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COMMODITY FUTURES TRADING COMMISSION

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

RIN 3038-AD99

Position Limits for Derivatives

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

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

DATES: *Effective date*: This Final Rule will become effective on **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Compliance date: Compliance dates for this Final Rule shall be as follows:

- January 1, 2022 in connection with the Federal speculative position limits for the 16 non-legacy core referenced futures contracts subject to Federal position limits for the first time under this Final Rule. This compliance date also applies to any associated referenced contracts other than economically equivalent swaps. Such swaps are subject to a separate compliance date noted below.
- January 1, 2022 in connection with an exchange's requirements under § 150.5, as adopted in this Final Rule.
- January 1, 2023 in connection with Federal speculative position limits for economically equivalent swaps, as defined under this Final Rule.
- January 1, 2023 in connection with the elimination of previously-granted risk management exemptions described in § 150.3(c), as adopted in this Final Rule.

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I. Background

A. Introduction

The Commission has long established and enforced speculative position limits for futures contracts and options on futures contracts on nine agricultural commodities as authorized by the CEA.[1] These nine agricultural commodity contracts, which have been subject to Federal position limits for decades, are generally referred to as the "nine legacy agricultural contracts." Under this Final Rule, the Commission additionally will establish Federal speculative position limits for certain commodity derivatives contracts associated with 16 additional commodities. The Commission refers to these 16 new commodities and their associated commodity derivatives contracts throughout this release as the "non-legacy" contracts since they are subject to Federal position limits for the first time under this Final Rule. Accordingly, under the Final Rule, certain commodity derivatives contracts associated with 25 commodities are subject to Federal position limits.

The Commission's existing position limits regulations[2] in existing part 150 of the Commission's regulations include three components:

First, the Commission's existing regulations establish separate position limit levels for each of the nine legacy agricultural contracts. These Federal position limit levels set the maximum speculative positions in each of the nine legacy agricultural contracts that a person may hold in the spot month, individual month, and all-months-combined.[3]

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

[2] 17 CFR part 150. Part 150 of the Commission's regulations establishes Federal position limits (that is, position limits established by the Commission) on the nine legacy agricultural contracts. The nine legacy agricultural contracts are: CBOT Corn (and Mini-Corn) (C), CBOT Oats (O), CBOT Soybeans (and Mini-Soybeans) (S), CBOT Wheat (and Mini-Wheat) (W), CBOT Soybean Oil (SO), CBOT Soybean Meal (SM), MGEX Hard Red Spring Wheat (MWE), CBOT KC Hard Red Winter Wheat (KW), and ICE Cotton No. 2 (CT). *See* 17 CFR 150.2. The Federal position limits on these agricultural contracts are referred to as "legacy" limits because these contracts have been subject to Federal position limits for decades.

[3] *See* 17 CFR 150.2.

Second, the existing Federal position limits framework provides exemptions to the Federal position limit levels for positions that constitute "bona fide hedging transactions or positions" and for certain "spread or arbitrage" positions.[4]

Third, the Commission's existing regulations determine which accounts and positions a person must aggregate for the purpose of determining compliance with the Federal position limit levels.[5]

The existing Federal speculative position limits function in parallel to exchange-set position limits and/or exchange-set position accountability required by designated contract market ("DCM") Core Principle 5.[6] As a result, the nine legacy agricultural contracts are subject to both Federal and exchange-set limits, whereas other exchange-traded futures contracts and options on futures contracts are subject only to DCM-set limits and/or position accountability.

As part of the Dodd-Frank Act, Congress amended the CEA's position limits provisions, which since 1936 have authorized the Commission (and its predecessor) to impose limits on speculative positions to prevent the harms caused by excessive speculation. As discussed below, the Commission interprets these amendments as, among other things, tasking the Commission with establishing such position limits as it finds are "necessary" for the purpose of "diminishing, eliminating, or preventing" excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity.[7] The Commission also interprets these

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[4] *See* 17 CFR 150.3.

[5] *See* 17 CFR 150.4.

[6] 7 U.S.C. 7(d)(5); 17 CFR 38.300. Paragraph (A) of DCM Core Principle 5 provides: To reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), the board of trade shall adopt for each contract of the board of trade, as is necessary and appropriate, position limitations or position accountability for speculators. Position limits generally cannot be exceeded absent an exemption, whereas position accountability allows an exchange to establish a level at which market participants, including those participants who do not qualify for an exemption, are required to: provide position information to the exchange prior to increasing a position above the accountability level; halt further position increases; and/or reduce positions in an orderly manner. Core Principle 6 in part 37 of the Commission's regulations for swap execution facilities ("SEFs") contains similar language. 17 CFR 38.600.

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

amendments as tasking the Commission with establishing position limits on any "economically equivalent" swaps.[8]

The Commission previously issued proposed and final rules in 2011 ("2011 Final Rulemaking") to implement the provisions of the Dodd-Frank Act regarding position limits and the bona fide hedge definition.[9] A September 28, 2012 order of the U.S. District Court for the District of Columbia vacated the 2011 Final Rulemaking, with the exception of the rule's amendments to 17 CFR 150.2.[10]

Subsequently, the Commission proposed position limits regulations in 2013 ("2013 Proposal"), in June of 2016 ("2016 Supplemental Proposal"), and again in December of 2016 ("2016 Reproposal").[11] The 2016 Reproposal would have amended part 150 of the Commission's regulations to, among other things: establish Federal position limits for 25 physical commodity futures contracts and their linked futures contracts, options on futures contracts, and "economically equivalent" swaps; revise the existing exemptions from such limits, including for bona fide hedges; and establish a framework for exchanges[12] to recognize certain positions as bona fide hedges and thus exempt from position limits.

To date, the Commission has not issued any final rulemaking based on the 2013 Proposal, 2016 Supplemental Proposal, or 2016 Reproposal. The 2016 Reproposal generally addressed comments received in response to the 2013 Proposal and the 2016 Supplemental Proposal. In a separate 2016 proposed rulemaking, the CFTC also proposed, and later adopted in 2016, amendments to rules in § 150.4 of the Commission's regulations governing aggregation of positions for purposes of compliance with Federal

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[8] 7 U.S.C. 6a(a)(5); *see also infra* Section II.B.1.iii.

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

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

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

[12] Unless indicated otherwise, the use of the term "exchanges" throughout this release refers to DCMs and SEFs.

position limits.[13] These aggregation rules currently apply only to the nine legacy agricultural contracts subject to existing Federal position limits. Going forward, these aggregation rules will apply to all commodity derivative contracts that are subject to Federal position limits under this Final Rule.

The Commission published a notice of a proposed rulemaking in the *Federal Register* on February 27, 2020 for a new position limits proposal ("2020 NPRM"). After reconsidering the prior proposals, including reviewing the comments responding thereto, the Commission in the 2020 NPRM withdrew from further consideration the 2013 Proposal, the 2016 Supplemental Proposal, and the 2016 Reproposal.[14]

In the 2020 NPRM, the Commission intended to: (1) recognize differences across commodities and contracts, including differences in commercial hedging and cash-market reporting practices; (2) focus on commodity derivative contracts that are critical to price discovery and distribution of the underlying commodities such that the burden of excessive speculation in the commodity derivative contracts may have a particularly acute impact on interstate commerce for the underling commodities; and (3) reduce duplication and inefficiency by leveraging existing expertise and processes at DCMs.

The public comment period for the 2020 NPRM ended May 15, 2020,[15] and the Commission received approximately 75 public comment letters.[16] After reviewing these

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

[14] Because the earlier proposals were withdrawn in the 2020 NPRM, comments on the earlier proposals are not part of the administrative record with respect to the 2020 NPRM nor with respect to this Final Rule, except where expressly referenced herein. In the 2020 NPRM, the Commission stated that commenters to the 2016 Reproposal should resubmit comments relevant to the subject proposal; commenters who wish to reference prior comment letters should cite those prior comment letters as specifically as possible. (85 FR at 11597). Accordingly, this Final Rule will not discuss comments submitted in connection with the 2016 Reproposal unless such comments were resubmitted for the 2020 NPRM.

[15] Comments were originally due by April 29, 2020. Due to the COVID-19 pandemic, the Commission extended the deadline to May 15, 2020.

[16] The Commission states "approximately 75 relevant comment letters" since several commenters submitted additional, or supplemental, comments. As a result, the total could change slightly depending on whether one includes these supplemental comment letters in the total. Thus, for the avoidance of doubt, the Commission uses "approximately." The Commission received comments from: American Cotton Shippers Association ("ACSA"); American Feed Industry Association ("AFIA"); American Gas Association ("AGA"); AQR Capital Management, LLC ("AQR"); Archer Daniels Midland ("ADM"); AMCOT; Americans for Financial Reform ("AFR"); Arthur Dunavant Investments ("Dunavant"); ASR Group International, Inc. ("ASR"); Atlantic Cotton Association ("ACA"); Barnard, Chris (Individual); Better Markets, Inc. ("Better Markets"); Cargill, Inc. ("Cargill"); Castleton Commodities International

public comment letters, and for the general reasons discussed in this release, the Commission is adopting the 2020 NPRM with certain modifications in this Final Rule.[17]

Before addressing the specifics of the Final Rule, the Commission outlines several themes underscoring the Commission's approach in the Final Rule.

First, the Commission believes that any position limits regime must take into account differences across commodities and contract types. The existing Federal position limits regulations apply only to the nine legacy agricultural contracts, all of which are physically-settled futures on agricultural commodities. Limits on these nine legacy agricultural contracts have been in place for decades, as have the Federal rules governing both the exemptions from these Federal position limits and the exchange-set position limits on the nine legacy agricultural contracts. The existing framework is largely a historical remnant of an approach that predates cash-settled futures contracts, institutional-investor interest in commodity indexes, highly liquid energy markets, and the Commission's jurisdiction over certain swaps.

Congress has tasked the Commission with establishing such limits as it finds are "necessary" for the purpose of preventing the burdens associated with excessive

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LLC ("CCI"); Chevron USA Inc. ("Chevron"); Choice Cotton Company, Inc. ("Choice Cotton"); CHS Inc. ("CHS Inc.") and CHS Hedging, LLC ("CHS Hedging") (collectively, "CHS"); Citadel; CME Group Inc. ("CME Group"); Commodity Markets Council ("CMC"); DECA Global LLC ("DECA"); East Cotton Company ("East Cotton"); Ecom Agroindustrial ("Ecom"); Edison Electric Institute ("EEI") and Electric Power Supply Association ("EPSA") (collectively, the "Joint Associations" or "EEI/EPSA"); Futures Industry Association ("FIA"); Glencore Agriculture Limited, Glencore Agriculture B.V. (collectively, "Glencore"); ICE Futures U.S. ("IFUS"); IMC Companies ("IMC"); Industrial Energy Consumers of America; Institute for Agriculture & Trade Policy ("IATP"); Intercontinental Exchange, Inc. ("ICE"); International Energy Credit Association ("IECA"); International Swaps and Derivatives Association, Inc. ("ISDA"); Jess Smith & Sons ("Jess Smith"); Lawson/O'Neill Global Institutional Commodity (LOGIC) Advisors ("Lawson/O'Neill"); Long Island Power Authority ("LIPA"); Louis Dreyfus Company ("LDC"); Mallory Alexander International Logistics ("Mallory Alexander"); Managed Funds Association and Alternative Investment Management Association (collectively, the "Associations" or "MFA/AIMA"); Marshal, Gerald (Independent Trader); Matsen, Eric (Individual - Physical Commodity Risk Management Consultant); McMeekin Cotton LLC ("McMeekin"); Memtex Cotton Marketing, LLC ("Memtex"); Minneapolis Grain Exchange, Inc. ("MGEX"); Moody Compress & Warehouse Company ("Moody Compress"); Namoi Cotton Alliance ("Namoi"); National Cotton Council ("NCC"); National Council of Farmer Cooperatives ("NCFC"); National Council of Textile Organizations ("NCTO"); National Energy & Fuels Institute ("NEFI"); National Grain and Feed Association ("NGFA"); National Oilseed Processors Association ("NOPA"); National Rural Electric Cooperative; Association American Public Power Association; and American Public Gas Association (collectively, "NRECA"); Natural Gas Supply Association ("NGSA"); Olam International Limited ("Olam"); Omnicotton Inc. ("Omnicotton"); Pacific Investment Management Company LLC ("PIMCO"); Parkdale Mills ("Parkdale"); Petroleum Marketers Association of America ("PMAA"); Public Citizen; Robert Rutkowski ("Rutkowski"); S. Canale Cotton Co. ("Canale Cotton"); Shell Energy North America (US), L.P. and Shell Trading (US) Company (collectively, "Shell"); SIFMA Asset Management Group ("SIFMA AMG"); Skylar Capital Management LP ("SCM"); Southern Cotton Association ("Southern Cotton"); Southwest Ag Sourcing ("SW Ag"); Suncor Energy Marketing Inc. and Suncor Energy USA Marketing Inc. (collectively, "SEMI"); Texas Cotton Association ("Texas Cotton"); The Coalition of Physical Energy Companies; The Commercial Energy Working Group ("CEWG"); The Walcot Trading Company, LLC ("Walcot"); Toyo Cotton Company ("Toyo"); VLM Commodities ("VLM"); Western Cotton Shippers Association ("WCSA"); White Gold Cotton Marketing, LLC ("White Gold").

[17] The Final Rule's regulations are discussed in detail throughout this release.

speculation causing sudden or unreasonable fluctuations or unwarranted changes in the price of an underlying commodity; and establishing limits on swaps that are "economically equivalent" to any futures contracts or options on futures contracts subject to Federal position limits. An approach that is flexible enough to accommodate potential future, unpredictable developments in commercial hedging practices is well-suited for the current derivatives markets by accommodating differences in commodity types, contract specifications, hedging practices, cash-market trading practices, organizational structures of hedging participants, and liquidity profiles of individual markets.

The Commission is building this flexibility into several parts of the Final Rule, including: (1) exchange-set limits or accountability levels outside of the spot month for referenced contracts based on commodities other than the nine legacy agricultural contracts; (2) the ability for exchanges to use more than one formula when setting their own limit levels; (3) an updated formula for Federal non-spot month position limit levels on the nine legacy agricultural contracts that is calibrated to recently observed open interest, which has generally increased over time; (4) a bona fide hedging definition that is broad enough to accommodate common commercial hedging practices, including unfixed-price transactions as well as anticipatory hedging practices, such as anticipatory merchandising; (5) a simplified process for market participants to submit a single application to obtain non-enumerated bona fide hedge recognitions for purposes of Federal and exchange-set position limits that are in line with common commercial hedging practices; (6) the elimination of a restriction for purposes of Federal position limits on holding positions during the last trading days of the spot month; and (7) broader discretion for market participants to measure risk in the manner most suitable for their businesses.

Second, the Final Rule establishes position limits with respect to 16 additional commodities during the spot month, for a total of 25 core referenced futures contracts,

and certain derivative contracts linked thereto, for which the Commission finds that speculative position limits are necessary.[18] As described below, this necessity finding for the 25 core referenced futures contracts is based on two interrelated factors: (1) the importance of the 25 core referenced futures contracts to their respective underlying cash markets, including that they require physical delivery of the underlying commodity; and (2) the particular importance to the national economy of the commodities underlying the 25 contracts.[19]

Third, there is an opportunity for greater collaboration between the Commission and the exchanges within the statutorily created parallel Federal and exchange-set position limit regimes. Given the exchanges' obligations to carry out self-regulatory responsibilities, resources, deep knowledge of their markets and trading practices, close interactions with market participants, existing programs for addressing exemption requests, and direct ability to leverage these resources to generally act more quickly than the Commission, the Commission believes that cooperation between the Commission and the exchanges on position limits should not only be continued, but enhanced. For example, exchanges are particularly well-positioned to: provide the Commission with estimates of deliverable supply in connection with their commodity contracts that require physical delivery; recommend limit levels for the Commission's consideration; and help administer the program for recognizing bona fide hedges. Further, given that the Final Rule requires exchanges to collect, and provide to the Commission upon request, cash-market information from market participants requesting recognition of bona fide hedges, the Commission is eliminating the Form 204 and part of the Form 304, which market participants with bona fide hedging positions in excess of position limits currently file each month with the Commission to demonstrate cash-market positions justifying such

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[18] *See infra* Section III.C.2.
[19] *Id*.

overages. Under enhanced collaboration, the Commission will maintain its access to such information from the exchanges, which will result in a more efficient administrative process, in part by reducing duplication of efforts.

