COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 150 and 151

RIN: 3038-AD17

POSITION LIMITS for FUTURES AND SWAPS

AGENCY: Commodity Futures Trading Commission

ACTION: Final Rule

SUMMARY: On January 26, 2011 the Commodity Futures Trading Commission ("Commission" or "CFTC") published in the Federal Register a notice of proposed rulemaking ("proposal" or "Proposed Rules"), which establishes a position limits regime for 28 exempt and agricultural commodity futures and options contracts and the physical commodity swaps that are economically equivalent to such contracts. The Commission is adopting the Proposed Rules, with modifications.

DATES: Effective date is [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Compliance dates for these final rules are discussed below.

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SUPPLEMENTARY INFORMATION:

I. BACKGROUND

A. Introduction

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1] Title VII of the Dodd-Frank Act[2] amended the Commodity Exchange Act ("CEA")[3] to establish a comprehensive new regulatory framework for swaps and security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating robust recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission's oversight.

As amended by the Dodd-Frank Act, section 4a(a)(2) of the CEA mandates that the Commission establish position limits for futures and options contracts traded on a designated contract market ("DCM") within 180 days from the date of enactment for exempt commodities and 270 days from the date of enactment for agricultural commodities.[4] Under section 4a(a)(5),

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1 See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at http://www.cftc.gov/LawRegulation/DoddFrankAct/index.htm.

2 Pursuant to section 701 of the Dodd-Frank Act, Title VII may be cited as the "Wall Street Transparency and Accountability Act of 2010."

3 7 U.S.C. 1 et seq.

4 Section 1a(20) of the CEA defines the term "exempt commodity" to mean a commodity that is not an excluded or an agricultural commodity. 7 U.S.C. 1a(20). Section 1a(19) defines the term "excluded commodity" to mean, among other things, an interest rate, exchange rate, currency, credit risk or measure, debt or equity instrument, measure of inflation, or other macroeconomic index or measure. 7 U.S.C. 1a(19). Although the CEA does not specifically define the term "agricultural commodity," section 1a(9) of the CEA, 7 U.S.C. 1a(9), enumerates a non-exclusive list of agricultural commodities, and the Commission recently added section 1.3(zz) to the Commission's regulations defining the term "agricultural commodity." See 76 FR 41048, Jul. 13, 2011.

Congress required the Commission to concurrently establish limits for swaps that are economically equivalent to such futures or options contracts traded on a DCM. In addition, the Commission must establish aggregate position limits for contracts based on the same underlying commodity that include, in addition to the futures and options contracts: (1) contracts listed by DCMs; (2) swaps that are not traded on a registered entity but which are determined to perform or affect a "significant price discovery function"; and (3) foreign board of trade ("FBOT") contracts that are price-linked to a DCM or swap execution facility ("SEF") contract and made available for trading on the FBOT by direct access from within the United States.

To implement the expanded mandate under the Dodd-Frank Act, the Commission issued Proposed Rules that would establish federal position limits and limit formulas for 28 physical commodity futures and option contracts ("Core Referenced Futures Contracts") and physical commodity swaps that are economically equivalent to such contracts (collectively, "Referenced Contracts").[5] The Commission also proposed aggregate position limits that would apply across different trading venues to contracts based on the same underlying commodity. In addition to developing position limits for the Referenced Contracts, the Proposed Rules would implement a new statutory definition of bona fide hedging transactions, revise the standards for aggregation of positions, and establish position visibility reporting requirements. The Proposed Rules would require DCMs and SEFs that are trading facilities to set position limits for exempt and agricultural commodity contracts and establish acceptable practices for position limits and position accountability rules in other commodities.

B. Overview of Public Comments

[5] See Position Limits for Derivatives, 76 FR 4752, 4753 Jan. 26, 2011. Specifically, the Commission proposed to withdraw its part 150 regulations, which set out the current position limit and aggregation policies, and replace them with new part 151 regulations.

The Commission received 15,116 comments from a broad range of the industry and other interested persons, including DCMs, trade organizations, banks, investment companies, commercial end-users, academics, and the general public. Of the total comments received, approximately 100 comment letters provided detailed comments and recommendations concerning whether, and how, the Commission should exercise its authority to set position limits pursuant to amended section 4a, as well as other specific aspects of the proposal. The majority of the over 15,000 comment letters received were generally supportive of the proposal. Many urged the Commission promptly to "restore balance to commodities markets."[6] On the other hand, approximately 55 commenters requested that the Commission either significantly alter or withdraw the proposal. The Commission considered all of the comments received in formulating the final regulations.

II. THE FINAL RULES

A. Statutory Framework

In the proposal, the Commission provided general background on the scope of its statutory authority under section 4a (as amended by the Dodd-Frank Act), together with the related legislative history, in support of the Proposed Rules.[7] Many commenters responded with their views and interpretations of the Commission's mandate under the CEA, and in particular whether the Commission must first make findings that position limits are "necessary" to

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[6] See e.g., Letter from Professor Greenberger, University of Maryland School of Law on March 28, 2011 ("CL-Prof. Greenberger") at 6-7; and Petroleum Marketers Association of America ("PMAA") and New England Fuel Institute ("NEFI") on March 28, 2011 ("CL-PMAA/NEFI") at 5. Also, over 6,000 comment letters urged the Commission to "act quickly" to adopt position limits.

[7] A more detailed background on the statutory and legislative history is provided in the proposal. See 76 FR at 4753-4755.

diminish, eliminate, or prevent undue burdens on interstate commerce resulting from excessive speculation before imposing them.[8]

As discussed in the proposal, CEA section 4a states that "excessive speculation" in any commodity traded on a futures exchange "causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity is an undue and unnecessary burden on interstate commerce" and directs the Commission to establish such limits on trading "as the Commission finds necessary to diminish, eliminate, or prevent such burden."[9] This basic statutory mandate has remained unchanged since its original enactment in 1936 and through subsequent amendments to section 4a, including the Dodd-Frank Act.[10]

In section 737 of the Dodd-Frank Act, Congress made major changes to CEA section 4a; among other things, Congress extended the Commission's reach to the heretofore unregulated swaps market.[11] In doing so, Congress reinforced and reaffirmed the Commission's broad

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8 See e.g., CME Group, Inc. ("CME I") on March 28, 2011 ("CL-CME I") at 4, 7.

9 See section 4a(a)(1) of the CEA, 7 U.S.C. 6a(a)(1).

10 As further detailed in the Proposed Rules, this long-standing statutory mandate is based on Congressional findings that market disruptions can result from excessive speculative trading. In the 1920s and into the 1930s, a series of studies and reports found that large speculative positions in the futures markets for grain, even without manipulative intent, can cause "disturbances" and "wild and erratic" price fluctuations. To address such market disturbances, Congress was urged to adopt position limits to restrict speculative trading notwithstanding the absence of manipulation. In 1936, based upon such reports and testimony, Congress provided the Commodity Exchange Authority (the predecessor of the Commission) with the authority to impose Federal speculative position limits. In doing so, Congress expressly observed the potential for market disruptions resulting from excessive speculative trading alone and the need for measures to prevent or minimize such occurrences. This mandate and underlying Congressional determination of its need has been re-affirmed through successive amendments to the CEA. See 76 FR at 4754-55.

11 In particular, Congress expanded the scope of transactions that could be subject to position limits to include swaps traded on a DCM or SEF, and swaps not traded on a DCM or SEF, but that perform or affect a significant price discovery function with respect to registered entities. See section 4a(a)(1) of the CEA, 7 U.S.C. 6a(a)(1). Congress also directed the Commission to establish aggregate limits on the amount of positions held in the same underlying commodity across markets for DCM contracts, FBOTs (with respect to certain linked contracts) and swaps that perform a "significant price discovery function." section 4a(a)(6) of the CEA, 7 U.S.C. 6a(a)(6).

authority to set position limits to prevent undue and unnecessary burdens associated with excessive speculation. Specifically, section 4a, as amended by the Dodd-Frank Act, provides that the Commission "shall" set position limits "as appropriate" and "to the maximum extent practicable, in its discretion" in order to protect against excessive speculation and manipulation while ensuring that the markets retain sufficient liquidity for bona fide hedgers and that their price discovery functions are not disrupted.[12] Further, the Dodd-Frank Act amended the CEA to direct the Commission to define the relevant factors to be considered in identifying swaps that serve a "significant price discovery" function and thus become subject to position limits.[13] Congress also authorized the Commission to exempt persons or transactions "conditionally or unconditionally" from position limits.[14]

In reaffirming the Commission's broad authority to set position limits, Congress also made clear that the Commission must impose them expeditiously. Under amended section 4a(a)(2), Congress directed that the Commission "shall" establish limits on the amount of positions, as appropriate, that may be held by any person in physical commodity futures and options contracts traded on a DCM. In section 4a(a)(5), Congress directed the Commission to establish, concurrently with the limits established under section 4a(a)(2), limits on the amount of positions, as appropriate, that may be held by any person with respect to swaps that are economically equivalent to the DCM contracts subject to the required limits under section

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12 See sections 4a(a)(3) to 4a(a)(5) of the CEA, 7 U.S.C. 6a(a)(3) to 6a(a)(5). Additionally, new section 4a(a)(2)(c) states that, in establishing limits, the Commission "shall strive to ensure" that FBOTs trading in the same commodity will be subject to "comparable" limits and that any limits imposed by the Commission will not cause the price discovery in the commodity to shift to FBOTs.

13 See section 4a(a)(4) of the CEA, 7 U.S.C. 6a(a)(4).

14 See section 4a(a)(7) of the CEA, 7 U.S.C. 6a(a)(7).

4a(a)(2). The Commission was directed to establish the limits within 180 days after enactment for exempt commodities and 270 days after enactment for agricultural commodities.

As discussed in the proposal, the Commission construes the amended CEA to mandate the Commission to impose position limits at the level it determines to be appropriate to diminish, eliminate, or prevent excessive speculation and market manipulation.[15] In setting such limits, the Commission is not required to find that an undue burden on interstate commerce resulting from excessive speculation exists or is likely to occur. Nor is the Commission required to make an affirmative finding that position limits are necessary to prevent sudden or unreasonable fluctuations in prices. Instead, the Commission must set position limits prophylactically, according to Congress' mandate in section 4a(a)(2), and, in establishing the limits Congress has required, exercise its discretion to set a limit that, to the maximum extent practicable, will, among other things, "diminish, eliminate, or prevent excessive speculation."[16]

Commenters were divided on the scope of the Commission's authority under CEA section 4a. A number of commenters supported the view that the Dodd-Frank Act, in extending the Commission's authority to swaps, imposed on the Commission a mandatory obligation to impose position limits.[17] For example, Professor Michael Greenberger stated that "[s]ection 737 emphatically provides that 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[.]' The language could not be clearer. The Commission is required to establish

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15 See 76 FR at 4754.

16 Section 4a(a)(3)(B)(i) of the CEA, 7 U.S.C. 6a(a)(3)(B)(i).

17 See e.g., American Public Gas Association ("APGA") on March 28, 2011 ("CL-APGA") at 2-3; Americans for Financial Reform ("AFR") on March 28, 2011 ("CL-AFR") at 5; U.S. Senator Harkin on December 15, 2010 ("CL-Sen. Harkin"). See also CL-PMAA/NEFI supra note 6 at 4-5.

position limits as Congress intentionally used the word, 'shall,' to impose the mandatory obligation."[18] Professor Greenberger further noted, "the plain reading of the phrase 'as appropriate' modifies only those position limits mandated to be imposed, i.e., the mandatory position limits must be promulgated 'as appropriate.' The term 'as appropriate' does not modify the heavily emphasized mandate that there 'shall' be position limits."[19]

Other commenters expressed similar views, asserting that the Commission is not required to demonstrate price fluctuations caused by excessive speculation or the efficacy of position limits in reducing excessive speculation or market manipulation. The Petroleum Marketers Association of America and the New England Fuel Institute ("PMAA/NEFI") in a joint comment letter argued, for example, that

> the purpose of position limits is not to punish past wrongdoing, but rather to deter and prevent potential future dysfunctions in the commodity staples derivatives markets and to prevent harm to market participants and burdens on interstate commerce. Because the purpose of position limits is to prevent future violations, the Commission should not be required to appreciate the complete and precise level of excessive speculation prior to taking action."[20]

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[18] CL-Prof. Greenberger supra note 6 at 4 (emphasis added).

[19] Id. at 5. In addition, Professor Greenberger noted that

> Section 719 of the Dodd-Frank Act specifically requires the Commission 'to conduct a study of the effects of the position limits imposed pursuant to the other provisions of this title on excessive speculation and on the movement of transactions.' The Commission is required to submit the report 'within 12 months after the imposition of position limits pursuant to the other provisions of this title.' Why would Congress specifically require the Commission to submit a report after imposing position limits if it had provided by statute (as opponents of position limits mistakenly argue) that the data must be available before the position limit rule is finally promulgated? The short answer is that Congress clearly understood the imminent danger excessive speculation and passive betting on price direction had caused by uncontrollable increases in the prices of energy and agricultural commodities. Therefore, the Commission is statutorily obligated to impose the 'appropriate' position limits.

Id. at 6-7.

[20] CL-PMAA/NEFI *supra* note 6 at 5. See also Delta Airlines, Inc. ("Delta") on March 28, 2011 ("CL-Delta") at 11. Delta believes that the Commission should instead strive to establish meaningful speculative position limits using sampling and other statistical techniques to make reasonable, working assumptions about positions in various market segments and refining the speculative limits based upon market experience and better data as it is developed. See also CL-Sen. Harkin supra note 17 at 1(opposing any delay in the implementation of position

On the other hand, numerous commenters posited that the Commission did not adequately demonstrate, or perform sufficient analysis establishing, the need for or appropriateness of the proposed limits and related requirements.[21] For example, according to the CME Group, Inc. ("CME"),

> the CEA sets up a two-pronged approach for imposing limits on speculative positions. First, [under CEA section 4a(a)(1)] the Commission must 'find' that any position limits are 'necessary' – a directive that Congress reaffirmed in [the Dodd-Frank Act]. Second, once the Commission makes the 'necessary' finding, [CEA sections 4a(a)(2)(A) and 4a(a)(3) provide that the Commission] must establish a particular position limit regime only 'as appropriate' – a statutory requirement added by Dodd-Frank."[22]

In this connection, CME and many other commenters asserted that because the Commission did not make a finding that position limits are necessary to prevent undue burdens on interstate commerce resulting from excessive speculation, it did not satisfy the pre-condition to establishing position limits.

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limits); and 56 National coalitions and organizations and 28 International coalitions and organizations from 16 countries ("ICPO") on March 28, 2011 ("CL-ICPO") at 1 (stating that the proposal regarding position limits should be implemented fully).

[21] See e.g., CL-CME I supra note 8; Commodity Markets Council ("CMC") on March 28, 2011 ("CL-CMC"); PIMCO on March 28, 2011 ("CL-PIMCO"); Edison Electric Institute ("EEI") and Electric Power Supply Association ("EPSA") on March 28, 2011 ("CL-EEI/EPSA"); BlackRock, Inc. ("BlackRock") on March 28, 2011 ("CL-BlackRock"); International Working Group on Trade-Finance Linkages ("IWGTFL") on March 28, 2011("CL-IWGTFL"); Coalition of Physical Energy Companies ("COPE") on March 28, 2011 ("CL-COPE"); Utility Group on March 28, 2011 ("CL-Utility Group");ISDA/SIFMA on March 28, 2011 ("CL-ISDA/SIFMA"); Futures Industry Association ("FIA I") on March 25, 2011 ("CL-FIA I"); Katten Muchin Rosenman LLP ("Katten") on March 31, 2011 ("CL-Katten"); Colorado Public Employees' Retirement ("PERA") on March28, 2011 ("CL-PERA"); American Petroleum Institute ("API") on March 28, 2011 ("CL-API"); Sullivan & Cromwell LLP ("Centaurus Energy") on March 28, 2011 ("CL-Centaurus Energy"); ICI on March 28, 2011 ("CL-ICI"); Morgan Stanley on March 28, 2011 ("CL-Morgan Stanley"); Asset Management Group ("AMG"), Securities Industry and Financial Markets Association ("SIFMA") on April 5, 2011("CL-SIFMA AMG I"); World Gold Council ("WGC") on March 28, 2011 ("CL-WGC"); and Managed Funds Association ("MFA") on March 28, 2011 ("CL-MFA").

[22] CME argued the Commission's interpretation of section 4a(a)(1) of the CEA would render the "as the Commission finds are necessary" language a nullity, effectively replacing it with statutory language imposing a lower threshold than is found elsewhere in the CEA. See CL-CME I supra note 8 at 3, citing Keene Corp. v. United States, 508 U.S. 200, 208 (1993) ("where Congress includes particular language in one section of a statute but omits it in another . . . , it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion" quoting Russello v. United States, 464 U.S. 16, 23 (1983).

Some of these commenters, such as the International Swaps and Derivatives Association and the Securities Industry and Financial Markets Association ("ISDA/SIFMA") (in a joint comment letter) and the Futures Industry Association ("FIA"), argued that the Commission is directed to set position limits "as appropriate," and "as appropriate" requires empirical evidence demonstrating that such limits would diminish, eliminate, or prevent excessive speculation. FIA claimed that in the absence of evidence concerning the impact of excessive speculation, it would be impossible to set position limits that comply with the statutory objectives of section 4a(a)(3). Similarly, Centaurus Energy Master Fund, LP ("Centaurus") and ISDA/SIFMA commented that the "as appropriate" language in section 4a(a)(2)(A) requires factual support before imposing position limits, and that "the imposition of position limits 'prophylactically' is not mandated by Dodd-Frank and is not supported by the facts."[23]

CME also contended that imposing position limits on "economically equivalent swaps" would be counter to Dodd-Frank because it will encourage market participants to enter into bespoke, uncleared, non-DCM or SEF-traded swaps.[24] Finally, CME and other commenters, suggested that position limits and position accountability levels should be set and administered by futures exchanges.

Upon careful consideration of the commenters' views, the Commission reaffirms its interpretation of amended section 4a. The Commission disagrees that it must first determine that position limits are necessary before imposing them or that it may set limits only after it has

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[23] CL-ISDA/SIFMA, supra note 21 at 3; and CL-Centaurus Energy, supra note 21 at 2. See also CL-COPE supra note 21 at 2-3; and CL-Utility Group supra note 21 at 3. Along similar lines, COPE and the Utility Group opined that "the deadline of 180 days after the date of enactment in clause (B)(i) is only triggered upon a determination that such limits are appropriate. Congress unambiguously modified the word 'shall' with the requirement that limits only be established 'as appropriate." Id.

[24] CL-CME I, supra note 8 at 11.

conducted a complete study of the swaps market. Congress did not give the Commission a choice. Congress directed the Commission to impose position limits and to do so expeditiously.[25] Section 4a(a)(2)(B) states that the limits for physical commodity futures and options contracts "shall" be established within the specified timeframes, and section 4a(a)(2)(5) states that the limits for economically equivalent swaps "shall" be established concurrently with the limits required by section 4a(a)(2). The congressional directive that the Commission set position limits is further reflected in the repeated references to the limits "required" under section 4a(a)(2)(A).[26] Section 4a(a)(6) similarly states, without qualification, that the Commission "shall" establish aggregate position limits.[27] While some commenters seize on the phrase "as appropriate," which appears in sections 4a(a)(2)(A), 4a(a)(3), and 4a(a)(5), that phrase, when considered in the context of the position limits provisions as a whole, is most sensibly read as directing the Commission to exercise its discretion in determining the extent of the limits that Congress required the Commission to impose.[28]

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[25] See also CL-Sen. Harkin, supra note 17 at 1 (opposing any delay in the implementation of position limits); and CL-ICPO, supra note 20 at 1 (stating that the Proposed Rules regarding position limits should be implemented fully).

[26] See sections 4a(a)(2)(B)(i)-(ii), 4a(a)(2)(C), and 4a(a)(3) of the CEA, 7 U.S.C. 6a(a)(2)(B)(i)-(ii), 6a(a)(2)(C), 6a(a)(3).

[27] Section 4a(a)(6) of the CEA directs the Commission to impose aggregate limits for contracts based on the same underlying commodity across: (a) DCM contracts, (b) FBOT contracts offered via direct access from inside the United States that are linked to contracts listed on a registered entity; and (c) swap contracts that perform or affect a significant price discovery function ("SPDF") with respect to registered entities. 7 U.S.C. 6a(a)(6). Although the scope of SPDF swaps is currently limited to economically equivalent swaps discussed herein, the Commission intends to address in a subsequent rulemaking, as was discussed in the proposal, a process by which SPDF swaps can be identified. See Position Limits for Derivatives, 76 FR 4752, 4753, Jan. 26, 2011.

[28] Section 719 of the Dodd-Frank Act requires the Commission to submit a report on the effects of the position limits imposed pursuant to the other provisions of this title. Such a provision gives further support to the Commission's view that Congress mandated that the Commission impose position limits, setting levels as appropriate, because the reporting requirement presupposes that limits will be imposed. Congress did not intend the Commission to have to demonstrate that such limits are "necessary" or that position limits in general are "appropriate" before imposing them and reporting on their operation. See also CL-Prof. Greenberger supra note 6 at 6-7.

In accordance with the statutory mandate, the Commission has established position limits and has exercised its discretion to set position limit levels to further the congressional objectives set out in section 4a(a)(3)(B) based upon the Commission's experience with existing position limits.[29] In adding section 4a(a)(3)(B), Congress reaffirmed the Commission's broad discretion to fix position limit levels (and to adopt related requirements) aimed at combating excessive speculation and market manipulation, while also protecting market liquidity (for bona fide hedgers) and price discovery. The provision reflects the Commission's historical approach to setting position limits, and it is consistent with the longstanding congressional directive in section 4a(a)(1) that the Commission set position limits in its discretion to prevent or minimize burdens that could result from excessive speculative trading.[30]

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[29] The Commission has applied those limits to specified Referenced Contracts based on their high levels of open interest and significant notional value or their capacity to serve as a reference price for a significant number of cash market transactions.

[30] Consistent with the congressional findings and objectives, the Commission has previously set position limits without finding excessive speculation or an undue burden on interstate commerce, and in so doing has expressly stated that such additional determinations by the Commission were not necessary in light of the congressional findings in section 4a of the Act. In its 1981 rulemaking to require all exchanges to adopt position limits for commodities for which the Commission itself had not established limits, the Commission stated, in response to similar comments that it had not made any factual determinations that excessive speculation had occurred or analytically demonstrated that the proposed limits were necessary to prevent excessive speculation in the future:

> [T]he prevention of large or abrupt price movements which are attributable to the 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 the speculative position limits since it appears that the capacity of any contract 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.

Establishment of Speculative Position Limits, 46 FR 50938, Oct. 16, 1981 (adopting then § 1.61 (now part of § 150.5)). The Commission reiterated this point in the proposed rulemaking in early 2010, before enactment of the Dodd-Frank Act. Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 FR 4144, at 4146, 4148-49, Jan. 26, 2010 ("[t] he Congressional endorsement [in section 4a] of the Commission's prophylactic use of position limits rendered unnecessary a specific finding that an undue burden on interstate commerce had actually occurred" because section 4a(a) represents an explicit Congressional finding that extreme or abrupt price fluctuations attributable to unchecked speculative positions are harmful to the futures markets and that position limits can be an effective prophylactic regulatory tool to diminish, eliminate or prevent

In sum, the contention that the Commission is required to demonstrate that position limits (or position limit levels) are necessary is contrary not only to the language of, and congressional objectives underlying, amended section 4a, but also to the regulatory history of position limits and to the choices Congress made in the Dodd-Frank Act in light of that history.[31]

For the reasons stated above, and for the reasons provided in the proposal, the Commission finds that it has authority under CEA section 4a, as amended by the Dodd-Frank Act, to impose the position limits herein.[32]

B. Referenced Contracts

The Commission identified 28 Core Referenced Futures Contracts and proposed to apply aggregate limits on a futures equivalent basis across all derivatives that are (i) directly or indirectly linked to the price of a Core Referenced Futures Contract; or (ii) based on the price of

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such activity"); withdrawn, 75 FR 50950, Aug. 18, 2010. During the consideration of the Dodd-Frank Act—as well as in the nearly three decades since the Commission issued its interpretation of section 4a in 1981—Congress was aware of the Commission's longstanding approach to position limits, including its interpretation that the Commission is not required to make a predicate finding prior to establishing limits. Congress did not disturb the language under which the Commission previously acted to impose position limits, and added new language that makes clear that the types of limits described in sections 4a(a)(2), (a)(5), and (a)(6) are required.

[31] The Commission also notes that Congress has reauthorized the Commission several times, both before and after the Commission established a position limit regime, without making a finding that position limits were "necessary" to combat excessive speculation. In this regard, Congress was aware of the Commission's historical interpretation of section 4a and has not elected to amend the relevant text, including in the Dodd-Frank Act, of that section. If Congress intended a different interpretation, Congress would have amended the language of section 4a. See Commodity Futures Trading Commission v. Schor, 478 U.S. 833, 846 (1986) ("It is well established that when Congress revisits a statute giving rise to a longstanding administrative interpretation without pertinent change, the 'congressional failure to revise or repeal the agency's interpretation is persuasive evidence that the interpretation is the one intended by Congress'") citing NLRB v. Bell Aerospace Co., 416 U.S. 267, 274-275 (1974).

[32] Some commenters submitted a number of studies and reports addressing the issue of whether position limits are effective or necessary to address excessive speculation. For the reasons explained above, the Commission is not required to make a finding as to whether position limits are effective or necessary to address excessive speculation. Accordingly, these studies and reports do not present facts or analyses that are material to the Commission's determinations in finalizing the Proposed Rules. A discussion of these studies is provided in section III A infra.

the same underlying commodity for delivery at the same delivery location as that of a Core Referenced Futures Contract, or another delivery location having substantially the same supply and demand fundamentals (such derivative products are collectively defined as "Referenced Contracts").[33] These Core Referenced Futures Contracts were selected on the basis that such contracts: (1) have high levels of open interest and significant notional value; or (2) serve as a reference price for a significant number of cash market transactions.

Edison Electric Institute and the Electric Power Supply Association argued that the Commission did not provide a reasoned explanation for selecting the 28 Referenced Contracts.[34] Other commenters requested that the Commission clarify the definition of Referenced Contracts or restrict it to those contracts sharing a common delivery point.[35]

Some commenters argued that the Commission should narrow the definition of economically equivalent swaps to cleared swaps.[36] Conversely, other commenters asked the Commission to broaden its definition of Referenced Contracts. For example, Better Markets asked the Commission to consider a "market-based approach" to determine whether to include a

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[33] 76 FR at 4752, 4753. These Core Referenced Futures Contracts are: Chicago Board of Trade ("CBOT") Corn, Oats, Rough Rice, Soybeans, Soybean Meal, Soybean Oil and Wheat; Chicago Mercantile Exchange Feeder Cattle, Lean Hogs, Live Cattle and Class III Milk; Commodity Exchange, Inc. Gold, Silver and Copper; ICE Futures U.S. Cocoa, Coffee C, FCOJ-A, Cotton No.2, Sugar No. 11 and Sugar No. 16; Kansas City Board of Trade ("KCBT") Hard Winter Wheat; Minneapolis Grain Exchange Hard Red Spring Wheat; and New York Mercantile Exchange Palladium, Platinum, Light Sweet Crude Oil, New York Harbor No. 2 Heating Oil, New York Harbor Gasoline Blendstock and Henry Hub Natural Gas.

[34] CL-EEI/EPSA, supra note 21 at 5.

[35] Alternative Investment Management Association ("AIMA") on March 28, 2011 ("CL-AIMA") at 2; CL-API supra note 21 at 5; BG Americas & Global LNG ("BGA") on March 28, 2011 ("CL-BGA") at 18; Chris Barnard on March 28, 2011 at 1; CL-COPE supra note 21 at 6; CL-ISDA/SIFMA supra note 21 at 20; Shell Trading ("Shell") on March 28, 2011 ("CL-Shell") at 7-8; CL-Utility Group supra note 21 at 7; and Working Group of Commercial Energy Firms ("WGCEF") on March 28, 2011 ("CL-WGCEF") at 22.

[36] CL-API, supra note 21 at 13; and CL-BGA, supra note 35 at 18. American Petroleum Institute explained that extending the definition of "Referenced Contract" beyond standardized cleared contracts would not be cost-effective. Similarly, BGA argued that because the Commission cannot identify uncleared contracts until they are executed, the scope of economically equivalent swaps should be limited to only those that are cleared.

contract within a Referenced Contract category, including hedging relationships used by market participants, cross-contract netting practices of clearing organizations, enduring price relationships, and physical characteristics.[37]

The Edison Electric Institute and Electrical Power Suppliers Association opined that the Commission should allow market participants to define what constitutes an economically equivalent contract consistent with commercial practices and to allow for a good-faith exemption for market participants relying on their own determination consistent with Commission guidance.[38] ISDA/SIFMA argued that the Commission should ensure that the concept of an economically equivalent derivative contract covers contracts whose correlation with futures can be established through accepted models that address features such as maturity, payout structure, locations basis, product basis, etc.[39]

The proposed § 151.1 definition of Referenced Contract excluded basis contracts and commodity index contracts.[40] Proposed § 151.1 defined basis contract as those contracts that are "cash settled based on the difference in price of the same commodity (or substantially the same commodity) at different delivery points." Commodity index contracts were defined in the proposal as contracts that are "based on an index comprised of prices of commodities that are not the same nor [sic] substantially the same." The proposal further excluded intercommodity spread

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37 Better Markets, Inc. ("Better Markets") on March 28, 2011 ("CL-Better Markets") at 68-69.

38 CL-EEI/EPSA, supra note 21 at 12.

39 CL-ISDA/SIFMA supra note 21 at 23.

40 The proposed definition of a Referenced Contract included contracts (i) directly or indirectly linked, including being partially or fully settled on, or priced at a differential to, the price of any Core Referenced Futures Contract; or (ii) directly or indirectly linked, including being partially or fully settled on, or priced at a differential to, the price of the same commodity for delivery at the same location, or at locations with substantially the same supply and demand fundamentals, as that of any Core Referenced Futures Contract.

contracts,[41] calendar spread contracts, and basis contracts from the definition of "commodity index contract." Many commenters appeared to interpret the proposal as subjecting positions in basis contracts or commodity index contracts to the position limits set forth in proposed § 151.4.[42] The Coalition of Physical Energy Companies and the Utility Group found that the definition of Referenced Contract was "vague" and "clearly extraordinarily broad" because, inter alia, it appeared to include some over-the-counter ("OTC") swaps that utilized a Core Referenced Futures Contract price as a component of a floating price calculation.[43] The Coalition of Physical Energy Companies and the Utility Group opined that even if the proposed class of Referenced Contracts that are priced based on "locations with substantially the same supply and demand fundamentals, as that of any Core Referenced Futures Contract" it is unclear whether the definition of Referenced Contract extends to "those [swaps] that are actually economically equivalent, e.g., look alikes."[44]

The Commission is adopting the proposal regarding Referenced Contracts with modifications and clarifications responsive to the comments. The Commission clarifies that the term "Referenced Contract" includes: (1) the Core Referenced Futures Contract; (2) "look-alike" contracts (i.e., those that settle off of the Core Referenced Futures Contract and contracts that are

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41 Proposed § 151.1 defined "intercommodity spread" contracts as those contracts that "represent[] 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."

42 See e.g., CL-Utility Group supra note 21 at 7-8; CL-COPE supra note 21 at 6; Commercial Alliance ("Commercial Alliance I") on June 5, 2011 ("CL-Commercial Alliance I") at 5-10 (arguing for the extension of the bona fide hedge exemption for physical market transactions and anticipated physical market transactions that could be hedged with a basis contract position).

43 CL-Utility Group supra note 21 at 7-8 (arguing that "virtual tolling swaps" that utilize a Referenced Contract-derived price series as a component of a floating price appear to be covered by the definition of "Referenced Contract"); and CL-COPE supra note 21 at 6.

44 Id.

based on the same commodity for the same delivery location as the Core Referenced Futures Contract); (3) contracts with a reference price based only on the combination of at least one Referenced Contract price and one or more prices in the same or substantially the same commodity as that underlying the relevant Core Referenced Futures Contract;[45] and (4) intercommodity spreads with two components, one or both of which are Referenced Contracts. These criteria capture contracts with prices that are or should be closely correlated to the prices of the Core Referenced Futures Contract.[46]

In response to commenters, the Commission is eliminating a proposed category of Referenced Contracts, namely, those based on "substantially the same supply and demand fundamentals." The Commission notes that the "substantially the same supply and demand fundamentals" criterion would require individualized evaluation of certain trading data to determine whether the price of a commodity may or may not be substantially related to a Core Referenced Futures Contract. Such analysis may require access to, among other things, data concerning bids and offers and transaction information regarding the cash market, which are not readily available to the Commission at this time.

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[45] E.g., a swap with a floating price based on the average of the settlement price of the New York Mercantile Exchange ("NYMEX") Light, Sweet Crude Oil futures contract and the settlement price of the IntercontinentalExchange ("ICE") Brent Crude futures contract.

[46] Under amended section 4a(a)(1), the Commission is required to establish aggregate position limits on contracts based on the same underlying commodity, including those swaps that are not traded on a DCM or SEF but which are determined to perform or affect a significant price discovery function ("SPDF"). 7 U.S.C. 6a(a)(1). The Commission currently lacks the data necessary to evaluate the pricing relationships between potential SPDF swaps and Referenced Contracts and therefore has determined not to set forth, at this time, standards for determining significant price discovery function swaps. As the Commission gathers additional data on the effect of position limits on the 28 Referenced Contracts and these contracts' relationship with other contracts, it could, in its discretion, extend position limits to additional contracts beyond the current set of Referenced Contracts. The Commission could determine, for example, that a contract, due to certain shared qualitative or quantitative characteristics with Referenced Contracts, performs a SPDF with respect to Referenced Contracts.

The remaining categories of Referenced Contract, i.e., derivatives that are directly or indirectly linked to or based on the same commodity for delivery at the same delivery location as a Core Referenced Futures Contract, are based on objective criteria and readily available data, which should provide market participants with clarity as to the scope of economically equivalent contracts.[47] The Commission clarifies that if a swap contract that utilizes as its sole floating reference price the prices generated directly or indirectly[48] from the price of a single Core Referenced Futures Contract, then it is a look-alike Referenced Contract and subject to the limits set forth in § 151.4.[49] If such a swap is priced based on a fixed differential to a Core Referenced Futures Contract, it is similarly a Referenced Contract.[50]

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[47] In finalizing the Commission's Large Trader Reporting for Physical Commodity Swaps rulemaking, and also in response to comments, the Commission modified the proposed definition of "paired swap" to exclude contracts based on the same commodity at different locations with substantially the same supply and demand fundamentals as that of any Core Referenced Futures Contract. See 76 FR 43855, Jul. 22, 2011.

[48] An "indirect" price link to a Core Referenced Futures Contract includes situations where the swap reference price is linked to prices of a cash-settled Referenced Contract that itself is cash-settled based on a physical-delivery Referenced Contract settlement price.

[49] The Commission clarifies, by way of example, that a swap based on the difference in price of a commodity (or substantially the same commodity) at different delivery locations is a "basis contract" and therefore not subject to the limits set forth in § 151.4. In addition, if a swap is based on prices of multiple different commodities comprising an index, it is a "commodity index contract" and therefore is not subject to the limits set forth in § 151.4. In contrast, if a swap is based on the difference between two prices of two different commodities, with one linked to a Core Referenced Futures Contract price (and the other either not linked to the price of a Core Referenced Futures Contract or linked to the price of a different Core Referenced Futures Contract), then the swap is an "intercommodity spread contract," is not a commodity index contract, and is a Referenced Contract subject to the position limits specified in § 151.4. The Commission further clarifies that a contract based on the prices of a Referenced Contract and the same or substantially the same commodity (and not based on the difference between such prices) is not a commodity index contract and is a Referenced Contract subject to position limits specified in § 151.4.

[50] The Commission has clarified in its definition of "Referenced Contract" that position limits extend to contracts traded at a fixed differential to a Core Referenced Futures Contract (e.g., a swap with the commodity reference price NYMEX Light, Sweet Crude Oil +$3 per barrel is a Referenced Contract) or based on the same commodity at the same delivery location as that covered by the Core Referenced Futures Contract, and not to unfixed differential contracts (e.g., a swap with the commodity reference price Argus Sour Crude Index is not a Referenced Contract because that index is computed using a variable differential to a Referenced Contract).

With respect to comments that the Commission should broaden the scope of Referenced Contracts, the Commission notes that expanding the scope of position limits based, for example, on cross-hedging relationships or other historical price analysis would be problematic. Historical relationships may change over time and, additionally, would require individualized determinations. For example, if the standard for determining economic equivalence was some level of historical correlation, then a commodity derivative might have met the correlation metric yesterday, fail it today, and again meet the metric tomorrow.[51] Under these circumstances, the Commission does not believe that it is necessary to expand the scope of position limits beyond those proposed. In this regard, the Commission notes that the commenters did not provide specific criteria or thresholds for making determinations as to which price-correlated commodity contracts should be subject to limits.[52] The Commission further notes that it would consider amending the scope of economically equivalent contracts (and the relevant identifying criteria) as it gains experience in this area. For clarity, the Commission has deleted the definition of the proposed term "Referenced paired futures contract, option contract, swap, or swaption" since that term was only used in the definitions section and incorporated the relevant provisions of that proposed term into the definition of Referenced Contracts. Lastly, the Commission has made amendments in § 151.2 that clarify that "Core Referenced Futures Contracts" include options that expire into outright positions in such contracts.

C. Phased Implementation

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[51] Nevertheless, a trader may decide to assume the risk that the historical price relationship might not hold and enter into a cross-hedging transaction in a derivative that has been and is expected to be price-fluctuation-related to that trader's cash market commodity and seek (and obtain) a bona fide hedge exemption.

[52] For example, the commenters did not address whether a derivatives contract on a commodity should be included if there were observed historical associated price correlations but no identified causation relationship.

The Commission proposed to implement the position limit rule in two phases. In the first phase, the spot-month limits for Referenced Contracts would be set at a level based on existing limits determined by the appropriate DCM. In the second phase, the spot-month limits would be adjusted on a regular schedule, set to 25 percent of the Commission's determination of estimated deliverable supply, which would be based on DCM-provided estimates or the Commission's own estimates. The Commission believes that spot-month position limits can be implemented on an advanced schedule, because such limits will initially be based on existing DCM limits or on estimates of deliverable supply for which data is available.

In the proposal, non-spot-month energy, metal, and "non-enumerated"[53] agricultural Referenced Contract limits would be based on open interest and would be set in the second phase pending the availability of certain positional data on physical commodity swaps.[54]

In general, commenters were divided on whether the Commission should, in whole or in part, delay the imposition of position limits. Some commenters stated that the Commission should stay or withdraw its proposal until such time that the Commission has gathered and analyzed data to determine if position limits are necessary or appropriate.[55] CME asserted that the Commission cannot impose spot-month limits until it has received and analyzed data on economically equivalent swaps since the limits cover such swaps.[56] Conversely, some

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53 In the final rulemaking, the term "legacy" replaced the term "enumerated" used in the proposal. The Commission has made this change in order to avoid unnecessary confusion.

54 As discussed in the proposal, the Commission retained the position limits for the enumerated agricultural Referenced Contracts "as an exception to the general open interest based formula." 76 FR at 4752, 4760.

55 CL-FIA I, supra note 21 at 8; CL-COPE, supra note 21 at 4; CL-Utility Group, supra note 21 at 5; CL-EEI/EPSA supra note 21 at 2; CL-Centaurus Energy, supra note 21 at 3; CL-PIMCO supra note 21 at 6; CL-SIFMA AMG I, supra note 21 at 15-16; CL-PERA, supra note 21 at 2; CL-Morgan Stanley, supra note 21 at 1; and CL-CMC, supra note 21 at 2.

56 CL-CME I, supra note 8 at 7-8.

commenters rejected the phased implementation of non-spot-month position limits and urged the Commission to implement such limits on a more expedited timeframe. One such commenter, Delta, argued "that the Commission should instead strive to establish meaningful speculative position limits using sampling and other statistical techniques to make reasonable, working assumptions about positions in various market segments and refining the speculative limits based upon market experience and better data as it is developed."[57] The Commission also received many letters requesting that the Commission impose position limits generally on an expedited basis.[58]

The Commission is finalizing the phased implementation schedule generally as proposed and in furtherance of the congressional directive that the Commission establishes position limits on an expedited timeframe. As stated above, spot-month limits, which are based on existing DCM limits and data that is available, can be implemented on an expedited timeframe. In addition, non-spot-month legacy limits do not require swap positional data to set the limits, and, thus, can be set on an expedited timeframe.[59] With respect to non-spot-month limits for non-legacy Referenced Contracts, which are dependent on open interest levels and thus dependent on swaps positional data, the Commission will initially set such limits following the collection of approximately 12 months of swaps positional data.[60]

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[57] CL-Delta, supra note 20 at 11.

[58] See e.g., Gary Krasilovsky on February 6, 2011 ("CL-Krasilovsky"); and Alan Murphy ("Murphy") on January 6, 2011 ("CL-Murphy").

[59] Non-spot-month limits for agricultural contracts currently subject to federal position limits under part 150 are referred to herein as "legacy limits." As noted earlier, such Referenced Contracts are generally referred to as "enumerated" agricultural contracts. 17 CFR 150.2.

[60] The Commission recently adopted reporting regulations that require routine position reports from clearing organizations, clearing members, and swap dealers. See 76 FR 43851, Jul. 22, 2011. The swaps positional data obtained through these reports are expected to serve as a primary source for determining open interests.

1. Compliance Dates

In light of the above referenced timeframe for implementation, the compliance date for all spot-month limits and non-spot-month legacy limits shall be 60 days after the term "swap" is further defined pursuant to section 721 of the Dodd-Frank Act. Prior to the Commission further defining the term swap, market participants shall continue to comply with the existing position limits regime contained in part 150 and any applicable DCM position limits or accountability levels. After the compliance date, the Commission will revoke part 150, and persons will be required to comply with all the provisions of this part 151, including § 151.5 for bona fide hedging and § 151.7 related to the aggregation of accounts. For non-spot-month non-legacy Referenced Contracts, the compliance date shall be set forth by Commission order establishing such limits approximately 12 months after the collection of swap positional data.[61]

Although the Commission proposed to revoke part 150 in the Proposed Rules, the Commission is retaining this provision until the compliance dates set forth above.

2. Transitional Compliance

As discussed below in detail in section II.B. of this release, § 151.1 excludes "basis contracts" and "commodity index contracts" from the definition of Referenced Contract. However, part 20 of the Commission's regulations requires reporting entities to report commodity reference price data sufficient to distinguish between basis and non-basis swaps and between commodity index contract and non-commodity index contract positions in covered contracts.[62] Therefore, the Commission intends to rely on the data elements in § 20.4(b) to

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[61] Prior to the compliance date, persons shall continue to comply with applicable exchange-set position limits and accountability levels.

[62] See § 20.2, 17 CFR 20.11 for a list of covered contracts.

distinguish data records subject to § 151.4 position limits from those contracts that are excluded from § 151.4. This will enable the Commission to set position limits using the narrower data set (i.e., Referenced Contracts subject to § 151.4 position limits) as well as conduct surveillance using the broader data set.

In addition, § 151.9 provides that traders may determine to either exclude (i.e., not aggregate) or net their pre-existing swap positions (as discussed below), while part 20 does not require a distinction to be made for reporting pre-existing swap positions. The Commission believes it is appropriate to include pre-existing swap positions in the basis for setting position limits and, thus, the part 20 data collection will provide this broader data set. This is because limits based on a narrower data set (that is, excluding pre-existing swaps) may be overly restrictive and, thus, may not provide adequate liquidity for bona fide hedgers, in light of the biennial reset of most non-spot-month position limits under § 151.4(d)(3). Nonetheless, and consistent with the statutory exclusion of swaps pre-existing the Dodd-Frank Act, position limits will not apply to such pre-existing swap positions.[63]

The Commission understands that most uncleared swaps are executed opposite a clearing member or swap dealer and would therefore result in positions reportable to the Commission under part 20. Part 20 reports will not provide data on positions where neither party to a swap is a clearing member or swap dealer, but these positions represent a small fraction of all uncleared

[63] While requiring reporting entities to submit data sufficient to allow the Commission to distinguish pre-existing positions from other positions would be helpful to the Commission, the Commission does not currently believe it would be cost-effective to impose this requirement broadly as it would require reporting entities to revisit transaction trade confirmation records that may or may not be readily linked to position-tracking databases. Moreover, the Commission could develop a reasonable estimate of the extent of a trader's pre-existing positions by comparing their positions as of the effective date with the positions held on a date in interest (e.g., when a trader appears to establish a position exceeding a position limit).

swaps. Since most uncleared swaps will be reportable under part 20, the Commission believes the swaps' data set will be adequate to set position limits.[64]

In order to determine a trader's compliance with position limits in light of the pre-existing position exemption and the sampling inherent in requiring swap position data reporting from clearing members and swap dealers, the Commission will utilize one existing and one new means to conduct the necessary market surveillance. First, the Commission may issue special calls under § 20.6(b) in instances where traders appear to have positions exceeding part 151 position limits. Traders subject to these special calls would then be afforded an opportunity to provide information on their positions demonstrating compliance with a part 151 position limit. Second, the Commission notes that traders are required to provide position visibility on their uncleared swaps positions under § 151.6(c) in 401 filings that would reflect all of their uncleared swap positions in Referenced Contracts as well as their total positions in Referenced Contracts, irrespective of whether these swaps were executed opposite a clearing member or swap dealer. These filings would allow the Commission to determine whether the trader is in compliance with part 151 position limits. The Commission clarifies that such 401 filings require the reporting of gross long and gross short positions in Referenced Contracts, excluding those positions that are not included in the definition of Referenced Contracts (e.g., excluding those positions arising

[64] Proposed § 151.4(e)(3) based the uncleared swap component of the open interest figure used to set non-spot-month position limits on open interest attributed to swap dealers. Section 20.4 requires position reporting from swap dealers as well as clearing organizations and clearing members. Final rule § 151.4(b)(2)(ii) permits estimation of the uncleared swap component using clearing organization or clearing member data obtained under § 20.4 reports.

from basis contract positions, pre-existing swap positions, and diversified commodity index positions).[65]

D. Spot-Month Limits

Proposed § 151.4 would apply spot-month position limits separately for physically-delivered contracts and cash-settled contracts (i.e., cash-settled futures and swaps).[66] A trader could therefore hold positions up to the spot-month position limit in both the physical-delivery and cash-settled contracts but a trader could not net cash-settled contracts with the physical-delivery contracts.[67] The proposed spot-month position limits for physical-delivery Core Referenced Futures Contracts initially would be set at existing DCM levels; cash-settled Referenced Contracts would be subject to limits set at the same level. As discussed above, during the second phase of implementation, the spot-month limits would be based on 25 percent of estimated deliverable supply, as determined by the Commission in consultation with DCMs. The Commission has determined to adopt the spot-month limits substantially as proposed but with certain changes to address commenters' concerns.

1. Definition of "Deliverable Supply"

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65 See supra under II.B. discussing the definition of Referenced Contract.

66 For the ICE Futures U.S. Sugar No. 16 (SF) and CME Class III Milk (DA), the Commission proposed to adopt the DCM single-month limits for the nearby month or first-to-expire Referenced Contract as spot-month limits. These contracts currently have single-month limits that are enforced in the spot month.

67 Thus, for example, if the spot-month limit for a Referenced Contract is 1,000 contracts, then a trader could hold up to 1,000 contracts long in the physical-delivery contract and 1,000 contracts long in the cash-settled contract. However, the same trader could not hold 1,001 contracts long in the physical-delivery contract and hold 1 contract short in the cash-settled and remain under the limit for the physical-delivery contract. A trader's cash-settled contract position would be a function of the trader's position in Referenced Contracts based on the same commodity that are cash-settled futures and swaps. For purposes of applying the limits, a trader shall convert and aggregate positions in swaps on a futures equivalent basis consistent with the guidance in the Commission's Appendix A to Part 20, Large Trader Reporting for Physical Commodity Swaps. See 76 FR 43851, 43865 Jul. 22, 2011.

In the proposal, the Commission defined "deliverable supply" generally as "the quantity of the commodity meeting a derivative contract's delivery specifications that can reasonably be expected to be readily available to short traders and saleable by long traders at its market value in normal cash marketing channels at the derivative contract's delivery points during the specified delivery period, barring abnormal movement in interstate commerce."[68] Several commenters supported "deliverable supply" as an appropriate basis for spot-month limits for physical-delivery contracts.[69] Other commenters disagreed, stating that "deliverable supply" was inappropriate, even for physical-delivery contracts, because it would result in overly stringent limits.[70] ISDA/SIFMA suggested that the Commission instead base spot-month limits on "available deliverable supply," a broader measure of physical supply.[71]

Similarly, two commenters suggested that the Commission include supply committed to long-term supply contracts in its definition of "deliverable supply" to avoid artificially reduced spot-month position limits.[72] In the Commission's experience overseeing the position limits

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68 76 FR at 4752, 4757.

69 See CL-AFR supra note 17 at 7-8; CL-AIMA supra note 35 at 2; CL-Prof. Greenberger supra note 6 at 17; InterContinental Exchange, Inc. ("ICE I") on March 28, 2011 ("CL-ICE I") at 5; and Natural Gas Exchange ("NGX") on March 28, 2011 ("CL-NGX") at 3.

70 CL-ISDA/SIFMA supra note 21 at 21; and CL-FIA I supra note 21 at 9.

71 "Available deliverable supply" includes: (1) all available local supply (including supply committed to long-term commitments); (2) all deliverable non-local supply; and (3) all comparable supply (based on factors such as product and location). See CL-ISDA/SIFMA supra note 21 at 21. Another commenter, the Alternative Investment Management Association, similarly advocated a more expansive definition of "deliverable supply." CL-AIMA supra note 35 at 3 ("This may include all supplies available in the market at all prices and at all locations, as if a party were seeking to buy a commodity in the market these factors would be relevant to the price.")

72 National Grain and Feed Association ("NGFA") on March 28, 2011 ("CL-NGFA") at 5; and CL-CME I supra note 8 at 9 (suggesting that if the Commission decides to retain this exclusion, it should define what it understands a "long-term" agreement to be and ensure consistency with the deliverable supply definition in the Core Principles and Other Requirements for Designated Contract Markets proposed rulemaking). Id. citing Appendix C of Part 38, 75 FR 80572, 80631, Dec. 22, 2010. (In Appendix C, the Commission states that commodity supplies that are "committed to some commercial use" should be excluded from deliverable supply, and requires DCMs to consult with market participants to estimate these supplies on a monthly basis).

established at the exchanges as well as federally-set position limits, "spot-month speculative position limits levels are 'based most appropriately on an analysis of current deliverable supplies and the history of various spot-month expirations.'"[73]

Other commenters argued that "deliverable supply" should not be the basis for position limits on cash-settled Referenced Contracts.[74] Niska, for example, asked the Commission to explain why spot-month limits for cash-settled contracts should be linked to deliverable supply.[75] Another commenter, BGA, opined that the Commission should set position limits for cash-settled swap Referenced Contracts based on the size of the swap market because swap contracts do not contemplate delivery of the underlying contract and therefore are not "tied to the physical limits of the market."[76]

The Commission finds that the use of deliverable supply to set spot-month limits is wholly consistent with its historical approach to setting spot-month limits and overseeing DCMs' compliance with Core Principles 3 and 5.[77] Currently, in determining whether a physical-delivery contract complies with Core Principle 3, the Commission staff considers whether the specified contract terms and conditions may result in a deliverable supply that is sufficient to

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[73] 64 FR 24038, 24039, May 5, 1999.

[74] Minneapolis Grain Exchange, Inc. ("MGEX") on March 28, 2011 ("CL-MGEX") at 4; CL-MFA supra note 21 at 16; Niska Gas Storage LLC ("Niska") on March 28, 2011 ("CL-Niska") at 2. See also CL-AIMA supra note 35 at 2 (asking the Commission to reconsider position limits on cash-settled contracts).

[75] CL-Niska supra note 75 at 2.

[76] CL-BGA supra note 35 at 19. See also Cargill, Incorporated ("Cargill") on March 28, 2011 ("CL-Cargill") at 13 (urging the Commission to study the impact of applying any position limit based on "deliverable supply" to the swaps market).

[77] Core Principle 3 specifies that a board of trade shall list only contracts that are not readily susceptible to manipulation, while Core Principle 5 obligates a DCM to establish position limits or position accountability provisions where necessary and appropriate "to reduce the threat of market manipulation or congestion, especially during the delivery month."

ensure that the contract is not conducive to price manipulation or distortion. In this context, the term "deliverable supply" generally means the quantity of the commodity meeting a derivative contract's delivery specifications that can reasonably be expected to be readily available to short traders and saleable by long traders at its market value in normal cash marketing channels at the derivative contract's delivery points during the specified delivery period, barring abnormal movement in interstate commerce.[78] The spot-month limit pursuant to Core Principle 5 is similarly established based on the analysis of deliverable supplies. The Acceptable Practices for Core Principle 5 state that, with respect to physical-delivery contracts, the spot-month limit should not exceed 25 percent of the estimated deliverable supply.[79] Lastly, with respect to cash-settled contracts on agricultural and exempt commodities, the spot-month limit is set at some percentage of calculated deliverable supply. Accordingly, the Commission is adopting deliverable supply as the basis of setting spot-month limits. In response to commenters, the Commission added § 151.4(d)(2)(iv) to clarify that, for purposes of estimating deliverable supply, DCMs may use any guidance issued by the Commission set forth in the Acceptable Practices for Core Principle 3.

2. Twenty-five Percent as the Deliverable Supply Formula

ICE commented that spot-month limits for physical-delivery contracts (but not cash-settled contracts) set at 25 percent of deliverable supply are necessary to prevent corners and

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[78] See e.g., the discussion of deliverable supply in Guideline No. 1. 17 CFR Part 40, app. A. See also the discussion of deliverable supply in the first publication of Guideline No. 1. 47 FR 49832, 49838, Nov. 3, 1982.

[79] Indeed, with three exceptions, the § 151.2-listed contracts with DCM-defined spot months are currently subject to exchange-set spot-month position limits, which would have been established in this manner. The only contracts based on a physical commodity that currently do not have spot-month limits are the COMEX mini-sized gold, silver, and copper contracts that are cash settled based on the futures settlement prices of the physical-delivery contracts. The cash-settled contracts have position accountability provisions in the spot month, rather than outright spot-month limits. These cash-settled contracts have relatively small levels of open interest.

squeezes.[80] Other commenters, however, opined that spot-month position limits based on 25 percent of deliverable supply are insufficient to prevent excessive speculation.[81] Americans for Financial Reform ("AFR"), for example, argued that while "deliverable supply" is an appropriate basis for setting spot-month limits,[82] the proposed spot-month limit addresses manipulation by a single actor and would not be set low enough to combat excessive speculation in the market as a whole and the volatility and delinking of commodities prices from economic fundamentals caused by excessive speculation.[83] Some commenters recommended that the Commission set the spot-month limits based on the "individual characteristics" of each Core Referenced Futures Contract, and not necessarily an exchange's deliverable supply estimate.[84]

The Commission has determined to adopt the 25 percent level of deliverable supply for setting spot-month limits. This formula is consistent with the long-standing Acceptable Practices for Core Principle 5,[85] which provides that, for physical-delivery contracts, the spot-month limit should not exceed 25 percent of the estimated deliverable supply. The use of the existing industry standard would provide clarity concerning the underlying methodology. Further, the Commission believes that, based on its experience, the formula has appeared to work effectively as a prophylactic tool to reduce the threat of corners and squeezes and promote convergence

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80 CL-ICE I supra note 69 at 5.

81 CL-AFR supra note 17 at 5; American Trucking Association ("ATA") on March 28, 2011 ("CL-ATA") at 3; Food & Water Watch ("FWW") on March 28, 2011 ("CL-FWW") at 10; National Farmers Union ("NFU") on March 28, 2011 ("CL-NFU") at 2; and CL-PMAA/NEFI supra note 6 at 7.

82 CL-AFR supra note 17 at 7-8.

83 See CL-AFR supra note 17 at 5, 7.

84 CL-FIA I supra note 21 at 9; CL-ISDA/SIFMA supra note 21 at 21; and CL-MFA supra note 21 at 18.

85 Core Principle 5 obligates a DCM to establish position limits and position accountability provisions where necessary and appropriate "to reduce the threat of market manipulation or congestion, especially during the delivery month."

without compromising market liquidity.[86] In making an estimate of deliverable supply, the Commission reminds DCMs to take into consideration the individual characteristics of the underlying commodity's supply and the specific delivery features of the futures contract.[87]

3. Cash-Settled Contracts

With respect to cash-settled contracts, proposed § 151.4 incorporated a conditional spot-month limit permitting traders without a hedge exemption to acquire position levels that are five times the spot-month limit if such positions are exclusively in cash-settled contracts (i.e., the trader does not hold positions in the physical-delivery Referenced Contract) and the trader holds physical commodity positions that are less than or equal to 25 percent of the estimated deliverable supply. The proposed conditional-spot-month position limits generally tracked exchange-set position limits currently implemented for certain cash-settled energy futures and swaps.[88]

Currently, with the exception of significant price discovery contracts, traders' swaps positions are not subject to position limit restrictions. The Commission is aware that counterparties to uncleared swaps may impose prudential credit restrictions that may directly (for example, by one party setting a maximum notional amount restriction that it will execute with a particular counterparty) or indirectly (for example, by one party setting a credit annex requirement such as posting of initial collateral by a counterparty) restrict the amount of bilateral

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[86] In this respect, the proposed limits formula is not intended to address speculation by a class or group of traders.

[87] As under current practice, DCM estimates of deliverable supplies (and the supporting data and analysis) will be subject to Commission staff review.

[88] For example, the NYMEX Henry Hub Natural Gas Last Day Financial Swap, the NYMEX Henry Hub Natural Gas Look-Alike Last Day Financial Futures, and the ICE Henry LD1 swap are all cash-settled contracts subject to a conditional-spot-month limit that, with the exception of the requirement that a trader not hold large cash commodity positions, is identical in structure to the proposed limit.

transactions between the parties. However, the proposed spot month limits would be the first broad position limit régime imposed on swaps.

Several commenters questioned the application of proposed spot-month position limits to cash-settled contracts.[89] Some of these commenters suggested that cash-settled contracts, if subject to any spot-month position limits at all, should be subject to relatively less restrictive limits that are not based on estimated deliverable supply.[90] BGA, for example, argued that position limits on swaps should be set based on the size of the open interest in the swaps market because swap contracts do not provide for physical delivery.[91] Further, certain commenters argued that imposing a single speculative limit on all cash-settled contracts would substantially reduce the cash-settled positions that a trader can hold because currently, each cash-settled contract is subject to a separate limit.[92] Other commenters urged the Commission to eliminate class limits and allow for netting across futures and swaps contracts so as not to impact liquidity.[93]

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89 CL-ISDA/SIFMA supra note 21 at 6-7, 19; Goldman, Sachs & Co. ("Goldman") on March 28, 2011 ("CL-Goldman") at 5; CL-ICI supra note 21 at 10; CL-MGEX supra note 74 at 4 (particularly current MGEX Index Contracts that do not settle to a Referenced Contract should be considered exempt from position limits because cash-settled index contracts are not subject to potential market manipulation or creation of market disruption in the way that physical-delivery contracts might be); CL-WGCEF supra note 35 at 20 ("the Commission should reconsider setting a limit on cash-settled contracts as a function of deliverable supply and establish a much higher, more appropriate spot-month limit, if any, on cash-settled contracts"); CL-MFA supra note 21 at 16-17; and CL-SIFMA AMG I supra note 21 at 7.

90 CL-BGA supra note 35 at 19; CL-ICI supra note 21 at 10; CL-MFA supra note 21 at 16-17; CL-WGCEF supra note 35 at 20; CL-Cargill supra note 76 at 13; CL-EEI/EPSA supra note 21 at 9; and CL-AIMA supra note 35 at 2.

91 CL-BGA supra note 35 at 10.

92 See e.g., CL-FIA I supra note 21 at 10; and CL-ICE I supra note 69 at 6

93 See e.g., CL-ISDA/SIFMA supra note 21 at 8.

A number of commenters objected to limiting the availability of a higher limit in the cash-settled contract to traders not holding any physical-delivery contract.[94] For example, CME argued that the proposed conditional limits would encourage price discovery to migrate to the cash-settled contracts, rendering the physical-delivery contract "more susceptible to sudden price movements during the critical expiration period."[95] AIMA commented that the prohibition against holding positions in the physical-delivery Referenced Contract will cause investors to trade in the physical commodity markets themselves, resulting in greater price pressure in the physical commodity.[96]

Some of these commenters, including the CME and the KCBT, argued against the proposed restriction with respect to cash-settled contracts and recommended that cash-settled Referenced Contracts and physical-delivery contracts should be subject to the same position limits.[97] Two commenters opined that if the conditional limits are adopted, they should be

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[94] American Feed Industry Association ("AFIA") on March 28, 2011 ("CL-AFIA") at 3; CL-AFR supra note 17 at 6; Air Transport Association of America ("ATAA") on March 28, 2011 ("CL-ATAA") at 7; CL-BGA supra note 35 at 11-12; CL-Centaurus Energy supra note 21 at 3; CL-CME I supra note 8 at 10; CL-WGCEF supra note 35 at 21-22; and CL-PMAA/NEFI supra note 6 at 14.

[95] CL-CME I supra note 8 at 10. Similarly, BGA argued that conditional limits incentivize the migration of price discovery from the physical contracts to the financial contracts and have the unintended effect of driving participants from the market and thereby increasing the potential for market manipulation with a very small volume of trades. CL-BGA supra note 35 at 12.

