURES CONTRACTS—Continued

Commodity type	*Designated contract market*	*Core referenced futures contract* [1]
	New York Mercantile Exchange	Silver (SI). Copper (HG). Palladium (PA). Platinum (PL).

[1] The core referenced futures contract includes any successor contracts.

(e) *Establishment of speculative position limit levels.* The levels of federal speculative position limits are fixed by the Commission at the levels listed in appendix E to this part; *provided however,* compliance with such speculative limits shall not be required until 365 days after publication in the **Federal Register**.

(f) *Designated contract market estimates of deliverable supply.* Each designated contract market listing a core referenced futures contract shall supply to the Commission an estimated spot month deliverable supply upon request by the Commission, and may supply such estimates to the Commission at any other time. Each estimate shall be accompanied by a description of the methodology used to derive the estimate and any statistical data supporting the estimate, and shall be submitted using the format and procedures approved in writing by the Commission. A designated contract market should use the guidance regarding deliverable supply in appendix C to part 38 of this chapter.

(g) *Pre-existing positions*—(1) *Pre-existing positions in a spot month.* A spot month speculative position limit established under this section shall apply to pre-existing positions other than pre-enactment swaps and transition period swaps.

(2) *Pre-existing positions in a non-spot month.* A single month or all-months-combined speculative position limit established under this section shall not apply to pre-existing positions, *provided however,* that if such position is not a pre-enactment swap or transition period swap then that position shall be attributed to the person if the person's position is increased after the effective date of such limit.

(h) *Positions on foreign boards of trade.* The speculative position limits established under this section shall apply to a person's combined positions in referenced contracts, including positions executed on, or pursuant to the rules of a foreign board of trade, pursuant to section 4a(a)(6) of the Act, *provided that:*

(1) Such referenced contracts settle against any price (including the daily or final settlement price) of one or more contracts listed for trading on a designated contract market or swap execution facility that is a trading facility; and

(2) The foreign board of trade makes available such referenced contracts to its members or other participants located in the United States through direct access to its electronic trading and order matching system.

(i) *Anti-evasion provision.* For the purposes of applying the speculative position limits in this section, if used to willfully circumvent or evade speculative position limits:

(1) A commodity index contract and/or a location basis contract shall be considered to be a referenced contract;

(2) A bona fide hedging transaction or position recognition or spread exemption shall no longer apply; and

(3) A swap shall be considered to be an economically equivalent swap.

(j) *Delegation of authority to the Director of the Division of Market Oversight.* (1) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, the authority in paragraph (f) of this section to request estimated deliverable supply from a designated contract market and to provide the format and procedures for submitting such estimates.

(2) The Director of the Division of Market Oversight may submit to the Commission for its consideration any matter which has been delegated in this section.

(3) Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

(k) *Eligible affiliates and aggregation.* For purposes of this part, if an eligible affiliate meets the conditions for any exemption from aggregation under § 150.4, the eligible affiliate may choose to utilize that exemption, or it may opt to be aggregated with its affiliated entities.

■ 20. Revise § 150.3 to read as follows:

§ 150.3 Exemptions.

(a) *Positions which may exceed limits.* The speculative position limits set forth in § 150.2 may be exceeded to the extent that all applicable requirements in this part are met, *provided that* such positions are one of the following:

(1) *Bona fide hedging transactions or positions.* Positions that comply with the bona fide hedging transaction or position definition in § 150.1, and are:

(i) Enumerated in appendix A to this part; or

(ii) Bona fide hedging transactions or positions, other than those enumerated in appendix A to this part, that are approved as non-enumerated bona fide hedging transactions or positions in accordance with paragraph (b)(4) of this section or § 150.9;

(2) *Spread transactions.* Transactions that:

(i) Meet the spread transaction definition in § 150.1; or

(ii) Do not meet the spread transaction definition in § 150.1, but have been approved by the Commission pursuant to paragraph (b)(4) of this section.

(3) *Financial distress positions.* Positions of a person, or related persons, under financial distress circumstances, when exempted by the Commission from any of the requirements of this part in response to a specific request made to the Commission pursuant to § 140.99 of this chapter, where financial distress circumstances include, but are not limited to, situations involving the potential default or bankruptcy of a customer of the requesting person or persons, an affiliate of the requesting person or persons, or a potential acquisition target of the requesting person or persons;

(4) *Conditional spot month limit exemption positions in natural gas.* Spot month positions in natural gas cash-settled referenced contracts that exceed the spot month speculative position limit set forth in § 150.2, *provided that such positions:*

(i) Do not exceed the equivalent of 10,000 contracts of the NYMEX Henry Hub Natural Gas core referenced futures contract per designated contract market that lists a natural gas cash-settled referenced contract;

(ii) Do not exceed 10,000 futures equivalent contracts in economically equivalent swaps in natural gas; and

(iii) That the person holding or controlling such positions does not hold or control positions in spot-month physical-delivery referenced contracts in natural gas; or

(5) *Pre-enactment and transition period swaps exemption.* The speculative position limits set forth in § 150.2 shall not apply to positions acquired in good faith in any pre-enactment swap, or in any transition period swap, in either case as defined by § 150.1; *provided however,* that a person may net such positions with post-effective date commodity derivative contracts for the purpose of complying with any non-spot month speculative position limit.

(b) *Application for relief.* Any person with a position in a referenced contract seeking recognition of such position as a bona fide hedging transaction or position, in accordance with paragraph (a)(1)(ii) of this section, or seeking an exemption for a spread position in accordance with paragraphs (a)(2)(ii) of this section, in each case for purposes of federal speculative position limits set forth in § 150.2, may submit an application to the Commission in accordance with this section.

(1) *Required information.* The application shall include the following information:

(i) With respect to an application for a recognition of a bona fide hedging transaction or position:

(A) A description of the position in the commodity derivative contract for which the application is submitted, including, but not limited to, the name of the underlying commodity and the derivative position size;

(B) Information to demonstrate why the position satisfies the requirements of section 4a(c)(2) of the Act and the definition of bona fide hedging transaction or position in § 150.1, including factual and legal analysis;

(C) A statement concerning the maximum size of all gross positions in commodity derivative contracts for which the application is submitted;

(D) A description of the applicant's activity in the cash markets and swaps markets for the commodity underlying the position for which the application is submitted, including, but not limited to, information regarding the offsetting cash positions; and

(E) Any other information that may help the Commission determine whether the position satisfies the requirements of section 4a(c)(2) of the Act and the definition of bona fide hedging transaction or position in § 150.1.

(ii) With respect to an application for a spread exemption:

(A) A description of the spread position for which the application is submitted;

(B) A statement concerning the maximum size of all gross positions in commodity derivative contracts for which the application is submitted; and

(C) Any other information that may help the Commission determine whether the position is consistent with section 4a(a)(3)(B) of the Act.

(2) *Additional information.* If the Commission determines that it requires additional information in order to determine whether to recognize a position as a bona fide hedging transaction or position, or grant a spread exemption, the Commission shall:

(i) Notify the applicant of any supplemental information required; and

(ii) Provide the applicant with ten business days in which to provide the Commission with any supplemental information.

(3) *Timing of application.* (i) Except as provided in paragraph (b)(3)(ii) of this section, a person seeking relief in accordance with this section must submit an application to the Commission and receive a notice of approval of such application prior to the date that the position for which the application was submitted would be in excess of the applicable federal speculative position limit set forth in § 150.2;

(ii) A person may, however, due to demonstrated sudden or unforeseen increases in their bona fide hedging needs, submit an application for a recognition of a bona fide hedging transaction or position within five business days after the person established the position that exceeded the applicable federal speculative position limit.

(A) Any application filed pursuant to paragraph (b)(3)(ii) of this section must include an explanation of the circumstances warranting the sudden or unforeseen increases in bona fide hedging needs.

(B) If an application filed pursuant to paragraph (b)(3)(ii) of this section is denied, the person must bring its position within the federal speculative position limits within a commercially reasonable time, as determined by the Commission in consultation with the applicant and the applicable designated contract market or swap execution facility.

(C) The Commission will not determine that the person holding the position has committed a position limits violation during the period of the Commission's review nor once the Commission has issued its determination.

(4) *Commission determination.* After review of the application and any supplemental information provided by the requestor, the Commission will determine, with respect to the transaction or position for which the request is submitted, whether to recognize all or a specified portion of such transaction or position as a bona fide hedging transaction or position or whether to exempt all or a specified portion of such spread transaction, as applicable. The Commission shall notify the applicant of its determination, and an applicant may exceed federal speculative position limits set forth in § 150.2 upon receiving a notice of approval.

(5) *Renewal of application.* With respect to any application approved by the Commission pursuant to this section, a person shall renew such application if the information provided pursuant to paragraph (b)(1) of this section changes or upon request by the Commission.

(6) *Commission revocation or modification.* If the Commission determines, at any time, that a recognized bona fide hedging transaction or position is no longer consistent with section 4a(c)(2) of the Act or the definition of bona fide hedging transaction or position in § 150.1, or that a spread exemption is no longer consistent with section 4a(a)(3)(B) of the Act, the Commission shall notify the person holding such position and, in its discretion, revoke or modify the bona fide hedge recognition or spread exemption for purposes of federal speculative position limits and require the person to reduce the derivatives position within a commercially reasonable time or otherwise come into compliance. This notification shall briefly specify the nature of the issues raised and the specific provisions of the Act or the Commission's regulations with which the position or application is, or appears to be, inconsistent.

(c) *Previously-granted risk management exemptions.* Exemptions previously granted by the Commission under § 1.47 of this chapter, or by a designated contract market or swap execution facility, in either case to the extent that such exemptions are for the risk management of positions in financial instruments, including but not limited to index funds, shall not apply after the effective date of speculative position limit levels adopted, pursuant to § 150.2(e). Nothing in this paragraph shall preclude the Commission, a designated contract market, or swap execution facility from recognizing a bona fide hedging transaction or position for the former holder of such a risk management exemption if the position complies with the definition of bona fide hedging transaction or position under this part, including appendices hereto.

(d) *Recordkeeping.* (1) Persons who avail themselves of exemptions or relief under this section shall keep and maintain complete books and records concerning all details of their related cash, forward, futures, options on futures, and swap positions and transactions, including anticipated requirements, production and royalties, contracts for services, cash commodity products and by-products, cross-commodity hedges, and records of bona fide hedging swap counterparties, and shall make such books and records available to the Commission upon request under paragraph (e) of this section.

(2) Any person that relies on a representation received from another person that a swap qualifies as a pass-through swap under paragraph (2) of the definition of bona fide hedging transaction or position in § 150.1 shall keep and make available to the Commission upon request all relevant books and records supporting such a representation, including any record the person intends to use to demonstrate that the pass-through swap is a bona fide hedging transaction or position, for a period of at least two years following the expiration of the swap.

(3) All books and records required to be kept pursuant to this section shall be kept in accordance with the requirements of § 1.31 of this chapter.

(e) *Call for information.* Upon call by the Commission, the Director of the Division of Enforcement or the Director's delegate, any person claiming an exemption from speculative position limits under this section shall 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 commodity derivative contracts or cash market positions which support the claimed exemption; and the relevant business relationships supporting a claimed exemption.

(f) *Aggregation of accounts.* Entities required to aggregate accounts or positions under § 150.4 shall be considered the same person for the purpose of determining whether they are eligible for an exemption under paragraphs (a)(1) through (4) of this section with respect to such aggregated account or position.

(g) *Delegation of authority to the Director of the Division of Market Oversight.* (1) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight, or such other employee or employees as the Director may designate from time to time:

(i) The authority in paragraph (a)(3) of this section to provide exemptions in circumstances of financial distress;

(ii) The authority in paragraph (b)(2) of this section to request additional information with respect to a request for a bona fide hedging transaction or position recognition or spread exemption;

(iii) The authority in paragraph (b)(3)(ii)(B) of this section to, if applicable, determine a commercially reasonable amount of time required for a person to bring its position within the federal speculative position limits:

(iv) The authority in paragraph (b)(4) of this section to make a determination whether to recognize a position as a bona fide hedging transaction or position or to grant a spread exemption; and

(v) The authority in paragraph (b)(2) or (b)(5) of this section to request that a person submit updated materials or renew their request with the Commission.

(2) The Director of the Division of Market Oversight may submit to the Commission for its consideration any matter which has been delegated in this section.

(3) Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

■ 21. Revise § 150.5 to read as follows:

§ 150.5 Exchange-set speculative position limits and exemptions therefrom.

(a) *Requirements for exchange-set limits on commodity derivative contracts subject to federal limits set forth in § 150.2*—(1) *Exchange-set limits.* For any commodity derivative contract that is subject to a federal speculative position limit under § 150.2, a designated contract market or swap execution facility that is a trading facility shall set a speculative position limit no higher than the level specified in § 150.2.

(2) *Exemptions to exchange-set limits.* A designated contract market or swap execution facility that is a trading facility may grant exemptions from any speculative position limits it sets under paragraph (a)(1) of this section in accordance with the following:

(i) *Exemption levels.* Exemptions of the type that conform to the exemptions the Commission identified in:

(A) Sections 150.3(a)(1)(i), (a)(2)(i), and (a)(4) through (5) may be granted at a level that exceeds the level of the applicable federal limit in § 150.2;

(B) Sections 150.3(a)(1)(ii) and (a)(2)(ii) may be granted at a level that exceeds the level of the applicable federal limit in § 150.2, *provided that,* the exemption is first approved in accordance with § 150.3(b) or 150.9, as applicable;

(C) Section 150.3(a)(3) may be granted at a level that exceeds the level of the applicable federal limit in § 150.2, *provided that,* the Commission has first approved such exemption pursuant to a request submitted under § 140.99 of this chapter; and

(D) Exemptions of the type that do not conform to the exemptions identified in § 150.3(a) shall be granted at a level that is capped at the level of the applicable federal limit in § 150.2 and that complies with paragraph (a)(2)(ii)(C) of this section, unless the Commission has first approved such exemption pursuant to § 150.3(b) or pursuant to a request submitted under § 140.99.

(ii) *Application for exemption from exchange-set limits.* A designated contract market or swap execution facility that is a trading facility that elects to grant exemptions under paragraph (a)(2)(i) of this section:

(A) *(1)* Except as provided in paragraph (a)(2)(ii)(A)*(2)* of this section, shall require traders to file an application requesting such exemption in advance of the date that such position would be in excess of the limits then in effect. Such application shall include any information needed to enable the designated contract market or swap execution facility to determine, and the Commission to verify, whether the facts and circumstances demonstrate that the designated contract market or swap execution facility may grant an exemption. Any application for a bona fide hedging transaction or position shall include a description of the applicant's activity in the cash markets and swaps markets for the commodity underlying the position for which the application is submitted, including, but not limited to, information regarding the offsetting cash positions.

(2) The designated contract market or swap execution facility may, however, adopt rules that allow a person, due to demonstrated sudden or unforeseen increases in its bona fide hedging needs, to file an application to request a recognition of a bona fide hedging transaction or position within five business days after the person

established the position that exceeded the applicable exchange-set speculative position limit.

(3) The designated contract market or swap execution facility must require that any application filed pursuant to paragraph (a)(2)(ii)(A)*(2)* of this section include an explanation of the circumstances warranting the sudden or unforeseen increases in bona fide hedging needs.

(4) If an application filed pursuant to paragraph (a)(2)(ii)(A)*(2)* of this section is denied, the applicant must bring its position within the designated contract market or swap execution facility's speculative position limits within a commercially reasonable time as determined by the designated contract market or swap execution facility.

(5) The designated contract market, swap execution facility, or Commission will not determine that the person holding the position has committed a position limits violation during the period of the designated contract market or swap execution facility's review nor once the designated contract market or swap execution facility has issued its determination;

(B) Shall require, for any such exemption granted, that the trader re-apply for the exemption at least on an annual basis;

(C) May, in accordance with the designated contract market or swap execution facility's rules, deny any such application, or limit, condition, or revoke any such exemption, at any time after providing notice to the applicant, and shall take into account whether the requested exemption would result in positions that would not be in accord with sound commercial practices in the relevant commodity derivative market and/or that would exceed an amount that may be established and liquidated in an orderly fashion in that market; and

(D) Notwithstanding paragraph (a)(2)(ii)(C) of this section, may require persons with positions that comply either with the bona fide hedging transactions or positions definition or the spread transactions definition in § 150.1, as applicable, to exit any such positions in excess of limits during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract, or to otherwise limit the size of such position. Designated contract markets and swap execution facilities may refer to paragraph (b) of appendix B to part 150 for guidance regarding the foregoing.

(3) *Exchange-set limits on pre-existing positions*—(i) *Pre-existing positions in a spot month.* A designated contract market or swap execution facility that is a trading facility shall require compliance with spot month exchange-set speculative position limits for pre-existing positions in commodity derivative contracts other than pre-enactment swaps and transition period swaps.

(ii) *Pre-existing positions in a non-spot month.* A single month or all-months-combined speculative position limit established under paragraph (a)(1) of this section shall not apply to any pre-existing positions in commodity derivative contracts, *provided however,* that if such position is not a pre-enactment swap or transition period swap, then such position shall be attributed to the person if the person's position is increased after the effective date of such limit.

(4) *Monthly reports detailing the disposition of each application.* (i) For commodity derivative contracts subject to federal speculative position limits, the designated contract market or swap execution facility shall submit to the Commission a report each month showing the disposition of any exemption application, including the recognition of any position as a bona fide hedging transaction or position, the exemption of any spread transaction or other position, the renewal, revocation, or modification of a previously granted recognition or exemption, or the rejection of any application, as well as the following details:

(A) The date of disposition;

(B) The effective date of the disposition;

(C) The expiration date of any recognition or exemption;

(D) Any unique identifier(s) the designated contract market or swap execution facility may assign to track the application, or the specific type of recognition or exemption;

(E) If the application is for an enumerated bona fide hedging transaction or position, the name of the enumerated bona fide hedging transaction or position listed in appendix A to this part;

(F) If the application is for a spread transaction listed in the spread transaction definition in § 150.1, the name of the spread transaction as it is listed in § 150.1;

(G) The identity of the applicant;

(H) The listed commodity derivative contract or position(s) to which the application pertains;

(I) The underlying cash commodity;

(J) The maximum size of the commodity derivative position that is recognized by the designated contract market or swap execution facility as a bona fide hedging transaction or position, specified by contract month and by the type of limit as spot month, single month, or all-months-combined, as applicable;

(K) Any size limitations or conditions established for a spread exemption or other exemption; and

(L) For bona fide hedging transactions or positions, a concise summary of the applicant's activity in the cash markets and swaps markets for the commodity underlying the commodity derivative position for which the application was submitted.

(ii) The designated contract market or swap execution facility shall submit to the Commission the information required by paragraph (a)(4)(i) of this section:

(A) As specified by the Commission on the Forms and Submissions page at *www.cftc.gov*; and

(B) Using the format, coding structure, and electronic data transmission procedures approved in writing by the Commission.

(b) *Requirements for exchange-set limits on commodity derivative contracts in a physical commodity that are not subject to the limits set forth in § 150.2*—(1) *Exchange-set spot month limits*—(i) *Spot month speculative position limit levels.* For any commodity derivative contract subject to paragraph (b) of this section, a designated contract market or swap execution facility that is a trading facility shall establish speculative position limits for the spot month no greater than 25 percent of the estimated spot month deliverable supply, calculated separately for each month to be listed.

(ii) *Additional sources for compliance.* Alternatively, a designated contract market or swap execution facility that is a trading facility may submit rules to the Commission establishing spot month speculative position limits other than as provided in paragraph (b)(1)(i) of this section, provided that the limits are set at a level that is necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index.