B. Executive Summary

This executive summary provides an overview of the key components of the Final Rule. The summary only highlights certain aspects of the final regulations and generally uses shorthand to summarize complex topics. The executive summary is neither intended to be a comprehensive recitation of the Final Rule nor intended to supplement, modify, or replace any interpretive or other language contained herein. Section II of this release includes a more detailed and comprehensive discussion of all of the final regulations. The final regulations and related appendices and guidance follow Section IV (Related Matters) of this release.

1. Contracts Subject to Federal Speculative Position Limits

Federal position limits apply to "referenced contracts," which, as described in turn below, include: (i) 25 "core referenced futures contracts" (*i.e.*, the nine legacy agricultural contracts together with the new 16 non-legacy contracts); (ii) futures contracts and options on futures contracts directly or indirectly linked to a core referenced futures contract; and (iii) "economically equivalent swaps."

i. Core Referenced Futures Contracts

Federal position limits under the Final Rule will apply to the following 25[20] physically-settled core referenced futures contracts:

[20] Reference to, or discussion of, derivatives contracts listed on IFUS, the DCM and subsidiary of ICE, will be referred to herein as "ICE [Commodity] [IFUS Commodity Code]" (*e.g.*, ICE Sugar No. 16 (SF)). Additionally, "CBOT" refers to the DCM Board of Trade of the City of Chicago, Inc.; "CME" refers to the DCM Chicago Mercantile Exchange, Inc.; "COMEX" refers to the DCM Commodity Exchange, Inc.; and "NYMEX" refers to the DCM New York Mercantile Exchange, Inc.

Legacy Agricultural (Federal position limit levels during and outside the spot month)	**Non-Legacy Agricultural** (Federal position limit levels only during the spot month)[21]	**Metals** (Federal position limit levels only during the spot month)
CBOT Corn (C)	CBOT Rough Rice (RR)	COMEX Gold (GC)
CBOT Oats (O)	ICE Cocoa (CC)	COMEX Silver (SI)
CBOT Soybeans (S)	ICE Coffee C (KC)	COMEX Copper (HG)
CBOT Wheat (W)	ICE FCOJ-A (OJ)	NYMEX Platinum (PL)
CBOT Soybean Oil (SO)	ICE Sugar No. 11 (SB)	NYMEX Palladium (PA)
CBOT Soybean Meal (SM)	ICE Sugar No. 16 (SF)	**Energy** (Federal position limit levels only during the spot month)
MGEX Hard Red Spring Wheat (MWE)	CME Live Cattle (LC)	NYMEX Henry Hub Natural Gas (NG)
ICE Cotton No. 2 (CT)		NYMEX Light Sweet Crude Oil (CL)
CBOT KC Hard Red Winter Wheat (KW)		NYMEX New York Harbor ULSD Heating Oil (HO)
		NYMEX New York Harbor RBOB Gasoline (RB)

ii. Futures Contracts and Options on Futures Contracts Linked to a Core Referenced Futures Contract

The term "referenced contract" encompasses any core referenced futures contract as well as any futures contract and any option on a futures contract that is: (1) directly or indirectly linked to the price of a core referenced futures contract; or (2) directly or indirectly linked to the price of the same commodity underlying the applicable core referenced futures contract, for delivery at the same location as specified in that core referenced futures contract.[22] The term "referenced contract," however, explicitly excludes location basis contracts, commodity index contracts, contracts that are based on

[21] While the Final Rule includes Federal non-spot month limits only for referenced contracts on the nine legacy agricultural contracts, the Final Rule requires exchanges to establish, consistent with Commission standards set forth in this Final Rule, exchange-set position limits and/or position accountability levels in the non-spot months for the 16 non-legacy core referenced futures contracts and for any associated referenced contracts.

[22] For clarity, clause (2) is intended to encompass potential physically-settled "look-alike" contracts that do not directly reference a core referenced futures contract but that are nonetheless based on the same commodity and delivery location as a core referenced futures contract.

prices across a month (*i.e.*, contracts commonly referred to as calendar month average contracts, trade month average contracts, or balance of month contracts), outright contracts that are based on a price reporting agency index price, swap guarantees, and trade options that meet certain requirements.

iii. Economically Equivalent Swaps

The term referenced contracts also includes economically equivalent swaps, defined as swaps with "identical material" contractual specifications, terms, and conditions to a referenced contract. Swaps in a commodity other than natural gas that have identical material specifications, terms, and conditions to a referenced contract are still deemed economically equivalent swaps even if they differ from the referenced contract with respect to one or more of the following: (a) lot size specifications or notional amounts, (b) delivery dates diverging by less than one calendar day for physically-settled swaps, or (c) post-trade risk management arrangement (*e.g.*, uncleared swaps versus cleared futures contracts).

The same general definition applies to natural gas swaps, except that the definition is expanded to include swaps with delivery dates diverging from the corresponding core referenced futures contract by less than *two* calendar days.

Instruments that are exempt from Commission jurisdiction or otherwise not deemed to be swaps under the Commission's regulations (*e.g.*, instruments that are excluded by the CEA's "swap" definition or Commission regulations as physically-settled forward contracts) are not "economically equivalent swaps" even if they otherwise fall within the "economically equivalent swap" definition.

2. Federal Position Limit Levels During the Spot Month

Federal spot month position limits apply to all 25 core referenced futures contracts and their associated referenced contracts. The Final Rule establishes the spot month position limit levels summarized in the table below. Each spot month limit is set

at or below 25% of deliverable supply, as estimated using recent data provided by the DCM listing the core referenced futures contract, and verified by the Commission. The Federal spot month position limits apply on a futures-equivalent basis based on the size of the unit of trading of the relevant core referenced futures contract.

Core Referenced Futures Contract	**2020 Final Rule Federal Spot Month Limit Level**	**2020 Proposed Federal Spot Month Limit Level**	**Existing Federal Spot Month Limit Level**	**Existing Exchange-Set Spot Month Limit Level**[23]
	Legacy Agricultural Contracts			
CBOT Corn (C)	1,200	1,200	600	600
CBOT Oats (O)	600	600	600	600
CBOT Soybeans (S)	1,200	1,200	600	600
CBOT Soybean Meal (SM)	1,500	1,500	720	720
CBOT Soybean Oil (SO)	1,100	1,100	540	540
CBOT Wheat (W)	1,200	1,200	600	600/500/400/300/220
CBOT KC Hard Red Winter Wheat (KW)	1,200	1,200	600	600
MGEX Hard Red Spring Wheat (MWE)	1,200	1,200	600	600
ICE Cotton No. 2 (CT)	900	1,800	300	300
	Other Agricultural Contracts			
CME Live Cattle (LC)	600/300/200[24]	600/300/200	n/a	600/300/200
CBOT Rough Rice (RR)	800	800	n/a	600/200/250
ICE Cocoa (CC)	4,900	4,900	n/a	1,000
ICE Coffee C (KC)	1,700	1,700	n/a	500
ICE FCOJ-A (OJ)	2,200	2,200	n/a	300
ICE Sugar No. 11 (SB)	25,800	25,800	n/a	5,000

[23] As of October 15, 2020.

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

ICE Sugar No. 16 (SF)	6,400	6,400	n/a	n/a[25]
	Metals Contracts			
COMEX Gold (GC)	6,000	6,000	n/a	6,000
COMEX Silver (SI)	3,000	3,000	n/a	1,500
COMEX Copper (HG)	1,000	1,000	n/a	1,000
NYMEX Platinum (PL)	500	500	n/a	500
NYMEX Palladium (PA)	50	50	n/a	50
	Energy Contracts			
NYMEX Henry Hub Natural Gas (NG)	2,000[26]	2,000	n/a	1,000[27]
NYMEX Light Sweet Crude Oil (CL)	6,000/5,000/4,000[28]	6,000/5,000/4,000	n/a	3,000
NYMEX New York Harbor ULSD Heating Oil (HO)	2,000	2,000	n/a	1,000
NYMEX New York Harbor RBOB Gasoline (RB)	2,000	2,000	n/a	1,000

i. Application of Federal Spot Month Limits to Commodities Other than Natural Gas

With the exception of natural gas, the Federal spot month position limit levels apply in the aggregate across exchanges and the over-the-counter ("OTC") swap markets.

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[25] ICE technically does not have an exchange-set spot month position limit level for ICE Sugar No. 16 (SF). However, it does have a single-month position limit level of 1,000 contracts, which effectively operates as a spot month position limit.

[26] As discussed below, the NYMEX Henry Hub Natural Gas (NG) Federal spot month limit for cash-settled look-alike referenced contracts will apply on a per-exchange and per-OTC swaps market basis rather than on an aggregate basis across exchanges.

[27] Currently, the cash-settled natural gas contracts are subject to an exchange-set spot month position limit level of 1,000 equivalent-sized contracts *per exchange*. As of publication of the Final Rule, there are three exchanges that list cash-settled natural gas contracts: NYMEX, IFUS, and Nodal. As a result, a market participant may hold up to 3,000 equivalent-sized cash-settled natural gas contracts under existing exchange-set limits.

The exchanges also have a conditional position limit framework for natural gas contracts. This exchange-set conditional spot month position limit permits up to 5,000 cash-settled NYMEX NG equivalent-sized referenced contracts *per exchange* that lists such contracts, provided that the market participant does not hold positions in the physically-settled NYMEX NG referenced contract.

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

During the spot month, Federal position limits apply "separately" to physically-settled and cash-settled referenced contracts.[29] Accordingly, during the spot month, a market participant is required to aggregate its net physically-settled positions, and separately its net cash-settled positions, across exchanges and the OTC swaps markets, but may not net cash-settled referenced contracts with physically-settled referenced contracts.

ii. Application of Federal Spot Month Limits to Natural Gas

For the NYMEX Henry Hub Natural Gas ("NYMEX NG") physically-delivered core referenced futures contract and its associated cash-settled referenced contracts, the Final Rule modifies the 2020 NPRM by providing that Federal position limits apply to NYMEX NG cash-settled referenced contracts on a per-exchange and per-OTC swaps market basis (*i.e.*, cash-settled positions are *not* aggregated across different exchanges and the OTC swaps market).

Specifically, a market participant may hold up to 2,000 cash-settled NYMEX NG referenced contracts (*i.e.*, the NYMEX NG Federal spot month position limit) on each exchange that lists for trading a cash-settled NYMEX NG referenced contract as well as the OTC swap market. Currently, three exchanges (NYMEX, IFUS, and Nodal)[30] list cash-settled "look-alike" NYMEX NG referenced contracts. Thus, a market participant is able to hold 2,000 cash-settled NYMEX NG referenced futures contracts on each exchange, which is 6,000 cash-settled look-alike NYMEX NG referenced contracts in total. In addition, a market participant is able to hold a position of 2,000 cash-settled NYMEX NG equivalent-sized economically equivalent swaps in the OTC swaps markets

[29] As discussed further under Section II.B.3.vi, cash-settled NYMEX NG referenced contracts under the Final Rule are subject to per-exchange and per-OTC swaps market Federal position limits. As a result, market participants are not required to aggregate their positions in natural gas referenced contracts across different exchanges and the OTC swaps markets but also may not net such positions across different exchanges or the OTC swaps market.

[30] "Nodal" refers to the Nodal Exchange, LLC.

for a total position of 8,000 cash-settled NYMEX NG referenced contracts across the four markets (*i.e.*, NYMEX, IFUS, Nodal, and the OTC swaps market).

As noted above, because Federal spot month position limit levels apply "separately" to cash-settled and physically-settled referenced contracts, a market participant further is able to hold an additional position of 2,000 physically-settled NYMEX NG referenced contracts for a total position of 10,000 NYMEX NG referenced contracts.

As discussed further below, market participants may hold additional cash-settled NYMEX NG referenced contracts under the Final Rule's Federal spot month conditional position limit exemption as long as the market participant satisfies certain requirements. However, for the avoidance of doubt, the Commission notes that the per-exchange 2,000 contract Federal spot month position limit level for cash-settled NYMEX NG referenced contracts discussed above is not part of the Federal spot month conditional position limit exemption but rather constitutes the default speculative Federal spot month position limit.

3. Federal Position Limit Levels Outside of the Spot Month

Under the Final Rule, Federal position limits outside of the spot month ("non-spot month" position limits) apply only to the nine legacy agricultural contracts and their associated referenced contracts.

In contrast, referenced contracts based on the 16 core referenced futures contracts subject to Federal position limits for the first time under the Final Rule are only subject to Federal position limits during the spot month, and are otherwise only subject to exchange-set limits or position accountability outside of the spot month.

The following Federal non-spot month position limit levels, summarized in the table below, are set at 10% of open interest for the first 50,000 contracts, with an incremental increase of 2.5% of open interest thereafter, and apply on a futures-

equivalent basis based on the size of the unit of trading of the relevant core referenced futures contract:

Core Referenced Futures Contract	**2020 Final Rule Federal Single Month[31] and All-Months-Combined Limit Levels**	**2020 Proposed Federal Single Month and All-Months-Combined Limit Levels**	**Existing Federal Single Month and All-Months-Combined Limit Levels**	**Existing Exchange-Set Single Month and All-Months-Combined Limit Levels[32]**
CBOT Corn (C)	57,800	57,800	33,000	33,000
CBOT Oats (O)	2,000	2,000	2,000	2,000
CBOT Soybean (S)	27,300	27,300	15,000	15,000
CBOT Soybean Meal (SM)	16,900	16,900	6,500	6,500
CBOT Soybean Oil (SO)	17,400	17,400	8,000	8,000
CBOT Wheat (W)	19,300	19,300	12,000	12,000
CBOT KC HRW Wheat (KW)	12,000	12,000	12,000	12,000
MGEX HRS Wheat (MWE)	12,000	12,000	12,000	12,000
ICE Cotton No. 2 (CT)	5,950 (single month)[33] 11,900 (all-months-combined)	11,900	5,000	5,000

4. Exchange-Set Limits and Exemptions Therefrom

i. Contracts Subject to Federal Position Limits

An exchange that lists a contract subject to Federal position limits, as specified above, is required to set its own limits for such contracts at a level that is no higher than the Federal level. Exchanges may grant exemptions from their own limits to a level that exceeds the applicable Federal limit, provided the exemption is self-effectuating (*e.g.*, an

[31] With the exception of the ICE Cotton No. 2 (CT) contract discussed below, for each of the legacy agricultural contracts, the single month limit is equal to the all-months-combined limit under the Final Rule.

[32] As of October 15, 2020.

[33] The single month limit for ICE Cotton No. 2 (CT) is set at 50% of the all-months-combined limit, or 5,950 contracts, as discussed more fully below.

enumerated bona fide hedge or a spread that satisfies the "spread transaction" definition) or provided the exemption is recognized by the Commission for purposes of Federal position limits (pursuant to an application submitted either directly to the Commission under § 150.3 or indirectly to the Commission through an exchange under § 150.9, as applicable). Exchanges may grant exemptions that are not recognized by the Final Rule; however, such exemptions must be capped at a level that is not higher than the applicable Federal position limit level.

ii. Physical Commodity Contracts Not Subject to Federal Position Limits

For physical commodity contracts, for which no necessity finding was supported, and which are therefore not subject to Federal position limits, an exchange is generally required to set spot month position limit levels at no greater than 25% of deliverable supply, but has flexibility to submit other approaches for review by the Commission, provided the approach results in spot month position limit levels that are "necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index" and complies with all other applicable regulations.

