

DIVISION OF MARKET OVERSIGHT ADVISORY

Bona Fide Hedge Treatment under the Commission's Position Limit Regulations

The Division of Market Oversight (“Division”) of the Commodity Futures Trading Commission (“CFTC” or “Commission”) issues this advisory to remind market participants that §§ 1.3(z) and 1.48 of the Commission’s regulations, as they existed prior to the Commission’s adoption of final rules addressing Position Limits for Futures and Swaps¹ (text provided below), will continue to apply to the position limits under the Commission’s part 150 regulations during the transition period, that is, from the effective date of the Final Rule (January 17, 2012) until the date 60 days after the date when the Commission and the Securities and Exchange Commission jointly publish a rule or rules in the Federal Register further defining the term “swap” under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010) (the “compliance date”).² Until the compliance date, market participants may request relief from Federal position limits for bona fide hedges that are enumerated under § 1.3(z). After the compliance date, § 1.3(z) will only apply to excluded commodities, and the bona fide hedging provisions under § 151.5 of the Final Rule will apply to exempt and agricultural commodities.³

As part of the transition to the part 151 position limits regime, pursuant to § 151.9(d), market participants who have been granted non-enumerated bona fide hedge exemptions under § 1.47 will continue to be allowed to manage the risk of the associated swap portfolio.⁴ However,

¹ 76 FR 71626 (Nov. 18, 2011) (the “Final Rule”).

² The transition period from the position limits regime under part 150 to the position limits regime in part 151 is described in detail in the Final Rule at 76 FR 71626, 71632.

³ *Id.*

⁴ As explained in the preamble to the final rule, the Commission will not be granting additional § 1.47 exemptions because of the transitional nature of providing for such relief. *See* 76 FR 71626, 71694 (November 18, 2011).

as provided in § 151.9(d), any relief granted under § 1.47 will not apply to any new swap positions (including positions which extend a swap with the same counterparty) established after the compliance date.

1.3(z) Bona fide hedging transactions and positions--

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

- (i) The potential change in the value of assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising,
- (ii) The potential change in the value of liabilities which a person owns or anticipates incurring, or
- (iii) The potential change in the value of services which a person provides, purchases, or anticipates providing or purchasing.

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

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

- (i) Sales of any commodity for future delivery on a contract market which do not exceed in quantity:
 - (A) Ownership or fixed-price purchase of the same cash commodity by the same person; and

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

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

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

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

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

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

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

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

1.48 Requirements for classification of sales or purchases for future delivery as bona fide hedging of unsold anticipated production or unfilled anticipated requirements under § 1.3(z)(2)(i)(B) or (ii)(C) of the regulations.

(a) Any person who wishes to avail himself of the provisions of § 1.3(z)(2)(i)(B) or (ii)(C) of the regulations and to make sales or purchases for future delivery in any commodity in excess of trading and position limits then in effect pursuant to section 4a of the Act for the purposes of

bona fide hedging shall file statements with the Commission in conformity with the requirements of this section. All or a specified portion of the unsold anticipated production or unfilled anticipated requirements described in these statements shall not be considered as offsetting positions for bona fide hedging transactions and positions if such person is so notified by the Commission within ten days after the Commission is furnished with the information required under paragraphs (b) or (c) of this section. The Commission may request the person notified to file specific additional information with the Commission to support a determination that the statement filed accurately reflects unsold anticipated production or unfilled anticipated requirements for manufacturing, processing or feeding. In such cases, the Commission shall consider all additional information so filed and, by notice to such person, shall specify its determination as to what portion of the production or requirements described constitutes unsold anticipated production or unfilled anticipated requirements for the purposes of bona fide hedging. In no case shall such transactions and positions which offset unsold anticipated production or unfilled anticipated requirements be considered bona fide hedging if they exceed the levels specified in paragraph (d) of this section of the regulations.

(b) Initial statement. Initial statements concerning the classification of transactions and positions as bona fide hedging pursuant to § 1.3(z)(2)(i)(B) or (ii)(C) shall be filed with the Commission at least ten days in advance of the date that such transactions or positions would be in excess of limits then in effect pursuant to section 4a of the Act. Such statements shall set forth in detail for a specified operating period not in excess of one year the person's unsold anticipated production or unfilled anticipated requirements for processing or manufacturing or feeding and explain the method of determination thereof, including, but not limited to, the following information:

(1) For unsold anticipated production:

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

(ii) Anticipated production of such commodity for a specified period not in excess of one year;

(iii) Fixed-price forward sales of such commodity;

(iv) Unsold anticipated production of such commodity for a specified period not in excess of one year.

(2) For unfilled anticipated requirements:

(i) Annual requirements of such commodity for processing or manufacturing or feeding for the three complete fiscal years preceding the current fiscal year;

(ii) Anticipated requirements of such commodity for processing or manufacturing or feeding for a specified operating period not in excess of one year;

(iii) Inventory and fixed-price forward purchases of such commodity, including any quantity in process of manufacture and finished goods and byproducts of manufacture or processing (in terms of such commodity);

(iv) Unfilled anticipated requirements of such commodity for processing or manufacturing or feedings for a specified operating period not in excess of one year.

(3) Additional information: Persons hedging unsold anticipated production or unfilled anticipated requirements which are not the same quantity or are not the same commodity as the commodity to be sold or purchased for future delivery shall furnish this information both in terms of the actual commodity produced or used and in terms of the commodity to be sold or purchased for future delivery. In addition, such persons shall explain the method for determining the ratio of conversion between the amount of the actual unsold anticipated production or unfilled anticipated requirements and the amount of commodity to be sold or purchased for future delivery. Persons hedging unfilled annual feeding requirements for livestock and poultry shall provide the number of cattle, hogs, sheep, or poultry expected to be fed during the specified period, not to exceed one year, and the derivation of their annual requirements based upon these numbers. Persons filing as an agent shall furnish this information on the basis of the fiscal or operating year of the person on whose behalf the filing is made.

(c) Supplemental reports. Whenever the sales or purchases which a person wishes to consider as bona fide hedging of unsold anticipated production or unfilled anticipated requirements shall exceed the amounts described by the figures for requirements furnished in the most recent filing pursuant to this section or the amounts determined by the Commission to constitute unsold anticipated production or unfilled anticipated requirements pursuant to paragraph (a) of this section, such person shall file with the Commission a statement which updates the information provided in the person's most recent filing and supplies the reason for this change at least ten days in advance of the date that person wishes to exceed these amounts.

(d) Maximum sales and purchases. Sales or purchases for future delivery considered as bona fide hedges pursuant to § 1.3(z)(2) (i)(B) or (ii)(C) shall at no time exceed the lesser of:

(1) A person's unsold anticipated production of unfilled anticipated requirements as described by the information most recently filed pursuant to this section or determined by the Commission pursuant to paragraph (a) of this section; or

(2) A person's actual unsold anticipated production or current unfilled anticipated requirements for the length of time specified in the information most recently filed pursuant to this section.

(e) Updated reports. Reports updating the information required pursuant to this section shall also be filed with the Commission upon specific request.

* * * * *

Issued in Washington, D.C. on March 22, 2012, by the Division of Market Oversight.

RICHARD A. SHILTS
DIRECTOR