(2) *Exchange-set limits or accountability outside of the spot month*—(i) *Non-spot month speculative position limit or accountability levels.* For any commodity derivative contract subject to paragraph (b) of this section, a designated contract market or swap execution facility that is a trading facility shall adopt either speculative position limits or position accountability outside of the spot month at a level that is necessary and appropriate to reduce the potential threat of market manipulation or price

distortion of the contract's or the underlying commodity's price or index.

(ii) *Additional sources for compliance.* A designated contract market or swap execution facility that is a trading facility may refer to the non-exclusive acceptable practices in paragraph (b) of appendix F of this part to demonstrate to the Commission compliance with the requirements of paragraph (b)(2)(i) of this section.

(3) *Look-alike contracts.* For any newly listed commodity derivative contract subject to paragraph (b) of this section that is substantially the same as an existing contract listed on a designated contract market or swap execution facility that is a trading facility, a designated contract market or swap execution facility that is a trading facility listing such newly listed contract shall adopt spot month, individual month, and all-months-combined speculative position limits comparable to those of the existing contract. Alternatively, if such designated contract market or swap execution facility seeks to adopt speculative position limits that are not comparable to those of the existing contract, such designated contract market or swap execution facility shall demonstrate to the Commission how the levels comply with paragraphs (b)(1) and/or (b)(2) of this section.

(4) *Exemptions to exchange-set limits.* A designated contract market or swap execution facility that is a trading facility may grant exemptions from any speculative position limits it sets under paragraphs (b)(1) or (b)(2) of this section in accordance with the following:

(i) Traders shall be required to apply to the designated contract market or swap execution facility for any such exemption from its speculative position limit rules; and

(ii) A designated contract market or swap execution facility that is a trading facility may deny any such application, or limit, condition, or revoke any such exemption, at any time after providing notice to the applicant, and shall take into account whether the requested exemption would result in positions that would not be in accord with sound commercial practices in the relevant commodity derivative market and/or would exceed an amount that may be established and liquidated in an orderly fashion in that market.

(c) *Requirements for security futures products.* For security futures products, speculative position limits and position accountability requirements are specified in § 41.25 of this chapter.

(d) *Rules on aggregation.* For commodity derivative contracts in a physical commodity, a designated contract market or swap execution facility that is a trading facility shall have aggregation rules that conform to § 150.4.

(e) *Requirements for submissions to the Commission.* A designated contract market or swap execution facility that is a trading facility that adopts speculative position limits and/or position accountability levels pursuant to paragraphs (a) or (b) of this section, and/or that elects to offer exemptions from any such levels pursuant to such paragraphs, shall submit to the Commission pursuant to part 40 of this chapter rules establishing such levels and/or exemptions. To the extent any such designated contract market or swap execution facility adopts speculative position limit levels, such part 40 submission shall also include the methodology by which such levels are calculated, and the designated contract market or swap execution facility shall review such speculative position limit levels regularly for compliance with this section and update such speculative position limit levels as needed.

(f) *Delegation of authority to the Director of the Division of Market Oversight*—(1) *Commission delegations.* The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight, or such other employee or employees as the Director may designate from time to time, the authority in paragraph (a)(4)(ii) of this section to provide instructions regarding the submission to the Commission of information required to be reported, pursuant to paragraph (a)(4)(i) of this section, by a designated contract market or swap execution facility, to specify the manner for submitting such information on the Forms and Submissions page at *www.cftc.gov* and to determine the format, coding structure, and electronic data transmission procedures for submitting such information.

(2) *Commission consideration of delegated matter.* The Director of the Division of Market Oversight may submit to the Commission for its consideration any matter which has been delegated in this section.

(3) *Commission authority.* Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

■ 22. Revise § 150.6 to read as follows:

§ 150.6 Scope.

This part shall only be construed as having an effect on speculative position limits set by the Commission or by a designated contract market or swap execution facility, including any associated recordkeeping and reporting regulations in this chapter. Nothing in this part shall be construed to relieve any contract market, swap execution facility, or its governing board from responsibility under section 5(d)(4) of the Act to prevent manipulation and corners. Further, nothing in this part shall be construed to affect any other provisions of the Act or Commission regulations, including, but not limited to, those relating to actual or attempted manipulation, corners, squeezes, fraudulent or deceptive conduct, or to prohibited transactions.

§ 150.7 [Reserved].

■ 23. Add and reserve § 150.7.

■ 24. Add § 150.8 to read as follows:

§ 150.8 Severability.

If any provision of this part, or the application thereof to any person or circumstances, is held invalid, such invalidity shall not affect the validity of other provisions or the application of such provision to other persons or circumstances that can be given effect without the invalid provision or application.

■ 25. Add § 150.9 to read as follows:

§ 150.9 Process for recognizing non-enumerated bona fide hedging transactions or positions with respect to federal speculative position limits.

For purposes of federal speculative position limits, a person with a position in a referenced contract seeking recognition of such position as a non-enumerated bona fide hedging transaction or position, in accordance with § 150.3(a)(1)(ii), shall submit an application to the Commission, pursuant to § 150.3(b), or submit an application to a designated contract market or swap execution facility in accordance with this section. If such person submits an application to a designated contract market or swap execution facility in accordance with this section, and the designated contract market or swap execution facility, with respect to its own speculative position limits established pursuant to § 150.5(a), recognizes the person's position as a non-enumerated bona fide hedging transaction or position, then the person may also exceed the applicable federal speculative position limit for such position, in accordance with paragraph (e) of this section. The designated contract market or swap execution facility may approve such applications only if the designated contract market or swap execution facility complies with the conditions set forth in paragraphs (a) through (e) of this section.

(a) *Approval of rules.* The designated contract market or swap execution facility maintains rules, consistent with the requirements of this section and approved by the Commission pursuant to § 40.5 of this chapter, that establish application processes and conditions for recognizing bona fide hedging transactions or positions.

(b) *Prerequisites for a designated contract market or swap execution facility to recognize bona fide hedging transactions or positions in accordance with this section.* (1) The designated contract market or swap execution facility lists the applicable referenced contract for trading;

(2) The position meets the definition of bona fide hedging transactions or positions in section 4a(c)(2) of the Act and the definition of bona fide hedging transactions or positions in § 150.1; and

(3) The designated contract market or swap execution facility does not recognize as a bona fide hedging transaction or position any position involving a commodity index contract and one or more referenced contracts, including exemptions known as risk management exemptions.

(c) *Application process.* The designated contract market or swap execution facility's application process meets the following conditions:

(1) *Required application information.* The designated contract market or swap execution facility requires the applicant to provide, and can obtain from the applicant, all information to enable the designated contract market or swap execution facility to determine, and the Commission to verify, whether the facts and circumstances demonstrate that the designated contract market or swap execution facility may recognize a position as a bona fide hedging transaction or position, including the following:

(i) A description of the position in the commodity derivative contract for which the application is submitted, including but not limited to, the name of the underlying commodity and the derivative position size;

(ii) Information to demonstrate why the position satisfies the requirements of section 4a(c)(2) of the Act and the definition of bona fide hedging transaction or position in § 150.1, including factual and legal analysis;

(iii) A statement concerning the maximum size of all gross positions in commodity derivative contracts for which the application is submitted;

(iv) A description of the applicant's activity in the cash markets and the swaps markets for the commodity underlying the position for which the application is submitted, including, but not limited to, information regarding the offsetting cash positions; and

(v) Any other information the designated contract market or swap execution facility requires, in its discretion, to verify that the position complies with paragraph (b)(2) of this section, as applicable.

(2) *Timing of application.* (i) Except as provided in paragraph (c)(2)(ii) of this section, the designated contract market or swap execution facility requires the applicant to submit an application and receive a notice of approval of such application prior to the date that the position for which such application was submitted would be in excess of the applicable federal speculative position limits.

(ii) A designated contract market or swap execution facility may, however, adopt rules that allow a person to, due to demonstrated sudden or unforeseen increases in its bona fide hedging needs, file an application with the designated contract market or swap execution facility to request a recognition of a bona fide hedging transaction or position within five business days after the person established the position that exceeded the applicable federal speculative position limit.

(A) The designated contract market or swap execution facility must require that any application filed pursuant to paragraph (c)(2)(ii) of this section include an explanation of the circumstances warranting the sudden or unforeseen increases in bona fide hedging needs.

(B) If an application filed pursuant to paragraph (c)(2)(ii) of this section is denied by the designated contract market, swap execution facility, or Commission, the applicant must bring its position within the applicable federal speculative position limits within a commercially reasonable time as determined by the Commission in consultation with the applicant and the applicable designated contract market or swap execution facility.

(C) The designated contract market, swap execution facility, or Commission will not determine that the person holding the position has committed a position limits violation during the period of the designated contract market, swap execution facility, or Commission's review nor once a determination has been issued.

(3) *Renewal of applications.* The designated contract market or swap execution facility requires each applicant to reapply for such recognition or exemption at least on an annual basis by updating the original application, and to receive a notice of approval of the renewal from the designated contract market or swap execution facility prior to the date that such position would be in excess of the applicable federal speculative position limits.

(4) *Exchange revocation authority.* The designated contract market or swap execution facility retains its authority to limit, condition, or revoke, at any time after providing notice to the applicant, any bona fide hedging transaction or position recognition for purposes of the designated contract market or swap execution facility's speculative position limits established under § 150.5(a), for any reason as determined in the discretion of the designated contract market or swap execution facility, including if the designated contract market or swap execution facility determines that the position no longer meets the conditions set forth in paragraph (b) of this section, as applicable.

(d) *Recordkeeping.* (1) The designated contract market or swap execution facility keeps full, complete, and systematic records, which include all pertinent data and memoranda, of all activities relating to the processing of such applications and the disposition thereof. Such records include:

(i) Records of the designated contract market or swap execution facility's recognition of any derivative position as a bona fide hedging transaction or position, revocation or modification of any such recognition, or the rejection of an application;

(ii) All information and documents submitted by an applicant in connection with its application, including documentation and information that is submitted after the disposition of the application, and any withdrawal, supplementation, or update of any application;

(iii) Records of oral and written communications between the designated contract market or swap execution facility and the applicant in connection with such application; and

(iv) All information and documents in connection with the designated contract market or swap execution facility's analysis of, and action(s) taken with respect to, such application.

(2) All books and records required to be kept pursuant to this section shall be kept in accordance with the requirements of § 1.31 of this chapter.

(e) *Process for a person to exceed federal speculative position limits on a referenced contract*—(1) *Notification to the Commission.* The designated contract market or swap execution facility must submit to the Commission a notification of each initial determination to recognize a bona fide hedging transaction or position in accordance with this section, concurrently with the notice of such determination the designated contract market or swap execution facility provides to the applicant.

(2) *Notification requirements.* The notification in paragraph (e)(1) of this section shall include, at a minimum, the following information:

(i) Name of the applicant;

(ii) Brief description of the bona fide hedging transaction or position being recognized;

(iii) Name of the contract(s) relevant to the recognition;

(iv) The maximum size of the position that may exceed federal speculative position limits;

(v) The effective date and expiration date of the recognition;

(vi) An indication regarding whether the position may be maintained during the last five days of trading during the spot month, or the time period for the spot month; and

(vii) A copy of the application and any supporting materials.

(3) *Exceeding federal speculative position limits on referenced contracts.* A person may exceed federal speculative position limits on a referenced contract ten business days after the designated contract market or swap execution facility issues the notification required pursuant to paragraph (e)(1) of this section, unless the Commission notifies the designated contract market or swap execution facility and the applicant otherwise, pursuant to paragraph (e)(5) of this section, before the ten business day period expires.

(4) *Exceeding federal speculative position limits on referenced contracts due to sudden or unforeseen circumstances.* If a person files an application for a recognition of a bona fide hedging transaction or position in accordance with paragraph (c)(2)(ii) of this section, then such person may rely on the designated contract market or swap execution facility's determination to grant such recognition for purposes of federal speculative position limits two business days after the designated contract market or swap execution facility issues the notification required pursuant to paragraph (e)(1) of this section, unless the Commission notifies the designated contract market or swap execution facility and the applicant otherwise, pursuant to paragraph (e)(5) of this section, before the two business day period expires.

(5) *Commission stay of pending applications and requests for additional information.* If the Commission determines to stay an application that requires additional time to analyze, or request additional information to determine whether the position for which the application is submitted meets the conditions set forth in paragraph (b) of this section, the Commission shall notify the applicable designated contract market or swap execution facility and applicant of the Commission's determination or request for any supplemental information required, and provide an opportunity for the applicant to respond with any supplemental information.

(6) *Commission determination.* If the Commission determines that a position for which the application is submitted does not meet the conditions set forth in paragraph (b) of this section, the Commission shall:

(i) Notify the designated contract market or swap execution facility and applicant, and, after providing an opportunity for the applicant to respond, the Commission may, in its discretion, reject the exchange's determination for purposes of federal speculative position limits and, as applicable, require the person to reduce the derivatives position within a commercially reasonable time, as determined by the Commission in consultation with the applicant and the applicable designated contract market or swap execution facility, or otherwise come into compliance; and

(ii) The Commission will not determine that the person holding the position has committed a position limits violation during the period of the Commission's review nor once the Commission has issued its determination.

(f) *Commission revocation of approved applications.* (1) If a designated contract market or swap execution facility limits, conditions, or revokes any recognition of a bona fide hedging transaction or position for purposes of the designated contract market or swap execution facility's speculative position limits established under § 150.5(a), then such recognition will also be deemed limited, conditioned, or revoked for purposes of federal speculative position limits.

(2) If the Commission determines, at any time, that a position that has been recognized as a bona fide hedging transaction or position has been granted for a position that, for purposes of federal speculative position limits, is no longer consistent with section 4a(c)(2) of the Act or the definition of bona fide hedging transaction or position in § 150.1, the following applies:

(i) The Commission shall notify the person holding the position and, after providing an opportunity to respond, the Commission may, in its discretion, revoke the exchange's determination for purposes of federal speculative position limits and require the person to reduce the derivatives position within a commercially reasonable time as determined by the Commission in consultation with the applicant and the applicable designated contract market or swap execution facility, or otherwise come into compliance;

(ii) The Commission shall include in its notification a brief explanation of the nature of the issues raised and the specific provisions of the Act or the Commission's regulations with which the position or application is, or appears to be, inconsistent; and

(iii) The Commission shall not determine that the person holding the position has committed a position limits violation during the period of the Commission's review nor once the Commission has issued its determination, provided the person reduced the derivatives position within a commercially reasonable time, as determined by the Commission in consultation with the applicant and the applicable designated contract market or swap execution facility, or otherwise came into compliance.

(g) *Delegation of authority to the Director of the Division of Market Oversight*—(1) *Commission delegations.* The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight, or such other employee or employees as the Director may designate from time to time, the authority in paragraph (e)(5) of this section, to request additional information from the applicable designated contract market or swap execution facility and applicant;

(2) *Commission consideration of delegated matter.* The Director of the Division of Market Oversight may submit to the Commission for its consideration any matter which has been delegated in this section.

(3) *Commission authority.* Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

■ 26. Add appendices A through F to read as follows:

Appendix A to Part 150—List of Enumerated Hedges

Persons that follow specific practices outlined in the enumerated hedges in this appendix shall establish compliance with the bona fide hedging transactions or positions definition in § 150.1 and with § 150.3(a)(1)(i) without being required to request approval under § 150.3 or § 150.9 prior to exceeding the applicable federal speculative position limit. All other persons must request approval pursuant to § 150.3 or § 150.9 prior to exceeding the applicable federal speculative position limit.

Compliance with an enumerated bona fide hedge listed below does not, however, diminish or replace, in any event, the obligations and requirements of the person to comply with the regulations provided under this part 150. The enumerated bona fide hedges do not state the exclusive means for establishing compliance with the bona fide hedging transactions or positions definition in § 150.1 or with the requirements of § 150.3(a)(1).

(a) *Enumerated hedges.* The following positions comply with the bona fide hedging transactions or positions definition in § 150.1:

(1) *Hedges of unsold anticipated production.* Short positions in commodity derivative contracts that do not exceed in quantity the person's unsold anticipated production of the contract's underlying cash commodity.

(2) *Hedges of offsetting unfixed-price cash commodity sales and purchases.* Both short and long positions in commodity derivative contracts that do not exceed in quantity the amount of the contract's underlying cash commodity that has been both bought and sold by the same person at unfixed prices:

(A) Basis different delivery months in the same commodity derivative contract; or

(B) Basis different commodity derivative contracts in the same commodity, regardless of whether the commodity derivative contracts are in the same calendar month.

(3) *Hedges of anticipated mineral royalties.* Short positions in a person's commodity derivative contracts offset by the anticipated change in value of mineral royalty rights that are owned by that person, *provided that* the royalty rights arise out of the production of the commodity underlying the commodity derivative contract.

(4) *Hedges of anticipated services.* Short or long positions in a person's commodity derivative contracts offset by the anticipated change in value of receipts or payments due or expected to be due under an executed contract for services held by that person, *provided that* the contract for services arises out of the production, manufacturing, processing, use, or transportation of the commodity underlying the commodity derivative contract.

(5) *Cross-commodity hedges.* Positions in commodity derivative contracts described in paragraph (2) of the bona fide hedging transactions or positions definition in § 150.1 or in paragraphs (a)(1) through (a)(4) and paragraphs (a)(6) through (a)(9) of this appendix A may also be used to offset the risks arising from a commodity other than the cash commodity underlying a commodity derivative contract, *provided that* the fluctuations in value of the position in the commodity derivative contract, or the commodity underlying the commodity derivative contract, shall be substantially related to the fluctuations in value of the actual or anticipated cash position or pass-through swap.

(6) *Hedges of inventory and cash commodity fixed-price purchase contracts.* Short positions in commodity derivative contracts that do not exceed in quantity the sum of the person's ownership of inventory and fixed-price purchase contracts in the contract's underlying cash commodity.

(7) *Hedges of cash commodity fixed-price sales contracts.* Long positions in commodity derivative contracts that do not exceed in quantity the sum of the person's fixed-price sales contracts in the contract's underlying cash commodity and the quantity equivalent of fixed-price sales contracts of the cash products and by-products of such commodity.

(8) *Hedges by agents.* Long or short positions in commodity derivative contracts by an agent who does not own or has not contracted to sell or purchase the commodity derivative contract's underlying cash commodity at a fixed price, *provided that* the agent is responsible for merchandising the cash positions that are being offset in commodity derivative contracts and the agent has a contractual arrangement with the person who owns the commodity or holds the cash market commitment being offset.

(9) *Offsets of commodity trade options.* Long or short positions in commodity derivative contracts that do not exceed in quantity, on a futures-equivalent basis, a position in a commodity trade option that meets the requirements of § 32.3 of this chapter. Such commodity trade option transaction, if it meets the requirements of § 32.3 of this chapter, may be deemed, for purposes of complying with this paragraph (a)(9) of this appendix A, a cash commodity purchase or sales contract as set forth in paragraphs (a)(6) or (a)(7) of this appendix A, as applicable.

(10) *Hedges of unfilled anticipated requirements.* Long positions in commodity derivative contracts that do not exceed in quantity the person's unfilled anticipated requirements for the contract's underlying cash commodity, for processing, manufacturing, or use by that person, or for resale by a utility as it pertains to the utility's obligations to meet the unfilled anticipated demand of its customers for the customer's use.

(11) *Hedges of anticipated merchandising.* Long or short positions in commodity derivative contracts that offset the anticipated change in value of the underlying commodity that a person anticipates purchasing or selling, *provided that:*

(A) The position in the commodity derivative contract does not exceed in quantity twelve months' of current or anticipated purchase or sale requirements of the same cash commodity that is anticipated to be purchased or sold; and

(B) The person is a merchant handling the underlying commodity that is subject to the anticipatory merchandising hedge, and that such merchant is entering into the position solely for purposes related to its merchandising business and has a demonstrated history of buying and selling the underlying commodity for its merchandising business.