Outside of the spot month, an exchange has additional flexibility to set either position limits or position accountability levels, provided the levels are "necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index." Non-exclusive Acceptable Practices are included in new Appendix F to part 150 under the Final Rule and provide several examples of formulas that the Commission has determined meet this standard, but an exchange has flexibility to develop other approaches.

An exchange has flexibility to grant a variety of exemption types. Exchanges must take into account whether the exemption results in a position that is "not in accord with sound commercial practices" in the market for which the exchange is considering

the application, and/or "exceed[s] an amount that may be established and liquidated in an orderly fashion in that market."

5. Limits on "Pre-Existing Positions"

As discussed above, only swaps that qualify as "economically equivalent swaps" are subject to Federal position limits under the Final Rule. However, economically equivalent swaps entered into in good faith prior to the Final Rule's Effective Date, including both "Pre-Enactment Swaps," which are swaps entered into prior to the Dodd-Frank Act whose terms have not expired, and "Transition Period Swaps," which are swaps entered into between July 22, 2010 and the Final Rule's effective date, are not subject to Federal position limits. Other pre-existing positions (*i.e.*, pre-existing positions that are futures contracts or options on futures contracts) will be subject to the Final Rule's Federal position limits.[34]

Market participants may net down their post-Effective Date positions in commodity derivatives contracts with any pre-existing swaps (as long as such swaps qualify as economically equivalent swaps) for purposes of complying with non-spot month Federal position limits. In contrast, during the spot month, market participants may not apply these pre-existing swap positions to net down their positions so as to avoid rendering Federal spot month position limits ineffective. The Commission is particularly concerned about protecting the spot month in physically-delivered futures from price distortions or potential manipulation and consequent disruption of the hedging and price discovery utility of the related futures contract.

6. Legal Standards for Exemptions from Federal Position Limits

i. Bona Fide Hedge Recognition

[34] However, as discussed further below, the Commission is providing for a compliance period until January 1, 2022 for the 16 non-legacy referenced contracts that will be subject to Federal position limits for the first time under this Final Rule. Similarly, the Commission is providing for a compliance period for any economically equivalent swaps, as well as in connection with the elimination of the risk management exemption, until January 1, 2023.

A bona fide hedging transaction or position may exceed Federal position limits if the hedge position satisfies all three elements of the Final Rule's "general" bona fide hedging definition. That is, (1) the position represents a substitute for transactions or positions made or to be made at a later time in a physical marketing channel ("temporary substitute test"); (2) the position is economically appropriate to the reduction of price risks in the conduct and management of a commercial enterprise ("economically appropriate test"); and (3) the position arises from the potential change in value of actual or anticipated assets, liabilities, or services ("change in value requirement").

The Final Rule makes several changes to the existing bona fide hedging definition, including those described immediately below:

First, the Commission is expanding the existing list of "enumerated" bona fide hedges to cover additional hedging practices, including adding a bona fide hedge for anticipated merchandising.[35] To provide greater certainty, the list of enumerated bona fide hedges is now incorporated into the regulation. In contrast, in the 2020 NPRM, this list of enumerated bona fide hedges was proposed in the form of non-binding acceptable practices in Appendix A to part 150. While the enumerated bona fide hedges will remain listed in Appendix A under the Final Rule, Appendix A to part 150 is now explicitly incorporated into Commission regulations and is part of the regulatory text rather than acceptable practices.

A person who holds a position that qualifies as a bona fide hedge and that is one of the enumerated hedges in Appendix A to part 150 is not required to request prior approval from the Commission to hold such bona fide hedge position above the Federal

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[35] The existing definition of "bona fide hedging transactions and positions" enumerates the following hedging transactions or positions: (1) hedges of inventory and cash commodity fixed-price purchase contracts under 1.3(z)(2)(i)(A); (2) hedges of unsold anticipated production under 1.3(z)(2)(i)(B); (3) hedges of cash commodity fixed-price sales and (4) hedges of fixed price sales of their cash products and byproducts contracts under 1.3(z)(2)(ii)(A) and (B); (5) hedges of unfilled anticipated requirements under 1.3(z)(2)(ii)(C); (6) hedges of offsetting unfixed price cash commodity sales and purchases under 1.3(z)(2)(iii); and (7) cross-commodity hedges under 1.3(z)(2)(iv). The following additional hedging practices are not enumerated in the existing regulation, but are included as enumerated hedges in the Final Rule: (1) hedges of anticipated merchandising; (2) hedges by agents; (3) hedges of anticipated royalties; (4) hedges of services; and (5) offsets of commodity trade options.

position limit. That is, the enumerated bona fide hedges are "self-effectuating" for purposes of Federal position limits. A person with an enumerated bona fide hedge position, however, would still need to request an exemption from the relevant exchange for any exchange-set limits.[36]

Second, with respect to the treatment of unfixed-price forward transactions and bona fide hedging under the Final Rule, the Commission clarifies that a commercial market participant may qualify for one of the Final Rule's enumerated anticipatory bona fide hedges (*i.e.*, enumerated bona fide hedges for unsold anticipated production, unfilled anticipated requirements, and anticipated merchandising) with respect to an unfixed-price forward transaction. The Commission believes that an unfixed-price forward transaction should not preclude a commercial market participant from qualifying for one of these enumerated anticipatory bona fide hedges, because such unfixed-price forward transactions do not give rise to outright price risk for a commercial market participant and do not otherwise fix an outright price. Accordingly, unfixed-price transactions do not "fill" or "address" the hedging need for which the enumerated anticipatory bona fide hedges are predicated.

The Commission notes that an unfixed-price forward transaction does not itself allow a market participant to qualify for one of these enumerated anticipatory bona fide hedges, and that a market participant must still satisfy the requirements of the applicable anticipatory bona fide hedge to qualify (*e.g.*, as an initial matter, by the commercial market participant being able to demonstrate its anticipated unsold production, anticipated unfilled requirements, and/or anticipated merchandising).

Third, the Final Rule clarifies whether and when market participants may measure risk on a gross basis rather than on a net basis. Instead of only being permitted to hedge

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[36] The processes for obtaining bona fide hedge recognitions and non-enumerated bona fide hedge recognitions are summarized in Section 7 below of this executive summary (Processes for Requesting Bona Fide Hedge Recognitions and Spread Exemptions).

on a "net basis" except in a narrow set of circumstances, a market participant is also able to generally hedge positions on a "gross basis," provided that the participant has done so over time in a consistent manner and is not doing so to evade Federal position limits. Among other items, the Final Rule differs from the 2020 NPRM in that the Final Rule: (1) eliminates the requirement that exchanges document their justifications when allowing gross hedging; (2) clarifies that market participants are not required to develop written policies or procedures that set forth when gross versus net hedging is appropriate; and (3) clarifies that gross hedging is permissible for both enumerated and non-enumerated hedges.

Fourth, market participants are permitted to hold bona fide hedges in excess of Federal position limits during the last five days of the spot period (or during the time period for the spot month if less than five days). While the Final Rule does not include a Federal restriction on holding bona fide hedging positions in excess of Federal position limits during the spot period, exchanges continue to have the discretion to adopt such restrictions (commonly referred to by market participants as the "Five-Day Rule"), or similar restrictions, for purposes of exchange-set limits. The Final Rule also includes guidance on the application of spot-period restrictions, including factors for exchanges with such restrictions to consider when determining to grant exemptions that are not subject to any such restrictions for purposes of their own limits.

Finally, the Final Rule modifies the "temporary substitute test" to require that a bona fide hedging transaction or position in a physical commodity must *always*, and not just *normally*, be connected to the production, sale, or use of a physical cash-market commodity. Therefore, a market participant is generally no longer allowed to treat positions entered into for "risk management purposes"[37] as a bona fide hedge, unless the

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

position qualifies as either: (i) an offset of a pass-through swap, where the offset reduces price risk attendant to the pass-through swap executed opposite a counterparty for whom the swap qualifies as a bona fide hedge; or (ii) a "swap offset," where the offset is used by a counterparty to reduce price risk attendant to a swap that qualifies as a bona fide hedge and that was previously entered into by that counterparty.

ii. Spread Exemption

A transaction or position may also exceed Federal position limits if it qualifies as a "spread transaction," which includes the following common types of spreads: intra-market spreads; inter-market spreads; intra-commodity spreads; inter-commodity spreads; calendar spreads; quality differential spreads; processing spreads (such as energy "crack" or soybean "crush" spreads); product and by-product differential spreads; and futures-options spreads.[38]

Spread exemptions may be granted using the process described in Section 7 below of this executive summary (Processes for Requesting Bona Fide Hedge Recognitions and Spread Exemptions).

iii. Financial Distress Exemption

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

iv. Conditional Spot Month Limit Exemption in Natural Gas

As long as a market participant holds no physically-settled NYMEX NG contracts, the Final Rule allows that market participant to exceed the NYMEX NG Federal spot month position limit level of 2,000 cash-settled referenced contracts per

[38] The Final Rule expands the 2020 NPRM's list of exempt spread transactions by also including intra-market spreads, inter-market spreads, and intra-commodity spreads.

exchange (and an additional 2,000 equivalent-sized economically equivalent OTC swaps) by holding 10,000 cash-settled NYMEX NG referenced contracts per DCM that lists cash-settled NYMEX NG referenced contracts, as well as an additional 10,000 equivalent-sized cash-settled economically equivalent NYMEX NG swaps. The Final Rule clarifies that market participants may not use a spread exemption to exceed the aforementioned conditional spot month limit for natural gas.

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

i. Self-effectuating Enumerated Bona Fide Hedges

A position that complies with the bona fide hedging definition in § 150.1 and falls within one of the enumerated bona fide hedges is self-effectuating for purposes of Federal position limits, provided the market participant separately applies to the relevant exchange for an exemption from exchange-set limits. Such market participants are no longer required to file Form 204/304 with the Commission on a monthly basis to demonstrate cash-market positions justifying Federal position limit overages. Instead, the Commission will have access to cash-market information that such market participants submit as part of their applications to an exchange for an exemption from exchange-set limits, typically filed on an annual basis.

ii. Bona Fide Hedges That Are Not Self-effectuating

The Commission may consider adding to the list of enumerated bona fide hedges at a later time, as the Commission may find appropriate. Until that time, all bona fide hedge positions that are not enumerated in Appendix A to part 150 must be granted pursuant to one of the processes for requesting a non-enumerated bona fide hedge recognition, as explained below.

A market participant seeking to exceed Federal position limits for a non-enumerated bona fide hedging transaction or position is able to choose whether to apply directly to the Commission or, alternatively, apply indirectly to the Commission through

the applicable exchange using a new streamlined process. If applying directly to the Commission, the market participant must also separately apply to the relevant exchange for relief from exchange-set position limits. If applying to an exchange using the new streamlined process, a market participant may file an application with an exchange, generally at least annually, which will be valid both for purposes of Federal and exchange-set position limits.

Under this streamlined process, if the exchange determines to grant a non-enumerated bona fide hedge recognition for purposes of its exchange-set position limits, the exchange must notify the Commission and the applicant simultaneously. Then, 10 business days (or two business days in the case of retroactive applications filed late due to sudden or unforeseen bona fide hedging needs) after the exchange issues such a determination, the bona fide hedge exemption may be deemed approved for purposes of Federal position limits unless the Commission (and not Commission staff) notifies the market participant otherwise. That is, after the 10 (or two) business days expire, the bona fide hedge exemption is considered approved for purposes of Federal position limits. Under the Final Rule, once the exchange notifies the Commission and the applicant of the exchange's determination to approve the application, the applicant may, at its own risk, exceed Federal position limits during the Commission's 10 business-day review period.

If the Commission determines to deny an exemption application, the applicant will not be subject to any Federal position limits violation, provided the person filed the application in good faith and brings the position into compliance with the applicable Federal position limit within a commercially reasonable amount of time, as applicable.

The Final Rule also allows a market participant with sudden or unforeseen hedging needs to file a request for a bona fide hedge exemption within five business days after exceeding the Federal limit (*i.e.*, commonly referred to as a "retroactive" exemption application). If the Commission denies such application, the market participant will not

be subject to a Federal position limit violation, provided the market participant filed the application in good faith and brings the position into compliance with the applicable Federal position limit within a commercially reasonable amount of time, as applicable.

Among other changes, market participants are no longer required to file Forms 204 or 304, as applicable, with the Commission on a monthly basis to demonstrate cash-market positions justifying position limit overages. Under the Final Rule, the Commission will instead leverage cash-market information submitted directly to the exchanges.

iii. Spread Exemptions

For a referenced contract on any commodity, a spread exemption is self-effectuating for purposes of Federal position limits, provided that (1) the position falls within one of the categories set forth in the "spread transaction" definition, and (2) the market participant separately applies to the applicable exchange for a spread exemption from exchange-set position limits.[39]

A market participant with a spread position that does not fit within the "spread transaction" definition with respect to any of the commodities subject to Federal position limits may apply directly to the Commission, and must also separately apply to the applicable exchange.

8. Compliance Date and Effective Date

i. Summary

The Final Rule's effective date is **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]** (the "Effective Date"). This means that all aspects of the Final Rule will be effective as of the Effective Date, including the new enumerated bona fide hedges (*e.g.*, anticipated merchandising) as well

[39] The Commission understands that certain exchanges may distinguish between the terms "spread," "arbitrage," and "straddle." For the purposes of the Commission's discussion and the Final Rule in general, the Commission's use of the term "spread" is meant to include all of these related trading strategies, and any Commission reference to "spread" rather than "arbitrage" or "straddle" is not intended to suggest a substantive difference in meaning.

as the higher Federal position limits for the nine legacy agricultural contracts. However, as discussed below, the Commission is also providing for compliance dates that extend beyond the Effective Date in connection with several of the Final Rule's requirements.

The Final Rule provides market participants with a compliance date of January 1, 2022 for purposes of compliance with the Federal position limits for the 16 non-legacy core referenced futures contracts that are subject to Federal position limits for the first time under this Final Rule. This compliance date also applies to any referenced contracts (other than economically equivalent swaps, which have a separate compliance date as discussed further below) related to these 16 non-legacy core referenced futures contracts.

The Final Rule also provides exchanges with a compliance date of January 1, 2022 for purposes of establishing exchange-set position limits and provisions associated with exemptions therefrom, including certain obligations to collect cash-market information from market participants in connection with market participants' applications for bona fide hedging exemptions to exchange-set limits, and to share the same with the Commission, consistent with the requirements under the Final Rule.

Additionally, the Final Rule provides a compliance date of January 1, 2023 with respect to (i) the elimination of previously-granted risk management exemptions,[40] and (ii) Federal position limits for economically equivalent swaps.

Because the nine legacy agricultural contracts are currently subject to Federal position limits under the existing Federal framework, the Final Rule does not provide a compliance date for the new Federal position limits under the Final Rule for such contracts, or a formal phase-in period. Therefore, such limits go into effect on the Effective Date. Thus, as of the Effective Date, market participants will be able to avail themselves of the Federal position limits under the Final Rule for the nine legacy

[40] As discussed above in Section 6 of this executive summary (Legal Standards for Exemptions from Federal Position Limits), the Commission is no longer recognizing risk management exemptions as bona fide hedges under the Final Rule.

agricultural contracts, all of which are higher than the existing Federal position limits (except for CBOT Oats, which will maintain the existing Federal position limit levels). However, the Commission notes that exchange-set position limits will remain at current levels unless and until the relevant exchange submits a rule amendment pursuant to part 40 of the Commission's regulations to amend the relevant exchange-set position limit.