[96] CL-AIMA supra note 35 at 2.

[97] CL-CME I supra note 8 at 10; Kansas City Board of Trade ("KCBT I") on March 28, 2011 ("CL-KCBT I") at 4; and CL-APGA supra note 17 at 6, 8. Specifically, KCBT argued that parity should exist in all position limits (including spot-month limits) between physical-delivery and cash-settled Referenced Contracts; otherwise, these limits would unfairly advantage the look-alike cash-settled contracts and result in the cash-settled contract unduly influencing price discovery. Moreover, the higher spot-month limit for the financial contract unduly restricts the physical market's ability to compete for spot-month trading, which provides additional liquidity to commercial market participants that roll their positions forward. CL-KCBT I at 4.

increased from five times 25 percent of deliverable supply.[98] ICE recommended that they be increased to at least ten times 25 percent of deliverable supply.[99]

In support of their view, the CME submitted data concerning its natural gas physical-delivery contract.[100] The data, however, generally indicates that the trading volume in the contract in the spot month has increased since the implementation of a conditional-spot-month limit, suggesting little (if any) adverse impact on market liquidity for the contract. Moreover, according to the same data set, both the outright volume and the average price range in the settlement period on the last trade day in the closing range have declined.[101] Other measures of average price range in the spot period also have declined.

The CME also submitted, for the same physical-delivery contract, a measure of the relative closing range as a ratio to volatility ("RCR") —that is, the ratio of the closing range to the 20-day standard deviation of settlement prices. The RCR measure has declined on average after implementation of the conditional limits across 17 expirations, while the RCR on two individual expirations was higher after implementation of the conditional limits, indicating a higher relative price volatility on those two days. However, during one of those two days, certain traders were active in the physical-delivery futures contracts and concurrently held cash-settled contracts, in excess of one times the limit on the physical-delivery contract; in the other day, this was not the case. In summary, the Commission does not believe that the data submitted

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98 CL-AIMA supra note 35 at 2; and CL-ICE I supra note 70 at 8.

99 CL-ICE I supra note 69 at 8. ICE also recommended that the Commission remove the prohibition on holding a position in the physical-delivery contract or shorten the duration to a narrower window of trading than the final three days of trading.

100 CME Group, Inc. ("CME III") on August 15, 2011 ("CL-CME III").

101 "Outright volume" means the volume of electronic outright transactions that the DCM used for purposes of calculating settlement prices and excludes, for example, spread exemptions executed at a differential.

by CME supports the assertion that setting the existing conditional limits on cash-settled contracts in the natural gas market has materially diminished the price discovery function of physical-delivery contracts.

Considering the comments that were received, the Commission is adopting, on an interim final rule basis, the proposed spot-month position limit provisions with modifications. Under the interim final rule, the Commission will apply spot-month position limits for cash-settled contracts using the same methodology as applied to the physical-delivery Core Referenced Future Contracts, with the exception of natural gas contracts, which will have a class limit and aggregate limit of five times the level of the limit for the physical-delivery Core Referenced Futures Contract. As further described below, the Commission is adopting these spot-month limit methodologies as interim final rules in order to solicit additional comments on the appropriate level of spot-month position limits for cash-settled contracts.

Specifically, the Commission is adopting, on an interim final rule basis, a spot-month position limit for cash-settled contracts (other than natural gas) that will be set at 25 percent of estimated deliverable supply, in parity with the methodology for setting spot-month limit levels for the physical-delivery Core Referenced Futures Contracts. The Commission believes, consistent with the comments, that parity should exist in all position limits (including spot-month limits) between physical-delivery and cash-settled Referenced Contracts (other than in natural gas); otherwise, these limits would permit larger position in look-alike cash-settled contracts that may provide an incentive to manipulate and undermine price discovery in the underlying physical-delivery futures contract. However, the Commission has a reasonable basis to believe that the cash-settled market in natural gas is sufficiently different from the cash-settled markets in other physical commodities to warrant a different spot-month limit methodology.

With respect to NYMEX Light, Sweet Crude Oil ("WTI crude oil"), NYMEX New York Harbor Gasoline Blendstock ("RBOB"), and NYMEX New York Harbor Heating Oil ("heating oil") contracts, administrative experience, available data, and trade interviews indicate that the sizes of the markets in cash-settled Referenced Contracts (as measured in notional value) are likely to be no greater in size than the related physical-delivery Core Referenced Futures Contracts. This is because there are alternative markets which may satisfy much of the demand by commercial participants to engage in cash-settled contracts for crude oil. These include a market for generally short-dated WTI crude oil forward contracts, as well as a well-developed forward market for Brent oil and an active cash-settled WTI futures contract (the cash-settled ICE Futures (Europe) West Texas Intermediate Light Sweet Crude Oil futures contract). That futures contract had, as of October 4, 2011, an open interest of less than one-third that of the physical-delivery NYMEX Light Sweet Crude Oil futures contract, as reported in the Commission's Commitment of Traders Report. That contract is subject to a spot-month limit equal to the spot-month limit imposed by NYMEX on the relevant physical-delivery futures contract, as a condition of a Division of Market Oversight no-action letter issued on June 17, 2008, CFTC Letter No. 08-09. A review of the Commission's large trader reporting system data indicated fewer than five traders recently held a position in that cash-settled ICE contract in excess of 3,000 contracts in the spot month, pursuant to exemptions granted by the exchange. Accordingly, given that the size of the cash-settled swaps market involving WTI does not appear to be materially larger than that of the physical-delivery Core Referenced Futures Contract, parity in spot month limits in WTI crude oil between physical-delivery and cash-settled contracts should ensure sufficient liquidity for bona fide hedgers in the cash-settled contracts.

With respect to the other energy commodities, based on administrative experience, available data, and trade interviews, the Commission understands the swaps markets in RBOB and heating oil are small relative to the relevant Core Referenced Futures Contracts. In this regard, unlike natural gas, there has been a small amount of trading in exempt commercial markets in RBOB and heating oil. Thus, parity in spot month limits in RBOB and heating oil between physical-delivery and cash-settled contracts should ensure sufficient liquidity for bona fide hedgers in the cash-settled contracts.

With respect to agricultural commodities, administrative experience, available data, and trade interviews indicate that the sizes of the markets in cash-settled Referenced Contracts (as measured in notional value) are small and not as large as the related Core Referenced Futures Contracts. This is likely due to the fact that, currently, off-exchange agricultural commodity swaps (that are not options) may only be transacted pursuant to part 35 of the Commission's regulations. Under current rules, exempt commercial markets and exempt boards of trade have not been permitted to, and have not, listed agricultural swaps (although the Commission has repealed and replaced part 35, effective December 31, 2011, at which point the Commission regulations would permit agricultural commodity swaps to be transacted under the same requirements governing other commodity swaps). Regarding off-exchange agricultural trade options, part 35 is not available; such transactions must be pursuant to the Commission's agricultural trade option rules found in Commission regulation 32.13. Under regulation 32.13, parties to the agricultural trade option must have a net worth of at least $10 million and the offeree must be a producer, processor, commercial user of, or merchant handling the agricultural commodity which is the subject of the trade option. Based on interviews with offerors of agricultural trade options believed to be the largest participants, administrative experience is that

the off-exchange markets are smaller than the relevant Core Referenced Futures Contracts. Accordingly, parity in spot month limits in agricultural commodities between physical-delivery and cash-settled contracts should ensure sufficient liquidity for bona fide hedgers in the cash-settled contracts.

With respect to the metal commodities, based on administrative experience, available data, and trade interviews, the Commission understands the cash-settled swaps markets also are small. Based on interviews with market participants, the Commission understands there is an active cash forward market and lending market in metals, particularly in gold and silver, which may satisfy some of the demand by commercial participants to engage in cash-settled contracts. The cash-settled metals contracts listed on DCMs generally are characterized by a low level of open interest relative to the physical-delivery metals contracts. Moreover, as is the case for RBOB and heating oil, there has not been appreciable trading in exempt commercial markets in metals. Accordingly, parity in spot month limits in metals commodities between physical-delivery and cash-settled contracts should ensure sufficient liquidity for bona fide hedgers in the cash-settled contracts.

In contrast, regarding natural gas, there are very active cash-settled markets both at DCMs and exempt commercial markets. NYMEX lists a cash-settled natural gas futures contract linked to its physical-delivery futures contract that has significant open interest. Similarly, ICE, an exempt commercial market, lists natural gas swaps contracts linked to the NYMEX physical-delivery futures contract. Moreover, both NYMEX and ICE have gained experience with conditional spot-month limits in natural gas where the cash-settled limit is five times the limit for the physical-delivery futures contract. In this regard, NYMEX imposed the same limit on its cash-settled natural contract as ICE imposed on its cash-settled natural gas contract when ICE

complied with the requirements of part 36 of the Commission's regulations regarding SPDCs. As discussed above, the Commission believes the existing conditional limits on cash-settled natural gas contracts have not materially diminished the price discovery function of physical-delivery contracts. The final rules relax the conditional limits by removing the condition, but impose a tighter limit on cash-settled contracts by aggregating all economically similar cash-settled natural gas contracts.[102]

Thus, the Commission has determined that the one-to-one ratio (between the level of spot-month limits on physical-delivery contracts and the level of the spot-month limits on cash-settled contracts in the agricultural, metals, and energy commodities other than natural gas) maximizes the objectives enumerated in section 4a(a)(3). Specifically, such limits ensure market liquidity for bona fide hedgers and protect price discovery, while deterring excessive speculation and the potential for market manipulation, squeezes, and corners. The Commission further notes that the formula is consistent with the level the Commission staff has historically deemed acceptable for cash-settled contracts, as well as the formula for physical-delivery contracts under Acceptable Practices for Core Principle 5 in part 38. Nevertheless, the Commission recognizes that after experience with the one-to-one ratio and additional reporting of swap transactions, it may be possible to maximize further these objectives with a different ratio and therefore will revisit the issue after it evaluates the effects of the interim final rule.

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[102] The Commission is removing the proposed restrictions for claiming the higher limit in cash-settled Referenced Contracts in the spot month. Unlike the proposed conditional limit, under the aggregate limit, a trader in natural gas can utilize the five times limit for the cash-settled Referenced Contract and still hold positions in the physical-delivery Referenced Contract. In addition, there is no requirement that the trader not hold cash or forward positions in the spot month in excess of 25 percent of deliverable supply of natural gas. Although the Commission's experience with DCMs using the more restrictive conditional limit in natural gas has been generally positive, the Commission, in agreeing with commenters, will wait to impose similar conditions until the Commission gains additional experience with the limits in the interim final rule. In this regard, the Commission will monitor closely the spot-month limits in these final rules and may revert to a conditional limit in the future in response to market developments.

In addition to the spot-month limit for cash-settled natural gas contracts, the interim final rule also provides for an aggregate spot-month limit set at five times the level of the spot-month limit in the relevant physical-delivery natural gas Core Referenced Futures Contract. A trader therefore must at all times fall within the class limit for the physical-delivery natural gas Core Referenced Futures Contract, the five-times limit for cash-settled Referenced Contracts in natural gas, and the five-times aggregate limit.

To illustrate the application of the spot-month limits in natural gas contracts, assume a physical-delivery Core Referenced Futures Contract limit on a particular commodity is set to a level of 100. Thus, a trader may hold a net position (long or short) of 100 contracts in that Core Referenced Futures Contract and a net position (long or short) of 500 contracts in the cash-settled Referenced Contracts on that same commodity, provided that the total directional position of both contracts is below the aggregate limit. Therefore, to comply with the aggregate limit, if a trader wanted to hold the maximum directional position of 100 contracts in the physical-delivery contract, the trader could hold only 400 contracts on the same side of the market in cash-settled contracts.[103] Thus, while the aggregate limit in isolation may appear to allow a trader to establish a position of 600 contracts in cash-settled contracts and 100 contracts on the opposite side of the market in the physical-delivery contract (that is, an aggregate net position of 500 contracts), the class limits restrict that trader to no more than 500 contracts net in cash-settled contracts. The aggregate limit is less restrictive than the proposed conditional limit in that a trader may elect to hold positions in both physical-delivery and cash-settled contracts, subject to the aggregate limit.

[103] Further to this example, if a trader wanted to hold 100 contracts in the physical-delivery contract in one direction, the trader could hold 500 cash-settled contracts in the opposite direction as the physical-delivery contract.

The Commission believes that, based on current experience with existing DCM and exempt commercial market ("ECM") conditional limits, the one-to-five ratio for natural gas contracts maximizes the statutory objectives, as set forth in section 4a(a)(3)(B) of the CEA, of preventing excessive speculation and market manipulation, ensuring market liquidity for bona fide hedgers, and promoting efficient price discovery. Nevertheless, the Commission recognizes that after experience with the one-to-five ratio and additional reporting of swap transactions, it may be possible to maximize further these objectives with a different ratio and therefore will revisit the issue after it evaluates the effects of the interim final rule. Accordingly, the Commission is implementing the one-to-five ratio in natural gas contracts on an interim final rule basis and is seeking comments on whether a different ratio can further maximize the statutory objectives in section 4a(a)(3)(B) of the CEA.

The Commission notes that, as would have been the case with the proposed conditional limits, the spot-month limits on cash-settled natural gas contracts will be more restrictive than the current natural gas conditional spot-month limits. The NYMEX Henry Hub Natural Gas ("NG") physical-delivery futures contract has a spot-month limit of 1,000 contracts. Both the NYMEX cash-settled natural gas futures contract ("NN") and the ICE Henry Hub Physical Basis LD1 contract ("LD1") have conditional-spot-month limits equivalent to 5,000 contracts in the NG futures contract. In contrast to the LD1 contract, swap contracts that are not significant price discovery contracts ("SPDCs") have not been subject to any position limits. However, the final rule aggregates the related cash-settled contracts, whether swaps or futures. For example, a trader under current rules may hold a position equivalent to 5,000 NG contracts in each of the NN and LD1 contracts (10,000 in total), but under the final rule, a speculative trader may hold only 5,000 cash-settled contracts net under the aggregate spot month limit (since a trader must

add its NN position to its LD1 position). Further, other economically-equivalent contracts would be aggregated with a trader's cash-settled contracts in NN and LD1.

Proposed § 151.11(a)(2) required that a DCM or SEF that is a trading facility adopt spot-month limits on cash-settled contracts for which no federal limits apply, based on the methodology in proposed § 151.4 (i.e., 25 percent of deliverable supply). Proposed § 151.4(a) did not establish spot-month limits in the cash-settled Core Referenced Futures Contracts (i.e., Class III Milk, Feeder Cattle, and Lean Hog contracts). Thus, under the proposal, a DCM or SEF that is a trading facility would be required to set a spot-month limit on such contracts at a level no greater than 25 percent of deliverable supply.

The final rules provide that the spot-month position limit for cash-settled Core Referenced Futures Contracts (i.e., Class III Milk, Feeder Cattle, and Lean Hog contracts) and related cash-settled Referenced Contracts will be set by the Commission at a level equal to 25 percent of deliverable supply.[104]

The Commission is also retaining class limits in the spot month for physical-delivery and cash-settled contracts. Under the class limit restriction, a trader may hold positions up to the spot-month limit in the physical-delivery contracts, as well as positions up to the applicable spot-month limit in cash-settled contracts (i.e., cash-settled futures and swaps), but a trader in the spot month may not net across physical-delivery and cash-settled contracts.[105] Absent such a restriction in the spot month, a trader could stand for 100 percent of deliverable supply during

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[104] See § 151.4(a).

[105] As discussed above, the Commission is eliminating the conditional spot-month limit.

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.[106]

In the Commission's view, the aggregate limit for natural gas will ensure that no trader amasses a speculative position greater than five times the level of the physical-delivery Referenced Contract position limit and thereby, the limit "diminishes the incentive to exert market power to manipulate the cash-settlement price or index to advantage a trader's position in the cash-settlement contract."[107]

As noted above, the Commission has developed the limits on economically equivalent swaps concurrently with limits established for physical commodity futures contracts and has established aggregate requirements for cash-settled futures and swaps. In establishing the spot-month limits for cash-settled futures, options, and swaps, the Commission seeks to ensure, to the maximum extent practicable, that there will be sufficient market liquidity for bona fide hedgers in swaps, especially those seeking to offset open positions in such contracts. Permitting traders to hold larger positions in natural gas cash-settled contracts near expiration should not materially affect the potential for market abuses, as the current Commission surveillance system serves to detect and prevent market manipulation, squeezes, and corners in the physical-delivery futures contracts as well as market abuses in cash-settled contracts on which position information is collected. In this regard, the Swaps Large Trader Reporting system will enhance the Commission's surveillance efforts by providing the Commission with transparency for the positions of traders holding large swap positions. The Commission will monitor closely the effects of its spot-month position limits to ensure that they do not disrupt the price discovery

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106 As will be discussed further below, the Commission is eliminating class limits outside of the spot month.

107 76 FR at 4752, 4758.

function of the underlying market and that they are effective in addressing the potential for market abuses in cash-settled contracts.

4. Interim Final Rule

The Commission believes that, based on administrative experience, available data, and trade interviews, the spot month limits formulas for energy, agricultural and metals contracts, as described above, at this time best maximizes the statutory objectives set forth in CEA section 4a(a)(3)(B) of preventing excessive speculation and market manipulation, ensuring market liquidity for bona fide hedgers, and promoting efficient price discovery. However, commenters presented a range of views as to the appropriate formula with respect to cash settled contracts. Some commenters believed that either a larger ratio was appropriate or there should be no limit on cash-settled contracts at all.[108] Other commenters believed there should be parity in the limits between physical-delivery contracts and cash-settled contracts.[109] Accordingly, the Commission is implementing the spot month limits on an interim rule basis and is seeking comments on whether a different ratio (e.g., one-to-three or one-to-four) can maximize further the statutory objectives in section 4a(a)(3)(B).

Specifically, the Commission invites commenters to address whether the interim final rule best maximizes the four objectives in section 4a(a)(3)(B). The Commission also seeks comments on whether it should set a different ratio for different commodities. Should the Commission consider setting the ratio higher than one-to-one and, if so, in which commodities? Commenters are encouraged, to the extent feasible, to be comprehensive and detailed in

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108 See e.g., CL-ICE I, supra note 69 at 8, CL-Centaurus, supra note 21 at 3; CL-BGA, supra note 35 at 12.

109 See e.g., CL-CME I, supra note 8 at 10; CL-KCBT, supra note 97 at 4; CL-APGA, supra note 17 at 6,8.

providing their approach and rationale. Commenters are requested to address how their suggested approach would better maximize the four objectives in section 4a(a)(3).

Additionally, commenters are encouraged to address the following questions:

Should the Commission consider the relationship between the open interest in cash-settled contracts in the spot month and open interest in the physical-delivery contract in the spot month in setting an appropriate ratio?

Are there other metrics that are relevant to the setting of a spot-month limit on cash-settled contracts (e.g., volume of trading in the physical-delivery futures contract during the period of time the cash-settlement price is determined)?

What criteria, if any, could the Commission use to distinguish among physical commodities for purposes of setting spot-month limits (e.g., agricultural contracts of relatively limited supplies constrained by crop years and limited storage life) and how would those criteria be related to the levels of limits?

The Commission also invites comments on the costs and benefits considerations under CEA section 15a. The Commission further requests commenters to submit additional quantitative and qualitative data regarding the costs and benefits of the interim final rule and any suggested alternatives. Thus, the Commission is seeking comments on the impact of the interim final rule or any alternative ratio on: (1) the protection of market participants and the public; (2) the efficiency, competitiveness, and financial integrity of the futures markets; (3) the market's price discovery functions; (4) sound risk management practices; and (5) other public interest considerations.

The comment period for the interim final rule will close [insert date 60 days after publication in the Federal Register].

After the Commission gains some experience with the interim final rule and has reviewed swaps data obtained through the Swaps Large Trader Reports, the Commission may further reevaluate the appropriate ratio between physical-delivery and cash-settled spot-month position limits and, in that connection, seek additional comments from the public.

5. Resetting Spot-Month Limits

The Proposed Rules required that DCMs submit estimates of deliverable supply to the Commission by the 31st of December of each calendar year. The Proposed Rules also provided that the Commission would rely on either these DCM estimates or its own estimates to revise spot-month position limits on an annual basis.[110] Two commenters commented that the Commission's proposed process for DCMs providing their deliverable supply estimates within the proposed time frame was operationally infeasible.[111]

Others criticized the setting of spot-month limits on an annual basis. MFA commented that the limits should reflect seasonal deliverable supply by using either data based on the prior year's deliverable supply estimates or more frequent re-setting.[112] The Institute for Agriculture and Trade Policy ("IATP") commented that the spot-month position limits for legacy agricultural commodities will likely require more than annual revision due to the effects of climate change on the estimated deliverable supply for each Referenced Contract.[113] IATP also urged the

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110 See § 151.4(c). Under the Proposed Rules, spot-month legacy limits would not be subject to periodic resets.

111 CL-CME I supra note 8 at 9; and CL-MGEX supra note 75 at 2. In addition, the MGEX stated that it is impractical to try to ascertain an accurate estimate of deliverable supply because there are too many variable and unknown factors that affect an agricultural commodity's production and the amount that is sent to delivery points. CL-MGEX supra note 74 at 2.

112 CL-MFA supra note 21 at 18.

113 IATP on March 28, 2011 ("CL-IATP") at 5.

Commission to amend the proposal to provide for emergency meetings to estimate deliverable supply if prices or supply become volatile.[114]

Two commenters expressed concern about the potential volatility in the limit levels introduced by the Commission's proposed annual process for setting spot-month limits. BGA commented that spot-month limits that are changed too frequently (annually would be too frequent in their view) could result in a "flash crash" as traders make large position changes in order to comply with a potentially new lower limit.[115] BGA suggested that this concern could be addressed through, among other things, less frequent changes to the spot-month position limit levels and by providing the market a several-month "cure period."[116] ISDA/SIFMA suggested that year-to-year spot-month limit level volatility could be addressed by using a five-year rolling average of estimated deliverable supply.[117]

The Commission recognizes the concerns regarding the necessity and desirability of an annual updating of the deliverable supply calculations on a single anniversary date, and that under normal market conditions, agricultural, energy, and metal commodities typically do not exhibit dramatic and sustained changes in their supply and demand fundamentals from year-to-year. Accordingly, the Commission has determined to update spot-month limits biennially (every two years) for energy and metal Referenced Contracts instead of annually, and to stagger the dates on which estimates of deliverable supply shall be submitted by DCMs. These changes should mitigate the costs of compliance for DCMs to prepare and submit estimates of deliverable

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114 Id. at 3.

115 CL-BGA supra note 35 at 20.

116 Id.

117 CL-ISDA/SIFMA supra note 21 at 22.

supply to the Commission. Under the final rule, DCMs may petition the Commission to update the limits on a more frequent basis should supply and demand fundamentals warrant it.

Finally, in response to comments, the Commission has made minor modifications to the definition of the "spot month" to provide for consistency with DCMs' current practices in the administration of spot-month limits for the Referenced Contracts.

E. Non-Spot-Month Limits

The Commission proposed to impose aggregate position limits outside of the spot month in order to prevent a speculative trader from acquiring excessively large positions and, thereby, to help prevent excessive speculation and deter and prevent market manipulations, squeezes, and corners.[118] Furthermore, the Commission provided that the "resultant limits are purposely designed to be high in order to ensure sufficient liquidity for bona fide hedgers and avoid disrupting the price discovery process given the limited information the Commission has with respect to the size of the physical commodity swap markets."[119]

In the proposal, the formula for the non-spot-month position limits is based on total open interest for all Referenced Contracts in a commodity. The actual position limit is based on a formula: 10 percent of the open interest for the first 25,000 contracts and 2.5 percent of the open interest thereafter.[120] The limits for each Referenced Contracts included class limits with one class comprised of all futures and option contracts and the second class comprised of all swap

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118 76 FR at 4752, 4759.

119 Id.

120 By way of example, assuming a Referenced Contract has average all-months-combined aggregate open interest of 1 million contracts, the level of the non-spot-month position limits would equal 26,900 contracts. This level is calculated as the sum of 2,500 (i.e., 10 percent times the first 25,000 contracts open interest) and 24,375 (i.e., 2.5 percent of the 975,000 contracts remaining open interest), which equals 26,875 (rounded up to the nearest 100 under the rules (i.e., 26,900)).

contracts. A trader could net positions within the same class, but could not net its position across classes. The limits also included an aggregate all-months-combined limit and a single month limit; however, the limit for the single month would be the same size as the limit for all months.

The Commission received many comments about the rationale for and design of the proposed non-spot-month limits. Many commenters opined that the proposed aggregate non-spot-month limits would not be sufficiently restrictive to prevent excessive speculation.[121] Better Markets explained, for example, that the proposed non-spot-month limits address manipulation by limiting the position size of a single individual while position limits intended to reduce excessive speculation should aim to reduce total speculative participation in the market.[122] These commenters recommended that, in order to address excessive speculation, the Commission should set limits designed to limit speculative activity to a target level.[123]

Other commenters questioned the utility of non-spot-month limits generally.[124] AIMA, for example, opined that "[a]lthough ... limits within the spot-month may be effective to prevent

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121 CL-ATA supra note 81 at 3-4; CL-ATAA supra note 94 at 7; CL-Better Markets supra note 37 at 70-71; CL-Delta supra note 20 at 2-6; CL-FWW supra note 81 at 11; and CL-PMAA/NEFI supra note 6 at 7, 10. 3,178 form comment letters asked the Commission to impose a limit of 1,500 contracts on Referenced Contracts in silver.

122 See e.g., CL-Better Markets supra note 37 at 61-64.

123 CL-ATA supra note 81 at 4-5; CL-AFR supra note 17 at 5-6; CL-ATAA supra note 94 at 3, 6, 9-10, 12; CL-Better Markets supra note 37 at 70-71 (recommending the Commission to limit non-commodity index and commodity index speculative participation in the market to 30 percent and 10 percent of open interest, respectively); CL-Delta supra note 20 at 5; and CL-PMAA/NEFI supra note 6 at 7. See also Daniel McKenzie on March 28, 2011 ("CL-McKenzie") at 3. The Petroleum Marketers Association of America and the New England Fuel Institute, for example, suggested that the distribution of large speculative traders' positions in the market may be an appropriate factor to be considered in developing these speculative target limits.

124 American Gas Association ("AGA") on March 28, 2011 ("CL-AGA") at 13; CL-AIMA supra note 35 at 3; CL-BlackRock supra note 21 at 18; CL-CME I supra note 8 at 21; CL-FIA I supra note 21 at 11 (Commission's prior guidance does not provide a basis today for an exemption from hard speculative position limits for markets with large open-interest, high trading volumes and liquid cash markets); CL-Goldman supra note 89 at 6; CL-ISDA/SIFMA supra note 21 at 18; CL-MGEX supra note 74 at 1 (Commission's proposed formulaic approach to non-spot-month position limits seems arbitrary); Natural Gas Supply Association ("NGSA") and National Corn Growers Association ("NCGA") on March 28, 201, ("CL-NGSA/NCGA") at 4-5 (position limits outside the spot month should be eliminated or be increased substantially because threats of manipulation and excessive speculation

'corners and squeezes' at settlement, the case for placing position limits in non-spot-months is less convincing and has not been made by the Commission."[125] The FIA commented that non-spot-month position limits are not necessary to prevent excessive speculation.[126]

A number of commenters opined that the Commission should increase the open interest multipliers in the formula used in determining the non-spot-month position limits.[127] Other commenters opined that the Commission should decrease the open interest multipliers to 5 percent of open interest for first 25,000 contracts and then 2.5 percent.[128] PMAA and the NEFI commented that the formula, which was developed in 1992 in the context of agricultural commodities, is inappropriate for current markets with larger open interest relative to the agricultural markets.[129]

Goldman Sachs recommended that the Commission use a longer observation period than one year for setting position limits and provided as an example five years in order to reduce pro-

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are primarily of concern in the physical-delivery spot month contract); CL-PIMCO supra note 21 at 6; Global Energy Management Institute, Bauer College of Business, University of Houston ("Prof. Pirrong") on January 27, 2011 ("CL-Prof. Pirrong") at para. 21 (Commission has provided no evidence that the limits it has proposed are necessary to reduce the Hunt-like risk that the Commission uses as a justification for its limits); CL-SIFMA AMG I supra note 21 at 8; Teucrium Trading LLC ("Teucrium") on March 28, 2011 ("CL-Teucrium") at 2 (limiting the size of positions that a non-commercial market participant can hold in forward (non-spot) futures contracts or financially-settled swaps, the Commission will restrict the flow of capital into an area where it is needed most - the longer term price curve); and CL-WGCEF supra note 35 at 4.

125 CL-AIMA supra note 35 at 3.

126 CL-FIA I supra note 21 at 11.

127 See CL-AIMA supra note 35 at 3; CL-CME I supra note 8 at 12 (for energy and metals); CL-FIA I supra note 21 at 12 (10 percent of open interest for first 25,000 contracts and then 5 percent); CL-ICI supra note 21 at 10 (10 percent of open interest until requisite market data is available); CL-ISDA/SIFMA supra note 21 at 20; CL-NGSA/NCGA supra note 125 at 5 (25 percent of open interest); and CL-PIMCO supra note 21 at 11.

128 See CL-Prof. Greenberger supra note 6 at 13; and CL-FWW supra note 82 at 12.

129 CL-PMAA/NEFI supra note 6 at 9 (PMAA/NEFI commented that as open interest in markets has grown well beyond the open interest assumptions made in 1992, the size of large speculative positions has not grown commensurately and that therefore the Commission should decrease the marginal multiplier in the position limit formula as open interest increases. PMAA/NEFI commented further that the Commission should look at the actual positions by traders and set limits to constrain the largest positions in the resulting distribution).

cyclical effects (e.g., a decrease in open interest due to decreased speculative activity in one period results in a limit in the subsequent period that is excessively restrictive or vice-versa).[130]

As stated in the proposal, the non-spot-month position limits are intended to maximize the CEA section 4a(a)(3)(B) objectives, consistent with the Commission's historical approach to setting non-spot-month speculative position limits.[131] Such a limits formula, in the Commission's view, prevents a speculative trader from acquiring excessively large positions and thereby would help prevent excessive speculation and deter and prevent market manipulations, squeezes, and corners. The Commission also believes, based on its experience under part 150, that the 10 and 2.5 percent formula will ensure sufficient liquidity for bona fide hedgers and avoids disruption to the price discovery process.

The Commission notes that Congress implicitly recognized the inherent uncertainty regarding future effects associated with setting limits prophylactically and therefore directed the Commission, under section 719(a) of the Dodd-Frank Act, to study on a retrospective basis the effects (if any) of the position limits imposed pursuant to section 4a on excessive speculation and on the movement of transactions from DCMs to foreign venues.[132] This study will be conducted in consultation with DCMs and is to be completed within 12 months after the imposition of position limits. Following Congress' direction, the Commission will conduct an evaluation of position limits in performing this study and, thereafter, the Commission plans to continue monitoring these limits, considering the statutory objectives under section 4a(a)(3), and, if warranted, amend by rulemaking, after notice and comment, the formula adopted herein to

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130 See CL-Goldman supra note 90 at 6-7.

131 The Commission has used the 10 and 2.5 percent formula in administering the level of the legacy all-months position limits since 1999. See e.g., 64 FR 24038, 24039, May 5, 1999. See also 17 CFR 150.5(c)(2).

132 Dodd-Frank Act, supra note 1, section 719(a).

determine non-spot-month position limits. The Commission may determine to reassess the formula used to set non-spot-month position limits based on the study's findings.

1. Single-month, Non-spot Position Limits

Under proposed § 151.4(d)(1), the Commission proposed to set the single-month limit at the same level as the all-months-combined position limit. Several commenters requested that the Commission reconsider this approach.[133] The Air Transportation Association of America, for example, argued that the proposed level would exacerbate the problem of speculative trading in the nearby (next to expire) futures month, the month upon which energy prices typically are determined.[134]

Three commenters, including ICE, cautioned the Commission not to impose position limits that constrain speculative liquidity in the outer month expirations of Referenced Contracts, that is, in contracts that expire in distant years, as opposed to nearby contract expirations.[135] ICE further asked the Commission to consider whether all-months-combined limits are necessary or appropriate in energy markets in the outer months. ICE stated that such limits would decrease liquidity for hedgers in the outer months and, moreover, all-months limits are not appropriate for energy markets where hedging is done on a much longer term basis relative to the agricultural markets where hedging is primarily conducted to hedge the next year's crops.[136] Teucrium

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133 CL-APGA supra note 17 at 2-3; CL-ATAA supra note 94 at 6, 13; CL-PMAA/NEFI supra note 6 at 11. 6,074 form comment letters asked the Commission to adopt "single-month limits that are no higher than two-thirds of the all-months-combined levels."

134 CL-ATAA supra note 94 at 6. They also asserted that the Commission did not provide adequate justification for substantially raising the single month limit to the same level as the all-months combined limit. Id. at 13.

135 CL-ICE I supra note 69 at 9-10; CL-ISDA/SIFMA supra note 21 at 19; and CL-Teucrium supra note 124 at 2.

136 CL-ICE I supra note 69 at 9-10.

Trading argued that by limiting the size of positions that a non-commercial market participant can hold in forward (non-spot) futures contracts or financially-settled swaps, the Commission would restrict the flow of capital into an area where it is needed most -- the longer term price curve, that is, contracts that expire in distant years.[137]

The Commission has determined to set the single-month position limit levels at the same level as the all-months-combined limits, consistent with the proposal. Under current part 150, the Commission sets a single-month limit at a level that is lower than the all-months-combined limit; it also provides a limited exemption for calendar spread positions to exceed that single-month limit under § 150.4(a)(3), as long as the single month position (including calendar spread positions) is no greater than the level of the all-months-combined limit. Further, the Commission does not have a standard methodology for determining how much smaller the level of the single-month limit is set in comparison to the level of the all-months-combined limit.

The Commission has made this determination for two reasons. First, setting the single-month limit to the same level as that of the all-months-combined limit simplifies the compliance burden on market participants and renders the calendar spread exemption unnecessary. Second, setting the limits at the same level for both spreaders and other speculative traders will permit parity in position size between these speculative traders in a single calendar month and, thus, may serve to diminish unwarranted price fluctuations.[138]

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137 CL-Teucrium supra note 124 at 2.

138 The Commission notes that commenters arguing for more restrictive individual month limits did not provide any supporting data.

With respect to objections to deferred-month limits, the Commission notes that Congress instructed the Commission to set limits on the spot month, each other month, and the aggregate number of positions that may be held by any person for all months.[139]

Finally, the Commission will continually monitor the size, behavior, and impact of large speculative positions in single contract months in order to determine whether it should adjust the single-month limit levels.

2. "Step-down" Position Limit

Three commenters recommended that the Commission adopt, in addition to the spot-month limit and the single-month and all-months-combined limits, an intermediate "step-down" limit between the spot-month position limit and the single-month non-spot-month position limit.[140] This "step-down" limit would be less restrictive than the spot-month limit, but more restrictive than the single-month limit. BGA recommended that the single-month limit should be scaled down rationally before it reaches the spot month so that the market will not be disrupted by panic selling on the day before the spot-month limit becomes effective.[141] The commenters did not propose alternative criteria for imposing a step-down provision.

Currently, the Commission and DCMs establish a single date when the spot-month limit becomes effective. DCMs publicly disseminate this date as part of their contracts' rules. The advance notice provides sufficient time for market participants to reduce their positions as necessary. The Commission is not aware of material issues related to these provisions regarding

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139 CEA section 4a(a)(3)(A), 7 USC 6a(a)(3)(A).

140 CL-BGA supra note 35 at 11; GFI Group ("GFI") on January 31, 2011 ("CL-GFI") at 2 (progressively tighter limits should apply for physically-delivered energy contracts as they near expiration/delivery); and CL-PMAA/NEFI supra note 6 at 11.

141 CL-BGA supra note 35 at 11.

the implementation of spot month limits. The Commission further believes this practice ensures sufficient market liquidity for bona fide hedgers and helps to deter and prevent squeezes and corners in the spot period while providing trader flexibility to manage positions and remain in compliance with the limits. The Commission notes, however, that it will monitor trading activity and resulting changes in prices in the transition period into the spot month in order to determine whether it should impose a new "step-down" limit for Referenced Contracts nearing the spot-month period.

3. Setting and Resetting Non-Spot-Month Limits

The Commission proposed all-months-combined aggregate limits and single-month aggregate limits in proposed § 151.4(d)(1). The Commission is adopting those proposed limits in final § 151.4(b)(1), which sets forth single-month and all-months-combined position limits for non-legacy Referenced Contracts (i.e., those agricultural contracts that currently are not subject to federal position limits as well as energy and metal contracts). These limits would be fixed based on the following formula: 10 percent of the first 25,000 contracts of average all-months-combined aggregated open interest and 2.5 percent of the open interest for any amounts above 25,000 contracts of average all-months-combined aggregated open interest.

Under proposed § 151.4(b)(1)(i), aggregated open interest is derived from month-end open interest values for a 12-month time period. The Commission would use open interest to determine the average all-months-combined open interest for the relevant period, which, in turn, will form the basis for the non-spot-month position limits.

Under the Proposed Rules, the Commission would calculate, for all Referenced Contracts, open interest on an annual basis for a 12-month period, January to December, and then, based on those calculations, publish the updated non-spot-month position limits by January

31st of the following calendar year. The updated limits would become effective 30 business days after such publication. With respect to the initial limits, they would become effective pursuant to a Commission order under proposed § 151.4(h)(3) and would be based on 12 months of open interest data.

Several commenters urged the Commission to use a transparent and accessible methodology to determine non-spot-month position limits.[142] Some of these commenters recommended that updated non-spot-month limits be determined through rulemaking, and not through automatic annual recalculations as proposed.[143]

The World Gold Council argued that uncertainty associated with floating, annually-set position limits may inadvertently discourage market participants from providing the requisite long-term hedges.[144] Encana asked the Commission to consider adopting procedures for a periodic reevaluation of the formulas to ensure that they do not reduce liquidity or impair the price discovery function of the markets.[145]

Many commenters objected to the proposed timeline for setting initial limits.[146] For example, many comments urged the Commission to act "expeditiously." Delta recommended

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142 CL-FIA I supra note 21 at 12; CL-BlackRock supra note 21 at 18; CL-CME I supra note 8 at 12; CL-EEI/EPSA supra note 21 at 11; CL-KCBT I supra note 97 at 3; CL-NGFA supra note 72 at 3; CL-WGC supra note 21 at 5; and CL-ISDA/SIFMA supra note 21 at 21.

143 CL-BlackRock supra note 21 at 18; CL-CME I supra note 8 at 12; CL-EEI/EPSA supra note 21 at 11; CL-KCBT I supra note 97 at 3; CL-NGFA supra note 70 at 3; and CL-WGC supra note 21 at 5. BlackRock argued that a formal rulemaking process for adjusting position limit levels would provide market participants with advanced notice of any potential changes and an opportunity to express their views on such changes.

144 CL-WGC supra note 21 at 5.

145 Encana Marketing (USA) Inc. ("Encana") on March 28, 2011 ("CL-Encana") at 2.

146 See e.g., CL-Delta supra note 20 at 11.

the Commission should use sampling and other statistical techniques to make reasonable, working assumptions about positions in various market segments to set initial limits.

In response to comments, the Commission has determined to amend the proposed process for setting initial and subsequent non-spot-month position limits. With respect to initial non-spot-month position limits, under § 151.4(d)(3)(i) the initial non-spot-month limits for non-legacy Referenced Contracts will be calculated and published after the Commission has received data sufficient to determine average all-months-combined aggregate open interest for a full 12-month period. The aggregate open interest will be derived from various sources, including data received from DCMs pursuant to part 16, swaps data under part 20, and data regarding linked, direct access FBOT contracts under a condition of a no-action letter and subsequently under part 48 regarding FBOT registration with the Commission, when finalized and made effective. The Commission accepts part of Delta's recommendation to utilize reasonable, working assumptions about positions in various market segments to set initial limits. In this regard, the Commission will strive to establish non-spot-month position limits in an expedited manner that complies with the directives of Congress, while ensuring that it has sufficient swaps data to properly estimate open interest levels for Referenced Contracts.

To compute 12 months of open interest data in uncleared all-months-combined swaps open interest, prior to the timely reporting of all swap dealers' net uncleared open swaps and swaptions positions by counterparty, the Commission may estimate uncleared open swaps positions, based upon uncleared open interest data submitted by clearing organizations or clearing members under part 20, in lieu of the aggregate of swap dealers' net uncleared open swaps. In developing accurate estimates of aggregate open interest under § 151.4(b)(2)(i), the Commission will adjust such uncleared open interest data submitted by clearing organizations or

clearing members by an appropriate ratio if it determines, using data regarding later periods submitted by swap dealers and clearing members, that the uncleared open interest data submitted by clearing members differ significantly from the open interest data submitted by swap dealers.[147] The Commission has accordingly provided, under § 151.4(b)(2)(ii), that, based on data provided to the Commission under part 20, it may estimate uncleared swaps open positions for the purpose of setting initial non-spot-month position limits.

Under final § 151.4(d)(3)(i), the Commission will review the staff computations, including the assumptions made in estimating 12 months of uncleared all-months-combined swap open interest, for consistency with the formula in the final rules. Once the Commission determines that the staff computations conform to the established formula, the Commission will approve and issue an order under final § 151.4(d)(3)(iii), publishing the initial levels of the non-spot-month position limits.

Under final § 151.4(d)(3)(ii), subsequent non-spot-month limits for non-legacy Referenced Contracts will be updated and published every two years, commencing two years after the initial determinations. These subsequent position limits would be based on the higher of the most recent 12 months average all-months-combined aggregate open interest or 24 months average all-months-combined aggregate open interest.[148] Under § 151.4(e), these limits would

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[147] An appropriate ratio is the ratio of uncleared open interest submitted by swap dealers in such later periods to the uncleared open interest submitted by clearing members in such later periods.

[148] For example, assume in a particular Referenced Contract that open interest has declined over a 24-month period; the average all-months-combined aggregate open interest levels are 900,000 contracts for the most recent 12 months and 1,000,000 contracts for the most recent 24 months. Position limits would be based on the higher 24-month average level of 1,000,000 contracts. Thereby, the higher level of the position limit may serve to ensure sufficient market liquidity for bona fide hedgers in the event, for example, a decline in use of derivatives occurred in the historical measurement period that may be associated with a recession. Because position limits apply to prospective time periods, the use of the higher level may be appropriate, for example, with a subsequent expansionary period.

be made effective on the first calendar day of the third calendar month after the date of publication on the Commission's website.

This procedure may provide for limits that would be generally less restrictive than the proposed limits, since, by way of example, a continued decline in open interest over two years under the Proposed Rule would result in a lower limit each year, whereas under the final rule the limit for the first year would not decline and the limit for the second year would be based on the higher 24-month average open interest. The Commission also notes that under § 151.4(e) the public would have notice of updated position limit levels at least two months in advance of the effective date of such limits (i.e., such limits would be made effective on the first calendar day of the third calendar month immediately following the publication of new limit levels).[149] Final § 151.5(e) requires the Commission to provide all relevant open interest data used to derive updated position limit levels. By making public this open interest data, the public can monitor and anticipate future position limit levels, consistent with the transparency suggestions made by several commenters.

In addition, § 151.4(b)(2)(i)(C) provides that, upon the entry of an order under Commission regulation 20.9 of the Commission's regulations determining that operating swap data repositories ("SDRs") are processing positional data that will enable the Commission to conduct surveillance in the relevant swaps markets, the Commission shall rely on such data in order to determine all-months-combined swaps open interest.

4. "Legacy Limits" for Certain Agricultural Commodities

The Proposed Rule would set non-spot-month limits for Reference Contracts in legacy agricultural commodities at the federal levels currently in place (referred to herein as "legacy

[149] For example, any limits fixed during the month of October would take effect on January 1.

limits"). Several commenters recommended that the Commission should keep the legacy limits.[150] The American Bakers Association argued that raising these legacy limits would increase hedging margins and increase volatility which would ultimately undermine commodity producers' ability to sell their product to consumers.[151] Amcot opined that the Commission need not proceed with phased implementation for the legacy agricultural markets because it could set their limits based on existing legacy limits.[152]

Several other commenters recommended that the Commission abandon the legacy limits.[153] U.S. Commodity Funds argued that the Commission offered no justification for treating legacy agricultural contracts differently than other Referenced Contract commodities.[154] Some of these commenters endorsed the limits proposed by CME.[155] Other commenters recommended the use of the open interest formula proposed by the Commission in determining the position limits applicable to the legacy agricultural Referenced Contract markets.[156] Finally,

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150 American Bakers Association ("ABA") on March 28, 2011 ("CL-ABA") at 3-4; CL-AFIA supra note 94 at 3; Amcot on March 28, 2011 ("CL-Amcot") at 2; CL-FWW supra note 81 at 13; CL-IATP supra note 113 at 5; and CL-NGFA supra note 72 at 1-2.

151 CL-ABA supra note 150 at 3-4.

152 CL-Amcot supra note 150 at 3.

153 CL-AIMA supra note 35 at 4; Bunge on March 28, 2011 ("CL-Bunge") at 1-2; Deutsche Bank AG ("DB") on March 28, 2011 ("CL-DB") at 6; Gresham Investment Management LLC ("Gresham") on February 15, 2011 ("CL-Gresham") at 4-5; CL-FIA I supra note 21 at 12; CL-MGEX supra note 74 at 2; CL-MFA supra note 21 at 18-19; and United States Commodity Funds LLC ("USCF") on March 25, 2011 ("CL-USCF") at 10-11.

154 CL-USCF supra note 153 at 10-11.

155 CL-Bunge supra note 153 at 1-2; CL-FIA I supra note 21 at 12; and CL-Gresham supra note 153 at 5. See CME Petition for Amendment of Commodity Futures Trading Commission Regulation 150.2 (April 6, 2010), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/df26_cmepetition.pdf.

156 CL-CMC supra note 21 at 3; CL-DB supra note 153 at 10; and CL-MFA supra note 21 at 19.

four commenters expressed their preference that non-spot position limits be kept consistent for the three wheat Core Referenced Futures Contracts.[157]

The Commission has determined to adopt the position limit levels proposed by the CME for the legacy Core Referenced Futures Contracts. Such levels would be effective 60 days after the publication date of this rulemaking and those levels would be subject to the existing provisions of current part 150 until the compliance date of these rules, which is 60 days after the Commission further defines the term "swap" under the Dodd-Frank Act. At that point, the relevant provisions of this part 151, including those relating to bona-fide hedging and account aggregation, would also apply. In the Commission's judgment, the CME proposal represents a measured approach to increasing legacy limits, similar to that previously implemented.[158] The Commission will use the CME's all-months-combined petition levels as the basis to increase the levels of the non-spot-month limits for legacy Referenced Contracts. The petition levels were based on 2009 average month-end open interest. Adoption of the petition levels results in increases in limit levels that range from 23 to 85 percent higher than the levels in existing § 150.2.

The Commission has determined to maintain the current approach to setting and resetting legacy limits because it is consistent with the Commission's historical approach to setting such limits. To ensure the continuation of maintaining a parity of limit levels for the major wheat contracts at DCMs and in response to comments supporting this approach, the Commission will

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157 CL-CMC supra note 21 at 3; CL-KCBT I supra note 97 at 1-2; CL-MGEX supra note 74 at 2; and CL-NGFA supra note 72 at 4.

158 58 FR 18057, April 7, 1993.

also increase the levels of the limits on wheat at the MGEX and the KCBT to the level for the wheat contract at the CBOT.[159]

5. Non-Spot Month Class Limits

The Commission proposed to create two classes of contracts for non-spot-month limits: (1) futures and options on futures contracts and (2) swaps. The Proposed Rule would apply single-month and all-months-combined position limits to each class separately.[160] The aggregate position limits across contract classes are in addition to the position limits within each contract class. Therefore, a trader could hold positions up to the allowed limit in each class (futures and options and swaps), provided that their overall position remains within the applicable position limits. Under the proposal, a trader could net positions within a class, such as a long swap position with a short swap position, but could not net positions in different classes, such as a long futures position with a short swap position. The class limits were designed to diminish the possibility that a trader could have market power as a result of a concentration in any one submarket and to prevent a trader that had a flat net aggregate position in futures and swaps combined from establishing extraordinarily large offsetting positions.

Several commenters stated that the class limits proposal was flawed and therefore should not be adopted.[161] For example, the CME argued that because the class limits would not permit

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159 For a discussion of the historical approach, see 64 FR 24038, 24039, May 5, 1999.

160 Within a contract class, the limits would be set at an amount equal to 10 percent of the first 25,000 contracts of average all-months-combined aggregate open interest in the contract and 2.5 percent of the open interest for any amounts above 25,000 contracts. The aggregate all-months-combined limits across contract classes would be set at 10 percent of the first 25,000 contracts of average all-months-combined aggregated open interests, and 2.5 percent of the open interest thereafter. The average all-months-combined aggregate open interest, which is the basis of these calculations, is determined annually by adding the all-months futures open interest and the all-month-combined swaps open interest for each of the 12 months prior to the effective date and dividing that amount by 12. Each trader's positions would be netted for the purpose of determining compliance with position limits.

161 CL-AIMA supra note 35 at 3 (they add "an unnecessary level of complexity"); CL-BlackRock supra note 21 at 17; CL-Cargill supra note 76 at 10; CL-CME I supra note 8 at 13; CL-DB supra note 153 at 8-9; CL-Goldman

netting across contract classes (that is, across futures and swaps), the class limits would not appropriately limit a trader's actual (net) speculative positions. CME further objected to this proposal by stating that the Commission provided no rationale as to why the positions in two futures contracts could be netted but positions in swaps and futures could not be netted.[162] Another commenter similarly argued that economically equivalent contracts (futures or swaps) are simply two components of a broader derivatives market for a particular commodity and, therefore, the concept of establishing limits on a class of economically equivalent derivatives was logically flawed.[163]

In response to the comments, the Commission has determined to eliminate class limits from the final rules. The Commission believes that comments regarding the ability of market participants to net swaps and future positions that are economically equivalent have merit. The Commission believes that concerns regarding the potential for market abuses through the use of futures and swaps positions can be addressed adequately, for the time being, by the Commission's large trader surveillance program. The Commission will closely monitor speculative positions in Referenced Contracts and may revisit this issue as appropriate.

F. Intraday Compliance with Position Limits

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supra note 89 at 6; CL-ICE I supra note 69 at 9; CL-ISDA/SIFMA supra note 21 at 23; CL-MFA supra note 21 at 18; CL- Prof. Pirrong supra note 124 at paras. 24-30; and CL-Shell supra note 35 at 6.

162 CL-Shell supra note 35 at 6; CL-BlackRock supra note 21 at 17 (arguing that the Commission failed to demonstrate that large positions in a submarket implies market power). See also CL-Cargill supra note 76 at 10; CL-AIMA supra note 35 (commenting that the proposed class limits add "an unnecessary level of complexity"); CL-ISDA/SIFMA supra note 21 at 23; CL-ICE I supra note 69 at 9;CL-CME I supra note 8 at 13; CL-DB supra note 153 at 8-9; CL-Goldman supra note 89 at 6; CL-MFA supra note 21 at 18; and CL-Prof. Pirrong supra note 124 at paras. 24-30.

163 CL-ICE I supra note 69 at pg. 9.

The Commission proposed to apply position limits on an intraday basis, and some commenters urged the Commission to reconsider such a requirement.[164] Barclays commented that the Commission should recognize intraday violations of aggregate limits as a form of excusable overage because of the challenge of sharing and collating position information on a real-time basis.

In the Commission's judgment, intraday compliance would constitute a marginal compliance cost and not be overly-burdensome. The Commission notes that firms may impose risk limits (i.e., position limits determined by the internal risk management department or equivalent unit) on individual traders and among related entities required to aggregate positions under § 151.7 to mitigate the need to create systems to ensure intraday compliance. Moreover, the expected levels of limits outside of the spot-month are not expected to affect many firms and those affected firms should have the capability to establish internal risk limits or real-time position reporting to ensure intraday compliance with position limits. Finally, the Commission notes that intraday compliance with position limits is consistent with existing Commission[165] and DCM[166] policy. The Commission's policy on intraday compliance reflects its concerns with very large speculative positions, whether or not they persist through the end of a trading day.

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164 CL-Shell supra note 35 at 6-7; CL-API supra note 21 at 14 (Commission should engage in a rigorous analysis of the regulatory burdens of intraday limits and ultimately clarify that position limits will only apply at the end of each trading day); Barclays Capital ("Barclays I") on March 28, 2011 ("CL-Barclays I") at 4-5 (Commission should reconsider requiring intraday compliance for non-spot-month position limits).

165 Commodity Futures Trading Commission Division of Market Oversight, Advisory Regarding Compliance with Speculative Position Limits (May 7, 2010), available at http://www.cftc.gov/ucm/groups/public/@industryoversight/documents/file/specpositionlimitsadvisory0510.pdf.

166 See e.g., CME Rulebook, Rule 443, available at http://www.cmegroup.com/rulebook/files/CME_Group_RA0909-5.pdf") (amended Sept. 14, 2009); ICE OTC Advisory, Updated Notice Regarding Position Limit Exemption Request Form for Significant Price Discovery Contracts, available at https://www.theice.com/publicdocs/otc/advisory_notices/ICE_OTC_Advisory_0110001.pdf (Jan. 4, 2010).

G. Bona Fide Hedging and Other Exemptions

The new statutory definition of bona fide hedging transactions or positions in section 4a(c)(2) of the CEA generally follows the definition of bona fide hedging in current Commission regulation 1.3(z)(1), with two significant differences. First, the new statutory definition recognizes a position in a futures contract established to reduce the risks of a swap position as a bona fide hedge, provided that either: (1) the counterparty to such swap transaction would have qualified for a bona fide hedging transaction exemption, i.e., the "pass-through" of the bona fides of one swap counterparty to another (such swaps may be termed "pass-through swaps"); or (2) the swap meets the requirements of a bona fide hedging transaction. Second, a bona fide hedging transaction or position must represent a substitute for a physical market transaction.[167]

Section 4a(c)(1) of the CEA authorizes the Commission to define bona fide hedging transactions or positions "consistent with the purposes of this Act." Congress directed the Commission, in amended CEA section 4a(c)(2), to adopt a definition of bona fide hedging transactions or positions for futures contracts (and options) for purposes of setting the position limits mandated by CEA section 4a(a)(2)(A). Pursuant to this authority, the Commission proposed a new regulatory definition of bona fide hedging transactions or positions in proposed § 151.5(a).[168] The Commission also proposed § 151.5 to establish five enumerated exemptions

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[167] In 1977, the Commission proposed a general or conceptual definition of bona fide hedging that did not include the modifying adverb "normally" to the verb "represent." 42 FR 14832, Mar. 17, 1977. The Commission introduced the adverb normally in the subsequent final rulemaking in order to accommodate balance sheet hedging that would otherwise not have met the general definition of bona fide hedging. 42 FR 42748, Aug. 24, 1977. The Commission noted that, for example, hedges of asset value volatility associated with depreciable capital assets might not represent a substitute for subsequent transactions in a physical marketing channel. Id. at 42749.

[168] By its terms, the definition of bona fide hedging applies only to futures (and options). Pursuant to section 4a(c), the Commission proposed to extend the definition of bona fide hedging transactions and positions to all Referenced Contracts, including swaps. The Commission is adopting the definition of bona fide hedging substantially as proposed. The Commission believes that applying the statutory definition of bona fide hedging to swaps is consistent with congressional intent as embodied in the expansion of the Commission's authority to swaps (i.e., those that are economically-equivalent and SPDFs), In granting the Commission authority over such swaps,

from position limits for bona fide hedging transactions or positions for exempt and agricultural commodities.

Under the proposal, a trader must meet the general requirements for a bona fide hedging transaction or position in proposed § 151.5(a)(1) and also meet the requirements for an enumerated hedging transaction in proposed § 151.5(a)(2). The general requirements call for the bona fide hedging transaction or position to represent a substitute for transactions in a physical marketing channel (that is, the cash market for a physical commodity), to be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, and to arise from the potential change in the value of certain assets, liabilities, or services. The five proposed enumerated hedging transactions are discussed below. The proposed section did not provide for non-enumerated hedging transactions or positions, which current Commission regulations 1.3(z)(3) and 1.47 permit. Under the proposal, Commission regulation 1.3(z) would be retained only for excluded commodities.

Proposed § 151.5(b) established reporting requirements for a trader upon exceeding a position limit. The trader would be required to submit information not later than 9:00 a.m. on the business day following the day the limit was exceeded. Proposed § 151.5(c) specified application and approval requirements for traders seeking an anticipatory hedge exemption, incorporating the current requirements of Commission regulation 1.48. Proposed § 151.5(d) established additional reporting requirements for a trader who exceeded the position limits in order to reduce the risks of certain swap transactions, discussed above.

Congress recognized that such swaps warrant similar treatment to their economically equivalent futures for purposes of position limits and therefore, intended that the statutory definition of bona fide hedging also be extended to swaps.

Proposed § 151.5(e) specified recordkeeping requirements for traders that acquire positions in reliance on bona fide hedge exemptions, as well as for swap counterparties for which a counterparty represents that the transaction would qualify as a bona fide hedging transaction. Swap dealers availing themselves of a hedge exemption would be required to maintain a list of such counterparties and make that list available to the Commission upon request. Proposed §§ 151.5(g) and (h) provided procedural documentation requirements for such swap participants.

Proposed § 151.5(f) required a cross-commodity hedger to provide conversion information, as well as an explanation of the methodology used to determine such conversion information, between the commodity exposure and the Referenced Contracts used in hedging. Proposed § 151.5(i) required reports by bona fide hedgers to be filed for each business day, up to and including the day the trader's position level first falls below the position limit that was exceeded.

The Commission has responded to the many comments received by making substantial changes to the Proposed Rules. A full discussion of the comments received and of the Commission's responses is found below. In summary, in the final rules, the Commission: (1) clarifies that a transaction qualifies as a bona fide hedging transaction without regard to whether the hedger's position would otherwise exceed applicable position limits; (2) expands the list of enumerated hedging transactions to include hedging of anticipated merchandising activity, royalty payments, and service contracts; (3) clarifies the conditions under which swaps executed opposite a commercial counterparty would be recognized as the basis for bona fide hedging; (4) reduces the burden of claiming a pass-through swap exemption; (5) introduces new § 151.5(b) to make the aggregation and bona fide hedging provisions of part 151 consistent; (6) clarifies that cash market risk can be hedged on a one-to-one transactional basis or can be hedged as a

portfolio of risk; (7) eliminates the restriction on holding hedges in cash-settled contracts up through the last trading day; (8) reduces the daily filing requirement for cash market information on the Form 404 and Form 404S to a monthly filing of daily reports; (9) allows for self-effectuating notice filings for those hedge exemptions that require such a filing; and (10) provides an exemption for situations involving "financial distress."

1. Enumerated Hedges

Under proposed § 151.5(a)(1), no transaction or position would be classified as a bona fide hedging transaction unless it also satisfies the requirements for one of five categories of enumerated hedging transactions.[169]

The Commission received many comment letters regarding the proposed definition of bona fide hedging, with a number of commenters expressing concern that the proposed definition was ambiguous and overly restrictive.[170] Morgan Stanley, for example, opined that the "very narrow" definition of bona fide hedging in the Proposed Rule would unnecessarily limit the ability of many market participants to engage in "many well-established risk reducing activities."[171] Several commenters requested bona fide hedging recognition for transactions beyond those expressly enumerated.[172] In this respect, some commenters, including the FIA and

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169 Thus, for example, an anticipatory merchandising transaction could only serve as a basis of an enumerated hedge if it, inter alia, reduces the risks attendant to transactions anticipated to be made in the physical marketing channel.

170 See e.g., CL-FIA I supra note 21 at 14-15; CL-Morgan Stanley supra note 21 at 4,5; and CL-ISDA/SIFMA supra note 21 at 9.

171 CL-Morgan Stanley supra note 21 at 5. According to Morgan Stanley, the proposed definition may preclude market participants from (i) netting exposure across different categories of related futures and swaps; (ii) hedging long-term risks in illiquid markets, common in the development of large infrastructure projects; and (iii) assuming the positions of a less stable market participant during times of market distress.

172 See e.g., CL-Commercial Alliance I supra note 42 at 2-3; CL-FIA I supra note 21 at 13; and Economists Inc. on March 28, 2011 ("CL-Economists Inc.") at 2.

Morgan Stanley, urged the Commission to exercise its broad exemptive authority under CEA section 4a(a)(7) to accommodate a wider range of legitimate hedging activities, including the hedging of general swap position risk, otherwise known as a risk management exemption.[173]

Several commenters argued that not permitting a risk management exemption would be inconsistent with other parts of the Act and Commission rulemakings.[174] For example, CME argued that the hedging standard under the major swap participant ("MSP") definition includes swap positions "maintained by [pension plans] for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan."[175] CME also pointed to the commercial end-user exception to mandatory clearing requirements, where the Commission's proposed definition of hedging "covers swaps used to hedge or mitigate any of a person's business risks."[176]

As discussed above, the Commission is authorized to define bona fide hedging for swaps. The Commission, however, does not believe that including a risk management provision is necessary or appropriate given that the elimination of the class limits outside of the spot-month will allow entities, including swap dealers, to net Referenced Contracts whether futures or economically equivalent swaps. As such, under the final rules, positions in Referenced Contracts entered to reduce the general risk of a swap portfolio will be netted with the positions in the portfolio.

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173 See e.g., CL-FIA I supra note 21 at 13; CL-ISDA/SIFMA supra note 21 at 8; CL-BlackRock supra note 21 at 16; CL-Barclays I supra note 164 at 3; and CL-ICI supra note 21 at 9.

