Commodity Futures Trading Commission

Office of Public Affairs

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Proposed Rulemaking Q & A

What is the goal of the proposed rulemaking?

The notice of rulemaking proposes to re-establish speculative position limits on regulated derivatives based on four major energy commodities. The proposed rules are designed to prevent excessive concentration in these markets, consistent with CFTC's statutory framework to prevent or diminish excessive speculation that may be a burden on interstate commerce.

Which commodities are covered by the proposed regulations?

The proposed regulations cover four referenced energy commodities—(1)Henry Hub natural gas, (2) light sweet crude oil prices (aka, West Texas Intermediate or WTI), (3) New York Harbor No. 2 heating oil, and (4) New York Harbor gasoline blendstock.

What exchanges are covered by the proposed regulations?

The proposed regulations would apply to all CFTC-regulated exchanges. Currently, these four referenced energy commodities are traded on two reporting markets: (1) the New York Mercantile Exchange (NYMEX); and (2) the IntercontinentalExchange (ICE) located in Atlanta, Georgia.

How is the proposal similar to the CFTC's speculative position limit framework for agricultural commodities?

The proposal is in part a product of the CFTC's experience in administering the speculative position limit framework for agricultural commodities and includes the following similarities:

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

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

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

How is the proposed energy speculative position limit framework different from the agricultural Federal speculative positions limits?

The proposed energy Federal limits differ in several ways from agricultural Federal limits:

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

How are the proposed all-months-combined and single-month position limits set?

The aggregate limits are set by formula based on open interest. The AMC speculative position limit would be 10% of the first 25,000 contracts of open interest and 2.5% of open interest beyond 25,000 contracts. The single-month position limit, in turn, is set at 2/3 of the AMC position limit.

To promote competition, for a small reporting market, the AMC limit would be up to 30% of a contract's total open interest on that exchange. The single-month limit that would apply to a single exchange would be equal to 2/3 of that value—or as much as 20%—of the total open interest on that exchange. For new reporting markets, a de minimis AMC limit would be the greater of 5,000 contracts or 1% of all open interest in a referenced energy commodity contract.

How are spot-month speculative position limits set for cash-settled contracts covered by the proposal?

A trader holding cash-settled contracts would be subject to a spot-month speculative position limit of 5 times the level fixed for the cash-settled contract's physically-settled counterpart if the trader holds no physically-settled contracts in the spot month. Otherwise, traders would be subject to the same limit fixed for a contract's physically-settled counterpart. Pursuant to recently adopted exchange rules, this is the same methodology for spot-month speculative position limits that applies to cash-settled Henry Hub natural gas contracts on NYMEX and ICE, beginning with the February 2010 contract months.

What types of exemptions would be available under the proposed regulations?

The proposal includes two types of exemptions: (1) a *bona fide* hedging exemption (currently applied to positions covered by the Federal agricultural limits) for traders with inventory or anticipatory purchase or sale transactions in the physical commodity; and (2) a new limited risk management exemption for swap dealers, in lieu of an exemption for a *bona fide* hedging transaction.

Traders hedging commercial risks (for example, airlines purchasing futures contracts to hedge the cost of fuel) would qualify for a *bona fide* hedging exemption from the proposed speculative position limits to the extent of their demonstrated needs to a reporting market.

Swap dealers establishing positions to offset customer initiated swap positions could also qualify for a limited risk management exemption for positions held outside the spot month. The limited risk management exemption for swap dealers would be administered by the CFTC and capped at two times an otherwise applicable proposed position limit (i.e., an AMC or single-month limit).

How would the positions of *bona fide* hedgers that also trade either as swap dealers or speculatively be treated under the proposed regulations?

The CFTC's proposal treats *bona fide* hedgers and swap dealers in a manner that is generally consistent with the practice of certain exchanges that independently administer an agricultural speculative position limit framework.

The proposed regulations would count *bona fide* hedging transactions against a trader's ability to hold speculative positions. For example, a trader holding *bona fide* hedging positions greater than a proposed Federal speculative position limit would not be able to simultaneously hold a speculative position. Further, a trader's swap risk management position also would count against a trader's ability to hold speculative positions.

A trader's combined *bona fide* hedging positions and swap risk management positions could be as large as two times a proposed Federal speculative position limit, before the trader's *bona fide* hedging positions begin to count against the swap risk management positions.

How would traders apply for an exemption for *bona fide* hedging positions or swap dealer risk management transactions?

Traders with *bona fide* hedging needs would apply to an exchange to receive a *bona fide* hedge exemption subject to CFTC audits. Swap dealers would have to apply to the CFTC for an exemption from the speculative position limits. Both *bona fide* hedgers and swap dealers would be subject to routine reporting requirements that support and substantiate their exemptions.

How many traders would the CFTC's proposal affect?

The notice of proposed rulemaking, if finalized, would have affected approximately ten large traders across the four referenced energy commodity contracts. These large traders could seek and may qualify for exemptions.

Did the CFTC find that there was excessive speculation in the regulated derivatives markets for the major energy commodities?

The Commodity Exchange Act directs the CFTC to act prospectively, as necessary, to curb or prevent excessive speculation that may burden interstate commerce. The CFTC's notice of proposed rulemaking does not speak to whether there was excessive speculation in the regulated derivatives markets for the major energy commodities.

Would the position limits affect the functioning of the regulated derivatives markets for the major energy commodities?

The proposed speculative position limits are intended to limit the concentration of positions and promote fair and orderly markets. The CFTC's proposed framework is designed to facilitate trading activity that promotes the pricing and risk management functions of the covered contracts, while prohibiting the concentration of large positions in the accounts of one or a few traders.

Would exchange position accountability levels and requirements be changed by the proposed energy positions limits?

No. The CFTC's proposed speculative position limits for major energy commodity derivatives would supplement the position accountability requirements of the exchanges.

Under the CFTC's proposal, would investors holding passive long-only positions be treated differently than other investors?

The CFTC's proposal would not classify and treat passive long-only investors differently. The proposal, however, solicits public comment on how to identify and define such positions and whether such positions should, including collectively, be limited in any way.