Appendix B to Part 150—Guidance on Gross Hedging Positions and Positions Held During the Spot Period

(a) *Guidance on gross hedging positions.* (1) A person's gross hedging positions may be deemed in compliance with the bona fide hedging transactions or positions definition in § 150.1, *provided that* all applicable regulatory requirements are met, including that the position is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise and otherwise satisfies the bona fide hedging definition in § 150.1, and *provided further that:*

(A) The manner in which the person measures risk is consistent and follows historical practice for that person;

(B) The person is not measuring risk on a gross basis to evade the speculative position limits in § 150.2 or the aggregation rules in § 150.4;

(C) The person is able to demonstrate compliance with paragraphs (A) and (B) upon the request of the Commission and/or of a designated contract market, including by providing information regarding the entities with which the person aggregates positions; and

(D) A designated contract market or swap execution facility that recognizes a particular gross hedging position as bona fide pursuant to § 150.9 documents the justifications for doing so, and maintains records of such justifications in accordance with § 150.9(d).

(b) *Guidance regarding positions held during the spot period.* Section 150.5(a)(2)(ii)(D) confirms the existing authority of designated contract markets and swap execution facilities to maintain rules that subject positions that comply with the bona fide hedging position or transaction definition in § 150.1 to a restriction that no such position is maintained in any physical-delivery commodity derivative contract during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract (the ''spot period''). Any such designated contract market or swap execution facility may waive any such restriction, including if:

(1) The position complies with the bona fide hedging transaction or position definition in § 150.1;

(2) There is an economically appropriate need to maintain such position in excess of federal speculative position limits during the spot period for such contract, and such need relates to the purchase or sale of a cash commodity; and

(3) The person wishing to exceed federal position limits during the spot period:

(A) Intends to make or take delivery during that time period;

(B) Provides materials to the designated contract market or swap execution facility supporting a classification of the position as a bona fide hedging transaction or position and demonstrating facts and circumstances that would warrant holding such position in excess of limits during the spot period;

(C) Demonstrates cash-market exposure in-hand that is verified by the designated contract market or swap execution facility and that supports holding the position during the spot period;

(D) Demonstrates that, for short positions, the delivery is feasible, meaning that the person has the ability to deliver against the short position (*i.e.,* has inventory on hand in a deliverable location and in a condition in which the commodity can be used upon delivery); and

(E) Demonstrates that, for long positions, the delivery is feasible, meaning that the person has the ability to take delivery at levels that are economically appropriate (*i.e.,* the delivery comports with the person's demonstrated need for the commodity and the contract is the cheapest source for that commodity).

Appendix C to Part 150—Guidance Regarding the Referenced Contract Definition in § 150.1

This appendix C provides guidance regarding the ''referenced contract'' definition in § 150.1, which provides in paragraph (3) that the definition of referenced contract does not include a location basis contract, a commodity index contract, or a trade option that meets the requirements of § 32.3 of this chapter. The term referenced contract is used throughout part 150 of the Commission's regulations to refer to contracts that are subject to federal limits. A position in a contract that is not a referenced contract is not subject to federal limits, and, as a consequence, cannot be netted with positions in referenced contracts for purposes of federal limits. This guidance is intended to clarify the types of contracts that would qualify as a location basis contract or commodity index contract.

Compliance with this guidance does not diminish or replace, in any event, the obligations and requirements of any person to comply with the regulations provided under this part, or any other part of the Commission's regulations. The guidance is for illustrative purposes only and does not state the exclusive means for a contract to qualify, or not qualify, as a referenced contract as defined in § 150.1, or to comply with any other provision in this part.

(a) *Guidance.* (1) As provided in paragraph (3) of the ''referenced contract'' definition in § 150.1, the following types of contracts are not deemed referenced contracts, meaning such contracts are not subject to federal limits and cannot be netted with positions in referenced contracts for purposes of federal limits: location basis contracts; commodity index contracts; swap guarantees; and trade options that meet the requirements of § 32.3 of this chapter.

(2) *Location basis contract.* For purposes of the referenced contract definition in § 150.1, a location basis contract means a commodity derivative contract that is cash-settled based on the difference in:

(i) The price, directly or indirectly, of:

(A) A particular core referenced futures contract; or

(B) A commodity deliverable on a particular core referenced futures contract, whether at par, a fixed discount to par, or a premium to par; and

(ii) The price, at a different delivery location or pricing point than that of the same particular core referenced futures contract, directly or indirectly, of:

(A) A commodity deliverable on the same particular core referenced futures contract, whether at par, a fixed discount to par, or a premium to par; or

(B) A commodity that is listed in appendix D to this part as substantially the same as a commodity underlying the same core referenced futures contract.

(3) *Commodity index contract.* For purposes of the referenced contract definition in § 150.1, a commodity index contract means an agreement, contract, or transaction based on an index comprised of prices of commodities that are not the same or substantially the same and that is not a location basis contract, a calendar spread contract, or an intercommodity spread contract as such terms are defined in this guidance, where:

(i) A calendar spread contract means a cash-settled agreement, contract, or transaction that represents the difference between the settlement price in one or a series of contract months of an agreement, contract, or transaction and the settlement price of another contract month or another series of contract months' settlement prices for the same agreement, contract, or transaction; and

(ii) An intercommodity spread contract means a cash-settled agreement, contract, or transaction that represents the difference between the settlement price of a referenced contract and the settlement price of another contract, agreement, or transaction that is based on a different commodity.

Appendix D to Part 150—Commodities Listed as Substantially the Same for Purposes of the Term ''Location Basis Contract'' As Used in the Referenced Contract Definition

The following table lists core referenced futures contracts and commodities that are treated as substantially the same as a commodity underlying a core referenced futures contract for purposes of the term ''location basis contract'' as used in the referenced contract definition under § 150.1, and as discussed in the associated appendix, Appendix C—Guidance Regarding the Referenced Contract Definition in § 150.1.

LOCATION BASIS CONTRACT LIST OF SUBSTANTIALLY THE SAME COMMODITIES

Core referenced futures contract	Commodities considered substantially the same (regardless of location)	Source(s) for specification of quality
NYMEX Light Sweet Crude Oil futures contract (CL):	1. Light Louisiana Sweet (LLS) Crude Oil.	NYMEX Argus LLS vs. WTI (Argus) Trade Month futures contract (E5). NYMEX LLS (Argus) vs. WTI Financial futures contract (WJ). ICE Futures Europe Crude Diff—Argus LLS vs WTI 1st Line Swap futures contract (ARK). ICE Futures Europe Crude Diff—Argus LLS vs WTI Trade Month Swap futures contract (ARL).
NYMEX New York Harbor ULSD Heating Oil futures contract (HO):	1. Chicago ULSD	NYMEX Chicago ULSD (Platts) vs. NY Harbor ULSD Heating Oil futures contract (5C).
	2. Gulf Coast ULSD	NYMEX Group Three ULSD (Platts) vs. NY Harbor ULSD Heating Oil futures contract (A6). NYMEX Gulf Coast ULSD (Argus) Up-Down futures contract (US). NYMEX Gulf Coast ULSD (Argus) Up-Down BALMO futures contract (GUD). NYMEX Gulf Coast ULSD (Platts) Up-Down BALMO futures contract (1L). NYMEX Gulf Coast ULSD (Platts) Up-Down Spread futures contract (LT). ICE Futures Europe Diesel Diff- Gulf Coast vs Heating Oil 1st Line Swap futures contract (GOH). CME Clearing Europe Gulf Coast ULSD(Platts) vs. New York Heating Oil (NYMEX) Spread Calendar swap (ELT). CME Clearing Europe New York Heating Oil (NYMEX) vs. European Gasoil (IC) Spread Calendar swap (EHA).
	3. California Air Resources Board Spec ULSD (CARB no. 2 oil).	NYMEX Los Angeles CARB Diesel (OPIS) vs. NY Harbor ULSD Heating Oil futures contract (KL).
	4. Gas Oil Deliverable in Antwerp, Rotterdam, or Amsterdam Area.	ICE Futures Europe Gasoil futures contract (G).

LOCATION BASIS CONTRACT LIST OF SUBSTANTIALLY THE SAME COMMODITIES—Continued

Core referenced futures contract	Commodities considered substantially the same (regardless of location)	Source(s) for specification of quality
		ICE Futures Europe Heating Oil Arb—Heating Oil 1st Line vs Gasoil 1st Line Swap futures contract (HOT).
		ICE Futures Europe Heating Oil Arb—Heating Oil 1st Line vs Low Sulphur Gasoil 1st Line Swap futures contract (ULL).
		NYMEX NY Harbor ULSD Heating Oil vs. Gasoil futures contract (HA).
NYMEX RBOB Gasoline futures contract (RB):	1. Chicago Unleaded 87 gasoline	NYMEX Chicago Unleaded Gasoline (Platts) vs. RBOB Gasoline futures contract (3C).
		NYMEX Group Three Unleaded Gasoline (Platts) vs. RBOB Gasoline futures contract (A8).
	2. Gulf Coast Conventional Blendstock for Oxygenated Blending (CBOB) 87.	NYMEX Gulf Coast CBOB Gasoline A1 (Platts) vs. RBOB Gasoline futures contract (CBA).
		NYMEX Gulf Coast Unl 87 (Argus) Up-Down futures contract (UZ).
	3. Gulf Coast CBOB 87 (Summer Assessment).	NYMEX Gulf Coast CBOB Gasoline A2 (Platts) vs. RBOB Gasoline futures contract (CRB).
	4. Gulf Coast Unleaded 87 (Summer Assessment).	NYMEX Gulf Coast 87 Gasoline M2 (Platts) vs. RBOB Gasoline futures contract (RVG).
		NYMEX Gulf Coast 87 Gasoline M2 (Platts) vs. RBOB Gasoline BALMO futures contract (GBB).
		NYMEX Gulf Coast 87 Gasoline M2 (Argus) vs. RBOB Gasoline BALMO futures contract (RBG).
	5. Gulf Coast Unleaded 87	NYMEX Gulf Coast Unl 87 (Platts) Up-Down BALMO futures contract (1K).
		NYMEX Gulf Coast Unl 87 Gasoline M1 (Platts) vs. RBOB Gasoline futures contract (RV).
		CME Clearing Europe Gulf Coast Unleaded 87 Gasoline M1 (Platts) vs. New York RBOB Gasoline (NYMEX) Spread Calendar swap (ERV).
	6. Los Angeles California Reformulated Blendstock for Oxygenate Blending (CARBOB) Regular.	NYMEX Los Angeles CARBOB Gasoline (OPIS) vs. RBOB Gasoline futures contract (JL).
	7. Los Angeles California Reformulated Blendstock for Oxygenate Blending (CARBOB) Premium.	NYMEX Los Angeles CARBOB Gasoline (OPIS) vs. RBOB Gasoline futures contract (JL).
	8. Euro-BOB OXY NWE Barges	NYMEX RBOB Gasoline vs. Euro-bob Oxy NWE Barges (Argus) (1000mt) futures contract (EXR).
		CME Clearing Europe New York RBOB Gasoline (NYMEX) vs. European Gasoline Euro-bob Oxy Barges NWE (Argus) (1000mt) Spread Calendar swap (EEXR).
	9. Euro-BOB OXY FOB Rotterdam	ICE Futures Europe Gasoline Diff—RBOB Gasoline 1st Line vs. Argus Euro-BOB OXY FOB Rotterdam Barge Swap futures contract (ROE).

Appendix E to Part 150—Speculative Position Limit Levels

Contract	Spot month	Single-month and all months
Legacy Agricultural:		
Chicago Board of Trade Corn (C)	1,200	57,800.
Chicago Board of Trade Oats (O)	600	2,000.
Chicago Board of Trade Soybeans (S)	1,200	27,300.
Chicago Board of Trade Soybean Meal (SM)	1,500	16,900.
Chicago Board of Trade Soybean Oil (SO)	1,100	17,400.
Chicago Board of Trade Wheat (W)	1,200	19,300.
Chicago Board of Trade KC HRW Wheat (KW)	1,200	12,000.
Minneapolis Grain Exchange Hard Red Spring Wheat (MWE)	1,200	12,000.
ICE Futures U.S. Cotton No. 2 (CT)	1,800	11,900.
Other Agricultural:		
Chicago Board of Trade Rough Rice (RR)	800	Not Applicable.
Chicago Mercantile Exchange Live Cattle (LC)	[1] 600/300/200	Not Applicable.
ICE Futures U.S. Cocoa (CC)	4,900	Not Applicable.
ICE Futures U.S. Coffee C (KC)	1,700	Not Applicable.
ICE Futures U.S. FCOJ–A (OJ)	2,200	Not Applicable.
ICE Futures U.S. Sugar No. 11 (SB)	25,800	Not Applicable.

Contract	Spot month	Single-month and all months
ICE Futures U.S. Sugar No. 16 (SF)	6,400	Not Applicable.
Energy:		
New York Mercantile Exchange Henry Hub Natural Gas (NG)	[2] 2,000	Not Applicable.
New York Mercantile Exchange Light Sweet Crude Oil (CL)	[3] 6,000/5,000/ 4,000	Not Applicable.
New York Mercantile Exchange NY Harbor ULSD (HO)	2,000	Not Applicable.
New York Mercantile Exchange RBOB Gasoline (RB)	2,000	Not Applicable.
Metal:		
Commodity Exchange, Inc. Copper (HG)	1,000	Not Applicable.
Commodity Exchange, Inc. Gold (GC)	6,000	Not Applicable.
Commodity Exchange, Inc. Silver (SI)	3,000	Not Applicable.
New York Mercantile Exchange Palladium (PA)	50	Not Applicable.
New York Mercantile Exchange Platinum (PL)	500	Not Applicable.

Appendix F to Part 150—Guidance on, and Acceptable Practices in, Compliance With § 150.5

The following are guidance and acceptable practices for compliance with § 150.5. Compliance with the acceptable practices and guidance does not diminish or replace, in any event, the obligations and requirements of the person to comply with the other regulations provided under this part. The acceptable practices and guidance are for illustrative purposes only and do not state the exclusive means for establishing compliance with § 150.5.

(a) *Acceptable practices for compliance with § 150.5(b)(2)(i) regarding exchange-set limits or accountability outside of the spot month.* A designated contract market or swap execution facility that is a trading facility may satisfy § 150.5(b)(2)(i) by complying with either of the following acceptable practices:

(1) *Non-spot month speculative position limits.* For any commodity derivative contract subject to § 150.5(b), a designated contract market or swap execution facility that is a trading facility sets individual single month or all-months-combined levels no greater than any one of the following:

(i) The average of historical position sizes held by speculative traders in the contract as a percentage of the average combined futures and delta-adjusted option month-end open interest for that contract for the most recent calendar year;

(ii) The level of the spot month limit for the contract;

(iii) 5,000 contracts (scaled-down proportionally to the notional quantity per contract relative to the typical cash-market transaction if the notional quantity per contract is larger than the typical cash market transaction, and scaled up proportionally to the notional quantity per contract relative to the typical cash-market transaction if the notional quantity per contract is smaller than the typical cash market transaction); or

(iv) 10 percent of the average combined futures and delta-adjusted option month-end open interest in the contract for the most recent calendar year up to 50,000 contracts, with a marginal increase of 2.5 percent of open interest thereafter.

(2) *Non-spot month position accountability.* For any commodity derivative contract subject to § 150.5(b), a designated contract market or swap execution facility that is a trading facility adopts position accountability, as defined in § 150.1.

(b) [Reserved]

PART 151—[REMOVED AND RESERVED]

■ 27. Under the authority of section 8a(5) of the Commodity Exchange Act, 7 U.S.C. 12a(5), remove and reserve part 151.

Issued in Washington, DC, on January 31, 2020, by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

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

Appendices to Position Limits for Derivatives—Commission Voting Summary, Chairman's Statement, and Commissioners' Statements

Appendix 1—Commission Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz and Stump voted in the affirmative. Commissioners Behnam and Berkovitz voted in the negative.

Appendix 2—Supporting Statement of Chairman Heath Tarbert

I am pleased to support the Commission's proposed rule on limits for speculative positions in futures and derivatives markets. Today's proposal is a pragmatic approach that will protect our agricultural, energy, and metals markets from excessive speculation. But just as importantly, it will ensure fair and easy access to these markets for businesses producing, consuming, and wholesaling commodities under our jurisdiction.

When I came to the Commission, I set out several strategic goals. Among them is to regulate our derivatives markets to promote the interests of all Americans. Another goal is to enhance the regulatory experience of market participants. The proposal we are issuing today will deliver on both. We also drew from each of our agency core values to craft it—commitment, forward-thinking, teamwork, and clarity. Clarity is of particular importance here because, ultimately, markets and their participants deserve regulatory certainty. We provide that today.

Making Our Markets Work for the American Economy

If adopted, our proposal will help ensure that futures markets in agricultural, energy and metals commodities work for American households and businesses. Farmers, ranchers, energy producers, utilities, and manufacturers are the backbone of the American economy. Our derivatives markets generally, and in particular the markets addressed in this proposal, are designed specifically to allow these businesses to hedge their exposure to price changes.

This Commission's proposal will protect Americans from some of the most nefarious machinations in our derivatives markets. First, capping speculative positions in the covered derivatives contracts will help prevent cornering and squeezing. Such manipulative schemes can cause artificial prices and can injure the users of commodities linked to the futures markets. Limiting speculative positions can also reduce the likelihood of chaotic price swings caused by speculative gamesmanship. In effect, position limits should help ensure that prices in our markets reflect real supply and demand.

Position limits are not a solution born inside the Washington Beltway and imposed

[1] Step-down spot month limits would be for positions net long or net short as follows: 600 contracts at the close of trading on the first business day following the first Friday of the contract month; 300 contracts at the close of trading on the business day prior to the last five trading days of the contract month; and 200 contracts at the close of trading on the business day prior to the last two trading days of the contract month.

[2] *See* § 150.3 regarding the conditional spot month limit exemption for cash-settled positions in natural gas.

[3] Step-down spot month limits would be for positions net long or net short as follows: 6,000 contracts at the close of trading three business days prior to the last trading day of the contract; 5,000 contracts at the close of trading two business days prior to the last trading day of the contract; and 4,000 contracts at the close of trading one business day prior to the last trading day of the contract.

on the market from afar. Instead, they are one of many tools that exchanges have used since the 19th century to mitigate the potentially damaging effects of excessive speculation. They are a pragmatic, Midwestern solution to a real-world problem. Recognizing the usefulness of exchange-set limits, the Commission has worked collaboratively with our exchanges since 1981 to put sensible position limits and accountability levels on speculative positions in all physical commodity futures markets.

Our proposal would also end the ''risk management'' exemption that has allowed banks, hedge funds, and trading firms to take large and purely speculative positions in agricultural markets. Nearly a decade ago, Congress directed the Commission to address this issue. Today we are acting.

Some observers have gone so far as to call position limits ''at best, a cure for a disease that does not exist or a placebo for one that does.'' [1] I respectfully disagree. To be sure, position limits are not a silver bullet against the damaging impact of excessive speculative activity. But I also believe, as did Congress when it amended the Commodity Exchange Act, that position limits can help to ''diminish, eliminate, or prevent'' potential damage to the commodities markets that are so critical to our real economy.

Still, setting limits requires balancing the competing need for liquidity in our markets against the potential for disruptive speculative positions. I believe that the spot month levels we are proposing are reasonably calibrated. They are based on the current rule of thumb that limits should be no more than 25 percent of the deliverable supply of the referenced commodity, in order to prevent corners and squeezes that everyone can agree are bad for the market.