174 See e.g., CL-CME I supra note 8 at 18.

175 See id. at 18 citing New CEA section 1a(33), 7 U.S.C. 1a(33).

176 See id. at 18 citing 75 FR 80747 (Dec. 23, 2010).

Some commenters also objected to the Commission's failure to recognize as bona fide hedging swap transactions that qualify for the end-user clearing exception. Such omission, these commenters added, will lead to unnecessary disruption to commercial hedgers' legitimate business practices.[177] The end-user clearing exception is available for swap transactions used to hedge or mitigate commercial risk. When Congress inserted a general definition of bona fide hedging in CEA section 4a(c)(2), Congress did not include language that paralleled the end-user clearing exception; rather, Congress included different criteria for bona fide hedging transactions or positions.[178] Accordingly, the Commission believes that the end-user exception's broader sweep, that the swap be used for "hedg[ing] or mitigat[ing] commercial risk," is not appropriate for a definition of a bona fide hedging transaction.[179]

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[177] See e.g., CL-FIA I supra note 21 at 151 and CL-EEI/EPSA supra note 21 at 15.

[178] The Commission notes that Congress also referred to positions held "for hedging or mitigating commercial risk" in the definition of major swap participant. CEA section 1a(33), 7 U.S.C. 1a(33). Due to the nearly identical wording, the Commission has proposed to interpret this phrase in the implementation of the end user exception in a near-identical manner in the further definition of major swap participant. CFTC, Notice of Proposed Rulemaking, End-User Exception to Mandatory Clearing of Swaps, 75 FR 80747, 80752-3, Dec. 23, 2010. In light of Congress's nearly identical use of this language in two separate provisions of the Dodd-Frank Act, but not within the definition of bona fide hedging, the Commission does not believe that Congress intended that the different wording in section 4a(c)(2) should be interpreted in an identical manner to these differently worded provisions.

[179] Under the new statutory definition of a bona fide hedge, positions must meet the following requirements: (1) they must represent a substitute for transactions made or to be made or positions taken or to be taken at a later time in the physical marketing channel; (2) they must be economically appropriate to the reduction of risk in the conduct and management of a commercial enterprise; and (3) the hedge must manage price risks associated with specific types of activities in the physical marketing channel (e.g., the production of commodity assets). CEA section 4a(c)(2), 7 U.S.C. 6a(c)(2). The conditions for the end-user exception may overlap with the general statutory definition of bona fide hedging on one of the latter's three prongs. Similarly, the statutory direction to define bona fide hedging does address whether at least one counterparty is not a financial entity and does not address how one meets its financial obligations, which are conditions for claiming the end-user exception.

Several commenters expressed concern that exemptions were not provided for arbitrage or spread positions in the list of enumerated bona fide hedges.[180] Some commenters, such as ISDA/SIFMA, argued that the Commission should use its exemptive authority under CEA section 4a(a)(7) to include an exemption for inter-commodity spread and arbitrage transactions, "which reflect a relationship between two commodities rather than an outright directional position in the spread components. . . . Arbitrage and inter-commodity spreads do not raise the same price volatility concerns as outright positions. On the contrary, they constitute a standard investment practice that minimizes exposure while capturing inefficiencies in an established relationship and aiding price discovery in each contract."[181]

With regard to spread exemptions, under current § 150.3(a)(3), a trader may use this exemption to exceed the single-month limit outside the spot month in a single futures contract or options thereon, but not to exceed the all-months limit in any single month. As explained in the proposal, the Commission proposed to set the single-month limit at the level of the all-months limit, making the "spread" exemption no longer necessary. Since the final rule retains the individual-month limit at the same level as the all-months-combined limit, it remains unnecessary to extend an exemption to spread positions.

With respect to the existing DCM arbitrage exemptions, under existing DCM rules a trader may receive an arbitrage exemption to the extent that the trader has offsetting positions at a separate trading venue. The Commission does not believe that it is necessary to provide for such an exemption from aggregate position limits because the Commission has eliminated class

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180 See e.g., CL-CME I supra note 8 at 18; CL-Commercial Alliance I supra note 42 at 3, 7, 9, CL-ISDA/SIFMA supra note 21 at 11; and CL-MFA supra note 21 at 18.

181 CL-ISDA/SIFMA supra note 21 at 17.

limits in these final rules for non-spot-month position limits. As such, a trader's offsetting positions among Referenced Contracts outside of the spot month, whether futures or economically-equivalent swaps, would be netted for purposes of applying the position limits and, therefore, there is no need for arbitrage exemptions. As discussed in further detail under II.N.3. below, however, the Commission has provided for an arbitrage exemption from DCM or SEF position limits under certain circumstances.

With regard to inter-commodity spreads, traders would not be able to net such positions unless the positions fall within the same category of Referenced Contracts. However, a trader offsetting multiple risks in the physical marketing channel may be eligible for a bona fide hedging exemption. For example, a processor seeking to hedge the price risk associated with anticipated processing activity may receive bona fide hedging treatment for an inter-commodity spread economically appropriate to the reduction of its anticipated price risks under final § 151.5(a)(ii)(C).

As discussed above, the final rules retain the class limits within the spot-month. Otherwise, if a trader were permitted to claim an arbitrage exemption in the spot month across physically-delivered and cash-settled spot-month class limits, then that trader would be able to amass an extraordinarily large long position in the physically-delivered Referenced Contract with an offsetting short position in a cash-settled Referenced Contract, effectively cornering the market at the entry prices to the contracts. In the proposal, the Commission asked whether it should grant a bona fide hedge exemption to an agent that is not responsible for the merchandising of the cash positions, but is linked to the production of the physical commodity, e.g., if the agent is the provider of crop insurance. Amcot recommended that the Commission

deny exemptions to crop insurance providers.[182] Similarly, Food and Water Watch questioned whether agents merely linked to production should be allowed to claim bona fide hedges.[183] CME, in contrast, argued that extending the bona fide hedge exemption to these entities would be appropriate.[184] The Commission notes that 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 Referenced Contract under § 151.5(a)(2)(vii).

In response to comments, the Commission clarifies in the final rule that whether a transaction qualifies as a bona fide hedging transaction or position is determined without regard to whether the hedger's position would otherwise exceed applicable position limits.[185] Accordingly, a person who uses a swap to reduce risks attendant to a position that qualifies for a bona fide hedging transaction may pass-through those bona fides to the counterparty, even if the person's swap position is not in excess of a position limit.

Proposed § 151.5(a)(2)(ii) stated that purchases of Referenced Contracts may qualify as bona fide hedges. However, the language in proposed § 151.5(a)(2)(i) provided that sales of any commodity underlying Referenced Contracts may qualify as bona fide hedges. Existing Commission regulation 1.3(z) treats equally purchases and sales of futures contracts (and does not explicitly cover sales or purchases of any commodity underlying). BGA requested that the

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182 CL-Amcot supra note 150 at 2.

183 CL-FWW supra note 81 at 2.

184 CL-CME I supra note 8 at 8.

185 The Commission also notes that the bona fide hedge definition in new CEA section 4a(c)(2), 7 U.S.C. 6a(c)(2), deals with an entity's transaction and not the entity itself. As such, the Commission declines to provide bona fide hedge status to an entity without reference to the underlying transaction.

Commission harmonize the perceived difference between the current and Proposed Rule texts.[186] The Commission has deleted the phrase "any commodity underlying" from "sales of any commodity underlying Referenced Contracts" in § 151.5(a)(2)(i) in order to clarify that it does not intend to treat hedges involving the sales of Referenced Contracts any differently than hedges involving the purchases of Referenced Contracts.

The Commission received many comments describing transactions that the commenters believed would not be covered by the Commission's proposed bona fide hedging provisions. Appendix B to part 151 has been added to list some of the transactions or positions that the Commission deems to qualify for the bona fide hedging exemption.[187] The appendix includes an analysis of each fact pattern to assist market participants in understanding the enumerated hedging transactions in final § 151.5(a)(2). As discussed in section II.G.4. and provided for in § 151.5(a)(5), if any person is engaging in other risk-reducing practices commonly used in the market which the person believes may not be specifically enumerated above, such person may ask for relief regarding the applicability of the bona fide hedging exemption from the staff under § 140.99 or the Commission under section 4a(a)(7) of the CEA.

Further, to provide transparency to the public, the Commission is considering publishing periodically general statistical information gathered from the bona fide hedging exemptions to inform the public of the extent of commercial firms' use of exemptions. This summary data may include the number of persons and extent to which such persons have availed themselves of cash-market, anticipatory, and pass-through-swaps bona fide hedge exemptions.

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186 CL-BGA supra note 35 at 15. See also CL-FIA I supra note 21 at 15; and CL-Morgan Stanley supra note 21 at 5.

187 Many of these transactions were described in comment letters. See e.g., CL-Economists Inc. supra note 172 at 10-17; CL-Commercial Alliance I supra note 42 at 5-10; and CL-FIA I supra note 21 at 14-15.

2. Anticipatory Hedging

As discussed in II.G.1. above, some commenters objected that proposed § 151.5(a)(1) included the anticipated ownership or merchandising of an exempt or agricultural commodity, but such transactions were not included in the list of enumerated hedges.[188] Commenters pointed out that, while the statutory definition of bona fide hedging appears to contemplate hedges of asset price risk,[189] including royalty or volumetric production payments,[190] hedges of liabilities or services,[191] and anticipatory ownership and merchandising,[192] these types of hedge transactions are not recognized among enumerated hedge transactions in the proposal.

In response to commenters, the Commission is expanding the list of enumerated hedging transactions to recognize, in final §§ 151.5(a)(2)(v)-(vii), the hedging of anticipated merchandising activity, royalty payments (a type of asset), and service contracts, respectively, under certain circumstances as discussed below in detail. The Commission has determined that the transactions fall within the statutory definition of bona fide hedging transactions and are otherwise consistent with the purposes of section 4a of the Act.

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188 See e.g., CL-FIA I supra note 21 at 15; CL-BGA supra note 35 at 14; CL-ISDA/SIFMA supra note 21 at 11; and CL-EEI/EPSA supra note 21 at 15.

189 See CL-Commercial Alliance I supra note 42 at 3. See also CL-Bunge supra note 153 at 3-4 (describing "enterprise hedging" needs arising from, *inter alia*, investments in operating assets and forward contract relationships with farmers and consumers that create timing mismatches between the cash flow associated with the physical commodity commitment and the hedge's cash flow).

190 See e.g., CL-FIA I supra note 21 at 15.

191 See e.g., CL-FIA I supra note 21 at 14; CL-Commercial Alliance I supra note 42 at 3; CL-BGA supra note 35 at 14; CL-ISDA/SIFMA supra note 21 at 11; and CL-EEI/EPSA supra note 21 at 14.

192 See e.g., CL-FIA I supra note 21 at 15; CL-BGA supra note 35 at 14; CL-ISDA/SIFMA supra note 21 at 11; and CL-EEI/EPSA supra note 21 at 15.

The Commission had never recognized anticipated ownership and merchandising transactions as bona fide hedging transactions, [193] due to its historical view that anticipatory ownership and merchandising transactions generally fail to meet the second "appropriateness" prong of the Commission's definition of a bona fide hedging transaction, [194] which requires that a hedge be economically appropriate and that it reduce risks in the conduct and management of a commercial enterprise. For example, a merchant may anticipate that it will purchase and sell a certain amount of a commodity, but has not acquired any inventory or entered into fixed-price purchase or sales contracts. Although the merchant may anticipate such activity, the price risk from merchandising activity is yet to be assumed and therefore a transaction in Referenced Contracts could not reduce this yet-to-be-assumed risk. Such a merchant would not meet the second prong of the bona fide hedging definition. To the extent that a merchant acquires inventory or enters into fixed-price purchase or sales contracts, the merchant would have established a position of risk and may meet the requirements of the second prong and the long-standing enumerated provisions to hedge those risks.

In response to comments, the Commission recognizes that in some circumstances, such as when a market participant owns or leases an asset in the form of storage capacity, the market participant could establish market positions to reduce the risk associated with returns anticipated from owning or leasing that capacity. In these narrow circumstances, the transactions in question may meet the statutory definition of a bona fide hedging transaction. However, to address Commission concerns about unintended consequences (e.g., creating a potential loophole that

[193] The Commission historically has recognized a merchandising transaction as a bona fide hedge in the narrow circumstances of an agent responsible for merchandising a cash market position which is being offset. 17 CFR 1.3(z)(3).

[194] The "appropriateness" test was contained in Commission regulation 1.3(z)(1). Congress incorporated that provision in the new statutory definition in 4a(c)(2)(A)(ii), 7 U.S.C. 6a(c)(2)(A)(ii).

may result in granting hedge exemptions for types of speculative activity), the Commission will recognize anticipatory merchandising transactions as a bona fide hedge, provided the following conditions are met: (1) the hedger owns or leases storage capacity; (2) the hedge is no larger than the amount of unfilled storage capacity currently, or the amount of reasonably anticipated unfilled storage capacity during the hedging period; (3) the hedge is in the form of a calendar spread (and utilizing a calendar spread is economically appropriate to the reduction of risk associated with the anticipated merchandising activity) with component contract months that settle in not more than twelve months; and (4) no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract for agricultural or metal contracts or during the spot month for other commodities.[195] In addition, the anticipatory merchandiser must meet specific new filing requirements under § 151.5(d)(1). As is the case with other anticipated hedges, the Commission clarifies in the final rule that such a hedge can only be maintained so long as the trader is reasonably certain that he or she will engage in the anticipated merchandising activity.

New §§ 151.5(a)(2)(vi)-(vii) provide for royalty and services hedges that are available only if: (1) the royalty or services contract arises out of the production, manufacturing, processing, use, or transportation of the commodity underlying the Referenced Contract; and (2) the hedge's value is "substantially related" to anticipated receipts or payments from a royalty or services contract. Specific examples of what types of royalties or service contracts would comply with § 151.5(a)(1) and would therefore be eligible as a basis for a bona fide hedge transaction are described in Appendix B to the final rule.

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[195] A specific example of this type of anticipated merchandising is described in Appendix B to the final rule.

Under proposed § 151.5(c), the Commission also limited the availability of an anticipatory hedge to a period of one year after the request date, in contrast to proposed § 151.5(a)(2), which only imposed this requirement for Referenced Contracts in agricultural commodities. Several commenters requested that the Commission expand the scope of anticipatory hedging to include hedging periods beyond one year.[196] These commenters opined that limiting anticipatory hedging to one year may make sense in the agricultural context because the risks are typically associated with an annual crop cycle; however, this same analysis does not apply to other commodities, particularly for electricity generators, utilities, and other energy companies.[197] For example, this restriction would be commercially unworkable for infrastructure projects that require multi-year hedges in order to secure financing.[198]

The Commission has amended the appropriate exemptions for anticipatory activities under § 151.5(a)(2) to clarify that the one-year limitation for production, requirements, royalty rights, and service contracts applies only to Referenced Contracts in an agricultural commodity, except that a one-year limitation for anticipatory merchandising, applies to all Referenced Contracts.

The Commission proposed in § 151.5(a)(2)(i) to recognize the hedging of unsold anticipated production as an enumerated hedge. The Commission clarifies in the final rule that anticipated production includes anticipated agricultural production, e.g., the anticipated production of corn in advance of a harvest.

3. Pass-Through Swaps

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196 CL-Cargill supra note 76 at 5; CL-FIA I supra note 21 at 16; CL-AGA supra note 124 at 7-8; and CL-EEI/EPSA supra note 21 at 5.

197 See CL-EEI/EPSA supra note 21 at 18.

198 See CL-FIA supra note 21 at 6; and CL-Morgan Stanley supra note 21 at 6.

In the proposal, the Commission explained that under CEA section 4a(c)(2)(B), pass-through swaps are recognized as the basis for bona fide hedges if the swap was executed opposite a counterparty for whom the transaction would qualify as a bona fide hedging transaction pursuant to CEA section 4a(c)(2)(A). Further, a swap in a Referenced Contract may be used as a bona fide hedging transaction if that swap itself meets the requirements of CEA section 4a(c)(2)(A). CEA section 4a(c)(2)(A) provides the general definition of a bona fide hedge transaction.

Several commenters requested clarification concerning the so-called pass-through provision.[199] For example, Cargill maintained that the rule is not clear on whether the non-hedging counterparty may claim a hedge exemption for the swap, and without such an exemption there would be less liquidity available to hedgers using swaps because potential counterparties would be subject to position limits for the swap itself.[200]

The Commission clarifies through new § 151.5(a)(3) (entitled "Pass-through swaps") that positions in futures or swaps Referenced Contracts that reduce the risk of pass-through swaps qualify as a bona fide hedging transaction. In response to comments regarding the bona fide hedging status of the pass-through swap itself,[201] the Commission also clarifies that the non-bona-fide counterparty (e.g., a swap-dealer) may classify this swap as a bona fide hedging transaction only if that non-bona-fide counterparty enters risk reducing positions, including in futures or other swap contracts, which offset the risk of the pass-through swap. For example, if a

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199 See e.g., CL-Cargill supra note 76 at 6; and CL-FIA I supra note 21 at 17.

200 See CL-Cargill supra note 76 at 6; and CL-EEI/EPSA supra note 21 at 17.

201 See e.g., CL-Cargill supra note 76 at 6.

person entered a pass-through swap opposite a bona fide hedger, either within or outside of the spot-month, that resulted in a directional exposure of 100 long positions in a Referenced Contract, that person could treat those 100 long positions as a bona fide hedging transaction only if that person also entered into 100 short positions to reduce the risk of the pass-through swap. Absent this restriction, a non-bona-fide counterparty could create a large speculative directional position in excess of limits simply by entering into pass-through swaps.

The Commission notes that regardless of the bona fide status of the pass-through swap, outside of the spot-month the risk-reducing positions in a Referenced Contract will net with the positions from the pass-through swap. Similarly, within the spot-month, if the non-bona-fide counterparty to a pass-through swap reduces the risk of that swap with cash-settled Referenced Contracts, the risk reducing positions in cash-settled contracts would net with the pass-through swap for purposes of the spot-month position limit.

Because the spot-month limits include class limits for physical-delivery futures contracts and cash-settled contracts, the bona fide hedging status of the pass-through swap would impact spot-month compliance if the non-bona-fide counterparty reduced the risk of the pass-through swap with physical-delivery futures contracts in the spot-month. However, as discussed above, so long as the risk of the pass-through swap is offset, these final rules would treat both the pass-through swap and the risk reducing positions as bona fide hedges. In this connection, the Commission notes that the non-bona-fide counterparty would still be subject to 151.5(a)(1)(v), and must exit the physical delivery futures contract in an orderly manner as the person "lifts" the hedge of the pass-through swap. Similarly, as with all transactions in Referenced Contracts, the person would be subject to the intra-day application of position limits. Therefore, as the person

"lifts" the hedge of the pass-through swap, if the pass-through swap is no longer offset, only the extent of the pass-through swap that is offset would qualify as a bona fide hedge.

The Commission clarifies through new § 151.5(a)(4) (entitled "Pass-through swap offsets") that a pass-through swap position will be classified as a bona fide hedging transaction for the counterparty for whom the swap would not otherwise qualify as a bona fide hedging transaction pursuant to paragraph (a)(2) of this section (the "non-hedging counterparty"), provided that the non-hedging counterparty purchases or sells Referenced Contracts that reduce the risks attendant to such pass-through swaps.

Commenters also requested further clarity concerning proposed § 151.5(g), which set forth certain procedural requirements for pass-through swap counterparties. FIA and ISDA, for example, stated that it was unclear whether the pass-through provision is limited to transactions where the swap counterparty is relying on an exemption to exceed the limits, and not simply entering a swap with a counterparty that is a bona fide hedger.[202] Other commenters requested clarification as to whether the hedger must wait until all written communications have been exchanged before it can enter into a hedging transaction.[203] According to these commenters, such a requirement could delay entering a swap for hours if not days,[204] forcing the hedger to assume the risk of price changes during the period between when it enters the swap and when the parties complete the written documentation process.[205] Finally, commenters believed the rule

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202 See e.g., CL-FIA I supra note 21 at 19; and CL-ISDA/SIFMA supra note 21 at 10.

203 See CL-FIA I supra note 21 at 18.

204 See CL-EEI/EPSA supra note 21 at 17.

205 See CL-FIA I supra note 21 at 19.

was unclear on the type of representation that must be provided by an end-user and may be relied upon by dealers.[206]

Some commenters recommended a less-costly verification regime that would allow parties to rely upon a one-time representation concerning eligibility for the bona fide hedging exemption.[207] ISDA/SIFMA also argued that the Commission should confirm the bona fide hedger status of a party in order to prevent, among other things, unwarranted disclosure of confidential information from an end-user to a dealer.[208] Further, ISDA/SIFMA argued that the determination should be on an entity-by-entity basis, and not on a transaction-by-transaction basis, in order to promote certainty for bona fide hedgers and their swap counterparties.[209] BGA argued that the proposal to require a dealer to continuously monitor whether the underlying swap continues to offset the cash commodity risk of the hedging counterparty would result in significant and costly burdens on end-users and other hedgers.[210]

In response to these comments, the Commission has determined to reduce the burden of claiming a pass-through swap exemption. Under new § 151.5(i), in order to rely on a pass-through exemption, a counterparty would be required to obtain from its counterparty a representation that the swap, in its good-faith belief, would qualify as an enumerated hedge under § 151.5(a)(2). Such representation must be provided at the inception (i.e., execution) of the swap transaction and the parties to the swap must keep records of the representation. This

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206 See e.g., CL-BGA supra note 35 at 16.

207 See e.g., CL-EEI/EPSA supra note 21 at 17; CL-ISDA/SIFMA supra note 21 at 12; and CL-FIA I supra note 21 at 19.

208 See CL-ISDA/SIFMA supra note 21 at 13.

209 See id.

210 See e.g., CL-BGA supra note 35 at 17; and ISDA/SIFMA supra note 21 at 12.

representation, which may be made in a trade confirmation, must be kept for a period of at least two years following the expiration of the swap and furnished to the Commission upon request.

Deutsche Bank also requested clarification as to whether the immediate counterparty to the swap must be a bona fide hedger or whether the Commission will look to a series of transactions to determine if it was connected to a bona fide hedger.[211] Deutsche Bank argued that given the complexity of the swaps marketplace, market participants often hedge their risk through multiple combinations of intermediaries; hence, the Commission should not require that the immediate counterparty be a bona fide hedger, but rather part of a network of transactions connected to a bona fide hedger.[212]

The Commission rejects extending the pass-through exemption to a series of swap transactions. Rather, consistent with this Congressional direction, a pass-through swap will be recognized as a bona fide hedge only to the extent it is executed opposite a counterparty eligible to claim an enumerated hedge exemption.[213]

The Commission clarifies that the pass-through swap exemption will allow non-hedging counterparties to such swaps to offset non-Referenced Contract swap risk in Referenced Contracts.[214]

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211 See CL-DB supra note 153 at 8.

212 See id. Barclays similarly noted that it should not matter whether the original holder of a pass-through swap risk manages the risk itself or asks another to manage it for them and that overall systemic risk would increase if risk transfer is made more difficult. CL-Barclays I supra note 164 at 4.

213 See CEA section 4a(c)(2)(B)(i), 7 U.S.C. 6a(c)(2)(B)(i). The Commission notes that the same restrictions on holding a position in the spot month or the last five days of trading of physical-delivery Core Referenced Futures Contracts that would apply to the swap counterparty with the underlying bona fide risk also apply to the holder of the pass-through swap. For example, if a swap dealer enters into a crude oil swap with an anticipatory production hedger, then it would be subject to the same restrictions on holding the hedge of that pass-through swap into the spot month of the appropriate physical-delivery Referenced Contract.

214 For example, Company A owns cash market inventory in a non-Referenced Contract commodity and enters into a Swap N with Bank B. Swap N would be an enumerated bona fide hedging transaction for Company A under

Some commenters recommended that the Commission exclude inter-affiliate swaps from any calculation of a trader's position for position limit compliance purposes.[215] API, for example, argued that swaps among affiliates would have no net effect on the positions of affiliated entities and the final rule should therefore make it clear that the Commission will not consider such swaps for purposes of position limits.[216] API commented further that this approach would be consistent with the Commission's treatment of inter-affiliate swaps in other proposed rulemakings, for example, the proposed rulemaking further defining, inter alia, swap dealer.[217]

In light of the structure of the aggregation rules regarding the treatment of a single person or a group of entities under common ownership or control, as provided for under § 151.7, the Commission has introduced § 151.5(b). This subsection clarifies that entities required to aggregate accounts or positions under § 151.7 shall be considered the same person for the purpose of determining whether a person or persons are eligible for a bona fide hedge exemption under § 151.5(a) to the extent that such positions are attributed among these entities. The Commission's intention in introducing new § 151.5(b) is to make the aggregation and bona fide hedging provisions of part 151 consistent. For example, a holding company that owns a sufficient amount of equity in an operating company would need to aggregate the operating

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the rules of a DCM or SEF. Because Swap N is not a Referenced Contract, Bank B does include Swap H in measuring compliance with position limits. However, Bank B, as is economically appropriate, may enter into a cross-commodity hedge to reduce the risk associated with Swap N. That risk reducing transaction is a bona fide hedging transaction for Bank B.

215 CL-COPE supra note 21 at 13; CL-API supra note 21 at 11; CL-Shell supra note 35 at 4-5; and CL-WGCEF supra note 35 at 23.

216 CL-API supra note 21 at 11.

217 Id.

company's positions with those of the holding company in order to determine compliance with position limits. Commission regulation 151.5(b) would clarify that the holding company could enter into bona fide hedge transactions related to the operating company's cash market activities, provided that the operating company has itself not entered into such hedge transactions with another person with whom it is not aggregated (i.e., the holding company's hedge activity must comply with the appropriateness requirement of § 151.5(a)(1)). Appendix B to the final regulations provides an illustrative example as to how this provision would operate.

4. Non-Enumerated Hedges

Many of the commenters objecting to the proposed definition of bona fide hedging requested that the Commission reintroduce a process for claiming non-enumerated hedging exemptions.[218] The Working Group of Commercial Energy Firms ("Working Group"), for example, argued that the Commission should maintain its current flexibility and preserve its ability to allow exemptions.[219] FIA commented further that such a provision is expressly authorized under CEA section 4a(a)(7).[220] The Commission has considered the comments and has expanded the list of enumerated hedge transactions, consistent with the statutory definition of bona fide hedging.

In response to questions raised by commenters, the Commission notes that market participants may request interpretive guidance (under § 140.99(a)(3)) regarding the applicability

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218 See e.g., CL-FIA I supra note 21 at 15; CL-EEI/EPSA supra note 21 at 15; CL-CME I supra note 8 at 19; CL-Morgan Stanley supra note 21 at 6; and CL-WGCEF supra note 35 at 5. It should be noted, however, that at least 184 comment letters opined that the Commission should define the bona fide hedge exemption "in the strictest sense possible" and that "[b]anks, hedge funds, private equity and all passive investors in commodities should not be deemed as bona fide hedgers."

219 CL-WGCEF supra note 35 at 5.

220 CL-FIA I supra note 21 at 15.

of any of the provisions of this part, including whether a transaction or class of transactions qualify as enumerated hedges under § 151.5(a)(2). Market participants may also petition the Commission to amend the current list of enumerated hedges or the conditions therein. Such a petition should set forth the general facts surrounding such class of transactions, the reasons why such transactions conform to the requirements of the general definition of bona fide hedging in § 151.5(a)(1), and the policy purposes furthered by the recognition of this class of transactions as the basis for enumerated bona fide hedges.

5. Portfolio Hedging

Some commenters requested clarification as to whether the new bona fide hedging exemption would require one-to-one tracking, and argued that portfolio hedging should be allowed because the combination of hedging instruments, such as futures, swaps and options, generally cannot be individually identified to particular physical transactions.[221] Some of these commenters argued that if the Commission does not permit portfolio hedging, the requirement to one-to-one track physical commodity transactions with corresponding hedge transactions will increase risk by preventing end-users from effectively hedging their commercial exposure.[222]

The Commission notes that the final § 151.5(a)(2) provides for bona fide hedging transactions and positions. The Commission intends to allow market participants either to hedge their cash market risk on a one-to-one transactional basis or to combine the risk associated with a number of enumerated cash market transactions in establishing a bona fide hedge, provided that the hedge is economically appropriate to the reduction of risk in the conduct and management of

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221 See e.g., CL-Cargill supra note 76 at 2-3; CL-BGA supra note 35 at 15; and CL-ISDA/SIFMA supra note 21 at 10-11.

222 See e.g., CL-BGA supra note 35 at 15.

a commercial enterprise, as required under § 151.5(a)(1)(ii). The Commission has clarified this intention by adding after "potential change in the value of" in § 151.5(a)(1)(iii) the phrase "one or several."[223]

6. Restrictions on Hedge Exemptions

Proposed § 151.5(a)(2)(v) generally followed the Commission's existing agricultural commodity position limits regime, which restricts cross-commodity hedge transactions from being classified as a bona fide hedge during the last five days of trading on a DCM.[224] Some commenters recommended that the Commission eliminate this prohibition, otherwise market participants will have to assume risks during that time period instead of shifting risks to those willing to assume them.[225] According to the FIA, unhedged risk, such as a commercial company unable to hedge jet fuel price exposure with heating oil futures or swap contracts in the last five days of trading, would reduce market liquidity and increase the risk of operating a commercial business.[226] Further, ISDA opined that the Commission did not adequately justify the purpose of applying a prohibition from the Commission's agricultural commodity position limits to other commodities.[227]

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223 Similarly, and in light of comments, the Commission has elected not to adopt proposed § 151.5(j) in recognition of the confusion this provision could have caused to market participants who hedge on a portfolio basis and to reduce the burden of requiring a continuing representation of bona fides by the swap counterparty. The proposed § 151.5(j) provided that a party to a swap opposite a bona fide hedging counterparty could establish a position in excess of the position limits, offset that position, and then re-establish a position in excess of the position limits, so long as the swap continued to offset the cash market commodity risk of a bona fide hedging counterparty.

224 See § 1.3(z)(2)(iv). In the proposal, anticipatory hedge transactions could not be held during the five last trading days of any Referenced Contract. This restriction has been clarified to be aligned with the trading calendar of the Core Referenced Futures Contract and applies to all anticipatory transaction hedges.

225 See e.g., CL-FIA I supra note 21 at 16l and CL-ISDA/SIFMA supra note 21 at 11.

226 See CL-FIA I supra note 21 at 16.

227 See CL-ISDA/SIFMA supra note 21 at 11.

The Commission recognizes the restriction on holding cross-commodity hedges in the last five days of trading may increase tracking risk if the trader were forced out of the Referenced Contract into a lesser correlated contract, or into a deferred contract month that was less correlated with the relevant cash market risk than the spot month. However, the Commission also continues to believe that such cross-commodity hedges are not appropriately recognized as bona fide in the physical-delivery contracts in the last five days of trading for agricultural and metal Referenced Contracts or the spot month for energy Referenced Contracts since the trader does not hold the underlying commodity for delivery against, or have a need to take delivery on, the underlying commodity The Commission agrees with the comments regarding the elimination of the restriction on holding a cross-commodity hedge in cash-settled contracts during the last five days of trading for agricultural and metal contracts and the spot month for other contracts and has relaxed this restriction for hedge positions established in cash-settled contracts. Under the final rules, traders may maintain their cross-commodity hedge positions in a cash-settled Referenced Contract through the final day of trading.

The Commission received a number of comments on similar restrictions proposed to apply to other enumerated hedge transactions.[228] The National Milk Producers Federation, for example, argued that the restriction on holding a hedge position through the last days of trading for cash-settled contracts should be eliminated because if a trader carried positions through the last days of trading in a cash-settled contract then it could not impact the orderly liquidation of the market.[229]

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228 See e.g., CL-Commercial Alliance I supra note 42 at 9; and National Milk Producers Federation ("NMPF") on July 25, 2011 ("CL-NMPF") at 3-4.

229 CL-NMPF, supra note 228 at 3-4.

In response to these comments, the Commission has eliminated all restrictions on holding a bona fide hedge position for cash-settled contracts and narrowed the restriction on holding a bona fide hedge position in physical-delivery contracts. Specifically, a bona fide hedge position for anticipatory hedges for production, requirements, merchandising, royalty rights, and service contract, and unfixed-price calendar spread risk hedges (§ 151.5(a)(2)(iii), and, as discussed above, cross-commodity hedges in all bona fide hedge circumstances will not retain bona fide hedge status if held, for physical-delivery agricultural and metal contracts, in the last five trading days and in the spot month for all other physical-delivery contracts. The Commission has modified the Proposed Rule in recognition of potential circumstances where inefficient hedging would be required if the restriction were maintained as proposed, the reduced concerns with a negative impact on the market of maintaining such a hedge if held in a cash-settled contract (as opposed to a physical-delivery contract), and a generally cautious approach to imposing new restrictions on the ability of traders active in the physical marketing channel to enter into cash-settled transactions to meet their hedging needs.

7. Financial Distress Exemption

Some commenters requested that the Commission introduce an exemption for market participants in financial distress scenarios. Morgan Stanley, for example, commented that during periods of financial distress, it may be beneficial for a financially sound entity to assume the positions (and corresponding risk) of a less stable market participant.[230] Morgan Stanley argued that not providing for an exemption in these types of situations could reduce liquidity and increase systemic risk. Similarly, Barclays argued that the Commission should preserve the flexibility to accommodate situations involving, for example, the exit of a line of business by an

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230 CL-Morgan Stanley supra note 21 at 16.

entity, a customer default at a futures commission merchant ("FCM"), or in the context of potential bankruptcy.[231]

In recognition of the public policy benefits of including such an exemption, the Commission has provided, in § 151.5(j), for an exemption for situations involving financial distress. The Commission's authority to provide for this exemption is derived from CEA section 4a(a)(7).[232] In this regard, the Commission clarifies that this exemption for financial distress situations does not establish or otherwise represent a form of hedging exemption.

8. Filing Requirements

Under the proposal, once an entity's total position exceeds a position limit, the entity must file daily reports on Form 404 for cash commodity transactions and corresponding hedge transactions and on Form 404S for information on swaps used for hedging.[233] Several commenters argued that bona fide hedgers should only be required to file monthly reports to the Commission because daily reporting is onerous and unnecessary.[234] In addition, the commenters pointed out that daily reporting will also be costly for the Commission,[235] and argued that the

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231 CL-Barclays I supra note 164 at 5.

232 New CEA section 4a(a)(7) provides that the Commission may "by rule, regulation, or order ... exempt ... any person or class of persons" from any requirement it may establish under section 4a. 7 U.S.C. 6a(a)(7). This provision requires that any exemption, general or bona fide, to position limits granted by the Commission, be done by Commission action.

233 See §§ 151.5(b) and (d).

234 See e.g., CL-Cargill supra note 76 at 3; CL-FIA I supra note 21 at 20; CL-Commercial Alliance I supra note 42 at 3-4; CL-BGA supra note 35 at 17; CL-EEI/EPSA supra note 21 at 15-16; and CL-Utility Group supra note 21 at 14. See also CL-ISDA/SIFMA supra note 21 at 12 (opposing daily reporting).

235 See CL-FIA I supra note 21 at 21; and CL-ISDA/SIFMA supra note 21 at 12.

Commission should instead utilize its special call authority on top of monthly reporting to ensure that it has sufficient information.[236]

The Commission has determined to address these concerns by requiring that a trader file a Form 404 three business days following the day that a position limit is exceeded and thereafter file daily data on a monthly basis. These monthly reports would, under §151.5(c)(1), provide cash market positions for each day that the trader exceeded the position limits during the monthly reporting period. This amendment would reduce the filing burden on market participants. The Commission believes the monthly reports, though less timely, would generally provide information sufficient to determine a trader's daily compliance with position limits, without requiring a trader to file additional information under a special call or, as discussed below, follow-up information on his or her notice filings. The Commission has also reduced the filing burden by allowing all such reports of cash market positions to be filed by the third business day following the day that a position limit is exceeded, rather than on the next business day.

Final § 151.5(d) asks for information relevant to the three new anticipatory hedging exemptions—for merchandising, royalties, and services contracts—that would be helpful for the Commission in evaluating the validity of such claims. For anticipated merchandising hedge exemptions, the Commission is most interested in understanding the storage capacity relating to the anticipated and historical merchandising activity. For anticipated royalty hedge exemptions, the Commission is interested in understanding the basis for the projected royalties. For anticipated services, the Commission is interested in understanding what types of service contracts have given rise to the trader's anticipated hedging exemption request.

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236 See e.g., CL-Cargill supra note 76 at 4.

The Commercial Alliance recommended that Form 404A filings for anticipatory hedgers be modified to require descriptions of activity, as opposed to calling for the submission of data reflecting a one-for-one correlation between an anticipated market risk and a hedge position.[237] The Commercial Alliance stated that companies are not managed in this manner and the data could not be collated and provided to the Commission in this way.[238] The Commercial Alliance provided recommended amendments to the requirements for Form 404A filers to reflect that information concerning anticipated activities would be appropriate to justify a hedge position, in accordance with regulations 151.5(a)(1) and (a)(2).

The Commission agrees with many of the Commercial Alliance's suggestions. For example, § 151.5 (c)(2) closely tracks the Commercial Alliance's suggested language revisions. The information required by this section should allow the Commission to understand whether the trader's bona fide hedging activity complies with the requirements of §151.5(a)(1). Final § 151.5(c)(2) clarifies that the 404 filing is a notice filing made effective upon submission.

Many commenters opined that the application and approval process for receiving an anticipatory hedge exemption set forth in proposed § 151.5(c) would impose an unnecessary compliance burden on hedgers.[239] In response to such comments, the Commission has amended the process for claiming an anticipatory hedge in § 151.5(d)(2) to allow market participants to claim an exemption by notice filing. The notice must be filed at least ten days in advance of the date the person expects to exceed the position limits and is effective after that ten-day period unless so notified by the Commission.

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237 Commercial Alliance ("Commercial Alliance II") on July 20, 2011 ("CL-Commercial Alliance II") at 1.

238 Id.

239 See e.g., CL-ICE I supra note 69 at 12; and CL-WGCEF supra note 35 at 2-3.

In response to commenters seeking greater procedural certainty for obtaining bona fide hedge exemptions,[240] § 151.5(e) clarifies the conditions of the Commission's review of 404 and 404A notice filings submitted under §§ 151.5(c) and 151.5 (d), respectively. Traders submitting these filings may be notified to submit additional information to the Commission in order to support a determination that the statement filed complies with the requirements for bona fide hedging exemptions under paragraph (a) of § 151.5.

H. Aggregation of Accounts

The proposed part 151 regulations would significantly alter the existing position aggregation rules and exemptions currently available in part 150. Specifically, the aggregation standards under proposed § 151.7 would eliminate the independent account controller ("IAC") exemption under § 150.3(a)(4), restrict many of the disaggregation provisions currently available under § 150.4, and create a new owned-financial entity exemption. The proposal would also require a trader to aggregate positions in multiple accounts or pools, including passively-managed index funds, if those accounts or pools have identical trading strategies. Lastly, disaggregation exemptions would no longer be available on a self-executing basis; rather, an entity seeking an exemption from aggregation would need to apply to the Commission, with the relief being effective only upon Commission approval.[241]

Some commenters supported the proposed aggregation standards, contending that the revised standards would enhance the Commission's ability to monitor and enforce position limits

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240 See e.g., CL-WGCEF supra note 35 at 2-3.

241 The Commission did not propose any substantive changes to existing § 150.4(d), which allows an FCM to disaggregate positions in discretionary accounts participating in its customer trading programs provided that the FCM does not, among other things, control trading of such accounts and the trading decisions are made independently of the trading for the FCM's other accounts. As further described below, however, the FCM disaggregation exemption would no longer be self-executing; rather, such relief would be contingent upon the FCM applying to the Commission for relief.

by preventing institutional investors, including hedge funds, from evading application of position limits by creating multiple smaller investment funds.[242] However, many of the commenters on the account aggregation rules objected to the change in the aggregation policy and, in particular, the proposed elimination of the IAC exemption.[243] Generally, these commenters expressed concern that the proposed aggregation standards would result in an inappropriate aggregation of independently controlled accounts, potentially cause harmful consequences to investors and investment managers, and potentially reduce liquidity in the commodities markets.

In response to comments, the Commission is adopting the proposed aggregation standard, with modifications as discussed below. In brief, the final rules largely retain the provisions of the existing IAC exemption and pool aggregation standards under current part 150. The final rules reaffirm the Commission's current requirements to aggregate positions that a trader owns in more than one account, including accounts held by entities in which that trader owns a 10 percent or greater equity interest. Thus, for example, a financial holding company is required to aggregate house accounts (that is, proprietary trading positions of the company) across all wholly-owned subsidiaries.

1. Ownership or Control Standard

Under proposed § 151.7, a trader would be required to aggregate all positions in accounts in which the trader, directly or indirectly, holds an ownership or equity interest of 10 percent or

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242 See e.g., CL-PMAA/NEFI supra note 6 at 16-17; CL- Prof. Greenberger supra note 6 at 18; CL-AFR supra note 17 at 8; and CL-FWW supra note 81 at 16.

243 See e.g., CL-FIA I supra note 21; CL-Commercial Alliance II supra note 237 at 1; CL-DB supra note 153 at 6; CL-CME I supra note 8 at 15-16; ICI supra note 21 at 8; CL-BlackRock supra note 21 at 9; New York City Bar Association—Committee on Futures and Derivatives ("NYCBA") on April 11, 2011 ("CL-NYCBA") at 2; and CL-SIFMA AMG supra note 21 at 10. One commenter did ask that the Commission allow for a significant amount of time for an orderly transition from the IAC to the more limited account aggregation exemptions in the proposed rules. See CL-Cargill supra note 76 at 7.

greater, as well as accounts over which the trader controls trading.[244] The Proposed Rule also treats positions held by two or more traders acting pursuant to an express or implied agreement or understanding the same as if the positions were held by a single trader.

As proposed, a trader also would be required to aggregate interests in funds or accounts with identical trading strategies. Proposed § 151.7 would require a trader to aggregate any positions in multiple accounts or pools, including passively-managed index funds, if those accounts or pools had identical trading strategies. The Commission is finalizing this provision as proposed.[245]

2. Independent Account Controller Exemption

The Commission proposed to eliminate the IAC exemption in part 150. Numerous commenters asserted that the Commission failed to provide a reasoned explanation for the departure from its long-standing exception from aggregation for independently controlled accounts.[246] These commenters also asserted that the elimination of the IAC exemption would force aggregation of accounts that are under the control of independent managers subject to

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244 In this regard, the Commission interprets the "hold" or "control" criterion as applying separately to ownership of positions and to control of trading decisions.

245 Barclays requested that, in light of the fundamental changes to the aggregation policy, the Commission should reconsider the 10 percent ownership standard. Specifically, Barclays stated that the ownership test should be tied to a "meaningful actual economic interest in the result of the trading of the positions in question," and that 10 percent ownership, in absence of control, is no longer a "viable" standard. See CL-Barclays I supra note 164 at 3. In view of the fact that the Commission is finalizing the aggregation provisions with modifications to the proposal that will substantially address the concerns of the comments, the Commission has determined to retain the long-standing 10 percent ownership standard that has worked effectively to date. In response to a point raised by Commissioner O'Malia in his dissent, the Commission clarifies that it will continue to use the 10 percent ownership standard and apply a 100 percent position aggregation standard, and therefore will not adopt Barclays' recommendation that "only an entity's pro rata share of the position that are actually controlled by it or in which it has ownership interest" be aggregated. Id. at 3. In the future, the Commission may reconsider whether to adopt Barclays' recommendation.

246 See e.g., CL-FIA I supra note 21 at 22-23; CL-CME I supra note 8 at 15; and CL-CMC supra note 21 at 4; CL-ISDA/SIFMA supra note 21 at 14-16; CL-Katten supra note 21 at 3; CL-MFA supra note 21 at 13;CL- Morgan Stanley supra note 21 at 7; CL-NYCBA supra note 243 at 2; Barclays Capital ("Barclays II") on June 14, 2011 ("CL-Barclays II") at 1; and U.S. Chamber of Commerce ("USCOC") on March 28, 2011 ("CL-USCOC") at 6.

meaningful information barriers and, hence, do not entail risk of coordinated excessive speculation or market manipulation.[247] Morgan Stanley asserted that the rationale for permitting disaggregation for separately controlled accounts is that "the correct application of speculative position limits hinges on attributing speculative positions to those actually making trading decisions for a particular account."[248] In absence of the IAC exemption, commenters further noted that otherwise independent trading operations would be required to communicate with each other as to their trading positions so as to avoid violating position limits, raising the risk for concerted trading.[249]

The Commission has carefully considered the views expressed by commenters and has determined to retain the IAC exemption largely as currently in effect, with clarifications to make explicit the Commission's long-standing position that the IAC exemption is limited to client positions, that is, only to the extent one trades professionally for others can one avail him or herself of this IAC exemption. Such a person has a fiduciary relationship to those clients for whom he or she trades.[250] Accordingly, eligible entities may continue to rely upon the IAC exemption to disaggregate client positions held by an IAC. This means that the IAC exemption does not extend to proprietary positions in accounts which a trader owns.

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247 See e.g., CL-CME I supra note 8 at 15; CL-ICI supra note 21 at 9; CL-BlackRock supra note 21 at 4, 9; CL-Katten supra note 21 at 3; CL-ISDA/SIFMA supra note 21 at 14;CL-AIMA supra note 35 at 5-6; DB Commodity Services LLC ("DBCS") on March 28, 2011 ("CL-DBCS") at 7; and CL-Barclays I supra note 164 at 2.

248 CL-Morgan Stanley supra note 21 at 7. Morgan Stanley added that the resulting inability to disaggregate separately controlled accounts of its various affiliates will have "[a] significantly adverse effect on Morgan Stanley's ability to provide risk management services to its clients and will reduce market liquidity."

249 See e.g., CL-MFA supra note 21 at 13.

250 See e.g., 56 FR 14308, 14312 (Apr. 9, 1991) (clarifying, among other things, that the IAC exemption is limited to those who trade professionally for others, and who have a fiduciary relationship to those for whom they trade).

After reviewing the comments in connection with the terms of the proposal, the Commission believes that retaining the IAC exemption for independently managed client accounts is in accord with the purposes of the aggregation policy. The fundamental rationale for the aggregation of positions or accounts is the concern that a single trader, through common ownership or control of multiple accounts, may establish positions in excess of the position limits and thereby increase the risk of market manipulation or disruption. Such concern is mitigated in circumstances involving client accounts managed under the discretion and control of an independent trader and subject to effective information barriers. The Commission also recognizes the wide variety of commodity trading programs available for market participants. To the extent that such accounts and programs are traded independently and for different purposes, such trading may enhance market liquidity for bona fide hedgers and promote efficient price discovery.

Under the current IAC exemption provision, an eligible entity, which includes mutual funds, banks, CPOs, commodity trading advisors ("CTAs"), and insurance companies, may disaggregate customer positions or accounts managed by an IAC from its proprietary positions (outside of the spot months), subject to the conditions specified therein. Specifically, an IAC must trade independently of the eligible entity and of any other IAC trading for the eligible entity and have no knowledge of trading decisions by any other IAC.[251]

A central feature of the IAC exemption is the requirement that the IAC trades independently of the eligible entity and of any other IAC trading for the eligible entity. The

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[251] If the IAC is affiliated with the eligible entity or another IAC trading on behalf of the eligible entity, each of the affiliated entities must, among other things, maintain written procedures to preclude them from having knowledge of, or gaining access to data about trades of the other, and each must trade such accounts pursuant to separately developed and independent trading systems. See § 150.3(a)(4)(i).

determination of whether a trader exercises independent control over the trading decisions of the customer discretionary accounts or trading programs within the meaning of the IAC exemption must be decided case-by-case based on the particular underlying facts and circumstances. In this respect, the Commission will look to certain factors or indicia of control in determining whether a trader has control over certain positions or accounts for aggregation purposes.[252]

A non-exclusive list of such indicia of control includes existence of a proper firewall separating the trading functions of the IAC and the eligible entity. That is, the Commission will consider, in determining whether the IAC trades independently, the degree to which there is a functional separation between the proprietary trading desk of the eligible entity and the desk responsible for trading on behalf of the managed client accounts. Similarly, the Commission will consider the degree of separation between the research functions supporting a firm's proprietary trading desk and the client trading desk. For example, a firm's research information concerning fundamental demand and supply factors and other data may be available to an IAC who directs trading for a client account of the firm. However, specific trading recommendations of the firm contained in such information may not be substituted for independently derived trading decisions. If the person who directs trading in an account regularly follows the trading suggestions disseminated by the firm, such trading activity will be evidence that the account is controlled by the firm. In the absence of a proper firewall separating the trading or research functions, among other things, an eligible entity may not avail itself of the IAC exemption.

3. Exemptions from Aggregation

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[252] 64 FR 33839, Jun. 13, 1979 ("1979 Aggregation Policy Statement"). In that release, the Commission provided certain indicia of independence, which included appropriate screening procedures, separate registration and marketing, and a separate trading system.

Several commenters expressed concern that forced aggregation of independently controlled and managed accounts would effectively require independent trading operations of commonly-owned entities to coordinate trading activities and commercial hedging opportunities, in potential violation of contractual and legal obligations, such as FERC affiliate rules,[253] bank regulatory restrictions, and antitrust provisions.[254] Some commenters also asserted that asset managers and advisers may be required to violate their fiduciary duty to clients by sharing confidential information with third parties, and which could also lead to anti-competitive activity if two unrelated entities, such as competitors in a joint-venture, are required to share such confidential information.[255] FIA also added that a company with an affiliate underwriter may not be aware that its affiliate has acquired a temporary, passive interest in another company trading commodities. Under the aggregation proposal, the first company would be required to share trading information with a temporary affiliate. In such instance, FIA concludes, the cost of aggregation "greatly outweighs the unarticulated regulatory benefits."[256]

According to commenters, this problem is exacerbated if aggregate limits are applied intraday as it requires real-time sharing of information, and, when added to the attendant

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253 See e.g., CL-FIA I supra note 21 at 23-24; CL-EEI/ESPA supra note 21 at 20; CL-ISDA/SIFMA supra note 21 at 16; and CL-AGA supra note 124 at 9.

254 See e.g., CL-FIA I supra note 21 at 24; CL-API supra note 21 at 11; CL-DBCS supra note 247 at 3; CL-CME I supra note 8 at 17; CL-ISDA/SIFMA supra note 21 at 16; CL-MFA supra note 21 at 13; CL-Morgan Stanley supra note 21 at 8; CL-SIFMA AMG I supra note 21 at 11; and CL-Barclays I supra note 164 at 2. See e.g., CL-Morgan Stanley supra note 21 at 8 (For example, advisors to private investment funds may not be able to permit certain investors to view position information unless the information is made available to all of the fund's investors on an equal basis).

255 See e.g., CL-CME I supra note 8 at 17; CL-Barclays II supra note 2468 at 2;CL- MFA supra note 21 at 13; CL-Morgan Stanley supra note 21 at 9; and CL-SIFMA AMG I supra note 21 at 11. See also CL-NYCBA supra note 243 at 4.

256 CL-FIA I supra note 21 at 24.

dismantling of information barriers and restructuring of information systems, would impose significant operational challenges and massive costly infrastructure changes.[257]

In view of these considerations, and as discussed above, the Commission is reinstating the IAC exemption. The majority of the contentions from the commenters stemmed from the removal of the IAC exemption, and therefore, incorporating this exemption into the final rules should address these concerns. In response to comments,[258] and to further mitigate the impact of the aggregation requirements that apply to commonly-owned entities or accounts, the Commission is adopting new § 151.7(g), which will allow a person to disaggregate when ownership above the 10 percent threshold also is associated with the underwriting of securities. In addition to a limited exemption for the underwriting of securities, new § 151.7(i) will provide for disaggregation relief, subject to notice filing and opinion of counsel, in instances where aggregation across commonly-owned affiliates (i.e., above the 10 percent ownership threshold) would require position information sharing that, in turn, would result in the violation of federal law.[259] The Commission notes, however, when a trader has actual knowledge of the positions of an affiliate, that trader is required to aggregate all such positions.

4. Ownership in Commodity Pools Exemption

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257 See e.g., CL-DBCS supra note 247 at 3; CL-CME I supra note 8 at 17; CL-FIA I supra note21 at 24; CL-ICI supra note 21 at 8-9; CL-ISDA/SIFMA supra note 21 at 17; CL-Barclays II supra note 246 at 2; and CL-Morgan Stanley supra note 21 at 8.

258 See e.g., CL-FIA I supra note 21 at 24.

259 Assume, for example, that Company A owns 10 percent of Company B. Company B may not share with Company A information regarding its positions unless it makes such data public. In this instance, Company A would file a notice with the Commission, along with opinion of counsel, that requiring the aggregation of such positions will require Company A to obtain information from Company B that would violate federal law.

Under current § 150.4(b), a trader who is a limited partner or shareholder in a commodity pool (other than the pool's commodity pool operator ("CPO")) generally need not aggregate so long as the trader does not control the pool's trading decisions. Under § 150.4(c)(2), if the trader is also a principal or affiliate of the pool's CPO, the trader need not aggregate provided that the trader does not control or supervise the pool's trading and the pool operator has proper informational barriers. In addition, mandatory aggregation based on a 25 percent ownership interest is only triggered with respect to a pool exempt from CPO registration under existing § 4.13.

The Commission's proposal would eliminate the disaggregation exemption for passive pool participants (i.e., participants who are not principals or affiliates of the pool's CPO). Under the Commission's proposal, all passive pool participants (with a 10 percent or greater ownership or equity interest and regardless of whether they are a principal or affiliate) would be subject to the aggregation requirement unless they meet certain exemption criteria. These criteria include: (i) an inability to acquire knowledge of the pool's positions or trading due to informational barriers maintained by the CPO, and (ii) a lack of control over the pool's trading decisions. The proposal would also require aggregation for an investor with a 25 percent or greater ownership interest in any pool, without regard to whether the operator operates a small pool exempt from CPO registration.

Commenters objected to the changes to the disaggregation provision applicable to interests in commodity pools, arguing that forcing aggregation of independent traders would increase concentration, limit investment opportunities, and thus potentially reduce liquidity in the US futures markets.[260] Morgan Stanley stated that the current disaggregation exemption for

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[260] See e.g., CL-MFA supra note 21 at 14-15; and CL-BlackRock supra note 21 at 6-7.

interests in commodity pools "reflect the current reality of investing in commodity pools structured as private investment funds."[261] It would be, Morgan Stanley explained, "extraordinarily difficult to monitor and limit ownership thresholds given that an investor's stake in a fund may rise due to actions of third parties, e.g., redemptions."[262] MFA likewise noted that "monitoring of ownership percentages of investors in a commodity pool is burdensome, difficult to manage, and creates a potential trap for investors who may unintentionally violate limits."[263]

Upon further consideration, and in response to the comments, the Commission has determined to retain the current disaggregation exemption for interests in commodity pools. The exemption was originally intended in part to respond to the growth of professionally managed futures trading accounts and pooled futures investment. The Commission finds that disaggregation for ownership in commodity pools, subject to appropriate safeguards, may continue to provide the necessary flexibility to the markets, while at the same time protecting the markets from the undue accumulation of large speculative positions owned by a single person or entity.

5. Owned Non-Financial Entity Exemption

The Commission proposed a limited disaggregation exemption for an entity that owns 10 percent or more of a non-financial entity (generally, a non-financial, operating company) if the entity can demonstrate that the owned non-financial entity is independently controlled and managed.[264] The Commission explained that this limited exemption was intended to allow

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261 CL-Morgan Stanley supra note 21 at 8.

262 Id.

263 CL-MFA supra note 21 at 14.

264 The proposed regulations included a non-exclusive list of indicia of independence for purposes of this exemption, including that the two entities have no knowledge of each other's trading decisions, that the owned non-

disaggregation primarily in the case of a conglomerate or holding company that "merely has a passive ownership interest in one or more non-financial operating companies. In such cases, the operating companies may have complete trading and management independence and operate at such a distance from the holding company that it would not be appropriate to aggregate positions."[265] Several commenters argued that the non-financial entity provision was too narrow to provide meaningful disaggregation relief and supported its extension to financial entities.[266] These commenters also asserted that the failure to extend the exemption was discriminatory against financial entities without a proper basis.[267] Other commenters asked for guidance from the Commission on whether business units of a company could qualify as owned non-financial entities for aggregation purposes.[268] These commenters argued that functionally these business units operate the same as separately organized entities, and should not be forced to undergo the costs and inefficiencies of becoming separately organized for position limit purposes.[269]

In view of the Commission's determination to retain the IAC exemption and the aggregation policy in general (which the Commission believes has worked effectively to date),

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financial entity have written policies and procedures in place to preclude such knowledge, and that the entities have separate employees and risk management systems.

265 76 FR 4752, at 4762.

266 See e.g., CL-FIA I supra note 21 at 23-24; CL-DBCS supra note 238 at 6; CL-PIMCO supra note 21 at 3; National Rural Electric Cooperative ("NREC"), Association American Public Power ("AAPP"), and Association Large Public Power Council ("ALLPC") on March 28, 2011 ("CL-NREC/AAPP/ALLPC") at 20; CL-MFA supra note 21 at 14; CL-CME I supra note 8 at 16; CL-ISDA/SIFMA supra note 21 at 15; CL-BlackRock supra note 21 at 9; CL-Morgan Stanley supra note 21 at 9; and CL-NYCBA supra note 243 at 4.

267 See e.g., CL-FIA I supra note 21 at 22-23; CL-CME I supra note 8 at 16-17; CL-ISDA/SIFMA supra note 21 at 15; CL-Morgan Stanley supra note 21 at 9; CL-USCOC supra note 246 at 6; CL-DBCS supra note 247 at 6; CL-PIMCO supra note 21 at 5 (position limits are not high enough to offset elimination of IAC as explained in the proposed §); CL-MFA supra note 21 at 14; Akin Gump Strauss Hauer & Field LLP ("Akin Gump") on March 25, 2011 ("CL-Akin Gump") at 4; and CL-CMC supra note 21 at 4.

268 See e.g., CL-BGA supra note 35 at 21; and CL-Cargill supra note 76 at 7.

269 See e.g., CL-Cargill supra note 76 at 7.

provide an exemption for federal law information sharing restrictions in final § 151.7(i) and provide an exemption for underwriting in final § 151.7(g), the Commission believes that it would not be appropriate, at this time, to expand further the scope of disaggregation exemptions to owned-non financial or financial entities. As described above, the final rules include express disaggregation exemptions to mitigate the impact of the aggregation requirements that apply to commonly-owned entities or accounts. These disaggregation exemptions are appropriately limited to situations that do not present the same concerns as those underlying the aggregation policy, namely, the sharing of transaction or position information that may facilitate coordinated trading; as such, the Commission does not believe further expansion of the disaggregation exemptions is warranted at this time.

6. Funds with Identical Trading Strategies

The proposal would require aggregation for positions in accounts or pools with identical trading strategies (e.g., long-only position in a given commodity), including passively-managed index funds. Under this provision, the general ownership threshold of 10 percent would not apply; rather, positions of any size in accounts or pools would require aggregation.

Several commenters objected to forcing aggregation on the basis of identical trading strategies because it did not, in their view, further the purpose of preventing unreasonable or unwarranted price fluctuations.[270] These commenters argued that the proposal would lead to a decrease in index fund participation, which will reduce market liquidity, especially in deferred months, as well as impact commodity price discovery. One commenter indicated support for extending the aggregation requirement to commodity index funds, and the swaps which are

[270] See e.g., CL-CME I supra note 8 at 18; and CL-BlackRock supra note 21 at 14.

indexed to each individual index.[271] PMAA/NEFI opined that positions of passive long speculators should be aggregated to the extent that they follow the same trading strategies regardless of whether their positions are held or controlled by the same trader in order to shield the markets from the cumulative impact of multiple passive long speculators who follow the same trading strategies.[272]

The Commission is adopting this aggregation provision as proposed, with the clarification that a trader must aggregate positions controlled or held in one account with positions controlled or held in one pool with identical trading strategies. As the Commission stated in the NPRM, this aggregation provision is intended to prevent circumvention of the aggregation requirements. In absence of such aggregation requirement, a trader can, for example, acquire a large long-only position in a given commodity through positions in multiple pools, without exceeding the applicable position limits.

7. Process for Obtaining Disaggregation Exemption

In contrast to the existing practice, the proposed aggregation exemptions were not self-effectuating. A trader seeking to rely on any aggregation exemption would be required to file an application for relief with the Commission, and the trader could not rely on the exemption until the Commission approved the application.[273] Further, the trader would be subject to an annual renewal application and approval.

Several commenters objected to the proposed change from self-executing disaggregation exemptions to an application-based exemption on the basis that it would create an additional

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271 See e.g., CL-Better Markets supra note 37 at 69-70.

272 CL-PMAA/NEFI supra note 6 at 14.

273 See e.g., CL-FIA I supra note 21 at 25; CL-CMC supra note 21 at 5; and CL-EEI/EPSA supra note 21 at 19-20.

burden on traders without any benefits. Some of these commenters argued that the disaggregation exemptions for FCMs should continue to be self-effectuating because FCMs are subject to direct oversight by the Commission, and the Proposed Rule does not provide a sufficient explanation for the change in policy.[274] MFA recommended that instead of requiring an application for exemptive relief and annual renewals, IACs should be required to file a notice informing the Commission that they intend to rely on the exemption and a representation that they meet the relevant conditions.[275]

Some of the commenters, objecting to the application-based exemption, requested that the Commission make the necessary applications for an exemption conditionally effective, rather than effective after a Commission determination.[276] Other commenters argued that the Commission should only require that exemption applications be initially filed with material updates as opposed to an annual reapplication process.[277]

With regard to the specific conditions for applying for an aggregation exemption, several commenters requested that the Commission remove or clarify the condition that entities submit an independent assessment report.[278] Similarly, commenters opined that the Commission should

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274 See e.g., CL-Morgan Stanley supra note 21 at 7. See also Futures Industry Association ("FIA II") on May 25, 2011 ("CL-FIA II") at 6.