Furthermore, the Commission is delaying implementation of exchange-set position limits on swaps since exchanges cannot view market participants' positions in swap positions across the various places they trade, including on competitor exchanges.[41] However, after the January 1, 2023 compliance date for economically equivalent swaps (discussed above), the Commission underscores that it will enforce Federal position limits in connection with swaps.

For convenience, the Commission is providing a table below identifying the Final Rule's Effective Date and compliance dates for market participants and exchanges in connection with certain obligations.

Effective Date	
All Final Rule provisions are effective on the Effective Date.	*[Insert date that is 60 days after publication in the Federal Register]*
For example, because all provisions of the Final Rule are effective on the Effective Date, this means, among other things, market participants may immediately avail themselves on the Effective Date of: • The new enumerated bona fide hedge and spread exemptions • The higher Federal position limits for the nine legacy agricultural contracts[42]	
Compliance Date	
For market participants	
Market participants must comply with Federal position limits for the 16 non-legacy core referenced futures contracts that are subject to Federal position limits for the first time under the Final Rule.	No later than January 1, 2022

[41] In two years, the Commission will reevaluate the ability of exchanges to establish and implement appropriate surveillance mechanisms to implement DCM Core Principle 5 and SEF Core Principle 6 with respect to swaps.

[42] As noted above, under the Final Rule the Federal position limit levels for all of the nine legacy agricultural contracts will increase, other than CBOT Oats. However, the Commission notes that exchange-set position limits will remain at current levels unless and until the relevant exchange submits a rule amendment pursuant to part 40 of the Commission's regulations to amend the relevant exchange-set position limit.

Market participants must comply with Federal position limits for economically equivalent swaps.	No later than January 1, 2023
Positions based on previously-granted risk management exemptions must be reduced to levels that comply with the applicable Federal position limits.[43]	No later than January 1, 2023
Until the applicable exchange that lists a given referenced contract implements § 150.5 under the Final Rule, market participants, if using bona fide hedges for Federal position limit purposes, must continue to provide the Commission with Form 204 and Parts I and II of Form 304 to the Commission consistent with the status quo.[44]	Exchanges must implement § 150.5 no later than January 1, 2022.
For exchanges	
Exchanges must comply with the processes and procedures in connection with § 150.5 (exchange-set position limits and exemptions therefrom).	No later than January 1, 2022
Exchanges may implement the processes and procedures in connection with §150.9, including with respect to processing market participant applications for purposes of non-enumerated bona fide hedge exemptions for Federal position limit purposes.	Implementation of § 150.9 is voluntary for exchanges. Exchanges may implement as soon as the Effective Date or any time thereafter (or they may choose not to implement at all).
Enforcement of exchange-set position limits on economically equivalent swaps.	No earlier than January 1, 2023. In two years, the Commission will reevaluate the ability of exchanges to establish and implement appropriate surveillance mechanisms to implement DCM Core Principle 5 and Swap Execution Facility ("SEF") Core Principle 6 with respect to swaps.

C. Section-by-Section Summary of Final Rule

The Commission is adopting revisions to §§ 150.1, 150.2, 150.3, 150.5, and 150.6 and to parts 1, 15, 17, 19, 40, and 140, as well as adding §§ 150.8, 150.9, and Appendices

[43] As discussed further in this release, the Commission will no longer recognize risk management exemptions under the Final Rule. However, positions that are entered into based on a market participant's previously-granted risk management exemptions will be subject to an extended compliance date until January 1, 2023 with respect to Federal position limits. That is, a market participant with a previously granted risk management exemption will have a compliance date of January 1, 2023 with respect to the elimination of such risk management exemption.

[44] Form 204 (for all nine legacy agricultural contracts other than cotton) and Parts I and II of Form 304 (for cotton) are submitted by a market participant to the Commission under the existing Federal position limits regulations in connection with Federal enumerated bona fide hedges employed by the market participants

A-G to part 150.[45] Most noteworthy, the Commission is adopting the following amendments to the foregoing rule sections, each of which, along with all other changes in the Final Rule, is discussed in greater detail in Section II of this release. The following summary is not intended to provide a substantive overview of this Final Rule, but rather is intended to provide a guide to the rule sections that address each topic. For an overview of this Final Rule organized by topic (rather than by section number), please see the executive summary above.

- The Commission finds that Federal speculative position limits are necessary for 25 core referenced futures contracts, and for any futures contracts and options on futures contracts linked thereto. The Commission adopts Federal position limits on physically-settled and linked cash-settled futures contracts, options on futures contracts, and "economically equivalent swaps" for such commodities. The 25 core referenced futures contracts include the nine "legacy" agricultural contracts currently subject to Federal position limits and 16 additional non-legacy contracts, which include: seven additional agricultural contracts, four energy contracts, and five metals contracts.[46] Federal spot and non-spot month limits apply to the nine "legacy" agricultural contracts currently subject to Federal position limits,[47] and only Federal spot-month limits apply to the additional 16 non-legacy contracts. Outside of the

[45] The 2020 NPRM proposed to remove and reserve part 151. It did not propose to amend current § 150.4 dealing with aggregation of positions for purposes of compliance with Federal position limits, which was amended in 2016 in a prior rulemaking. *See* Final Aggregation Rulemaking, 81 FR at 91454.

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

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

spot month, these 16 non-legacy contracts are subject to exchange-set limits and/or accountability levels if listed on an exchange.

- Amendments to § 150.1 add or revise several definitions for use throughout part 150, including: new definitions of the terms "core referenced futures contract" (pertaining to the 25 physically-settled futures contracts explicitly listed in the regulations) and "referenced contract" (pertaining to futures contracts and options on futures contracts that have certain direct and/or indirect linkages to the core referenced futures contracts, and to "economically equivalent swaps") to be used as shorthand to refer to contracts subject to Federal position limits; an expanded "spread transaction" definition; and a "bona fide hedging transaction or position" definition that is broad enough to accommodate hedging practices in a variety of contract types, including hedging practices that may develop over time.
- Amendments to § 150.2 list the 25 core referenced futures contracts which, along with any associated referenced contracts, are subject to Federal position limits; and specify the Federal spot and non-spot month position limit levels. Federal spot month position limit levels are set at or below 25 percent of estimated deliverable supply, whereas Federal non-spot month limit levels are set at 10% of open interest for the first 50,000 contracts of open interest, with an incremental increase of 2.5% of open interest thereafter.
- Amendments to § 150.3 specify the types of positions for which exemptions from Federal position limit requirements may be granted, and set forth and/or reference the processes for requesting such exemptions, including recognitions of bona fide hedges and exemptions for spread positions, financial distress positions, certain natural gas positions held during the spot

month, and pre-enactment and transition period swaps. For all contracts subject to Federal position limits, bona fide hedge exemptions listed in Appendix A to part 150 as an enumerated bona fide hedge are self-effectuating for purposes of Federal position limits. For non-enumerated bona fide hedges, market participants must submit an application either directly to the Commission under § 150.3 or indirectly through an exchange for Federal position limit purposes under new § 150.9 (discussed below).

- Amendments to § 150.5 refine the process, and establish non-exclusive methodologies, by which exchanges may set exchange-level limits and grant exemptions therefrom with respect to futures and options on futures, including separate methodologies for contracts subject to Federal position limits and physical commodity derivatives not subject to Federal position limits.[48] While the Commission will oversee compliance with Federal position limits on swaps, the Commission has also determined to delay the enforcement of exchange-set position limits on swaps otherwise required in amended § 150.5 because exchanges cannot view market participants' positions in swaps across the various places they trade, including on competitor exchanges.[49]
- New § 150.9 establishes a streamlined process for addressing requests for bona fide hedging recognitions for purposes of Federal position limits, and leveraging exchange expertise and resources. This process will be used by market participants with non-enumerated bona fide hedge positions. Under

[48] Rule § 150.5 addresses exchange-set position limits and exemptions therefrom, whereas § 150.3 addresses exemptions from Federal position limits, and § 150.9 addresses a streamlined process for recognizing non-enumerated bona fide hedges for purposes of Federal position limits. Exchange rules typically refer to "exemptions" in connection with bona fide hedging and spread positions, whereas the Commission uses the nomenclature "recognition" with respect to bona fide hedges, and "exemption" with respect to spreads.

[49] With respect to exchange-set position limits on swaps, in two years the Commission will reevaluate the ability of exchanges to establish and implement appropriate surveillance mechanisms to implement DCM Core Principle 5 and SEF Core Principle 6.

the Final Rule, market participants can provide one application for a non-enumerated bona fide hedge to a DCM or SEF, as applicable, and receive approval of such request based on the same application from both the exchange for purposes of exchange-set limits and from the Commission for purposes of Federal position limits.

- New Appendix A to part 150 contains a list of enumerated bona fide hedges. Positions that comply with the bona fide hedging transaction or position definition in § 150.1 and that are enumerated in Appendix A may exceed Federal position limits to the extent that all applicable requirements in part 150 are met. Persons holding such positions enumerated in Appendix A may exceed Federal position limits without being required to request prior approval under § 150.3 or § 150.9. Positions that do not fall within any of the enumerated hedges could still potentially be recognized as bona fide hedging positions, provided the positions otherwise comply with the proposed bona fide hedging definition and all other applicable requirements, including the approval process under § 150.3 or § 150.9.
- Amendments to part 19 and related provisions eliminate Form 204 (and corresponding Parts I and II of Form 304 for cotton), enabling the Commission to leverage cash-market reporting submitted directly to the exchanges under §§ 150.5 and 150.9. The Final Rule maintains Part III of Form 304, related to the cotton on-call report.

D. Effective Date and Compliance Period

The 2020 NPRM included proposed § 150.2(e), which provided that the Federal position limit levels for the 25 core referenced futures contracts would have a compliance date 365 days after publication of the final position limits regulations in the *Federal*

Register. Additionally, proposed § 150.3(c) provided that previously-granted risk management exemptions shall not be effective after the Final Rule's effective date.

The Commission is removing from the Final Rule the compliance date requirements in proposed §§ 150.2(e) and 150.3(c) and instead addressing the effective and compliance dates together within this *Federal Register* release. The Commission is making two modifications from the 2020 NPRM relating to the effective date and compliance period of the Final Rule.

First, as noted above in the executive summary, the Commission is providing a general compliance date of January 1, 2022 for both market participants and exchanges. In contrast, the 2020 NPRM did not provide a specific date as the compliance date but rather stated 365 days after publication in the *Federal Register*.[50]

This compliance date of January 1, 2022 applies to (i) the Federal position limits set forth in Appendix E to part 150 for only the 16 non-legacy core referenced futures contracts that are subject to Federal position limits for the first time under this Final Rule, and (ii) exchange obligations under final § 150.5. This compliance date also applies to referenced contracts for any of the 16 non-legacy core referenced futures contracts (other than economically equivalent swaps, which have a separate compliance date as discussed immediately below). In contrast, the 2020 NPRM's compliance date applied only to market participants' compliance with the new Federal position limit levels. However, as discussed below, the Final Rule does not provide a separate compliance date for the nine legacy agricultural contracts since they are already subject to existing Federal position limits.

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[50] The Commission is adopting calendar dates for compliance to provide clarity rather than the 2020 NPRM's approach of stating that the compliance period ends 365 days after publication in the *Federal Register* since the Commission believes that providing a set calendar date provides greater clarity to market participants. Based on the timing of the Final Rule, the Commission believes that the January 1, 2022 general compliance date will not reduce the compliance period compared to the 2020 NPRM's approach and may provide slightly more time prior to the commencement of the compliance period.

Second, the Commission is establishing a separate compliance date of January 1, 2023 in connection with (i) economically equivalent swaps and (ii) the elimination of previously-granted risk management exemptions (*i.e.*, market participants may continue to rely on their previously-granted risk management exemptions until January 1, 2023). As noted above, the 2020 NPRM only had a single general compliance date and did not provide a separate compliance date for economically equivalent swaps or related to previously-granted risk management exemptions.

In this section, the Commission will discuss the following related issues: (i) compliance with Federal position limits for the nine legacy agricultural contracts; (ii) compliance by exchanges with § 150.5 under the Final Rule and market participants' related obligation to temporarily continue providing Forms 204/304 in connection with bona fide hedges; (iii) exchanges' voluntary implementation of § 150.9 under the Final Rule; and (iv) comments received in connection with the compliance date proposed in the 2020 NPRM.

i. Compliance with Federal Position Limits for the Nine Legacy Agricultural Contracts

With respect to the nine legacy agricultural contracts, the Commission is not providing a compliance date with respect to the spot month and non-spot month Federal position limit levels. Accordingly, the new Federal position limit levels under the Final Rule will become effective on the Effective Date. The nine legacy agricultural contracts are currently subject to Federal position limits and will continue to be subject under the Final Rule, which, as noted above, is increasing the Federal position limit levels for the nine legacy agricultural contracts (other than CBOT Oats, which will maintain the existing Federal position limit levels). The Commission has determined not to provide a separate compliance date for the nine legacy agricultural contracts since market participants trading in these markets already are familiar with Federal position limits and

have established the necessary monitoring and compliance oversight processes, in connection with these legacy contracts.

With respect to exchange-set position limits, the Final Rule does not require exchanges to increase their respective exchange-set position limit levels. Rather, the Final Rule only requires that exchange-set position limits are established at a level no higher than the corresponding Federal position limits. As a result, in response to the Final Rule, an exchange may: (1) raise its exchange-set limits to be as high as (or lower than) the corresponding Federal position limits immediately on the Effective Date or anytime thereafter; (2) implement a phase-in period where exchange-set position limits increase from existing exchange-set levels over time; or (3) not increase the exchange-set position limit levels at all, in each case as the exchange may determine appropriate for its markets.

ii. Exchange Implementation of § 150.5 and Market Participants' Obligations to Continue Providing Forms 204 and 304, as Applicable, in Connection with Federal Enumerated Bona Fide Hedges

For clarity, in connection with the nine legacy agricultural contracts, market participants may avail themselves of the new enumerated bona fide hedges (*e.g.*, anticipatory merchandising) immediately upon the Effective Date (market participants will not need to be concerned with availing themselves of bona fide hedge recognitions for the 16 non-legacy contracts upon the Effective Date since these contracts will have a compliance date of January 1, 2022). To the extent that market participants seek to rely on any Federal enumerated bona fide hedges, market participants must continue to provide, as applicable, the Commission with Forms 204/304, which are otherwise eliminated by the Final Rule upon the Effective Date, until the relevant exchange that lists the applicable referenced contract implements § 150.5 under the Final Rule. As discussed below, final § 150.5 governs, among other things, exchange rules and

procedures, including (i) the exchange's collection of certain cash-market information from market participants in connection with their bona fide hedge applications for exchange-set limits and (ii) the exchange's sharing of related information with the Commission. As discussed further below, the Final Rule predicates the elimination of Forms 204/304 on the relevant exchange's sharing of the information with the Commission under final § 150.5 (which provides for a new process for the exchange to share data with the Commission similar to data that the Commission previously obtained through Forms 204/304 under the Federal framework existing prior to the Final Rule).[51] Exchanges must implement final § 150.5 by the Final Rule's general compliance date of January 1, 2022.

iii. Exchange Implementation of § 150.9 in Connection with the Market Participants' Applications through Exchanges for Non-Enumerated Bona Fide Hedges for Purposes of Federal Position Limits

As discussed above, the Final Rule establishes a streamlined process for market participants to apply through exchanges for non-enumerated bona fide hedges for purposes of Federal position limits. That is, a market participant may submit a single non-enumerated bona fide hedge exemption application to an exchange for purposes of both Federal and exchange-set position limits, and the Commission will review, and make a determination based on, the application that the market participant submitted to the exchange. For clarity, the Commission notes that the Final Rule does not require exchanges to participate in such process.