For the nine grain futures contracts currently subject to position limits,[2] revising non-spot limits required the Commission to consider an additional complication. Eliminating the risk management exemption could potentially take away a source of liquidity further out the curve. For a farmer who needs to hedge the price risk on crops that are still in the ground, a bank with a risk management exemption may be the only willing buyer. To mitigate the impact of eliminating the risk management exemption, we have raised the non-spot month limits for the grain contracts. This should allow a broader set of market participants to provide liquidity and help farmers hedge their crop risk as far in advance as they need.

Ensuring Access for Bona Fide Hedgers

Position limits is the rare rule where the exception is as important as the rule itself. It cannot be said too often that these limits are on speculative activity. Congress has always intended that positions that are a bona fide hedge of price risk should not be subject to limits.

It is critical, therefore, that we not disrupt the regulatory experience of American producers, middlemen, and end-users of commodities. The greatest risk of a position limits rule is that hedgers are caught in the limits aimed at speculators. This could reduce their ability to protect themselves from risk, which could in turn negatively impact the broader economy. If a farmer cannot offset a risk on next year's crop—if a refiner cannot offset a risk on crude oil for a new plant—or if a wholesaler cannot offset risks on inventory it is buying, those businesses will not expand their operations.

Any position limits rule must therefore be written with those hedging needs in mind. Congress and the American people expect nothing less. The proposal addresses those needs through (i) a broad exemption for ''bona fide'' hedging, and (ii) a streamlined and non-intrusive process for recognizing those exemptions.

On the first point, the proposal will expand the types of hedging strategies that are presumed to meet the bona fide hedging definition—and therefore be eligible for an exemption from position limits. For the first time, we have included anticipated merchandising, meaning that wholesalers and middlemen connecting producers and consumers could more readily hedge their risks. We have also expanded the definition to conform to the hedging strategies that are common in energy markets. This will ensure that the new federal speculative limits on energy markets do not inadvertently undermine the producers, refiners, pipeline operators, and utilities that keep this country running.

On the second point, we have built on prior proposals to create a practical and efficient way for hedgers to avail themselves of the bona fide hedging exemption. Creating burdensome red tape or slowing down approvals to take on hedging positions could result in lost business opportunities for the participants we are called to protect.

For parties whose hedging needs fit within the enumerated list, they could exceed federal position limits without requesting approval from the Commission. They also would not need to submit information on their cash market positions—a duplicative and burdensome exercise that is better handled by the exchanges.

For parties whose hedging needs do not fit within the enumerated list, we are offering a process whereby an exchange could evaluate that hedging need. If the exchange finds that the need is a bona fide hedge not captured by our list, the exchange would notify the Commission. Unless the Commission votes to reject it within 10 business days, the exchange's recognition would be deemed effective for purposes of federal position limits. Given our expanded definition of bona fide hedging, I anticipate that it would be a rare case that a market participant finds its legitimate hedging needs are not already covered in the list of enumerated exemptions. Still, this process would provide flexibility and legal certainty, without excessive red tape.

Striking the Right Balance

The Commission has grappled with position limits for a decade. The 2011 proposal was finalized, but struck down by a court because of concerns over its legal justification. Subsequent proposals in 2013 and 2016 were never finalized, following pushback from market participants about access to bona fide hedge exemptions. The Commission and staff have worked with diligence and good faith to solve this puzzle. There are difficult, often competing interests to address in this seemingly simple rule. If an easy solution exists, I have no doubt that the Commission would have found it.

Today's proposal is the culmination of ten years of effort across four Chairmen's tenures. I sincerely thank my predecessors, as well as the Commission staff, who have worked so hard for so long to strike the right balance. Each proposal and every piece of feedback has helped improve the proposal before the Commission today. I believe that the proposal offers the pragmatic, workable solution that would protect markets from corners and squeezes while preserving the ability of American businesses to manage their risks.

Putting the Burden in the Right Place

Finally, I want to draw attention to one fundamental shift in approach between prior position limits rules and the present proposal. Previously, the Commission had read the Commodity Exchange Act to require federal limits to be placed on every futures contract for a physical commodity. This would have required the Commission to evaluate approximately 1,200 individual contracts to determine the appropriate levels.

The 2011 position limits rule was challenged in court on this ground and was struck down. The court found that the statute was ambiguous about whether the Commission must impose limits on all futures, or whether it should impose limits only ''as the Commission finds are necessary[.]'' The court said that ''it is incumbent upon the agency not to rest simply on its parsing of the statutory language. It must bring its experience and expertise to bear in light of competing interests at stake to resolve the ambiguities in the statute.'' [3]

The Commission is now bringing its experience and expertise to bear on this matter. We have taken a big picture approach to determine when position limits are in fact necessary. In short, we are proposing that speculative limits are necessary for those futures contracts that are physically delivered and where the futures market is important in the price discovery process for the underlying commodity. The Commission also examined whether a disruption in the distribution of that commodity would have a significant impact on our economy. This has led us to propose limits on 25 physically delivered futures contracts,[4] which covers the vast majority of trading volume and open interest in physically delivered derivatives. In addition to the nine grain futures contracts currently subject to federal limits, this

[1] *https://www.cftc.gov/PressRoom/SpeechesTestimony/dunnstatement101811*.

[2] The proposal would not set non-spot month limits on the 16 contracts that are not currently subject to federal position limits.

[3] *Int'l Swap Dealers Assoc.* v. *CFTC,* 887 F.Supp.2d 259, 281 (D.D.C. 2012).

[4] The proposal would also impose limits on approximately 400 other futures contracts that are linked, directly or indirectly, to the 25 core physically delivered contracts.

includes the largest energy, metals, and other agricultural futures contracts.

Position limits are like medicine; they can help cure a symptom but can have undesirable side effects. And like medicine, position limits should be prescribed only when necessary. I believe this change in the underlying rationale for the proposal will require thoughtful reflection before imposing additional position limits on additional contracts in the future. Position limits will always create a burden on someone in the market—whether a compliance burden on parties having to track their positions relative to limits, or potentially the loss of a business opportunity because the risks cannot be hedged.

The statutory provisions on position limits can reasonably be read in two ways. The first reading would put the burden on the Commission to find position limits to be necessary before imposing them on new contracts. The second reading would mandate federal limits on all futures contracts irrespective of any need, reflexively putting placing a burden on all markets and all market participants. Given the choice of burdening a government agency or private enterprise, I think it is more prudent to put the burden on the government. That is what today's proposal does. As Thomas Jefferson said, ''Government exists for the interests of the governed, not for the governors.''

Appendix 3—Supporting Statement of Commissioner Brian Quintenz

I am pleased to support the agency's revitalized approach to position limits. Today's iteration marks the CFTC's fifth proposed position limits rule since the Dodd-Frank Act [1] amended the Commodity Exchange Act's (CEA) section on position limits. This proposal is, by far, the strongest of them all.

Today's proposed rule promotes flexibility, certainty, and market integrity for end-users—farmers, ranchers, energy producers, transporters, processors, manufacturers, merchandisers, and all who use physically-settled derivatives to risk manage their exposure to physical goods. The proposal includes an expansive list of enumerated and self-effectuating bona fide hedge exemptions, and a streamlined, exchange-centered process to adjudicate non-enumerated bona fide hedge exemption requests.

Of the five proposed rules, this proposal is the most true to the CEA in many significant respects: By requiring, as has long been the Commission's practice, a necessity finding before imposing limits, by including economically equivalent swaps, and, perhaps most importantly, by following Congress' instruction that, ''to the maximum extent practicable,'' any limits set by the Commission balance the interests among promoting liquidity, deterring manipulation, squeezes, and corners, and ensuring the price discovery function of the underlying market is not disrupted.[2] The confluence of these factors occurs most acutely in the spot month for physically-settled contracts where the delivery process and price convergence is most vulnerable to potential manipulation or disruption due to outsized positions. By focusing exclusively on spot month position limits in the new set of physically-settled (and closely related cash-settled) contracts, the proposal elegantly balances the countervailing policy interests enumerated in the statute.

Necessity Finding

Today's proposal, unlike the recent prior proposals, premises new limits on a finding that they are necessary to diminish, eliminate, or prevent the burden on interstate commerce from extraordinary price movements caused by excessive speculation (''necessity finding'') in specific contracts, as Congress has long required in the CEA and its legislative precursors since 1936.[3] I am pleased that the proposal complies with the District Court's ruling in the ISDA-position limits litigation: That the Commission must decide whether section 4a of the CEA mandates the CFTC set new limits or only permits the CFTC to set such limits pursuant to a necessity finding.[4] As the District Court noted, ''the Dodd-Frank amendments do not constitute a clear and unambiguous mandate to set position limits.'' [5] I agree with the proposal's determination that, when read together, paragraphs (1) and (2) of section 4a demand a necessity finding.

Section 4a(a)(2)(A) states that the Commission shall establish limits ''in accordance with the standards set forth in paragraph (1) of this subsection.'' [6] Paragraph (1) establishes the Commission's authority to, ''proclaim and fix such limits on the amounts of trading . . . as the Commission finds are necessary to diminish, eliminate or prevent [the] burden'' on interstate commerce caused by unreasonable or unwarranted price moves associated with excessive speculation. This language dates back almost verbatim to legislation passed in 1936, in which Congress directed the CFTC's precursor to make a necessity finding before imposing position limits. The Congressional report accompanying the CEA from the 74th Congress includes the following directive, ''[Section 4a of the CEA] gives the Commodity Exchange Commission the power, after due notice and opportunity for hearing and a finding of a burden on interstate commerce caused by such speculation, to fix and proclaim limits on futures trading . . .'' [7] In its ISDA opinion, the District Court noted the following: ''This text clearly indicated that Congress intended for the CFTC to make a 'finding of a burden on interstate commerce caused by such speculation' prior to enacting position limits.'' [8]

I support the proposal's view that the most natural reading of section 4a(a)(2)(A)'s reference to paragraph (1)'s ''standards'' is that it logically includes the ''necessity'' standard. Paragraph (1)'s requirement to make a necessity finding, along with the aggregation requirement, provide substantive guidance to the Commission about when and how position limits should be implemented.

If Congress intended to mandate that the Commission impose position limits on all physical commodity derivatives, there is little reason it would have referred to paragraph (1) and the Commission's long established practice of necessity findings. Instead, Congress intended to focus the Commission's attention on whether position limits should be considered for a broader set of contracts than the legacy agricultural contracts, but did not mandate those limits be imposed.

Setting New Limits ''As Appropriate''

The proposal preliminarily determines that position limits are necessary to diminish, eliminate, or prevent the burden on interstate commerce posed by unreasonable or unwarranted prices moves that are attributable to excessive speculation in 25 referenced commodity markets that each play a crucial role in the U.S. economy. I am aware that there is significant skepticism in the marketplace and among academics as to whether position limits are an appropriate tool to guard against extraordinary price movements caused by extraordinarily large position size. Some argue there is no evidence that excessive speculation currently exists in U.S. derivatives markets.[9] Others believe that large and sudden price fluctuations are not caused by hyper-speculation, but rather by market participants' interpretations of basic supply and demand fundamentals.[10] In contrast, still

[1] 76 FR 4752 (Jan. 26, 2011); 78 FR 75680 (Dec. 12, 2013); 81 FR 38458 (June 13, 2016) (''supplemental proposal''); and 81 FR 96704 (Dec. 30, 2016). The CEA addresses position limits in section (sec.) 4a (7 U.S.C. 6a).

[2] Sec. 4a(a)(3).

[3] Sec. 4a(1).

[4] *ISDA et al.* v *CFTC,* 887 F. Supp. 2d 259, 278 and 283–84 (D.D.C. Sept. 28, 2012).

[5] *Id.* at 280.

[6] Sec. 4a(a)(2)(A) (''In accordance with the standards set forth in paragraph (1) of this subsection and consistent with the good faith exception cited in subsection (b)(2), with respect to physical commodities other than excluded commodities as defined by the Commission, the Commission shall by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a designated contract market.'')

[7] H.R. Rep. 74–421, at 5 (1935).

[8] 887 F. Supp. 2d 259, 269 (fn 4).

[9] Testimony of Erik Haas (Director, Market Regulation, ICE Futures U.S.) before the CFTC at 70 (Feb. 26, 2015) (''We point out the makeup of these markets, primarily to show that any regulations aimed at excessive speculation is a solution to a nonexistent problem in these contracts.''), *available at: https://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/emactranscript022615.pdf.*

[10] BAHATTIN BUYUKSAHIN & JEFFREY HARRIS, CFTC, THE ROLE OF SPECULATORS IN THE CRUDE OIL FUTURES MARKET 1, 16–19 (2009) (''Our results suggest that price changes leads the net position and net position changes of speculators and commodity swap dealers, with little or no feedback in the reverse direction. This uni-directional causality suggests that traditional speculators as well as commodity swap dealers are generally trend followers.''), *available at http://www.cftc.gov/idc/groups/public/@swaps/documents/file/plstudy_19_cftc.pdf*; Testimony of Philip K. Verleger, Jr. before the CFTC, Aug. 5, 2009 (''The increase in crude prices between 2007 and 2008 was caused by the incompatibility of environmental regulations with the then-current

others believe that outsized speculative positions, however defined, may aggravate price volatility, leading to price run-ups or declines that are not fully supported by market fundamentals.[11]

In my opinion, position limits should not be viewed as a means to counteract long-term directional price moves. The CFTC is not a price setting agency and we should not impede the market from reflecting long term supply and demand fundamentals. It is worth noting that the physically-settled contract which has seen the largest sustained price increase recently is palladium,[12] which has also seen its exchange-set position limit decline four times since 2014 to what is now the smallest limit of any contract in the referenced contract set.[13] Nevertheless, between the start of 2018 and the end of 2019, palladium futures prices rose 76%.[14] Taking these conflicting views and facts into account, it is clear the Commission correctly stated in its 2013 proposal, ''there is a demonstrable lack of consensus in the [academic] studies'' as to the effectiveness of position limits.[15]

With that healthy dose of skepticism, I think the proposal appropriately focuses on the time period and contract type where position limits can have the most positive, and the least negative, impact—the spot month of physically settled contracts—while also calibrating those limits to function as just one of many tools in the Commission's regulatory toolbox that can be used to promote credible, well-functioning derivatives and cash commodity markets.

Because of the significance of these 25 core referenced futures contracts to the underlying cash markets, the level of liquidity in the contracts, as well as the importance of these cash markets to the national economy, I think it is appropriate for the Commission to protect the physical delivery process and promote convergence in these critical commodity markets. Further, the limits proposed today are higher than in the past, notably because the proposal utilizes current estimates of deliverable supply—numbers which haven't been updated since 1999.[16] I am interested to hear feedback from commenters about whether the estimates of deliverable supply, and the calibrated limits based off of them, are sufficiently tailored for the individual contracts.

Taking End-Users Into Account

Perhaps more than any other area of the CFTC's regulations, position limits directly affect the participants in America's real economy: Farmers, ranchers, energy producers, manufacturers, merchandisers, transporters, and other commercial end-users that use the derivatives market as a risk management tool to support their businesses. I am pleased that today's proposal takes into account many of the serious concerns that end-users voiced in response to the CFTC's previous five unsuccessful position limits proposals.

Importantly, and in response to many comments, this proposal, for the first time, expands the possibility for enterprise-wide hedging,[17] proposes an enumerated anticipated merchandising exemption,[18] eliminates the ''five-day rule'' for enumerated hedges,[19] and no longer requires the filing of certain cash market information with the Commission that the CFTC can obtain from exchanges.[20] Regarding enterprise-wide hedging—otherwise known as ''gross hedging''—the proposal would provide an energy company, for example, with increased flexibility to hedge different units of its business separately if those units face different economic realities.

With respect to cross-commodity hedging, today's proposal completely rejects the arbitrary, unworkable, ill-informed, and frankly, ludicrous ''quantitative test'' from the 2013 proposal.[21] That test would have required a correlation of at least 0.80 or greater in the spot markets prices of the two commodities for a time period of at least 36 months in order to qualify as a cross-hedge.[22] Under this test, longstanding hedging practices in the electric power generation and transmission markets would have been prohibited. Today's proposal not only shuns this Government-Knows-Best approach, it also proposes new flexibility for the cross-commodity hedging exemption, allowing it to be used in conjunction with other enumerated hedges.[23] For example, a commodity merchant could rely on the enumerated hedge for unsold anticipated production to exceed limits in a futures contract subject to the CFTC's limits in order to hedge exposure in a commodity for which there is no futures contract, provided that the two commodities share substantially related fluctuations in value.

Bona Fide Hedges and Coordination With Exchanges

For those market participants who employ non-enumerated bona fide hedging practices in the marketplace, this proposal creates a streamlined, exchange-focused process to approve those requests for purposes of both exchange-set and federal limits. As the marketplaces for the core referenced futures contracts addressed by the proposal, the DCMs have significant experience in, and responsibility towards, a workable position limits regime. CEA core principles require DCMs and swap execution facilities to set position limits, or position accountability levels, for the contracts that they list in order to reduce the threat of market manipulation.[24] DCMs have long administered position limits in futures contracts for which the CFTC has not set limits, including in certain agricultural, energy, and metals markets. In addition, the exchanges have been strong enforcers of their own rules: during 2018 and 2019, CME Group and ICE Futures US concluded 32 enforcement matters regarding position limits.

As part of their stewardship of their own position limits regimes, DCMs have long granted bona fide hedging exemptions in those markets where there are no federal limits. Today's proposal provides what I believe is a workable framework to utilize exchanges' long standing expertise in granting exemptions that are not enumerated by CFTC rules.[25] This proposed rule also recognizes that the CEA does not provide the Commission with free rein to delegate all of the authorities granted to it under the statute.[26] The Commission itself, through a majority vote of the five Commissioners, retains the ability to reject an exchange-granted non-enumerated hedge request within 10 days of the exchange's approval. The Commission has successfully and responsibly used a similar process for both new contract listings as well as exchange rule filings, and I am pleased to see the proposal expand that approach to non-enumerated hedge exemption requests that will limit the uncertainty for bone fide commercial market participants.

I look forward to hearing from end-users about whether this proposal provides them the flexibility and certainty they need to manage their exposures in a way that reflects the complexities and realities of their physical businesses. In particular, I am interested to hear if the list of enumerated bona fide hedging exemptions should be broadened to recognize other types of common, legitimate commercial hedging activity.

global crude supply. Speculation had nothing to do with the price rise.''), *available athttps://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/hearing080509_verleger.pdf*.

[11] For a discussion of studies discussing supply and demand fundamentals and the role of speculation, *see* 81 FR 96704, 96727 (Dec. 30, 2016). *See, e.g.,* Hamilton, Causes and Consequences of the Oil Shock of 2007–2008, Brookings Paper on Economic Activity (2009); Chevallier, Price Relationships in Crude oil Futures: New Evidence from CFTC Disaggregated Data, Environmental Economics and Policy Studies (2012).

[12] *Platinum, gold slide as dollar soars; palladium eases off record,* Reuters (Sept. 30, 2019), available at: *https://www.reuters.com/article/global-precious/precious-platinum-gold-slide-as-dollar-soars-palladium-eases-off-record-idUSL3N26L3UV*.

[13] Between 2014 and 2017, the CME Group lowered the spot month position limit in the contract four times, from 650, to 500, to 400, to 100, to the current limit of 50 (NYMEX regulation 40.6(a) certifications, filed with the CFTC, 14–463 (Oct. 31, 2014), 15–145 (Apr. 14, 2015), 15–377 (Aug. 27, 2015), and 17–227 (June 6, 2017)), *available at: https://sirt.cftc.gov/sirt/sirt.aspx?Topic=ProductTermsandConditions*.

[14] Palladium futures were at $1,087.35 on Jan. 2, 2018 and at $1,909.30 on Dec. 31, 2019. Historical prices *available at: https://futures.tradingcharts.com/historical/PA_/2009/0/continuous.html.*

[15] 78 FR 75694 (Dec. 12, 2013).