275 See CL-MFA supra note 21 at 16.

276 See e.g., CL-FIA I supra note 21 at 25; Willkie Farr & Gallagher LLP ("Willkie") on March 28, 2011 ("CL-Willkie") at 7; CL-API supra note 21 at 12; Gavilon Group, LLC ("Gavilon") on March 28, 2011("CL-Gavilon") at 8; and CL-CMC supra note 21 at 4. See also CL-BGA supra note 35 at 22.

277 See e.g., CL-Cargill supra note 76 at 9.

278 See e.g., CL-FIA I supra note 21 at 26-27; and CL-BGA supra note 35 at 22.

not require applicants to designate an office and employees responsible for coordinating compliance with aggregation rules and position limits.[279]

The Commission is adopting the proposal with modifications to address the concerns expressed in the comments. Specifically, the Commission is eliminating the requirement that a trader seeking to rely on a disaggregation exemption file an application for exemptive relief and annual renewals. Instead, the trader must file a notice, effective upon filing, setting forth the circumstances that warrant disaggregation and a certification that they meet the relevant conditions.

The Commission believes that the new notice process (with its attendant certification requirement) for disaggregation relief represents a less burdensome, yet effective, alternative to the proposed application and pre-approval process. The notice procedure will allow market participants to rely on aggregation exemptions without the potential delay of Commission approval, thus lessening the burden on both market participants and the Commission to respond to such applications. In addition, the notice filings will give the Commission insight into the application of the various exemptions, which the Commission could not do under a self-certification regime.

Under the notice provisions, upon call by the Commission, any person claiming a disaggregation exemption must provide relevant information concerning the claim for exemption.[280] Thus, for example, if the Commission identifies potential concerns regarding the integrity of the information barrier supporting a trader's reliance on the IAC exemption, it can

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279 See e.g., CL-FIA I supra note 21 at 27.

280 See § 151.7(h)(2).

audit the subject trader for adequacy of such information barrier and related practices. To the extent the Commission finds that a trader is not appropriately following the conditions of the exemption, upon notice and opportunity for the affected person to respond, the Commission may amend, suspend, terminate, or otherwise modify a person's aggregation exemption.

In response to the concerns of commenters, the Commission has determined to remove the conditions that a person submit an independent assessment report and designate an office and employees responsible for coordinating compliance with aggregation rules and position limits as part of the notice filing for an exemption.

I. Preexisting Positions

The Commission proposed to apply the good-faith exemption under CEA section 4a(b) for pre-existing positions in both futures and swaps. This provided a limited exemption for pre-existing positions that are in excess of the proposed position limits, provided that they were established in good-faith prior to the effective date of a position limit set by rule, regulation, or order. However, "[s]uch person would not be allowed to enter into new, additional contracts in the same direction but could take up offsetting positions and thus reduce their total combined net positions."[281] Thus, the Commission would calculate a person's pre-existing position for purposes of position limit compliance, but a person could not violate position limits based upon pre-existing positions alone.

The Commission also proposed a broader scope of the good-faith exemption for swaps entered before the effective date of the Dodd-Frank Act. Such swaps would not be subject to position limits, and the Commission would allow pre-effective date swaps to be netted with post-effective date swaps for the purpose of complying with position limits.

[281] 76 FR at 4752, 4763.

Finally, the Commission proposed to permit persons with risk-management exemptions under current Commission regulation 1.47 to continue to manage the risk of their swap portfolio that exists at the time of implementation of the legacy limits, and no new swaps would be covered.

The Working Group and BGA requested that the Commission grandfather any positions put on in good faith prior to the effective date of any final rule implementing position limits for Referenced Contracts.[282] CME and Blackrock urged that the Commission instead phase in position limits to minimize market disruption.[283]

Commenters addressing the pre-existing positions exemption in the context of index funds recommended that these funds be grandfathered in order that they may "roll" their futures positions after the effective date of any position limits rule.[284] Absent such grandfather treatment, commenters such as SIFMA opined that funds and accounts could be prevented from implementing rollovers in the most advantageous manner, and could conceivably be put in the anomalous positions of having to liquidate positions to return funds to investors if pre-existing positions cannot be replaced as necessary to meet stated investment goals."[285] CME also put

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282 See CL-BGA supra note 35 at 20; and CL-WGCEF supra note 35 at 20.

283 CL-CME I supra note 8 at 19-20; CL-BlackRock supra note 21 at 17; and CL-SIFMA AMG I supra note 21 at 16.

284 See e.g., CL-CME I supra note 8 at 19-20; CL-SIFMA AMG I supra note 21 at 16; CL-BlackRock supra note 21 at 17; CL-MFA supra note 21 at 19. These commenters generally explained that these funds "typically replace or 'roll over' their contracts in a staggered manner, before they reach their spot months, in order to maintain position allocations in as stable a manner as possible and without causing price impact."

285 CL-SIFMA AMG I supra note 21 at 16.

forth that "[i]ndex fund managers who do not or cannot roll-over positions would also be deviating from disclosed-to-investors trading strategies.[286]

With regard to the proposal to permit swap dealers to continue to manage the risk of a swap portfolio that exists at the time of implementation of the proposed regulations, CME requested that such relief be extended to swap dealers with swap portfolios in contracts that were not previously subject to position limits and therefore did not require exemptions.[287]

The Commission is finalizing the scope of the pre-existing position and grandfather exemption as proposed, subject to modifications below, in final § 151.9. The exemption for pre-existing positions implements the provisions of section 4a(b)(2) of the CEA, and is designed to phase in position limits without significant market disruption. In response to concerns over the scope of the pre-existing position exemption, the Commission clarifies that a person can rely on this exemption for futures, options and swaps entered in good faith prior to the effective date of the rules finalized herein for non-spot month-position limits.[288] Such pre-existing futures, options and swaps transactions that are in excess of the proposed position limits would not cause the trader to be in violation based solely on those positions. To the extent a trader's pre-existing futures, options or swaps positions would cause the trader to exceed the non-spot-month limit, the trader could not increase the directional position that caused the positions to exceed the limit

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286 CL-CME I supra note 8 at 19-20; and CL-BlackRock supra note 21 at 17.

287 CL-CME I supra note 8 at 19.

288 Notwithstanding the pre-existing exemption in non-spot months, a person must comply with spot-month limits. Any spot-month limit that is initially set or reset under Final § 151.4(a) will apply to all spot month periods. The Commission notes it will provide at least two months advance notice of changes to levels of such spot-month limits under Final § 151.4(e).

until the trader reduces the positions to below the position limit.[289] As such, persons who established a net position below the speculative limit prior to the enactment of a regulation would be permitted to acquire new positions, but the Commission would calculate the combined position of a person based on pre-existing positions with any new position.[290]

Notwithstanding the combined calculation of pre-existing positions with new positions, the Commission is also retaining the broader exemption for swaps entered prior to the effective date of the Dodd-Frank Act and prior to the initial implementation of position limits under final § 151.4. The pre-effective date swaps would not be subject to the position limits adopted herein, and persons may, but need not, net swaps entered before the effective date of Dodd-Frank with swaps entered after the effective date.

With regard to comments addressing index funds that "roll" their pre-existing positions, the Commission notes that CEA section 4a(b)(2) only extends the exemption for pre-existing positions that were entered "prior to the effective date of such rule, regulation, or order [establishing position limits]." Given this statutory stricture, index funds that "roll" their pre-existing positions after the effective date of a position limit rule do not fall within the scope of the pre-existing position exemption.[291]

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289 For example, if the position limit in a particular reference contract is 1,000 and a trader's pre-existing position amounted to 1,005 long positions in a Referenced Contract, the trader would not be in violation of the position limit. However, the trader could not increase its long position with additional new long positions until its position decreased to below the position limit of 1,000. Once below the position limit of 1,000, this hypothetical trader would be subject to the position limit of 1,000.

290 76 FR at 4763.

291 The Commission also notes that absent this limitation on pre-existing positions, any entity that rolls futures positions would in effect not be subject to position limits because the subsequent positions would be subject to exemption.

With regard to persons with existing exemptions under Commission regulation 1.47 to manage the risk of their existing swap portfolio, the Commission is adopting this provision as proposed. Specifically, the Commission is adopting a limited exemption to provide for transition into these position limit rules for persons with existing § 1.47 exemptions under final § 151.9(d). This limited exemption is also designed to limit market disruptions as market participants transition to these position limit rules. However, the Commission will only apply this relief to market participants with existing § 1.47 exemptions because the transitional nature of providing such relief dictates that the Commission should not extend a general exemption for persons to manage their existing swap book outside of § 1.47 exemptions. Further, since the proposed non-spot month class limits are not being adopted, such a person may net positions across futures and swaps in a Referenced Contract. This largely mitigates the need for a risk management exemption.

J. Commodity Index or Commodity-Based Funds

The definition of "Referenced Contract" in § 151.1 expressly excludes commodity index contracts. A commodity index contract is defined as a contract, agreement, or transaction "that is not a basis or any type of spread contract, [and] based on an index comprised of prices of commodities that are not the same nor substantially the same." Thus, by the terms of this provision, contracts with diversified commodity reference prices are excluded from the proposed position limit regime. As a result, single commodity index contracts fall within the scope of the proposal. Further, under amended section 4a(a)(1) of the CEA, the Commission is empowered to establish position limits by "group or class of traders," and new section 4a(a)(7) gives the Commission authority to provide exemptions from those position limits to any "person or class of persons."

A number of commenters argued that commodity index funds ("CIFs") should be exempted from the final rulemaking for position limits.[292] DB Commodity Services argued that passive CIFs apply "zero net buying pressure across the commodity term structure."[293] Gresham Investments argued that "unleveraged, solely exchange-traded, fully transparent, clearinghouse guaranteed" CIFs that pose "no systemic risk" should be treated differently than highly leveraged futures traders, who pose a continuing systemic risk to the commodity markets.[294] Three commenters argued that CIFs increase market liquidity for bona fide hedgers.[295] Finally, BlackRock also argued that there is no empirical evidence supporting a causal connection between CIFs and commodity price volatility.[296] Senator Blanche Lincoln argued that position limits should not apply to diversified, unleveraged index funds because they provide "necessary liquidity to assist in price discovery and hedging for commercial users . . . [and] are an effective way [for] investors to diversify their portfolios and hedge against inflation."[297] Further, Senator Lincoln opined that that the Commission should distinguish between "trading activity that is unleveraged or fully collateralized, solely exchange-traded, fully transparent, clearinghouse

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292 CL-BlackRock supra note 21 at 15; CL-DB supra note 153 at 2-4; CL-PIMCO supra note 21 at 9; ETF Securities on March 28, 2011 ("CL-ETF Securities") at 3-4; and CL-SIFMA AMG I supra note 21 at 13.

293 CL-DBCS supra note 247 at 3.

294 CL-Gresham supra note 153 at 2, 6-7.

295 CL-BlackRock supra note 21 at 15; CL-PIMCO supra note 21 at 10 (citing Sen. Lincoln's remarks on index funds); and CL-DBCS supra note 247 at 3-4.

296 CL-BlackRock supra note 21 at 15.

297 See Senator Lincoln ("Sen. Lincoln") on Dec. 16, 2010 ("CL-Sen. Lincoln") at 1-2 ("I urge the CFTC not to unnecessarily disadvantage market participants that invest in diversified and unleveraged commodity indices.")

guaranteed, and poses no systemic risk and highly leveraged swaps trading in its implementation of position limits."[298]

Commenters also submitted studies regarding index traders. In particular, several studies conducted by two agricultural economists were highlighted by commenters. The authors of the studies contended that there is no evidence that the influx of index fund trading unduly influences prices.[299] Commenters also cited the Commission's 2008 Staff Report on Commodity Index Traders and Swap Dealers, in which Commission staff provided an overview for the public regarding the participation of these types of traders in commodity derivatives markets.[300]

Other commenters, however, asserted that CIFs should be subject to special, more restrictive position limits.[301] Some of these commenters argued that the presence of CIFs upsets the price discovery function of the market because investors buy interests in CIFs without regard

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298 Id.

299 Irwin, Scott and Dwight Sanders "The Impact of Index and Swap Funds on Commodity Futures Markets", OECD Food, Agriculture, and Fisheries Working Papers, (2010); Sanders, Dwight and Scott Irwin "A Speculative Bubble in Commodity Futures Prices? Cross-Sectional Evidence", Agricultural Economics, (2010); Sanders, Dwight, Scott Irwin, and Robert Merrin "The Adequacy of Speculation in Agricultural Futures Markets: Too Much of a Good Thing?" University of Illinois at Urbana-Champaign, (2008).

300 U.S. Commodity Futures Trading Commission "Staff Report on Commodity Swap Dealers and Index Traders with Commission Recommendations" (2008). While the majority of the report is broad in scope and serves as a guide to the special calls issued to swap dealers and index traders by the Commission, there is a discussion of the impact of these types of participants (generally considered to be speculators in most markets). Specifically, the report looks at the vast increase in notional value of NYMEX crude oil futures contracts in relationship to the vast increase in commodity index investment from December 2007 to June 2008. Staff concluded that the increase in notional value is due to the appreciation of existing positions, and not the influx of new money into the market, citing the observation that the actual number of futures-equivalent contracts declined over the same period.

301 CL-ABA supra note 150 at 4; CL-ATAA supra note 94 at 15; CL-ATA supra note 81 at 4,5; CL-PMAA/NEFI supra note 6 at 12-14; CL-ICPO supra note 20 at 1; CL-Better Markets supra note 37 at 71 ("limiting commodity index funds to 10 percent of total market open interest would likely have significant beneficial effects [on excessive speculation]"); and International Pizza Hut Franchise Holders Association (IPHFHA") on March 24, 2011 ("CL-IPHFHA") at 1. There were 6,074 form comment letters that urged the Commission to adopt "lower speculative position limits for passive, long-only traders."

to the market fundamentals price.[302] The Air Transport Association of America recommended that the Commission undertake a study to analyze and determine the effect of such passive, long-only traders on the price discovery function of the markets.[303]

Some studies opined that the recent influx of CIF trading has caused an increase in prices that is not explained by market fundamentals alone.[304] For example, one study argued that index speculators have been at least partially responsible for the tripling of commodity futures prices over the last five years.[305]

Regardless of whether a CIF is non-diversified or diversified, the Commission did not propose to impose different position limits on CIFs or to exempt CIFs from position limits. In addition to considering comments regarding the role of CIFs in commodity derivatives markets, the Commission has reviewed and evaluated studies cited by commenters presenting conflicting views on the effect of certain groups of index traders.[306] Historically, the Commission has applied position limits to individual traders rather than a group or class of traders, and does not have a similar level of experience with respect to group or class limits as it has with position

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302 CL-PMAA/NEFI supra note 6 at 12-13; CL-Delta supra note 20 at 7-8; CL-Better Markets supra note 37 at 35-36; and Industrial Energy Consumer of America ("IECA") on March 28, 2011 ("CL-IECA") at 2.

303 CL-ATAA supra note 94 at 15.

304 Tang, Ke and Wei Xiong "Index Investing and the Financialization of Commodities", Working Paper, Department of Economics, Princeton University, (2010).; Mou, EthanY. "Limits to Arbitrage and Commodity Index Investment: Front-Running the Goldman Roll", Working Paper, Columbia University, (2010).; Gilbert, Christopher L. "Speculative Influences on Commodity Futures Prices, 2006-2008", Working Paper, Department of Economics, University of Trento, Italy, (2009).; Gilbert, Christopher L. "How to Understand High Food Prices", Journal of Agricultural Economics, 61(2): 398-425. (2010).

305 Masters, Michael and Adam White "The Accidental Hunt Brothers: How Institutional Investors are Driving up Food and Energy Prices", White Paper, (2008). "As hundreds of billions of dollars have poured into the relatively small commodities futures markets, prices have risen dramatically. Index Speculators working through swaps dealers have been the single biggest source of new speculative money. This has driven prices far beyond the levels that supply and demand would indicate, and has done tremendous damage to our economy as a result."

306 In addition, the Commission has reviewed all other studies submitted by commenters; a detailed description can be found in Section III of this release.

limits for individual traders. Therefore, the Commission believes more analysis is required before the Commission would impose a separate position limit regime, or establish an exemption, for a group or class of traders, including CIFs.[307] The Commission welcomes further submissions of studies to assist in subsequent rulemakings on the treatment of various groups or classes of speculative traders.

K. Exchange Traded Funds

CME commented that the Commission should coordinate its position limit policy with the Securities and Exchange Commission ("SEC") in order to avoid encouraging market participants to replace their commodity derivatives exposures with physical commodity exchange-traded fund ("ETF") exposures.[308] As previously stated, the Commission believes that the final rules will ensure sufficient market liquidity for bona fide hedgers in accordance with CEA section 4a(a)(3)(B)(iii). With respect to the potential increase in ETF exposures, the Commission notes that such products are not within the scope of this rulemaking.

L. Position Visibility

The Proposed Rule established an enhanced reporting regime for traders who hold or control positions in certain energy and metal Referenced Contracts above a specified number of net long or net short positions.[309] These "position visibility levels" are set below the proposed non-spot-month position limit levels. A trader's positions in all-months-combined for listed Referenced Contracts would be aggregated under the Proposed Rule, including bona fide hedge positions. Once a trader crosses a proposed position visibility level, the trader would have to file

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307 In this regard, the lack of consensus in the studies submitted demonstrates the need for additional analysis.

308 CL-CME I supra note 8 at 20.

309 See Proposed Rule 151.6. The position visibility levels did not apply to agricultural commodity contracts.

monthly reports with the Commission that generally capture the trader's physical and derivatives portfolio in the same commodity and substantially same commodity as that underlying the Referenced Contract.[310]

The general purpose behind the position visibility levels was to enhance the Commission's surveillance functions to better understand the largest traders for energy and metal Referenced Contracts, and to better enable the Commission to set and adjust subsequent position limits, as appropriate.[311]

Commenters were divided on the utility of position visibility levels. A number of commenters supported the proposed visibility levels, with some urging the Commission to expand their application to agricultural contracts.[312] Many of the supportive commenters stated that the Commission should extend the position visibility regime to agricultural Referenced Contracts.[313] At least one commenter specifically requested that the Commission expand the position visibility levels to metal-based ETFs as well as contracts traded on the London Metals Exchange as a method to deter excessive speculation and manipulation.[314]

Several commenters stated that the enhanced reporting requirements would be onerous to implement along with other Dodd-Frank Act requirements with little benefit to combating

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310 While the proposed position visibility regime would only trigger reporting requirements, the preamble did note that trading at or near such levels was "in no way intended to imply that positions at or near such levels cannot constitute excessive speculation or be used to manipulate prices or for other wrongful purposes." See Proposed Rule at 4759.

311 75 FR 4752, 4761-62, Jan. 26, 2011.

312 See e.g., CL-Prof. Greenberger supra note 6 at 18; CL-AFR supra note 17 at 8; and CL-AIMA supra note 35 at 4.

313 See e.g., CL-FWW supra note 81 at 15.

314 See e.g., Vandenberg & Feliu LLP ("Vandenberg") on March 28, 2011 ("CL-Vandenberg") at 2-3.

excessive speculation.[315] Certain commenters also asserted that the reporting requirements would disproportionately impact bona fide hedgers because such entities would have to produce reports surrounding their hedging activity whereas a speculative trader would not have to produce similar reports.[316] One commenter pointed out that the Commission could instead utilize its special call authority under § 18.05 to receive data similar to the data to be reported in the position visibility regime.[317] One commenter argued that the reporting frequency should be semi-annual as opposed to monthly because the Commission would not need to analyze this additional data on a monthly basis.[318] Another commenter assumed that the reporting requirements would be daily and therefore requested the Commission alter the requirement to monthly.[319] Some commenters opined that the scope of the position visibility reports was vague because it required reporting of uncleared swap positions in substantially the same commodity.[320]

Commenters also argued that the Commission should alter the position visibility levels to a position accountability regime similar to the rules on DCMs. However, among the commenters who supported converting position visibility levels to position accountability levels, there were

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315 See e.g., CL-BGA supra note 35 at 20-21; CL-FIA I supra note 21 at 13; CL-EEI/EPSA supra note 21 at 6 (EEI alternatively argued that the Commission should raise the threshold levels for certain contracts if the Commission retained the visibility regime); CL-MFA supra note 21 at 3; CL-Utility Group supra note 21 at 13-14; CL-NREC/AAPP/ALLPC supra note 266 at 12; CL-USCF supra note 153 at 11; and CL-WGCEF supra note 35 at 23. Some commenters expressed concern that the Commission would not have sufficient resources to review the data, and therefore the cost of compliance would not produce a benefit. See e.g., CL-MFA supra note 21 at 3.

316 See e.g., CL-EEI/EPSA supra note 21 at 6; and CL-WGCEF supra note 35 at 23.

317 See e.g., CL-BGA supra note 35 at 20-21.

318 See e.g., CL-USCF supra note 153 at 11.

319 See e.g., CL-NGFA supra note 72 at 5.

320 See e.g., CL-AGA supra note 124 at 12.

two distinct approaches. Some commenters wanted the Commission to implement position accountability levels as an interim measure until the Commission could fully implement hard position limits outside of the spot-month.[321] The second group requested that the Commission eliminate visibility levels and position limits, and in their place implement position accountability levels.[322]

The Commission is adopting the position visibility proposal with certain modifications in response to comments. The Commission continues to believe that position visibility levels represent an important surveillance tool in the metal and energy Referenced Contracts because the Commission does not anticipate that the number of traders with positions in excess of the limits for metal and energy Referenced Contracts will constitute a significant segment of the market. As such, the Commission would not receive a large number of bona fide hedging reports and other data for many traders in excess of the position limit, and the position visibility levels would improve the Commission's ability to monitor the positions of the largest traders in the markets. In this regard, the Commission anticipates that more traders in the agricultural Referenced Contracts will be above the anticipated position limits, and therefore, the Commission does not currently anticipate a similar need to apply the position visibility levels to agricultural Referenced Contracts.

To accommodate compliance cost concerns raised by some commenters the position visibility level will be raised to approximately 50 percent of the projected aggregate position limit (based on current futures and swaps open interest data), with the exception of NYMEX

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321 See e.g., CL-PMAA/NEFI supra note 6 at 15; CL-ATAA supra note 94 at 5, 16; CL-APGA supra note 17 at 8-9; and CL-Delta supra note 20 at 11.

322 See e.g., CL-BlackRock supra note 21 at 18-19; and CL-CME I supra note 8 at 6. See also, CL-FIA I supra note 21 at 13; and CL-EEI/EPSA supra note 21 at 10.

Light Sweet Crude Oil (CL) and NYMEX Henry Hub Natural Gas (NG) Referenced Contracts where the levels have been set lower to approximate the point where ten traders, on an annual basis, would be subject to position visibility reporting requirements. The Commission believes that this increase is appropriate in order to reduce the number of traders burdened by the associated reporting obligations. In addition, under §151.6(b)(2)(ii), the Commission will require position visibility reports to include uncleared swaps in Referenced Contracts, but will not require reporting of swaps in substantially the same commodity. [323] The position visibility rule will become effective on the date that new federal spot month limits become effective. Additionally, the Commission has eliminated the requirement to submit 404A filings under § 151.6 in order to further reduce the compliance burden for firms reporting under that provision. The Commission believes it will receive sufficient information on the cash market activity for general surveillance purposes through 404 filings under § 151.6(c).[324]

The Commission has eliminated the separate 402S filing and will gather information on uncleared swaps through the revised 401 filing. The revised 401 filing will provide information for general surveillance purposes in light of the data management issues discussed in II.C. of this release.

The Commission has also reduced the required frequency of reporting on the 401 and 404 filings. The Commission may request more specific data, either in terms of data granularity (e.g., a break-out of data based on expirations) or with respect to a trader's position on a specific date or dates under its existing authority under Commission regulations 18.05 and 20.6. The

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[323] Proposed § 151.6(c) required reporting of uncleared swaps in substantially the same commodity.

[324] The Commission has also amended § 151.6(b)(1) to require the reporting of the dates, instead of the total number of days, that a trader held a position exceeding visibility levels.

Commission clarifies that 401 and 404 filings required under § 151.6 are to reflect the reporting person's relevant positions as of the first business Tuesday of a calendar quarter and on the date on which the person held the largest net position in excess of the level in all months. The Commission would require such a filing to be made within ten business days of the last day of the quarter in which the trader held a position exceeding position visibility levels.

M. International Regulatory Arbitrage

Section 4a(a)(2)(C) of the CEA, as amended by section 737 of the Dodd-Frank Act, requires the Commission to "strive to ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits and that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade." The Commission received several comments expressing concerns regarding the regulatory arbitrage opportunities that might arise as a result of the imposition of position limits.[325]

The U.S. Chamber of Commerce stated that "hasty and ill-conceived limits on the U.S. derivatives markets will undoubtedly lead to a significant migration of market participants to less-regulated overseas markets."[326] Similarly, ISDA/SIFMA stated that a permanent position limit regime should be postponed until the Commission has fully consulted with its counterparts around the globe about harmonizing limits and phasing them in simultaneously, so as to ensure

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[325] See e.g., CL-BlackRock supra note 21 at 18 ("The variability of position limits from year to year also will create uncertainty for market participants as to what limits will apply to their long-term trading strategies, causing some participants to shift their commodity-risk positions to markets with no limits at all or possibly even fixed limits."); and CL-ISDA/SIFMA supra note 21 at 24-25 (" . . . we believe that the Proposed Rules will likely result in market participants, especially those that operate outside the U.S., shifting their trading activity to non- U.S. markets.").

[326] CL-USCOC supra note 246 at 4.

that position limits imposed on U.S. markets do not shift business offshore.[327] Accordingly, ISDA/SIFMA strongly urged "the CFTC to work with foreign regulators to ensure that foreign commodity market participants are subject to position limits that are comparable to those imposed on U.S. market participants."[328] Michael Greenberger, on the other hand, opined that the proposed position limits would result in minimal international regulatory arbitrage because (i) the Commission has extraterritorial jurisdiction reach under Dodd-Frank Act section 722, (ii) many swap dealers would be required to register under the Dodd-Frank Act thereby ensuring that the Commission would have jurisdiction over them, (iii) other authorities are working to harmonize their rules and have expressed a hostility to the financialization of commodity markets, and (iv) many other authorities have shown a willingness to impose additional requirements on expatriate U.S. banks.[329]

The Commission agrees that it should seek to avoid regulatory arbitrage and participate in efforts to raise regulatory standards internationally. The Commission has worked to achieve that general goal through its participation in the International Organization of Securities Commissions ("IOSCO"). Most recently, the Commission assisted in the development of an international consensus on principles for the regulation and supervision of commodity derivatives markets, which included a requirement that market authorities should have the authority, among other things, to establish ex-ante position limits, at least in the delivery

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327 CL-ISDA/SIFMA supra note 21 at 24-25 (" . . . we believe that the Proposed Rules will likely result in market participants, especially those that operate outside the U.S., shifting their trading activity to non- U.S. markets.")

328 Id.

329 CL-Prof. Greenberger supra note 6 at 20.

month.[330] The Commission intends, through its activities within IOSCO, to seek further elaboration on the degree to which commodity derivatives market authorities implement those principles, including the extent to which position limits are been imposed.

The Commission rejects the view, however, that section 4a(a)(2)(C) of the CEA prohibits Commission rulemaking unless and until there is uniformity in position limit policies in the United States and other major market jurisdictions. Such a view would subordinate the explicit statutory directive to impose position limits as a means to address excessive speculation in U.S. derivatives markets to a potentially lengthy period of policy negotiations with foreign regulators.

The Commission also rejects the view suggested in some of the comment letters that it is a foregone conclusion that the mere existence of differences in position limit policies will inevitably drive trading abroad. The Commission's prior experience in determining the competitive effects of regulatory policies reveals that it is difficult to attribute changes in the competitive position of U.S. exchanges to any one factor. For example, prior concerns with regard to the competitive effect on U.S. contract markets of alleged lighter regulation abroad led the CFTC to study those concerns both in 1994, pursuant to a congressional directive,[331] and again in 1999.[332] In both cases, the Commission's staff reports concluded that differences in regulatory regimes between various countries did not appear to have been a significant factor in

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330 See Principles for the Regulation and Supervision of Commodity Derivatives Markets, IOSCO Technical Committee (2011).

331 The Futures Trading Practices Act of 1992 ("FTPA") required the CFTC to study the competitiveness of boards of trade over which it has jurisdiction compared with the boards of trade over which "foreign futures authorities" have jurisdiction. The Commission submitted its report on this issue, "A Study of the Global Competitiveness of U. S. Futures Markets" ("1994 Study"), to the Senate and House agriculture committees in April 1994.

332 The Global Competitiveness of U.S. Futures Markets Revisited, CFTC Division of Economic Analysis (November 1999) http://www.cftc.gov/dea/compete/deaglobal_competitiveness.htm.

the competitive position of the world's leading exchanges.[333]

Nonetheless, the Commission takes seriously the need to avoid disadvantaging U.S. futures exchanges and will monitor for any indication that trading is migrating away from the United States following the establishment of the position limit structure set forth in this rulemaking.[334]

N. Designated Contract Market and Swap Execution Facility Position Limits and Accountability Levels

For contracts subject to federal position limits imposed under section 4a(a) of the CEA, sections 5(d)(5)(B) and 5h(f)(6)(B) require DCMs and SEFs that are trading facilities,[335] respectively, to set and enforce speculative position limits at a level no higher than those established by the Commission. Section 4a(a)(2) of the CEA, in turn, directs the Commission to set position limits on "physical commodities other than excluded commodities." Section 5(d)(5)(A) of the CEA requires that DCMs set, "as is necessary and appropriate, position limitations or position accountability for speculators" for each contract executed pursuant to their rules. A similar duty is imposed on SEFs that are trading facilities under section 5h(f)(6)(A) of the CEA.

1. Required DCM and SEF Position Limits for Referenced Contracts

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333 CFTC press release #4333-99F (November 4, 1999) http://www.cftc.gov/opa/press99/opa4333-99.htm Among other things, the 1999 report concluded that the U.S. share of total worldwide futures and option trading activity appears to be stabilizing as the larger foreign markets have matured. As in 1994, the most actively traded foreign products tend to fill local or regional risk management needs and few products offered by foreign exchanges directly duplicate products offered by U.S. markets; and the increased competition among mature segments of the global futures industry, particularly in Europe, may reflect industry restructuring and the introduction of new technologies, particularly electronic trading.

334 As discussed above in II.E., section 719(a) of the Dodd-Frank Act directs the Commission to study the "effects (if any) of the positions limits imposed pursuant to [section 4a] on excessive speculation and on the movement of transactions" from DCMs to foreign venues and to submit a report on these effects to Congress within 12 months after the imposition of position limits. This study will be conducted in consultation with DCMs. See Dodd-Frank Act, supra note 1, section 719(a).

335 All references to "SEFs" below are to SEFs that are trading facilities.

Proposed § 151.11(a) would have required DCMs and SEFs to set spot month, single month, and all-months position limits for all commodities, with exceptions for securities futures and some excluded commodities. Under proposed § 151.11(a)(1), DCMs and SEFs would be required to set additional, DCM or SEF spot-month and non-spot-month position limits for Referenced Contracts at a level no higher than the federal position limits established pursuant to proposed § 151.4. For other contracts (including other physical commodity contracts), under proposed § 151.11(a)(2), DCMs and SEFs would be required to set position limits utilizing the Commission's historic approach to position limits.

Shell requested that if the Commission adopts federal spot month limits, exchange-based position limits should be eliminated because these limits will be redundant, at best, and may cause unintended apportionment of trading across exchanges, at worst.[336] Several other commenters opined that the Commission should require exchanges to set spot month limits and to refrain from setting federal position limits.[337]

The Commission has determined, consistent with the statute and the proposal, to require the establishment of position limits by DCMs and SEFs for Referenced Contracts.[338] As discussed above under II.A, the Commission has been directed under section 4a(a)(2) of the CEA to establish position limits on physical commodity DCM futures and options contracts and has been granted discretion to determine the specific levels. The Commission has exercised this

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336 CL-Shell supra note 35 at 5-6.

337 See e.g., CL-ICE I supra note 69 at 6-8 (Cash-settled contract limits should apply to each exchange-traded contract separately and there should not be an aggregate spot-month limit.); CL-DB supra note 153 at 9-10; and CL-Centaurus supra note 21 at 4.

338 As discussed below in II.M.3, the Commission has recognized an arbitrage exemption for registered entity limits for all but physical-delivery contracts in the spot month. This is consistent with the Commission's approach on non-spot month class limits as it ensures that registered entity limits do not create a marginal incentive to establish a position in a class of otherwise economically equivalent contracts outside of the spot month.

discretion by imposing federally-administered position limits under § 151.4 for 28 "Referenced Contract" physical commodity derivatives markets and under § 151.11 by directing DCMs and SEFs to establish methodologically similar position limits for Referenced Contracts.[339] While DCM or SEF limits are not administered by the Commission, the Commission may nonetheless enforce trader compliance with such limits as violations of the Act.[340] The Commission did not propose federally-administered position limits over other physical commodity contracts and intends to do so as practicable in the future. In the interim, the Commission will rigorously enforce DCM and SEF compliance with Core Principles 5 and 6.

The Commission notes that section 4a(a)(2) of the CEA requires the Commission to establish speculative position limits on physical commodity DCM contracts. This requirement does not extend to SEF contracts. The Commission has determined that SEF limits for physical commodity contracts are "necessary and appropriate" because the policy purposes effectuated by establishing such limits on DCM contracts are equally present in SEF markets.[341] The Commission notes that the Proposed Rules would have required SEFs to establish limits for all physical commodity derivatives under proposed § 151.11(a).[342] Accordingly, the Commission has determined to establish essentially identical standards for establishing position limits (and accountability levels) for DCMs and SEFs.

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339 The Commission notes that under Core Principle 1 for DCMs and SEFs, the Commission may "by rule or regulation" prescribe standards for compliance with Core Principles. Sections 5(d)(1)(B) and 5h(f)(1)(B) of the CEA, 7 U.S.C. 7(d)(1)(B), 7b-3(f)(1)(B).

340 See section 4a(e) of the CEA, 7 U.S.C. 6a(e).

341 See Core Principle 6 for SEFs, section 5h(f)(6)(A) of the CEA, 7 U.S.C. 7b-3(f)(6)(A).

342 The Commission further notes that it did not receive any comments on this specific proposed requirement for SEFs.

Under § 151.11(a), the Commission requires DCMs and SEFs to establish spot-month limits for Referenced Contracts at levels no greater than 25 percent of estimated deliverable supply for the underlying commodity and no greater than the limits established under § 151.4(a)(1).

The requirement in proposed § 151.11(a)(2) for position limits for contracts at designation has been modified in § 151.11(b)(3) in three important ways. First, consistent with the congressional mandate to establish position limits on all DCM physical commodity contracts, the Commission is requiring that DCMs (and SEFs by extension)[343] establish position limits for all physical commodity contracts. Second, the Commission has clarified this provision to apply to new contracts offered by DCMs and SEFs. The Commission has further clarified that it will be an acceptable practice that the notional quantity of the contract subject to such limits corresponds to a notional quantity per contract that is no larger than a typical cash market transaction in the underlying commodity. For example, if a DCM or SEF offers a new physical commodity contract and sets the notional quantity per contract at 100,000 units while most transactions in the cash market for that commodity are for a quantity of between 1,000 and 10,000 units and exactly zero percent of cash market transactions are for 100,000 units or greater, then the notional quantity of the derivatives contract offered by the DCM or SEF would be atypical. This clarification is intended to deter DCMs and SEFs from setting non-spot-month position limits for new contracts at levels where they would constitute non-binding constraints on speculation through the use of an excessively large notional quantity per contract. This

[343] As discussed above, the Commission has determined that SEF limits for physical commodity contracts are "necessary and appropriate" in order to effectuate the policy purposes underlying limits on DCM contracts.

clarification is not expected to result in additional marginal cost because, among other things, it reflects current Commission custom in reviewing new contracts and is an acceptable practice for Core Principle compliance and not a requirement per se for DCMs or SEFs.

Finally, the Commission in the preamble to the Proposed Rule indicated that a DCM or SEF could elect to establish position accountability levels in lieu of position limits if the open interest in a contract was less than 5,000 contracts.[344] The Commission did not, however, provide for this in the Proposed Rule's text. One commenter specifically supported the position taken by the Commission in the Proposed Rule's preamble because it recognized that position accountability may be more appropriate for certain contracts with lower levels of open interest.[345]

The Commission clarifies that it is not adopting the preamble discussion for low open interest contracts. Rather, final § 151.11(b)(3) provides that it shall be an acceptable practice to provide for speculative limits for an individual single-month or in all-months-combined at no greater than 1,000 contracts for non-energy physical commodities and at no greater than 5,000 contracts for other commodities.[346]

2. DCM and SEF Accountability Levels for Non-Referenced and Excluded Commodities

Under proposed § 151.11(c), consistent with current DCM practice, DCMs and SEFs have the discretion to establish position accountability levels in lieu of position limits for excluded commodities.[347] DCMs and SEFs could impose position accountability rules in lieu of

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344 76 FR at 4752, 4763.

345 CL-AIMA supra note 35 at 6.

346 Proposed § 151.11(a)(2) and Final § 151.11(b)(3).

347 See Section 1a(19) of the Act, 7 U.S.C. 1a(19).

position limits only if the contract involves either a major currency or certain excluded commodities (such as measures of inflation) or an excluded commodity that: (1) has an average daily open interest of 50,000 or more contracts, (2) has an average daily trading volume of 100,000 or more contracts, and (3) has a highly liquid cash market.

Under final § 151.11(c)(1), the Commission provides that the establishment of position accountability rules are an acceptable alternative to position limits outside of the spot month for physical commodity contracts when a contract has an average month-end open interest of 50,000 contracts and an average daily volume of 5,000 contracts and a liquid cash market, consistent with current acceptable practices for tangible commodity contracts. With respect to excluded commodities, consistent with the current DCM practice, DCMs and SEFs may provide for exemptions from their position limits for "bona fide hedging." The term "bona fide hedging," as used with respect to excluded commodities, would be defined in accordance with amended § 1.3(z).[348] Additionally, consistent with the current DCM practice, DCMs and SEFs could continue to provide exemptions for "risk-reducing" and "risk-management" transactions or positions consistent with existing Commission guidelines.[349] Finally, though the Commission is removing the procedure to apply to the Commission for bona fide hedge exemptions for non-enumerated transactions or positions under § 1.3(z)(3), the Commission will continue to recognize prior Commission determinations under that section, and DCMs and SEFs could recognize non-enumerated hedge transactions subject to Commission review.

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348 See § 151.11(d)(1)(ii) of these proposed regulations. As explained in section G of this release, the definition of bona fide hedge transaction or position contained in § 4a(c)(2) of the Act, 7 U.S.C. 6a(c)(2), does not, by its terms, apply to excluded commodities.

349 See Clarification of Certain Aspects of Hedging Definition, 52 FR 27195, Jul. 20, 1987; and Risk Management Exemptions From Speculative Position Limits Approved under Commission regulation 1.61 (Sept. 14, 1987).

3. DCM and SEF Hedge Exemptions and Aggregation Rules

Final §§ 151.11(e) and 151.11(f)(1)(i) require DCMs and SEFs to follow the same account aggregation and bona fide exemption standards set forth by §§ 151.5 and 151.7 with respect to exempt and agricultural commodities (collectively "physical" commodities). Section 151.11(f)(2) requires traders seeking a hedge exemption to "comply with the procedures of the designated contract market or swap execution facility for granting exemptions from its speculative position limit rules."

MGEX commented on the role of DCMs and SEFs in administering bona fide hedge exemptions. MGEX noted that while § 151.5 contemplated a Commission-administered bona fide hedging regime, proposed § 151.11(e)(2) would require persons seeking to establish eligibility for an exemption to comply with the DCM's or SEF's procedures for granting exemptions. MGEX recommended that the Commission be the primary entity for administering bona fide hedge exemptions and that when necessary that information be shared with the necessary DCMs and SEFs.

With respect to a DCM's or SEF's duty to administer hedge exemptions, the Commission intended that DCMs and SEFs administer their own position limits under § 151.11. Accordingly, under its rulemaking, the Commission is requiring that DCMs and SEFs create rules and procedures to allow traders to claim a bona fide hedge exemption, consistent with § 151.5 for physical commodity derivatives and § 1.3(z) for excluded commodities. Section 151.11 contemplates that DCMs and SEFs would administer their own bona fide hedge exemption regime in parallel to the Commission's regime. Traders with a hedge position in a Referenced Contract subject to DCM or SEF limits will not be precluded from filing the same bona fide

hedging documentation, provided that the hedge position would meet the criteria of Commission regulation151.5 for both the purposes of federal and DCM or SEF position limits.

Section 4a(a) of the CEA provides the Commission with authority to exempt from the position limits or to impose different limits on spread, straddle, or arbitrage trades. Current § 150.4(a)(3) recognizes these exemptions in the context of the single contract position limits set forth under § 150.2. MFA opined that the Commission should restore the arbitrage exemptions because they are central to managing risk and maintaining balanced portfolios.[350]

The Commission has determined to re-introduce a version of this exemption in the final rulemaking in response to commenters that opined directly on this issue[351] as well as those that argued against the imposition of the proposed class limits, as discussed above in II.D.5. The Commission has therefore introduced an arbitrage exemption for DCM or SEF limits under § 151.11(g)(2) that allows traders to claim as an offset to their positions on a DCM or SEF positions in the same Referenced Contracts or in an economically equivalent futures or swap position.[352] This arbitrage exemption does not, however, apply to physical-delivery contracts in the spot month. The Commission has reintroduced this exemption, available to those traders that demonstrate compliance with a DCM or SEF speculative limit through offsetting trades on different venues or through OTC swaps in economically equivalent contracts.

4. DCM and SEF Position Limits and Accountability Rules Effective Date

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350 CL-MFA supra note 21 at 18.

351 See the discussion of non-spot month class limits under II.D.5 and II.F.1 supra discussing comments expressing concern that arbitrage exemptions were not recognized in the proposal. See e.g., CL-ISDA/SIFMA supra note 21 at 11; and CL-MFA supra note 21 at 18. See also, CL-Shell supra note 35 at 5-6.

352 See section 4a(a)(1) of the CEA, 7 U.S.C. 6a(a)(1).

Section 151.11(i) provides that generally the effective date for the position limits or accountability levels described in § 151.11 shall be made effective sixty days after the term "swap" is further defined. The Commission has set this effective date to coincide with the effective date of the spot-month limits established under § 151.4. The one exception to this general rule is with respect to the acceptable guidance for DCMs and SEFs in establishing position limits or accountability rules for non-legacy Referenced Contracts executed pursuant to their rules prior to the implementation of federal non-spot-month limits on such Referenced Contracts. Under § 151.11(j), the acceptable practice for these contracts during this transition phase will be either to retain existing non-spot-month position limits or accountability rules or to establish non-spot-month position limits pursuant to the acceptable practice described in § 151.11(b)(2) (i.e., to impose limits based on ten percent of the average combined futures and delta-adjusted option month-end open interest for the most recent two calendar years up to 25,000 contracts with a marginal increase of 2.5 percent thereafter) based on open interest in the contract and economically equivalent contracts traded on the same DCM or SEF.

O. Delegation

Proposed § 151.12 would have delegated certain of the Commission's proposed part 151 authority to the Director of the Division of Market Oversight and to other employee or employees as designated by the Director. The delegated authority would extend to: (1) determining open interest levels for the purpose of setting non-spot-month position limits; (2) granting an exemption relating to bona fide hedging transactions; and (3) providing instructions, determining the format, coding structure, and electronic data transmission procedures for submitting data records and any other information required under proposed part 151. The purpose of this delegation provision was to facilitate the ability of the Commission to respond to

changing market and technological conditions and thus ensure timely and accurate data reporting.

The Commission requested comments on whether determinations of open interest or deliverable supply should be adopted through Commission orders. With respect to spot-month position limits, a few commenters contended that spot month limits should be set by rulemaking.[353] With respect to non-spot-month position limits, several commenters submitted that such limits should be calculated by rulemaking not by annual recalculation so that market participants can have sufficient advance notice and opportunity to comment on changes in position limit levels.[354] CME, for example, commented that the Commission should set initial limits through this rulemaking and make subsequent limit changes subject to notice and comment, unless the formula's automatic annual application would result in higher limits.[355] BlackRock commented that the Commission could mitigate the adverse effects of volatile limit levels by setting limits subject to notice and comment.[356]

The Commission has determined to adopt proposed § 151.12 substantially unchanged with some additional delegations provided for in the final rule text. Under § 151.4(b)(2)(i)(A), the Commission has addressed concerns about the volatility of non-spot-month position limit levels for non-legacy Referenced Contracts by providing for automatic adjustments based on the higher of 12 or 24 months of aggregate open interest data. As discussed earlier in this release,

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353 See e.g., CL-WGCEF supra note 35 at 19-20 (proposing a specific schedule for the setting of spot-month position limits by notice and comment); CL-BGA supra note 35 at 20. See also, CL-ISDA/SIFMA supra note 21 at 22.

354 See e.g., CL-BlackRock supra note 21 at 18; CL-CME I supra note 8 at 12; CL-NGFA supra note 72 at 3; CL-EEI/EPSA supra note 21 at 11; CL-KCBT I supra note 97 at 3; and CL-WGC supra note 21 at 5.

355 CL-CME I supra note 8 at 12.

356 CL-BlackRock supra note 21 at 18.

the Commission believes that adjustments to Referenced Contract spot month and non-legacy Referenced Contracts non-spot-month position limit levels on a scheduled basis by Commission order provide for a process that is responsive to the changing size of the underlying physical and financial market for the relevant Referenced Contracts respectively.

III. Related Matters

A. Consideration of Costs and Benefits

In this final rulemaking, the Commission is establishing position limits for 28 exempt and agricultural commodity derivatives, including futures and options contracts and the physical commodity swaps that are "economically equivalent" to such contracts. The Commission imposes two types of position limits: limits in the spot-month and limits outside of the spot-month. Generally, this rulemaking is comprised of three main categories: (1) the position limits; (2) exemptions from the limits; and (3) the aggregation of accounts.

Section 15(a) of the CEA requires the Commission to "consider the costs and benefits" of its actions 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.[357] The Commission may, in its discretion, give greater weight to any one of the five enumerated areas and may determine that, notwithstanding costs, a particular rule protects the public interest.

In the Notice of Proposed Rulemaking, the Commission stated, "[t[he proposed position limits and their concomitant limitation on trading activity could impose certain general but

[357] 7 U.S.C. 19(a).

significant costs."[358] In particular, the Commission noted that "[o]verly restrictive position limits could cause unintended consequences by decreasing speculative activity and therefore liquidity in the markets for Referenced Contracts, impairing the price discovery process in their markets, and encouraging the migration of speculative activity and perhaps price discovery to markets outside of the Commission's jurisdiction."[359] The Commission invited comments on its consideration of costs and benefits, including a specific invitation for commenters to "submit any data or other information that they may have quantifying or qualifying the costs and benefits of proposed part 151."[360]

In consideration of the costs and benefits of the final rules, the Commission has, wherever feasible, endeavored to estimate or quantify the costs and benefits of the final rules; where estimation or quantification is not feasible, the Commission provides a qualitative assessment of such costs and benefits.[361] In this respect, the Commission notes that public comment letters provided little quantitative data regarding the costs and benefits associated with the Proposed Rules.

In the following discussion, the Commission addresses the costs and benefits of the final rules, considers comments regarding the costs and benefits of position limits, and subsequently considers the five broad areas of market and public concern under section 15(a) of the CEA

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358 See 76 FR at 4764.

359 Id.

360 Id.

361 Accordingly, to assist the Commission and the public to assess and understand the economic costs and benefits of the final rule, the Commission is supplementing its consideration of costs and benefits with wage rate estimates based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association ("SIFMA"). The wage estimates the Commission uses are derived from an industry-wide survey of participants and thus reflect an average across entities; the Commission notes that the actual costs for any individual company or sector may vary from the average. In response to comments, the Commission has also addressed its PRA estimates in this Considerations of Costs and Benefits section.

within the context of the three broad areas of this rule: position limits; exemptions; and account aggregation.

1. General Comments

A number of commenters argued that the Commission did not make the requisite finding that position limits are necessary to combat excessive speculation.[362] Specifically, one commenter argued that the Commission has ignored the wealth of empirical evidence supporting the view that the proposed position limits and related exemptions would actually be counterproductive by decreasing liquidity in the CFTC-regulated markets which, in turn, will increase both price volatility and the cost of hedging especially in deferred months.[363] Similarly, some commenters opposing position limits questioned the benefits that would be derived from speculative limits in all markets or in particular markets.[364] Several commenters denied or questioned that the Commission had demonstrated that excessive speculation exists or that the proposed speculative limits were necessary.[365] Other commenters suggested that speculative limits would be inappropriate because the U.S. derivatives markets must compete against exchanges elsewhere in the world that do not impose position limits.[366] Some commenters argued that even with the provisions concerning contracts on FBOTs, speculators could easily circumvent limits by migrating to FBOTs, and in fact the Proposed Rules could encourage such

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362 See e.g., CL-CME I supra note 8 at 2; and CL-COPE supra note 21 at 2-5.

363 CL-CME I supra note 8 at 2. See also CL-Blackrock supra note 21 at 3.

364 See e.g., CL-Utility Group supra note 21 at 2 (submitting that the compliance burden of the Commission's position limits proposal is not justified by any demonstrable benefits); and CL-COPE supra note 21 (stating that there is no predicate for finding federal position limits to be appropriate at this time; and the Position Limits NOPR is overly complex and creates significant and burdensome requirements on end-users).

365 See e.g., CL-Morgan Stanley supra note 21 at 4.

366 See e.g., CL-CME I supra note 8 at 2.

behavior.[367] Other commenters opined that certain physical commodities, such as gold, should not be subject to position limits due to considerations unique to those particular commodities.[368]

One commenter stated that the Commission's cost estimates did not accurately reflect the true cost to the market incurred as a result of the Proposed Rules because the wage estimates used were inaccurate; this commenter also stated that cost estimates in the PRA section were not addressed in the costs and benefits section of the Proposed Rule.[369]

As discussed above in sections II.A and II.C of this release, in section 4a(a)(1) Congress has determined that excessive speculation causing "sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity." Further, Congress directed that for the purpose of "diminishing, eliminating, or preventing such burden," the Commission "shall . . . proclaim and fix such [position] limits . . . as the Commission finds are necessary to diminish, eliminate, or prevent such burden."[370] New sections 4a(a)(2) and 4a(a)(5) of the CEA contain an express congressional directive that the Commission "shall" establish position limits, as appropriate, within an expedited timeframe after the date of enactment of the Dodd-Frank Act. In requiring these position limits, Congress specified in section 4a(a)(3)(B) that in addition to establishing limits on the number of positions that may be held by any person to diminish, eliminate, or prevent excessive speculation, the Commission should also, to the maximum extent practicable, set such limits at a level to "deter and prevent market manipulation, squeezes and corners,"

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367 See e.g., CL-USCOC supra note 246 at 3; CL-PIMCO, supra note 21 at 8; and CL-ISDA/SIFMA, supra note 21 at 24.

368 See e.g., CL-WGC supra note 21 at 3.

369 See CL-WGCEF supra note 34 at 25-26.

370 Section 4a(a)(1) of the CEA, 7 U.S.C. 6a(a)(1).

"ensure sufficient market liquidity for bona fide hedgers," and "to ensure that the price discovery function of the underlying market is not disrupted."

In light of the congressional mandate to impose position limits, the Commission disagrees with comments asserting that the Commission must first determine that excessive speculation exists or prove that position limits are an effective regulatory tool. Section 4a(a) expresses Congress's determination that excessive speculation may create an undue and unnecessary burden on interstate commerce and directs the Commission to establish such limits as are necessary to "diminish, eliminate, or prevent such burden." Congress intended the Commission to act to prevent such burdens before they arise. The Commission does not believe it must first demonstrate the existence of excessive speculation or the resulting burdens in order to take preventive action through the imposition of position limits. Similarly, the Commission need not prove that such limits will in fact prevent such burdens.

In enacting the Dodd-Frank Act, Congress re-affirmed the findings regarding excessive speculation, first enacted in the Commodity Exchange Act of 1936, as well as the direction to the Commission to establish position limits.[371] In the Dodd-Frank Act, Congress also expressly required that the Commission impose limits, as appropriate, to prevent excessive speculation and market manipulation while ensuring the sufficiency of liquidity for bona fide hedgers and the integrity of price discovery function of the underlying market. Comments to the Commission regarding the efficacy of position limits fail to account for the mandate that the Commission shall impose position limits. By its terms, CEA Section 15(a) requires the Commission to consider and evaluate the prospective costs and benefits of regulations and orders of the

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[371] See Commodity Exchange Act of 1936, Pub L. 74-675, 49 Stat. 1491 (1936).

Commission prior to their issuance; it does not require the Commission to evaluate the costs and benefits of the actions or mandates of Congress.

2. Studies

A number of commenters submitted or cited studies to the Commission regarding excessive speculation.[372] Generally, the comments and studies discussed whether or not excessive speculation exists, the definition of excessive speculation, and/or whether excessive speculation has a negative impact on derivatives markets. Some of these studies did not explicitly address or focus on the issue of position limits as a means to prevent excessive speculation or otherwise, while some studies did generally opine on the effect of position limits on derivatives markets.

Thirty-eight of the studies were focused on the impact of speculative activity in futures markets, i.e., how the behavior of non-commercial traders affected price levels.[373] These 38

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[372] Twenty commenters cited over 52 studies by institutional, academic, and industry professionals.

[373] See e.g., Anderson, David, Joe L. Outlaw, Henry L. Bryant, James W. Richardson, David P. Ernstes, J. Marc Raulston, J. Mark Welch, George M. Knapek, Brian K. Herbst, and Marc S. Allison, The Agricultural and Food Policy Center Texas A&M University, Research Report 08-1, The Effects of Ethanol on Texas Food and Feed (2008); Antoshin, Sergei, Elie Canetti, and Ken Miyajima, IMF, Global Financial Stability Report, Financial Stress and Deleveraging, Macrofinancial Implications and Policy: Annex 1.2. Financial Investment in Commodities Markets, at 62-66 (2008); Baffes, John, and Tasos Haniotos, World Bank, Washington D.C., Policy Research Working Paper 5371, Placing the 2006/08 Commodity Boom into Perspective (2010); Brunetti, Celso, and Bahattin Buyuksahin, CFTC, Working Paper Series, Is Speculation Destabilizing? (2009); Buyuksahin, Bahattin, and Jeff Harris, The Energy Journal, The Role of Speculators in the Crude Oil Market (2011); Buyuksahin, Bahattin, and Michel Robe, CFTC, Working Paper, Speculators, Commodities, and Cross-Market Linkages (2010); Buyuksahin, Bahattin, Michael Haigh, Jeff Harris, James Overdahl, and Michel Robe, CFTC, Working Paper, Fundamentals, Trader Activity, and Derivative Pricing (2008); Eckaus, R.S., MIT Center for Energy and Environmental Policy Research, Working Paper 08-007WP, The Oil Price Really Is A Speculative Bubble (2008); Einloth, James T., Division of Insurance and Research, Federal Deposit Insurance Corporation, Washington, D.C., Working Paper, Speculation and Recent Volatility in the Price of Oil (2009); Gilbert, Christopher L., Department of Economics, University of Trento, Italy, Working Paper, Speculative Influences on Commodity Futures Prices, 2006-2008 (2009); Gilbert, Christopher L., Journal of Agricultural Economics, How to Understand High Food Prices (2010); Government Accountability Office (GAO), Issues Involving the Use of the Futures Markets to Invest in Commodity Indexes (2009); Haigh, Michael, Jana Hranaiova, and James Overdahl, CFTC OCE, Staff Research Report, Price Dynamics, Price Discovery, and Large Futures Trader Interactions in the Energy Complex (2005); Haigh, Michael, Jeff Harris, James Overdahl, and Michel Robe, CFTC, Working Paper, Trader Participation and Pricing in Energy Futures Markets (2007); Hamilton, James, Brookings Paper on Economic Activity, The Causes and Consequences of the Oil Shock of 2007-2008 (2009); HM Treasury (UK), Global Commodities: A Long Term Vision for Stable,

studies did not provide a view on position limits in general or on the Commission's implementation of position limits in particular. While the Commission reviewed these studies in connection with this rulemaking, the Commission again notes that it is not required to make a finding on the impact of speculation on commodity markets. Congress mandated the imposition of position limits, and the Commission does not have the discretion to alter an express mandate from Congress. As such, studies suggesting that there is insufficient evidence of excessive speculation in commodity markets fail to address that the Commission must impose position limits, and do not address issues that are material to this rulemaking.

Secure, and Sustainable Global Markets (2008); Interagency Task Force on Commodity Markets, Interim Report on Crude Oil (2008); International Monetary Fund, World Economic Outlook, Is Inflation Back? Commodity Prices and Inflation, at 83-128 (2008); Irwin, Scott and Dwight Sanders, OECD Food, Agriculture, and Fisheries Working Papers, The Impact of Index and Swap Funds on Commodity Futures Markets (2010); Irwin, Scott, Dwight Sanders, and Robert Merrin, Journal of Agricultural and Applied Economics, Devil or Angel? The Role of Speculation in the Recent Commodity Price Boom (and Bust) (2009); Jacks, David, Explorations in Economic History, Populists vs Theorists: Futures Markets and the Volatility of Prices (2006); Kilian, Lutz, American Economic Review, Not All Oil Price Shocks are Alike: Disentangling Demand and Supply Shocks in the Crude Oil Market (2009); Kilian, Lutz, and Dan Murphy, University of Michigan, Working Paper, The Role of Inventories and Speculative Trading in the Global Market for Crude Oil (2010); Korniotis, George, Federal Reserve Board of Governors, Finance and Economics Discussion Series, Does Speculation Affect Spot Price Levels? The Case of Metals with and without Futures Markets (2009); Mou, Ethan Y., Columbia University, Working Paper, Limits to Arbitrage and Commodity Index Investment: Front-Running the Goldman Roll (2010); Nissanke, Machinko, University of London School of Oriental and African Studies, Commodity Markets and Excess Volatility: Sources and Strategies to Reduce Adverse Development Impacts (2010); Phillips, Peter C.B., and Jun Yu, Yale University, Cowles Foundation Discussion Paper No. 1770, Dating the Timeline of Financial Bubbles During the Subprime Crisis (2010); Plato, Gerald, and Linwood Hoffman, NCCC-134 Conference on Applied Commodity Price Analysis, Forecasting, and Market Risk Management, Measuring the Influence of Commodity Fund Trading on Soybean Price Discovery (2007); Robles, Miguel, Maximo Torero, and Joachim von Braun, International Food Policy Research Institute, IFPRI Issue Brief 57, When Speculation Matters (2009); Sanders, Dwight, and Scott Irwin, Agricultural Economics, A Speculative Bubble in Commodity Futures Prices? Cross-Sectional Evidence (2010); Sanders, Dwight, Scott Irwin, and Robert Merrin, University of Illinois at Urbana-Champaign, The Adequacy of Speculation in Agricultural Futures Markets: Too Much of a Good Thing? (2008); Smith, James, Journal of Economic Perspectives, World Oil: Market or Mayhem? (2009); Technical Committee of the International Organization of Securities Commission. IOSCO, Task Force on Commodity Futures Markets Final Report (2009); Stoll, Hans, and Robert Whaley, Vanderbilt University, Working Paper, Commodity Index Investing and Commodity Futures Prices (2009); Tang, Ke, and Wei Xiong, Department of Economics, Princeton University, Working Paper, Index Investing and the Financialization of Commodities (2010); Trostle, Ronald, ERS (USDA), Global Agricultural Supply and Demand: Factors Contributing to the Recent Increase in Food Commodity Prices (2008); U.S. Commodity Futures Trading Commission, Staff Report on Commodity Swap Dealers and Index Traders with Commission Recommendations (2008); Wright, Brian, World Bank, Policy Research Working Paper, International Grain Reserves and Other Instruments to Address Volatility in Grain Markets (2009).