However, if an exchange chooses to do so, the Commission is clarifying, for the avoidance of doubt, that the exchange may implement this streamlined process for non-enumerated bona fide hedge applications as soon as the Effective Date, or anytime thereafter (or not at all). In response to certain concerns by market participants and

[51] For further discussion of the elimination of Form 204 and Parts I and II of Form304, *see* Section II.H.2, *infra*.

exchanges, discussed immediately below, the Commission believes that, to the extent an exchange chooses to participate in this streamlined application process, the implementation of § 150.9 soon after the Effective Date may help ensure minimal disruption to market participants' existing trading strategies as well as avoid having the potentially unfeasible situation of requiring the exchanges to process a number of non-enumerated bona fide hedge applications simultaneously at the end of the general compliance period on January 1, 2022. Furthermore, the Commission clarifies in Section II.G.3.iii that market participants with existing Commission-granted non-enumerated or anticipatory bona fide hedge recognitions in connection with the nine legacy agricultural contracts under the existing framework are *not* required to reapply to the Commission for a new recognition under the Final Rule.

iv. Comments – Compliance Period

Generally, commenters supported the proposed compliance date, noting that an adequate compliance period would afford sufficient time to make necessary business adjustments (*e.g.*, time to build compliance systems, develop technology, train personnel, etc.).[52] The Commission agrees with these observations and believes that a general compliance date of January 1, 2022, except for economically equivalent swaps and positions based on a previously-granted risk management exemption, will provide exchanges and market participants sufficient time to adjust their operations and compliance and monitoring systems.

Some commenters also requested an extended compliance date (beyond the general compliance date) for economically equivalent swaps to mitigate the numerous legal, operational, and compliance challenges of implementing position limits for swaps for the first time.[53] Unlike exchange-listed contracts that are currently subject to either

[52] CME Group at 8; FIA at 2-3; ISDA at 2, 8; Shell at 4; and SIFMA AMG at 2, 9-10.
[53] MFA/AIMA at 8; NCFC at 6; NGSA at 15-16; SIFMA AMG at 9-10; and Citadel at 9-10.

Federal position limits or exchange-set limits, commenters noted that exchanges do not have existing compliance and monitoring resources for economically equivalent swaps from which to leverage. The Commission agrees with commenters that additional time for economically equivalent swaps is warranted, and, as discussed above, is thus delaying the compliance date for economically equivalent swaps for an additional year, until January 1, 2023.

CME Group expressed concern that it may receive an influx of exemption applications at the end of the compliance period, and therefore suggested a rolling process where market participants are grandfathered into their current exemptions, permitting them to file for those exemptions on the same annual schedule.[54] The Commission believes this concern is mitigated since exchanges, at their discretion, may implement final § 150.9 as soon as the Effective Date, which will allow exchanges to review non-enumerated bona fide hedge applications on a rolling basis between the Effective Date and the end of the compliance period rather than having to process a large number of applications at once. Furthermore, as noted above, market participants with existing Commission-granted non-enumerated or anticipatory bona fide hedge recognitions are *not* required to reapply to the Commission for a new recognition under the Final Rule.

E. The Commission Construes CEA Section 4a(a) to Require the Commission to Make a Necessity Finding Before Establishing Position Limits for Physical Commodities Other than Excluded Commodities

The Commission is required by *ISDA* to determine whether CEA section 4a(a)(2)(A) requires the Commission to find, before establishing a position limit, that such limit is "necessary."[55] The provision states in relevant part that "the Commission

[54] CME Group at 8.
[55] *ISDA*, 887 F.Supp.2d at 281.

shall" establish position limits "as appropriate" for futures contracts in physical commodities other than excluded commodities "[i]n accordance with the standards set forth in" the preexisting section 4a(a)(1).[56] That preexisting provision requires the Commission to establish position limits as it "finds are necessary to diminish, eliminate, or prevent" certain enumerated burdens on interstate commerce.[57] In the 2011 Final Rulemaking, the Commission interpreted this language as an unambiguous mandate to establish position limits without first finding that such limits are necessary, but with discretion to determine the "appropriate" levels for each.[58] In *ISDA*, the U.S. District Court for the District of Columbia disagreed and held that section 4a(a)(2)(A) is ambiguous as to whether the "standards set forth in paragraph (1)" include the requirement of an antecedent finding that a position limit is necessary.[59] The court vacated the 2011 Final Rulemaking and directed the Commission to apply its experience and expertise to resolve that ambiguity.[60] The Commission has done so and determines that section 4a(a)(2)(A) should be interpreted to require that before establishing position limits, the Commission must determine that limits are necessary.[61] A full legal analysis is set forth *infra* at Sections III.C.-E.

The Commission finds that position limits are necessary for the 25 core referenced futures contracts, including certain commodity derivative contracts that are directly or indirectly linked to a core referenced futures contract. The Commission's finding with respect to the 25 core referenced futures contracts is based on two interrelated factors: the particular importance of the 25 core referenced futures contracts to their respective underlying cash markets, including that they require physical delivery of the underlying commodity, and, the commodities' particular importance to the national

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[56] 7 U.S.C. 6a(a)(2)(A).
[57] 7 U.S.C. 6a(a)(1).
[58] 76 FR at 71626, 71627.
[59] *ISDA*, 887 F.Supp.2d at 279-280.
[60] *Id.* at 281.
[61] *See infra* Section III.B.

economy. Separately, the Commission finds that position limits are necessary during the spot month for all 25 core referenced futures contracts and outside of the spot month only for the nine legacy agricultural commodity contracts (in each instance including certain commodity derivative contracts that are directly or indirectly linked to a core referenced futures contract). A full discussion of the necessity findings is set forth *infra* at Sections III.C.-E.

F. The Commission's Use of Certain Terminology

The Commission is aware that this Final Rule will likely be reviewed by a diverse range of members of the public from varied backgrounds and industries and with different levels of knowledge and experience with derivatives markets. Furthermore, even among experienced market participants, terminology may differ by industry, commodity, or exchange. The Commission also recognizes that certain terms commonly referenced by market participants may differ from the technical legal terms used in the Commission's regulations and/or the CEA.

Accordingly, unless otherwise noted, the Commission will attempt to use terms and phrases in their ordinary, plain English sense. When required, the Commission will explicitly identify technical or nuanced legal/regulatory or industry "terms of art." The Commission wishes to briefly review certain terms and phrases used throughout this release below, as follows:

- *Bona fide hedges.* The CEA uses the legal term "bona fide hedging transaction or position" in both the singular and plural. The Commission currently defines the term in existing § 1.3 in the plural as "bona fide hedging transactions or positions" while the Final Rule now incorporates the singular "bona fide hedging transaction or position." The Commission understands that most market participants simply refer to "bona fide hedge(s)" (in both the singular and the plural). Accordingly, for short hand throughout this release, the Commission may

refer to "bona fide hedges," "bona fide hedge positions," "bona fide hedge transactions," "bona fide hedges," "bona fide hedging positions," and similar phrasing.

These terms are meant to apply as short hand and are not intended to imply a substantive difference either with the defined legal term "bona fide hedging transaction or position" or with one another.

Similarly, the plural term in the existing Commission regulations and the singular in the Final Rule, as discussed below, are not intended to reflect a substantive difference.

- *Federal position limits*. The Final Rule creates a new defined term, "speculative position limit," in part 150 of the Commission's regulations to refer to the maximum position, net long or net short, that a market participant may maintain in a referenced contract. Throughout this release, the Commission will use as a general term either "position limits" or "Federal position limits" to refer to the general Federal position limits framework and related regulations, including the defined term "speculative position limit." When discussing the individual "speculative position limit" levels for each commodity derivative contract, as opposed to the Final Rule's general Federal regulatory framework, the Commission instead may refer to the "Federal position limit *levels*," although all these phrases are intended to refer to the same general concept. The Commission may also specifically refer to *exchange-set* position limits when referring to the general framework, process, or specific position limit levels established by the respective exchanges.
- *Exchanges*. This Final Rule applies to both DCMs and SEFs. Unless otherwise distinguished, the Commission will refer to "exchanges" throughout this release to refer to any relevant DCM or SEF.

- *Cash-Settled* and *Physically-Settled*. The Commission throughout this release refers to "cash-settled" and "physically-settled" commodity derivative contracts. When a futures contract expires, all open futures contract positions in such contract are settled by either: (1) physical delivery, which the Commission refers to as a "*physically-settled*" contract, or (2) cash settlement, which the Commission refers to as a "*cash-settled*" contract, in each case depending on the contract terms set by the exchange. Deliveries on "physically-settled" futures contracts are made through the exchange's clearinghouse, and the delivery of the physical commodity must be consummated between the buyer and seller per the exchange rules and contract specifications. On the other hand, other futures contracts are "cash-settled" because they do not involve the transfer of physical commodity ownership and require that all open positions at expiration be settled by a transfer of cash to or from the clearinghouse based upon the final settlement price of the contracts.

  The Commission further notes that some market participants may instead use the terms "physical-delivery" contracts or "financially-settled" contracts instead of the Commission's terms "physically-settled" contracts and "cash-settled" contracts, respectively. The Commission does not intend a substantive difference in meaning with the choice of its terms.

- *Spread Positions*. The Commission views its use of the term "spread" to mean the same as "arbitrage" or "straddle" as those terms are used in CEA section 4a(a) and existing § 150.3(a)(3) of the Commission's regulations. Consistent with existing regulations, the Commission's sole use of the term "spread" in this Final Rule is intended to also capture arbitrage or straddle strategies referred to in CEA section 4a(a) and existing § 150.3(a)(3), and referring to "spread" rather than "arbitrage" or "straddle" is not intended to be a substantive difference. The

Commission notes that certain exchanges may distinguish between "spread" and "arbitrage" positions for purposes of exchange exemptions, but the Commission does not make that distinction here for purposes of its "spread transaction" definition as used in this release.

- *Unfixed Price Forward Transactions*. Throughout this release, the Commission will use as general terms either "unfixed price forward transactions," "unfixed price transactions," "unfixed price forward contracts," and/or "unfixed price contracts" to refer to transactions that are either purchases or sales of a cash commodity where the purchase or sales price, as applicable, is determined based on the settlement price of a benchmark, such as the settlement price of a commodity derivative contract on a certain date (*e.g.*, the price on the settlement date of a core referenced futures contract) or other index price (*e.g.*, a spot index price). Market participants may also refer to unfixed price transactions as "floating price" transactions, and the Commission does not intend a substantive difference in meaning with the choice of these terms.

G. Recent Volatility in the WTI Contract

Several commenters noted the volatility in the NYMEX Light Sweet Crude Oil (CL) contract, also known as the West Texas Intermediate crude oil contract ("WTI contract"), that occurred in April 2020 (subsequent to the issuance of the 2020 NPRM) in their comments to the 2020 NPRM. Some commenters suggested that the volatility may have been caused, in part, by excessive speculation[62] or highly leveraged traders,[63] or both. Better Markets suggested that a combination of passive exchange-traded funds,[64]

[62] PMAA at 2.
[63] NEFI at 3-4.
[64] Better Markets at 9.

the use of trading-at-settlement ("TAS") orders,[65] automated trading,[66] and, according to Better Markets, a lack of "meaningful position limits,"[67] may have contributed to the volatility. Other commenters suggested that this event could have been mitigated through additional liquidity provided by financial end users during the critical time period, among other measures.[68] Commenters also pointed to the event to bolster arguments for and against Commission deference to exchanges in implementing position limits.[69] A few commenters requested that the Commission refrain from finalizing the rule until it better understands this event and other issues.[70]

The Commission has been closely examining the circumstances surrounding the volatility in the WTI contract since it occurred in April 2020. The Commission will continue to analyze the events of April 2020 to evaluate whether any changes to the position limits regulations may be warranted in light of the circumstances surrounding the volatility in the WTI contract. Any proposed changes that the Commission finds may be warranted would be subject to public comment pursuant to the requirements of the Administrative Procedure Act.

H. Brief Summary of Comments Received

As stated previously, the Commission received approximately 75 relevant comment letters in response to the 2020 NPRM.[71] Though several commenters did not

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[65] Better Markets at 13. A TAS order is an order that is placed during the trading session but is executed at the settlement price (or with a small price range around the settlement price). Trading at Settlement (TAS), https://www.cmegroup.com/trading/trading-at-settlement.html (last visited Aug. 29, 2020); TRADE AT SETTLEMENT (TAS) FREQUENTLY ASKED QUESTIONS July 2020, https://www.theice.com/publicdocs/futures_us/TAS_FAQ.pdf (last visited Aug. 29, 2020).

[66] Better Markets at 14-17.

[67] Better Markets at 10.

[68] AQR at 5-7 ("The inability of position limits themselves to eliminate the unpredictability of commodity futures markets highlights the importance of existing Commission and exchange oversight of these markets and the dangers of overreliance on a single regulatory tool to address market dynamics for which it may not have been designed....[W]e encourage the Commission to consider not only concerns around potential manipulation, but also the potential unintended consequences of such limits and the need for liquidity during sensitive time periods for commodity futures markets."); SCM at 2-3 ("This liquidity, provided by financial trading firms and hedge funds…, is essential to balance, check and smooth the otherwise uncontrollable trading that can occur when only commercial firms and unsophisticated trading participants are active in a market.").

[69] IATP suggested that the event demonstrates the problems of Commission deference to DCMs' "experience and capacity" on many of the provisions in the 2020 NPRM. *See* IATP at 18. Conversely, SEMI stated that a final rule should not be overly restrictive in response to the recent market conditions in WTI oil markets, given that it is the exchanges that "have the expertise, experience and existing tools to effectively manage the orderly expiration of futures contracts that are in the spot month under such circumstances." SEMI at 13.

[70] AFR at 3; Rutkowski at 2; IATP at 2-3.

[71] *See supra*, n.16.

support the Commission adopting the 2020 NPRM and requested its withdrawal,[72] most of the 75 comments received generally supported the 2020 NPRM, or supported specific elements of the 2020 NPRM. However, many of these commenters suggested modifications to portions of the 2020 NPRM, which are discussed in the relevant sections discussing the Final Rule below. In addition, several commenters requested Commission action beyond the scope of the 2020 NPRM, also discussed in the relevant sections below.

II. Final Rule

A. § 150.1—Definitions

Definitions relevant to the existing position limits regime currently appear in both §§ 1.3 and 150.1 of the Commission's regulations.[73] The Commission proposed to update and supplement the definitions in § 150.1, including moving a revised definition of "bona fide hedging transactions and positions" from § 1.3 into § 150.1. The proposed changes were intended, among other things, to conform the definitions to certain of the Dodd-Frank Act amendments to the CEA.[74] Each proposed defined term is discussed in alphabetical order below.

1. "Bona Fide Hedging Transaction or Position"

i. Background - Bona Fide Hedging Transaction or Position

Under CEA section 4a(c)(1), position limits shall not apply to transactions or positions that are shown to be bona fide hedging transactions or positions, as such terms shall be defined by the Commission.[75] The Dodd-Frank Act directed the Commission, for purposes of implementing CEA section 4a(a)(2), to adopt a bona fide hedging

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[72] *E.g.* AFR; Better Markets; IATP; Eric Matsen; NEFI; Public Citizen; Robert Rutkowski; SCM; and VLM.

[73] 17 CFR 1.3 and 150.1, respectively.

[74] In addition to the amendments described below, the Commission proposed to re-order the defined terms so that they appear in alphabetical order, rather than in a lettered list, so that terms can be more quickly located. Moving forward, any new defined terms would be inserted in alphabetical order, as recommended by the Office of the Federal Register. *See Document Drafting Handbook*, Office of the Federal Register, National Archives and Records Administration, 2–31 (Revision 5, Oct. 2, 2017) (stating, "[i]n sections or paragraphs containing only definitions, we recommend that you do not use paragraph designations if you list the terms in alphabetical order. Begin the definition paragraph with the term that you are defining.").