[16] 64 FR 24038 (May 5, 1999).

[17] Proposed Appendix B, paragraph (a).

[18] Proposed Appendix A, paragraph (a)(11).

[19] Preamble discussion of Proposed Enumerated Bona Fide Hedges for Physical Commodities.

[20] Elimination of CFTC Form 204.

[21] 78 FR 75,717 (Dec. 12, 2013).

[22] *Id.*

[23] Proposed Appendix A, paragraph (a)(5).

[24] DCM Core Principle 5 (sec. 5 of the CEA, 7 U.S.C. 7) (implemented by CFTC regulation 38.300) and SEF Core Principle 6 (sec. 5h of the CEA, 7 U.S.C. 7b-3) (implemented by CFTC regulation 37.600).

[25] Proposed regulation 150.9.

[26] Preamble discussion of proposed regulation 150.9, including references to cases pointing out the extent to which an agency can delegate to persons outside of the agency.

Proposed Limits on Swaps

The CEA requires the Commission to consider limits not only on exchange-traded futures and options, but also on ''economically equivalent'' swaps.[27] Today's proposal provides the market with far greater certainty on the universe of such swaps than the previous proposals. Prior proposals failed to sufficiently explain what constituted an ''economically equivalent swap,'' thereby ensuring that compliance with position limits was essentially unworkable, given real-time aggregation requirements and ambiguity over in-scope contracts. In stark contrast, today's proposed rule narrows the scope of ''economically equivalent'' swaps to those with material contractual specifications, terms, and conditions that are identical to exchange-traded contracts.[28] For example, in order for a swap to be considered ''economically equivalent'' to a physically-settled core referenced futures contract, that swap would also have to be physically-settled, because settlement type is considered a material contractual term. I believe the proposed narrowly-tailored definition will provide market participants with clarity over those contracts subject to position limits. I also welcome suggestions from commenters regarding ways in which the definition can be further refined to complement limits on exchange-traded contracts.

Conclusion

Section 2a(10) of the CEA is not an often cited passage of text. It describes the Seal of the United States Commodity Futures Trading Commission, and in particular, lists a number of symbols on the seal which represent the mission and legacy of our agency: The plough showing the agricultural origin of futures markets; the wheel of commerce illuminating the importance of hedging markets to the broader economy; and, the scale of balanced interests, proposing a fair weighing of competing or contradicting forces.

As I think about the proposal in front of us today, I believe it speaks to all of those elements enshrined in our agency's legacy, but the scale of balanced interests comes most to mind with this rule: new flexibility combined with new regulation, the removal of a few exemptions with the expansion or addition of others, the reliance on exchange expertise but with Commission review and oversight, and the balance of liquidity and price discovery against the threat of corners and squeezes. I am very pleased to support today's revitalized, confined, and tempered approach to position limits and look forward to comment letters, particularly from the end-user community.

Appendix 4—Dissenting Statement of Commissioner Rostin Behnam

Introduction

The ceremony for the 92nd Academy Awards will air in a little over a week. I haven't seen too many movies this year given my two young girls and hectic work schedule, but I did see ''Ford v Ferrari.'' [1] ''Ford v Ferrari'' earned four award nominations, including best motion picture of the year. The film tells the true story of American car designer Carroll Shelby and British-born driver Ken Miles who built a race car for Ford Motor Company and competed with Enzo Ferrari's dominating and iconic red racing cars at the 1966 24 Hours of Le Mans.[2] This high drama action film focuses foremost on the relationship between Shelby and Miles—the co-designers and driver of Ford's own iconic GT40—and their triumph over the competition, the course, the rulebook, and the bureaucracy. Even if you aren't a car enthusiast, the action, acting, and accuracy of the story are well worth your time. However, there is a lot more to this movie than racing.

There is a great scene where Miles is talking to his son about achieving the ''perfect lap''—no mistakes, every gear change, and every corner perfect. In response to his son's observation that you can't just ''push the car hard'' the whole time, Miles agrees, pensively staring down the track towards the setting sun. He says, ''If you are going to push a piece of machinery to the limit, and expect it to hold together, you have to have some sense of where that limit is.''

It's been nine years since the Commission first set out to establish the position limits regime required by amendments to section 4a of the Commodity Exchange Act (the ''Act'' or ''CEA''), [3] under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[4] While I would like to be in a position to say that today's proposed rule addressing Position Limits for Derivatives (the ''Proposal'') is leading us towards that ''perfect lap,'' I cannot. While the Proposal purports to respect Congressional intent and the purpose and language of CEA section 4a, in reality, it pushes the bounds of reasonable interpretation by deferring to the exchanges [5] and setting the Commission on a course where it will remain perpetually in the draft, unable to acquire the necessary experience to retake the lead in administering a position limits regime.

In 2010 and the decades leading up to it, Congress understood that for the derivatives markets in physical commodities to perform optimally, there needed to be limits on the amount of control exerted by a single person (or persons acting in agreement). In tasking the Commission with establishing limits and the framework around their operation, Congress was aware of our relationship with the exchanges, but nevertheless opted for our experience and our expertise to meet the policy objectives of the Act.

Right now, we are pushing to go faster and just get to the finish line, making real-time adjustments without regard for even trying for that ''perfect lap.'' It is unfortunate, but despite the Chairman's leadership and the talented staff's hard work, I do not believe that this Proposal will hold itself together. I must therefore, with all due respect, dissent.

Deference to Our Detriment

While I have a number of concerns with the Proposal, my principal disagreement is with the Commission's determination to in effect disregard the tenets supporting the statutorily created parallel federal and exchange-set position limit regime, and take a back seat when it comes to administration and oversight. In doing so, the Commission claims victory for recognizing that the exchanges are better positioned in terms of resources, information, knowledge, and agility, and therefore ought to take the wheel. While the Commission believes it can withdraw and continue to maintain access to information that is critical to oversight, I fear that giving way absent sufficient understanding of what we are giving up, and planning for ad hoc Commission (and staff) determinations on key issues that are certain to come up, will let loose a different set of responsibilities that we have yet to consider.

I believe the Proposal has many flaws that could be the subject of dissent. I am focusing my comments on those issues that I think are most critical for the public's review. Based on consideration of the Commission's mission, and Congressional intent as evinced in the Dodd-Frank Act amendments to CEA section 4a and elsewhere in the Act, I believe that (1) the Commission is required to establish position limits based on its reasoned and expert judgment within the parameters of the Act; (2) the Commission has not provided a rational basis for its determination *not* to propose federal limits outside of the spot month for referenced contracts based on commodities other than the nine legacy agricultural commodities; and (3) the Commission's seemingly unlimited flexibility in proposing to (a) significantly broaden the bona fide hedging definition, (b) codify an expanded list of self-effectuating enumerated bona fide hedges, (c) provide for exchange recognition of non-enumerated bona fide hedge exemptions with respect to federal limits, and (d) simultaneously eliminate notice and reporting mechanisms, is both inexplicably complicated to parse and inconsistent with Congressional intent.

The Commission Is Required To Establish Position Limits

The Proposal goes to great lengths to reconcile whether the CEA section 4a(a)(2)(A) requires the Commission to make an antecedent necessity finding before establishing any position limit,[6] with the implication that if a necessity finding is required, then the Commission could rationalize imposing no limits at all. I do not believe it was necessary to rehash the legislative and regulatory histories to determine the Commission's authority with respect to CEA section 4a. Nor do I believe it was worthwhile here to reply in such great

[27] Sec. 4a(5).

[28] Proposed regulation 150.1.

[1] Ford v Ferrari (Twentieth Century Fox 2019).

[2] Ford v Ferrari, Fox Movies, *https://www.foxmovies.com/movies/ford-v-ferrari* (Last visited Jan. 28, 2020, 1:55 p.m.).

[3] *See* Position Limits for Derivatives, 76 FR 4752 (proposed Jan. 26, 2011) (the ''2011 Proposal'').

[4] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203 section 737, 124 Stat. 1376, 1722–25 (2010) (the ''Dodd-Frank Act'').

[5] As in the Proposal, unless otherwise indicated, the use of the term ''exchanges'' throughout this statement refers to designated contract markets (''DCMs'') and swap execution facilities (''SEFs'').

[6] *See* Proposal at III.

depth to the U.S. District Court for the District of Columbia's opinion vacating the Commission's 2011 final rulemaking on Position Limits for Futures and Swaps.[7] The Proposal uses a tremendous amount of text to try and flesh out what is meant by ''necessary'', and yet I fear it does not demonstrate the Commission's ''bringing its expertise and experience to bear when interpreting the statute,'' giving effect to the meaning of each word in the statute, and providing an explanation for how any interpretation comports with the policy objectives of the Act as amended by the Dodd-Frank Act, as directed by the District Court.[8] The Commission ought to avoid the temptation to retract when doing so requires the torture of strawmen. Not only do we look complacent, but we invite criticism for our unnecessary affront to the sensibilities of the public we serve.

Looking back at the record, what is necessary is that the Commission complies with the mandate.[9] In response to the District Court's directive, the Commission could have gone back through its own records to the 2011 Proposal. If it had done so, it would have found that the Commission provided a review of CEA section 4a(a)—interpreting the various provisions, giving effect to each paragraph, acknowledging the Commission's own informational and experiential limitations regarding the swaps markets at that time, and focusing on the Commission's primary mission of fostering fair, open and efficient functioning of the commodity derivatives markets.[10] Of note, ''Critical to fulfilling this statutory mandate,'' the Commission pronounced, ''is protecting market users and the public from undue burdens that may result from 'excessive speculation.' ''[11] Federal position limits, as predetermined by Congress, are most certainly the only means towards addressing the burdens of excessive speculation when such limits must address a ''proliferation of economically equivalent instruments trading in multiple trading venues.''[12] Exchange-set position limits or accountability levels simply cannot meet the mandate.

In exercising its authority, the Commission may evaluate whether exchange-set position limits, accountability provisions, or other tools for contracts listed on such exchanges are currently in place to protect against manipulation, congestion, and price distortions.[13] Such an evaluation—while permissible—is just one factor for consideration. The existence of exchange-set limits or accountability levels, on their own, can neither predetermine deference nor be justified absent substantial consideration. The authority and jurisdiction of individual exchanges are necessarily different than that of the Commission. They do not always have congruent interests to the Commission in monitoring instruments that do not trade on or subject to the rules of their particular platform or the market participants that trade them. They do not have the attendant authority to determine key issues such as whether a swap performs or affects a significant price discovery function, or what instruments fit into the universe of economically equivalent swaps. They are not permitted to define bona fide hedging transactions or grant exemptions for purposes of federal position limits. It is therefore clear that CEA section 4a, as amended by the Dodd-Frank Act ''warrants extension of Commission-set position limits beyond agricultural products to metals and energy commodities.''[14]

Unsupportable Deference

In spite of all of this—the foregoing mandate; the clear Congressional intent in CEA section 4a(a)(3)(A); and the Commission's real experience and expertise (including its unique data repository)—the Commission only proposes to maintain federal non-spot month limits for the nine legacy agricultural contracts (with questionably appropriate modifications), ''because the Commission has observed no reason to eliminate them.''[15] Essentially, in the Commission's reasoned judgment, ''if it ain't broke, don't fix it.'' And so, the Commission, in keeping with this relatively riskless course of action, similarly was able to conclude that federal non-spot month limits are not necessary for the remaining 16 proposed core referenced futures contracts identified in the Proposal.

The Commission provides two reasons in support of its determination, and neither sufficiently demonstrates that the Commission utilized its experience and expertise. Rather, the Commission backs into deferring to the exchanges' authority to establish position limits or accountability levels. This course of action ignores the reality that Commission-set position limits serve a higher purpose than just addressing threats of market manipulation[16] or creating parameters for exchanges in establishing their own limits.[17] The Proposal advocates that there is no need to disturb the status quo, despite the fact that we have nothing to compare it to. The Commission places a higher value on minimizing the impact on industry—which it appears to have not quantified for purposes of the Proposal—than actually evaluating the appropriateness of limits in light of the purposes of the Act and as described in CEA section 4a(a)(3).

The first reason the Commission submits in defense of not proposing federal limits outside of the spot month for the 16 aforementioned contracts is that ''corners and squeezes cannot occur outside the spot month . . . and there are other tools other than federal position limits for deterring and preventing manipulation outside of the spot month.''[18] The ''other tools'' include surveillance by the Commission and exchanges, coupled with exchange-set limits and/or accountability levels. As laid out in several paragraphs of the Proposal, the Commission would maintain a window into the setting of any limits or accountability levels that in its view are ''an equally robust'' alternative to federal non-spot month speculative position limits. In describing how accountability levels implemented by exchanges work, the Commission touts the flexibility in application because they provide exchanges—and not the Commission—the ability to ask questions about positions, determine if a position raises any concerns, provide an opportunity to intervene—or not—etc.[19]

While all of this reads well, it ignores Congressional intent. The Proposal never considers that Congress directed the Commission to establish limits—not accountability levels. Given the Commission's ''decades of experience in overseeing accountability levels implemented by the exchanges,'' Congress would have been well aware that this alternative path would be a viable option if it were truly as robust in choosing the legislative language. But the Commission has failed to make that case. Foremost, federal position limits are aimed at diminishing, eliminating, and preventing sudden and unwarranted price changes. These sudden price changes may occur regardless of manipulative, intentional or reckless activity—both within and outside of the spot month. The Commission provides no explanation regarding how exchange-set limits or accountability levels would compare, in terms of effectiveness, to federal position limits, which among other things, must apply in the aggregate as mandated by CEA section 4a(a)(6). It is difficult to measure the robustness of a regime when there is nothing to compare it to. As well, the Commission's observation that exchange-set accountability levels have ''functioned as-intended'' until this point time, ignores the wider purpose and function of aggregate position limits established by the Commission, and is shortsighted given the ever expanding universe of economically equivalent instruments trading across multiple trading venues. Not to belabor the point, but it seems odd to conclude that Congress envisioned that its painstaking amendments to CEA section 4a were a directive for the Commission to check the box that the current system is working perfectly.

The Commission's second reason is that layering federal non-spot limits for the 16 contracts on top of existing exchange-set limit/accountability levels may only provide minimal benefits—if any—while sacrificing the benefits associated with flexible accountability levels.[20] The Commission,

[7] *Int'l Swaps & Derivatives Ass'n* v. *CFTC,* 887 F. Supp. 2d 259 (D.D.C. 2012).

[8] *Id.* at 284.

[9] The Proposal's analysis in support of its denial of a mandate misconstrues form over substance and assumes the answer it is looking for by providing a misleading recitation of *Michigan* v. *EPA,* 135 S.Ct. 2699 (2015). In doing so, the Proposal seems to suggest that the Commission is free to ignore a Congressional mandate if it determines that Congress is wrong about the underlying policy. *See* Proposal at III.D.

[10] 76 FR at 4752–54.

[11] *Id.* at 4753.

[12] *Id.* at 4754–55.

[13] *See* 76 FR at 4755.

[14] *Id.*

[15] Proposal at II.B.2.d.

[16] *See* 7 U.S.C. 7(d)(5) and 7b–3(f)(6).

[17] *See, e.g.,* 7 U.S.C. 6a(e).

[18] Proposal at II.B.2.d.

[19] *See id.*

[20] *See id.*

again, ignores that Congress was clearly aware of the possible layering effect, and did not find it to be comparable let alone as robust.[21] Moreover, the Commission fails to support or otherwise quantify its argument with data. Presumably, the Commission could calculate anticipated non-spot month position limits—based on the formula in the proposed part 150.2(e) (and described in section II.B.2. e. of the Proposal)—for the 16 proposed core referenced futures contracts that have never been subject to such limits. The Commission could have based its determination on aggregate position data it collects through surveillance, and it could have provided a rough estimate of the potential impact that limits may have, absent consideration of any of the proposed enumerated bona fide hedges or spread exemptions. While I am not sure such evidence if presented would have changed my mind, it certainly would have been helpful in determining the reasonableness of the Commission's determination.

What if?

When muscles are overly flexible, they require appropriate strength to ensure that they can perform under stress. In addition to largely deferring to the exchanges in addressing excessive speculation outside of the spot-month for the majority of the 25 core referenced futures contracts, the Proposal also incorporates flexibility in a multitude of other ways. The Proposal would provide for significantly broader bona fide hedging opportunities that will be largely self-effectuating; it would defer to the exchanges in recognizing non-enumerated bona fide hedging; and it would eliminate longstanding notice and reporting mechanisms. In proposing these various provisions, the Proposal flexes and contorts to accommodate each piece. In doing so, it seems the Commission will be left insufficient strength to accomplish its mandated role of exercising appropriate surveillance, monitoring, and enforcement authorities—and this will be to the detriment of the derivatives markets and the public we serve.

The main point to get across here is that while I support enhancing the cooperation between the Commission and the exchanges, the Commission here is cooperating by dropping back and promising to remain in the draft—never able to fully compete, or take advantage of a ''slingshot effect.'' We will simply never gain the necessary direct experience with the new regime. The Commission lacks experience in administering spot month limits for 16 of the 25 core referenced futures contracts and lacks familiarity with both common commercial hedging practices for the 16 contracts and the proliferation of the use of the dozen or so self-effectuating enumerated hedges and spread exemptions (also largely self-effectuating) being proposed. While prior drafts of the Proposal admitted this as recently as two weeks ago, the Commission determined to change course and quickly let go of the line. The Commission's decision to essentially give up primary authority to recognize non-enumerated bona fide hedges, and to rely on the exchanges to collect and hold relevant cash market data for the Commission's use only after requesting it, seems both careless and inconsistent with Congressional intent.

For example, while the Proposal provides the Commission with the authority to reject an exchange's granting of a non-enumerated bona fide hedge recognition, this determination must be in the form of a ''Commission action,'' and it must take place in the span of ten business days (or two in the case of sudden or unforeseen circumstances). Furthermore, the Proposal offers no guidance as to what factors the Commission may consider, or the criteria it may use to make the determination. This narrow window of time likely will not provide Commission staff with a reasonable timeframe to prepare the necessary documentation for the full Commission to deliberate and either request additional information, stay the application, or vote to accept the recognition.[22] It seems more likely that the Commission will be unable to act within the ten or two-day window and the recognition will default to being approved. Regardless of what the Commission determines—even if it ultimately determines that a position for which an application for a bona fide hedge recognition does not meet the CEA definition of a bona fide hedge or the requirements in proposed part 150.9(b)—the Commission could not determine that the person holding the position has committed a position limits violation during the Commission's ongoing review or upon issuing its determination. I have so many ''what ifs'' in response to this set up that I feel trapped.

In the Proposal, the Commission requires exchanges to collect cash-market information from market participants requesting bona fide hedges, and to provide it to the Commission only upon request. The Proposal also eliminates Commission Form 204, which market participants currently file each month when they have bona fide hedging positions in excess of the federal limits. This form is a necessary mechanism by which market participants demonstrate cash-market positions justifying such overages. These changes may be well-intentioned, but they are ill-conceived in consideration of the various changes being proposed to the federal position limits regime.

Foremost, under the Proposal, the Commission would receive a monthly report showing the exchange's disposition of any applications to recognize a position as a bona fide hedge (both enumerated and non-enumerated) or to grant a spread or other exemption (including any renewal, revocation of, or modification of a prior recognition or exemption).[23] While the Proposal argues that the monthly report would be a critical element of the Commission's surveillance program by facilitating its ability to track bona fide hedging positions and spread exemptions approved by the exchanges,[24] it would not itself appear to be useful in discerning any market participants ongoing justification for, or compliance with, self-effectuating or approved bona fide hedge, spread, or other exemption requirements. While the contents of the report may prompt the Commission to request records from the exchange, it is unclear what may be involved in the making of, and response to, such requests—including time and resources on both sides. Not to mention that the Proposal opines that exchanges would only collect responsive information on an annual basis,[25] and part 150.9(e) does not require exchanges to notify the Commission of any renewal applications. Of course, the Proposal posits that the Commission would likely only need to make such requests ''in the event that it noticed an issue that could cause market disruptions.''[26] My guess is that our surveillance staff and Division of Enforcement may have other ideas, but I will leave that with the ''what ifs.''