The remaining studies did generally addresses the concept of position limits as part of their discussion of speculative activity. The authors of some of these studies and papers expressed views that speculative position limits were an important regulatory tool and that the CFTC should implement limits to control excessive speculation.[374] For example, one author opined that ". . . strict position limits should be placed on individual holdings, such that they are not manipulative."[375] Another stated, "[S]peculative position limits worked well for over 50 years and carry no unintended consequences. If Congress takes these actions, then the speculative money that flowed into these markets will be forced to flow out, and with that the price of commodities futures will come down substantially. Until speculative position limits are restored, investor money will continue to flow unimpeded into the commodities futures markets and the upward pressure on prices will remain."[376] The authors of one study claimed that "Rules for speculative position limits were historically much stricter than they are today. Moreover,

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[374] Greenberger, Michael, The Relationship of Unregulated Excessive Speculation to Oil Market Price Volatility, at 11 (2010) (On position limits: "The damage price volatility causes the economy by needlessly inflating energy and food prices worldwide far outweighs the concerns about the precise application of what for over 70 years has been the historic regulatory technique for controlling excessive speculation in risk-shifting derivative markets.".); Khan, Mohsin S., Peterson Institute for International Economics, Washington, D.C., Policy Brief PB09-19, The 2008 Oil Price 'Bubble', at 8 (2009) ("The policies being considered by the CFTC to put aggregate position limits on futures contracts and to increase the transparency of futures markets are moves in the right direction."); U.S. Senate, Permanent Subcommittee on Investigations, Excessive Speculation in the Wheat Market, at 12 (2009) ("The activities of these index traders constitute the type of excessive speculation the CFTC should diminish or prevent through the imposition and enforcement of position limits as intended by the Commodity Exchange Act."); U.S. Senate, Permanent Subcommittee on Investigations, Excessive Speculation in the Natural Gas Marketat 8" (2007) (The Subcommittee recommended that Congress give the CFTC authority over ECMs, noting that "[to] ensure fair energy pricing, it is time to put the cop back on the beat in all U.S. energy commodity markets."); UNCTAD, The Global Economic Crisis: Systemic Failures and Multilateral Remedies: Report by the UNCTAD Secretariat Task Force on Systemic Issues and Economic Cooperation, at 14, (2009) (The UNCTAD recommends that "...regulators should be enabled to intervene when swap dealer positions exceed speculative position limits and may represent 'excessive speculation'.); UNCTAD, United Nations, Trade and Development Report, 2009: Chapter II: The Financialization of Commodity Markets, at 26 (2009) (The report recommends tighter restrictions, notably closing loopholes that allow potentially harmful speculative activity to surpass position limits.).

[375] De Schutter, O., United Nations Special Report on the Right to Food: Briefing Note 02, Food Commodities Speculation and Food Price Crises at 8 (2010).

[376] Masters, Michael, and Adam White, White Paper: The Accidental Hunt Brothers: How Institutional Investors are Driving up Food and Energy Prices at 3 (2008).

despite rhetoric that imposing stricter limits would harm market liquidity, there is no evidence to support such claims, especially in light of the fact that the market was functioning very well prior to 2000, when speculative limits were tighter."[377]

One study claimed that position limits will not restrain manipulation,[378] while another argued that position limits in the agricultural commodities have not significantly affected volatility.[379] Another study noted that while position limits are effective as an anti-manipulation measure, they will not prevent asset bubbles from forming or stop them from bursting.[380] One study cautioned that while limits may be effective in preventing manipulation, they should be set at an optimal level so as to not harm the affected markets.[381] One study claimed that position limits should be administered by DCMs, as those entities are closest to and most familiar with

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377 Medlock, Kenneth, and Amy Myers Jaffe, Rice University: Who Is In the Oil Futures Market and How Has It Changed?" at 8 (2009).

378 Ebrahim, Muhammed: Working Paper, Can Position Limits Restrain Rogue Traders?" at 27 (2011) (". . . binding constraints have an unintentional effect. That is, they lead to a degradation of the equilibria and augmenting market power of Speculator in addition to other agents. We therefore conclude that position limits are not helpful in curbing market manipulation. Instead of curtailing price swings, they could exacerbate them."

379 Irwin, Scott, Philip Garcia, and Darrel L. Good: Working Paper,The Performance Of Chicago Board Of Trade Corn, Soybean, And Wheat Futures Contracts After Recent Changes In Speculative Limits at 16 (2007) ("The analysis of price volatility revealed no large change in measures of volatility after the change in speculative limits. A relatively small number of observations are available since the change was made, but there is little to suggest that the change in speculative limits has had a meaningful overall impact on price volatility to date.").

380 Parsons, John: Economia, Vol. 10, Black Gold and Fools Gold: Speculation in the Oil Futures Market at 30 (2010) ("Restoring position limits on all nonhedgers, including swap dealers, is a useful reform that gives regulators the powers necessary to ensure the integrity of the market. Although this reform is useful, it will not prevent another speculative bubble in oil. The general purpose of speculative limits is to constrain manipulation . . . . Position limits, while useful, will not be useful against an asset bubble. That is really more of a macroeconomic problem, and it is not readily managed with microeconomic levers at the individual exchange level.").

381 Wray, Randall, The Levy Economics Institute of Bard College: The Commodities Market Bubble: Money Manager Capitalism and the Financialization of Commodities at 41, 43 (2008) "("While the participation of traditional speculators offers clear benefits, position limits must be carefully administered to ensure that their activities do not "demoralize" markets. . . .The CFTC must re-establish and enforce position limits.").

the intricacies of markets and thus can implement the most efficient position limits policy.[382] Finally, one commenter cited a study that notes the similar efforts under discussion in European markets.[383]

Although these studies generally discuss the impact of position limits, they do not address or provide analysis of how the Commission should specifically implement position limits under section 4a. As the Commission explained in the proposal, "overly restrictive" limits can negatively impact market liquidity and price discovery. These consequences are detailed in several of the studies criticizing the impact of position limits.[384] Similarly, limits that are set too high fail to address issues surrounding market manipulation and excessive speculation. Market manipulation and excessive speculation are also detailed in several of the studies claiming the need for position limits.[385] In section 4a(a)(3)(B) Congress sought to ensure that the Commission would "to the maximum extent practicable" ensure that position limits would be set

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382 CME Group, Inc.: CME Group White Paper, Excessive Speculation and Position Limits in Energy Derivatives Markets at 6 ("Indeed, as the Commission has previously noted, the exchanges have the expertise and are in the best position to fix position limits for their contracts. In fact, this determination led the Commission to delegate to the exchanges authority to set position limits in non-enumerated commodities, in the first instances, almost 30 years ago.").

383 European Commission, Review of the Markets in Financial Instruments Directive (2010), note 282:

> European Parliament resolution of 15 June 2010 on derivatives markets: future policy actions (A7-0187/2010) calls on the Commission to develop measures to ensure that regulators are able to set position limits to counter disproportionate price movements and speculative bubbles, as well as to investigate the use of position limits as a dynamic tool to combat market manipulation, most particularly at the point when a contract is approaching expiry. It also requests the Commission to consider rules relating to the banning of purely speculative trading in commodities and agricultural products, and the imposition of strict position limits especially with regard to their possible impact on the price of essential food commodities in developing countries and greenhouse gas emission allowances.

Id. at 82.

384 See e.g., Wray, Randall, supra.

385 See e.g., Medlock, Kenneth and Amy Myers Jaffe, supra.

at a level that would "diminish, eliminate, or prevent excessive speculation" and deter or prevent market manipulation, while at the same time ensure there is sufficient market liquidity for bona fide hedgers and the price discovery function of the market would be preserved. The Commission historically has recognized the potential impact of both overly restrictive and unrestrictive limits, and through the consideration of the statutory objectives in section 4a(a)(3)(B) as well as the costs and benefits, has determined to finalize these rules.

3. General Costs and Benefits

As stated in the Proposed Rule, the Commission anticipates that the final rules establishing position limits and related provisions will result in costs to market participants. Generally, market participants will incur costs associated with developing, implementing and maintaining a method to ensure compliance with the position limits and its attendant requirements (e.g., bona fide hedging exemptions and aggregation standards). Such costs will include those related to the monitoring of positions in the relevant Referenced Contracts, related filing, reporting, and recordkeeping requirements, and the costs (if any) of changes to information technology systems. It is expected that market participants whose positions are exclusively in swaps (and hence currently not subject to any position limits regime) will incur larger initial costs relative to those participants in the futures markets, as the latter should be accustomed to operating under DCM and/or Commission position limit regimes.

The final rules are also expected to result in costs to market participants whose market participation and trading strategies will need to take into account and be limited by the new position limits rule. For example, a swap dealer that makes a market in a particular class of swaps may have to ensure that any further positions taken in that class of swaps are hedged or offset in order to avoid increasing that trader's position. Similarly, a trader that is seeking to

adopt a large speculative position in a particular commodity and that is constrained by the limits would have to either diversify or refrain from taking on additional positions.[386]

The Commission does not believe it is reasonably feasible to quantify or estimate the costs from such changes in trading strategies. Quantifying the consequences or costs of market participation or trading strategies would necessitate having access to and understanding of an entity's business model, operating model, and hedging strategies, including an evaluation of the potential alternative hedging or business strategies that would be adopted if such limits were imposed. Because the economic consequences to any particular firm will vary depending on that firm's business model and strategy, the Commission believes it is impractical to develop any type of generic or representative calculation of these economic consequences.[387]

The Commission believes that many of the costs that arise from the application of the final rules are a consequence of the congressional mandate that the Commission impose position limits. As described more fully below, the Commission has considered these costs in adopting these final rules, and has, where appropriate, attempted to mitigate costs while observing the express direction of Congress in section 4a of the CEA.

In the discussions below as well as in the Paperwork Reduction Act ("PRA") section of this release, the Commission estimates or quantifies the implementing costs wherever reasonably feasible, and where infeasible provides a qualitative assessment of the costs and benefits of the final rule. In many instances, the Commission finds that it is not feasible to estimate or quantify

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386 In this respect, the costs of these limits may not in fact be additional expenditures or outlays but rather foregone benefits that would have accrued to the firm had it been permitted to hold positions in excess of the limits. For ease of reference, the term "costs" as used in this context also refers to foregone benefits.

387 Further, the Commission also believes it would be impractical to require all potentially affected firms to provide the Commission with the information necessary for the Commission to make this determination or assessment for each firm. In this regard, the Commission notes that none of the commenters provided or offered to provide any such analysis to the Commission.

the costs with reliable precision, primarily due to the fact that the final rules apply to a heretofore unregulated swaps markets and, as previously noted, the Commission does not have the resources or information to determine how market participants may adjust their trading strategies in response to the rules.[388]

At present, the Commission has limited data concerning swaps transactions in Referenced Contracts (and market participants engaged in such transactions).[389] In light of these data limitations, to inform its consideration of costs and benefits the Commission has relied on: (1) its experience in the futures markets and information gathered through public comment letters, its hearing, and meetings with the industry; and (2) relevant data from the Commission's Large Trader Reporting System and other relevant data concerning cleared swaps and SPDCs traded on ECMs.[390]

4. Position Limits

To implement the Congressional mandate under Dodd-Frank, the proposal identified 28 core physical delivery futures contracts in proposed Regulation 151.2 ("Core Referenced Futures Contracts"),[391] and would apply aggregate limits on a futures equivalent basis across all derivatives that are (i) directly or indirectly linked to the price of a Core Referenced Futures

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388 Further, as previously noted, market participants did not provide the Commission with specific information regarding how they may alter their trading strategies if the limits were adopted.

389 The Commission should be able to obtain an expanded set of swaps data through its swaps large trader reporting and SDR regulations. See Large Trader Reporting for Physical Commodity Swaps, 76 FR 43851, Jul. 22, 2011; and Swap Data Repositories: Registration Standards, Duties and Core Principles, 76 FR 54538, Sept. 1, 2011.

390 Prior to the Dodd-Frank Act and at least until the Commission can begin regularly collecting swaps data under the Large Trader Reporting for Physical Commodity Swaps regulations (76 FR 43851, Jul. 22, 2011), the Commission's authority to collect data on the swaps market was generally limited to Commission regulation 18.05 regarding Special Calls, and Part 36 of the Commission's regulations.

391 This is discussed in greater detail in II.B. of this release. These Core Referenced Futures Contracts are listed in regulation 151.2 of these final rules.

Contracts, or (ii) based on the price of the same underlying commodity for delivery at the same delivery location as that of a Core Referenced Futures Contracts, or another delivery location having substantially the same supply and demand fundamentals ("economically equivalent contracts") (collectively with Core Referenced Futures Contracts, "Referenced Contracts").[392]

As explained in the proposal, the 28 Core Referenced Futures Contracts were selected on the basis that (i) they have high levels of open interest and significant notional value or (ii) they serve as a reference price for a significant number of cash market transactions. The Commission believes that contracts that meet these criteria are of particular significance to interstate commerce, and therefore warrant the imposition of federally administered limits. The remaining physical commodity contracts traded on a DCM or SEF that is a trading facility will be subject to limits set by those facilities.[393]

With regard to the scope of "economically equivalent" contracts that are subject to limits concurrently with the 28 Core Referenced Futures Contract limits, this definition incorporates contracts that price the same commodity at the same delivery location or that utilize the same cash settlement price series of the Core Referenced Futures Contracts (i.e., "look-alikes" as discussed above in II.B.).[394] The Commission continues to believe, as mentioned in the proposal, that

> "[t]he proliferation of economically equivalent instruments trading in multiple trading venues,... warrants extension of Commission-set position limits beyond agricultural products to metals and energy commodities. The Commission anticipates this market

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392 76 FR at 4753.

393 The Commission further considers registered entity limits in section III.A.3.e.

394 The Commission notes economically equivalent contracts are a subset of "Referenced Contracts."

> trend will continue as, consistent with the regulatory structure established by the Dodd-Frank Act, economically equivalent derivatives based on exempt and agricultural commodities are executed pursuant to the rules of multiple DCMs and SEFs and other Commission registrants. Under these circumstances, uniform position limits should be established across such venues to prevent regulatory arbitrage and ensure a level playing field for all trading venues."[395]

In addition, by imposing position limits on contracts that are based on an identical commodity reference price (directly or indirectly) or the price of the same commodity at the same delivery location, the final rules help to prevent manipulative behavior. Absent such limits on related markets, a trader would have a significant incentive to attempt to manipulate the physical-delivery market to benefit a large position in the cash-settled market.

The final rule should provide for lower costs than the proposal with respect to determining whether a contract is a Referenced Contract because the final rule provides an objective test for determining Referenced Contracts and does not require case by case analysis of the correlation between contracts. In response to comments, the Commission eliminated the category of Referenced Contracts regarding contracts that have substantially the same supply and demand fundamentals of the Core Referenced Futures Contracts because this category did not establish objective criteria and would be difficult to administer when the correlation between two contracts change over time.

The final categories of economically equivalent Referenced Contracts should also limit the costs of determining whether a contract is a Referenced Contract because the scope is objectively defined and does not require case by case analysis of the correlation between contracts. In this regard, the Commission eliminated the category of Referenced Contracts

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395 See 75 FR 4755.

regarding contracts that have substantially the same supply and demand fundamentals of the Core Referenced Futures Contracts because this category did not establish objective criteria and would be difficult to administer when the correlation between two contracts change over time.

The definitional criteria for the core physical delivery futures contracts, together with the criteria for "economic equivalent" derivatives, are intended to ensure that those contracts that are of major significance to interstate commerce and show a sufficient nexus to create a single market across multiple venues are subject to federal position limits.[396] Nevertheless, the Commission recognizes that the criteria informing the scope of Referenced Contracts may need to evolve given the Commission's limited data and changes in market structure over time. As the Commission gains further experience in the swaps market, it may determine to expand, restrict, or otherwise modify through rulemaking the 28 Core Referenced Futures Contracts and the related definition of "economically equivalent" contracts.

The Commission anticipates that the additional cost of monitoring positions in Referenced Contracts should be minimal for market participants that currently monitor their positions throughout the day for purposes such as compliance with existing DCM or Commission position limits, to meet their fiduciary obligations to shareholders, to anticipate margin requirements, etc. The Commission estimates that trading firms that currently track compliance with DCM or Commission position limits will incur an additional implementation cost of two or three labor weeks in order to adjust their monitoring systems to track the position

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[396] One commenter (CL-WGC supra note 21 at 3) opined that gold should not be subject to position limits because "gold is not consumed in a normal sense, as virtually all the gold that has ever been mined still exists" and given the "beneficial qualities of gold to the international monetary and financial systems." Section 4a requires the Commission to impose limits on all physical-delivery contracts and relevant "economically equivalent" contracts. The Commission notes that Congress directed the Commission to impose limits on physical commodities, including exempt and agricultural commodities. The scope of such commodities includes metal commodities.

limits for Referenced Contracts. Assuming an hourly wage of $78.61,[397] multiplied by 120 hours, this implementation cost would amount to approximately $12,300 per firm, for a total across all estimated participants affected by such limits (as described in subsequent sections) of $4.2 million.[398] These costs are generally associated with adjusting systems for monitoring futures and swaps Referenced Contracts to track compliance with position limits.[399]

Participants currently without reportable futures positions (i.e., those who trade solely or mostly in the swaps marketplaces, or "swaps-only" traders), and traders with certain positions outside of the spot month in Referenced Contracts that do not currently have position limits or position accountability levels, would likely incur an initial cost in excess of those traders that do monitor their positions for the purpose of compliance with position limits. Because firms with positions in the futures markets should already have systems and procedures in place for monitoring compliance with position limits, the Commission believes that firms with positions mostly or only in the swaps markets would be representative of the highest incremental costs of

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397 The Commission staff's estimates concerning the wage rates are based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association ("SIFMA"). The $78.61 per hour is derived from figures from a weighted average of salaries and bonuses across different professions from the SIFMA Report on Management & Professional Earnings in the Securities Industry 2010, modified to account for an 1800-hour work-year and multiplied by 1.3 to account for overhead and other benefits. The wage rate is a weighted national average of salary and bonuses for professionals with the following titles (and their relative weight): "programmer (senior)" (30 percent); "programmer" (30 percent); "compliance advisor" (intermediate) (20 percent); "systems analyst" (10 percent); and "assistant/associate general counsel" (10 percent).

398 Although one commenter provided a wage estimate of $120 per hour, the Commission believes that the SIFMA industry average properly accounts for the differing entities that would be subject to these limits. See CL-WGCEF supra note 35at 26, "Internal data collected and analyzed by members of the Working Group suggest that the average cost per hour is approximately $120, much higher than SIFMA's $78.61, as relied upon by the Commission." In any event, even using the Working Group's higher estimated wage cost, the resulting cost per firm of approximately $18,000 per firm would not materially change the Commission's consideration of these costs in relation to the benefits from the limits, and in light of the factors in CEA section 15(a), 7 U.S.C. 19(a).

399 Among other things, a market participant will be required to identify which swap positions are subject to position limits (i.e., swaps that are Referenced Contracts) and allocate these positions to the appropriate compliance categories (e.g., the spot month, all months, or a single month of a Referenced Contract).

the rules. Specifically, swaps-only traders may incur larger start-up costs to develop a compliance system to monitor their positions in Referenced Contracts and to comply with an applicable position limit. The Commission estimates that approximately 100 swaps-only firms would be subject to position limits for the first time.

The Commission believes that many swaps-only market participants potentially affected by the spot month limits are likely to have developed business processes to control the size of swap positions for a variety of business reasons, including (i) managing counterparty credit risk exposure, (ii) limiting the value at risk to such swap positions, and (iii) ensuring desired accounting treatment (e.g., hedge accounting under Generally Accepted Accounting Principles ("GAAP")). These processes are more likely to be well developed by people with a larger exposure to swaps, particularly those persons with position sizes with a notional value close to a spot-month position limit. For example, traders with positions in Referenced Contracts at the spot-month limit in the final rule would have a notional value of approximately $8.2 million to a maximum of $544.3 million, depending on the underlying physical commodity.[400] The minimum value in this range represents a significant exposure in a single payment period for swaps; therefore, the Commission expects that traders with positions at the spot-month limit will have already developed some system to control the size of their positions on an intraday basis. The Commission also anticipates, based on current swap market data, comment letters, and trade interviews, that very few swaps-only traders would have positions close to the non-spot-month

[400] These notional values were determined based on notional values determined as of September 7, 2011 closing prices. The computation used was a position at the size of the spot-month limit in appendix A to part 151 (e.g., 600 contracts in wheat) times the unit of trading (e.g., 5,000 bushels per contract) times the closing price per quantity of commodity (e.g., dollars per bushel).

position limits imposed by the final rules, given that the notional value of a position at an all-months-combined limit will be much larger than that of a position at a spot-month limit.

As explained above, the Commission expects that traders with positions at the spot-month limit will have already developed some system to control the size of their positions on an intraday basis. However, the Commission recognizes that there may be a variety of ways to monitor positions for compliance with federal position limits. While specific cost information regarding such swaps-only entities was not provided to the Commission in comment letters, the Commission anticipates that a firm could implement a monitoring regime amid a wide range of compliance systems based on the specific, individual needs of the firm. For example, a firm may elect to utilize an automatic software system, which may include high initial costs but lower long-term operational and labor costs. Conversely, a firm may decide to use a less capital-intensive system that requires more human labor to monitor positions. Thus, taking this range into account, the Commission anticipates, on average, labor costs per entity ranging from 40 to 1,000 annual labor hours, $5,000 to $100,000 in total annualized capital/start-up costs, and $1,000 to $20,000 in annual operating and maintenance costs.[401]

During the initial period of implementation, a large number of traders are expected to be able to avail themselves of the preexisting position exemption as defined in § 151.9. As preexisting positions are replaced with new positions, traders will be able to incorporate an understanding of the new regime into existing and new trading strategies. The Commission has

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401 These costs would likely be lower for firms with swaps-only positions far below the speculative limit, as those firms may not need comprehensive, real-time analysis of their swaps positions for position limit compliance to observe whether they are at or near the limit. Costs may be higher for firms with very large or very complex positions, as those firms may need comprehensive, real-time analysis for compliance purposes. Due to the variation in both number of positions held and degree of sophistication in existing risk management systems, it is not feasible for the Commission to provide a greater degree of specificity as to the particularized costs for firms in the swaps market.

also incorporated a broader exclusion for swaps entered into before the effective date of the Dodd-Frank Act in addition to the general application of position limits to pre-existing futures and swaps positions entered into before the effective date of this rulemaking, which should allow swaps market participants to gradually transition their trading activity into compliance with the position limits set forth in part 151.

The final position limit rules impose the costs outlined above on traders who hold or control Referenced Contracts to monitor their futures and swaps positions on both an end-of-day and on an intraday basis to ensure compliance with the limit.[402] Commenters raised concerns regarding the ability for their current compliance systems to conduct the requisite tracking and monitoring necessary to comply with the Proposed Rules, citing the additional contracts and markets needing monitoring in real-time.[403]

The Commission and DCMs have historically applied position limits to both intraday and end-of-day positions; the regulations do not represent a departure from this practice.[404] In this regard, the costs necessary to monitor positions in Referenced Contracts on an intraday basis

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402 The Commission notes that generally, entities have not previously tracked their swaps positions for purposes of position limit compliance. With regard to implementing systems to monitor positions for this rule, the Commission also notes that some entities that engage in only a small amount of swaps activity significantly below the applicable position limit may determine, based on their own assessment, not to track their position on an intraday basis because their positions do not raise concerns about a limit.

403 CL-COPE supra note 21 at 5; and CL-Utility Group supra note 21 at 6. See also CL-Barclays I supra note 164 at 5; CL-API supra note 21 at 14; and CL-Shell supra note 35 at 6-7.

404 See section II.F of this release. See also Commodity Futures Trading Commission Division of Market Oversight, Advisory Regarding Compliance with Speculative Position Limits (May 7, 2010), available at http://www.cftc.gov/ucm/groups/public/@industryoversight/documents/file/specpositionlimitsadvisory0510.pdf. See e.g., CME Rulebook, Rule 443, quoted at http://www.cmegroup.com/rulebook/files/CME_Group_RA0909-5.pdf") (amended Sept. 14, 2009); ICE OTC Advisory, Updated Notice Regarding Position Limit Exemption Request Form for Significant Price Discovery Contracts, available at https://www.theice.com/publicdocs/otc/advisory_notices/ICE_OTC_Advisory_0110001.pdf (Jan. 4, 2010).

outlined above do not constitute a significant additional cost on market participants.[405] Positions above the limit levels, at any time of day, provide opportunity and incentive to trade such large quantities as to unduly influence market prices. The absence of position limits during the trading day would make it impossible for the Commission to detect and prevent market manipulation and excessive speculation as long as positions were below the limit at the end of the day.

Further, as discussed above, the Commission anticipates that the cost of monitoring positions on an intraday basis should be marginal for market participants that are already required to monitor their positions throughout the day for compliance purposes. For those entities whose positions historically have been only in the swaps or OTC markets, the costs of monitoring intraday positions have been calculated as part of the costs to create and monitor compliance systems for position limits in general, discussed above in further detail.

As the Commission gains further experience and data regarding the swaps market and market participants trading therein, it may reevaluate the scope of the Core Referenced Futures Contracts, including the definition of economically equivalent contracts.

a. Spot-Month Limits for Physical Delivery Contracts

The Commission is establishing position limits during the spot-month for physically delivered Core Referenced Futures Contracts. For non-enumerated agricultural, as well as energy and metal Referenced Contracts, the Commission initially will impose spot-month position limits for physical-delivery contracts at the levels currently imposed by the DCMs. Thereafter, the Commission will establish the levels based on the 25 percent of estimated deliverable supply formula with DCMs submitting estimates of deliverable supply to the

[405] The Commission notes that the CEA mandates DCMs and SEFs to have methods for conducting real-time monitoring of trading. Sections 5(d)(4)(A) and 5h(f)(4)(B) of the CEA, 7 U.S.C. 7(d)(4)(A), 7b-3(f)(4)(B).

Commission to assist in establishing the limit. For legacy agricultural Reference Contracts, the Commission will impose the spot-month limits currently imposed by the Commission.

Pursuant to Core Principles 3 and 5 under the CEA, DCMs generally are required to fix spot-month position limits to reduce the potential for manipulation and the threat of congestion, particularly in the spot month.[406] Pursuant to these Core Principles and the Commission's implementing guidance,[407] DCMs have generally set the spot-month position limits for physical-delivery futures contracts based on the deliverable supply of the commodity in the spot month. These spot-month limits under current DCM rules are generally within the levels that would be established using the 25 percent of deliverable supply formula described in these final rules. The Commission received several comments regarding costs of position limits in the spot month.

One commenter noted the definition of deliverable supply was vague and could increase costs to market participants.[408] One commenter suggested that the Commission instead base spot-month limits on "available deliverable supply," a broader measure of physical supply.[409] Commenters also raised an issue with the schedule for resetting limits, explaining that resetting

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406 Core Principle 3 specifies that a board of trade shall list only contracts that are not readily susceptible to manipulation, while Core Principle 5 obligates a DCM to establish position limits and position accountability provisions where necessary and appropriate "to reduce the threat of market manipulation or congestion, especially during the delivery month."

407 See appendix B, part 38, Commission regulations.

408 See e.g., CL-API supra note 21 at 5.

409 "Available deliverable supply" includes (i) all available local supply (including supply committed to long-term commitments), (ii) all deliverable non-local supply, and (iii) all comparable supply (based on factors such as product and location). See CL-ISDA/SIFMA supra note 21 at 21. Another commenter, AIMA, similarly advocated a more expansive definition of deliverable supply. CL-AIMA supra note 35 at 3 ("This may include all supplies available in the market at all prices and at all locations, as if a party were seeking to buy a commodity in the market these factors would be relevant to the price.").

the limits on an annual basis would introduce uncertainty into the market, increase the burden on DCMs, and increase costs for the Commission.[410]

In addition to the costs associated with generally monitoring positions in Referenced Contracts, the Commission anticipates some costs associated with the level of this spot-month position limit for physical-delivery contracts. The Commission estimates,[411] on an annual basis, 84 traders in legacy agricultural Core Referenced Futures Contracts, approximately 50 traders in non-legacy agricultural Referenced Contracts, 12 traders in metal Referenced Contract, and 85 traders in energy Referenced Contracts would hold or control positions that could exceed the spot-month position limits in § 151.4(a).[412] For the majority of participants, the 25 percent of deliverable supply formula is estimated to impose limits that are sufficiently high, so as not to affect their hedging or speculative activity; thus, the number of participants potentially in excess of these limits is expected to be small in proportion to the market as a whole.[413]

To estimate the number of traders potentially affected by the spot-month position limits in physically delivered contracts, the Commission looked to the number of traders currently

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410 See e.g., CL-MGEX supra note 74 at 2-4; and CL-BGA supra note 35 at 20.

411 The Commission's estimates of the number of affected participants for both spot-month and non-spot-month limits are based on the data it currently has on futures, options, and the limited set of data it has on cleared swaps. As such, the actual number of affected participants may vary from these estimates.

412 These estimates are based on the number of unique traders holding hedge exemptions for existing DCM, ECM, or FBOT spot-month position limits for Referenced Contracts.

413 To illustrate this, the Commission selected examples from each category of Core Referenced Futures Contracts. In the CBOT Corn contract (a legacy agricultural Referenced Contract), only approximately 4.8 percent of reportable traders are estimated to be impacted using the methods explained above. Using the ICE Futures Coffee contract as an example of a non-legacy agricultural Referenced Contract, COMEX Gold as an example of a metal Referenced Contracts, and NYMEX Crude Oil as an example of an energy Referenced Contract, the Commission estimates only 1.7 percent, 1.2 percent, and 8 percent (respectively) of all reportable traders in those markets would be impacted by the spot-month limit for physical-delivery contracts. These estimates indicate that the number of affected entities is expected to be small in comparison to the rest of the market.

relying on hedging and other exemptions from DCM position limits.[414] While the Commission believes that the statutory definition of bona fide hedging will to a certain extent overlap with the bona fide hedging exemptions applied at the various DCMs, the definitions are not completely co-extensive. As such, the costs of adjusting hedging strategies or reducing the size of positions both within and outside of the spot-month are difficult to determine. For example, some of the traders relying on a current DCM hedging exemption may be eligible for bona fide hedging or other exemptions from the limits adopted herein, and thus incur the costs associated with filing exemption paperwork. However, other traders may incur the costs associated with the reduction of positions to ensure compliance. Absent data on the application of a bona fide hedge exemption, the Commission cannot determine at this time the number of entities who will be eligible for an exemption under the revised statute, and thus cannot determine the number of participants who may realize the benefits of being exempt from position limits and would incur a filing cost for the exemption, compared to those who may need to reduce their positions.[415] The estimated monetary costs associated with claiming a bona fide hedge exemption are discussed below in consideration of the costs and benefits for bona fide hedging as well as in the PRA section of this final rule.

Regarding costs related to market participation and trading strategies that need to take into account the new position limits rule, as mentioned above, the Commission is currently unable to estimate these costs associated with the spot-month position limit. Market participants

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414 Currently, DCMs report to the Commission which participants receive hedging and other exemptions that allow those participants to exceed position limit levels in the spot month.

415 The Commission notes that under the pre-existing positions exemption, a trader would not be in violation of a position limit based solely upon the trader's pre-existing positions in Referenced Contracts. Further, swaps entered into before the effective date of the Dodd-Frank Act will not count toward a speculative limit, unless the trader elects to net such swaps positions to reduce its aggregate position.

who are the primary source of such information did not provide the Commission with any such information in their comments on the proposal. Additionally, the Commission believes it would not be feasible to require market participants to share such strategies with the Commission, or for the Commission to attempt its own assessment of the costs of potential business strategies of market participants. While the Commission does anticipate some cost for certain firms to adjust their trading and hedging strategy to account for position limits, the Commission does not believe such costs to be overly burdensome. All of the 28 Core Referenced Futures Contracts have some form of spot-month position limits currently in place by their respective DCMs, and thus market participants with very large positions (at least those whose primary activity is in futures and options markets) should be currently incurring costs (or foregoing benefits) associated with those limits. Further, the Commission notes that CEA section 4a(a) mandates the imposition of a spot-month position limit, and therefore, a certain level of costs is already necessary to comply with the Congressional mandate.

The Commission further notes that the spot limits continue current market practice of establishing spot-month position limits at 25 percent of deliverable supply. This continuity in the regulatory scheme should reduce the number of strategy changes that participants may need to make as a result of the promulgation of the final rule, particularly for current futures market participants who already must comply with this limit under the current position limits regimes.

With regard to the use of deliverable supply to set spot-month position limits, in the Commission's experience of overseeing the position limits established at the exchanges as well as federally-set position limits, "spot-month speculative position limits levels are 'based most appropriately on an analysis of current deliverable supplies and the history of various spot-month

expirations.'"[416] The comments received provide no compelling reason for changing that view. The Commission continues to believe that deliverable supply represents the best estimate of how much of a commodity is actually available in the cash market, and is thus the best basis for determining the proper level to deter manipulation and excessive speculation while retaining liquidity and protecting price discovery. In this regard, the Commission and exchanges have historically applied the formula of 25 percent of deliverable supply to set the spot-month position limit, and in the Commission's experience, this formula is effective in diminishing the potential for manipulative behavior and excessive speculation without unduly restricting liquidity for bona fide hedgers or negatively impacting the price discovery process. Further, the definition of deliverable supply adopted in these final rules is consistent with the current DCM practice in setting spot-month limits. The Commission believes that this consistent approach facilitates an orderly transition to federal limits.

The final rules require DCMs to submit estimates of deliverable supply to the Commission every other year for each non-legacy Referenced Contract. The Commission will use this information to estimate deliverable supply for a particular commodity in resetting position limits. The Commission does not anticipate a significant additional burden on DCMs to submit estimates of deliverable supply because DCMs currently monitor deliverable supply to comply with Core Principles 3 and 5 and they must, as part of their self-regulatory responsibilities, make such calculations to justify initial limits for newly listed contracts or to justify changes to position limits for listed contracts. Given that DCMs that list Core Referenced Futures Contracts have considerable experience in estimating deliverable supply for purposes of position limits, this expertise will be of significant benefit to the Commission in its determination

[416] 64 FR 24038, 24039, May 5, 1999.

of the level of deliverable supply for the purpose of resetting spot-month position limits. The additional data provided by DCMs will help the Commission to accurately determine the amounts of deliverable supply, and therefore the proper level of spot-month position limits.

Moreover, the Commission has staggered the resetting of position limits for agricultural contracts, energy contracts, and metal contracts as outlined in II.D.5. and II.E.3. of this release in order to further reduce the burden of calculating and submitting estimates of deliverable supply to the Commission. As explained in the PRA section, the Commission estimates the cost to DCMs to submit deliverable supply data to be a total marginal burden, across the six affected entities, of 5,000 annual labor hours for a total of $511,000 in labor costs and $50,000 in annualized capital and start-up costs and annual total operating and maintenance costs.

b. Spot-Month Limits for Cash-Settled Contracts

A spot-month limit is also being implemented for cash-settled contract markets, including cash-settled futures and swaps. Under the final rules, with the exception of natural gas contracts, a market participant could hold positions in cash-settled Referenced Contracts equal to twenty-five percent of deliverable supply underlying the relevant Core Referenced Futures Contracts. With regard to cash-settled natural gas contracts, a market participant could hold positions in cash-settled Referenced Contracts that are up to five times the limit applicable to the relevant physical-delivery Core Referenced Futures Contracts. The final rules also impose an aggregate spot-month limit across physical-delivery and cash-settled natural gas contracts at a level of five times the spot month limit for physical-delivery contracts. The Commission has determined not to adopt the proposed conditional spot-month limit, under which a trader could maintain a position of five times the position limit in the Core Referenced Futures Contract only if the

participant did not hold positions in physical-delivery Core Referenced Futures Contracts and did not hold 25 percent or more of the deliverable supply of the underlying cash commodity.

Several commenters questioned the application of proposed spot-month position limits to cash-settled contracts.[417] Some of these commenters suggested that cash-settled contracts should not be subject to spot-month limits based on estimated deliverable supply, and should be subject to relatively less restrictive spot-month position limits, if subject to any limits at all.[418]

BGA, for example, argued that position limits on swaps should be set based on the size of the open interest in the swaps market because swap contracts do not provide for physical delivery.[419] Further, certain commenters argued that imposing an aggregate speculative limit on all cash-settled contracts will reduce substantially the cash-settled positions that a trader can hold because, currently, each cash-settled contract is subject to a separate, individual limit, and there is no aggregate limit.[420] Other commenters urged the Commission to eliminate class limits and allow for netting across futures and swaps contracts so as not to impact liquidity.[421]

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417 CL-ISDA/SIFMA supra note 21 at 6-7, 19; CL-Goldman supra note 90 at 5; CL-ICI supra note 21 at 10; CL-MGEX supra note 74 at 4 (particularly current MGEX Index Contracts that do not settle to a Referenced Contract should be considered exempt from position limits because cash-settled index contracts are not subject to potential market manipulation or creation of market disruption in the way that physical-delivery contracts might be); CL-WGCEF supra note 35 at 20 ("the Commission should reconsider setting a limit on cash-settled contracts as a function of deliverable supply and establish a much higher, more appropriate spot-month limit, if any, on cash-settled contracts"); CL-MFA supra note 21 at 16-17; and CL-SIFMA AMG I supra note 21 at 7.

418 CL-BGA supra note 35 at 19; CL-ICI supra note 21 at 10; CL-MFA supra note 21 at 16-17; CL-WGCEF supra note 35 at 20; CL-Cargill supra note 76 at 13; CL-EEI/EPSA supra note 21 at 9; and CL-AIMA supra note 35 at 2. See also CL-NGSA/NCGA supra note 124 at 4-5 (cash-settled contracts should have no limits, or at least limits much greater than the proposed limit, given the different economic functions of the two classes of contracts).

419 CL-BGA supra note 35 at 10.

420 See e.g., CL-FIA I supra note 21 at 10; and CL-ICE I supra note 69 at 6

421 See e.g., CL-ISDA/SIFMA supra note 21 at 8.

A number of commenters objected to limiting the availability of a higher limit in the cash-settled contract to traders not holding any physical-delivery contract.[422] For example, CME argued that the proposed conditional limits would encourage price discovery to migrate to the cash-settled contracts, rendering the physical-delivery contract "more susceptible to sudden price movements during the critical expiration period."[423] AIMA commented that the prohibition against holding positions in the physical-delivery Core Referenced Futures Contract will cause investors to trade in the physical commodity markets themselves, resulting in greater price pressure in the physical commodity.[424]

Some of these commenters, including the CME Group and KCBT, recommended that cash-settled Referenced Contracts and physical-delivery contracts be subject to the same position limits.[425] Two commenters opined that if the conditional limits are adopted, they should be

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422 CL-AFIA supra note 94 at 3; CL-AFR supra note 17 at 6; CL-ATAA supra note 94 at 7; CL-BGA supra note 35 at 11-12; CL-Centaurus Energy supra note 21 at 3;CL-CME I supra note 8 at 10; CL-WGCEF supra note 35 at 21-22; and CL-PMAA/NEFI supra note 6 at 14.

423 CL-CME I supra note 8 at 10. Similarly, BGA argued that conditional limits incentivize the migration of price discovery from the physical contracts to the financial contracts and have the unintended effect of driving participants from the market, thereby increasing the potential for market manipulation with a very small volume of trades. CL-BGA supra note 35 at 12.

424 CL-AIMA supra note 35 at 2.

425 CL-CME I supra note 8 at 10; CL-KCBT I supra note 97 at 4; and CL-APGA supra note 17 at 6, 8. Specifically, the KCBT argued that parity should exist in all position limits (including spot-month limits) between physical-delivery and cash-settled Referenced Contracts; otherwise, these limits would unfairly advantage the look-alike cash-settled contracts and result in the cash-settled contract unduly influencing price discovery. Moreover, the higher spot-month limit for the financial contract unduly restricts the physical market's ability to compete for spot-month trading, which provides additional liquidity to commercial market participants that roll their positions forward. CL-KCBT I supra note 97 at 4.

greater than five times the 25 percent of deliverable supply formula.[426] ICE recommended that they be increased to at least ten times the 25 percent of deliverable supply.[427]

Several commenters expressed concern that the conditional spot-month limits would "restrict the physically-delivered contract market's ability to compete for spot-month speculative trading interest," thereby restricting liquidity for bona fide hedgers in those contracts.[428] Another noted that the limit may be detrimental to the physically settled contracts because it restricts the ability of a trader to be in both the physical-delivery and cash-settled markets.[429] Conversely, one commenter expressed concern that the anti-manipulation goal of spot-month position limits would not be met because the structure of the conditional limit in the Proposed Rule allowed a trader to be active in both the physical commodity and cash-settled contracts, and so could use its position in the cash commodity to manipulate the price of a physically settled contract to benefit a leveraged cash-settled position.[430]

With regard to the application of position limits to cash-settled contracts, the Commission notes that Congress specifically directed the Commission to impose aggregate spot-month limits on DCM futures contracts and swaps that are economically equivalent to such contracts. Therefore, the Commission is required to impose limits on such contracts. As explained in the

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426 CL-AIMA supra note 35 at 2; and CL-ICE I supra note 69 at 8.

427 CL-ICE I supra note 69 at 8. ICE also recommended that the Commission remove the prohibition on holding a position in the physical-delivery contract or the duration to a narrower window of trading than the final three days of trading.

428 See e.g., CL-KCBT I supra note 97 at 4 "[T]he higher spot-month limit for the financial contract unduly restricts the physical market's ability to compete for spot month speculative trading interests, which provide additional liquidity to commercial market participants (bona fide hedgers) as they unwind or roll their positions forward.")

429 See e.g., CL-Centaurus Energy supra note 21 at 3.

430 See e.g., CL-Prof. Pirrong supra note 124.

proposal, the Commission believes that "limiting a trader's position at expiration of cash-settled contracts diminishes the incentive to exert market power to manipulate the cash-settlement price or index to advantage a trader's position in the cash-settlement contract." Further, absent such limits on related markets, a trader would have a significant incentive to attempt to manipulate the physical-delivery market to benefit a large position in the cash-settled economically equivalent contract.

The Commission is adopting, on an interim final rule basis, spot-month limits for cash-settled contract, other than natural gas contracts, at 25 percent of the estimated deliverable supply. These limits will be in parity with the spot-month limits set for the related physical-delivery contracts. As discussed in section II.D.3. of this release, the Commission has determined that the one-to-one ratio for commodities other than natural gas between the level of spot-month limits on physical-delivery contracts and the level on cash-settled contracts maximizes the objectives enumerated in section 4a(a)(3) of the CEA by ensuring market liquidity for bona fide hedgers, while deterring the potential for market manipulation, squeezes, and corners. The Commission further notes that this formula is consistent with the level the Commission staff has historically deemed acceptable for cash-settled contracts, as well as the formula for physical-delivery contracts under Acceptable Practices for Core Principle 5 set forth in part 38 of the Commission's regulations.

At this time, the Commission's data set does not allow the Commission to estimate the specific number of traders that could potentially be impacted by the limits on cash-settled contracts in the spot-month for agricultural, metals and energy commodities (other than natural gas). However, given the Commission's understanding of the overall size of the swaps market in these commodities, the Commission believes that a one-to-one ratio of position limits for

physical-delivery and cash-settled Referenced Contracts maximizes the four statutory factors in section 4a(a)(3)(B) of the CEA.

The Commission is also adopting, on an interim final rule basis, an aggregate spot-month limit for physical-delivery and cash-settled natural gas contracts, as well as a class limit for cash-settled natural gas contracts, both set at a level of five times the level of the spot-month limit in the relevant Core Referenced physical-delivery natural gas contract.

As discussed in section II.D.3. of this release, the Commission has determined that the one-to-five ratio between the level of spot-month limits on physical-delivery natural gas contracts and the level of spot-month limits on cash-settled natural gas contracts maximizes the objectives enumerated in section 4a(a)(3) of the CEA by ensuring market liquidity for bona fide hedgers, while deterring the potential for market manipulation, squeezes, and corners. The Commission notes that this formula is consistent with the administrative experience with conditional limits in DCM and exempt commercial market natural gas contracts.

As described in section II.D.3. of the release, this aggregate limit for natural gas contracts responds to commenters' concerns regarding potentially negative impacts on liquidity and the price discovery function of the physical-delivery contract if traders are not permitted to hold any positions in the physical-delivery contract when they hold contracts in the cash-settled Referenced Contract (which are subject to higher limits than the physical-delivery contracts).

The Commission is also no longer restricting the higher limit for cash-settled natural gas contracts to entities that hold or control less than 25 percent of the deliverable supply in the cash commodity. As pointed out by certain commenters,[431] this provision would create significant compliance costs for entities to track whether they meet such a condition. The Commission

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[431] CL-ISDA/SIFMA supra note 21 at 7.

believes at this time that the class and aggregate limits in the spot month for natural gas contracts should adequately account for market manipulation concerns with regard to entities with large cash-market positions; however, the Commission will continue to monitor developments in the market to determine whether to incorporate a cash-market restriction in the higher cash-settled contract limit, and the extent of the benefit provided through restricting cash-market positions.

The Commission expects that its estimate as to the number of traders affected by the limits in cash-settled contracts will change as swap positions are reported to the Commission through its Large Swaps Trader Reporting and SDR regulations. Given the Commission's limited data with regard to swaps, the Commission looked to exemptions from position limits granted by DCMs and ECMs to estimate the number of traders that may be affected by the finalized limits for cash-settled contracts. At this time, the only data available pertains to energy commodities. The Commission estimates that approximately 70 to 75 traders hold exemptions from DCM and ECM limits and therefore at least this number of traders may be impacted by the spot-month limit for cash-settled contracts. Until the Commission has accurate information on the size and composition of off-exchange cash-settled Referenced Contracts for agricultural, metal, and energy contracts, it is unable more precisely to determine the number of traders potentially impacted by the aggregate limit.[432] As discussed above, by implementing the one-to-one and one-to-five ratios on an interim basis, the Commission can further gather and analyze the ratio and its impact on the market.

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[432] The Commission notes that it is currently unable to determine the applicability of bona fide hedge exemptions because of differences in the revised statutory definition compared to the current definition applied by DCMs and ECMs. In addition, traders may net cash-settled contracts for purposes of the class limit in the spot month. Thus, absent complete data on swaps positions, the Commission cannot accurately estimate a trader's position for the purposes of compliance with spot-month limits for cash-settled contracts.

The Commission also notes that swap dealers and commercial firms enter into a significant number of swap transactions that are not submitted to clearing.[433] Based on the nature of the commercial counterparty to such transactions, the Commission anticipates that many of these transactions involving commercial firm counterparties would likely be entitled to bona fide hedging exemptions as provided for in § 151.5, which should limit the number of persons affected by the spot-month limit in cash-settled contracts without an applicable exemption.

The Commission also notes that swaps and other over-the-counter market participants may face additional costs (including foregone benefits) in terms of adjusting position levels and trading strategies to the position limits on cash-settled contracts. While current data precludes estimating the extent of the financial impact to swap market participants, these costs are inherent in establishing limits that reach swaps that are economically equivalent to DCM futures contracts, as required under section 4a(a)(5).

c. Non-Spot-Month Limits

Section 151.4(b) provides that the non-spot-month position limits for non-legacy Referenced Contracts shall be fixed at a number determined as a function of the level of open interest in the relevant Referenced Contract. This formula is defined as 10 percent of the open interest up to the first 25,000 contracts plus 2.5 percent of open interest thereafter ("10-2.5 percent formula"). This is the same formula that has been historically used to set position limits on futures exchanges.[434] With regard to the nine legacy agricultural Core Referenced Futures

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433 This observation is based upon Commission staff discussions with members of industry. See https://www.cftc.gov/LawRegulation/.

434 See 17 C.F.R. part 150 (2010).

Contracts, which are currently subject to Commission imposed non-spot-month position limits, as described in section II.E.4. of this release, the Commission is raising those existing position limits to the levels described in the CME petition.

Commenters expressed concern that non-spot-month limits could be harmful, potentially distorting price discovery or liquidity and damaging long term hedging strategies.[435] Others argued that there should be no limits outside the spot-month or that the Commission had not adequately justified non-spot-month limits.[436] One commenter argued that the proposed non-spot-month class limits would increase costs for hedgers and harm market liquidity.[437] Several commenters opined that the Commission should increase the open interest multipliers used in determining the non-spot-month position limits,[438] while some commenters explained that the Commission should decrease the open interest multipliers to 5 percent of open interest for first 25,000 contracts and 2.5 percent thereafter.[439] Other commenters suggested significantly different methodologies for setting limits that would result in relatively more restrictive limits on speculators.[440]

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435 See e.g., CL-Teucrium supra note 124 at 2; and CL-ICE I supra note 69 at 6.

436 See e.g., CL-WGCEF supra note 35 at 5; and CL-Goldman supra note 89 at 2.

437 See e.g., CL-DBCS supra note 247 at 8-9.

438 CL-AIMA supra note at 35 pg. 3; CL-CME I supra note 8 at 12 (for energy and metals); CL-FIA I supra note 21 at 12 (10% of open interest for first 25,000 contracts and then 5%); CL-ICI supra note 21 at 10 (10% of open interest until requisite market data is available); CL-ISDA/SIFMA supra note 21 at 20; CL-NGSA/NCGA supra note 124 at 5 (25% of open interest); and CL-PIMCO supra note 21 at 11.

439 CL-Greenberger supra note 6 at 13; and CL-FWW supra note 81 at 12.

440 See e.g., CL-ATA supra note 81 at 4-5; CL-AFR supra note 17 at 5-6; CL-ATAA supra note 94 at 3, 6, 9-10, 12; CL-Better Markets supra note 37 at 70-71 (recommending the Commission to limit non-commodity index and commodity index speculative participation in the market to 30% and 10% of open interest respectively); CL-Delta supra note 20 atpg.5; and CL-PMAA/NEFI supra note 6 at 7.

Several commenters recommended that the Commission should keep the legacy limits for legacy agricultural Referenced Contracts.[441] One commenter argued that raising these limits would increase hedging margins and increase volatility which would ultimately undermine commodity producers' ability to sell their product to consumers.[442] Another opined that the Commission need not proceed with phased implementation for the legacy agricultural markets because it could set their limits based on existing legacy limits.[443]

Several other commenters recommended that the Commission abandon the legacy limits.[444] One commenter argued that the Commission offered no justification for treating legacy agricultural contracts differently than other Referenced Contract commodities.[445] Some of these commenters endorsed the limits proposed by CME.[446] Other commenters recommended the use of the open interest formula proposed by the Commission in determining the position limits applicable to the legacy agricultural Referenced Contract markets.[447] Finally, four commenters

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441 CL-ABA supra note 150 at 3-4; CL-AFIA supra note 94 at 3; CL-Amcot supra note 150 at 2; CL-FWW supra note 81 at 13; CL-IATP supra note 113 at 5; and CL-NGFA supra note 72 at 1-2.

442 CL-ABA supra note 150 at 3-4.

443 CL-Amcot supra note 150 at 3.

444 CL-AIMA supra note 35 at 4; CL-Bunge supra note 153 at 1-2; CL-DB supra note 153 at 6; CL-Gresham supra note 153 at 4-5; CL-FIA I supra note 21 at 12; CL-MGEX supra note 74 at 2; CL-MFA supra note 21 at 18-19; and USCF supra note 153 at 10-11.

445 CL-USCF supra note 153 at 10-11.

446 CL-Bunge supra note 153 at 1-2; CL-FIA I supra note 21 at 12; and CL-Gresham supra note 153 at 5. See CME Petition for Amendment of Commodity Futures Trading Commission Regulation 150.2 (April 6, 2010), available at http//www.cftc.gov/LawRegulation/DoddFrankAct/Rulemaking/DF_26_PosLimits/index.htm.

447 CL-CMC supra note 21 at 3; CL-DB supra note 153 at 10; and CL-MFA supra note 21 at 19.

expressed their preference that non-spot position limits be kept consistent for the wheat Referenced Contracts.[448]

In addition to the costs associated with generally monitoring positions in Referenced Contracts on an intraday basis, the Commission anticipates some costs to result from the establishment of the non-spot-month position limit, though the Commission expects the resulting costs should be minimal for most market participants. To determine the number of potentially affected entities, the Commission took existing data and calculated the number of traders whose positions would be over the final non-spot-month limits.[449] For the majority of participants, the non-spot month levels are estimated to impose limits that are sufficiently high so as to not affect their hedging or speculative activity; thus, the Commission projects that relatively few market participants will have to adjust their activities to ensure that their positions are not in excess of the limits.[450] According to these estimates, the position limits in § 151.4(d) would affect, on an annual basis, eighty traders in agricultural Referenced Contracts, twenty-five traders in metal Referenced Contract, and ten traders in energy Referenced Contracts.[451]

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448 CL-CMC supra note 21 at 3; CL-KCBT I supra note 97 at 1-2; CL-MGEX supra note 74 at 2; and CL-NGFA supra note 72 at 4.

449 The data was based on the Commission's large trader reporting data for futures contracts and limited swaps data covering certain cleared swap transactions

450 To illustrate this, the Commission selected examples from each category of Core Referenced Futures Contracts. In the CBOT Corn contract (a agricultural Referenced Contract), only approximately 4.8% of reportable traders are estimated to be impacted using the methods explained above. Using the COMEX Gold contract as an example of a metal Referenced Contracts, and NYMEX Crude Oil as an example of a energy Referenced Contract, the Commission estimates only 1.4% and .2% (respectively) of all reportable traders in those markets would be impacted by the non-spot-month limit. These estimates indicate that the number of affected entities is expected to be small in comparison to the rest of the market.

451 These estimates do not take into account open interests from a significant number of swap transactions, and therefore, the Commission believes that the size of the non-spot position limit will increase over this estimate as the Commission is able to analyse additional data.

As noted above, the Commission's data on uncleared swaps is limited. The information currently available to the Commission indicates that the uncleared swaps market is primarily comprised of transactions between swap dealers and commercial entities. As such, some of the above entities that may hold positions in excess of the non-spot-month limits may be entitled to bona fide hedging exemptions as provided for in § 150.5. Moreover, the Commission understands that swap dealers, who constitute a large percentage of those anticipated to be near or above the position limits set forth in § 151.4, generally use futures contracts to offset the residual portfolio market risk of their uncleared swaps positions.[452] Under these final rules, market participants can net their physical delivery and cash-settled futures contracts with their swaps transactions for purposes of complying with the non-spot-month limit. In this regard, the netting of futures and swaps positions for such swap dealers would reduce their exposure to an applicable position limit.

Taking these considerations into account, the Commission anticipates that for the majority of participants, the non-spot month levels are estimated to impose limits that are sufficiently high so as to not affect their hedging or speculative activity as these participants could either rely on a bona fide hedge exemption or hold a net position that is under the limit. Thus, the Commission projects that relatively few market participants will have to adjust their activities to ensure that their positions are not in excess of the limits.

The economic costs (or foregone benefits) of the level of position limits is difficult to determine accurately or quantify because, for example, some participants may be eligible for bona fide hedging or other exemptions from limits, and thus incur the costs associated with filing

[452] The estimated monetary costs associated with claiming a bona fide hedge exemption are discussed below in consideration of the costs and benefits for bona fide hedging as well as in the Paperwork Reduction Act section of this final rule.

exemption paperwork, while others may incur the costs associated with altering their business strategies to ensure that their aggregate positions do not exceed the limits. In the absence of data on the extent to which the bona fide hedge exemption will apply to swaps transactions, at this time the Commission cannot determine or estimate the number of entities that will be eligible for such an exemption. Accordingly, the Commission cannot determine or estimate the total costs industry-wide of filing for the exemption.[453]

Similarly, the Commission is unable to determine or estimate the number of entities that may need to alter their business strategies.[454] Commenters did not provide any quantitative data as to such potential impacts from the proposed limits, and the Commission cannot independently evaluate the potential costs to market participants of such changes in strategies, which would necessarily be based on the underlying business models and strategies of the various market participants.

While the Commission is unable to quantify the resulting costs to the relatively few number of market participants that the Commission estimates may be affected by these limits; to a certain extent costs associated with a change in business or trading strategies to comply with the non-spot-month position limits imposed by the Commission are a consequence of the Congressionally-imposed mandate for the Commission to establish such limits. Commenters suggesting that the Commission should not adopt non-spot-month position limits fail to address the mandate of Congress in CEA section 4a(a)(3)(A) that the Commission impose non-spot-month limits. Based on the Commission's long-standing experience with the application of the

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453 As previously noted, the costs to an individual firm of filing an exemption are estimated at section III.A.3.

454 The Commission notes that under the pre-existing positions exemption, a trader would not be in violation of a position limits based solely upon the trader's pre-existing positions in Referenced Contracts. Further, swaps entered before the effective date of the Dodd-Frank Act will not count toward a speculative limit, unless the trader elects to net such swaps positions to reduce their aggregate position.

10 – 2.5 percent formula to establish non-spot-month limits in the futures market as well as the Commission's limited swaps data, the Commission anticipates that the application of this similar formula to both the futures and swaps market will appropriately maximize the statutory objectives in section 4a(a)(3). The data regarding the swaps market that is currently available to the Commission indicates that a limited number of market participants will be at or near the speculative position limits and that the imposition of these limits should not result in a significant decrease in liquidity in these markets. Accordingly, the Commission believes that non-spot-month limits imposed as a result of these final rules will ensure there continues to be sufficient liquidity for bona fide hedgers and the price discovery of the underlying market will not be disrupted.

The Commission has determined to adopt the position limit levels proposed by the CME for the legacy Referenced Contracts. Such levels would be effective 60 days after the publication date of this rulemaking and those levels would be subject to the existing provisions of current part 150 until the compliance date of these rules, which is 60 days after the Commission further defines the term "swap" under the Dodd-Frank Act. At that point, the relevant provisions of this part 151, including those relating to bona-fide hedging and account aggregation, would also apply. In the Commission's judgment, the CME proposal represents a measured approach to increasing legacy limits, similar to that previously implemented.[455] The Commission will use the CME's all-months-combined petition levels as the basis to increase the levels of the non-spot-month limits for legacy Referenced Contracts. The petition levels were based on 2009 average month-end open interest. Adoption of the petition levels results in

[455] 58 FR 18057, April 7, 1993.

increases in limit levels that range from 23 to 85 percent higher than the levels in existing § 150.2.

The Commission has determined to maintain the current approach to setting and resetting legacy limits because it is consistent with the Commission's historical approach to setting such limits and ensures the continuation of maintaining a parity of limit levels for the major wheat contracts at DCMs. In response to comments supporting this approach, the Commission will also increase the levels of the limits on wheat at the MGEX and the KCBT to the level for the wheat contract at the CBOT.[456]

d. Position Visibility

As discussed in II.L. of this release, the Commission is adopting position visibility levels as a supplement to position limits. These levels will provide the Commission with the ability to conduct surveillance of market participants with large positions in the energy and metal Reference Contracts.[457] As discussed in the Paperwork Reduction Act section of these final rules, the Commission increased the position visibility levels and reduced the reporting requirements in order to decrease the compliance costs associated with position visibility levels.

Commenters generally stated that the position visibility requirements are unnecessary, redundant, burdensome, and overly restrictive.[458] While some commenters acknowledged the usefulness of the data collected through position visibility requirements, they maintained the

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[456] For a discussion of the historical approach, see 64 FR 24038, 24039, May 5, 1999.

[457] As discussed in section II.L of this release, the Commission is not extending position visibility reporting to agricultural contracts because the Commission believes that reporting related to bona fide hedging and other exemptions should provide the Commission with sufficient data on the largest traders in agricultural Referenced Contacts.

[458] See e.g., CL-BGA supra note 35 at 19-20; CL-CME I supra note 8 at 6; CL-WGCEF supra note 35 at 23; and CL-MFA supra note 21 at 3.

burden associated with complying with these requirements was too great.[459] One commenter noted that it is too costly to require monthly visibility reporting; another suggested these compliance costs would most affect bona fide hedgers because of the extra information required of those claiming a bona fide hedging exemption.[460] Another commenter noted that position visibility requirements may prove duplicative once the Commission can evaluate data received from swaps dealers and major swaps participants, DCOs, SEFs and SDRs.[461]

The comments that suggested semi-annual reporting or no reporting at all, instead of monthly reporting, have not been adopted because of the surveillance utility afforded by the visibility reporting. The Commission notes that once an affected person adopts processes to comply with the standard reporting format, visibility reporting may result in a lesser burden when compared to the alternative of frequent production of books and records under special calls. With regard to frequency, reporting that is too infrequent may undermine the effectiveness of the Commission's surveillance efforts, as one goal of reporting under position visibility levels is to provide the Commission with timely and accurate data regarding the current positions of a market's largest traders in order to detect and deter manipulative behavior. The Commission notes that until SDRs are operational and the Commission's large trader reporting for physical commodity swaps are fully implemented, the Commission would not have access to the data necessary to have a holistic view of the marketplace and to set appropriate position limit levels.

To further mitigate costs on reporting entities, the Commission has determined to reduce the filing burden associated with position visibility to one filing per trader per calendar quarter,

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459 See e.g., CL-USCF supra note 153 at 11.

460 See e.g., CL-USCF supra note 153 at 11; and CL-WGCEF supra note 35 at 22-23.

461 CL-FIA I supra note 21, at 13.

as opposed to a monthly filing. This reduced reporting is not anticipated to significantly impact the overall surveillance benefit provided through the position visibility reporting. However, if the large position holders subject to position visibility reporting requirements were to submit reports any less often, then the reports would not provide sufficiently regular information for the Commission to be able to determine the nature (hedging or speculative) of the largest positions in the market. This data should assist the Commission in its required report to Congress regarding implementation of position limits,[462] and in ongoing assessment of the appropriateness of the levels of such limits.

The Commission has also raised the visibility levels to approximately 50 to 60 percent of the projected aggregate position limits for the Reference Contract (from 10 to 30 percent of the limit in the Proposed Rule), with the exception of the Light, Sweet Crude Oil (CL) and Henry Hub Natural Gas (NG) Referenced Contracts, for which these levels have been raised from the proposal but are still lower than 50 to 60 percent of projected aggregate position limits in order capture a target number of traders.[463] Based on the Commission's current data regarding futures and certain cleared swap transactions, the higher visibility levels as compared to the Proposed Rule will reduce the number of traders (including bona fide hedgers) subject to the reporting requirements, while still providing the Commission sufficient data on the positions of the largest traders in the respective Referenced Contract.

The Commission estimates that, on an annual basis, at most 73 traders would be subject to position visibility reporting requirements. As discussed in the PRA section of this release, the Commission estimates the costs of compliance to be a total burden, across all of these entities, of

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462 See section 719 of the Dodd-Frank Act.

463 See § 151.6.

7,760 annual labor hours resulting in a total of $611,000 in annual labor costs and $7 million in annualized capital and start-up costs and annual total operating and maintenance costs.