[75] 7 U.S.C. 6a(c)(1).

definition consistent with CEA section 4a(c)(2).[76] The existing definition of "bona fide hedging transactions and positions," which first appeared in § 1.3 of the Commission's regulations in the 1970s,[77] is inconsistent, in certain ways described below, with the revised statutory definition in CEA section 4a(c)(2).

Accordingly, and for the reasons outlined below, the Commission proposed to remove the existing bona fide hedging definition from § 1.3 and replace it with a revised bona fide hedging definition that would appear alongside all of the other position limits related definitions in proposed § 150.1.[78] This definition would be applied in determining whether a position in a commodity derivative contract is a bona fide hedge that may exceed Federal position limits set forth in § 150.2.

This section of the release discusses the bona fide hedging definition and the substantive standards for bona fide hedges. The process for granting bona fide hedge recognitions is discussed later in this release in connection with §§ 150.3 and 150.9.[79]

The discussion in this section is organized as follows:

i. This background section discussion;

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[76] 7 U.S.C. 6a(c)(2).

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

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

Further, the version of § 1.3 that appears in the Code of Federal Regulations applies only to excluded commodities and is not the version of the bona fide hedging definition currently in effect. The version currently in effect, the substance of which remains as it was amended in 1987, applies to all commodities, not just to excluded commodities. *See* Revision of Federal Speculative Position Limits, 52 FR 38914 (Oct. 20, 1987). While the 2011 Final Rulemaking amended the § 1.3 bona fide hedging definition to apply only to excluded commodities, that rulemaking was vacated, as noted previously, by a September 28, 2012 order of the U.S. District Court for the District of Columbia, with the exception of the rule's amendments to 17 CFR 150.2. Although the 2011 Final Rulemaking was vacated, the 2011 version of the bona fide hedging definition in § 1.3, which applied only to excluded commodities, has not yet been formally removed from the Code of Federal Regulations. The currently-in-effect version of the Commission's bona fide hedging definition thus does not currently appear in the Code of Federal Regulations. The closest to a "current" version of the definition is the 2010 version of § 1.3, which, while substantively current, still includes the "(z)" denomination that was removed in 2018. The Commission proposed to address the need to formally remove the incorrect version of the bona fide hedging definition as part of the 2020 NPRM.

[79] *See infra* Section II.C. (discussing § 150.3) and Section II.G. (discussing § 150.9).

ii. An overview of the existing "general" elements of the bona fide hedging definition and the specific "enumerated" bona fide hedges listed in the existing bona fide hedge definition;

iii. A discussion of each of the elements of the existing "general" bona fide hedging definition, including the (a) temporary substitute test (and the related elimination of the risk management exemption), (b) economically appropriate test, (c) change in value requirement, (d) incidental test, and (e) orderly trading requirement;

iv. The treatment of unfixed-price transactions under the Final Rule;

v. A discussion of each enumerated bona fide hedge in the Final Rule;

vi. A discussion of the elimination of the Five-Day Rule;

vii. A discussion of the guidance on measuring risk (*i.e.*, gross versus net hedging);

viii. A discussion of the Final Rule's implementation of the CEA's statutory pass-through swap and pass-through swap offset provisions; and

ix. A discussion of the form, location, and organization of the enumerated bona fide hedges.

ii. Overview of the Commission's Existing Bona Fide Hedging Definition in § 1.3

Paragraph (1) of the existing bona fide hedging definition in Commission regulation § 1.3 contains what is currently labeled the "general definition" of bona fide hedging. This "general" bona fide hedging definition comprises five key elements which require that in order for a position to be deemed a bona fide hedge for Federal position limits, the position must:

- "normally" represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel ("temporary substitute test");

- be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise ("economically appropriate test");
- arise from the potential change in value of (1) assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising, (2) liabilities which a person owns or anticipates incurring, or (3) services which a person provides, purchases, or anticipates providing or purchasing ("change in value requirement");
- have a purpose to offset price risks incidental to commercial cash or spot operations ("incidental test"); and
- be established and liquidated in an orderly manner ("orderly trading requirement").[80]

As discussed more fully below, the Dodd-Frank Act's amendments to the CEA included the first three factors in the amended CEA, but did not include the last two factors.

Additionally, paragraph (2) of the bona fide hedging definition in existing § 1.3 currently sets forth a non-exclusive list of seven total enumerated bona fide hedges, contained in four general bona fide hedging transaction categories, that comply with the general bona fide hedging definition in paragraph (1). These bona fide hedge categories that are explicitly listed in existing § 1.3's bona fide hedging definition are generally referred to as the "enumerated" bona fide hedges, a term the Commission uses throughout in this release. Market participants thus need not seek approval from the Commission of such positions as bona fide hedges prior to exceeding limits for such positions. Rather, market participants must simply report any such positions on the monthly Form 204 (or Form 304 for cotton), as required by part 19 of the Commission's existing regulations.[81]

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[80] 17 CFR 1.3.

[81] 17 CFR part 19.

The seven existing enumerated hedges fall into the following four categories: (1) sales of futures contracts to hedge (i) ownership or fixed-price cash commodity purchases and (ii) unsold anticipated production; (2) purchases of futures contracts to hedge (i) fixed-price cash commodity sales of the same commodity, (ii) fixed-price sales of the cash commodity's cash products and by-products, and (iii) unfilled anticipated requirements; (3) offsetting sales and purchases of futures contracts to hedge offsetting unfixed-price cash commodity sales and purchases; and (4) cross-commodity hedges.[82]

As discussed further below, market participants may not use either the existing enumerated bona fide hedges for unsold anticipated production or unfilled anticipated requirements to hedge more than twelve-months' unsold production or unfilled requirements, respectively (the "twelve-month restriction"). Further, the existing enumerated bona fide hedges for unsold production and for offsetting sales and purchases of unfixed price transactions do not apply during the five last trading days. Similarly, the existing enumerated bona fide hedge for unfilled anticipated requirements has a modified version of the Five-Day Rule and provides that during the "five last trading days" a market participant may not maintain a position that exceeds the market participant's unfilled anticipated requirement for "that month and for the next succeeding month."

Paragraph (3) of the current bona fide hedging definition states that the Commission may recognize "non-enumerated" bona fide hedging transactions and positions pursuant to a specific request by a market participant using the process described in § 1.47 of the Commission's regulations.[83]

iii. Amended Bona Fide Hedge Definition for Physical Commodities in § 150.1; "General" Elements of the Bona Fide Hedge Definition Under the Final Rule

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[82] 17 CFR 1.3.

[83] *Id.*

The Commission is adopting the proposed general elements currently found in the bona fide hedging definition in § 1.3 that conform to the revised statutory bona fide hedging definition in CEA section 4a(c)(2), as amended by the Dodd-Frank Act, and is eliminating the general elements that do not conform.[84] In particular, the Commission is adopting updated versions of the temporary substitute test, economically appropriate test, and change in value requirements that are described below, and eliminating the incidental test and orderly trading requirement, which are not included in the revised statutory text. Each of these changes is discussed in more detail below.[85]

a. Temporary Substitute Test

(1) Background – Temporary Substitute Test

The language of the temporary substitute test in the Commission's existing bona fide hedging definition is inconsistent with the language of the temporary substitute test that appears in the CEA, as amended by the Dodd-Frank Act. Specifically, the Commission's existing regulatory definition currently provides that a bona fide hedging position *normally* represents a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel.[86] Prior to the enactment of the Dodd-Frank Act, the temporary substitute test in section 4a(c)(2)(A)(i) of the CEA also contained the word "normally," so that the Commission's existing bona fide hedging definition mirrored the previous section 4a(c)(2)(A)(i) of the CEA prior to the Dodd-Frank Act. The word "normally" acted as a qualifier for the instances in which a position must be a temporary substitute for transactions or positions made at a later time in a

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[84] The Commission is also making a non-substantive change to the introductory language of § 150.3 by referring in the proviso to "such person's transactions or positions." The Commission views this as a clarifying edit, and does not intend a substantive difference in meaning with the choice of these terms.

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

[86] 17 CFR 1.3. As noted earlier in this release, the currently-in-effect version of the Commission's bona fide hedging definition does not currently appear in the current Code of Federal Regulations. The closest to a "current" version of the definition is the 2010 version of § 1.3, which, while substantively current, still includes the "(z)" denomination that was removed in 2018. The Commission proposed to address the need to formally remove the incorrect version of the bona fide hedging definition as part of the 2020 NPRM. *See supra* n.74.

physical marketing channel. However, the Dodd-Frank Act removed that qualifier by deleting the word "normally" from the temporary substitute test in CEA section 4a(c)(2)(A)(i).[87]

In a 1987 interpretation, the Commission stated that, among other things, the inclusion of the word "normally" in connection with the pre-Dodd-Frank-Act version of the temporary substitute language indicated that the bona fide hedging definition should not be construed to apply only to firms using futures to reduce their exposures to risks in the cash market.[88] Instead, the 1987 interpretation took the view that to qualify as a bona fide hedge, a transaction in the futures market did not necessarily need to be a temporary substitute for a later transaction in the cash market.[89] In other words, that interpretation took the view that a futures position could still qualify as a bona fide hedging position even if it was not in connection with the production, sale, or use of a physical commodity.

Commission staff has previously granted so-called "risk management exemptions" on such grounds. In connection with physical commodities, the phrase "risk management exemption" has historically been used by Commission staff to refer to non-enumerated bona fide hedge recognitions granted under § 1.47 to allow swap dealers and others to hold agricultural futures positions in excess of Federal position limits in order to offset their positions in commodity index swaps or related exposure.[90] Risk management exemptions were granted outside of the spot month, and the related swap exposure that was being offset (*i.e.*, hedged by the futures or options position entered into based on the risk management exemption) was typically opposite an institutional investor for which the swap was not a bona fide hedge.

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[87] 7 U.S.C. 6a(c)(2)(A)(i).

[88] *See* Clarification of Certain Aspects of the Hedging Definition, 52 FR 27195, 27196 (July 20, 1987).

[89] *Id*.

[90] As described below, due to differences in statutory language, the phrase "risk management exemption" often has a broader meaning in connection with excluded commodities than with physical commodities. *See infra* Section II.A.1.x. (discussing proposed pass-through language).

(2) Summary of the 2020 NPRM – Temporary Substitute Test

As described above, the Dodd-Frank Act clearly and unambiguously removed the word "normally" from the temporary substitute test in CEA section 4a(c)(2)(A)(i), as amended by the Dodd-Frank Act. As such, in the 2020 NPRM, the Commission interpreted the Dodd-Frank Act's removal of the word "normally" as reflecting Congressional statutory direction that a bona fide hedging position in physical commodities must *always* (and not just "normally") be in connection with the production, sale, or use of a physical cash-market commodity.[91] The Commission interpreted this change to signal that the Commission should cease to recognize "risk management" positions as bona fide hedges for physical commodities, unless the positions satisfy the pass-through swap/swap offset requirements in section 4a(c)(2)(B) of the CEA, further discussed below.[92]

In order to implement that statutory change, the Commission: (1) proposed a narrower bona fide hedging definition for physical commodities in proposed § 150.1 that did not include the word "normally" currently found in the temporary substitute regulatory language in paragraph (1) of the existing § 1.3 bona fide hedging definition; and (2) proposed to eliminate all previously-granted risk management exemptions that did not otherwise qualify for pass-through treatment.[93] Under the 2020 NPRM, any such previously-granted risk management exemption would generally no longer apply 365 days after publication of final position limits rules in the *Federal Register*.[94]

(3) Summary of the Commission Determination – Temporary Substitute Test

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[91] 85 FR at 11596.

[92] 7 U.S.C. 6a(c)(2)(B).

[93] *See* final § 150.3(c). *See also infra* Section II.A.1.x.b. (discussing proposed pass-through language). Excluded commodities, as described in further detail below, are not subject to the statutory bona fide hedging definition. Accordingly, the statutory restrictions on risk management exemptions that apply to physical commodities subject to Federal position limits do not apply to excluded commodities.

[94] *See infra* Section II.A.1.iii.a(5) (discussing of revoking existing risk management exemptions).

As proposed, the Final Rule eliminates the word "normally" from the Commission's temporary substitute test and eliminates the risk management exemption for contracts subject to Federal position limits. However, as described below, the Final Rule is extending the compliance date for existing risk management exemption holders.

(4) Comments – Temporary Substitute Test

Commenters were divided regarding the proposed elimination of the risk management exemptions. Some public interest groups and the agricultural industry supported the proposed removal of the word "normally" and/or the accompanying rescission of risk management exemptions.[95] These commenters argued that risk management positions are harmful to the market and can adversely impact price dynamics.[96]

Commenters from the financial industry, ICE, and MGEX opposed the proposed removal of "normally" and/or the proposed elimination of the risk management exemption.[97] These commenters contended that the elimination of the risk management exemption will harm the market, including by reducing liquidity,[98] and that even though Congress removed "normally" from the statute, Congress did not use the term "always."[99] One commenter opposed to the ban claimed that the European Commission is

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[95] AMCOT at 1; Ecom at 1; White Gold at 1-2; Walcot at 2; East Cotton at 2; CMC at 11 (stating that the increased limits and allowances for pass-through exemptions will limit any potential loss of liquidity); NCFC at 7 (noting that it supports the elimination in light of the increased limits); NGFA at 3; LDC at 2; PMAA at 4; ACSA at 2, 4; IMC at 2; Mallory at 1; McMeekin at 1-2; Memtex at 2; Omnicotton at 2; NCC at 1; S Canale Cotton at 2; Texas Cotton at 2; SW Ag at 2; Jess Smith at 2; Choice Cotton at 1; Olam at 1-2; Better Markets at 4, 51-54 (agreeing with the proposed interpretation that the Dodd-Frank Act requires the change and stating that the elimination of the risk management exemption may mean very little in light of the increased limits); ACA at 2; Moody Compress at 2; Toyo at 2; and DECA at 1.

[96] See, *e.g.*, Mallory Alexander at 1; DECA at 1; Ecom at 2; Southern Cotton at 2; Canale Cotton at 2; ACA at 2; IMC at 2; Olam at 1-2; Moody Compress at 1; SW Ag at 2; East Cotton at 2; Toyo at 2; Jess Smith at 2; McMeekin at 1-2; Omnicotton at 2; Texas Cotton at 2; Walcot at 2; White Gold at 1-2; and PMAA at 3-4 (arguing that risk management positions have the potential to create significant volatility); Better Markets at 9, 17 (noting the distortive effects of risk management positions).

[97] ICE at 5-8 (noting that risk management positions are non-speculative and arguing that the pass-through provision is not an adequate substitute for such positions); FIA at 10, 21-24; ISDA at 6; PIMCO at 5-6; SIFMA AMG at 8; MGEX at 2.

[98] FIA at 23-24 (contending that the 2020 NPRM may harm pension funds and create a bifurcated liquidity pool since dealers may need to move their hedges from physically-settled to financially-settled contracts earlier than they would otherwise); ISDA at 6, 11; PIMCO at 5-6; and ICE at 5-6.