Conclusion

The 24 Hours of Le Mans awards the victory to the car that covers the greatest distance in 24 hours. While the Proposal shoots for victory by similarly attempting to achieve a great amount over a short time period, I am concerned that all of it will not hold together. The Proposal attempts to justify deferring to the exchanges on just about everything, and in-so-doing it pushes to the back any earnest interpretation of the Commission's mandate or the guiding Congressional intent. This is not cooperation, this is stepping-aside, backing down, giving way, and getting comfortable in the draft. I am not comfortable in this or any draft. It's my understanding that the Commission has the tools and resources to develop a better sense of where federal position limits ought to be in order to achieve the purposes for which they were designed, while maintaining our natural, Congressionally-mandated lead. The Proposal fails to recognize that Congress already set the course in directing us that our derivatives markets will operate optimally with limits—we just need to provide a sense of where they are. Perhaps the Proposal was just never aiming for the ''perfect lap.''

Appendix 5—Statement of Commissioner Dawn D. Stump

Reasonably designed. Balanced in approach. And workable in practice—both for market participants and for the Commission. These are the 3 guideposts by which I have evaluated the proposal before us to update the Commission's rules regarding position limits for derivatives. Is it reasonable in its design? Is it balanced in its approach? And is it workable in practice for

[21] *See, e.g.,* 7 U.S.C. 6a(e) (providing, among other things and consistent with core principles for DCMs and SEFs, that exchange-set position limits shall not be higher that the limits fixed by the Commission).

[22] *See* Proposed part 150.9(e).

[23] *See* Proposed Commission regulation 150.5(a)(4).

[24] *See* Proposal at II.D.4.

[25] *See* Proposal at I.B.7.a. and b.

[26] *Id.* As well, the Proposal opines that the Commission's reliance on the ''limited circumstances'' set forth in proposed part 150.9(f) under which it would revoke a bona fide hedge recognition granted by an exchange would be rarely exercised, suggesting a preference to defer to the judgment of the exchange. *See* Proposal at II.G.3.f.

both market participants and the Commission? Overall, I believe the answer to each of these questions is yes, and I therefore support the publication of this proposal for public comment.

There is one question that I have not asked: Is it perfect? It is not. There are two particular areas discussed below that I believe can be improved—the list of enumerated hedging transactions and positions, and the process for reviewing hedging practices outside of that list.

But in reality, how could a position limits proposal ever achieve perfection? In section 4a(a) of the Commodity Exchange Act (''CEA''),[1] Congress has given the Commission the herculean task of adopting position limits that:

- It finds necessary to diminish, eliminate, or prevent an undue and unnecessary burden on interstate commerce as a result of excessive speculation in derivatives;
- Deter and prevent market manipulation, squeezes, and corners;
- Ensure sufficient market liquidity for bona fide hedgers; [2]
- Ensure that the price discovery function of the underlying market is not disrupted;
- Do not cause price discovery to shift to trading on foreign boards of trade; and
- Include economically equivalent swaps.

And it must do so, according to the CEA's purposes set out in section 3(b), through a system of effective self-regulation of trading facilities.[3]

These statutory objectives are not only numerous, but in many instances they are in tension with one another. As a result, it is not surprising that each of us will have a different view of the perfect position limits framework. Perfection simply cannot be the standard by which this proposal is judged.

But after nearly a decade of false starts, I believe the proposal before us brings us close to the end of that long journey. It is reasonably designed. It is balanced in its approach. And it is workable in practice. I am pleased to support putting it before the public for comment.

The Commission Has a Mandate To Impose Position Limits It Finds Are Necessary

Background

Before digging into the substantive provisions of the proposal, let me offer my view on a legal issue that has been debated seemingly without end throughout the past decade in the Commission's rulemaking proceedings and in federal court. As noted in testimony by the CFTC's General Counsel in July 2009, a year before the Dodd-Frank Act [4] became law, the CEA has always given the Commission a mandate to impose federal position limits—that is, a mandate to impose federal position limits that it finds are necessary.[5] The issue that has consumed the agency, the industry, and the bar is this: Did the amendments to the CEA's position limits provisions that were enacted as part of the Dodd-Frank Act strip the Commission of its discretion not to impose limits if it does not find them to be necessary?

I consider it unfortunate that the Commission has spent so much time, energy, and resources on this debate. That time, energy, and resources would have been much better spent focusing on the development of a position limits framework that is reasonably designed, balanced in approach, and workable in practice for both market participants and the Commission—which simply cannot be said of the Commission's prior efforts in this area. But, in the words of American writer Isaac Marion in his ''zombie romance'' novel *Warm Bodies:* ''We are where we are, however we got here.'' [6] And so, a few thoughts on necessity and mandates.

In the *ISDA* v. *CFTC* case, a federal district court in 2012 vacated the Commission's first post-Dodd-Frank Act attempt to adopt a position limits rulemaking. The court concluded that the Dodd-Frank Act amendments to the position limits provisions of the CEA ''are ambiguous and lend themselves to more than one plausible interpretation.'' Accordingly, it remanded the position limits rulemaking to the Commission to ''bring its experience and expertise to bear in light of competing interests at stake'' in order to ''fill in the gaps and resolve the ambiguities.'' [7]

The Commission attempted to follow the court's directive in a proposed position limits rulemaking published in 2013. There, the Commission concluded that the Dodd-Frank Act required the agency to adopt position limits even in the absence of finding them necessary but, ''in an abundance of caution,'' also made a finding of necessity with respect to the position limits that it was proposing.[8] The Commission promulgated this same analysis when, three years later, it re-proposed its position limits rulemaking in 2016.[9] The proposal before us today, by contrast, bases its proposed limits solely on finding them to be necessary—albeit a finding of necessity that is different from the one relied upon in the 2013 Proposal and the 2016 Re-Proposal.

Practical Considerations

I find the analysis put forward by our General Counsel's Office in the proposed rulemaking before us today—which explains the Commission's legal interpretation that its mandate to impose position limits under the CEA exists only when it finds the limits are necessary—to be well-reasoned and compelling. I add two practical considerations in support of that conclusion.

First, if Congress in the Dodd-Frank Act had wanted to eliminate a necessity finding as a prerequisite to the imposition of position limits, it could simply have removed the requirement to find necessity that already existed in the CEA. That it did not do so indicates that on this point, the CEA both before and after the Dodd-Frank Act provides that the Commission has a mandate to impose position limits that it finds are necessary.

Second, I do not believe that Congress would have directed the Commission to spend its limited resources developing and administering position limits that are not necessary. We must be careful stewards of the taxpayer dollars entrusted to us, and absent a clear statement of Congressional intent to do so, I do not believe those dollars should be spent on position limits that the Commission does not find to be necessary to achieve the objectives of the CEA.

Statutory Analysis

This section walks through some of the statutory text in CEA section 4a(a) that is relevant to the question of whether a finding of necessity is a prerequisite to the Commission's mandate of imposing position limits. A diagram entitled ''Commodity Exchange Act Section 4a(a): Finding Position Limits Necessary is a Prerequisite to the Mandate for Establishing Such'' accompanies this statement on the Commission's website, which may aid in reading the discussion.

Subsection (1) of section 4a(a) is legacy text that has been in the CEA for decades. As noted above, it has long mandated that the Commission impose position limits that it finds necessary to diminish, eliminate, or prevent the burden on interstate commerce resulting from excessive speculation in derivatives. Subsection (2) of section 4a(a), on the other hand, was added to the CEA by the Dodd-Frank Act.

[1] CEA section 4a(a), 7 U.S.C. 6a(a).

[2] Section 4a(c) of the CEA further requires that the Commission's position limit rules ''permit producers, purchasers, sellers, middlemen, and users of a commodity or a product derived therefrom to hedge their legitimate anticipated business needs . . .'' CEA section 4a(c), 7 U.S.C. 6a(c).

[3] CEA section 3(b), 7 U.S.C. 5(b).

[4] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010) (''Dodd-Frank Act'').

[5] ''Position Limits and the Hedge Exemption, Brief Legislative History,'' Testimony of General Counsel Dan M. Berkovitz, Commodity Futures Trading Commission, before Hearing on Speculative Position Limits in Energy Futures Markets at 1 (July 28, 2009) (''Today, I will provide a brief legislative history of the *mandate* in the CEA concerning position limits and the exemption from those limits for bona fide hedging transactions. . . . Since its enactment in 1936, the Commodity Exchange Act (CEA) . . . has directed the Commodity Futures Trading Commission (CFTC) to establish such limits on trading 'as the Commission finds are necessary to diminish, eliminate, or prevent such burden [on interstate commerce].' The basic statutory *mandate* in Section 4a of the CEA to establish position limits to prevent such burdens has remained unchanged over the past seven decades) (emphasis added), *available at https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement072809; see also, id.* at 5 (''By the mid-1930s . . . Congress finally provided a federal regulatory authority with the *mandate* and authority to establish and enforce limits on speculative trading. In Section 4a of the 1936 Act (CEA), the Congress . . . . directed the Commodity Exchange Commission [the CFTC's predecessor agency] to establish such limits on trading 'as the commission finds is [sic] necessary to diminish, eliminate, or prevent' such burdens . . .'') (emphasis added).

[6] Isaac Marion, Warm Bodies and The New Hunger: A Special 5th Anniversary Edition, 97, Simon and Schuster (2016).

[7] *International Swaps and Derivatives Association* v. *U.S. Commodity Futures Trading Commission,* 887 F.Supp. 2d 259, 281–282 (D.D.C. 2012) (emphasis in the original) (''*ISDA* v. *CFTC*''), *citing PDK Labs. Inc.* v. *U.S. DEA,* 362 F.3d 786, 794, 797–98 (D.C. Cir. 2004).

[8] Position Limits for Derivatives, 78 FR 75680, 75685 (proposed Dec. 12, 2013) (''2013 Proposal'').

[9] Position Limits for Derivatives, 81 FR 96704, 96716 (proposed Dec. 30, 2016) (''2016 Re-Proposal'').

In my view, subsections (1) and (2) are linked, and cannot each be considered in isolation, because the Dodd-Frank Act specifically tied them together. First, subparagraph (A) of subsection (2) links the Commission's obligation to set position limits to the ''standards'' set forth in subsection (1)—including the standard of finding necessity as a prerequisite to the mandate of imposing position limits. Then, subparagraph (B) of subsection (2) links the timing of issuing position limits to the limits required under subparagraph (A)—which, as noted, is connected to the standards set forth in subsection (1), including the standard of finding necessity.

In sum, the new timing provisions in subparagraph (2)(B) apply to the requirement in subparagraph (2)(A). Subparagraph (2)(A), in turn, informs how Congress intended the Commission to establish limits, *i.e.,* in specific accordance with the standards in subsection (1)—which includes the necessity standard. They are all linked.

Yet, some have relied in isolation on the ''shall . . . establish limits'' wording in subparagraph (A) of subsection (2) to argue that the Dodd-Frank Act imposed a mandate on the Commission to establish position limits even in the absence of a finding of necessity. Some also have pointed to the timing provisions in subparagraph (B) of subsection (2) to argue that the Dodd-Frank Act imposed a mandate on the Commission to establish position limits because subparagraph (B) twice says that position limits ''shall be established.'' I agree that, under subparagraph (B), position limits ''shall be established'' as required under subparagraph (A)—but as noted, subparagraph (A) states that the Commission shall establish limits ''[i]n accordance with the standards set forth in [subsection (1)].'' This latter point cannot be overlooked or ignored.

Some also have asked why Congress would add all this new language to CEA section 4a(a) if not to impose a new mandate. Yet, it makes perfect sense to me that while expanding the Commission's authority to regulate swaps in the Dodd-Frank Act, Congress took the opportunity to review and enhance the Commission's position limit authorities to ensure they were fit for purpose considering the addition of the new expanded authorities, including how swaps would be considered in the context of position limits. The timing of the review period was spelled out and the manner in which the Commission would go about establishing limits was refined to account for this massive change in oversight.

But never did anyone suggest that the legacy language in subsection (1) of section 4a(a), including the required prerequisite of a necessity finding, had effectively been eliminated and replaced with a new mandate that would apply even in the absence of a necessity finding.

Subsequent History

Finally, as noted above, the court in *ISDA* v. *CFTC* instructed the Commission to use its ''experience and expertise'' to resolve the ambiguity it found in the statute. That experience and expertise cannot look only to the era in which these position limit provisions were enacted. We are where we are, and so the application of the Commission's experience and expertise must include a consideration of the substantial changes in the markets since that time.

Given the intervention of a global financial crisis, it is hard to recall that the Dodd-Frank Act amendments to the CEA's position limit provisions were borne at a time of skyrocketing energy prices during 2007–2008. The price of oil climbed to over $147 a barrel in July 2008, which represented a 50% increase in one year and a seven-fold increase since 2002.[10] Gas prices at the pump peaked at over $4 a gallon in June and July of 2008.[11]

Some at the time charged that these price spikes were caused by excessive speculation in futures contracts on energy commodities traded on U.S. futures exchanges—another topic of debate on which I will save my views for another day. But not surprisingly, legislation soon followed. By the end of 2008, the House of Representatives had passed amendments to the CEA's position limit provisions,[12] and after the Senate failed to act, the issue was subsequently addressed in the Dodd-Frank Act.

How times have changed. The United States, due to a boom in oil and natural gas production relating to shale drilling and the development of liquefied natural gas, will soon become a net energy exporter.[13] Although no new federal position limits have been imposed, prices of energy commodities have generally dropped and stabilized, and cries of excessive speculation in the derivatives markets are rare. Also, our derivatives markets have grown substantially. Global trading in listed futures and options increased from 22.4 billion contracts in 2010 to a record 34.47 billion contracts in 2019. Global open interest increased to a record 900 million contracts from 718.5 million in 2010.[14]

Applying our experience and expertise, what these developments teach us is that economic conditions change over time. Technology marches on. Markets evolve. And prices fluctuate in response to a myriad of influences. Having lived through the energy price increases of the mid-2000s, I do not minimize the pain they caused, or the importance of the Commission taking appropriate steps to prevent excessive speculation in derivatives markets that can contribute to a burden on interstate commerce. Given the history of the past decade, however, I do not believe Congress intended, based on the moment in time of 2007–2008, to forever lock our derivatives markets into a straightjacket, or to deny the Commission the flexibility to draw conclusions of necessity based on particular circumstances.

Returning to our zombie romance, I'm afraid I have not been fair to its author. That is because there is a second line to the quotation, which reads: ''We are where we are, however we got here. What matters is where we go next.'' [15]

It is my fervent hope that the majority of comment letters we receive on today's proposal provide constructive input on where the proposal would take us next with respect to position limits—and not simply fan the flames of the necessity debate. And it is the topic of where we go next that I will now turn.

What position limits are necessary?

Having concluded that the CEA mandates the Commission to impose position limits that it finds are necessary, the question then becomes: What position limits are necessary?

In the 2013 Proposal, the Commission's necessity finding determined that federal spot month position limits were necessary for 28 core referenced futures contracts on various agricultural, energy, and metals commodities. In the 2016 Re-Proposal, the Commission utilized the same necessity finding to determine that federal spot month limits were necessary for 25 of the 28 core referenced futures contracts for which they had been found necessary in 2013.[16] And today's proposal, although utilizing a different approach to the necessity finding, determines that federal spot month limits are necessary for the same 25 core referenced futures contracts for which they were found to be necessary in the 2016 Re-Proposal.

In other words, three different iterations of the Commission have found federal spot month position limits to be necessary for these 25 core referenced futures contracts. That degree of consistency alone demonstrates the reasonableness of this determination.

To be sure, both the 2013 Proposal and the 2016 Re-Proposal found federal position limits for non-spot months to be necessary for these 25 contracts, whereas today's proposal does so for only the nine legacy agricultural contracts that are currently subject to federal non-spot month limits. Yet, the necessity findings in the 2013 Proposal and the 2016 Re-Proposal were based largely, if not entirely, on just two episodes: (1) The activity of the Hunt Brothers in the silver market in 1979–1980; and (2) the activity of the Amaranth hedge fund in the natural gas market in the mid-2000s.

[10] Rebeka Kebede, *Oil Hits Record Above $147,* Reuters Business News, July 10, 2008, *available at https://www.reuters.com/article/us-markets-oil/oil-hits-record-above-147-idUST14048520080711.*

[11] Leigh Ann Caldwell, *Face the Facts: A Fact Check on Gas Prices,* CBS News Face the Nation, March 21, 2012, *available at https://www.cbsnews.com/news/face-the-facts-a-fact-check-on-gas-prices/.*

[12] Commodity Markets Transparency and Accountability Act of 2008, H.R. 6604, 110th Cong. sec. 8 (2008).

[13] Tom DiChristopher, *US to Become a Net Energy Exporter in 2020 for First Time in Nearly 70 Years, Energy Dept. Says,* CNBC Business News, Energy, Jan. 24, 2019, *available at https://www.cnbc.com/2019/01/24/us-becomes-a-net-energy-exporter-in-2020-energy-dept-says.html.*

[14] Futures Industry Association, *Global Futures and Options Trading Reaches Record Level in 2019,* Jan. 16, 2020, *available at https://fia.org/articles/global-futures-and-options-trading-reaches-record-level-2019.*

[15] *See* fn. 6, *supra,* at 97.

[16] The 2016 Re-Proposal did not propose that federal position limits be imposed on three cash-settled futures contracts (Class III Milk, Feeder Cattle, and Lean Hogs) that were included as core referenced futures contracts in the 2013 Proposal. *See* 2016 Re-Proposal, 81 FR at 96740 n.368.

The Hunt Brothers silver episode and Amaranth natural gas episode occurred over 30 and over 15 years ago, respectively. It also should be noted that the Commission settled enforcement actions against both the Hunt Brothers and Amaranth charging that they had engaged in manipulation and/or attempted manipulation.[17] Since that time, Congress has provided the Commission with enhanced anti-manipulation enforcement authority as part of the Dodd-Frank Act, which the Commission has used aggressively and serves as an effective tool to deter and combat potential manipulation involving trading in non-spot months.

Again, I do not minimize the seriousness of the Hunt Brothers and Amaranth episodes, both of which had significant ramifications. But I am comfortable with the proposal's determination that two dated episodes of manipulation during the past 30 years do not establish that it is necessary to take the drastic step of restricting trading (and liquidity) in non-spot months by imposing position limits for the core referenced futures contracts in these two commodities—let alone for the other 14 contracts at issue. I therefore support publishing the necessity finding in the proposal before us—including the limitation on proposed non-spot month limits to the nine legacy agricultural contracts—for public comment.

Setting Limit Levels

With respect to setting position limit levels, the Commission's historical practice has been to set federal spot month levels at or below 25 percent of deliverable supply based on estimates provided by the exchanges and verified by the Commission. Yet, some of the deliverable supply estimates underlying the existing federal spot month limits on the nine legacy agricultural futures contracts have remained the same for decades, notwithstanding the revolutionary changes in U.S. futures markets and the explosive growth in trading volume over the years. These outdated delivery supply estimates require updating.