The Commission estimates that 25 of the traders affected by position visibility regulations would be bona fide hedgers. Specifically with regard to bona fide hedgers, the Commission estimates compliance costs for position visibility reporting to be a total burden, across all bona fide hedgers, of 2,000 total annual labor hours resulting in a total of $157,200 in annual labor costs and $1.625 million in annualized capital and start-up costs and annual total operating and maintenance costs. The Commission notes that these estimated costs for bona fide hedgers are a subset of, and not in addition to, the costs for all participants combined enumerated above.

The information gained from position visibility levels provides essential transparency to the Commission as a means of preventing potentially manipulative behavior. In the Commission's judgment, such data is a critical component of an effective position limit regime as it will help to maximize to the extent practicable the statutory objectives of preventing excessive speculation and manipulation, while ensuring sufficient liquidity for bona fide hedgers and protecting the price discovery function of the underlying market. It allows the Commission to monitor the positions of the largest traders and the effects of those positions in the affected markets. While the extent of these benefits is not readily quantifiable, the ability to better understand the balance in the market between speculative and non-speculative positions is critical to the Commission's ability to monitor the effectiveness of position limits and potentially recalibrate the levels in order to ensure the limits sufficiently address the statutory objectives that the Commission must consider and maximize in establishing appropriate position limits. In this way, position visibility levels are not unlike position accountability levels that are currently

utilized for many DCM contracts. Finally, as discussed under section II.C.2. of this release, position visibility reporting will enable the Commission to address data gaps that will exist prior to the availability of comprehensive data from SDRs.

e. DCMs and SEFs

Pursuant to Core Principle 5(B) for DCMs and Core Principle 6(B) for SEFs that are trading facilities, such registered entities are required to establish position limits "[f]or any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a)." The core principles require that these levels be set "at a level not higher than the position limitation established by the Commission." As such, the final rules require DCMs and SEFs to set position limits on the 28 physical commodity Referenced Contracts traded or executed on such DCMs and SEFs.

Under the proposal, DCMs and SEFs would have been required to implement a position limit regime for all physical commodity contracts executed on their facility. This proposal would effectively create a class limit for the trading facility's contracts. Because the Commission determined to eliminate class limits outside of the spot-month for the 28 contracts subject to Commission limits, the Commission has determined not to adopt the proposed requirements that would have effectively created class limits for a particular trading venue. Accordingly, the final rules permit the trading facility to grant spread or arbitrage exemptions regardless of the trading facility or market in which such positions are held. To remain consistent with the Commission's class limits within the spot-month, DCMs and SEFs cannot grant spread or arbitrage exemptions with regard to physical-delivery commodity contracts. These provisions allow DCMs and SEFs to comply with the core principles for contracts subject to Commission position limits without

creating an incentive for traders to migrate their speculative positions off of the trading facility to avoid the SEF or DCM limit.[464]

The Commission notes that the establishment of federal limits on the 28 Core Referenced Futures Contracts should not significantly affect the compliance costs for DCMs because they currently impose spot month limits for physical commodity contracts in compliance with existing Core Principle 5.[465] DCMs in particular have long enforced spot-month limits, and the Commission notes that such spot-month position limits are currently in place for all physical-delivery physical commodity futures under Core Principle 5 of section 5(d) of the CEA. The final rule on physical-delivery spot month limits should impose minimal, if any, additional compliance costs on DCMs.

As outlined above in this section III.A.3, the Commission believes that the position limits finalized herein will likely cause relevant DCMs, SEFs, and market participants to incur various additional costs (or forego benefits). At this time, the Commission is unable to quantify the cost of such changes because the effect of this determination will vary per market and because the requirements applicable to SEFs extend to swaps, which heretofore were generally not subject to federally-set position limits. The Commission also notes that to a certain extent these costs are a consequence of the statutory requirement for DCMs and SEFs to set and administer position limits on contracts that have federal position limits in accordance with the Core Principles applicable to such facilities.

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464 For example, traders could utilize swaps not traded on a DCM or SEF.

465 The Commission has further provided for acceptable practices for DCMs and SEFs seeking compliance with their respective position limit and accountability-related Core Principles in other commodity contracts.

For the remaining physical commodity contracts executed on a DCM or SEF that is a trading facility, i.e., those contracts which are not Referenced Contracts, DCMs and SEFs are required to comply with new Core Principle 5 for DCMs and Core Principle 6 for SEFs in establishing position limitations or position accountability levels. The costs resulting from this requirement also are a consequence of the statutory provision requiring DCMs and SEFs to set and administer position limits or accountability levels.

f. CEA Section 15(a) Considerations: Position Limits

As stated above, section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions 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.

i. Protection of Market Participants and the Public

Congress has determined that excessive speculation causing "sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity." Further, Congress directed that for the purpose of "diminishing, eliminating, or preventing such burden," the Commission "shall . . . proclaim and fix such [position] limits . . . as the Commission finds are necessary to diminish, eliminate, or prevent such burden."[466] This rulemaking responds to the Congressional mandate for the Commission to impose position limits both within and outside of the spot month on DCM futures and economically equivalent swaps.

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466 Section 4a(a)(1) of the CEA, 7 U.S.C. 6a(a)(1).

The Congressional mandate also directed that the Commission set limits, to the maximum extent practicable, in its discretion, to diminish, eliminate or prevent excessive speculation, deter or prevent market manipulation, ensure sufficient liquidity for bona fide hedgers, and ensure that the price discovery function of the underlying market is not disrupted.[467] To that end, the Commission evaluated its historical experience setting limits and overseeing DCMs that administer limits, reviewed available futures and swaps data, and considered comments from the public in order to establish limits that address, to the maximum extent practicable within the Commission's discretion, the above mentioned statutory objectives.

The spot-month limit, set at 25% of deliverable supply, retains current practice in setting spot-month position limits, and in the Commission's experience this formula is effective in diminishing the potential for manipulative behavior and excessive speculation within the spot-month. As evidenced by the limited number of traders that may need to adjust their trading strategies to account for the limits, the Commission does not believe that this formula will impose an overly stringent constraint on speculative activity; and therefore, should ensure sufficient liquidity for bona fide hedgers and that the price discovery function of the underlying market is not disrupted. In addition, continuing the practice of registered entity spot-month position limits should serve to more effectively monitor trading to prevent manipulation and in turn protect market participants and the price discovery process.

With regard to the interim final rules for cash-settled contracts in the spot-month, as previously explained the Commission believes that the level of five times the applicable limit for the physical-delivery natural gas contracts should protect market participants through maximizing, to the extent practicable, the objectives set forth by Congress in CEA section

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[467] See section 4a(a)(3)(B) of the CEA, 7 U.S.C. 6a(a)(3)(B).

4a(a)(3)(B). In addition, based upon the Commission's limited swaps data, the limits on cash-settled agricultural, metals, and energy (other than natural gas) contracts should ensure sufficient liquidity for bona fide hedgers and avoid disruption to price discovery in the underlying market due to the overall size of the swap market in those commodities. Nevertheless, the Commission intends to monitor trading activity under the new limits to determine the effect on market liquidity of these limits and whether the limits should be modified to further maximize the four statutory objectives set forth in CEA section 4a(a)(3)(B). The Commission also invites public comment as to these determinations.

With regard to the non-spot-month position limits, which are set at a percentage of open interest, the Commission believes such limits will also protect market participants and the public through maximization, to the extent practicable, the four objectives set forth in CEA section 4a(a)(3)(B). The Commission selected the general 10-2.5% formula for calculating position limits as a percentage of market open interest based on the Commission's longstanding experience overseeing DCM position limits outside of the spot-month, which are based on the same formula. Further, as evidenced by the relatively few traders that the Commission estimates would hold positions in excess of such levels, the relatively small percentage of total open interest these traders would hold in excess of these limits, and that many large traders are expected to be bona fide hedgers; the Commission concludes that these limits should protect the public through ensuring sufficient liquidity for bona fide hedgers and protecting the price discovery function of the underlying market.

Finally, the position visibility levels established in these final rules should protect market participants by giving the Commission data to monitor the largest traders in Referenced metal and energy contracts. The data reported under position visibility levels will help the

Commission in considering whether to reset position limits to maximize further the four statutory objectives in section 4a(a)(3(B) of the CEA. Further, monitoring the largest traders in these markets should provide the Commission with data that may help prevent or detect potentially manipulative behavior.

ii. Efficiency, Competiveness, and Financial Integrity of Futures Markets

The federal spot-month and non-spot-month formulas adopted under the final rules are designed, in accordance with CEA section 4a(a)(3)(B),to deter and prevent manipulative behavior and excessive speculation, while also maintaining sufficient liquidity for hedging and protecting the price discovery process. To the extent that the position limit formulas achieve these objectives, the final rules should protect the efficiency, competitiveness, and financial integrity of futures markets.

iii. Price Discovery

Based on its historical experience, the Commission believes that adopting formulas for position limits that are based on formulas that have historically been used by the Commission and DCMs to establish position limits maximizes the extent practicable, at this time, the four statutory objectives set forth by Congress in CEA section 4a(a)(3). Based on its prior experience with these limits, the Commission believes that the price discovery function of the underlying market will not be disrupted. Similarly, as effective price discovery relies on the accuracy of prices in futures markets, and to the extent that the position limits described herein protect prices from market manipulation and excessive speculation, the final rules should protect the price discovery function of futures markets.

iv. Sound Risk Management Practices

To the extent that these position limits prevent any market participant from holding large positions that could cause unwarranted price fluctuations in a particular market, facilitate manipulation, or disrupt the price discovery process, such limits serve to prevent market participants from holding positions that present risks to the overall market and the particular market participant as well. To this extent, requiring market participants to ensure that they do not accumulate positions that, when traded, could be disruptive to the overall market—and hence themselves as well—promotes sound risk management practices by market participants.

v. Public Interest Considerations

The Commission has not identified any other public interest considerations related to the costs and benefits of the rules establishing limits on positions.

5. Exemptions: Bona Fide Hedging

As discussed section II.G. of this release, the Dodd-Frank Act provided a definition of bona fide hedging for futures contracts that is more narrow than the Commission's existing definition under regulation § 1.3(z). Pursuant to sections 4a(c)(1) and (2) of the CEA, the Commission incorporated the narrowed definition of bona fide hedging into the Proposed Rules, and incorporates this definition into these final rules. The Commission also limited bona fide hedging transactions to those specifically enumerated transactions and pass-through swap transactions set forth in final § 151.5. In response to commenters' inquiries over whether certain transactions qualified as an enumerated hedge transaction, the Commission expanded the list of enumerated hedge transactions eligible for the bona fide hedging exemption, and also gave examples of enumerated hedge transactions in appendix B to this release.[468]

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[468] This appendix provides examples of transactions that would qualify as an enumerated hedge transaction; the enumerated examples do not represent the only transactions that could qualify.

Pursuant to CEA section 4a(c)(1), the Commission also proposed to extend the definition of bona fide hedging transactions to all referenced contracts, including swaps transactions. The Commission is adopting the definition of bona fide hedging as proposed. The Commission believes that applying the statutory definition of bona fide hedging to swaps is consistent with congressional intent as embodied in the expansion of the Commission's authority to swaps (i.e., those that are economically-equivalent and SPDFs). In granting the Commission authority over such swaps, Congress recognized that such swaps warrant similar treatment to their economically equivalent futures for purposes of position limits and therefore, intended that statutory definition of bona fide hedging also be extended to swaps.[469]

The Commission also established a reporting and recordkeeping regime for bona fide hedge exemptions. Under the proposal, a trader with positions in excess of the applicable position limit would be required to file daily reports to the Commission regarding any claimed bona fide hedge transactions. In addition, all traders would be required to maintain records related to bona fide hedging exemptions, including the exemption for "pass-through" swaps. In response to comments, the Commission has reduced the reporting frequency from daily to monthly, and streamlined the recordkeeping requirements for pass-through swap counterparties. These modifications should permit the Commission to retain its surveillance capabilities to ensure the proper application of the bona fide hedge exemption as defined in the statute, while addressing commenters' concerns regarding costs.

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[469] The Commission notes that the impact of the definition of bona fide hedging for both futures and swaps will vary depending of the positions of each entity. Due to this variability among potentially affected entities, the specifics of which are not known to the Commission, and cannot be reasonably ascertained, the Commission cannot reasonably quantify the impact of applying the same definition of bona fide hedging for swaps and futures transactions.

Commenters argued that the definition of bona fide hedging, as proposed, was too narrow and, if applied, would reduce liquidity in affected markets.[470] These commenters suggested that the list of enumerated transactions did not adequately take into account all possible hedging transactions.[471] The lack of a broad risk management exemption also caused concerns among some commenters, who noted that the cost of reclassifying transactions would be significant and could induce companies to do business in other markets.[472] Other commenters expressed concerns regarding the pass-through exemption for swap dealers whose counterparties are bona fide hedgers, suggesting that the provision implied bona fide hedgers must manage the hedging status of their transactions and report them to the swap dealer, thus burdening the hedger in favor of the swap dealer.[473] Some commenters suggested that the Commission develop a method for exempting liquidity providers in order to retain the valuable services such participants provide.[474] One commenter urged the Commission to remove limit exemptions for index fund investors in agricultural markets in order to decrease volatility and allow for true price discovery.[475] Another commenter requested that the Commission allow categorical exemptions for trade associations to reduce the burden on smaller entities.[476]

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470 See e.g., CL-Gavilon supra note 276 at 6; CL-FIA I supra note 21 at 14-15.

471 See e.g., CL-Commercial Alliance I supra note 42 at 2; CL-FIA I supra note 21 at 14; and CL-Economists Inc. supra note 172 at 19.

472 See e.g., CL-Gavilon supra note 276 at 6.

473 CL-BGA supra note 35 at 17.

474 See e.g., CL-FIA I supra note 21 at 17-18; and CL-Katten supra note 21 at 2-3.

475 CL-ABA supra note 150 at 6.

476 CL-NREC/AAPP/ALLPC supra note 266 at 27.

Many commenters argued that the reporting requirements were overly burdensome and requested monthly reporting of bona fide hedging activity as opposed to the daily reporting that would be required by the Proposed Rule.[477] The commenters also criticized proposed restrictions on holding a hedge into the last five days of trading.[478] Some commenters on anticipatory hedging exemptions noted the proposed one year limitation on anticipatory hedging was biased toward agricultural products and did not take into account the different structure of other markets.[479] One commenter noted that the requirement to obtain approval for anticipatory hedge exemptions at a time close to when the position may exceed the limit is burdensome.[480]

The Commission is implementing the statutory directive to define bona fide hedging for futures contracts as provided in CEA section 4a(c)(2). In this respect, the Commission does not have the discretion to disregard a directive from Congress concerning the narrowed scope of the definition of bona fide hedging transactions.[481] Thus, for example, as discussed in section II.G. of this release, the final rules do not provide for risk management exemptions, given that the statutory definition of bona fide hedging generally excludes the application of a risk management exemption for entities that generally manage the exposure of their swap portfolio.[482] As

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477 See e.g., CL-API supra note 21 at 10; CL-Encana supra note 145 at 3; CL-FIA I supra note 21 at 21; CL-WGCEF supra note 35 at 14-15; CL-ICE I supra note 69 at 11-12; CL-COPE supra note 21 at 12; CL-EEI/ESPA supra note 21 at 6-7.

478 See e.g., CL-FIA I supra note 21 at 16; and CL-ISDA/SIFMA supra note 21 at 11.

479 See e.g., CL-Economists, Inc. supra note 172 at 20-21.

480 See e.g., CL-AGA supra note 124 at 7.

481 Some commenters suggested that the Commission should use its exemptive authority in section 4a(a)(7) of the CEA, 7 U.S.C. 6a(a)(7), to expand the definition of bona fide hedging to include certain transactions; however, the Commission cannot use its exemptive authority to reshape the statutory definition provided in section 4a(c)(2) of the CEA, 7 U.S.C. 6a(c)(2).

482 As discussed in II.G.1, the plain text of the new statutory definition directs the Commission to define bona fide hedging for futures contracts to include hedging for physical commodities (other than excluded commodities

discussed above, the Commission is authorized to define bona fide hedging for swaps and in this regard, may construe bona fide hedging to include risk management transactions. The Commission, however, does not believe that including a risk management provision is necessary or appropriate given that the elimination of the class limits outside of the spot-month will allow entities, including swap dealers, to net Referenced Contracts whether futures or economically equivalent swaps.[483] As such, under the final rules, positions in Referenced Contracts entered to reduce the general risk of a swap portfolio will be netted with the positions in the portfolio outside of the spot-month.[484]

The Commission estimates that there may be significant costs (or foregone benefits) associated with the implementation of the new statutory definition of bona fide hedging to the extent that the restricted definition of bona fide hedging may require traders to potentially adjust their trading strategies. Additionally, there may be costs associated with the application of the narrowed bona fide hedging definition to swaps. The Commission anticipates that certain firms may need to adjust their trading and hedging strategies to ensure that their aggregate positions do not exceed position limits. As previously noted, however, the Commission is unable to estimate

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derivatives) only if such transactions or positions represent substitutes for cash market transactions and offset cash market risks. This definition excludes hedges of general swap position risk (i.e., a risk-management exemption), but does include a limited exception for pass-through swaps.

[483] The removal of class limits should also generally mitigate the impact of not having a risk management exemption across futures and swaps because affected traders can net risk-reducing positions in the same Referenced Contract outside of the spot-month.

[484] The statutory definition of bona fide hedging does not include a risk management exemption for futures contracts. The impact of not having a risk-management exemption will vary depending on the positions of each entity, and the extent of mitigation through netting futures and swaps outside of the spot-month will also vary depending on the positions of each entity. Due to this variability among potentially affected entities, the specifics of which are not known to the Commission, and cannot be reasonably ascertained, the Commission cannot reasonably quantify the impact of not incorporating a risk-management exemption within the definition of bona fide hedging. Further, as noted above, the Commission is currently unable to quantify the cost that a firm may incur as a result of position limits impacting trading strategies.

the costs to market participants from such adjustments in trading and hedging strategies. Commenters did not provide any quantitative data as to such potential impacts from the proposed limits and the Commission does not have access to any such business strategies of market participants; thus, the Commission cannot independently evaluate the potential costs to market participants of such changes in strategies.

In light of the requests from commenters for clarity on whether specific transactions qualified as bona fide hedge transactions, the Commission developed Appendix B to these Final Rules to detail certain examples of bona fide hedge transactions provided by commenters that the Commission believes represent legitimate hedging activity as defined by the revised statute.[485]

As described further in the PRA section, the Commission estimates the costs of bona fide hedging-related reporting requirements will affect approximately 200 entities annually and result in a total burden of approximately $29.8 million across all of these entities, including 29,700 annual labor hours resulting in a total of $2.3 million in annual labor costs and $27.5 million in annualized capital and start-up costs and annual total operating and maintenance costs. These estimated costs amount to approximately $149,000 per entity. The reduction in the frequency of reporting from daily in the proposal to monthly in the final rule will decrease the burden on bona fide hedgers while still providing the Commission with adequate data to ensure the proper application of the statutory definition of bona fide hedging transaction. Further, the advance application required for an anticipatory exemption has also been changed to a notice filing, which should also decrease costs for bona fide hedgers as such entities can rely on the exemption and implement hedging strategies upon filing the notice as opposed to incurring a delay while awaiting the Commission to respond to the application.

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485 See II.G.1. of this release.

The Commission has also eliminated restrictions on maintaining certain types of bona fide hedges (e.g., anticipatory hedges) in the last five days of trading for all cash-settled Referenced Contracts. The Commission will maintain this general restriction for physically-delivered Referenced Contracts. However, the Commission is clarifying the time period for these restrictions in the physical delivery contracts, distinguishing the agricultural physical-delivery contacts from the non-agricultural physical delivery contracts. The Commission will retain the proposed restrictions for the last five days of trading in agricultural physical-delivery Referenced Contracts, while non-agricultural physical delivery Referenced Contracts will be subject to a prohibition that applies to holding the hedge into the spot month. The Commission has removed these restrictions in cash settled contracts in order to avoid, for example, requiring a trader with an anticipatory hedge exemption either to apply for a hedge exemption based on newly produced inventories (i.e., the hedge no longer being anticipatory) or to roll before the spot period restriction. The restriction on holding an anticipatory hedge into the last days of trading on a physical-delivery contract mitigates concerns that liquidation of a very large bona fide hedging position would have a negative impact on a physical-delivery contract during the last few days since such an anticipatory hedger neither intended to make nor take delivery and, thus, would liquidate a large position at a time of reduced trading activity, impacting orderly trading in the contracts. Such concerns generally are not present in cash-settled contracts, since a trader has no need to liquidate to avoid delivery. The Commission believes that permitting the maintenance of such hedges in cash settled contracts will not negatively affect the integrity of these markets.

Also in response to commenters, the one-year limitation on anticipatory hedging has been amended in the final rules to apply only to agricultural markets; the limitation has been lifted on

energy and metal markets, in recognition of the differences in the characteristics of the markets for different commodities, such as the annual crop cycle for agricultural commodities, that are not present in energy and metal commodities.

a. CEA Section 15(a) Considerations: Bona Fide Hedging

Congress established the definition of bona fide hedge transaction for contracts of future delivery in CEA section 4a(c)(2), and the Commission incorporated this definition into the final rules. As described in section II.G. of this release and in the consideration of costs and benefits, Congress limited the scope of bona fide hedging transactions to those tied to a physical marketing channel.[486] The Commission believes the enumerated hedges provide an appropriate scope of exemptions for market participants, consistent with the statutory directive for the Commission to define bona fide hedging transactions and positions.

i. Protection of Market Participants and the Public

The Commission's filing and recordkeeping requirements for bona fide hedging activity are intended to enhance the Commission's ability to monitor bona fide hedging activities, and in particular, to ascertain whether large positions in excess of an applicable position limit reflect bona fide hedging and thus are exempt from position limits. The Commission anticipates that the filing and recordkeeping provisions will impose costs on entities. However, the Commission believes that these costs provide the benefit of ensuring that the Commission has access to information to determine whether positions in excess of a position limit relate to bona fide hedging or speculative activity. To reduce the compliance burden on bona fide hedgers, the Commission has reduced the reporting frequency from daily to monthly. As a necessary

[486] For the reasons discussed above in this section III.A.4., the Commission is defining bona fide hedging for swaps to replicate the statutory definition for futures contracts.

component of an effective position limits regime, the Commission believes that the requirements related to bona fide hedging will protect participants and the public.

ii. Efficiency, Competitiveness, and financial integrity of Futures Markets

In CEA section 4a, as amended by the Dodd-Frank Act, Congress explicitly exempted those market participants with legitimate bona fide hedge positions from position limits. In implementing this definition, the final rules' position limits will not constrict the ability for hedgers to mitigate risk--a fundamental function of futures markets. In addition, as previously noted, the Commission has set these position limits at levels that will, in the Commission's judgment, to the maximum extent practicable at this time, meet the objectives set forth in CEA section 4a(a)(3)(B), which includes ensuring sufficient liquidity for bona fide hedgers. In maximizing these objectives, the Commission believes that such limits will preserve the efficiency, competitiveness, and financial integrity of futures markets. Similarly, the filing and recordkeeping requirements should help to ensure the proper application of the bona fide hedge exemption.

However, Congress also narrowed the definition of what the Commission could consider to be a bona fide hedge for contracts as compared to the Commission's definition in regulation 1.3(z). The Commission has attempted to mitigate concerns regarding any potential negative impact to the efficiency of futures markets based upon the new statutory definition. For instance, the Commission has expanded the list of enumerated hedging transactions to clarify the application of the statutory definition.[487] In addition, the Commission has removed the application of class limits outside of the spot-month, which should mitigate the impact of narrowing the bona fide hedge exemption, since positions taken in the futures market to hedge

[487] As described in earlier sections and as found in Appendix B of these rules.

the risk from a position established in the swaps market (or vice versa) can be netted for the purpose of calculating whether such positions are in excess of any applicable position limits. In light of these considerations, the Commission anticipates that the Commission's implementation of the statutory definition of bona fide hedging will not negatively affect the competitiveness or efficiency of the futures markets.

iii. Price Discovery

As discussed above, the Commission is implementing the new statutory definition of bona fide hedging. Based on its historical experience with position limits at the levels similar to those established in the final rules, and in light of the measures taken to mitigate the effects of the narrowed statutory definition of bona fide hedging, the Commission does not anticipate the rules relating to the bona fide hedge exemption will disrupt the price discovery process.

iv. Sound Risk Management Practices

While the bona fide hedging requirements will cause market participants to monitor their physical commodity positions to track compliance with limits, the bona fide hedging requirements do not necessarily affect how a firm establishes and implements sound risk management practices.

v. Public Interest Considerations

The Commission has not identified any other public interest considerations related to the costs and benefits of the rules with respect to bona fide hedging.

6. Aggregation of Accounts

The final regulations, as adopted, largely clarify existing Commission aggregation standards under part 150 of the Commission's regulations. As discussed in section II.H. of this release, the Commission proposed to significantly alter the current aggregation rules and exemptions. Specifically, proposed part 151 would eliminate the independent account controller

(IAC) exemption under current § 150.3(a)(4), restrict many of the disaggregation provisions currently available under § 150.4 and create a new owned-financial entity exemption. The proposal would also require a trader to aggregate positions in multiple accounts or pools, including passively managed index funds, if those accounts or pools have identical trading strategies. Lastly, disaggregation exemptions would no longer be available on a self-executing basis; rather, an entity seeking an exemption from aggregation would need to apply to the Commission, with the relief being effective only upon Commission approval.[488]

Commenters asserted that the elimination of the longstanding IAC exemption would lead to a variety of negative effects, including reduced liquidity and distorted price signals, among many other things.[489] One commenter mentioned that without the IAC exemption, multi-advisor commodity pools may become impossible.[490] Commenters also expressed concerns that the proposed owned non-financial entity exemption lacked a rational basis for drawing a distinction between financial and non-financial entities; and the absence of the IAC exemption could force a firm to violate other federal laws by sharing of position information across otherwise separate

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488 The Commission did not propose any substantive changes to existing § 150.4(d), which allows an FCM to disaggregate positions in discretionary accounts participating in its customer trading programs provided that the FCM does not, among other things, control trading of such accounts and the trading decisions are made independently of the trading for the FCM's other accounts. As further described below, however, the FCM disaggregation exemption would no longer be self-executing; rather, such relief would be contingent upon the FCM applying to the Commission for relief.

489 See e.g. CL-DBCS supra note 247 at 6; CL-Morgan Stanley supra note 21 at 8-9; and CL-PIMCO supra note 21 at 4.

490 CL-Willkie supra note 276 at 3-4

entities.[491] Other commenters criticized the costs of the aggregation exemption applications, stating that the process would be burdensome for participants.[492]

In addition, commenters objected to the changes to the disaggregation exemption as it applies to interests in commodity pools, arguing that forcing aggregation of independent traders would increase concentration, limit investment opportunities, and thus potentially reduce liquidity in the US futures markets.[493] Commenters also objected to the Commission's proposal to aggregate on the basis of identical trading strategies, arguing that it would decrease index fund participation and reduce liquidity. [494]

The primary rationale for the aggregation of positions or accounts is the concern that a single trader, through common ownership or control of multiple accounts, may establish positions in excess of the position limits - or otherwise attain large concentrated positions - and thereby increase the risk of market manipulation or disruption. Consistent with this goal, the Commission, in its design of the aggregation policy, has strived to ensure the participation of a minimum number of traders that are independent of each other and have different trading objectives and strategies.

Upon further consideration, and in response to commenters, the Commission is retaining the IAC exemption in existing § 150.4, recognizing that to the extent that an eligible entity's

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491 See e.g. CL-PIMCO supra note 21 at 4-5; CL-BGA supra note 35 at 22; CL-FIA I supra note 21 at 24; CL-ICE I supra note 69 at 6; and CL-CME I supra note 8 at 16.

492 See e.g. CL-ICE I supra note 69 at 13; CL-CME I supra note 8 at 17; CL-FIA I supra note 21 at 26-27; and CL-Cargill supra note 76 at 9.

493 See e.g. CL-MFA supra note 21 at 14-15; and CL-Blackrock supra note 21 at 6-7.

494 See e.g. CL-CME I supra note 8 at 18; and CL-Blackrock supra note 21 at 14.

client accounts are traded by independent account controllers,[495] with appropriate safeguards, such trading may enhance market liquidity and promote efficient price discovery without increasing the risk of market manipulation or disruption.[496]

The final rules expressly provide that the Commission's aggregation policy will apply to swaps and futures. The extension of the aggregation requirement to swaps may force a trader to adjust its business model or trading strategies to avoid exceeding the limits. The Commission is unable to provide a reliable estimation or quantification of the costs (including foregone benefits) of such changes because, among other things, the effect of this determination will vary per entity and would require information concerning the subject entity's underlying business models and strategies, to which the Commission does not have access.[497]

To further respond to concerns from commenters, the Commission is establishing an exemption from the aggregation standards in circumstances where the aggregation of an account would result in the violation of other federal laws or regulations, and an exemption for the temporary ownership or control of accounts related to underwriting securities. In addition, in response to commenters' concerns regarding potential negative market impacts on liquidity and competitiveness, the Commission is not adopting the proposed changes to the standards for commodity pool aggregation and is instead retaining the existing standards. However, the

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495 The Commission has long recognized that concerns regarding large concentrated positions are mitigated in circumstances involving client accounts managed under the discretion and control of an independent trader, and subject to effective information barriers.

496 In retaining the IAC exemption, the Commission has decided not to adopt the proposed exemption for owned non-financial entities, which addresses commenters' concern that the proposal would have resulted in unfair over discriminatory treatment of financial entities.

497 The Commission notes that this cost is directly attributable to the congressional mandate that the Commission impose limits on economically equivalent swaps. That is to say, unless the aggregation policy is extended to swaps on equal basis, the express congressional mandate to impose limits on futures (options) and economically equivalent swaps would be undermined.

Commission is retaining the provision that requires aggregation for identical trading strategies in order to prevent the evasion of speculative position limits.[498]

In light of the importance of the aggregation standards in an effective position limits regime, it is critical that the Commission effectively and efficiently monitor the extent to which traders rely on any of the disaggregation exemptions. During the period of time that the exemptions from aggregation were self-certified, the Commission did not have an adequate ability to monitor whether entities were properly interpreting the scope of an exemption or whether entities followed the conditions applicable for exemptive relief. Accordingly, traders seeking to rely on any disaggregation exemption will be required to file a notice with the Commission; the disaggregation exemption is no longer self-executing. As discussed in the PRA section, the Commission estimates costs associated with reporting regulations will affect approximately ninety entities resulting in a total burden, across all of these entities, of 225,000 annual labor hours and $5.9 million in annualized capital and start-up costs and annual total operating and maintenance costs.

a. CEA Section 15(a) Considerations: Aggregation

The aggregation standards finalized herein largely track the Commission's longstanding policy on aggregation, which will now apply to futures and swaps transactions. The Commission has added certain additional safeguards to ensure the proper aggregation of accounts for position limit purposes.

i. Protection of Market Participants and the Public

[498] The cost to monitor positions in identical trading strategies is reflected in the Commission's general estimates to track positions on a real-time basis.

The Commission's general policy on aggregation is derived from CEA section 4a(a)(1), which directs the Commission to aggregate based on the positions held as well as the trading done by any persons directly or indirectly controlled by such person.[499] The Commission has historically interpreted this provision to require aggregation based upon ownership or control. The commenters largely supported the existing aggregation standards, and as noted above, the Commission has largely retained the aggregation policy from part 150 and extended its application to positions in swaps.

As discussed above, the Commission anticipates that the aggregation standards will impose additional costs to various market participants, including the monitoring of positions and filing for an applicable exemption. However, the benefits derived from a notice filing, which ensure proper application of aggregation exemptions, and the general monitoring of positions, which are a necessary cost to the imposition of position limits, warrant adoption of the final aggregation rules. The continued use of existing aggregation standards, which are followed at the Commission and DCM level, may mitigate costs for entities to continue to aggregate their positions. In addition, the new aggregation provision related to identical trading strategies furthers the Commission policy on aggregation by preventing evasion of the limits through the use of positions in funds that follow the same trading strategy. Accordingly, as a necessary component of an effective position limit regime, and based on its experience with the current aggregation rules, the Commission believes that the provisions relating to aggregation in the final rules will promote the protection of market participants and the public.

ii. Efficiency, Competitiveness, and Financial Integrity of Futures Markets

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[499] Section 4a(a)(1) also directs that the Commission aggregate "trading done by, two or more persons acting pursuant to an express or implied agreement or understanding, the same as if the positions were held by, or trading were done by, a single person." 7 U.S.C. 6a(a)(1).

For reasons discussed above, an effective position limits regime must include a robust aggregation policy that is designed to prevent a trader from attaining market power through ownership or control over multiple accounts. To the extent that the aggregation policy under the final rules prevent any market participant from holding large positions that could cause unwarranted price fluctuations in a particular market, facilitate manipulation, or disrupt the price discovery process, the aggregation standards finalized herein operate to help ensure the efficiency, competitiveness and financial integrity of futures markets. In addition to the existing exemptions under part 150, to address commenter concerns over forced information sharing in violation of federal law and regarding the underwriting of securities, the Commission is providing for limited exemptions to cover such circumstances.

iii. Price Discovery

For similar reasons, the Commission believes that the aggregation requirements will further the price discovery process. An effective aggregation policy has been a longstanding component of the Commission's position limit regime. As a necessary component of an effective position limit regime, and based on its experience with the current aggregation rules, the Commission believes that the provisions relating to aggregation in the final rules will also help protect the price discovery process.

iv. Sound Risk Management

As a necessary component of an effective position limits regime, and based on its experience with the current aggregation rules, the Commission believes that the provisions relating to aggregation in the final rules will promote sound risk management.

v. Public Interest Considerations

The Commission has not identified any other public interest considerations related to the costs and benefits of the rules with respect to aggregation.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") requires Federal agencies to consider the impact of its rules on "small entities."[500] 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).[501] In its proposal, the Commission explained that "[t]he requirements related to the proposed amendments fall mainly on [DCMs and SEFs], futures commission merchants, swap dealers, clearing members, foreign brokers, and large traders."[502]

In response to the Proposed Rules, the Not-For-Profit Electric End User Coalition ("Coalition") submitted a comment generally criticizing the Commission's "rule-makings [as] an accumulation of interrelated regulatory burdens and costs on non-financial small entities like the NFP Electric End Users, who seek to transact in Energy Commodity Swaps and "Referenced Contracts" only to hedge the commercial risks of their not-for-profit public service activities."[503] In addition, the Coalition requested "that the Commission streamline the use of the bona fide hedging exemption for non-financial entities, especially for those that engage in CFTC-regulated

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500 5 U.S.C. 601 et seq.

501 5 U.S.C. sections 601(2), 603, 604 and 605.

502 76 FR 4765.

503 Not-For-Profit Electric End User Coalition ("EEUC") on March 28, 2011 ("CL-EEUC") at 29.

transactions as 'end user only / bona fide hedger only' market participants."[504] However, such persons necessarily would be large traders.

The Commission has determined that this position limits rule will not have a significant economic impact on a substantial number of small businesses. With regard to the position limits and position visibility levels, these would only impact large traders, which the Commission has previously determined not to be small entities for RFA purposes.[505] The Commission would impose filing requirements under final §§ 151.5(c) and (d) associated with bona fide hedging if a person exceeds or anticipates exceeding a position limit. Although regulation § 151.5(h) of these rules requires counterparties to pass-through swaps to keep records supporting the transaction's qualification for an enumerated hedge, the marginal burden of this requirement is mitigated through overlapping recordkeeping requirements for reportable futures traders (Commission regulation 18.05) and reportable swap traders (Commission regulation 20.6(b). Further, the Commission understands that entities subject to the recordkeeping requirements for their swaps transactions maintain records of these contracts, as they would other documents evidencing material financial relationships, in the ordinary course of their businesses. Therefore, these rules would not impose a significant economic impact even if applied to small entities.

The remaining requirements in this final rule generally apply to DCMs, SEFs, futures commission merchants, swap dealers, clearing members, and foreign brokers. The Commission previously has determined that DCMs, futures commission merchants, and foreign brokers are

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504 Id. at 15.

505 Policy Statement and Establishment of Definitions of "Small Entities" for Purposes of the Regulatory Flexibility Act, 47 FR 18618, Apr. 30, 1982 (FCM, DCM and large trader determinations).

not small entities for purposes of the RFA.[506] Similarly, swap dealers, clearing members, and traders would be subject to the regulations only if carrying large positions.

The Commission has proposed, but not yet determined, that SEFs should not be considered to be small entities for purposes of the RFA for essentially the same reasons that DCMs have previously been determined not to be small entities.[507] Similarly, the Commission has proposed, but not yet determined, that swap dealers should not be considered ''small entities'' for essentially the same reasons that FCMs have previously been determined not to be small entities.[508] For all of the reasons stated in those previous releases, the Commission has determined that SEFs and swap dealers are not ''small entities'' for purposes of the RFA.

The Commission notes that it has not previously determined whether clearing members should be considered small entities for purposes of the RFA. The Commission does not believe that clearing members who will be subject to the requirements of this rulemaking will constitute small entities for RFA purposes. First, most clearing members will also be registered as FCMs, who as a category have been previously determined to not be small entities. Second, any clearing member effected by this rule will also, of necessity be a large trader, who as a category has also been determined to not be small entities. For all of these reasons, the Commission has determined that clearing members are not ''small entities'' for purposes of the RFA.

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506 See 47 FR at 18618; 72 FR 34417, Jun. 22, 2007 (foreign broker determination).

507 See 75 FR 63745, Oct. 18, 2010.

508 See 76 FR 6715, Feb. 8, 2011.

Accordingly, the Chairman, on behalf of the Commission, certifies, pursuant to 5 U.S.C. 605(b), that the actions to be taken herein will not have a significant economic impact on a substantial number of small entities.

C. Paperwork Reduction Act

1. Overview

The Paperwork Reduction Act ("PRA")[509] imposes certain requirements on Federal agencies in connection with their conducting or sponsoring any collection of information as defined by the PRA. Certain provisions of the regulations will result in new collection of information requirements within the meaning of the PRA. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Commission submitted the proposing release to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The Commission requested that OMB approve and assign a new control number for the collections of information covered by the proposing release.

The Commission invited the public and other Federal agencies to comment on any aspect of the reporting and recordkeeping burdens discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicited 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

[509] 44 U.S.C. 3501 et seq.

information to be collected, and (iv) minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

The Commission received three comments on the burden estimates and information collection requirements contained in its proposing release. The World Gold Council stated that the recordkeeping and reporting costs were not addressed.[510] MGEX argued that the Commission's estimated burden for DCMs to determine deliverable supply levels was too low.[511] Specifically, it commented that the Commission's estimate of "6,000 hours per year for all DCMs at a combined annual cost of $50,000 among all DCMs" would result "in an hourly wage of less than $10" to comply with the rules.[512] The combined annual cost estimate cited by MGEX appears to be the amount the Commission estimated for annualized capital and start-up costs and annual total operating and maintenance costs;[513] this estimate is separate from any calculation of labor costs. The Working Group commented that it could not meaningfully respond to the costs until it had a complete view of all the Dodd-Frank Act rulemakings, that the Commission did not provide sufficient explanation for its estimates of the number of market participants affected by the final regulations, and that the Commission underestimated wage and personnel estimates.[514] As further discussed below, the Commission has carefully reviewed its burden analysis and estimates, and it has determined its estimates to be reasonable.

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510 CL-WGC supra note 21 at 5.

511 CL-MGEX supra note 74 at 4.

512 Id.

513 In this regard the Commission notes that the cost estimate for annualized capital and start-up costs and annual total operating and maintenance costs was $55,000.

514 CL-WGCEF supra note 35 at 25-26.

Responses to the collections of information contained within these final rules are mandatory, and the Commission will protect proprietary information according to the Freedom of Information Act and 17 CFR part 145, headed "Commission Records and Information." In addition, the Commission emphasizes that section 8(a)(1) of the Act strictly prohibits the Commission, unless specifically authorized by the Act, from making public "data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers."[515] The Commission also is required to protect certain information contained in a government system of records pursuant to the Privacy Act of 1974.[516]

The title for this collection of information is "Part 151—Position Limit Framework for Referenced Contracts." OMB has approved and assigned OMB control number 3038–[_] to this collection of information.

2. Information Provided and Recordkeeping Duties

Proposed § 151.4(a)(2) provided for a special conditional spot-month limit for traders under certain conditions, including the submission of a certification that the trader met the required conditions, to be filed within a day after the trader exceeded a conditional spot-month limit. The Commission anticipated that approximately one hundred traders per year would submit conditional spot-month limit certifications and estimated that these one hundred entities would incur a total burden of 2,400 annual labor hours, resulting in a total of $189,000 in annual

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515 7 U.S.C. 12(a)(1).

516 5 U.S.C. 552a.

labor costs[517] and $1 million in annualized capital, start-up,[518] total operating, and maintenance costs. As described above, the Commission has eliminated the conditional spot-month limit as described in the Proposed Rules. These final rules now provide for a limit on cash-settled Referenced Contracts of five times the limit on the physical-delivery Referenced Contract. The cash-settled and physical-delivery contracts would also be subject to separate class limits, and the Commission would impose an aggregate limit set at five times the level of the spot-month limit in the relevant Core Referenced Futures Contract that is physically delivered.. As such, traders need not file a certification to avail themselves of the conditional limit for cash-settled contracts. Therefore, these capital and labor cost estimates do not apply to the final regulations.

Section 151.4(c) requires that DCMs submit an estimate of deliverable supply for each Referenced Contract that is subject to a spot-month position limit and listed or executed pursuant to the rules of the DCM. Under the Proposed Rules, the Commission estimated that the reporting would affect approximately six entities annually, resulting in a total marginal burden, across all of these entities, of 6,000 annual labor hours and $55,000 in annualized capital, start-up, total operating, and maintenance costs. As discussed above, in response to comments concerning the process for determining deliverable supply, the Commission has determined to update spot-month limits biennially (every two years) instead of annually in the case of energy and metal

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517 The Commission staff's estimates concerning the wage rates are based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association ("SIFMA"). The $78.61 per hour is derived from figures from a weighted average of salaries and bonuses across different professions from the SIFMA Report on Management & Professional Earnings in the Securities Industry 2010, modified to account for an 1800-hour work-year and multiplied by 1.3 to account for overhead and other benefits. The wage rate is a weighted national average of salary and bonuses for professionals with the following titles (and their relative weight): "programmer (senior)" (30 percent); "programmer" (30 percent); "compliance advisor (intermediate)" (20 percent); "systems analyst" (10 percent); and "assistant/associate general counsel" (10 percent).

518 The capital/start-up cost component of "annualized capital/start-up, operating, and maintenance costs" is based on an initial capital/start-up cost that is straight-line depreciated over five years.

contracts, and to stagger the dates on which estimates of deliverable supply shall be submitted by DCMs. As a result of these changes, the Commission estimates that this reporting will result in a total marginal burden, across the six affected entities, of 5,000 annual labor hours for a total of $511,000 in annual labor costs and $50,000 in annualized capital, start-up, total operating, and maintenance costs.

Section 151.5 sets forth the application procedure for bona fide hedgers and counterparties to bona fide hedging swap transactions that seek an exemption from the Commission-set federal position limits for Referenced Contracts. If a bona fide hedger seeks to claim an exemption from position limits because of cash market activities, then the hedger would submit a 404 filing pursuant to § 151.5(b). The 404 filing would be submitted when the bona fide hedger exceeds the applicable position limit and claims an exemption or when its hedging needs increase. Similarly, parties to bona fide hedging swap transactions would be required to submit a 404S filing to qualify for a hedging exemption, which would also be submitted when the bona fide hedger exceeds the applicable position limit and claims an exemption or when its hedging needs increase. If a bona fide hedger seeks an exemption for anticipated commercial production or anticipatory commercial requirements, then the hedger would submit a 404A filing pursuant to § 151.5(c).

Under the Proposed Rules, 404 and 404S filings would have been required on a daily basis. In light of comments concerning the burden of daily filings to both market participants and the Commission, the final regulations require only monthly reporting of 404 and 404S filings. These monthly reports would provide information on daily positions for the month reporting period.

The Commission estimated in the Proposed Rules that these bona fide hedging-related reporting requirements would affect approximately two hundred entities annually and result in a total burden of approximately $37.6 million across all of these entities, 168,000 annual labor hours, resulting in a total of $13.2 million in annual labor costs and $25.4 million in annualized capital, start-up, total operating, and maintenance costs. As a result of modifications made to the Proposed Rules, under the final regulations these bona fide hedging-related reporting requirements will affect approximately two hundred entities annually and result in a total burden of approximately $28.6 million across all of these entities, 29,700 annual labor hours, resulting in a total of $2.3 million in annual labor costs and $26.3 million in annualized capital, start-up, total operating, and maintenance costs.

With regard to 404 filings, under the Proposed Rules, the Commission estimated that 404 filing requirements would affect approximately ninety entities annually, resulting in a total burden, across all of these entities, of 108,000 total annual labor hours and $11.7 million in annualized capital, start-up, total operating, and maintenance costs. Under the final regulations, 404 filing requirements will affect approximately ninety entities annually, resulting in a total burden, across all of these entities, of 108,000 total annual labor hours and $11.7 million in annualized capital, start-up, total operating, and maintenance costs.

With regard to 404A filings, under the Proposed Rules, the Commission estimated that 404A filing requirements would affect approximately sixty entities annually, resulting in a total burden, across all of these entities, of 6,000 total annual labor hours and $4.2 million in annualized capital, start-up, total operating, and maintenance costs. In addition to adjustments in these estimates stemming from the change in the frequency of filings, the estimate of entities affected by 404A filing requirements has been modified to reflect the fact that the final

regulations include certain anticipatory hedging exemptions that were absent from the Proposed Rules. Thus, under the final regulations, 404A filing requirements will affect approximately ninety entities annually, resulting in a total burden, across all of these entities, of 2,700 total annual labor hours and $6.3 million in annualized capital, start-up, total operating, and maintenance costs.

With regard to 404S filings, under the Proposed Rules the Commission estimated that 404S filing requirements would affect approximately forty-five entities annually, resulting in a total burden, across all of these entities, of 54,000 total annual labor hours and $9.5 million in annualized capital, start-up, total operating, and maintenance costs. Under the final regulations, 404S filing requirements will affect approximately forty-five entities annually, resulting in a total burden, across all of these entities, of 16,200 total annual labor hours and $9.5 million in annualized capital, start-up, total operating, and maintenance costs.

Section 151.5(e) specifies recordkeeping requirements for traders who claim bona fide hedge exemptions. These recordkeeping requirements include complete books and records concerning all of their related cash, futures, and swap positions and transactions and make such books and records, along with a list of swap counterparties to the Commission. Regulations 151.5(g) and 151.5(h) provide procedural documentation requirements for those availing themselves of a bona fide hedging transaction exemption. These firms would be required to document a representation and confirmation by at least one party that the swap counterparty is relying on a bona fide hedge exemption, along with a confirmation of receipt by the other party to the swap. Paragraph (h) of § 151.5 also requires that the written representation and

confirmation be retained by the parties and available to the Commission upon request.[519] The marginal impact of this requirement is limited because of its overlap with existing recordkeeping requirements under § 15.03. The Commission estimates, as it did under the Proposed Rules, that bona fide hedging-related recordkeeping regulations will affect approximately one hundred sixty entities, resulting in a total burden, across all of these entities, of 40,000 total annual labor hours and $10.4 million in annualized capital, start-up, total operating, and maintenance costs.

Section 151.6 requires traders with positions exceeding visibility levels in Referenced Contracts in metal and energy commodities to submit additional information about cash market and derivatives activity in substantially the same commodity. Section 151.6(b) requires the submission of a 401 filing which would provide basic position information on the position exceeding the visibility level. Section151.6(c) requires additional information, through a 402S filing, on a trader's uncleared swaps in substantially the same commodity. The Commission has determined to increase the visibility levels from the proposed levels, meaning fewer market participants will be affected by the relevant reporting requirements. In addition, the Proposed Rules included a requirement to submit 404A filings under proposed § 151.6, but the Commission has eliminated this requirement in order to reduce the compliance burden for firms reporting under § 151.6.

Requirements under 401 filing reporting regulations in the Proposed Rules would have affected approximately one hundred forty entities annually, resulting in a total burden, across all of these entities, of 16,800 total annual labor hours and $15.4 million in annualized capital, start-up, total operating, and maintenance costs. In the final regulations, these requirements will affect

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[519] The Commission notes that entities would have to retain such books and records in compliance with § 1.31.

approximately seventy entities annually, resulting in a total burden, across all of these entities, of 8,400 total annual labor hours and $5.3 million in annualized capital, start-up, total operating, and maintenance costs.

Requirements under 402S filing reporting regulations in the Proposed Rules would have affected approximately seventy entities annually, resulting in a total burden, across all of these entities, of 5,600 total annual labor hours and $4.9 million in annualized capital, start-up, total operating, and maintenance costs. In the final regulations, the Commission has eliminated the 402S filing, thus eliminating any burden stemming from such reports.

Requirements under visibility level-related 404 filing reporting regulations[520] in the Proposed Rules would have affected approximately sixty entities annually, resulting in a total burden, across all of these entities, of 4,800 total annual labor hours and $4.2 million in annualized capital, start-up, total operating, and maintenance costs. In the final regulations, these requirements will affect approximately thirty entities annually, resulting in a total burden, across all of these entities, of 2,400 total annual labor hours and $2.1 million in annualized capital, start-up, total operating, and maintenance costs.

As noted above, 404A filing requirements under § 151.6 have been eliminated in the final regulations. Therefore, the burden estimates for this requirement under the Proposed Rules (approximately forty entities affected annually, resulting in a total burden, across all of these entities, of 3,200 total annual labor hours and $2.8 million in annualized capital, start-up, total operating, and maintenance costs) do not apply to the final regulations.

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[520] For the visibility level-related 404 filing requirements, the estimated burden is based on reporting duties not already accounted for in the burden estimate for those submitting 404 filings pursuant to proposed § 151.5. For many of these firms, the experience and infrastructure developed submitting or preparing to submit a 404 filing under § 151.5 would reduce the marginal burden imposed by having to submit filings under § 151.6.

As a result of this modification and higher visibility levels, estimates for the overall burden of visibility level-related reporting regulations have been modified. In the Proposed Rules, the Commission estimated that visibility level-related reporting regulations would affect approximately one hundred forty entities annually, resulting in a total burden, across all of these entities, of 30,400 annual labor hours, resulting, a total of $2.4 million in annual labor costs, and $27.3 million in annualized capital, start-up, total operating, and maintenance costs. Under the final regulations, visibility level-related reporting regulations will affect approximately seventy entities annually, resulting in a total burden, across all of these entities, of 8,160 annual labor hours, resulting in a total of $642,000 in annual labor costs and $7.4 million in annualized capital, start-up, total operating, and maintenance costs.

Section 151.7 concerns the aggregation of trader accounts. Proposed § 151.7(g) provided for a disaggregation exemption for certain limited partners in a pool, futures commission merchants that met certain independent trading requirements, and independently controlled and managed non-financial entities in which another entity had an ownership or equity interest of 10 percent or greater. In all three cases, the exemption would become effective upon the Commission's approval of an application described in proposed § 151.7(g), and renewal was required for each year following the initial application for exemption.

As discussed in greater detail above, in the final regulations the Commission has made several modifications to account aggregation rules and exemptions. The modifications include reinstatement of the IAC exemption and exemption for certain interests in commodity pools (both of which are part of current Commission account aggregation policy but were absent from the Proposed Rules), an exemption from aggregation related to the underwriting of securities, and an exemption for situations in which aggregation across commonly owned affiliates would

require the sharing of position information that would result in the violation of federal law. In addition, the final regulations contain a modified procedure for exemptive relief under § 151.7. The Commission has eliminated the provision in the Proposed Rules requiring a trader seeking a disaggregation exemption to file an application for exemptive relief as well as annual renewals. Instead, under the final regulations the trader must file a notice, effective upon filing, setting forth the circumstances that warrant disaggregation and a certification that they meet the relevant conditions.

As a result of these modifications, estimates for the burden of reporting regulations related to account aggregation have been modified. Under the Proposed Rules, the Commission estimated that these reporting regulations would affect approximately sixty entities, resulting in a total burden, across all of these entities, of 300,000 annual labor hours and $9.9 million in annualized capital, start-up, total operating, and maintenance costs. Under the final regulations, these reporting regulations will affect approximately ninety entities, resulting in a total burden, across all of these entities, of 225,000 annual labor hours and $5.9 million in annualized capital, start-up, total operating, and maintenance costs.

List of Subjects

17 CFR Part 1

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

17 CFR Part 150

Commodity futures, Cotton, Grains

17 CFR Part 151

Position limits, Bona fide hedging, Referenced Contracts.

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

PART 1 – GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

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

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

2. Revise § 1.3(z) to read as follows:

a. Revise the heading in paragraph (z) by adding "for excluded commodities" after the phrase "positions."

b. Revise paragraph (z)(1) by removing the phrase "transactions or positions in a contract for future delivery on any contract market, or in a commodity option" after the phrase "Bona fide hedging transactions or positions shall mean," and replace the removed text with "any agreement, contract or transaction in an excluded commodity on a designated contract market or swap execution facility that is a trading facility."

c. Revise the last paragraph immediately following 1.3(z)(1)(iii) by removing "and sections 1.47 and 1.48 of the regulations."

d. Revise paragraph (z)(2)(i) by removing the phrase "commodity for future delivery on a contract market " after "Sales of any" and replace the removed text with "agreement, contract or transaction in a excluded commodity on a designated contract market or swap execution facility that is a trading facility."

e. Revise paragraph (z)(2)(i)(B) by removing the phrase "future during the five last trading days of that future" and replace the removed text with "agreement, contract or transaction during the five last trading days."

f. Revise paragraph (z)(2)(ii) by removing the phrase "commodity for future delivery on a contract market" after "Purchases of any" and replace the removed text with "agreement, contract or transaction in a excluded commodity on a designated contract market or swap execution facility that is a trading facility."

g. Revise paragraph (z)(2)(ii)(C) by removing the phrase "one future" and replace the removed text with "agreement, contract or transaction."

h. Revise paragraph (z)(2)(iii) by removing the phrase "for future delivery on a contract market" after "Offsetting sales and purchases" and replace the removed text with "in any agreement, contract or transaction in a excluded commodity on a designated contract market or swap execution facility that is a trading facility." Also revise paragraph (z)(2)(iii) by removing the phrase "future during the five last trading days of that future" and replace the deleted text with "agreement, contract or transaction during the five last trading days."

i. Redesignate paragraph (z)(2)(iv) as paragraph (z)(2)(v).

j. Revise newly redesignated paragraph (z)(2)(v) by removing the phrase "for future delivery described in paragraphs (z)(2)(i), (z)(2)(ii) and (z)(2)(iii)" and replacing the removed text with "described in paragraphs (z)(2)(i), (z)(2)(ii), (z)(2)(iii) and (z)(2)(iv)." Also revise newly redesignated paragraph (z)(2)(v) by removing the phrase "for future delivery" after the phrase "fluctuations in value of the position" and replace the deleted text with "in any agreement, contract or transaction." Also revise newly redesignated paragraph (z)(2)(v) by removing the phrase "positions in any one future shall not be maintained during the five last trading days of

that future" and replace the deleted text with "positions in any agreement, contract or transaction shall not be maintained during the five last trading days."

k. Add new paragraph (z)(2)(iv) to read as follows:

(iv) Purchases or sales by an agent who does not own or has not contracted to sell or purchase the offsetting cash commodity at a fixed price, provided that the agent is responsible for the merchandising of the cash position that is being offset, and the agent has a contractual arrangement with the person who owns the commodity or has the cash market commitment being offset.

l. Revise paragraph (z)(3) to read as follows:

(z)(3) Non-Enumerated cases. A designated contract market or swap execution facility that is a trading facility may recognize, consistent with the purposes of this section, transactions and positions other than those enumerated in paragraph (2) of this section as bona fide hedging. Prior to recognizing such non-enumerated transactions and positions, the designated contract market or swap execution facility that is a trading facility shall submit such rules for Commission review under section 5c of the Act and part 40 of this chapter.

PART 1.47 – [Removed and Reserved]

PART 1.48 – [Removed and Reserved]

Add part 151 to read as follows:

PART 151 – POSITION LIMITS FOR FUTURES AND SWAPS

Sec.

151.1 Definitions.

151.2 Core Referenced Futures Contracts.

151.3 Referenced Contract Spot Months.

151.4 Position Limits for Referenced Contracts.

151.5 Bona Fide Hedging and Other Exemptions for Referenced Contracts.

151.6 Position Visibility.

151.7 Aggregation of Positions.

151.8 Foreign Boards of Trade.

151.9 Pre-existing Positions.

151.10 Form and Manner of Reporting and Submitting Information or Filings.

151.11 Designated Contract Market and Swap Execution Facility Position Limits.

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

151.13 Severability.

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6c, 6f, 6g, 6t, 12a, 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).

§ 151.1 Definitions.

As used in this part –

Basis contract means an agreement, contract or transaction that is cash-settled based on the difference in price of the same commodity (or substantially the same commodity) at different delivery locations;

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.

Commodity index contract means an agreement, contract, or transaction that is not a basis or any type of spread contract, based on an index comprised of prices of commodities that are not the same or substantially the same; provided that, a commodity index contract used to circumvent speculative position limits shall be considered to be a Referenced Contract for the purpose of applying the position limits of § 151.4.

Core Referenced Futures Contract means a futures contract that is listed in § 151.2.

Eligible Entity means a commodity pool operator; the operator of a trading vehicle which is excluded, or which itself has qualified for exclusion from the definition of the term "pool" or "commodity pool operator," respectively, under § 4.5 of this chapter the limited partner 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; 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 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.

Independent Account Controller means a person:

(1) Who specifically is authorized by an eligible entity 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 registered as a futures commission merchant, an introducing broker, a commodity trading advisor, or an associated person of any such registrant , or is a general partner of a commodity pool the operator of which is exempt from registration under § 4.13 of this chapter.

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.

Referenced Contract means, on a futures equivalent basis with respect to a particular Core Referenced Futures Contract, a Core Referenced Futures Contract listed in § 151.2, or a futures contract, options contract, swap or swaption, other than a basis contract or contract on a commodity index that is:

(1) 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

(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 that particular Core Referenced Futures Contract for delivery at the same location or locations as specified in that particular Core Referenced Futures Contract.

Spot month means, for Referenced Contracts, the spot month defined in § 151.3.

Spot-month, single-month, and all-months-combined position limits mean, for Referenced Contracts based on a commodity identified in § 151.2, the maximum number of contracts a trader may hold as set forth in § 151.4.

Spread contract means either a calendar spread contract or an intercommodity spread contract.

Swap means "swap" as defined in section 1a of the Act and as further defined by the Commission.

Swaption means an option to enter into a swap or a physical commodity option.

Swap dealer means "swap dealer" as that term is defined in section 1a of the Act and as further defined by the Commission.

Trader means a person that, for its own account or for an account that it controls, makes transactions in Referenced Contracts or has such transactions made.

§ 151.2 Core Referenced Futures Contracts.

(a) Agricultural commodities. Core Referenced Futures Contracts in agricultural commodities include the following futures contracts and options thereon:

(1) Core Referenced Futures Contracts in legacy agricultural commodities:

(i) Chicago Board of Trade Corn (C);

(ii) Chicago Board of Trade Oats (O);

(iii) Chicago Board of Trade Soybeans (S);

(iv) Chicago Board of Trade Soybean Meal (SM);

(v) Chicago Board of Trade Soybean Oil (BO);

(vi) Chicago Board of Trade Wheat (W);

(vii) ICE Futures U.S. Cotton No.2 (CT);

(viii) Kansas City Board of Trade Hard Winter Wheat (KW); and

(ix) Minneapolis Grain Exchange Hard Red Spring Wheat (MWE).

(2) Core Referenced Futures Contracts in non-legacy agricultural commodities:

(i) Chicago Mercantile Exchange Class III Milk (DA);

(ii) Chicago Mercantile Exchange Feeder Cattle (FC);

(iii) Chicago Mercantile Exchange Lean Hog (LH);

(iv) Chicago Mercantile Exchange Live Cattle (LC);

(v) Chicago Board of Trade Rough Rice (RR);

(vi) ICE Futures U.S. Cocoa (CC);

(vii) ICE Futures U.S. Coffee C (KC);

(viii) ICE Futures U.S. FCOJ-A(OJ);

(ix) ICE Futures U.S. Sugar No. 11 (SB); and

(x) ICE Futures U.S. Sugar No. 16 (SF).

(b) Metal commodities. Core Referenced Futures Contracts in metal commodities include the following futures contracts and options thereon:

(1) Commodity Exchange, Inc. Copper (HG);

(2) Commodity Exchange, Inc. Gold (GC);

(3) Commodity Exchange, Inc. Silver (SI);

(4) New York Mercantile Exchange Palladium (PA); and

(5) New York Mercantile Exchange Platinum (PL).

(c) Energy commodities The Core Referenced Futures Contracts in energy commodities include the following futures contracts and options thereon:

(1) New York Mercantile Exchange Henry Hub Natural Gas (NG);

(2) New York Mercantile Exchange Light Sweet Crude Oil (CL);

(3) New York Mercantile Exchange New York Harbor Gasoline Blendstock (RB); and

(4) New York Mercantile Exchange New York Harbor Heating Oil (HO)

§ 151.3 Spot Months for Referenced Contracts.