[99] ISDA at 6; FIA at 21-22; and ICE at 5, 8.

considering revising MiFID II[100] to address a "failure to include an appropriate hedge exemption for financial risks."[101]

Finally, several commenters noted that even if the Commission finalizes the ban as proposed, the Commission should: (i) revoke the exemptions gradually so as to avoid disruption;[102] (ii) clarify that the Commission maintains the authority under CEA section 4a(a)(7) to grant risk management exemptions in the future;[103] and (iii) allow exchanges to grant risk management exemptions.[104]

(5) Discussion of Final Rule – Temporary Substitute Test

The Commission is eliminating the word "normally" from the Commission's temporary substitute test and eliminating the existing risk management exemption for contracts subject to Federal position limits as proposed. However, as described below, the Commission is extending the compliance date by which positions based on existing risk management exemptions must be reduced to levels that comply with the applicable Federal position limits. While the Commission appreciates commenter concerns regarding the elimination of the risk management exemption, the Commission interprets the Dodd-Frank Act's removal of the word "normally" from the CEA's statutory temporary substitute test as signaling Congressional intent to reverse the flexibility afforded by the presence of the word "normally" prior to the Dodd-Frank Act. As such,

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[100] According to the European Securities and Market Authority, "MiFID is the Markets in Financial Instruments Directive (2004/39/EC). It has been applicable across the European Union since November 2007. It is a cornerstone of the EU's regulation of financial markets seeking to improve their competitiveness by creating a single market for investment services and activities and to ensure a high degree of harmonised protection for investors in financial instruments." MiFID sets out: conduct of business and organisational requirements for investment firms; authorisation requirements for regulated markets; regulatory reporting to avoid market abuse; trade transparency obligation for shares; and rules on the admission of financial instruments to trading."

"On 20 October 2011, the European Commission adopted a legislative proposal for the revision of MiFID which took the form of a revised Directive and a new Regulation. After more than two years of debate, the Directive on Markets in Financial Instruments repealing Directive 2004/39/EC and the Regulation on Markets in Financial Instruments, commonly referred to as MiFID II and MiFIR, were adopted by the European Parliament and the Council of the European Union. They were published in the EU Official Journal on 12 June 2014." European Securities and Market Authority website at https://www.esma.europa.eu/policy-rules/mifid-ii-and-mifir.

[101] SIFMA AMG at 8.

[102] ISDA at 7.

[103] ICE at 6; FIA at 3, 22, 24; ISDA at 6-7; and IECA at 12.

[104] FIA at 3, 22; ISDA at 6-7; and ICE at 5-6.

even were the Commission inclined to retain the status quo of risk management exemptions, the Commission's statutory interpretation prevents it from doing so.

Further, retaining such exemptions for swap intermediaries, without regard to the purpose of their counterparties' swaps, would not only be inconsistent with the post-Dodd-Frank Act version of the temporary substitute test, but would also be inconsistent with the statutory restrictions on pass-through swap offsets. In particular, the statutory pass-through provision requires that the swap position being offset qualify as a bona fide hedging position.[105] Many risk management exemptions have been used to offset swap positions that would not qualify as bona fide hedging positions.

In response to the comment regarding a potential expansion of MiFID II to accommodate activity akin to risk management exemptions, the Commission believes that the European Commission's stated posture does not appear to contemplate a blanket exemption for financial risks as suggested by the commenter. Instead, the European Commission's approach appears to be largely consistent with the narrower pass-through approach adopted by the Commission in this Final Rule.[106]

The Commission is, however, making several changes and clarifications to address commenter concerns:

First, the Commission is extending the compliance date by which risk management exemption holders must reduce their risk management exemption positions to comply with Federal position limits under the Final Rule to January 1, 2023.[107] This provides approximately two years beyond the Effective Date for the nine legacy

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[105] *See* 7 U.S.C. 6a(c)(2)(B)(i) (was executed opposite a counterparty for which the transaction would qualify as a bona fide hedging transaction). The pass-through swap offset language in the Final Rule's bona fide hedging definition is discussed in greater detail below.

[106] *See* MiFID II Review report on position limits and position management (April 1, 2020), available at https://www.esma.europa.eu/sites/default/files/library/esma70-156-2311_mifid_ii_review_report_position_limits.pdf. The exemption under consideration for financial counterparties appears to be in line with the Final Rule's pass-through provision, in that the "exemption would apply to the positions held by that financial counterparty that are objectively measurable as reducing risks directly related to the commercial activities of the non-financial entities of the group . . . .this hedging exemption should not be considered as an additional exemption to the position limit regime but rather as a 'transfer' to the financial counterparty of the group of the hedging exemption otherwise available to the commercial entities of the group." *Id.* at 32-33.

[107] For clarity, a risk management exemption holder may enter into new positions based on, and in accordance with, its previously-granted risk management exemption, during this compliance period, until January 1, 2023.

agricultural contracts.[108] The Commission believes that this will provide sufficient time for existing positions to roll off and/or be replaced with positions that conform with the Federal position limits adopted in this Final Rule, without adversely affecting market liquidity.

Second, including pass-through swaps and pass-through swap offsets within the definition of a bona fide hedge will mitigate some of the potential impact resulting from the rescission of the risk management exemption. The Final Rule's pass-through provisions should help address certain of the hedging needs of persons seeking to offset the risk from swap books, allowing for sufficient liquidity in the marketplace for both bona fide hedgers and their counterparties.

Third, although the Commission will no longer recognize risk management positions as bona fide hedges under this Final Rule, the Commission maintains other authorities, including the authority under CEA section 4a(a)(7), to exempt risk management positions from Federal position limits.

Finally, consistent with existing industry practice, exchanges may continue to recognize risk management positions for contracts that are not subject to Federal position limits, including for excluded commodities.

b. Economically Appropriate Test

(1) Background - Economically Appropriate Test

The statutory and regulatory bona fide hedging definitions in section 4a(c)(2)(A)(ii) of the CEA and in existing § 1.3 of the Commission's regulations both provide that a bona fide hedging position must be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise.[109] The

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[108] For further discussion of the Final Rule's compliance and effective dates, *see* Section I.D. Both existing risk management exemptions, as discussed herein, and swap positions, will be subject to the extended compliance data to January 1, 2023.

[109] 7 U.S.C. 6a(c)(2)(A)(ii) and 17 CFR 1.3.

Commission has, when defining bona fide hedging, historically focused on transactions that offset price risk.[110]

(2) Summary of the 2020 NPRM - Economically Appropriate Test

In the 2020 NPRM, the Commission proposed to amend the economically appropriate prong of the bona fide hedge definition with one clarification: consistent with the Commission's longstanding practice regarding what types of risk may be offset by bona fide hedging positions in excess of Federal position limits,[111] the Commission made explicit in the proposed bona fide hedging definition that the word "risks" refers to, and is limited to, "price risk." This proposed clarification did not reflect a change in policy, as the Commission has a longstanding policy that hedges of non-price risk alone cannot be recognized as bona fide hedges.[112]

As stated in the 2020 NPRM, the Commission clarified its view that risk must be limited to price risk for purposes of the economically appropriate test due to the difficulty that the Commission or exchanges may face in objectively evaluating whether a particular derivatives position is economically appropriate to the reduction of non-price risks. For example, the Commission or an exchange's staff can objectively evaluate whether a particular derivatives position is an economically appropriate hedge of a price risk arising from an underlying cash-market transaction, including by assessing the correlations between the risk and the derivatives position. It would be more difficult, if not impossible, to objectively determine whether an offset of non-price risk is economically appropriate for the underlying risk.

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

[111] *See, e.g.*, 78 FR at 75709, 75710.

[112] *See supra* n.109 for further discussion on the Commission's longstanding policy regarding "price" risk.

Finally, the Commission requested comment on whether price risk is attributable to a variety of factors, including political and weather risk, and could therefore allow hedging political, weather, or other risks, or whether price risk is something narrower in the application of bona fide hedging.[113]

(3) Summary of the Commission Determination - Economically Appropriate Test

The Commission is adopting the economically appropriate prong of the bona fide hedge definition as proposed. However, as discussed below, the Commission is clarifying in response to commenter requests that while the Commission is explicitly limiting "risks" to "price risks" as used in the economically appropriate test, the Commission recognizes that price risk can be informed and impacted by various other types of non-price risk.

(4) Comments - Economically Appropriate Test

The Commission received comments from market participants seeking greater clarity with respect to the Commission's proposed reference to "price risk" in the context of applying the "economically appropriate" test in the bona fide hedging definition. Many commenters stated that the economically appropriate test should include offsets of non-price risk.[114] Other commenters stated that a variety of non-price risk factors (i) actually affect price risk and therefore are objective,[115] or (ii) are simply another form of price risk and therefore should be permitted.[116]

For example, ADM stated that when market participants discuss "risks" such as political, weather, delivery, transportation, and more, they are discussing the impact these

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[113] 85 FR at 11622.

[114] MGEX at 2; NGSA at 5-6; CHS at 3; NCFC at 2; FIA at 10-11; CMC at 3; LDC at 2; ICE at 4; IFUS at Exhibit 1 RFC (6).

[115] FIA at 10-11 (Stating that, "[T]he Commission should recognize that the statutory definition of a bona fide hedging position encompasses the reduction of all risks that affect the value of a cash-market position, including time risk, location risk, quality risk, execution and logistics risk, counterparty credit risk, weather risk, sovereign risk, government policy risk (*e.g.*, an embargo), and any other risks that affect price. These are objective, rather than subjective, risks that commercial enterprises incur on a regular basis in connection with their businesses as producers, processors, merchants handling, and users of commodities that underlie the core referenced futures contracts").

[116] ADM at 5.

factors may have on the price.[117] Hence the risk being hedged is price risk as influenced by these factors.[118] Other commenters stated that market participants should have the flexibility to measure risk in the manner most suitable for their business.[119] In addition, commenters also stated they were not opposed to "price risk" so long as the Commission clarified that price risk is not static or an absolute objective measure, and consequently that the term "price risks" incorporates a commercial hedger's independent assessment of price risk.[120]

In contrast, Better Markets supported the 2020 NPRM's rationale to permit only "price risk."[121] Better Markets also suggested that the Commission clarify that the term "commercial enterprise" refers to "solely [a] transaction or position that would be directly and demonstrably risk reducing to 'cash or spot operations' for physical commodities underlying the contracts" to be hedged.[122]

Finally, ICE, MGEX, and FIA requested that if the Commission adopts the proposed economically appropriate prong, the Commission should permit market participants to use the non-enumerated bona fide hedge process to receive recognition of bona fide hedges of non-price risk on a case-by-case basis.[123]

(5) Discussion of the Final Rule – The Bona Fide Hedging Definition's "Economically Appropriate Test"

The Commission is adopting the economically appropriate prong of the bona fide hedging definition as proposed, codifying existing practice, as well as existing § 1.3's treatment of price risk, by making it explicit in the rule text that the word "risks" refers to, and is limited to, "price risk."

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[117] *Id*.
[118] ADM at 5.
[119] LDC at 2.
[120] CMC at 3.
[121] Better Markets at 52-53.
[122] Better Markets at 53.
[123] MGEX at 2; FIA at 11.

The Commission emphasizes that the Final Rule is not intended to represent a change to the Commission's existing interpretation of the economically appropriate prong of bona fide hedging, but rather is maintaining the application of the economically appropriate test in connection with bona fide hedges on the nine legacy agricultural contracts to the 16 new non-legacy core referenced futures contracts.

In promulgating existing § 1.3, the Commission explained that a bona fide hedging position must, among other things, "be economically appropriate to risk reduction, such risks must arise from operation of a commercial enterprise, and the *price* fluctuations of the futures contracts used in the transaction must be substantially related to fluctuations of the cash-market value of the assets, liabilities or services being hedged."[124] (emphasis added). Consistent with this longstanding policy of the Commission to recognize hedges of price risk of an underlying commodity position as bona fide hedges (and consistent with the Commission's existing application of bona fide hedging to the nine legacy agricultural contracts under the existing Federal position limit regulations), the Commission is also clarifying further below that price risk can be informed and impacted by various other types of risks.

As the Commission stated in the 2020 NPRM and continues to believe, for any given non-price risk, such as geopolitical turmoil, weather, or counterparty credit risks, there could be multiple commodities, directions, and contract months which a particular market participant may subjectively view as an economically appropriate offset for that non-price risk. Moreover, multiple market participants faced with the same non-price risk might take different views on which offset is the most effective.[125] A system of

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[124] Bona Fide Hedging Transactions or Positions, 42 FR 14832, 14833 (Mar. 16, 1977) (emphasis added). "Value" is generally understood to mean price times quantity. The Dodd-Frank Act added CEA section 4a(c)(2), which copied the economically appropriate test from the Commission's definition in § 1.3. *See also* 78 FR at 75702, 75703 (stating that the "core of the Commission's approach to defining bona fide hedging over the years has focused on transactions that offset a recognized physical price risk").

[125] 85 FR at 11606.

allowing for bona fide hedges based solely by reference to such non-price risks would be difficult to administer on a pragmatic and consistently fair basis.

Further, it also would be difficult to evaluate whether a particular commodity derivative contract would be the proper offset as a bona fide hedge, as defined in this Final Rule, to a potential non-price risk, or would remove exposure to the potential change in value to the market participant's cash positions resulting from the non-price risk. Thus, hedging *solely* to protect against changes in value of non-price risks would fall outside the category of a bona fide hedge which offsets the "price risk" of an underlying commodity cash position.

However, the Commission agrees with commenters who stated that market participants form independent economic assessments of how different possible events might create potential risk exposures for their business.[126] Such risks that create or impact the price risk of underlying cash commodities may include, but are not limited to, geopolitical turmoil, weather, or counterparty credit risks. The Commission recognizes that these risks can create price risks and understands that firms may manage these potential risks to their businesses differently and in the manner most suitable for their business. As noted above, by limiting the economically appropriate prong to price risk, the Commission is reiterating its historical practice, which has applied well to the legacy agricultural contracts for decades, to recognize hedges of price risk of an underlying commodity position as bona fide hedges while acknowledging that price risk may itself be impacted by non-price risks.

The foregoing discussion of price risk is limited to the question of whether a position in a referenced contract meets the economically appropriate test to satisfy the bona fide hedge requirements. Market participants may thus continue to manage non-price risks in a variety of ways, which may include participation in the futures markets or

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[126] CMC at 3.

exposure to other financial products. In fact, market participants may decide to use futures contracts that are not subject to Federal position limits (*e.g.*, location basis contracts), if they determine such contracts will help them manage non-price risks faced by their businesses.[127] For example, a market participant seeking to manage risk, including non-price risk, with positions in contracts that are not referenced contracts, such as freight or weather derivatives, would not be subject to Federal speculative position limits and thus would not need to comply with the economically appropriate test in connection with such positions in non-referenced contracts.

To satisfy the economically appropriate test, a position must ultimately offset the price risk of an underlying cash commodity.[128] Non-price risk may also be a consideration in hedging decisions, but cannot be a substitute for price risk associated with the cash commodity underlying the derivatives position. The foregoing view precludes the Commission from adopting commenter suggestions to permit market participants to use the non-enumerated hedge process to receive recognition of hedges of non-price risk on a case-by-case basis because, while the Commission acknowledges that price risk can be informed and impacted by non-price risk, price risk is required to satisfy the economically appropriate test.

c. Change in Value Requirement

(1) Background - Change in Value Requirement

CEA section 4a(c)(2)(A)(iii) and existing § 1.3 include the "change in value requirement," which provides that the bona fide hedging position must arise from the potential change in the value of: (I) assets that a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing,

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[127] The enumerated cross-commodity hedge provision adopted herein and discussed below offers may also offer additional flexibility to those market participants using referenced contracts to manage risk, by allowing market participants to hedge price risk associated with a particular commodity using a derivative contract based on a different commodity, assuming all applicable requirements of the cross-commodity enumerated bona fide hedge are met.

[128] This view is consistent with the spirit of Better Market's comment suggesting a focus on reducing risks associated with a cash-market position in a physical commodity. *See* Better Markets at 53.

or merchandising; (II) liabilities that a person owns or anticipates incurring; or (III) services that a person provides, purchases, or anticipates providing or purchasing.[129]

(2) Summary of the 2020 NPRM - Change in Value Requirement

The Commission proposed to retain the substance of the change in value requirement in existing § 1.3, with some non-substantive technical modifications, including modifications to correct a typographical error.[130] Aside from the typographical error, the proposed § 150.1 change in value requirement mirrors the Dodd-Frank Act's change in value requirement in CEA section 4a(c)(2)(A)(iii).