The proposal adheres to the Commission's historical approach, which is reasonable given the Commission's years of experience administering federal spot month limits on the legacy agricultural contracts. And it provides a long-overdue update to deliverable supply estimates for those legacy contracts to reflect the realities of today's markets. The proposed spot month limits for the 25 core referenced futures contracts are based on deliverable supply estimates of the exchanges that know their markets best, but that have been carefully analyzed by Commission staff to assure that they strike an appropriate balance between protecting market integrity and restricting liquidity for bona fide hedgers.

For limit levels outside the spot month, the Commission historically has used a formula based on 10% of open interest for the first 25,000 contracts, with a marginal increase of 2.5% of open interest thereafter. Again, the proposal reasonably adheres to this general formula with which the Commission is familiar in proposing non-spot month limits for the nine legacy agricultural contracts, but it would apply the 2.5% calculation to open interest above 50,000 contracts rather than the current level of 25,000 contracts.

Open interest has roughly doubled since federal limits were set for these markets, which has made the current non-spot month limits significantly more restrictive as the years have gone by. Nevertheless, I appreciate that such a change to established limits may raise concern. I am therefore pleased that the proposal includes a question asking whether the proposed increases in federal non-spot month limits should be implemented incrementally over a period of time, rather than immediately at the effective date. (There is additionally a question seeking input on the impact of increases in non-spot month limits for convergence that is of great interest to me.)

Finally, it is important to remember that the 16 core referenced futures contracts for which federal non-spot month limits are not being proposed remain subject to exchange-set position limit levels or position accountability levels.[18] The Commission has decades of experience overseeing accountability levels implemented by exchanges, including for all 16 contracts that would not be subject to federal limits outside the spot month under this proposal. Position accountability enables the exchange to obtain information about a potentially problematic position while it is at a relatively low level, and to require a trader to halt increasing that position or to reduce the position if the exchange considers it warranted. Exchange position accountability rules, in combination with market surveillance by both the exchanges and the Commission and the Commission's enhanced anti-manipulation authority granted by the Dodd-Frank Act, provide a robust means of detecting and deterring problems in the outer months of a contract. The proposal reasonably continues to rely on these tools in the non-legacy contracts.

Undoubtedly, there will be those who believe the proposed spot and non-spot month limits are too high, and others who consider them too low. I look forward to receiving public comments along these lines, but expect that any such comments will include market data and analysis for the Commission to consider in developing final rules.

Bona Fide Hedging Transactions and Positions

The CEA provides that the Commission's position limit rules shall not apply to bona fide hedging transactions or positions. It gives the Commission the authority to define ''bona fide hedging transactions and positions'' with the purpose of ''permit[ting] producers, purchasers, sellers, middlemen, and users of a commodity or a product derived therefrom to hedge their legitimate anticipated business needs . . .'' [19] This serves as a statutory reminder of the fundamental point that the Commission is imposing *speculative* position limits, and since bona fide hedging is outside the scope of speculative activity, it is by definition outside the scope of the position limit rules.

The Commission's current definition of the term ''bona fide hedging transactions and positions'' is set out in what is referred to as ''Rule 1.3(z).'' In addition to providing a definition, Rule 1.3(z) also identifies certain specific ''enumerated'' hedging practices that the Commission recognizes as falling within the scope of that definition and therefore not subject to position limits. Other ''non-enumerated'' hedging practices can still be recognized as bona fide hedging, but only after a Commission review process.

I am delighted that the proposal before us recognizes an expanded list of enumerated bona fide hedging practices than are currently recognized in Rule 1.3(z). This is entirely appropriate. Hedging practices at companies that produce, process, trade, and use agricultural, energy, and metals commodities are far more sophisticated, complex, and global than when the Commission last considered Rule 1.3(z). This is yet one more instance where the Commission's position limit rules simply have not kept pace with developments in, and the realities of, the marketplace. In addition, the proposal would expand federal limits to contracts in commodities not previously subject to federal limits, and thus common hedging practices in the markets for those commodities must be considered for inclusion in the list of enumerated bona fide hedges.

I am particularly pleased that, at my request, the proposal recognizes anticipatory merchandising as an enumerated bona fide hedge. After all, the CEA itself identifies anticipatory merchandising as bona fide hedging activity,[20] and the Commission has previously granted non-enumerated hedge recognitions for anticipatory merchandising. There is no policy basis for distinguishing merchandising or anticipated merchandising from other activities in the physical supply chain. Although there must be appropriate safeguards against abuse, where merchandisers anticipate taking price risk, they should have the same opportunity as others in the physical supply chain to manage their risk through recognized risk-reducing transactions that qualify as bona fide hedging.

Although the proposal refers to enumerated bona fide hedges as ''self-effectuating'' for purposes of federal limits, this is a bit of a misnomer. Even if a hedge is enumerated, the trader still must receive approval from the relevant exchange to

[17] The 2016 Re-Proposal acknowledged that ''both episodes involved manipulative intent.'' 2016 Re-Proposal, 81 FR at 96716.

[18] The use of position accountability in lieu of hard limits is expressly permitted by the CEA for both designated contract markets, CEA section 5(d)(5), 7 U.S.C. 7(d)(5), and swap execution facilities, CEA section 5h(f)(6), 7 U.S.C. 7b-3(f)(6).

[19] CEA section 4a(c)(1), 7 U.S.C. 6a(c)(1).

[20] CEA section 4a(c)(2)(A)(iii)(I), 7 U.S.C. 6a(c)(2)(A)(iii)(I) (bona fide hedging transaction or position is a transaction or position that, among other things, ''arises from the potential change in the value of . . . assets that a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or *merchandising* . . .'' (emphasis added)).

exceed the exchange-set limits.[21] This, too, is entirely appropriate. The exchanges know their markets, and they are very familiar with current hedging practices in agricultural, energy, and metals commodities, and thus are well-suited to apply the enumerated bona fide hedges in real-time. And, as noted above, Congress has declared it a purpose of the CEA to serve the public interest with respect to derivatives trading ''through a system of effective self-regulation of trading facilities . . .'' [22]

I find perplexing what the proposal refers to as a ''streamlined'' process for recognizing non-enumerated bona fide hedging practices with respect to federal position limits. Pursuant to proposed 150.9, if an exchange recognizes a non-enumerated practice as a bona fide hedge for purposes of the exchange's position limits, that recognition would apply to the federal limits as well, unless the Commission notifies the exchange and market participant otherwise. The Commission would have 10 business days for an initial application, or 2 business days in the case of a sudden or unforeseen increase in the applicant's bona fide hedging needs, to approve or reject the exchange's bona fide hedging recognition.

I do not believe this ''10/2-Day Rule'' is workable in practice for either market participants or the Commission because it is both too long and too short. It is too long to be workable for market participants that may need to take a hedging position quickly, and it is too short for the Commission to meaningfully review the relevant circumstances and make a reasoned determination related to the exchange's recognition of the hedge as bona fide.

My preference would have been to propose that recognition of non-enumerated hedges be the responsibility of the exchanges that, again, are most familiar both with their own markets and with the hedging practices of participants in those markets. The Commission would monitor this process through our routine, ongoing review of the exchanges. I welcome public comment on the proposal's legal discussion of the sub-delegation of agency decision making authority as relevant to this question, and on how the proposed 10/2-Day Rule might be improved in a final rulemaking to make the process workable for market participants and the Commission alike.

A Word About Economically Equivalent Swaps

CEA section 4a(a)(5) provides that ''[n]otwithstanding any other provision'' in section 4a, the Commission's position limit rules shall establish limits, ''as appropriate,'' with respect to economically equivalent swaps, and that such limits must be ''develop[ed] concurrently'' and ''establish[ed] simultaneously'' with the limits imposed on futures contracts and options on futures contracts.[23] I share the view that section 4a(a)(5) thereby requires that this rulemaking encompass economically equivalent swaps, although I invite public comment from those who believe another interpretation may be permissible and appropriate.

The proposal sets forth a narrow definition of the term ''economically equivalent swap,'' which I believe is appropriate. A measured approach is reasonable given that: (1) The Commission's regulatory regime for swaps remains in its relative infancy; (2) swaps have never been subject to position limits, be it federal or exchange-set limits; and (3) the implications of imposing position limits on economically equivalent swaps cannot be predicted with any degree of confidence at this time. Further, a measured approach is more workable because it is the Commission, rather than an exchange, that will be responsible for administering the new position limits regime for swaps given that: (1) Many swaps trade over-the-counter (''OTC'') so there is no exchange to fulfill this responsibility; and (2) for swaps traded on swap execution facilities (''SEFs''), those SEFs lack the information about a trader's swap positions on other SEFs and OTC that would be necessary to fulfill this responsibility.

That said, the proposed definition of an ''economically equivalent swap'' is broader than that used in the European position limits regime. In Europe, economic equivalence requires identical terms; the proposal, by contrast, requires only that material terms be identical. I look forward to receiving comment on this distinction, and the experience that market participants have had with the European application of position limits to swaps.

Conclusion

The fact that the Commission has been trying to update these rules for nearly a decade demonstrates the challenge presented by position limits. I am extremely grateful to the many members of our staff in the Division of Market Oversight, the Office of General Counsel, and the Chief Economist's Office who have dedicated a significant portion of their lives to helping us try to meet that challenge. I also appreciate the efforts of my fellow Commissioners as well.

Each of us has committed that we would work to finish a position limits rulemaking. The time has come. Overall, today's proposal is reasonable in design, balanced in approach, and workable for both market participants and the Commission. I therefore support it.

I ask market participants to view the proposal in that spirit. Please provide us with your constructive input on how we can make a good proposal even better.

Appendix 6—Dissenting Statement of Commissioner Dan M. Berkovitz

Introduction

I dissent from today's position limits proposal (''Proposal''). The Proposal would create an uncertain and unwieldy process with the Commission demoted from head coach over the hedge exemption process to Monday-morning quarterback for exchange determinations.[1] The Proposal would abruptly increase position limits in many physical delivery agricultural, metals, and energy commodities, in some instances to multiples of their current levels. It would provide no opportunity for the Commission to monitor the effect of these increases, or to act if necessary to preserve market integrity. The Proposal provides inadequate explanation for other key approaches in the document, including the use of position accountability rather than numerical limits for energy and metals commodities in non-spot months. The Proposal also ignores Congress's mandate in the Dodd-Frank Act, and reverses decades of legal interpretations of the Commodity Exchange Act (''CEA'') by the Commission and the courts regarding the Commission's authority and responsibility to impose position limits. It would require, for the first time, the Commission to find that position limits are necessary for each commodity prior to imposing limits.

I Support an Effective Position Limits Framework With Transparency and Certainty

Position limits is one of the last remaining items in the Commission's reform agenda arising from the Dodd-Frank Act. In the wake of the 2008 oil price spike to $147 per barrel, the Amaranth hedge fund's dominance of the natural gas futures and swaps market, the rise of commodity index funds, and the financial crisis, Congress mandated that the Commission promptly establish, as appropriate, position limits and hedge exemptions for exempt and agricultural commodities and economically equivalent swaps. We must not forget the lessons from the financial crisis or prior episodes of excessive speculation, nor be lulled back into the belief that unfettered markets yield optimal outcomes. A meaningful, effective position limits regime was important to the reform agenda in 2010, and it must remain our goal today.

I support an effective position limits regime that includes both effective limits on speculative positions and appropriate bona fide hedge exemptions to meet market participants' legitimate commercial needs. Position limits are critical to preventing market manipulation or distortion due to excessively large speculative positions. Together, position limits and bona fide hedge exemptions promote the market integrity and the price discovery process, while enabling producers, end-users, merchants, and others to use the futures and swaps markets to manage their commercial risks. The Dodd-Frank Act, adopted by Congress in 2010 in the midst of the financial crisis, affirmed Congress's commitment to federal speculative position limits and its determination that the Commission should act decisively to address excessive speculation in physical commodity markets.

Since joining the Commission, I have traveled the country to meet with market participants in many segments of the physical commodity markets. I have been to soybean farms and rice mills in Arkansas, feedlots in Colorado, dairy co-ops and

[21] Further, the absence of Commission approval of an enumerated bona fide hedge does not mean that the Commission has no access to data about the position or insight into the hedger's trading activity.

[22] *See* fn. 3, *supra*.

[23] CEA section 4a(a)(5), 7 U.S.C. 6a(a)(5).

[1] *See* Position Limits for Derivatives (''Proposal'') at rule text section 150.9(e).

cornfields in Minnesota, and grain mills and elevators in Kansas, Arkansas, Colorado, and Minnesota. I have met with coffee and cocoa graders in New York, energy companies in Texas, cotton merchandisers from Tennessee, and many others to understand how end-users participate in our markets. I have visited the CME in Chicago, ICE in New York, and the Minneapolis Grain Exchange in Minneapolis. The fundamental purpose of the commodity markets we oversee is to enable end-users to manage the price risks they face in their businesses. I am committed to ensuring that this rule is workable for end-users and provides them with sufficient clarity, predictability, and transparency.

In my view, a position limits rule must meet three basic criteria. First, the rule must provide effective limits on speculative positions. Second, the rule must recognize legitimate bona fide hedging activities. The Commission should provide market participants with certainty regarding which activities constitute bona fide hedging and establish a workable, transparent process for qualifying additional types of activities as bona fide hedging. Such a process should recognize both the traditional role of the Commission in determining, generally, which activities constitute bona fide hedging, and the role of the exchanges in determining whether the specific activities of particular commercial market participants fall within such bona fide hedging categories as determined by the Commission.

Third, from a legal perspective, a final rule must recognize that Congress has authorized and directed the Commission to promulgate position limits—without a predicate finding that position limits are necessary to prevent excessive speculation—and that the Commission has the flexibility to determine the appropriate tools and limits to accomplish that Congressional directive.

Unfortunately, the Proposal fails to satisfy any of these criteria. The Proposal would greatly increase position limits in many physical delivery agricultural, metals, and energy commodities in spot and individual non-spot months, with no opportunity to monitor for or guard against adverse market impacts. Although I am pleased that the Proposal would no longer recognize risk management exemptions as bona fide hedges for physical commodities,[2] the higher limits allowed under the Proposal could accommodate substantially more speculative positions,[3] with potentially adverse impacts on markets. There is solid evidence that the financialization and growth of commodity index investments can raise commodity prices and negatively affect end-users in the real economy.[4]

The Proposal departs from the well-established roles of the Commission and exchanges in the bona fide hedge framework. As affirmed by the Dodd-Frank Act, it is the Commission's responsibility to define what constitutes a bona fide hedge.[5] For practical reasons, including limited Commission resources, I support delegating to exchanges the authority to determine whether a particular position, under the particular facts and circumstances presented, constitutes a bona fide hedge as defined by the Commission. The exchanges are well suited for this role and have decades of experience in making such determinations. However, the initial legal and policy determination of what types of positions constitute bona fide hedges must remain the Commission's responsibility.

The Proposal carries forward all of the bona fide hedges currently enumerated in the Commission's rules, adds several additional categories to the list of enumerated hedges, and opens the door to an unlimited number of additional, undefined non-enumerated exemptions. The Proposal states, ''the proposed enumerated hedges are in no way intended to limit the *universe* of hedging practices which could otherwise be recognized as bona fide.'' [6] The ''universe'' is a very large place indeed.

On the other hand, the Proposal does not address practices that market participants have urged the Commission to recognize as bona fide hedges, including practices currently recognized by the exchanges. The Proposal thus deprives end-users and other market participants of legal certainty regarding what constitutes a bona fide hedge for various practices currently permitted by the exchanges as bona fide hedges.

Rather than determine whether to recognize these practices as bona fide hedges through notice and comment in today's rulemaking, the Proposal contemplates that additional non-enumerated bona fide hedges should first be considered by the exchanges, and then reviewed by the Commission during a cramped 10-day retrospective review period.[7] Determination of what constitutes a bona fide hedge for non-enumerated hedges would begin anew each time that an exchange must decide whether a purported bona fide hedge held by a market participant is consistent with the CEA, and then await the Commission's retrospective review. Market participants should be able to discern whether particular types of practices qualify as bona fide hedging by reading the Commission's rules and regulations rather than by engaging lawyers and lobbyists to guide them through an opaque, non-public process through the halls of the Commission's headquarters in Washington, DC.

The Commission has almost 40 years of experience with exchange implementation of position limits for energy and metals commodities, and more for agricultural commodities. Based on this experience, I support many of the types of bona fide hedges that exchanges recognize in these markets today. However, the Commission should recognize these exemptions in its own rules through prospective, notice and comment rulemaking, not delegate these determinations to the exchanges.

The legal analysis in this Proposal is a convoluted and confusing legal interpretation of the Dodd-Frank Act that defies Congressional intent. It is implausible that in the aftermath of the financial crisis and the run-up to oil at $147 per barrel, Congress made it *more* difficult for the Commission to impose position limits. Yet that is the result of the Commission's revisionist interpretation that a predicate finding of necessity (*i.e.,* that position limits are necessary) is required for the imposition of a position limit for each commodity. Moreover, the Proposal's finding of necessity for the 25 core reference futures contracts subject to the rule is unpersuasive both economically and legally, and is highly unlikely to survive legal challenge. The necessity finding largely consists of general economic statistics about the importance of the physical commodities underlying these futures contracts to commerce, together with statistics about open interest and trading volume in those futures contracts. These statistics bear little rational relationship to why position limits are necessary to prevent excessive speculation in derivative contracts for these commodities. For example, the imposition of limits on cocoa futures is justified on the basis that ''in 2010 the United States exported chocolate and chocolate-type confectionary products worth $799 million to more than 50 countries around the world.'' [8] There is a simpler, more logical, and defensible path forward, as I will outline later in this statement.

I thank the Commission staff for working with my office on the Proposal. Although I am not able to support it as currently formulated, I look forward to working with my colleagues and staff to improve the Proposal so that it effectively protects our markets from excessive speculation and provides end-users and other market participants with the regulatory certainty they need. I encourage market participants to comment on the Proposal.

Additional Flaws in the Proposal

No Phase-In for Large Increase in Speculative Position Limits

The Proposal would generally increase existing federal or exchange spot month position limits for 25 physical delivery agricultural, metals, and energy commodities by a factor of two or more.[9] It would

[2] *See* Proposal at preamble section II(A)(1)(c)(ii)(1). This change comports with amendments to the definition of bona fide hedging in CEA section 4a(c)(2) made by the Dodd-Frank Act.

[3] Proposal at preamble section II(A)(1)(c)(ii)(1).

[4] *See, e.g.,* Ke Tang & Wei Xiong, *Index Investment and Financialization of Commodities,* 68 Financial Analysts Journal 54, 55 (2012); Luciana Juvenal & Ivan Petrella, *Speculation in the Oil Market,* Federal Reserve Bank of St. Louis, Working Paper 2011–027E (June 2012), available at *http://research.stlouisfed.org/wp/2011/2011-027.pdf.*

[5] *See* CEA section 4a(c); 7 U.S.C. 6a(c).

[6] Proposal at preamble section II(A)(1)(c)(i) (emphasis added).

[7] The Proposal would establish two distinct processes for recognition of non-enumerated hedges. One process would be Commission-based, but the Proposal anticipates that this process would rarely, if ever, be used by market participants. *See* Proposal at rule text section 150.3. The other, in proposed § 150.9(e), would require the Commission to retroactively review bona fide hedge exemptions approved by an exchange. *See* Proposal at rule text section 150.9(e). Such review would need to be conducted within business10 days, would involve the five-member Commission itself, and could be stayed for a longer period.

[8] Proposal at preamble section III(F)(3).

[9] *See* Proposal at preamble section I(B).

substantially increase existing federal single month and all months combined limits for the nine legacy agricultural commodities. As examples, spot month limits on ICE's frozen concentrated orange juice contract would increase from 300 to 2,200 contracts, and single month and all months combined limits on CBOT soybean meal would increase from 6,500 to 16,900 contracts.[10] Single month and all months combined limits for CBOT corn would increase to 57,800 contracts.[11] The proposed increases are largely due to increases in deliverable supply, and the new spot and non-spot month limits continue to reflect the Commission's 25% and 10%/2.5% of deliverable supply formulas.