(a) Agricultural commodities. For Referenced Contracts based on agricultural commodities, the spot month shall be the period of time commencing:

(1) At the close of business on the business day prior to the first notice day for any delivery month and terminating at the end of the delivery period in the underlying Core Referenced Futures Contract for the following Referenced Contracts:

(i) ICE Futures U.S. Cocoa (CC) contract;

(ii) ICE Futures U.S. Coffee C (KC) contract;

(iii) ICE Futures U.S. Cotton No. 2 (CT) contract;

(iv) ICE Futures U.S. FCOJ-A (OJ) contract;

(v) Chicago Board of Trade Corn (C) contract;

(vi) Chicago Board of Trade Oats (O) contract;

(vii) Chicago Board of Trade Rough Rice (RR) contract;

(viii) Chicago Board of Trade Soybeans (S) contract;

(ix) Chicago Board of Trade Soybean Meal (SM) contract;

(x) Chicago Board of Trade Soybean Oil (BO) contract;

(xi) Chicago Board of Trade Wheat (W) contract;

(xii) Minneapolis Grain Exchange Hard Red Spring Wheat (MW) contract; and

(xiii) Kansas City Board of Trade Hard Winter Wheat (KW) contract;

(2) At the close of business of the first business day after the fifteenth calendar day of the calendar month preceding the delivery month if the fifteenth calendar day is a business day, or at the close of business of the second business day after the fifteenth day if the fifteenth day is a non-business day and terminating at the end of the delivery period in the underlying Core Referenced Futures Contract for the ICE Futures U.S. Sugar No. 11 (SB) Referenced Contract;

(3) At the close of business on the sixth business day prior to the last trading day and terminating at the end of the delivery period in the underlying Core Referenced Futures Contract for the ICE Futures U.S. Sugar No. 16 (SF) Referenced Contract;

(4) At the close of business on the business day immediately preceding the last five business days of the contract month and terminating at the end of the delivery period in the underlying Core Referenced Futures Contract for the Chicago Mercantile Exchange Live Cattle (LC) Referenced Contract;

(5) On the ninth trading day prior to the last trading day and terminating on the last trading day for Chicago Mercantile Exchange Feeder Cattle (FC) contract;

(6) On the first trading day of the contract month and terminating on the last trading day for the Chicago Mercantile Exchange Class III Milk (DA) contract; and

(7) At the close of business on the fifth business day prior to the last trading day and terminating on the last trading day for the Chicago Mercantile Exchange Lean Hog (LH) contract.

(b) Metal commodities. The spot month shall be the period of time commencing at the close of business on the business day prior to the first notice day for any delivery month and terminating at the end of the delivery period in the underlying Core Referenced Futures Contract for the following Referenced Contracts:

(i) Commodity Exchange, Inc. Gold (GC) contract;

(ii) Commodity Exchange, Inc. Silver (SI) contract;

(iii) Commodity Exchange, Inc. Copper (HG) contract;

(iv) New York Mercantile Exchange Palladium (PA) contract; and

(v) New York Mercantile Exchange Platinum (PL) contract.

(c) Energy commodities. The spot month shall be the period of time commencing at the close of business of the third business day prior to the last day of trading in the underlying Core Referenced Futures Contract and terminating at the end of the delivery period for the following Referenced Contracts:

(i) New York Mercantile Exchange Light Sweet Crude Oil (CL) contract;

(ii) New York Mercantile Exchange New York Harbor No. 2 Heating Oil (HO) contract;

(iii) New York Mercantile Exchange New York Harbor Gasoline Blendstock (RB) contract; and

(iv) New York Mercantile Exchange Henry Hub Natural Gas (NG) contract.

§ 151.4 Position Limits for Referenced Contracts.

(a) Spot-month position limits. In accordance with the procedure in paragraph (d) of this section, and except as provided or as otherwise authorized by § 151.5, no trader may hold or control a position, separately or in combination, net long or net short, in Referenced Contracts in the same commodity when such position is in excess of:

(1) For physical-delivery Referenced Contracts, a spot-month position limit that shall be based on one-quarter of the estimated spot-month deliverable supply as established by the Commission pursuant to paragraphs (d)(1) and (d)(2) of this section; and

(2) For cash-settled Referenced Contracts:

(i) A spot-month position limit that shall be based on one-quarter of the estimated spot-month deliverable supply as established by the Commission pursuant to paragraphs (d)(1) and (d)(2) of this section. Provided, however,

(ii) For New York Mercantile Exchange Henry Hub Natural Gas Referenced Contracts:

(A) A spot-month position limit equal to five times the spot-month position limit established by the Commission for the physical-delivery New York Mercantile Exchange Henry Hub Natural Gas Referenced Contract pursuant to paragraph (a)(1); and

(B) An aggregate spot-month position limit for physical-delivery and cash-settled New York Mercantile Exchange Henry Hub Natural Gas Referenced Contracts equal to five times the spot-month position limit established by the Commission for the physical-delivery New York Mercantile Exchange Henry Hub Natural Gas Referenced Contract pursuant to paragraph (a)(1).

(b) Non-spot-month position limits. In accordance with the procedure in paragraph (d) of this section, and except as otherwise authorized in § 151.5, no person may hold or control positions, separately or in combination, net long or net short, in the same commodity when such positions, in all months combined (including the spot month) or in a single month, are in excess of:

(1) Non-legacy Referenced Contract position limits:

All-months-combined aggregate and single-month position limits, fixed by the Commission based on 10 percent of the first 25,000 contracts of average all-months-combined aggregated open interest with a marginal increase of 2.5 percent thereafter as established by the Commission pursuant to paragraph (d)(3) of this section;

(2) Aggregate open interest calculations for non-spot-month position limits for non-legacy Referenced Contracts:

(i) For the purpose of fixing the speculative position limits for non-legacy Referenced Contracts in paragraph (b)(1) of this section, the Commission shall determine:

(A) The average all-months-combined aggregate open interest, which shall be equal to the sum, for 12 or 24 months of values obtained under paragraph (B) and (C) of this section for a period of 12 or 24 months prior to the fixing date divided by 12 or 24 respectively as of the last day of each calendar month;

(B) The all-months-combined futures open interest of a Referenced Contract is equal to the sum of the month-end open interest for all of the Referenced Contract's open contract months in futures and option contracts (on a delta adjusted basis) across all designated contract markets; and

(C) The all-months-combined swaps open interest is equal to the sum of all of a Referenced Contract's month-end open swaps positions, considering open positions attributed to both cleared and uncleared swaps, where the uncleared all-months-combined swaps open positions shall be the absolute sum of swap dealers' net uncleared open swaps positions by counterparty and by single Referenced Contract month as reported to the Commission pursuant to part 20 of this chapter, provided that, other than for the purpose of determining initial non-spot-month position limits, open swaps positions attributed to swaps with two swap dealer counterparties shall be counted once for the purpose of determining uncleared all-months-combined swaps open positions, provided further that, upon entry of an order under § 20.9 of this chapter determining that operating swap data repositories are processing positional data that will enable the Commission effectively to conduct surveillance in swaps, the Commission shall rely on data from such swap data repositories to compute the all-months-combined swaps open interest;

(ii) Notwithstanding the provisions of this section, for the purpose of determining initial non-spot-month position limits for non-legacy Referenced Contracts, the Commission may estimate uncleared all-months-combined swaps open positions based on uncleared open swaps positions reported to the Commission pursuant to part 20 of this chapter by clearing organizations or clearing members that are swap dealers; and

(3) Legacy agricultural Referenced Contract position limits:

All-months-combined aggregate and single-month position limits, fixed by the Commission at the levels provided below as established by the Commission pursuant to paragraph (d)(4) of this section:

Referenced Contract	**Position Limits**
Chicago Board of Trade Corn (C) contract	33,000

Chicago Board of Trade Oats (O) contract	2,000
Chicago Board of Trade Soybeans (S) contract	15,000
Chicago Board of Trade Wheat (W) contract	12,000
Chicago Board of Trade Soybean Oil (BO) contract	8,000
Chicago Board of Trade Soybean Meal (SM) contract	6,500
Minneapolis Grain Exchange Hard Red Spring Wheat (MW) contract	12,000
ICE Futures U.S. Cotton No. 2 (CT) contract	5,000
Kansas City Board of Trade Hard Winter Wheat (KW) contract	12,000

(c) Netting of positions.

(1) For Referenced Contracts in the spot month:

(i) For the spot-month position limit in paragraph (a) of this section, a trader's positions in the physical-delivery Referenced Contract and cash-settled Referenced Contract are calculated separately. A trader cannot net any physical-delivery Referenced Contract with cash-settled Referenced Contracts towards determining the trader's positions in each of the physical-delivery Referenced Contract and cash-settled Referenced Contracts in paragraph (a) of this section. However, a trader can net positions in cash-settled Referenced Contracts in the same commodity.

(ii) Notwithstanding the netting provision in paragraph (c)(1)(i) of this section, for the aggregate spot-month position limit in New York Mercantile Exchange Henry Hub Natural Gas Referenced Contracts in paragraph (a)(2)(ii) of this section, a trader's positions shall be combined and the net resulting position in the physical-delivery Referenced Contract and cash-settled Referenced Contracts shall be applied towards determining the trader's aggregate position.

(2) For the purpose of applying non-spot-month position limits, a trader's position in a Referenced Contract shall be combined and the net resulting position shall be applied towards determining the trader's aggregate single-month and all-months-combined position.

(d) Establishing and effective dates of position limits.

(1) Initial spot-month position limits for Referenced Contracts:

(i) Sixty days after the term "swap" is further defined under the Wall Street Transparency and Accountability Act of 2010, the spot-month position limits for Referenced Contracts referred to in Appendix A shall apply to all the provisions of this part.

(2) Subsequent spot-month position limits for Referenced Contracts:

(i) Commencing January 1st of the second calendar year after the term "swap" is further defined under the Wall Street Transparency and Accountability Act of 2010, the Commission shall fix position limits by Commission order that shall supersede the initial limits established under paragraph (d)(1) of this section.

(ii) In fixing spot-month position limits for Referenced Contracts, the Commission shall utilize the estimates of deliverable supply provided by a designated contract market under paragraph (d)(2)(iii) of this section unless the Commission determines to rely on its own estimate of deliverable supply.

(iii) Each designated contract market shall submit to the Commission an estimate of deliverable supply for each Core Referenced Futures Contract that is subject to a spot-month position limit and listed or executed pursuant to the rules of the designated contract market according to the following schedule commencing January 1st of the second calendar year after the term "swap" is further defined under the Wall Street Transparency and Accountability Act of 2010:

(A) For metal Core Referenced Futures Contracts listed in § 151.2(b), by the 31st of December and biennially thereafter;

(B) For energy Core Referenced Futures Contracts listed in § 151.2(c), by the 31st of March and biennially thereafter;

(C) For corn, wheat, oat, rough rice, soybean and soybean products, livestock, milk, cotton, and frozen concentrated orange juice Core Referenced Futures Contracts, by the 31st of July, and annually thereafter;

(D) For coffee, sugar, and cocoa Core Referenced Futures Contracts, by the 30th of September, and annually thereafter.

(iv) For purposes of estimating deliverable supply, a designated contract market may use any guidance adopted in the Acceptable Practices for Compliance with Core Principle 3 found in part 38 of the Commission's regulations.

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

(vi) The Commission shall fix and publish pursuant to paragraph (e) of this section, the spot-month limits by Commission order, no later than:

(A) For metal Referenced Contracts listed in § 151.2(b), by the 28th of February following the submission of estimates of deliverable supply provided to the Commission under paragraph (d)(2)(iii)(A) of this section and biennially thereafter;

(B) For energy Referenced Contracts listed in § 151.2(c), by the 31st of May following the submission of estimates of deliverable supply provided to the Commission under paragraph (d)(2)(iii)(B) of this section and biennially thereafter;

(C) For corn, wheat, oat, rough rice, soybean and soybean products, livestock, milk, cotton, and frozen concentrated orange juice Referenced Contracts, by the 30th of September following the submission of estimates of deliverable supply provided to the Commission under paragraph (d)(2)(iii)(C) of this section and annually thereafter;

(D) For coffee, sugar, and cocoa Referenced Contracts, by the 30th of November following the submission of estimates of deliverable supply provided to the Commission under paragraph (d)(2)(iii)(D) of this section and annually thereafter.

(3) Non-spot-month position limits for non-legacy Referenced Contracts:

(i) Initial non-spot-month limits for non-legacy Referenced Contracts shall be fixed and published within one month after the Commission has obtained or estimated 12 months of values pursuant to paragraphs (b)(2)(i)(B), (b)(2)(i)(C), and (b)(2)(ii) of this section, and shall be fixed and made effective as provided in paragraph (b)(2) and (e) of this section.

(ii) Subsequent non-spot-month limits for non-legacy Referenced Contracts shall be fixed and published within one month after two years following the fixing and publication of initial non-spot-month position limits and shall be based on the higher of 12 months average all-months-combined aggregate open interest, or 24 months average all-months-combined aggregate open interest, as provided for in paragraphs (b)(2) and (e) of this section.

(iii) Initial non-spot-month limits for non-legacy Referenced Contracts shall be made effective by Commission order.

(4) Non-spot-month legacy limits for legacy agricultural Referenced Contracts:

The non-spot-month position limits for legacy agricultural Referenced Contracts shall be effective sixty days after the term "swap" is further defined under the Wall Street Transparency and Accountability Act of 2010, and shall apply to all the provisions of this part.

(e) Publication. The Commission shall publish position limits on the Commission's website at http://www.cftc.gov prior to making such limits effective, other than those limits specified under paragraph 4(b)(3) of this section and Appendix A.

(1) Spot-month position limits shall be effective:

(A) For metal Referenced Contracts listed in § 151.2(b), on the 1st of May after the Commission has fixed and published such limits under paragraph (d)(2)(vi)(A) of this section;

(B) For energy Referenced Contracts listed in § 151.2(c), on the 1st of August after the Commission has fixed and published such limits under paragraph (d)(2)(vi)(B) of this section;

(C) For corn, wheat, oat, rough rice, soybean and soybean products, livestock, milk, cotton, and frozen concentrated orange juice Referenced Contracts, on the 1st of December after the Commission has fixed and published such limits under paragraph (d)(2)(vi)(C) of this section; and

(D) For coffee, sugar, and cocoa Referenced Contracts, on the 1st of February after the Commission has fixed and published such limits under paragraph (d)(2)(vi)(D) of this section.

(2) The Commission shall publish month-end all-months-combined futures open interest and all-months-combined swaps open interest figures within one month, as practicable, after such data is submitted to the Commission.

(3) Non-spot-month position limits established under paragraph (b)(2) of this section shall be effective on the 1st calendar day of the third calendar month immediately following publication on the Commission's website under paragraph (d)(3) of this section.

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

§ 151.5 Bona fide Hedging and Other Exemptions for Referenced Contracts.

(a) Bona fide hedging transactions or positions.

(1) Any person that complies with the requirements of this section may exceed the position limits set forth in § 151.4 to the extent that a transaction or position in a Referenced Contract:

(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 risks in the conduct and management of a commercial enterprise; and

(iii) Arises from the potential change in the value of one or several—

(A) Assets that a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;

(B) Liabilities that a person owns or anticipates incurring; or

(C) Services that a person provides, purchases, or anticipates providing or purchasing; or

(iv) Reduces risks attendant to a position resulting from a swap that—

(A) Was executed opposite a counterparty for which the transaction would qualify as a bona fide hedging transaction pursuant to paragraph (a)(1)(i) through (a)(1)(iii) of this section; or

(B) Meets the requirements of paragraphs (a)(1)(i) through (a)(1)(iii) of this section.

(v) Notwithstanding the foregoing, no transactions or positions shall be classified as bona fide hedging for purposes of § 151.4 unless such transactions or positions are established and liquidated in an orderly manner in accordance with sound commercial practices and the provisions of paragraph (a)(2) regarding enumerated hedging transactions and positions or paragraphs (3) or (4) regarding pass-through swaps of this section have been satisfied.

(2) Enumerated hedging transactions and positions. Bona fide hedging transactions and positions for the purposes of this paragraph mean any of the following specific transactions and positions:

(i) Sales of Referenced Contracts that do not exceed in quantity:

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

(B) Unsold anticipated production of the same commodity, which may not exceed one year of production for an agricultural commodity, by the same person provided that no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(ii) Purchases of Referenced Contracts that do not exceed in quantity:

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

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

(C) Unfilled anticipated requirements of the same cash commodity, which may not exceed one year for agricultural Referenced Contracts, for processing, manufacturing, or use by the same person, provided that no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(iii) Offsetting sales and purchases in Referenced Contracts that do not exceed in quantity that amount of the same cash commodity that has been bought and sold by the same person at unfixed prices basis different delivery months, provided that no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(iv) Purchases or sales by an agent who does not own or has not contracted to sell or purchase the offsetting cash commodity at a fixed price, provided that the agent is responsible for the merchandising of the cash positions that is being offset in Referenced Contracts and the agent has a contractual arrangement with the person who owns the commodity or holds the cash market commitment being offset.

(v) Anticipated merchandising hedges. Offsetting sales and purchases in Referenced Contracts that do not exceed in quantity the amount of the same cash commodity that is anticipated to be merchandised, provided that:

(A) the quantity of offsetting sales and purchases is not larger than the current or anticipated unfilled storage capacity owned or leased by the same person during the period of anticipated merchandising activity, which may not exceed one year;

(B) the offsetting sales and purchases in Referenced Contracts are in different contract months, which settle in not more than one year; and

(C) no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(vi) Anticipated royalty hedges. Sales or purchases in Referenced Contracts offset by the anticipated change in value of royalty rights that are owned by the same person provided that:

(A) the royalty rights arise out of the production, manufacturing, processing, use, or transportation of the commodity underlying the Referenced Contract, which may not exceed one year for agricultural Referenced Contracts; and

(B) no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(vii) Service hedges. Sales or purchases in Referenced Contracts offset by the anticipated change in value of receipts or payments due or expected to be due under an executed contract for services held by the same person provided that:

(A) the contract for services arises out of the production, manufacturing, processing, use, or transportation of the commodity underlying the Referenced Contract, which may not exceed one year for agricultural Referenced Contracts;

(B) the fluctuations in the value of the position in Referenced Contracts are substantially related to the fluctuations in value of receipts or payments due or expected to be due under a contract for services; and

(C) no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(viii) Cross-commodity hedges. Sales or purchases in Referenced Contracts described in paragraphs (a)(2)(i) through (vii), of this section may also be offset other than by the same quantity of the same cash commodity, provided that:

(A) the fluctuations in value of the position in Referenced Contracts are substantially related to the fluctuations in value of the actual or anticipated cash position; and

(B) no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(3) Pass-through swaps. Bona fide hedging transactions and positions for the purposes of this paragraph include the purchase or sales of Referenced Contracts that reduce the risks attendant to a position resulting from a swap that was executed opposite a counterparty for whom the swap transaction would qualify as a bona fide hedging transaction pursuant to paragraph (a)(2) of this section ("pass-through swaps"), provided that no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts unless such pass-through swap position continues to offset the cash market commodity price risk of the bona fide hedging counterparty.

(4) Pass-through swap offsets. For swaps executed opposite a counterparty for whom the swap transaction would qualify as a bona fide hedging transaction pursuant to paragraph (a)(2) of this section (pass-through swaps), such pass-through swaps shall also be classified as a bona fide hedging transaction for the counterparty for whom the swap would not otherwise qualify as a bona fide hedging transaction pursuant to paragraph (a)(2) of this section ("non-hedging counterparty"), provided that the non-hedging counterparty purchases or sells Referenced Contracts that reduce the risks attendant to such pass-through swaps. Provided further, that the pass-through swap shall constitute a bona fide hedging transaction only to the

extent the non-hedging counterparty purchases or sells Referenced Contracts that reduce the risks attendant to the pass-through swap.

(5) Any person engaging in other risk-reducing practices commonly used in the market which they believe may not be specifically enumerated in § 151.5(a)(2) may request relief from Commission staff under § 140.99 of this title or the Commission under section 4a(a)(7) of the Act concerning the applicability of the bona fide hedging transaction exemption.

(b) Aggregation of accounts. Entities required to aggregate accounts or positions under § 151.7 shall be considered the same person for the purpose of determining whether a person or persons are eligible for a bona fide hedge exemption under § 151.5(a).

(c) Information on cash market commodity activities. Any person with a position that exceeds the position limits set forth in § 151.4 pursuant to paragraphs (a)(2)(i)(A), (a)(2)(ii)(A), (a)(2)(ii)(B), (a)(2)(iii), or (a)(2)(iv) of this section shall submit to the Commission a 404 filing, in the form and manner provided for in § 151.10.

(1) The 404 filing shall contain the following information with respect to such position for each business day the same person exceeds the limits set forth in § 151.4, up to and through the day the person's position first falls below the position limits:

(A) The date of the bona fide hedging position, an indication of under which enumerated hedge exemption or exemptions the position qualifies for bona fide hedging, the corresponding Core Referenced Futures Contract, the cash market commodity hedged, and the units in which the cash market commodity is measured;

(B) The entire quantity of stocks owned of the cash market commodity that is being hedged;

(C) The entire quantity of fixed-price purchase commitments of the cash market commodity that is being hedged;

(D) The sum of the entire quantity of stocks owned of the cash market commodity and the entire quantity of fixed-price purchase commitments of the cash market commodity that is being hedged;

(E) The entire quantity of fixed-price sale commitments of the cash commodity that is being hedged;

(F) The quantity of long and short Referenced Contracts, measured on a futures-equivalent basis to the applicable Core Referenced Futures Contract, in the nearby contract month that are being used to hedge the long and short cash market positions;

(G) The total number of long and short Referenced Contracts, measured on a futures equivalent basis to the applicable Core Referenced Futures Contract, that are being used to hedge the long and short cash market positions; and

(H) Cross-commodity hedging information as required under paragraph (g) of this section.

(2) Notice filing. Persons seeking an exemption under this paragraph shall file a notice with the Commission, which shall be effective upon the date of the submission of the notice.

(d) Information on anticipated cash market commodity activities.

(1) Initial statement. Any person who intends to exceed the position limits set forth in § 151.4 pursuant to paragraph (a)(2)(i)(B), (a)(2)(ii)(C), (a)(2)(v), (a)(2)(vi), or (a)(2)(vii) of this section in order to hedge anticipated production, requirements, merchandising, royalties, or services connected to a commodity underlying a Referenced Contract, shall submit to the

Commission a 404A filing in the form and manner provided in § 151.10. The 404A filing shall contain the following information with respect to such activities, by Referenced Contract:

(i) A description of the type of anticipated cash market activity to be hedged; how the purchases or sales of Referenced Contracts are consistent with the provisions of (a)(1) of this section; and the units in which the cash commodity is measured;

(ii) The time period for which the person claims the anticipatory hedge exemption is required, which may not exceed one year for agricultural commodities or one year for anticipated merchandising activity;

(iii) The actual use, production, processing, merchandising (bought and sold), royalties and service payments and receipts of that cash market commodity during each of the three complete fiscal years preceding the current fiscal year;

(iv) The anticipated use production, or commercial or merchandising requirements (purchases and sales), anticipated royalties, or service contract receipts or payments of that cash market commodity which are applicable to the anticipated activity to be hedged for the period specified in (d)(1)(ii) of this section;

(v) The unsold anticipated production or unfilled anticipated commercial or merchandising requirements of that cash market commodity which are applicable to the anticipated activity to be hedged for the period specified in (d)(1)(ii) of this section;

(vi) The maximum number of Referenced Contracts long and short (on an all-months-combined basis) that are expected to be used for each anticipatory hedging activity for the period specified in (d)(1)(ii) of this section on a futures equivalent basis;

(vii) If the hedge exemption sought is for anticipated merchandising pursuant to (a)(2)(v) of this section, a description of the storage capacity related to the anticipated merchandising

transactions, including (1) the anticipated total storage capacity, the anticipated merchandising quantity, and purchase and sales commitments for the period specified in (d)(1)(ii) of this section, (2) current inventory, and (3) the total storage capacity and quantity of commodity moved through the storage capacity for each of the three complete fiscal years preceding the current fiscal year; and

(viii) Cross-commodity hedging information as required under paragraph (g) of this section.

(2) Notice filing. Persons seeking an exemption under this paragraph shall file a notice with the Commission. Such a notice shall be filed at least ten days in advance of a date the person expects to exceed the position limits established under this part, and shall be effective after that ten day period unless otherwise notified by the Commission.

(3) Supplemental reports for 404A filings. Whenever a person intends to exceed the amounts determined by the Commission to constitute a bona fide hedge for anticipated activity in the most recent statement or filing, such person shall file with the Commission a statement that updates the information provided in the person's most recent filing at least ten days in advance of the date that person wishes to exceed those amounts.

(e) Review of notice filings. The Commission may require persons submitting notice filings provided for under paragraphs (c)(2) and (d)(2) of this section to submit such other information, before or after the effective date of a notice, which is necessary to enable the Commission to make a determination whether the transactions or positions under the notice filing fall within the scope of bona fide hedging transactions or positions described under paragraph (a).

(1) The transactions and positions described in the notice filing shall not be considered, in part or in whole, as bona fide hedging transactions or positions if such person is so notified by the Commission.

(f) Additional information from swap counterparties to bona fide hedging transactions. All persons that maintain positions in excess of the limits set forth in § 151.4 in reliance upon the exemptions set forth in paragraphs (a)(3) and (4) of this section shall submit to the Commission a 404S filing, in the form and manner provided for in § 151.10. Such 404S filing shall contain the following information with respect to such position for each business day that the same person exceeds the limits set forth in § 151.4, up to and through the day the person's position first falls below the position limit that was exceeded:

(i) By Referenced Contract;

(ii) By commodity reference price and units of measurement used for the swaps that would qualify as a bona fide hedging transaction or position gross long and gross short positions; and

(iii) Cross-commodity hedging information as required under paragraph (g) of this section.

(g) Conversion methodology for cross-commodity hedges. In addition to the information required under this section, persons who avail themselves of cross-commodity hedges pursuant to (a)(2)(viii) of this section shall submit to the Commission a form 404, 404A, or 404S filing, as appropriate. The first time such a form is filed where a cross-commodity hedge is claimed, it should contain a description of the conversion methodology. That description should explain the conversion from the actual commodity used in the person's normal course of business to the Referenced Contract that is being used for hedging, including an explanation of the methodology

used for determining the ratio of conversion between the actual or anticipated cash positions and the person's positions in the Referenced Contract.

(h) Recordkeeping. Persons who avail themselves of bona fide hedge exemptions shall keep and maintain complete books and records concerning all of their related cash, futures, and swap positions and transactions and make such books and records, along with a list of pass-through swap counterparties for pass-through swap exemptions under (a)(3) of this section, available to the Commission upon request.

(i) Additional requirements for pass-through swap counterparties. A party seeking to rely upon § 151.5(a)(3) to exceed the position limits of § 151.4 with respect to such a swap may only do so if its counterparty provides a written representation (e.g., in the form of a field or other representation contained in a mutually executed trade confirmation) that, as to such counterparty, the swap qualifies in good faith as a bona fide hedging transaction under paragraph (a)(3) of this section at the time the swap was executed. That written representation shall be retained by the parties to the swap for a period of at least two years following the expiration of the swap and furnished to the Commission upon request. Any person that represents to another person that the swap qualifies as a pass-through swap under paragraph (a)(3) shall keep and make available to the Commission upon request all relevant books and records supporting such a representation for a period of at least two years following the expiration of the swap.

(j) Financial distress exemption. Upon specific request made to the Commission, the Commission may exempt a person or related persons under financial distress circumstances for a time certain from any of the requirements of this part. Financial distress circumstances are situations involving the potential default or bankruptcy of a customer of the requesting person or

persons, affiliate of the requesting person or persons, or potential acquisition target of the requesting person or persons. Such exemptions shall be granted by Commission order.

§ 151.6 Position Visibility.

(a) Visibility levels. A person holding or controlling positions, separately or in combination, net long or net short, in Referenced Contracts that equal or exceed the following levels in all months or in any single month (including the spot month), shall comply with the reporting requirements of paragraphs (b) and (c) of this section:

Visibility Levels for Metal Referenced Contracts

Commodity Exchange, Inc. Copper (HG)	8,500
Commodity Exchange, Inc. Gold (GC)	30,000
Commodity Exchange, Inc. Silver (SI)	8,500
New York Mercantile Exchange Palladium (PA)	1,500
New York Mercantile Exchange Platinum (PL)	2,000

Visibility Levels for Energy Referenced Contracts

New York Mercantile Exchange Light Sweet Crude Oil (CL)	50,000
New York Mercantile Exchange Henry Hub Natural Gas (NG)	50,000
New York Mercantile Exchange New York Harbor Gasoline Blendstock (RB)	10,000
New York Mercantile Exchange New York Harbor No. 2 Heating Oil (HO)	16,000

(b) Statement of person exceeding visibility level. Persons meeting the provisions of paragraph (a) of this section, shall submit to the Commission a 401 filing in the form and manner provided for in § 151.10. The 401 filing shall contain the following information, by Referenced Contract:

(1) A list of dates, within the applicable calendar quarter, on which the person held or controlled a position that equaled or exceeded such visibility levels; and

(2) As of the first business Tuesday following the applicable calendar quarter and as of the day, within the applicable calendar quarter, in which the person held the largest net position (on an all months combined basis) in excess of the level in paragraph (a) of this section:

(i) Separately by futures, options and swaps, gross long and gross short futures equivalent positions in all months in the applicable Referenced Contract(s) (using economically reasonable and analytically supported deltas) on a futures-equivalent basis; and

(ii) If applicable, by commodity referenced price, gross long and gross short uncleared swap positions in all months basis in the applicable Referenced Contract(s) futures-equivalent basis (using economically reasonable and analytically supported deltas).

(c) 404 filing. A person that holds a position in a Referenced Contract that equals or exceeds a visibility level in a calendar quarter shall submit to the Commission a 404 filing in the form and manner provided for in § 151.10, and it shall contain the information regarding such positions as described in § 151.5(c) as of the first business Tuesday following the applicable calendar quarter and as of the day, within the applicable calendar quarter, in which the person held the largest net position in excess of the level in all months.

(d) Alternative filing. With the express written permission of the Commission or its designees, the submission of a swaps or physical commodity portfolio summary statement spreadsheet in digital format, only insofar as the spreadsheet provides at least the same data as that required by paragraphs (b) or (c) respectively may be substituted for the 401 or 404 filing respectively.

(e) Precedence of other reporting obligations. Reporting obligations imposed by regulations other than those contained in this section shall supersede the reporting requirements of paragraphs (b) and (c) of this section but only insofar as other reporting obligations provide at least the same data and are submitted to the Commission or its designees at least as often as the reporting requirements of paragraphs (b) and (c) of this section.

(f) Effective date. The effective date of this section shall be sixty days after the term "swap" is further defined under the Wall Street Transparency and Accountability Act of 2010.

§ 151.7 Aggregation of Positions.

(a) Positions to be aggregated. The position limits set forth in § 151.4 shall apply to all positions in accounts for which any person by power of attorney or otherwise directly or indirectly holds positions or controls trading and to positions held by two or more persons acting pursuant to an expressed or implied agreement or understanding the same as if the positions were held by, or the trading of the position were done by, a single individual.

(b) Ownership of accounts generally. For the purpose of applying the position limits set forth in § 151.4, except for the ownership interest of limited partners, shareholders, members of a limited liability company, beneficiaries of a trust or similar type of pool participant in a commodity pool subject to the provisos set forth in paragraph (c) of this section or in accounts or positions in multiple pools as set forth in paragraph (d) of this section, any person holding positions in more than one account, or holding accounts or positions in which the person by power of attorney or otherwise directly or indirectly has a 10 percent or greater ownership or equity interest, must aggregate all such accounts or positions.

(c) Ownership by limited partners, shareholders or other pool participants.

(1) Except as provided in paragraphs (c)(2) and (c)(3) of this section, a person that is a limited partner, shareholder or other similar type of pool participant with an ownership or equity interest of 10 percent or greater in a pooled account or positions who is also a principal or affiliate of the operator of the pooled account must aggregate the pooled account or positions with all other accounts or positions owned or controlled by that person, unless:

(i) The pool operator has, and enforces, written procedures to preclude the person from having knowledge of, gaining access to, or receiving data about the trading or positions of the pool;

(ii) The person does not have direct, day-to-day supervisory authority or control over the pool's trading decisions; and

(iii) The pool operator has complied with the requirements of paragraph (h) of this section on behalf of the person or class of persons.

(2) A commodity pool operator having ownership or equity interest of 10 percent or greater in an account or positions as a limited partner, shareholder or other similar type of pool participant must aggregate those accounts or positions with all other accounts or positions owned or controlled by the commodity pool operator.

(3) Each limited partner, shareholder, or other similar type of pool participant having an ownership or equity interest of 25 percent or greater in a commodity pool the operator of which is exempt from registration under § 4.13 of this chapter must aggregate the pooled account or positions with all other accounts or positions owned or controlled by that person.

(d) Identical trading. Notwithstanding any other provision of this section, for the purpose of applying the position limits set forth in § 151.4, any person that holds or controls the trading of positions, by power of attorney or otherwise, in more than one account, or that holds or

controls trading of accounts or positions in multiple pools with identical trading strategies must aggregate all such accounts or positions that a person holds or controls.

(e) Trading control by futures commission merchants. The position limits set forth in § 151.4 shall be construed to apply to all positions held by a futures commission merchant or its separately organized affiliates in a discretionary account, or in an account which is part of, or participates in, or receives trading advice from a customer trading program of a futures commission merchant or any of the officers, partners, or employees of such futures commission merchant or its separately organized affiliates, unless:

(1) A trader other than the futures commission merchant or the affiliate directs trading in such an account;

(2) The futures commission merchant or the affiliate maintains only such minimum control over the trading in such an account as is necessary to fulfill its duty to supervise diligently trading in the account; and

(3) Each trading decision of the discretionary account or the customer trading program is determined independently of all trading decisions in other accounts which the futures commission merchant or the affiliate holds, has a financial interest of 10 percent or more in, or controls.

(f) Independent Account Controller. An eligible entity need not aggregate its positions with the eligible entity's client positions or accounts carried by an authorized independent account controller, as defined in § 151.1, except for the spot month provided in physical-delivery Referenced Contracts, provided, however, that the eligible entity has complied with the requirements of paragraph (h) of this section, and that the overall positions held or controlled by such independent account controller may not exceed the limits specified in § 151.4.

(1) Additional requirements for exemption of Affiliated Entities. If the independent account controller is affiliated with the eligible entity or another independent account controller, each of the affiliated entities must:

(i) Have, and enforce, written procedures to preclude the affiliated entities from having knowledge of, gaining access to, or receiving data about, trades of the other. Such procedures must include document routing and other procedures or security arrangements, including separate physical locations, which would maintain the independence of their activities; provided, however, that such procedures may provide for the disclosure of information which is reasonably necessary for an eligible entity to maintain the level of control consistent with its fiduciary responsibilities and necessary to fulfill its duty to supervise diligently the trading done on its behalf;

(ii) Trade such accounts pursuant to separately developed and independent trading systems;

(iii) Market such trading systems separately; and

(iv) Solicit funds for such trading by separate disclosure documents that meet the standards of § 4.24 or § 4.34 of this chapter, as applicable where such disclosure documents are required under part 4 of this chapter.

(g) Exemption for underwriting. Notwithstanding any of the provisions of this section, a person need not aggregate the positions or accounts of an owned entity if the ownership interest is based on the ownership of securities constituting the whole or a part of an unsold allotment to or subscription by such person as a participant in the distribution of such securities by the issuer or by or through an underwriter.

(h) Notice filing for exemption.

(1) Persons seeking an aggregation exemption under paragraph (c), (f), or (i) of this section shall file a notice with the Commission, which shall be effective upon submission of the notice, and shall include:

(i) a description of the relevant circumstances that warrant disaggregation; and

(ii) a statement certifying that the conditions set forth in the applicable aggregation exemption provision has been met.

(2) Upon call by the Commission, any person claiming an aggregation exemption under this section shall provide to the Commission such information concerning the person's claim for exemption. Upon notice and opportunity for the affected person to respond, the Commission may amend, suspend, terminate, or otherwise modify a person's aggregation exemption for failure to comply with the provisions of this section.

(3) In the event of a material change to the information provided in the notice filed under this paragraph, an updated or amended notice shall promptly be filed detailing the material change.

(4) A notice shall be submitted in the form and manner provided for in § 151.10.

(i) Exemption for federal law information sharing restriction. Notwithstanding any provision of this section, a person is not subject to the aggregation requirements of this section if the sharing of information associated with such aggregation would cause either person to violate federal law or regulations adopted thereunder and provided that such a person does not have actual knowledge of information associated with such aggregation. Provided, however, that such person file a prior notice with the Commission detailing the circumstances of the exemption and an opinion of counsel that the sharing of information would cause a violation of federal law or regulations adopted thereunder.

§ 151.8 Foreign Boards of Trade.

The aggregate position limits in § 151.4 shall apply to a trader with positions in Referenced Contracts executed on, or pursuant to the rules of a foreign board of trade, provided that:

(a) 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

(b) 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.

§ 151.9 Pre-existing Positions.

(a) Non-spot-month position limits. The position limits set forth in § 151.4(b) of this chapter may be exceeded to the extent that positions in Referenced Contracts remain open and were entered into in good faith prior to the effective date of any rule, regulation, or order that specifies a position limit under this part.

(b) Spot-month position limits. Notwithstanding the pre-existing exemption in non-spot months, a person must comply with spot month limits.

(c) Pre-Dodd-Frank and transition period swaps. The initial position limits established under § 151.4 shall not apply to any swap positions entered into in good faith prior to the effective date of such initial limits. Swap positions in Referenced Contracts entered into in good faith prior to the effective date of such initial limits may be netted with post-effective date swap and swaptions for the purpose of applying any position limit.

(d) Exemptions granted by the Commission under § 1.47 for swap risk management shall not apply to swap positions entered into after the effective date of initial position limits established under § 151.4.

§ 151.10 Form and Manner of Reporting and Submitting Information or Filings.

Unless otherwise instructed by the Commission or its designees, any person submitting reports under this section shall submit the corresponding required filings and any other information required under this part to the Commission as follows:

(a) Using the format, coding structure, and electronic data transmission procedures approved in writing by the Commission; and

(b) Not later than 9:00 a.m. Eastern Time on the next business day following the reporting or filing obligation is incurred unless:

(1) A 404A filing is submitted pursuant § 151.5(d), in which case the filing must be submitted at least ten business days in advance of the date that transactions and positions would be established that would exceed a position limit set forth in § 151.4;

(2 A 404 filing is submitted pursuant to §151.5(c) or a 404S is submitted pursuant to §151.5 (f), the filing must be submitted not later than 9:00 a.m. on the third business day after a position has exceeded the level in a Referenced Contract for the first time and not later than the third business day following each calendar month in which the person exceeded such levels;

(3) The filing is submitted pursuant to § 151.6, then the 401 or 404, or their respective alternatives as provided for under § 151.6(d), shall be submitted within ten business days following the quarter in which the person holds a position in excess in the visibility levels provided in § 151.6(a); or

(4) A notice of disaggregation is filed pursuant to § 151.7(h), in which case the notice shall be submitted within five business days of when the person claims a disaggregation exemption.

(e) When the reporting entity discovers errors or omissions to past reports, the entity so notifies the Commission and files corrected information in a form and manner and at a time as may be instructed by the Commission or its designee.

§ 151.11 Designated Contract Market and Swap Execution Facility Position Limits and Accountability Rules.

(a) Spot-month limits.

(1) For all Referenced Contracts executed pursuant to their rules, swap execution facilities that are trading facilities and designated contract markets shall adopt, enforce, and, establish rules and procedures for monitoring and enforcing spot-month position limits set at levels no greater than those established by the Commission under § 151.4.

(2) For all agreements, contracts, or transactions executed pursuant to their rules that are not subject to the limits set forth in paragraph (a)(1) of this section, it shall be an acceptable practice for swap execution facilities that are trading facilities and designated contract markets to adopt, enforce, and establish rules and procedures for monitoring and enforcing spot-month position limits set at levels no greater than 25 percent of estimated deliverable supply, consistent with Commission guidance set forth in this title.

(b) Non-spot-month limits.

(1) Referenced Contracts. For Referenced Contracts executed pursuant to their rules, swap execution facilities that are trading facilities and designated contract markets shall adopt enforce, and establish rules and procedures for monitoring and enforcing single month and all-

months limits at levels no greater than the position limits established by the Commission under § 151.4(d)(3) or § 151.4(d)(4).

(2) Non-referenced contracts. For all other agreements, contracts, or transactions executed pursuant to their rules that are not subject to the limits set forth in § 151.4, except as provided in § 151.11(b)(3) and § 151.11(c), it shall be an acceptable practice for swap execution facilities that are trading facilities and designated contract markets to adopt, enforce, and establish rules and procedures for monitoring and enforcing single-month and all-months-combined position limits at levels no greater than ten percent of the average delta-adjusted futures, swaps, and options month-end all months open interest in the same contract or economically equivalent contracts executed pursuant to the rules of the designated contract market or swap execution facility that is a trading facility for the greater of the most recent one or two calendar years up to 25,000 contracts with a marginal increase of 2.5 percent thereafter.

(3) Levels at designation or initial listing. Other than in Referenced Contracts, at the time of its initial designation or upon offering a new contract, agreement, or transaction to be executed pursuant to its rules, it shall be an acceptable practice for a designated contract market or swap execution facility that is a trading facility to provide for speculative limits for an individual single-month or in all-months-combined at no greater than 1,000 contracts for physical commodities other than energy commodities and 5,000 contracts for other commodities, provided that the notional quantity for such contracts, agreements, or transactions, corresponds to a notional quantity per contract that is no larger than a typical cash market transaction in the underlying commodity.

(4) For purposes of this paragraph, it shall be an acceptable practice for open interest to be calculated by combining the all months month-end open interest in the same contract or

economically equivalent contracts executed pursuant to the rules of the designated contract market or swap execution facility that is a trading facility (on a delta-adjusted basis, as appropriate) for all months listed during the most recent one or two calendar years.

(c) Alternatives. In lieu of the limits provided for under § 151.11(a)(2) or § 151.11(b)(2), it shall be an acceptable practice for swap execution facilities that are trading facilities and designated contract markets to adopt, enforce, and establish rules and procedures for monitoring and enforcing position accountability rules with respect to any agreement, contract, or transaction executed pursuant to their rules requiring traders to provide information about their position upon request by the exchange and to consent to halt increasing further a trader's position upon request by the exchange as follows:

(1) On an agricultural or exempt commodity that is not subject to the limits set forth in § 151.4, having an average month-end open interest of 50,000 contracts and an average daily volume of 5,000 contracts and a liquid cash market, provided, however, such swap execution facilities that are trading facilities and designated contract markets are not exempt from the requirement set forth in paragraph (a)(2) that they adopt a spot-month position limit with a level no greater than 25 percent of estimated deliverable supply; or

(2) On a major foreign currency, for which there is no legal impediment to delivery and for which there exists a highly liquid cash market; or

(3) On an excluded commodity that is an index or measure of inflation, or other macroeconomic index or measure; or

(4) On an excluded commodity that meets the definition of § 1a(19)(ii), (iii), or (iv) of the Act.

(d) Securities futures products. Position limits for securities futures products are specified in part 41.

(e) Aggregation. Position limits or accountability rules established under this section shall be subject to the aggregation standards of § 151.7.

(f) Exemptions.

(1) Hedge exemptions.

(i) For purposes of exempt and agricultural commodities, no designated contract market or swap execution facility that is a trading facility bylaw, rule, regulation, or resolution adopted pursuant to this section shall apply to any position that would otherwise be exempt from the applicable federal speculative position limits as determined by § 151.5; provided, however, that the designated contract market or swap execution facility that is a trading facility may limit bona fide hedging positions or any other positions which have been exempted pursuant to § 151.5 which it determines are not in accord with sound commercial practices or exceed an amount which may be established and liquidated in an orderly fashion.

(ii) For purposes of excluded commodities, no designated contract market or swap execution facility that is a trading facility by law, rule, regulation, or resolution adopted pursuant to this section shall apply to any transaction or position defined under § 1.3(z); provided, however, that the designated contract market or swap execution facility that is a trading facility may limit bona fide hedging positions that it determines are not in accord with sound commercial practices or exceed an amount which may be established and liquidated in an orderly fashion.

(2) Procedure. Persons seeking to establish eligibility for an exemption must comply with the procedures of the designated contract market or swap execution facility that is a trading facility for granting exemptions from its speculative position limit rules. In considering whether

to permit or grant an exemption, a designated contract market or swap execution facility that is a trading facility must take into account sound commercial practices and paragraph (d)(1) of this section and apply principles consistent with § 151.5.

(g) Other exemptions. Speculative position limits adopted pursuant to this section shall not apply to:

(1) Any position acquired in good faith prior to the effective date of any bylaw, rule, regulation, or resolution which specifies such limit;

(2) Spread or arbitrage positions either in positions in related Referenced Contracts or, for contracts that are not Referenced Contracts, economically equivalent contracts provided that such positions are outside of the spot month for physical-delivery contracts; or

(3) Any person that is registered as a futures commission merchant or floor broker under authority of the Act, except to the extent that transactions made by such person are made on behalf of or for the account or benefit of such person.

(h) Ongoing responsibilities. Nothing in this part shall be construed to affect any provisions of the Act relating to manipulation or corners or to relieve any designated contract market, swap execution facility that is a trading facility, or governing board of a designated contract market or swap execution facility that is a trading facility from its responsibility under other provisions of the Act and regulations.

(i) Effective date. The effective date of this Section shall be 60 days after the term "swap" is further defined under the Wall Street Transparency and Accountability Act of 2010.

(j) Notwithstanding paragraph (i) of this section, the provisions of § 151.11(b)(1) as it applies to non-legacy Referenced Contracts shall not be effective until the establishment of any non-spot-month position limits pursuant to § 151.4(d)(3). In the period prior to the establishment

of any non-spot-month position limits pursuant to § 151.4(d)(3) it shall be an acceptable practice for a designated contract market or swap execution facility to either:

(1) Retain existing non-spot-month position limits or accountability rules; or

(2) Establish non-spot-month position limits or accountability levels pursuant to the acceptable practice described in §§ 151.11(b)(2) and 151.11(c)(1) based on open interest in the same contract or economically equivalent contracts executed pursuant to the rules of the designated contract market or swap execution facility that is a trading facility.

§ 151.12 Delegation of Authority to the Director of the Division of Market Oversight.

(a) 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:

(1) In § 151.4(b) for determining levels of open interest, in § 151.4(d)(2)(ii) to estimate deliverable supply, in § 151.4(d)(3)(ii) to fix non-spot-month limits, and in § 151.4(e) to publish position limit levels.

(2) In § 151.5 requesting additional information or determining whether a filing should not be considered as bona fide hedging;

(3) In § 151.6 for accepting alternative position visibility filings under paragraphs (c)(2) and (d) therein;

(4) In § 151.7(h)(2) to call for additional information from a trader claiming an aggregation exemption;

(5) In § 151.10 for providing instructions or determining the format, coding structure, and electronic data transmission procedures for submitting data records and any other information required under this part.

(b) 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.

(c) Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

§ 151.13 Severability

If any provision of this part, or the application thereof to any person or circumstances, is held invalid, such invalidity shall not affect other provisions or application of such provision to other persons or circumstances which can be given effect without the invalid provision or application.

Appendix A – Spot-Month Position Limits

Contract	Referenced Contract Spot-Month Limit
Agricultural Referenced Contracts	
ICE Futures U.S. Cocoa	1,000
ICE Futures U.S. Coffee C	500
Chicago Board of Trade Corn	600
ICE Futures U.S. Cotton No. 2	300
ICE Futures U.S. FCOJ-A	300
Chicago Mercantile Exchange Class III Milk	1500
Chicago Mercantile Exchange Feeder Cattle	300
Chicago Mercantile Exchange Lean Hog	950
Chicago Mercantile Exchange Live Cattle	450
Chicago Board of Trade Oats	600
Chicago Board of Trade Rough Rice	600
Chicago Board of Trade Soybeans	600
Chicago Board of Trade Soybean Meal	720
Chicago Board of Trade Soybean Oil	540
ICE Futures U.S. Sugar No. 11	5,000
ICE Futures U.S. Sugar No. 16	1,000
Chicago Board of Trade Wheat	600
Minneapolis Grain Exchange Hard Red Spring Wheat	600
Kansas City Board of Trade Hard Winter Wheat	600
Metal Referenced Contracts	
Commodity Exchange, Inc. Copper	1,200
New York Mercantile Exchange Palladium	650
New York Mercantile Exchange Platinum	500
Commodity Exchange, Inc. Gold	3,000
Commodity Exchange, Inc. Silver	1,500
Energy Referenced Contracts	
New York Mercantile Exchange Light Sweet Crude Oil	3,000
New York Mercantile Exchange New York Harbor Gasoline Blendstock	1,000
New York Mercantile Exchange Henry Hub Natural Gas	1,000
New York Mercantile Exchange New York Harbor Heating Oil	1,000

Appendix B to Part 151 – Examples of Bona Fide Hedging Transactions and Positions

A non-exhaustive list of examples of bona fide hedging transactions or positions under § 151.5 is presented below. A transaction or position qualifies as a bona fide hedging transaction or position when it meets the requirements under § 151.5(a)(1) and one of the enumerated provisions under § 151.5(a)(2). With respect to a transaction or position that does not fall within an example in this Appendix, a person seeking to rely on a bona fide hedging exemption under § 151.5 may seek guidance from the Division of Market Oversight.

1. Royalty Payments

a. Fact Pattern: In order to develop an oil field, Company A approaches Bank B for financing. To facilitate the loan, Bank B first establishes an independent legal entity commonly known as a special purpose vehicle (SPV). Bank B then provides a loan to the SPV. Payments of principal and interest from the SPV to the Bank are based on a fixed price for crude oil. The SPV in turn makes a production loan to Company A. The terms of the production loan require Company A to provide the SPV with volumetric production payments (VPPs) based on the SPV's share of the production and the prevailing price of crude oil. Because the price of crude may fall, the SPV reduces that risk by entering into a NYMEX Light Sweet Crude Oil crude oil swap with Swap Dealer C. The swap requires the SPV to pay Swap Dealer C the floating price of crude oil and for Swap Dealer C to pay a fixed price. The notional quantity for the swap is equal to the expected production underlying the VPPs to the SPV.

Analysis: The swap between Swap Dealer C and the SPV meets the general requirements for bona fide hedging transactions (§ 151.5(a)(1)(i)-(iii)) and the specific requirements for royalty payments (§ 151.5(a)(2)(vi)). The VPPs that the SPV receives represent anticipated royalty payments from the oil field's production. The swap represents a substitute for transactions to be made in the physical marketing channel. The SPV's swap position qualifies as a hedge because it is economically appropriate to the reduction of risk. The SPV is reasonably certain that the notional quantity of the swap is equal to the expected production underlying the VPPs. The swap reduces the risk associated with a change in value of a royalty asset. The fluctuations in value of the SPV's anticipated royalties are substantially related to the fluctuations in value of the NYMEX Light Sweet Crude Oil Referenced Contract swap with Swap Dealer C. The risk-reducing position will not qualify as a bona fide hedge in a physical-delivery Referenced Contract during the spot month.

b. Continuation of Fact Pattern: Swap Dealer C offsets the risk associated with the swap to the SPV by selling Referenced Contracts. The notional quantity of the Referenced Contracts sold by Swap Dealer C exactly matches the notional quantity of the swap with the SPV.

Analysis: Because the SPV enters the swap as a bona fide hedger under § 151.5(a)(2)(vi), the offset of the risk of the swap in a Referenced Contract by Swap Dealer C qualifies as a bona fide hedging transaction under § 151.5(a)(3). As provided in § 151.5(a)(3), the risk reducing position

of Swap Dealer C does not qualify as a bona fide hedge in a physical-delivery Referenced Contract during the spot month.

2. Sovereigns

a. Fact Pattern: A Sovereign induces a farmer to sell his anticipated production of 100,000 bushels of corn forward to User A at a fixed price for delivery during the expected harvest. In return for the farmer entering into the fixed-price forward sale, the Sovereign agrees to pay the farmer the difference between the market price at the time of harvest and the price of the fixed-price forward, in the event that the market price is above the price of the forward. The fixed-price forward sale of 100,000 bushels of corn reduces the farmer's downside price risk associated with his anticipated agricultural production. The Sovereign faces commodity price risk as it stands ready to pay the farmer the difference between the market price and the price of the fixed-price contract. To reduce that risk, the Sovereign purchases 100,000 bushels of Chicago Board of Trade ("CBOT") Corn Referenced Contract call options.

Analysis: Because the Sovereign and the farmer are acting together pursuant to an express agreement, the aggregation provisions of § 151.7 and § 151.5(b) apply and they are treated as a single person. Taking the positions of the Sovereign and farmer jointly, the risk profile of the combination of the forward sale and the long call is approximately equivalent to the risk profile of a synthetic long put.[521] A synthetic long put may be a bona fide hedge for anticipated production. Thus, that single person satisfies the general requirements for bona fide hedging transactions (§ 151.5(a)(1)(i)-(iii)) and specific requirements for anticipated agricultural production (§ 151.5(a)(2)(i)(B)). The synthetic long put is a substitute for transactions that the farmer will make at a later time in the physical marketing channel after the crop is harvested. The synthetic long put reduces the price risk associated with anticipated agricultural production. The size of the hedge is equivalent to the size of the Sovereign's risk exposure. As provided under § 151.5(a)(2)(i)(B), the Sovereign's risk-reducing position will not qualify as a bona fide hedge in a physical-delivery Referenced Contract during the last five trading days.

3. Services

a. Fact Pattern: Company A enters into a risk service agreement to drill an oil well with Company B. The risk service agreement provides that a portion of the revenue receipts to Company A depends on the value of the oil produced. Company A is concerned that the price of oil may fall resulting in lower anticipated revenues from the risk service agreement. To reduce that risk, Company A sells 5,000 NYMEX Light Sweet Crude Oil Referenced Contracts, which is equivalent to the firm's anticipated share of the oil produced.

Analysis: Company A's hedge of a portion of its revenue stream from the risk service agreement meets the general requirements for bona fide hedging (§ 151.5(a)(1)(i)-(iii)) and the specific provisions for services (§ 151.5(a)(2)(vii)). Selling NYMEX Light Sweet Crude Oil

[521] Put-call parity describes the mathematical relationship between price of a put and call with identical strike prices and expiry.

Referenced Contracts is a substitute for transactions to be taken at a later time in the physical marketing channel once the oil is produced. The Referenced Contracts sold by Company A are economically appropriate to the reduction of risk because the total notional quantity of the Referenced Contracts sold by Company A equals its share of the expected quantity of future production under the risk service agreement. Because the price of oil may fall, the transactions in Referenced Contracts arise from a potential reduction in the value of the service that Company A is providing to Company B. The contract for services involves the production of a commodity underlying the NYMEX Exchange Light Sweet Crude Oil Referenced Contract. As provided under § 151.5(a)(2)(vii), the risk reducing position will not qualify as a bona fide hedge during the spot month of the physical-delivery Referenced Contract.

b. Fact Pattern: A City contracts with Firm A to provide waste management services. The contract requires that the trucks used to transport the solid waste use natural gas as a power source. According to the contract, the City will pay for the cost of the natural gas used to transport the solid waste by Firm A. In the event that natural gas prices rise, the City's waste transport expenses rise. To mitigate this risk, the City establishes a long position in NYMEX Natural Gas Referenced Contracts that is equivalent to the expected use of natural gas over the life of the service contract.

Analysis: This transaction meets the general requirements for bona fide hedging transaction (§ 151.5(a)(1)(i)-(iii)) and the specific provisions for services (§ 151.5(a)(2)(vii)). Because the City is responsible for paying the cash price for the natural gas used to power the trucks that transport the solid waste under the services agreement, the long hedge is a substitute for transactions to be taken at a later time in the physical marketing channel. The transaction is economically appropriate to the reduction of risk because the total notional quantity of the positions Referenced Contracts purchased equals the expected use of natural gas over the life of the contract. The positions in Referenced Contracts reduce the risk associated with an increase in anticipated liabilities that the City may incur in the event that the price of natural gas increases. The service contract involves the use of a commodity underlying a Referenced Contract. As provided under § 151.5(a)(2)(vii), the risk reducing position will not qualify as a bona fide hedge during the spot month of the physical-delivery Referenced Contract.

c. Fact Pattern: Natural Gas Producer A induces Pipeline Operator B to build a pipeline between Producer A's natural gas wells and the Henry Hub pipeline interconnection by entering into a fixed-price contract for natural gas transportation that guarantees a specified quantity of gas to be transported over the pipeline. With the construction of the new pipeline, Producer A plans to deliver natural gas to Henry Hub at a price differential between his gas wells and Henry Hub that is higher than its transportation cost. Producer A is concerned, however, that the price differential may decline. To lock in the price differential, Producer A decides to sell outright NYMEX Henry Hub Natural Gas Referenced Contract cash-settled futures contracts and buy an outright swap that NYMEX Henry Hub Natural Gas at his gas wells.

Analysis: This transaction satisfies the general requirements for a bona fide hedge exemption (§§ 151.5(a)(1)(i)-(iii)) and specific provisions for services (§ 151.5(a)(2)(vii)).[522] The hedge represents a substitute for transactions to be taken in the future (e.g., selling natural gas at Henry Hub). The hedge is economically appropriate to the reduction of risk that the location differential will decline, provided the hedge is not larger than the quantity equivalent of the cash market commodity to be produced and transported. As provided under § 151.5(a)(2)(vii), the risk reducing position will not qualify as a bona fide hedge during the spot month of the physical-delivery Referenced Contract.

4. Lending a Commodity

a. Fact Pattern: Bank B lends 1,000 ounces of gold to Jewelry Fabricator J at LIBOR plus a differential. Under the terms of the loan, Jewelry Fabricator J may later purchase the gold at a differential to the prevailing price of Commodity Exchange, Inc. ("COMEX") Gold (i.e., an open-price purchase agreement embedded in the terms of the loan). Jewelry Fabricator J intends to use the gold to make jewelry and reimburse Bank B for the loan using the proceeds from jewelry sales. Because Bank B is concerned about its potential loss if the price of gold drops, it reduces the risk of a potential loss in the value of the gold by selling COMEX Gold Referenced Contracts with an equivalent notional quantity of 1,000 ounces of gold.

Analysis: This transaction meets the general bona fide hedge exemption requirements (§§ 151.5(a)(1)(i)-(iii)) and the specific requirements associated with owing a cash commodity (§ 151.5(a)(2)(i)). Bank B's short hedge of the gold represents a substitute for a transaction to be made in the physical marketing channel. Because the total notional quantity of the amount of gold contracts sold is equal to the amount of gold that Bank B owns, the hedge is economically appropriate to the reduction of risk. Finally, the transactions in Referenced Contracts arise from a potential change in the value of the gold owned by Bank B.

b. Fact Pattern: Silver Processor A agrees to purchase scrap metal from a Scrap Yard that will be processed into 5,000 ounces of silver. To finance the purchase, Silver Processor A borrows 5,000 ounces of silver from Bank B and sells the silver in the cash market. Using the proceeds from the sale of silver in the cash market, Silver Processor A pays the Scrap Yard for the scrap metal containing 5,000 ounces of silver at a negotiated discount from the current spot price. To repay Bank B, Silver Processor A may either: provide Bank B with 5,000 ounces of silver and an interest payment based on a differential to LIBOR; or repay the Bank at the current COMEX Silver settlement price plus an interest payment based on a differential to LIBOR (i.e., an open-price purchase agreement). Silver Processor A processes and refines the scrap to repay Bank B. Although Bank B has lent the silver, it is still exposed to a reduction in value if the price of silver falls. Bank B reduces the risk of a possible decline in the value of their silver asset over the loan period by selling COMEX Silver Referenced Contracts with a total notional quantity equal to 5,000 ounces.

[522] Note that in addition to the use of Referenced Contracts, Producer A could have hedged this risk by using a basis contract, which is excluded from the definition of Referenced Contracts.

Analysis: This transaction meets the general requirements for a bona fide hedging transaction (§§ 151.5(a)(1)(i)-(iii)) and specific provisions for owning a commodity (§ 151.5(a)(2)(i)). Bank B's hedge of the silver that it owns represents a substitute for a transaction in the physical marketing channel. The hedge is economically appropriate to the reduction of risk because the bank owns 5,000 ounces of silver. The hedge reduces the risk of a potential change in the value of the silver that it owns.

5. Processor Margins

a. Fact Pattern: Soybean Processor A has a total throughput capacity of 100 million tons of soybeans per year. Soybean Processor A "crushes" soybeans into products (soybean oil and meal). It currently has 20 million tons of soybeans in storage and has offset that risk through fixed-price forward sales of the amount of products expected to be produced from crushing 20 million tons of soybeans, thus locking in the crushing margin on 20 million tons of soybeans. Because it has consistently operated its plant at full capacity over the last three years, it anticipates purchasing another 80 million tons of soybeans over the next year. It has not sold the crushed products forward. Processor A faces the risk that the difference in price between soybeans and the crushed products could change such that crush products (i.e., the crush spread) will be insufficient to cover its operating margins. To lock in the crush spread, Processor A purchases 80 million tons of CBOT Soybean Referenced Contracts and sells CBOT Soybean Meal and Soybean Oil Referenced Contracts, such that the total notional quantity of soybean meal and oil Referenced Contracts equals the expected production from crushing soybeans into soybean meal and oil respectively.