The Proposal does not provide for phasing in the new, higher limits or for otherwise providing a transition period.[12] It presents no analysis of the market's ability to absorb these large increases without disruption, and no analysis of how large new speculative positions may affect the price discovery process.

Large increases in the amounts of speculative activity in individual non-spot months have the potential to disrupt the convergence process and distort market signals regarding storage of commodities. The Proposal provides no analysis of whether these potential price distortions and their attendant detrimental consequences could be avoided by distributing the large increases in the numerical limits across several non-spot months, rather than permit such large positions in individual months. Instead, the Proposal would codify an abrupt increase 365 days after publication of any final rule in the **Federal Register**. A transition period or lower individual spot month limits would give the Commission the time and ability to mitigate any issues that may arise if markets are unable to absorb the higher limits in an orderly manner, and prevent disruption if necessary. It is a prudent measure that the Commission should adopt in any final rule.

2. Absence of Non-Spot Month Limits for Exempt and Certain Agricultural Commodities

I am concerned with the Proposal's failure to adopt federal non-spot limits for 16 energy, metals, and certain agricultural commodities included in the Proposal.[13] CEA section 4a(a)(3) directs that the Commission ''shall set limits'' on positions held not only in the spot month, but also ''each other month'' and ''for all months,'' ''as appropriate.''[14] Despite this directive, the Proposal does not adopt non-spot month limits for these commodities. It includes virtually no analysis of why the Commission believes that non-spot limits are not appropriate.

Exchanges have demonstrated an ability to manage speculation and maintain orderly markets with position accountability in non-spot months. However, experiences such as the collapse of the Amaranth hedge fund in 2006 demonstrate how large trades in the non-spot month can also distort markets, widen spreads, and increase volatility.[15] I believe the exchanges have learned from the Amaranth experience and that position accountability can be an effective tool, where appropriate. The Proposal, however, also fails to demonstrate why accountability levels, rather than numerical limits, are appropriate in light of the statutory directives in the CEA. It provides no discussion of the effect of applying the 10/2.5% formula to the energy and metals contracts covered by the Proposal, and why the application of this traditional formula would not be appropriate. Similarly, there is no analysis regarding the numerical limits that could result from applying the four factors specified in 4a(a)(3), and why such numerical limits would not be appropriate.

3. Definition of Economically Equivalent Swap

The Proposal would define an economically equivalent swap as a swap that ''shares identical material contractual specifications, terms, and conditions with the referenced contract . . . .''[16] The Proposal offers several rationales for this narrow definition that could potentially lend itself to evasion through financial engineering. One such rationale is that it would reduce market participants' ability to net down their speculative positions through swaps that are not materially identical. While this and other rationales proffered in the Proposal have merit, the Commission must also ensure that economically equivalent swaps are not structured in a manner to evade federal or exchange regulation through minor modifications to material terms. I invite public comment on this issue.

4. The Proposal's Necessity Finding Misconstrues the CEA as Amended by the Dodd-Frank Act

The Proposal states that, for any particular commodity, ''prior to imposing position limits, [the Commission] must make a finding that they are necessary.''[17] This is a reversal of prior Commission determinations.[18] Neither the statutory language of CEA section 4a(a)(2), nor the district court's decision in *ISDA* v. *CFTC,* compels this outcome.[19] The Commission should not adopt it.

Title VII of the Dodd-Frank Act amended CEA section 4a and directed in 4a(a)(2)(A) that ''the Commission shall'' establish position limits for agricultural and exempt physical commodities ''as appropriate.''[20] In *ISDA* v. *CFTC,* the district court directed the Commission to resolve a perceived ambiguity in section 4a(a)(2)(A) by bringing the Commission's ''experience and expertise to bear in light of the competing interests at stake . . . .''[21] That experience includes over 80 years of position limits rulemakings, as described below. It provides ample practical and legal bases to determine that Congress intended the Commission to adopt federal position limits for certain commodities pursuant to CEA section 4a(a)(2).

Starting in 1936, and across multiple iterations of the CEA and its predecessors, the CEA has consistently and continuously reflected Congress's finding that excessive speculation in a commodity can cause sudden, unreasonable, and unwarranted movements in commodity prices that are undue burden on interstate commerce.[22] Congress also has declared that ''[f]or the purpose of diminishing, eliminating, or preventing such burden,'' the Commission shall . . . proclaim and fix such [position] limits'' that the Commission finds ''are necessary to diminish, eliminate, or prevent such burden.'' In plain English, Congress has found that excessive speculation is a burden on interstate commerce, and the CFTC is directed to impose position limits that are necessary to prevent that burden. Congress did not direct the Commission to study excessive speculation, to prepare any reports on excessive speculation, or to second-guess Congress's finding that excessive speculation was a problem that needed to be prevented. Rather, Congress directed the Commission to impose position limits that the Commission believed were necessary to accomplish the statutory objectives.

Following the passage of the 1936 Act, the Commission set position limits for grains in 1938, cotton in 1940, and soybeans in 1951. As the Proposal recognizes, in these rulemakings the Commission did not publish any analyses or make any ''necessity finding,'' other than to include a ''recitation'' of the statutory findings regarding the undue

[10] *Id.* Other notable examples include increased spot limits for ICE U.S. Sugar No. 11 (SB) from 5,000 to 25,800 contracts; increased spot month limits for ICE Cotton No. 2 (CT) from 300 to 1,800 contracts; increased single month and all months combined limits for CBOT Soybean Oil (SO) from 8,000 to 17,400 contracts; and increased single month and all months combined limits for ICE Cotton No. 2 (CT) from 5,000 to 11,900 contracts.

[11] *Id.* Although the proposed new limit for CBOT Corn (C) is less than twice the current limit (57,800 contracts proposed versus 33,000 contracts currently), it would still be a significantly larger position limit and the largest single month and all months combined limit in the Proposal.

[12] *See* Proposal at rule text section 150.2 and Appendix E.

[13] *See* Proposal at rule text section 150.5(b)(2), providing for exchange-set position limits or position accountability in non-spot months contracts not subject to federal speculative position limits.

[14] CEA section 4a(a)(3); 7 U.S.C. 6a(a)(3).

[15] *See* Excessive Speculation In the Natural Gas Market, Staff Report with Additional Minority Staff Views, Permanent Subcommittee on Investigations, United States Senate (2007).

[16] Proposal at preamble section (II)(A)(4) and proposed rule text section 150.1.

[17] Proposal at preamble section III(D). The Proposal also states that ''[t]he Commission will therefore determine whether position limits are necessary for a given contract, in light of those premises, considering facts and circumstances and economic factors.'' Proposal at preamble section III(F)(1).

[18] The Proposal acknowledges ''this approach differs from that taken in earlier necessity findings.'' Proposal at preamble section III(F)(1). Specifically, the Proposal identifies different approaches taken in position limit rulemaking undertaken by the Commission's predecessor agency, the Commodity Exchange Commission (''CEC'') from 1938 through 1951, the Commission's 1981 rulemaking that required exchanges to impose position limits for each contract not already subject to a federal limit, and the proposed rulemakings in 2013 and 2016. *Id.*

[19] *Int'l Swaps and Derivatives Ass'n (''ISDA'')* v. *CFTC,* 887 F. Supp. 2d 259 (D.D.C. 2012).

[20] CEA section 4a(a)(2)(A); 7 U.S.C. 6a(a)(2)(A).

[21] *ISDA,* 887 F. Supp. 2d at 281.

[22] Commodity Exchange Act of 1936, P.O. 76–675, 49 Stat. 1491 section 5.

burdens on commerce that can be caused by excessively large positions. These rulemakings then set numerical limits on the amounts of commodity futures contracts that could be held.

Court decisions from the 1950s through the 1970s in cases involving the application of the position limits rules reflect a common-sense reading: The statute mandates that the Commission establish position limits, while providing the Commission with discretion as to how to craft those limits. In *Corn Refining Products* v. *Benson,* [23] defendants challenged the suspension by the Secretary of Agriculture of their trading privileges on the Chicago Board of Trade for violating position limits in corn futures on the grounds that the statutory prohibition only applied to speculative positions. The U.S. Court of Appeals for the Second Circuit denied the appeal, stating in part:

The discretionary powers of the Commission and the exemptions from the 'trading limits' established under the Act are carefully delineated in [section] 4a. The Commission is given discretionary power to prescribe '* * * different trading limits for different commodities, markets futures, or delivery months, or different trading limits for the purposes of buying and selling operations, or different limits for the purposes of subparagraphs (A) (*i.e.,* with respect to trading during one business day) and (B) (*i.e.,* with respect to the net long or net short position held at any one time) of this section * * *'. . . .

Although [section] 4a expresses an intention to curb 'excessive speculation,' we think that the unequivocal reference to 'trading,' coupled with a specific and well-defined exemption for bona-fide hedging, *clearly indicates that all trading in commodity futures was intended to be subject to trading limits unless within the terms of the exemptions.* [24]

In *United States* v. *Cohen,*[25] the defendant challenged his criminal conviction for violating CEC trading limits in potato futures contracts. In upholding the conviction, the court of appeals stated that ''[t]rading in potato futures, as for other commodities, is limited by statute and by regulations issued by the Commission. *The statute here requires the Commission to fix a trading limit* . . . .'' [26] The court of appeals further observed: ''*Congress expressed in the statute a clear intention to eliminate excessive futures trading that can cause sudden or unreasonable fluctuations.*'' [27]

In *CFTC* v. *Hunt,* [28] the Hunt brothers challenged the validity of the agency's position limit on soybeans of three million bushels on the basis that the agency ''made no analysis of the relationship between the size of soybean price changes and the size of the change in the net position of large traders. They argue[d] that there is no direct relationship between these phenomena, and, therefore, the regulation limiting the positions and the trading of the large soybean traders is unreasonable.'' [29] Fundamentally, the Hunts alleged that the agency failed to demonstrate that the limits were a reasonable means—or, alternatively put, ''necessary''—to prevent unwarranted price fluctuations in soybeans. ''The essence of the Hunts' attack on the validity of the regulation is their substantive contention that there is no connection between large scale speculation by individual traders and fluctuations in the soybean trading market.'' [30]

The U.S. Court of Appeals for the Seventh Circuit denied the Hunt brothers' challenge. It held, ''[t]he Commodity Exchange Authority, *operating under an express congressional mandate to formulate limits on trading in order to forestall the evils of large scale speculation,* was deciding on whether to raise its then existing limit on soybeans. . . . There is ample evidence in the record to support the regulation.'' [31]

The *Hunt* case also illustrates the difference between the requirement for a predicate finding of necessity and the requirement that the Commission's rulemakings be supported by sufficient evidence. Under the Administrative Procedure Act (''APA''), the Commission's regulations must not be ''arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.'' [32] To make this finding, ''the court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment.'' [33]

In 1981, following the silver crisis of 1979–1980, the Commission adopted a seminal final rule requiring exchanges to establish position limits for *all* commodities that did not have federal limits.[34] In the final rulemaking, the Commission determined that predicate findings are not necessary in position limits rulemakings. It affirmed its long-standing statutory mandate going back to 1936: ''Section 4a(1) represents an express Congressional finding that excessive speculation is harmful to the market, and a finding that speculative limits are an effective prophylactic measure.'' [35] The 1981 final rule found that ''speculative position limits are appropriate for all contract markets irrespective of the characteristics of the underlying market.'' [36] It required exchanges to adopt position limits for all listed contracts, and it did so based on statutory language that is nearly identical to CEA section 4a(a)(1).[37]

In the 1981 rulemaking, the Commission also responded to comments that the Commission had failed to ''demonstrate[ ] that position limits provided necessary market protection,'' or were appropriate for futures markets in ''international soft'' commodities, such as coffee, sugar, and cocoa. The Commission rejected comments that it was required to make predicate necessity findings for particular commodities. The Commission stated:

The Commission believes that the observations concerning the general desirability of limits are contrary to Congressional findings in sections 3 and 4a of the Act and considerable years of Federal and contract market regulatory experience. . . .

* * *

As stated in the proposal, the prevention of large and/or abrupt price movements which are attributable to extraordinarily large speculative positions is a Congressionally endorsed regulatory objective of the Commission. Further, it is the Commission's view that this objective is enhanced by speculative limits since it appears 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.[38]

In the ''Legal Matters'' section of the preamble, the Proposal would jettison the interpretation that has prevailed over the past four decades as the basis for the Commission's position limits regime. Relying on a non sequitur incorporating a double negative, the Preamble brushes off nearly forty years of Commission jurisprudence:

[B]ecause the Commission has preliminarily determined that section 4a(a)(2) does not mandate federal speculative limits for all commodities, it cannot be that federal position limits are 'necessary' for all physical commodities, within the meaning of section 4a(a)(1), on the basis of a property shared by all of them, *i.e.,* a limited capacity to absorb the establishment and liquidation of large speculative positions in an orderly fashion.[39]

[23] 232 F.2d 554 (2d Cir. 1956).

[24] *Id.* at 560 (emphasis added).

[25] 448 F.2d 1224 (2d Cir. 1971).

[26] *Id.* at 1225–6 (emphasis added).

[27] *Id.* at 1227 (emphasis added).

[28] 591 F.2d 1211 (7th Cir. 1979).

[29] *Id.* at 1216.

[30] *Id.*

[31] *Id.* at 1218 (emphasis added).

[32] 5 U.S.C. 706(2)(A).

[33] *Hunt,* 591 F.2d at 1216. In the proposed regulation increasing the speculative position limits for soybeans from 2 million to 3 million bushels, the Commission's predecessor, the Commodity Exchange Authority (''Authority''), did not make a soybean-specific finding that the limit of three million bushels was necessary to prevent undue burdens on commerce. Rather, the Authority relied on its 1938 and 1951 position limit rulemakings for the general principle that ''the larger the net trades by large speculators, the more certain it becomes that prices will respond directly to trading.'' Corn and Soybeans, Limits on Position and Daily Trading for Future Delivery, 36 FR 1340 (Jan. 28, 1971). The Authority then stated that its analysis of speculative trading between 1966 and 1969 ''did not show that undue price fluctuations resulted from speculative trading as the trading by individual traders grew larger.'' *Id.* Following a public hearing, the Authority adopted the proposed increase. *See* 36 FR 12163 (June 26, 1971). For the past *82 years,* the Commission has relied on this general principle to justify its position limits regime.

[34] During the silver crisis, the Hunt brothers and others attempted to corner the silver market through large physical and futures positions. The price of silver rose more than five-fold from August 1979 to January 1980.

[35] *See* Establishment of Speculative Positon Limits, 46 FR 50938, 50940 (Oct. 16, 1981) (''1981 Position Limits Rule'').

[36] 1981 Position Limits Rule at 50941.

[37] In the proposed regulation, the Commission noted that as of April 1975, position limits were in effect for ''almost all'' actively traded commodities then under regulation. Speculative Position Limits, 45 FR 79831, 79832 (Dec. 2, 1980).

[38] 1981 Position Limits Rule at 50940.

[39] Proposal at preamble section III(F)(1).

In 2010, Congress enacted Title VII of the Dodd-Frank Act and amended CEA section 4a by directing the Commission to establish speculative position limits for agricultural and exempt commodities and economically equivalent swaps.[40] Congress also set forth criteria for the Commission to consider in establishing limits, including diminishing, eliminating, or preventing excessive speculation; deterring and preventing market manipulation; ensuring sufficient liquidity for bona fide hedgers; and ensuring that price discovery in the underlying market is not disrupted.[41] Congress directed the Commission to establish the required speculative limits within tight deadlines of 180 days for exempt commodities and 270 days for agricultural commodities.

It defies history and common sense to assert that the amendments to section 4a enacted by Congress in the Dodd-Frank Act made it more difficult for the Commission to impose position limits, such as by requiring predicate necessity findings on a commodity-by-commodity basis. This is particularly true given Congress's repeated use of mandatory words like ''shall'' and ''required'' and the tight timeframe to respond to the new Congressional directives. In light of the run up in the price of oil and the financial crisis that precipitated the legislation, it is unreasonable to interpret the Dodd-Frank amendments as creating new obstacles for the Commission to establish position limits for oil, natural gas, and other commodities whose significant price fluctuations had caused economic harm to consumers and businesses across the nation. The Commission's interpretation is revisionist history.

The Commission's necessity finding that follows its legal analysis is sure to persuade no one. Unless substantially modified in the final rulemaking, it will likely doom this regulation as ''arbitrary, capricious, or an abuse of discretion'' under the APA. The necessity finding for the 25 core referenced futures contracts selected for this rulemaking boils down to simplistic assertions that the futures contracts and economically equivalent swaps for these contracts ''are large and critically important to the underlying cash markets.''[42] As part of the necessity finding for these 25 commodities, the Proposal presents general economic measures, such as production, trade, and manufacturing statistics, to illustrate the importance of these commodities to interstate commerce, and therefore for the need for position limits. On the other hand, the Proposal fails to present any rational reason as to why the economic trade, production, and value statistics for commodities other than the 25 core referenced futures contracts are insufficient to support a similar finding that position limits are necessary for futures contracts in those other commodities.

For example, the Proposal justifies the exclusion of aluminum, lead, random length lumber, and ethanol as examples of contracts for which a necessity finding was not made on the basis that the open interest in these contracts is less than the open interest in the oat futures contracts. This comparison has no basis in rationality. The need for position limits for commodity futures contracts in aluminum, lead, lumber, and ethanol is not in any way rationally related to the open interest in those commodity futures contracts relative to the open interest in oat futures. The Proposal is rife with other such illogical statements.

Fundamentally, general economic measures of commodity production, trade, and value are irrelevant with respect to the need for position limits to prevent excessive speculation. The Congress has found that position limits are an effective prophylactic tool to prevent excessive speculation for all commodities. The Congressional findings in CEA section 4a regarding the need for position limits are not limited to only the most important or the largest commodity markets. General economic data regarding a commodity in interstate commerce is irrelevant to the need for position limits for futures contracts for that commodity.

The collapse of the Amaranth hedge fund in 2006 is another strong example of why a position limits regime is necessary to prevent excessive speculation, in this case in non-spot months. Amaranth was a large speculative hedge fund that at one point held some 100,000 natural gas contracts, or approximately 5% of all natural gas used in the U.S. in a year. As the Commission has explained in other position limits proposals since 2011, the collapse of Amaranth was a factor in the Dodd-Frank's amendments to CEA section 4a.

The Commission has ample practical experience and legal precedent to resolve the perceived ambiguity in CEA section 4a(a)(2) as instructed by the district court in *ISDA* v. *CFTC* without making the antecedent necessity finding now incorporated in the Proposal. Our remaining task is to design the overall position limits framework, including determining the appropriate limit levels, defining bona fide hedges through prospective rulemaking, and appropriately considering other options such as position accountability and exchange-set limits.

Conclusion

In CEA section 4a, Congress directed the Commission to establish position limits and appropriate hedge exemptions to prevent the undue burdens on interstate commerce that result from excessive speculation. Congress has also entrusted to the Commission's discretion the appropriate regulatory tools to meet this mandate. Congress' overarching policy directive for position limits is straightforward and has been remarkably consistent for 84 years. The Commission has had ten years, three prior proposals, one supplemental proposal, and hundreds of pages of comment letters to define bona fide hedge exemptions. Now is the time to finish the job, and to do it the right way.

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[40] *See* CEA section 4a(a)(2); 7 U.S.C. 6a(a)(2); CEA section 4a(a)(5); 7 U.S.C. 6a(a)(5).

[41] *See* CEA section 4a(a)(3); 7 U.S.C. 6a(a)(3).

[42] Proposal at preamble section III(F)(2).