Analysis: These hedging transactions meet the general requirements for bona fide hedging transactions (§§ 151.5(a)(1)(i)-(iii)) and the specific provisions for unfilled anticipated requirements and unsold anticipated agricultural production (§§ 151.5(a)(2)(i)-(ii)). Purchases of soybean Referenced Contracts qualify as bona fide hedging transaction provided they do not exceed the unfilled anticipated requirements of the cash commodity for one year (in this case 80 million tons). Such transactions are a substitute for purchases to be made at a later time in the physical marketing channel and are economically appropriate to the reduction of risk. The transactions in Referenced Contracts arise from a potential change in the value of soybeans that the processor anticipates owning. The size of the permissible hedge position in soybeans must be reduced by any inventories and fixed-price purchases because they are no longer *unfilled* requirements. As provided under § 151.5(a)(2)(ii)(C), the risk reduction position that is not in excess of the anticipated requirements for soybeans for that month and the next succeeding month qualifies as a bona fide hedge during the last five trading days provided it is not in a physical-delivery Referenced Contract.

Given that Soybean Processor A has purchased 80 million tons worth of CBOT Soybean Referenced Contracts, it can reduce its processing risk by selling soybean meal and oil Referenced Contracts equivalent to the expected production. The sale of CBOT Soybean, Soybean Meal, and Soybean Oil contracts represents a substitute for transactions to be taken at a later time in the physical marketing channel by the soybean processor. Because the amount of soybean meal and oil Referenced Contracts sold forward by the soybean processor corresponds to expected production from 80 million tons of soybeans, the hedging transactions are

economically appropriate to the reduction of risk in the conduct and management of the commercial enterprise. These transactions arise from a potential change in the value of soybean meal and oil that is expected to be produced. The size of the permissible hedge position in the products must be reduced by any fixed-price sales because they are no longer unsold production. As provided under § 151.5(a)(2)(i)(B), the risk reducing position does not qualify as a bona fide hedge in a physical-delivery Referenced Contract during the last five trading days in the event the anticipated crushed products have not been produced.

6. Portfolio Hedging

a. Fact Pattern: It is currently January and Participant A owns five million bushels of corn located in its warehouses. Participant A has entered into fixed-price forward sale contracts with several processors for a total of five million bushels of corn that will be delivered in May of this year. Participant A has separately entered into fixed-price purchase contracts with several merchandisers for a total of two million bushels of corn to be delivered in March of this year. Participant A's gross long cash position is equal to seven million bushels of corn. Because Participant A has sold forward five million bushels of corn, its net cash position is equal to long two million bushels of corn. To reduce its price risk, Participant A chooses to sell the quantity equivalent of two million bushels of CBOT Corn Referenced Contracts.

Analysis: The cash position and the fixed-price forward sale and purchases are all in the same crop year. Participant A currently owns five million bushels of corn and has effectively sold that amount forward. The firm is concerned that the remaining amount – two million bushels worth of fixed-price purchase contracts – will fall in value. Because the firm's net cash position is equal to long two million bushels of corn, the firm is exposed to price risk. Selling the quantity equivalent of two million bushels of CBOT Corn Referenced Contracts satisfies the general requirements for bona fide hedging transactions (§§ 151.5(a)(1)(i)-(iii)) and the specific provisions associated with owning a commodity (§ 151.5(a)(2)(i)).[523] Participant A's hedge of the two million bushels represents a substitute to a fixed-price forward sale at a later time in the physical marketing channel. The transaction is economically appropriate to the reduction of risk because the amount of Referenced Contracts sold does not exceed the quantity equivalent risk exposure (on a net basis) in the cash commodity in the current crop year. Lastly, the hedge arises from a potential change in the value of corn owned by Participant A.

7. Anticipated Merchandising

a. Fact Pattern: Elevator A, a grain merchandiser, owns a 31 million bushel storage facility. The facility currently has 1 million bushels of corn in storage. Based upon its historical purchasing and selling patterns for the last three years, Elevator A expects that in September it

[523] Participant A could also choose to hedge on a gross basis. In that event, Participant A would sell the quantity equivalent of seven million bushels of March Chicago Board of Trade Corn Referenced Contracts, and separately purchase the quantity equivalent of five million bushels of May Chicago Board of Trade Corn Referenced Contracts.

will enter into fixed-price forward purchase contracts for 30 million bushels of corn that it expects to sell in December. Currently the December corn futures price is substantially higher than the September corn futures price. In order to reduce the risk that its unfilled storage capacity will not be utilized over this period and in turn reduce Elevator A's profitability, Elevator A purchases the quantity equivalent of 30 million bushels of September CBOT Corn Referenced Contracts and sells 30 million bushels of December CBOT Corn Referenced Contracts.

Analysis: This hedging transaction meets the general requirements for bona fide hedging transactions (§§ 151.5(a)(1)(i)-(iii)) and specific provisions associated with anticipated merchandising (§ 151.5(a)(2)(v)). The hedging transaction is a substitute for transactions to be taken at a later time in the physical marketing channel. The hedge is economically appropriate to the reduction of risk associated with the firm's unfilled storage capacity because: (1) the December CBOT Corn futures price is substantially above the September CBOT Corn futures price; and (2) Elevator A reasonably expects to engage in the anticipated merchandising activity based on a review of its historical purchasing and selling patterns at that time of the year. The risk arises from a change in the value of an asset that the firm owns. As provided by § 151.5(a)(2)(v), the size of the hedge is equal to the firm's unfilled storage capacity relating to its anticipated merchandising activity. The purchase and sale of offsetting Referenced Contracts are in different months, which settle in not more than twelve months. As provided under § 151.5(a)(2)(v), the risk reducing position will not qualify as a bona fide hedge in a physical-delivery Referenced Contract during the last 5 trading days of the September contract.

8. Aggregation of Persons

a. Fact Pattern: Company A owns 100 percent of Company B. Company B buys and sells a variety of agricultural products, such as wheat and cotton. Company B currently owns 1 million bushels of wheat. To reduce some of its price risk, Company B decides to sell the quantity equivalent of 600,000 bushels of CBOT Wheat Referenced Contracts. After communicating with Company B, Company A decides to sell the quantity equivalent of 400,000 bushels of CBOT Wheat Referenced Contracts.

Analysis: Because Company A owns more than 10 percent of Company B, Company A and B are aggregated together as one person under § 151.7. Under § 151.5(b), entities required to aggregate accounts or positions under § 151.7 shall be considered the same person for the purpose of determining whether a person or persons are eligible for a bona fide hedge exemption under paragraph § 151.5(a). The sale of wheat Referenced Contracts by Company A and B meets the general requirements for bona fide hedging transactions (§§ 151.5(a)(1)(i)-(iii)) and the specific provisions for owning a cash commodity (§ 151.5(a)(2)(i)). The transactions in Referenced Contracts by Company A and B represent a substitute for transactions to be taken at a later time in the physical marketing channel. The transactions in Referenced Contracts by Company A and B are economically appropriate to the reduction of risk because the combined total of 1,000,000 bushels of CBOT Wheat Referenced Contracts sold by Company A and Company B does not exceed the 1,000,000 bushels of wheat that is owned by Company A. The risk exposure for Company A and B results from a potential change in the value of wheat.

9. Repurchase Agreements

a. Fact Pattern: When Elevator A purchased 500,000 bushels of wheat in April it decided to reduce its price risk by selling the quantity equivalent of 500,000 bushels of CBOT Wheat Referenced Contracts. Because the price of wheat has steadily risen since April, Elevator A has had to make substantial maintenance margin payments. To alleviate its concern about further margin payments, Elevator A decides to enter into a repurchase agreement with Bank B. The repurchase agreement involves two separate contracts: a fixed-price sale from Elevator A to Bank B at today's spot price; and an open-priced purchase agreement that will allow Elevator A to repurchase the wheat from Bank B at the prevailing spot price three months from now. Because Bank B obtains title to the wheat under the fixed-price purchase agreement, it is exposed to price risk should the price of wheat drop. It therefore decides to sell the quantity equivalent of 500,000 bushels of CBOT Wheat Referenced Contracts.

Analysis: Bank B's hedging transaction meets the general requirements for bona fide hedging transactions (§§ 151.5(a)(1)(i)-(iii)) and the specific provisions for owning the cash commodity (§ 151.5(a)(2)(i)). The sale of Referenced Contracts by Bank B is a substitute for a transaction to be taken at a later time in the physical marketing channel either to Elevator A or to another commercial party. The transaction is economically appropriate to the reduction of risk in the conduct and management of the commercial enterprise of Bank B because the notional quantity of Referenced Contracts sold by Bank B is not larger than the quantity of cash wheat purchased by Bank B. Finally, the purchase of CBOT Wheat Referenced Contracts reduces the risk associated with owning cash wheat.

10. Inventory

a. Fact Pattern: Copper Wire Fabricator A is concerned about possible reductions in the price of copper. Currently it is November and it owns inventory of 100,000 pounds of copper and 50,000 pounds of finished copper wire. Currently, deferred futures prices are lower than the nearby futures price. Copper Wire Fabricator A expects to sell 150,000 pounds of finished copper wire in February. To reduce its price risk, Copper Wire Fabricator A sells 150,000 pounds of February COMEX Copper Referenced Contracts.

Analysis: The Copper Wire Fabricator A's hedging transaction meets the general requirements for bona fide hedging transactions (§§ 151.5(a)(1)(i)-(iii)) and the provisions for owning a commodity (§ 151.5(a)(2)(i)(A)). The sale of Referenced Contracts represents a substitute for transactions to be taken at a later time. The transactions are economically appropriate to the reduction of risk in the conduct and management of the commercial enterprise because the price of copper could drop further. The transactions in Referenced Contracts arise from a possible reduction in the value of the inventory that it owns.

Issued by the Commission this 18th day of October, 2011, in Washington, DC.

David Stawick

Secretary of the Commission

Appendices to Position Limits for Futures and Swaps—Commission Voting Summary and Statements of Commissioners

NOTE: The following appendices will not appear in the Code of Federal Regulations

Appendix 1—Commission Voting Summary

On this matter, Chairman Gensler and Commissioners Dunn and Chilton voted in the affirmative; Commissioners Sommers and O'Malia voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support the final rulemaking to establish position limits for physical commodity derivatives.

The CFTC does not set or regulate prices. Rather, the Commission is charged with a significant responsibility to ensure the fair, open and efficient functioning of derivatives markets. Our duty is to protect both market participants and the American public from fraud, manipulation and other abuses.

Position limits have served since the Commodity Exchange Act passed in 1936 as a tool to curb or prevent excessive speculation that may burden interstate commerce.

When the CFTC set position limits in the past, the agency sought to ensure that the markets were made up of a broad group of market participants with no one speculator having an outsize position. At the core of our obligations is promoting market integrity, which the agency has historically interpreted to include ensuring that markets do not become too concentrated.

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

In the Dodd-Frank Act, Congress mandated that the CFTC set aggregate position limits for certain physical commodity derivatives. The Dodd-Frank Act broadened the CFTC's position limits authority to include aggregate position limits on certain swaps and certain linked contracts traded on foreign boards of trade in addition to U.S. futures and options on futures. Congress also narrowed the exemptions traditionally available from position limits by modifying the definition of bona fide hedge transaction, which particularly would affect swap dealers.

Today's final rule implements these important new provisions. The final rule fulfills the Congressional mandate that we set aggregate position limits that, for the first time, apply to both futures and economically equivalent swaps, as well as linked contracts on foreign boards of trade. The final rule establishes federal position limits in 28 referenced commodities in agricultural, energy and metals markets.

Per Congress's direction, the rule implements one position limits regime for the spot month and another for single-month and all-months combined limits. It implements spot-month limits, which are currently set in agriculture, energy and metals markets, sooner than the single-month or all-months-combined limits. Spot-month limits are set for futures contracts that can by physically settled as well as those swaps and futures that can only be cash-settled. We are seeking additional comment as part of an interim final rule on these spot month limits with regard to cash-settled contracts.

Single-month and all-months-combined limits, which currently are only set for certain agricultural contracts, will be re-established in the energy and metals markets and be extended to certain swaps. These limits will be set using a formula that is consistent with that which the CFTC has used to set position limits for decades. The limits will be set by a Commission order based upon data on the total size of the swaps and futures market collected through the position reporting rule the Commission finalized in July. It is only with the passage and implementation of the Dodd-Frank Act that the Commission now has broad authority to collect data in the swaps market.

The final rule also implements Congress's direction to narrow exemptions while also ensuring that bona fide hedge exemptions are available for producers and merchants.

The final position limits rulemaking builds on more than two years of significant public input. The Commission benefited from more than 15,100 comments received in response to the January 2011proposal. We first held three public meetings on this issue in the summer of 2009 and got a great deal of input from market participants and the broader public. We also benefited from the more than 8,200 comments we received in response to the January 2010 proposed rulemaking to re-establish position limits in the energy markets. We further benefited from input received from the public after a March 2010 meeting on the metals markets.

Appendix 3—Statement of Commissioner Jill Sommers

I respectfully dissent from the action taken today by the Commission to issue final rules establishing position limits for futures and swaps.

It has been nearly two years since the Commission issued its January 2010 proposal to impose position limits on a small group of energy contracts. Since then, Commission staff and the Commission have spent an enormous amount of time and energy on the issue of imposing speculative position limits, time that could have been much better spent implementing the specific Dodd-Frank regulatory reforms that will actually reduce systemic risk and prevent another financial crisis.

This vote today on position limits is no doubt the single most significant vote I have taken since becoming a Commissioner. It is not because imposing position limits will fundamentally change the way the U.S. markets operate, but because I believe this agency is setting itself up for an enormous failure.

As I have said in the past, position limits can be an important tool for regulators. I have been clear that I am not philosophically opposed to limits. After all, this agency has set limits in certain markets for many years. However, I have had concerns all along about the particular application of the limits in this rule, compounded by the unnecessary narrowing of the bona-fide hedging exemptions, beyond what was required by the Dodd-Frank Act.

Over the last four years, many have argued for position limits with such fervor and zeal, believing them to be a panacea for everything. Just this past week, the Commission has been bombarded by a letter-writing campaign suggesting that the five of us have the power to end world hunger by imposing position limits on agricultural commodities. This latest campaign exemplifies my ongoing concern and may result in damaging the credibility of this agency. I do

not believe position limits will control prices or market volatility, and I fear that this Commission will be blamed when this final rule does not lower food and energy costs. I am disappointed at this unfortunate circumstance because, while the Commission's mission is to protect market users and the public from fraud, manipulation, abusive practices and systemic risk related to derivatives that are subject to the Commodity Exchange Act, and to foster open, competitive, and financially sound markets, nowhere in our mission is the responsibility or mandate to control prices.

When analyzing the potential impact this final rule will have on market participants, I am most concerned that rules designed to "reign in speculators" have the real potential to inflict the greatest harm on bona fide hedgers – that is, the producers, processers, manufacturers, handlers and users of physical commodities. This rule will make hedging more difficult, more costly, and less efficient, all of which, ironically, can result in increased food and energy costs for consumers.

Currently, the Commission sets and administers position limits and exemptions for contracts on nine agricultural commodities. For contracts of the remaining commodities, the exchanges set and administer position limits and exemptions. Pursuant to the final rule the Commission issued today, the Commission will set and administer position limits and exemptions for 28 reference contracts. This will amount to a substantial transfer of responsibility from the exchanges to the Commission. As a result of taking on this responsibility for 19 new reference contracts, the Commission is significantly increasing its front-line oversight of the granting and monitoring of bona-fide hedging exemptions for the transactions of massive, global corporate conglomerates

that on a daily basis produce, process, handle, store, transport, and use physical commodities in their extremely complex logistical operations.

At the very time the Commission is taking on this new responsibility, the Commission is eliminating a valuable source of flexibility that has been a part of regulation 1.3(z) for decades – that is, the ability to recognize non-enumerated hedge transactions and positions. This final rule abandons important and long-standing Commission precedent without justification or reasoned explanation, by merely stating "the Commission has . . . expanded the list of enumerated hedges." The Commission also seems to be saying that we no longer need the flexibility to allow for non-enumerated hedge transactions and positions because one can seek interpretative guidance pursuant to Commission Regulation 140.99 on whether a transaction or class of transactions qualifies as a bona-fide hedge, or can petition the Commission to amend the list of enumerated transactions. The Commission also recognizes that CEA Section 4a(a)(7) grants it the broad exemptive authority is issue an order, rule, or regulation, but offers no guidance on when it may do so, and what factors it may consider or criteria it may use to make a determination.

These processes are cold comfort. There is no way to tell how long interpretative guidance or a Commission Order will take. Moreover, if a market participant petitions the Commission to amend the list of enumerated transactions, if the Commission chooses to do so, it must formally propose the amendment pursuant to APA notice and comment. As we know all too well, issuing new rules and regulations is a time consuming process fraught with delay and uncertainty. In the

end, none of these processes is flexible or useful to the needs of hedgers in a complex global marketplace.

When the Commission first recognized the need to allow for non-enumerated hedges in 1977, the Commission stated "The purpose of the proposed provision was to provide flexibility in application of the general definition and to avoid an extensive specialized listing of enumerated bona fide hedging transactions and positions. . . ." Today the global marketplace and commercial firms' hedging strategies are much more complex than in 1977. Yet, we are content to abandon decades of precedent that provided flexibility in favor of specifying a specialized list of enumerated bona fide hedging transactions and positions. I am not comfortable with notion that a list of eight bona-fide hedging transactions in this rule is sufficiently extensive and specialized to cover the complex needs of today's bona-fide hedgers. Repealing the ability to recognize non-enumerated hedge transactions and positions is a mistake and the statute does not require it. The Commission should have remained true to its precedent and utilized the broad authority contained in CEA Section 4a (a)(7) to include within Regulation 151.5(a)(2) a ninth enumerated hedging transaction and position, with the same conditions as the previous eight, as follows: "Other risk-reducing practices commonly used in the market that are not enumerated above, upon specific request made in accordance with Regulation section 1.47."

In addition to abandoning decades of flexibility to recognize non-enumerated hedging transactions and positions, the final rules today do not fully effect the authority the Commission has had for decades to define bona-fide hedging transactions and positions "to permit producers, purchasers, sellers, middlemen, and users of a commodity or a product derived therefrom to

hedge their legitimate anticipated business needs...." This authority is found in CEA Section 4a(c)(1). In addition, Section 4a(c)(2) clearly recognizes the need for anticipatory hedging by using the word "anticipates" in three places. Nonetheless, without defining what constitutes "merchandising" the Commission has limited "Anticipated Merchandising Hedging" in Regulation 151.5(a)(2)(v) to transactions not larger than "current or anticipated unfilled storage capacity." It appears then that merchandising does not include the varying activities of "producers, purchasers, sellers, middlemen, and users of a commodity" as contemplated by Section 4a(c)(1), but merely consists of storing a commodity. This limited approach is needlessly at odds with the statute and with the legitimate needs of hedgers.

I have always believed that there was a right way and a wrong way for us to move forward on position limits. Unfortunately I believe we have chosen to go way beyond what is in the statute and have created a very complicated regulation that has the potential to irreparably harm these vital markets.

Appendix 4—Statement of Commissioner Scott O'Malia

I respectfully dissent from the action taken today by the Commission to issue final rules relating to position limits for futures and swaps. While I have a number of serious concerns with this final rule, my principal disagreement is with the Commission's restrictive interpretation of the statutory mandate under Section 4a of the Commodity Exchange Act ("CEA" or "Act") to establish position limits without making a determination that such limits are necessary and effective in relation to the identifiable burdens of excessive speculation on interstate commerce.

While I agree that the Commission has been directed to establish position limits applicable to futures, options, and swaps that are economically equivalent to such futures and options (for exempt and agricultural commodities as defined by the Act), I disagree that our mandate provides for so little discretion in the manner of its execution. Throughout the preamble, the Commission uses, "Congress did not give the Commission a choice"[524] as a rationale in adopting burdensome and unmanageable rules of questionable effectiveness. This statement, in all of its iterations in this rule, is nothing more than hyperbole used tactfully to support a politically-driven overstatement as to the threat of "excessive speculation" in our commodity markets. In aggrandizing a market condition that it has never defined through quantitative or qualitative criteria in order to justify draconian rules, the Commission not only fails to comply with Congressional intent, but misses an opportunity to determine and define the type and extent of speculation that is likely to cause sudden, unreasonable and/or unwarranted commodity price movements so that it can respond with rules that are reasonable and appropriate.

In relevant part, section 4a(a)(1) of the Act states: "Excessive speculation in any commodity under contracts of sale of such commodity for future delivery . . . or swaps . . . causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity." Section 4a(a)(1) further defines the Commission's duties with regard to preventing such price fluctuations through position limits, clearly stating: "For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time, after due notice and opportunity for hearing, by rule, regulation, or order, proclaim and fix such limits . . . as the

[524] Position Limits for Futures and Swaps, 76 FR _____, _____ (____ __, 2011) (to be codified at 17 CFR pts. 1, 150 and 151).

Commission finds are necessary to diminish, eliminate, or prevent such burden." Congress could not be more clear in its directive to the Commission to utilize not only its expertise, but the public rulemaking process, each and every time it determines to establish position limits to ensure that such limits are essential and suitable to combat the actual or potential threats to commodity prices due to excessive speculation.

An Ambiguously Worded Mandate Does Not Relieve the Commission of Its Duties Under the Act

Historically, the Commission has taken a much more disciplined and fact-based approach in considering the question of positions limits; a process that is lacking from the current proposal. The general authority for the Commission to establish "limits on the amounts of trading which may be done or positions which may be held . . . as the Commission finds are necessary to diminish, eliminate, or prevent" the "undue burdens" associated with excessive speculation found in section 4a of the Act has remained unchanged since its original enactment in 1936 and through subsequent amendments, including the Dodd-Frank Act.[525] Over thirty years ago, on December 2, 1980, the Commission, pursuant in part to its authority under section 4a (1) of the Act, issued a proposal to implement rules requiring exchanges to impose position limits on contracts that were not currently subject to Commission imposed limits.[526]

In support of its proposal, the Commission relied on a June 1977 report on speculative limits prepared by the Office of the Chief Economist (the "Staff Report"). The Staff Report addressed three major policy questions: (1) whether there should be limits and for what groups of commodities; (2) what guidelines are appropriate in setting the level of limits; and (3) whether

[525] Position Limits for Futures and Swaps, 76 FR _____, _____ (_____ __, 2011) (to be codified at 17 CFR pts. 1, 150 and 151).

[526] Speculative Position Limits, 45 FR 79831 (proposed Dec. 2, 1980) (to be codified at 17 CFR pt. 1).

the Commission or the exchange should set the limits.[527, 528] In considering these questions, the Staff Report noted, "Although the Commission is authorized to establish speculative limits, it is not required to do so."[529] In its Interpretation of the above language in section 4a, the Staff Report at the outset provided the legal context for its study as follows:

> [T]he Commission need not establish speculative limits if it does not find that excessive speculation exists in the trading of a particular commodity. Furthermore, apparently, the Commission does not have to establish limits if it finds that such limits will not effectively curb excessive speculation.[530]

While not directly linked to the statutory language of section 4a or an interpretation of such language, the Staff Report utilized its findings to formulate a policy for the Commission to move forward, which, based on comments to the Commission's January 2011 proposal,[531] is clearly embodied in the purpose and spirit of the Act:

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[527] Id. at 79832; Speculative Limits: a staff paper prepared for Commission discussion by the Office of the Chief Economist at 1, June 24, 1977.

[528] The Staff Report ultimately made four general recommendations. First, the Commission ought to adopt a policy of establishing speculative limits only in those markets where the characteristics of the commodity, its marketing system, and the contract lend themselves to undue influence from large scale speculative positions. Second, that in markets where limits are deemed to be necessary, such limits should only be established to curtail extraordinary speculative positions which are not offset by comparable commercial positions. Third, there ought to be no limits on daily trading except to the extent that the limits would prevent the accumulation of large intraday positions. Fourth, in markets where limits are deemed necessary, the exchange should set and review the limits subject to Commission approval. Office of Chief Economist, supra note 4, at 5-6.

[529] Office of Chief Economist, supra note 4, at 7.

[530] Id. at 7-8.

[531] See, e.g., Comment letter from Futures Industry Association on Position Limits for Derivatives (RIN 2028-AD15 and 3038-AD16) at 6-7 (Mar. 25, 2011), available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34054&SearchText=futures%20industry%20association; Comment letter from CME Group on Position Limits for Derivatives at 1-7 (Mar. 28, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=33920&SearchText=cme; and Comment Letter of International Swaps and Derivatives Association, Inc. and Securities Industry and Financial Markets Association on Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD15 and 3038-AD16) at 3-6 (Mar. 28, 2011), available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=33568&SearchText=isda.

> Perhaps the most important feature brought out in the study is that, prior to the adoption of speculative position limits for any commodity in which limits are not now imposed by CFTC, the Commission should carefully consider the need for and effectiveness of such limits for that commodity and the resources necessary to enforce such limits.[532]

In its final rule, published in the Federal Register on October 16, 1981—almost exactly thirty years ago today—the Commission chose to base its determination on Congressional findings embodied in section 4a(1) of the Act that excessive speculation is harmful to the market, and a finding that speculative limits are an effective prophylactic measure. The Commission did not do so because it found that more specific determinations regarding the necessity and effectiveness of position limits were not required. Rather, the Commission was fashioning a rule "to assure that the exchanges would have an opportunity to employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate."[533] Moreover, none of the commenters opposing the adoption of limits for all markets demonstrated to the Commission that its findings as to the prophylactic nature of the proposal before them were unsubstantiated.[534] Therefore, the Commission did not eschew a requirement to demonstrate whether position limits were necessary and would be effective—it delegated these determinations to the exchanges.

Today, the Commission reaffirms its proposed interpretation of amended section 4a that in setting position limits pursuant to directives in sections 4a(a)(2)(A), 4a(a)(3) and 4a(a)(5), it

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[532] Office of Chief Economist, supra note 7, at 5.
[533] 46 FR at 50938, 50940.
[534] Id.

need not first determine that position limits are necessary before imposing them or that it may set limits only after conducting a complete study of the swaps market.[535] Relying on the various directives following "shall," the Commission has bluntly stated that "Congress did not give the Commission a choice."[536] This interpretation ignores the plain language in the statute that the "shalls" in sections 4a(a)(2)(A), 4a(a)(3) and 4a(a)(5) are connected to the modifying phrase, "as appropriate." Although the Commission correctly construes the "as appropriate" language in the context of the provisions as a whole to direct the Commission to exercise its discretion in determining the *extent* of the limits that Congress "required" it to impose, the Commission ignores the fact that in the context of the Act, such discretion is broad enough to permit the Commission to *not* impose limits if they are not appropriate. Though a permissible interpretation, the Commission's narrow view of its authority permeates the final rules today and provides a convenient rationale for many otherwise unsustainable conclusions, especially with regard to the cost-benefit analysis of the rule.

Section 4a(a)(2)(A), in relevant part, states that the Commission "shall by rule, regulation, or order establish limits on the amount of positions, as appropriate" that may be held by any person in physical commodity futures and options contracts traded on a designated contract market (DCM). In section 4a(a)(5), Congress directed that the Commission "shall establish limits on the amount of positions, including aggregate position limits, as appropriate" that may be held by any person with respect to swaps. Section 4a(a)(3) qualifies the Commission's authority by directing it so set such limits "required" by section 4a(a)(2), "as appropriate . . . [and] to the maximum extent practicable, in its discretion" (1) to diminish,

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[535] Position Limits for Futures and Swaps, 76 FR _____, _____ (_____ __, 2011) (to be codified at 17 CFR pts. 1, 150 and 151).
[536] Id.

eliminate, or prevent excessive speculation as described under this section (section 4a of the Act), (2) to deter and prevent market manipulation, squeezes, and corners, (3) to ensure sufficient market liquidity for bona fide hedgers, and (4) to ensure that the price discovery function of the underlying market is not disrupted.[537]

Congress, in repeatedly qualifying its mandates with the phrase "as appropriate" and by specifically referring back to the Commission's authority to set position limits as proscribed in section 4a(a)(1), clearly did not relieve the Commission of any requirement to exercise its expertise and set position limits only to the extent that it can provide factual support that such limits will diminish, eliminate or prevent excessive speculation.[538] Instead, by directing the Commission to establish limits "as appropriate,"[539] Congress intended to provide the Commission with the discretion necessary to establish a position limit regime in a manner that will not only protect the markets from undue burdens due to excessive speculation and manipulation, but that will also provide for market liquidity and price discovery in a level playing field while preventing regulatory arbitrage.[540]

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[537] See section 4a(a)(3)(B) of the CEA.

[538] See, e.g., Comment letter from BG Americas & Global LNG on Proposed Rule Regarding Position Limits for Derivatives (RIN 2028-AD15 and 3038-AD16) at 4 (Mar. 28, 2011), available at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=965 ("Notwithstanding the Commission's argument that it has authority to use position limits absent a specific finding that an undue burden on interstate commerce had actually resulted, the language and intent of CEA Section 4a(a)(1) remains unchanged by the Dodd-Frank Act. As a consequence, the Commission has not been relieved of the obligation under Section 4a(a)(1) to show that the proposed position limits for the Referenced Contracts are necessary to prevent excessive speculation.")..

[539] See La Union Del Pueblo Entero v. FEMA, No. B-08-487, slip op., 2009 WL 1346030 at *4 (S.D. Tex. May 13, 2009) ("[W]hen 'shall' is modified by a discretionary phrase such as 'as may be necessary' or 'as appropriate' an agency has some discretion when complying with the mandate." (citing Consumer Fed'n of America v. U.S. Dep't of Health and Human Servs., 83 F.3d 1497, 1503 (D.C. Cir. 1996) (indicating that where Congress in mandating administrative action modifies the word "shall" with the phrase "as appropriate" an agency has discretion to evaluate the circumstances and determine when and how to act))).

[540] Section 4a(a)(6) mandates through an unqualified "shall," that the Commission set aggregate limits across trading venues including foreign boards of trade.

I agree with commenters who argued that the Commission is directed under its new authority to set position limits "as appropriate," or in other words meaning that whatever limits the Commission sets are supported by empirical evidence demonstrating that those would diminish, eliminate, or prevent excessive speculation.[541] In the absence of such evidence, I also agree with commenters that we are unable, at this time, to fulfill the mandate and assure Congress and market participants that any such limits we do establish will comply with the statutory objectives of section 4a(a)(3). And, to be clear, without empirical data, we cannot assure Congress that the limits we set will not adversely affect the liquidity and price discovery functions of affected markets. The Commission will have significant additional data about the over-the-counter (OTC) swaps markets in the next year, and at a minimum, I believe it would be appropriate for the Commission to defer any decisions about the nature and extent of position limits for months outside of the spot-month, including any determinations as to appropriate formulas, until such time as we have had a meaningful opportunity to review and assess the new data and its relevance to any determinations regarding excessive speculation. At a future date, when the Commission applies the second phase of the position limits regime and sets the non-spot-month limits (single and all-months combined limits), I will work to ensure that the position formulas and applicable limits are validated by Commission data to be both appropriate and effective so that those limits truly "diminish, eliminate, or prevent excessive speculation."

An Absence of Justification

[541] See, e.g., Comment letter from Futures Industry Association on Position Limits for Derivatives (RIN 2028-AD15 and 3038-AD16) at 6-8; Comment Letter of International Swaps and Derivatives Association, Inc. and Securities Industry and Financial Markets Association on Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD15 and 3038-AD16) at 3-4.

Today the Commission voted to move forward on a rule that (1) establishes hard federal position limits and position limit formulas for 28 physical commodity futures and options contracts and physical commodity swaps that are economically equivalent to such contracts in the spot-month, for single months, and for all-months combined; (2) establishes aggregate position limits that apply across different trading venues to contracts based on the same underlying commodity; (3) implements a new, more limited statutory definition of *bona fide* hedging transactions; (4) revises account aggregation standards; (5) establishes federal position visibility reporting requirements; and (6) establishes standards for position limits and position accountability rules for registered entities. The Commission voted on this multifaceted rule package without the benefit of performing an objective factual analysis based on the necessary data to determine whether these particular limits and limit formulas will effectively prevent or deter excessive speculation. The Commission did not even provide for public comment a determination as to what criteria it utilized to determine whether or not excessive speculation is present or will potentially threaten prices in any of the commodity markets affected by the new position limits.

Moreover, while it engaged in a public rulemaking, the Commission's Notice of Proposed Rulemaking,[542] in its complexity and lack of empirical data and legal rationale for several new mandates and changes to existing policies—in spite of the fact that we largely rely on our historical experiences in setting such limits—tainted the entire process. By failing to put forward data evidencing that commodity prices are threatened by the negative influence of a defined level of speculation that we can define as "excessive speculation," and that today's measures are appropriate (*i.e.* necessary and effective) in light of such findings, I believe that we

[542] Position Limits for Derivatives, 76 FR 4752 (proposed Jan. 26, 2011) (to be codified at 17 CFR pts. 1, 150 and 151).

have failed under the Administrative Procedure Act to provide a meaningful and informed opportunity for public comment.[543]

Substantive comment letters, of which there were approximately 100,[544] devoted at times substantial text to expressions of confusion and requests for clarification of vague descriptions and processes. In more than one instance, preamble text did not reflect proposed rule text and vice versa.[545] Indeed, the entire rulemaking process has been plagued by internal and public debates as to what the Commission's motives are and to what extent they are based on empirical evidence, in policy, or are simply without reason.

Implementing An Appropriate Program for Position Management

This rule, like several proposed before it, fails to make a compelling argument that the proposed position limits, which only target large concentrated positions,[546] will dampen price distortions or curb excessive speculation—especially when those position limits are identified by the overall participation of speculators as an increased percentage of the market. What the rule argues is that there is a Congressional mandate to set position limits, and therefore, there is no

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[543] See Am. Med. Ass'n v. Reno, 57 F.3d 1129, 1132-3 (D.C. Cir. 1995) ("Notice of a proposed rule must include sufficient detail on its content and basis in law and evidence to allow for meaningful and informed comment: 'the Administrative Procedure Act requires the agency to make available to the public in a form that allows for meaningful comment, the data the agency used to develop the proposed rule.'") (quoting Engine Mfrs. Ass'n v. EPA, 20 F.3d 1177, 1181 (D.C. Cir. 1994)).

[544] Position Limits for Futures and Swaps, 76 FR _____, _____ (____ __, 2011) (to be codified at 17 CFR pts. 1, 150 and 151).

[545] See, e.g., 76 FR at 4752, 4763 and 4775 (In its discussion of registered entity position limits, the preamble makes no mention of proposed §151.11(a)(2) which would remove a registered entity's discretion under CEA §5(d)(5)(A) for designated contract markets (DCMs) and under CEA §5h(f)(6)(A) for swap execution facilities (SEFs) that are trading facilities to set position accountability in lieu of position limits for physical commodity contracts for which the Commission has not set Federal limits.).

[546] Today's final rule does not hide the fact that the position limits regime is aimed at "prevent[ing] a large trader from acquiring excessively large positions and thereby would help prevent excessive speculation and deter and prevent market manipulations, squeezes, and corners." See Position Limits for Futures and Swaps, 76 FR _____, _____ (____ __, 2011) (to be codified at 17 CFR pts. 1, 150 and 151). See also Comment letter from Better Markets on Position Limits for Derivatives (RIN 2028-AD15 and 3038-AD16) at 62 (Mar. 28, 2011) available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34010&SearchText=better%20markets ("[T]here are critical differences between a commodities market position limit regime focused just on manipulation, and one focusing on a very different concept of excessive speculation.").

duty on the Commission to determine that excessive speculation exists (and is causing price distortions), or to "prove that position limits are an effective regulatory tool."[547] This argument is incredibly convenient given that the proposed position limits are modeled on the agricultural commodities position limits, and despite those federal position limits, contracts such as wheat, corn, soybeans, and cotton contracts were not spared record-setting price increases in 2007 and 2008. Indeed, the cotton No. 2 futures contract has hit sixteen "record-setting" prices since December 1, 2010. The most recent high was set on March 4, 2011 when the March 2011 future traded at a price of $215.15.

To be clear, I am not opposed to position or other trading limits in all circumstances. I remain convinced that position limits, whether enforced at the exchange level or by the Commission, are effective only to the extent that they mitigate potential congestion during delivery periods and trigger reporting obligations that provide regulators with the complete picture of an entity's trading. I therefore believe that accountability levels and visibility levels provide a more refined regulatory tool to identify, deter, and respond in advance to threats of manipulation and other non-legitimate price movements and distortions. I would have supported a rule that would impose position limits in the spot-month for physical commodities, *i.e.* the referenced contracts,[548] and would establish an accountability level. The Commission's ability to monitor such accountability levels would rely on a technology based, real-time surveillance program that the Commission must be committed to deploying if it is to take its market oversight mission seriously.

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[547] Position Limits for Futures and Swaps, 76 FR _____, _____ (____ __, 2011) (to be codified at 17 CFR pts. 1, 150 and 151) ("In light of the congressional mandate to impose position limits, the Commission disagrees with comments asserting that the Commission must first determine that excessive speculation exists or prove that position limits are an effective tool.").

[548] As defined in new §151.1.

And to be absolutely clear, "speculation" in the world of commodities is a technical term ascribed to any trading that does not qualify as "bona fide hedging." Congress has not outlawed speculation, even when that speculation reaches some unspecified tipping point where it becomes "excessive." What Congress has stated, for over seventy years until the passage of the Dodd-Frank Act, is that excessive speculation that causes sudden or unreasonable fluctuations or unwarranted changes in the price of a commodity is a burden on interstate commerce, and the Commission has authority to utilize its expertise to establish limits on trading or positions that will be effective in diminishing, eliminating, or preventing such burden.[549] The Commission, however, is not, and has never been, without other tools to detect and deter those who engage in abusive practices.[550] What the Dodd-Frank Act *did* do is direct the Commission to exercise its authority at a time when there is simply a lack of empirical data to support doing so, in a universe of legal uncertainty. However, the Dodd-Frank Act did not leave us without a choice, as contended by today's rule. Rather, against the current backdrop of market uncertainty, and Congress's longstanding deference to the expertise of the Commission, the most reasonable interpretation of Dodd-Frank's mandate is that while we must take action and establish position limits, we must only do so to the extent they are appropriate.

Today I write to not only reiterate my concerns with regard to the effectiveness of position limits generally, but to highlight some of the regulatory provisions that I believe pose the greatest fundamental problems and/or challenges to the implementation of the rule passed today. In addition to disagreeing with the Commission's interpretation of its statutory mandate, I

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[549] See section 4a(a)(1) of the CEA.

[550] See Establishment of Speculative Position Limits, 46 FR 50938, 50939 (Oct. 16, 1981) (to be codified at 17 CFR pt. 1) ("The Commission wishes to emphasize, that while Congress gave the Commission discretionary authority to impose federal speculative limits in section 4a(1), the development of an alternate procedure was not foreclosed, and section 4a(1) should not be read in a vacuum.").

believe the Commission has so severely restricted the permitted activities allowed under the bona fide hedging rules that the pursuit by industry of legitimate and appropriate risk management is now made unduly onerous. These limitations, including a veritable ban on anticipatory hedging for merchandisers, are inconsistent with the statutory directive and the very purpose of the markets to, among other things, provide for a means for managing and assuming price risks. I also believe that the rules put into place overly broad aggregation standards, fail to substantiate claims that they adequately protect against international regulatory arbitrage, and do not include an adequate cost-benefit analysis.

Bona Fide Hedging: Guilty Until Proven Innocent

The Commission's regulatory definition of bona fide hedging transactions in §151.5 of the rules, as directed by new section 4a(c)(1) of the Act, generally restricts bona fide hedge exemptions from the application of federally-set position limits to those transactions or positions which represent a substitute for an actual cash market transaction taken or to be taken later, or those trading as the counterparty to an entity that it engaged in such transaction. This definition is narrower than current Commission regulation 1.3(z)(1), which allows for an exemption for transactions or positions that normally represent a substitute for a physical market transaction.

When combined with the remaining provisions of §151.5, which provide for a closed universe of enumerated hedges and ultimately re-characterize longstanding acceptable bona fide hedging practices as speculative, it is evident that the Commission has used its authority to further narrow the availability of bona fide hedging transactions in a manner that will negatively impact the cash commodity markets and the physical commodity marketplace by eliminating certain legitimate derivatives risk management strategies, most notably anticipatory hedging. Among other things, I believe the Commission should have defined bona fide hedging

transactions and positions more broadly so that they encompass long-standing risk management practices and should have preserved a process by which bona fide hedgers could expeditiously seek exemptions for non-enumerated hedging transactions.

In this instance, Congress was particularly clear in its mandate under section 4a(c)(2) that the Commission must limit the definition of bona fide hedging transactions/positions to those that represent actual substitutes for cash market transactions, but Congress did not so limit the Commission in any other manner with regard to the new regulatory provisions addressing anticipatory hedging and the availability of non-enumerated hedges.[551] Moreover, inasmuch as the bona fide hedging definition is restrictive, section 4a(a)(7) provides the Commission broad exemptive authority which it could have utilized to create a process for expeditious adjudication of petitions from entities relying on a broader set of legitimate trading strategies that those that fit the confines of section 4a(c)(1). In addition, given the complex, multi-faceted nature of hedging for commodity-related risks, the Commission could have, as suggested by one commenter, engaged in a separate and distinct informal rulemaking process to develop a workable, commercially practicable definition of bona fide hedging.[552] Given the commercial interests at stake, this would have been a welcome approach. Instead, the Commission chose form over function so that it could "check the box" on its mandate.

In order to qualify as a bona fide hedging transaction or position, a transaction must meet both the requirements under §151.5(a)(1) and qualify as one of eight specific and enumerated

[551] To the contrary, Congress specifically indicated that in defining bona fide hedging transactions or positions, the Commission may do so in such a manner as "to permit producers, sellers, middlemen, and users of a commodity or a product derived therefrom to hedge their legitimate anticipated business needs for that period of time into the future for which an appropriate futures contract is open and available on an exchange." See section 4a(c)(1) of the CEA.

[552] See, e.g., Comment letter from BG Americas & Global LNG on Proposed Rule Regarding Position Limits for Derivatives (RIN 2028-AD15 and 3038-AD16) at 13.

hedging transactions described in §151.5(a)(2). While the list of enumerated hedging transactions is an improvement from the proposed rules, and responds to several comments, especially with regard to the addition of an Appendix B to the final rule describing examples of bona fide hedging transactions, it remains inflexible. In response to commenters, the Commission has decided – at the last minute – to permit entities engaging in practices that reduce risk but that may not qualify as one of the enumerated hedging transactions under §151.5(a)(2) to seek relief from Commission staff under § 140.99 or the Commission under section 4a(a)(7) of the CEA. Whereas this change to the preamble and the rule text is helpful, neither of these alternatives provides for an expeditious determination, nor do they provide for a predictable or certain outcome. In its refusal to accommodate traders seeking legitimate bona fide hedging exemptions in compliance with the Act with an expeditious and straightforward process, the Commission is being short-sighted in light of the dynamic (and in the case of the OTC markets, uncertain) nature of the commodity markets and with respect to the appropriate use of Commission resources.

One particularly glaring example of the Commission's decision to pursue form over function is found in the enumerated exemption for anticipated merchandising found at §151.5(2)(v). The new statutory provision in section 4a(c)(d)(A)(ii) is included to assuage unsubstantiated concerns about unintended consequences such as creating a potential loophole for clearly speculative activity.[553] The Commission has so narrowly defined the anticipated merchandising that only the most elementary operations will be able to utilize it.

For example, in order to qualify an anticipatory merchandising transaction as a bona fide hedge, a hedger must (i) own or lease storage capacity and demonstrate that the hedge is no

[553] Position Limits for Futures and Swaps, 76 FR _____, _____ (_____ __, 2011) (to be codified at 17 CFR pts. 1, 150 and 151).

greater than the amount of current or anticipated unfilled storage capacity owned or leased by the same person during the period of anticipated merchandising activity, which may not exceed one year, (ii) execute the hedge in the form of a calendar spread that meets the "appropriateness" test found in §151.5(a)(1), and (iii) exit the position prior to the last five days of trading if the Core Referenced Futures Contract is for agricultural or metal contracts or the spot month for other physical-delivery commodities. In addition, (iv) an anticipatory merchandiser must meet specific filing requirements under §151.5(d), which among other things, (v) requires that the person who intends on exceeding position limits complete the filing at least ten days prior to the date of expected overage.

Putting the burdens associated with the §151.5(d) filings aside, the anticipatory merchandising exemption and its limitations on capacity, the requirement to "own or lease" such capacity, and one-year limitation for agricultural commodities does not comport with the economic realities of commercial operations. In recent testimony, Todd Thul, Risk Manager for Cargill AgHorizons, commented on its understanding of this provision. He said that by limiting the exemption to unfilled storage capacities through calendar spread positions for one year, the CFTC will reduce the industry's ability to continue offering the same suite of marketing tools to farmers that they are accustomed to using.[554] Mr. Thul offered a more reasonable and appropriate limitation on anticipatory hedging based on annual throughput actually handled on a historic basis by the company in question. It is unclear from today's rule as to whether the Commission considered such an alternative, but according to Mr. Thul, by going forward with the exemption as-is, we will "severely limit the ability of grain handlers to participate in the market and impede the ability to offer competitive bids to farmers, manage risk, provide liquidity

[554] Testimony of Todd Thul, Risk Manager, Cargill AgHorizons before the House Committee on Agriculture, Oct. 12, 2011, available at http://agriculture.house.gov/pdf/hearings/Thul111012.pdf.

and move agriculture products from origin to destination."[555, 556] Limiting commercial participation, Mr. Thul points out, increases volatility—and that is clearly not what Congress intended. I agree. I cannot help but think that the Commission is waging war on commercial hedging by employing a "government knows best" mandate to direct companies to employ only those hedging strategies that we give our blessing to and can conceive of at this point in time. Imagine the absurdity that we could prevent a company such as a cotton merchandiser from hedging forward a portion of his expected cotton purchase. Or, if they meet the complicated prerequisites, the commercial firm must get approval from the Commission before deploying a legitimate commercial strategy that exchanges have allowed for years.

Aggregation Disparity

In another attack on commercial hedging the Commission has developed a flawed aggregation rule that singles out owned-non financial firms for unique and unfair treatment under the rule. These commercial firms, which, among others, could be energy producers or merchandisers, are not provided the same protections under the independent controller rules as financial entities such as hedge funds or index funds. I believe that the aggregation provisions of the final rule would have benefited from a more thorough consideration of additional options and possible re-proposal of at least two provisions: the general aggregation provision found in §151.7(b) and the proposed aggregation for exemption found in §151.7(f) of the proposed rule,[557] now commonly referred to at the Commission as the owned non-financial exemption or "ONF."

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[555] Id.

[556] Though I rely upon the example of agricultural operations to illustrate my point, the limitations on the anticipated merchandising hedge are equally harmful to other industries that operate in relatively volatile environments that are subject to unpredictable supply and demand swings due to economic factors, most notably energy. See, e.g., Comment letter from ISDA on Notice of Proposed Rulemaking – Position Limits for Derivatives at 3-5 (Oct. 3, 2011).

[557] See 76 FR at 4752, 4762 and 4774.

Under §151.7(b), absent the applicability of a specific exemption found elsewhere in §151.7, a direct or indirect ownership interest of ten percent or greater by any entity in another entity triggers a 100% aggregation of the "owned" entity's positions with that of the owner. While commenters agreed that an ownership interest of ten percent or greater has been the historical basis for requiring aggregation of positions under Commission regulation §150.5(b), absent applicable exemptions, historically, aggregation has not been required in the absence of indicia of control over the "owned" entity's trading activities, consistent with the independent account controller exemption (the "IAC") under Commission regulation §150.3(a)(4). While the final rule preserves the IAC exemption, it only does so in response to overwhelming comments arguing against its proposed elimination, which was without any legal rationale.[558] And, to be clear, the IAC is only available to "eligible entities" defined in §151.1, namely financial entities, and only with respect to client positions.

The practical effect of this requirement is that non-eligible entities, such as holding companies who do not meet any of the other limited specified exemptions will be forced to aggregate on a 100% basis the positions of any operating company in which it holds a ten percent or greater equity interest in order to determine compliance with position limits. While the Commission concedes that the holding company could conceivably enter into bona fide hedging transactions relating to the operating company's cash market activities, provided that the operating company itself has not entered into such hedges,[559] this is an inadequate, operationally-impracticable solution to the problem of imparting ownership absent control. Moreover, by requiring 100% aggregation based on a ten percent ownership interest, the Commission has

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[558] See 76 FR at 4752, 4762.

[559] Position Limits for Futures and Swaps, 76 FR _____, _____ (____ __, 2011) (to be codified at 17 CFR pts. 1, 150 and 151).

determined that it would prefer to risk double-counting of positions over a rational disaggregation provision based on a concept of ownership that does not clearly attach to actual control of trading of the positions in question.

Exemptions like those found in §§151.7(g) and (i) that provide for disaggregation when ownership above the ten percent threshold is specifically associated with the underwriting of securities or where aggregation across commonly-owned affiliates would require information sharing that would result in a violation of federal law, are useful and no doubt appreciated. However, the Commission has failed to apply a consistent standard supporting the principles of ownership and control across all entities in this rulemaking.

Tiered Aggregation – A Viable and Fair Solution

Also, the Commission did not address in the final rules a proposal put forth by Barclays Capital for the Commission to clarify that when aggregation is triggered, and no exemption is available, only an entity's pro rata share of the position that is actually controlled by it, or in which it has an ownership interest will be aggregated. This proposal included a suggestion that the Commission consider positions in tiers of ownership, attributing a percentage of the positions to each tier. While Barclays acknowledged that the monitoring would still be imperfect, the measures would be more accurate than an attribution of a full 100% ownership and would decrease the percentage of duplicative counting of positions.[560]

I believe that a tiered approach to aggregation should have been considered in these rules, and not be entirely removed from consideration as we move forward with these final rules. Barclays (and perhaps others) has made a compelling case and staff has not persuaded me that there is any legal rationale for not further exploring this option. While I understand that it may

[560] Comment letter from Barclays Capital on Position Limits for Derivatives (RIN 3038-AD15 and 3038-AD16) at 3 (Mar. 28, 2011), *available at* http://comments.cftc.gov/PublicComments/CommentList.aspx?id=965.

be more administratively burdensome for the Commission to monitor tiered aggregation, I would presume that we could engage in a cost-benefit analysis to more fully explore such burdens in light of the potential costs to industry associated with the implementation of 100% aggregation.

Owned Non-Financial – No Justification

The best example of the Commission's imbalanced treatment of market participants is manifest in the aggregation rules applied to owned non-financial firms. The Commission has shifted its aggregation proposal from the draft proposal to this final version. The final rule does not ultimately adopt the proposed owned-non-financial entity exemption which was proposed in lieu of the IAC to allow disaggregation primarily in the case of a conglomerate or holding company that "merely has a passive ownership interest in one or more non-financial companies."[561] The rationale was that, in such cases, operating companies would likely have complete trading and management independence and operate at such a distance that is would simply be inappropriate to aggregate positions.[562] While several commenters argued that the ONF was too narrow and discriminated against financial entities without a proper basis, the Commission provided no substantive rationale for its decision to fully drop the ONF exemption from consideration. Instead, the Commission relied upon its determination to retain the IAC exemption and add the additional exemptions under §§151.7(g) and (i) described above to find that it "may not be appropriate, at this time, to expand further the scope of disaggregation exemptions to owned-non financial entities."

In failing to articulate a basis for its decision to drop outright from consideration the ONF exemption, the Commission places itself in the same improvident position it was in when it proposed eliminating the IAC exemption, and now has given no reasoned explanation for

[561] 76 FR at 4752, 4762.
[562] Id.

discriminating against non-financial entities. This is especially disconcerting since at least one commenter has pointed out that baseless decision-making of this kind creates a risk that a court will strike down our action as arbitrary and capricious.[563]

Since I first learned of the Commission's change of course, I have requested that the Commission re-propose the ONF exemption in a manner that establishes an appropriate legal basis and provides for additional public comment pursuant to the Administrative Procedure Act. The Commission has outright refused to entertain my request to even include in the preamble of the final rules a commitment to further consider a version of the ONF exemption that would be more appropriate in terms of its breadth. The Commission's decision puts the rule at risk of being overturned by the courts and exemplifies the pains at which this rule has been drafted to put form over function.

The Great Unknown: International Regulatory Arbitrage

In addressing concerns relating to the opportunities for regulatory arbitrage that may arise as a result of the Commission imposing these position limits, the Commission points out that is has worked to achieve the goal of avoiding such regulatory arbitrage through participation in the International Organization of Securities Commissions ("IOSCO") and summarily rejects commenters who believe it is a foregone conclusion that the existence of international differences in position limit policies will result in such arbitrage in reliance on prior experience. While I don't disagree that the Commission's work within IOSCO is beneficial in that it

[563] See Comment letter from CME Group on Position Limits for Derivatives at 16 (Mar. 28, 2011), available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=33920&SearchText=CME ("Where agencies do not articulate a basis for treating similarly situated entities differently, as the Commission fails to do here, courts will strike down their actions as arbitrary and capricious. See, e.g., Indep. Petroleum Ass'n of America v. Babbitt, 92 F.3d 1248 (D.D. Cir. 1996) ("An Agency must treat similar cases in a similar manner unless it can provide a legitimate reason for failing to do so." (citing Nat'l Ass'n of Broadcasters v. FCC, 740 F.2d 1190, 1201 (D.C. Cir. 1984))).

increases the likelihood that we will reach international consensus with regard to the use of position limits, the Commission ought to be more forthcoming as to principles as a whole.

In particular, while the IOSCO Final Report on Principles for the Regulation and Supervision of Commodity Derivatives Markets[564] does, for the first time, call on market authorities to make use of intervention powers, including the power to set ex-ante position limits, this is only one of many such recommendations that international market authorities are not required to implement. The IOSCO Report includes the power to set position limits, including less restrictive measures under the more general term "position management." Position Management encompasses the retention of various discretionary powers to respond to identified large concentrations. It would have been preferable for the Commission to have explored some of these other discretionary powers as options in this rulemaking, thereby putting us in the right place to put our findings into more of a practice.

As to the Commission's stance that today's rules will not, by their very passage, drive trading abroad, I am concerned that the Commission's prior experience in determining the competitive effects of regulatory policies is inadequate. Today's rules by far represent the most expansive exercise of the Commission's authority both with regard to the setting of position limits and with regard to its jurisdiction in the OTC markets. The Commission's past studies regarding the effects of having a different regulatory regime than our international counterparts, conducted in 1994 and 1999, cannot possibly provide even a baseline comparison. Since 2000, the volume of actively traded futures and option contracts on U.S. exchanges alone has increased almost tenfold. Electronic trading now represents 83% of that volume, and it is not too difficult to imagine how easy it would be to take that volume global.

[564] Principles for Regulation and Supervision of Commodity Derivatives Markets, IOSCO Technical Committee (Sept. 2011), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD358.pdf.

I recognize that we cannot dictate how our fellow market authorities choose to structure their rules and that in any action we take, we must do so with the knowledge that as with any rules, we risk triggering a regulatory race to the bottom. However, I believe that we ought not to deliver to Congress, or the public, an unsubstantiated sense of security in these rules.

Cost-Benefit Analysis: Hedgers Bear the Brunt of an Undue and Unknown Burden

With every final rule, the Commission has attempted to conduct a more rigorous cost-benefit analysis. There is most certainly an uncertainty as to what the Commission must do in order to justify proposals aimed at regulating the heretofore unregulated. These analyses demonstrate that the Commission is taking great pains to provide quantifiable justifications for its actions, but only when reasonably feasible. The baseline for reasonability was especially low in this case because, in spite of the availability of enough data to determine that this rule will have an annual effect on the economy of more than $100 million, and the citation of at least fifty-two empirical studies in the official comment record debating all sides of the excessive speculation debate, the Commission is not convinced that it must "determine that excessive speculation exists or prove that position limits are an effective regulatory tool."[565] I suppose this also means that the Commission did not have to consider the costs of alternative means by which it could have complied with the statutory mandates. It is utterly astounding that the Commission has designed a rule to combat the unknown threat of "excessive speculation" that will likely cost market participants $100 million dollars annually and yet, "[T]he Commission need not prove that such limits will in fact prevent such burdens."[566] A flip remark such as this undermines the entire rule, and invites legal challenge.

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[565] Position Limits for Futures and Swaps, 76 FR _____, _____ (____ __, 2011) (to be codified at 17 CFR pts. 1, 150 and 151).
[566] *Id.*

I respect that the Commission has been forthcoming in that the overall costs of this final rule will be widespread throughout the markets and that swap dealers and traditional hedgers alike will be forced to change their trading strategies in order to comply with the position limits. However, I am unimpressed by the Commission's glib rationale for not fully quantifying them. The Commission does not believe it is reasonably feasible to quantify or even estimate the costs from changes in trading strategies because doing so would necessitate having access to and an understanding of entities' business models, operating models, hedging strategies, and evaluations of potential alternative hedging or business strategies that would be adopted in light of such position limits.[567] The Commission believed it impractical to develop a generic or representative calculation of the economic consequences of a firm altering its trading strategies.[568] It seems that the numerous swap dealers and commercial entities who provided comments as to what kind of choices they would be forced to make if they were to find themselves faced with hard position limits, the loss of exchange-granted bona fide hedge exemptions for risk management and anticipatory hedging, and forced aggregation of trading accounts over which they may not even have current access to trading strategies or position information, more likely than not thought they were being pretty clear as to the economic costs.

In choosing to make hardline judgments with regard to setting position limits, limiting bona fide hedging, and picking clear winners and losers with regard to account aggregation, the Commission was perhaps attempting to limit the universe of trading strategies. Indeed, as one runs through the examples in the preamble and the new Appendix B to the final rules, one cannot help but conclude that how you choose to get your exposure will affect the application of

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[567] Id.
[568] Id.

position limits. And the Commission will help you make that choice even if you aren't asking for it.

I have numerous lingering questions and concerns with the cost-benefit analysis, but I will focus on the impact of these rules on the costs of claiming a bona fide hedge exemption.

In addition to incorporating the new, narrower statutory definition of bona fide hedging for futures contracts into the final rules, the Commission also extended the definition of bona fide hedging transactions to swaps and established a reporting and recordkeeping regime for bona fide hedging exemptions. In the section of the cost-benefit analysis dedicated to a discussion of the bona fide hedging exemptions, the Commission "estimates that there *may* be significant costs (or foregone benefits)" and that firms "*may* need to adjust their trading and hedging strategies" (emphasis added)[569] Based on the comments of record and public contention over these rules, that *may* be the understatement of the year. To be clear, however, there is no quantification or even qualification of this potentially tectonic shift in how commercial firms and liquidity providers conduct their business because the Commission is unable to estimate these kinds of costs, and the commenters did not provide any quantitative data for them to work with.[570] I think this part of the cost-benefit analysis *may* be susceptible to legal challenge.

The Commission does attempt a strong comeback in estimating the costs of bona fide hedging-related reporting requirements. The Commission estimates that these requirements, even after all of the commenter-friendly changes to the final rule, will affect approximately 200 entities annually and result in a total burden of approximately $29.8 million. These costs, it argues, are necessary in that they provide the benefit of ensuring that the Commission has access

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[569]Position Limits for Futures and Swaps, 76 FR _____, _____ (____ __, 2011) (to be codified at 17 CFR pts. 1, 150 and 151).
[570]Id.

to information to determine whether positions in excess of a position limit relate to bona fide hedging or speculative activity.[571] This $29.8 million represents almost thirty percent of the overall estimated costs at this time, and it only covers *reporting* for entities seeking to hedge their legitimate commercial risk. I find it difficult to believe that the Commission cannot come up with a more cost-effective and less burdensome alternative, especially in light of the current reporting regimes and development of universal entity, commodity, and transaction identifiers. I was not presented with any other options. I will, however, continue to encourage the rulemaking teams to communicate with one another in regard to progress in these areas and ensure that the Commission's new Office of Data and Technology is tasked with the permanent objective of exploring better, less burdensome, and more cost-efficient ways of ensuring that the Commission receives the data it needs.

We Have Done What Congress Asked—But, What Have We Actually Done?

The consequence is that in its final iteration, the position limits rule represents the Commission's desire to "check the box" as to position limits. Unfortunately, in its exuberance and attempt to justify doing so, the Commission has overreached in interpreting its statutory mandate to set position limits. While I do not disagree that the Commission has been directed to impose position limits, as appropriate, this rule fails to provide a legally sound, comprehensible rationale based on empirical evidence. I cannot support passing our responsibilities on to the judicial system to pick apart this rule in a multitude of legal challenges, especially when our action could negatively affect the liquidity and price discovery function of our markets, or cause them to shift to foreign markets. I also have serious reservations regarding the excessive regulatory burden imposed on commercial firms seeking completely legitimate and historically

[571] Id.

provided relief under the bone fide hedge exemption. These firms will spend excessive amounts to remain within the strict limitations set by this rule. Congress clearly conceived of a much more workable and flexible solution that this Commission has ignored.

In its comment letter of March 25, 2011, the Futures Industry Association (FIA) stated, "The price discovery and risk-shifting functions of the U.S. derivatives markets are too important to U.S. and international commerce to be the subject of a position limits experiment based on unsupported claims about price volatility caused by excessive speculative positions."[572] Their summation of our proposal as an experiment is apt. Today's final rule is based on a hypothesis that historical practice and approach, which has not been proven effective in recognized markets, will be appropriate for this new integrated futures and swaps market that is facing uncertainty from all directions largely due to the other rules we are in the process of promulgating. I do not believe the Commission has done its research and assessed the impacts of testing this hypothesis, and that is why I cannot support the rule. As the Commission begins to analyze the results of its experiment, it remains my sincerest hope that our miscalculations ultimately do not lead to more harm than good. I will take no comfort if being proven correct means that the agency has failed in its mission.

[572] Comment letter from Futures Industry Association on Position Limits for Derivatives (RIN 2028-AD15 and 3038-AD16) at 3 (Mar. 25, 2011), available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34054&SearchText=futures%20industry%20association.