(3) Summary of the Commission Determination - Change in Value Requirement

For the same reasons set out in the 2020 NPRM, the Commission is adopting the change in value requirement of the bona fide hedge definition as proposed.

(4) Comments - Change in Value Requirement

No specific comments on the change in value requirement were received.

d. Incidental Test and Orderly Trading Requirement

(1) Background - Incidental Test and Orderly Trading Requirement

Two general requirements contained in the existing § 1.3 definition of bona fide hedging position include: (I) the incidental test and (II) the orderly trading requirement. For a position to be recognized as a bona fide hedging position, the incidental test requires that the purpose is to offset price risks incidental to commercial cash, spot, or forward operations.

Under the orderly trading requirement, such position is established and liquidated in an orderly manner in accordance with sound commercial practices. Notably, Congress

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[129] 7 U.S.C. 6a(c)(2)(A)(iii), 17 CFR 1.3.

[130] The Commission proposed to replace the phrase "liabilities which a person *owns*," which appears in the statute erroneously, with "liabilities which a person *owes*," which the Commission believed was the intended wording (emphasis added). The Commission interpreted the word "owns" to be a typographical error. A person may owe on a liability, and may anticipate incurring a liability. If a person "owns" a liability, such as a debt instrument issued by another, then such person owns an asset. The fact that assets are included in CEA section 4a(c)(2)(A)(iii)(I) further reinforces the Commission's interpretation that the reference to "owns" means "owes." The Commission also proposed several other non-substantive modifications in sentence structure to improve clarity.

in the Dodd-Frank Act did not include the incidental test or the orderly trading requirement in the statutory bona fide hedging definition in CEA section 4a(c)(2).[131]

(2) Summary of the 2020 NPRM - Incidental Test and Orderly Trading Requirement

While the Commission proposed to maintain the substance of the three core elements of the existing bona fide hedging definition described above, with some modifications, the Commission also proposed to eliminate two elements contained in the existing § 1.3 definition: the incidental test and orderly trading requirement that currently appear in paragraph (1)(iii) of the § 1.3 bona fide hedging definition.[132]

(3) Summary of the Commission Determination - Incidental Test and Orderly Trading Requirement

The Commission is eliminating the incidental test and orderly trading requirement from the bona fide hedge definition as proposed.

(4) Comments - Incidental Test and Orderly Trading Requirement

NGSA supported elimination of the incidental test and orderly trading requirement, claiming that the changes will facilitate hedging,[133] while IATP and Better Markets opposed the removal of these provisions, contending that the provisions are important for preventing market disruption.[134]

(5) Discussion of the Final Rule - Incidental Test and Orderly Trading Requirement

The Commission is eliminating the incidental test and orderly trading requirement from the bona fide hedge definition as proposed. As noted above, neither the incidental test nor orderly trading requirement is part of the CEA's current statutory definition of bona fide hedge. The Commission views the incidental test as redundant because the Commission proposed to maintain both (1) the change in value requirement (as noted

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[131] 7 U.S.C. 6a(c)(2).
[132] 17 CFR 1.3.
[133] NGSA at 4.
[134] IATP at 14-15; Better Markets at 53.

above, the reference to "value" in the change in value requirement is generally understood to mean price per unit times quantity of units) as well as (2) the economically appropriate test (which includes the concept of the offset of price risks in the conduct and management of, *i.e.*, incidental to, a commercial enterprise).

In response to IATP and Better Markets, the Commission does not view the orderly trading requirement as needed to prevent market disruption. The statutory bona fide hedging definition does not include an orderly trading requirement,[135] and the meaning of "orderly trading" is unclear in the context of the OTC swap market and in the context of permitted off-exchange transactions, such as exchange for physicals. The elimination of the orderly trading requirement does not diminish an exchange's obligation to prohibit any disruptive trading practices, including a case where an exchange believes that a bona fide hedge position may result in disorderly trading. Further, in eliminating the orderly trading requirement from the definition in the regulations, the Commission is not amending or modifying interpretations of any other related requirements, including any of the anti-disruptive trading prohibitions in CEA section 4c(a)(5),[136] or any other statutory or regulatory provisions.

Taken together, the retention of the updated temporary substitute test, economically appropriate test, and change in value requirement, coupled with the elimination of the incidental test and orderly trading requirement, should reduce uncertainty by eliminating provisions that do not appear in the statute, and by clarifying the language of the remaining provisions. By reducing uncertainty surrounding some parts of the bona fide hedging definition for physical commodities, the Commission anticipates that, as described in greater detail elsewhere in this release, it would be easier

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

[136] 7 U.S.C. 6c(a)(5).

going forward for the Commission, exchanges, and market participants to address whether novel trading practices or strategies may qualify as bona fide hedges.

iv. Treatment of Unfixed Price Transactions under the Final Rule

a. Background and Summary of Commission Determination - Treatment of Unfixed Price Transactions

The Commission has a long history of recognizing fixed-price commitments as the basis for a bona fide hedge.[137] While the existing bona fide hedging definition in § 1.3 includes one enumerated hedge that explicitly mentions "unfixed" prices,[138] the availability of this hedge is limited to circumstances where a market participant has both an unfixed-price purchase *and* an unfixed-price sale on hand, precluding a market participant with only an unfixed-price purchase *or* an unfixed-price sale from qualifying for this particular enumerated hedge. Further, the extent to which the other existing enumerated hedges apply to unfixed-price commitments is ambiguous from the plain reading of the text of the existing bona fide hedging definition.

However, Commission staff have previously considered the extent to which market participants with unfixed-price commitments may qualify for an enumerated hedge. Commission staff issued interpretive letter 12-07 in 2012 ("Staff Letter No. 12-07") in response to a narrow question submitted by a market participant regarding qualifying for the existing enumerated unfilled anticipated requirements bona fide hedge[139] while entering into "unfixed-price transactions."[140] In that interpretive letter, staff clarified that a commercial entity may qualify for the existing enumerated bona fide hedge for unfilled anticipated requirements even if the commercial entity has entered into

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[137] *See, e.g.*, paragraphs (2)(i)(A) and (2)(ii)(A) of existing § 1.3.

[138] *See* paragraph (2)(iii) of existing § 1.3 (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 at unfixed prices basis different delivery months of the contract market)

[139] Paragraph (2)(ii)(C) of existing § 1.3 provides in relevant part that the bona fide hedging definition includes purchases which do not exceed in quantity Twelve months' unfilled anticipated requirements of the same cash commodity for processing, manufacturing, or feeding by the same person.

[140] CFTC Staff Letter 12-07, issued August 16, 2012, https://www.cftc.gov/LawRegulation/CFTCStaffLetters/letters.htm, title search "12-07."

long-term, unfixed-price supply or requirements contracts because, as staff explained, the unfixed-price purchase contract does not "fill" the commercial entity's anticipated requirements.[141] As explained in Staff Letter No. 12-07, the price risk of such "unfilled" anticipated requirements is not offset by the unfixed-price forward contract because the price risk remains with the commercial entity, even though the entity has contractually assured a supply of the commodity.[142] Instead, the price risk continues until the unfixed-price contract's price is fixed.[143] Once the price is fixed on the supply contract, the commercial entity no longer has price risk, and its derivative position, to the extent the position is above an applicable position limit, and unless the market participant qualifies for another exemption (as discussed below), must be liquidated in an orderly manner in accordance with sound commercial practices.[144]

As discussed below, the Commission is affirming this narrow interpretation for the Final Rule – that commercial entities that enter into unfixed-price transactions may continue to qualify for the enumerated bona fide hedge for unfilled anticipated requirements – and the Commission is adopting this rationale to also apply to: (1) the existing enumerated bona fide hedge for unsold anticipated production;[145] and (2) the new enumerated bona fide hedge for anticipated merchandising.[146] In other words, under this Final Rule, a commercial market participant in the physical marketing channel that enters into an unfixed-price transaction may qualify for one of these enumerated anticipatory bona fide hedges, as long as the commercial market participant otherwise satisfies all applicable requirements for such anticipatory bona fide hedge.

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[141] CFTC Staff Letter 12-07 at 1.

[142] CFTC Staff Letter 12-07 at 1-2. In the 2016 Reproposal, the Commission affirmed staff's interpretation articulated in Staff Letter No. 12-07. *See* 81 FR at 96750.

[143] CFTC Staff Letter 12-07 at 2.

[144] *Id.* at 2-3.

[145] For further discussion regarding the enumerated bona fide hedge for "unsold anticipated production," *see* Section II.A.1.vi.d.

[146] For further discussion regarding the new enumerated bona fide hedge for "anticipated merchandising," *see* Section II.A.1.vi.f.

For this section of the release, the Commission will refer to the enumerated bona fide hedges for anticipated unfilled requirements, anticipated unsold production, and anticipated merchandising, collectively, as the "anticipatory bona fide hedges." Additionally, by using the term "unfixed-price transaction," the Commission means a forward contract (*i.e.*, a firm commitment) at an open price or at a price to be determined at a later date (for example, by reference to an index based on the settlement price of a corresponding futures contract).

The Commission discusses the 2020 NPRM's general treatment of unfixed price transactions below, followed by a summary of comments and the Commission's determination on the issue of unfixed-price transactions generally. A more detailed discussion of each specific enumerated hedge, including the three anticipatory bona fide hedges, appears further below.

b. Summary of the 2020 NPRM - Treatment of Unfixed Price Transactions

Like the bona fide hedging definition in existing § 1.3, the proposed bona fide hedging definition in § 150.1 of the 2020 NPRM included one enumerated hedge addressing unfixed-price transactions, which required offsetting unfixed-price purchase *and* sale transactions.[147] Aside from that one enumerated bona fide hedge, the other proposed bona fide hedges did not specify whether a market participant with an unfixed-price transaction could qualify for a bona fide hedge exemption, including any of the proposed anticipatory bona fide hedges.

However, the 2020 NPRM did preliminarily and indirectly address previous queries on the matter of unfixed-price transactions. In particular, the 2020 NPRM addressed a petition for exemptive relief submitted in response to the 2011 Final Rule. In that petition, the Working Group of Commercial Energy Firms (which has since

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[147] *See* proposed paragraph (a)(2) of Appendix A to part 150. Like the existing enumerated hedge in paragraph (2)(iii) of § 1.3, this proposed enumerated hedge was limited to circumstances where a market participant has both an unfixed-price purchase *and* an unfixed-price sale in hand. This specific proposed enumerated bona fide hedge, along with all other proposed enumerated hedges, is described in detail further below.

reconstituted itself as the Commercial Energy Working Group, or "CEWG") requested exemptive relief for transactions that are described by 10 examples set forth therein as bona fide hedging transactions ("BFH Petition").[148]

In the 2020 NPRM, the Commission preliminarily determined that commodity derivative positions described in two examples related to unfixed-price transactions did not fit within any of the proposed enumerated hedges. Specifically, the Commission preliminarily determined that the positions described in examples #3 (unpriced physical purchase or sale commitments) and #7 (scenario 2) (use of physical delivery referenced contracts to hedge physical transactions using calendar month average pricing) of the BFH Petition did not fit within any of the proposed enumerated bona fide hedges, but that market participants could apply for a non-enumerated exemption.[149]

The Commission requested comment on the extent to which the proposed enumerated bona fide hedges should encompass the types of positions discussed in examples #3 (unpriced physical purchase or sale commitments) and #7 (scenario 2) (use of physical delivery reference contracts to hedge physical transactions using calendar month averaging pricing) of the CEWG's BFH Petition.[150]

c. Comments - Treatment of Unfixed Price Transactions

In response to the 2020 NPRM, many commenters requested the Commission either clarify or make explicit that the proposed bona fide hedge definition would apply

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[148] The Working Group BFH Petition is available at http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgbfhpetition012012.pdf. In the 2013 Proposal, the Commission provided that the transactions contemplated under the working group's examples Nos. 1, 2, 6, 7 (scenario 1), and 8 would be permitted under the proposed definition of bona fide hedging. In the 2020 NPRM, the Commission preliminarily determined that transactions described in four additional CEWG examples would comply with the proposed expanded bona fide hedging definition in the 2020 NPRM: examples #4 (Binding, Irrevocable Bids or Offers), #5 (Timing of Hedging Physical Transactions), #9 (Holding a cross-commodity hedge using a physical delivery contract into the spot month) and #10 (Holding a cross-commodity hedge using a physical delivery contract to meet unfilled anticipated requirements).

[149] 85 FR at 11612.

[150] 85 FR at 11622.

to commodity derivatives contracts used to hedge exposure to price risk arising from unfixed-price transactions.[151]

Several commenters provided various examples in support of their requests that the Commission recognize that unfixed price transactions may serve as the basis for an enumerated bona fide hedge position for purposes of Federal position limits.[152]

Comments on the treatment of unfixed price transactions often were submitted in connection with discussions on the scope of the proposed enumerated bona fide hedge for anticipated merchandising. As discussed further below, under the Final Rule's enumerated anticipated merchandising bona fide hedge section, many commenters requested the Commission clarify whether the proposed enumerated hedge for anticipated merchandising could be used to manage price risk arising from unfixed-price physical commodity transactions.

With regards to CEWG's BFH Petition example #3 (unpriced physical purchase or sale commitments), many commenters disagreed with the Commission's preliminary determination in the 2020 NPRM that this type of transaction would not qualify for an enumerated bona fide hedge. Generally, commenters expressed the view that unfixed-price transactions for physical commodities are a common and standard market practice. The CEWG indicated that unfixed physical purchase or sale commitments are routinely conducted in numerous markets and commodities on a daily basis.[153]

Similar to the BFH Petition's example #3 (unpriced physical purchase or sale commitments), ACSA provided examples intended to demonstrate that merchants are exposed to calendar spread and supply price risk because they typically fulfill sales contracts by selling a commodity for future delivery in advance of purchasing the

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[151] *See, e.g.*, Ecom at 1; ACA at 2; CEWG at 22-24; Chevron at 11; CME Group at 8-9; DECA at 2; East Cotton at 2; Gerald Marshall at 2; IFUS at 5-7; IMC at 2; Jess Smith at 2; LDC at 2; Mallory Alexander at 2; McMeekin at 2; Memtex at 2; Moody Compress 1; NCC at 1; NGFA at 7; Olam at 2; Omnicotton at 2; Canale Cotton at 2; Shell at 7; Southern Cotton at 2; Suncor at 7; SW Ag at 2; Toyo at 2; Texas Cotton at 2; Walcot at 2; White Gold at 2.

[152] CMC at 4; FIA at 16; ICE at 4-5; ACSA at 6-7; ADM at 3; CME Group at 8-9; CEWG at 19-21.

[153] CEWG at 20 (also providing a similar example as it submitted in the original petition which included Example #3 (unpriced physical purchase and sale commitments)).

commodity needed to fulfill the sale.[154] ACSA, along with other commenters,[155] stated that unfixed-price transactions for the purchase or sale of the physical commodities are common, where a market participant buys the commodity at a price that is based on (*i.e.*, is "indexed" to) the settlement price of the nearby (or spot) futures month contract and later sells the commodity at a price that is indexed to the deferred month futures contract. ACSA and other commenters indicated that merchants do this to "effectively bridge the gap between timing mismatches of supply and demand in the global marketplace."[156]

Related to the BFH Petition example #7 (scenario 2) (use of physical delivery reference contracts to hedge physical transactions using calendar month averaging pricing "CMA"), commenters requested that the Commission clarify that hedges of underlying physical transactions that utilize CMA pricing structures fall within the enumerated bona fide hedge for anticipated merchandising.[157] Chevron requested the Commission clarify that commercial firms that price commercial transactions to purchase or sell physical crude oil or natural gas using a CMA pricing structure (whether they are solely merchants or conduct merchant activities as part of an integrated energy company), should receive bona fide hedge treatment for their commodity derivative contract positions that offset the risks arising from those CMA priced purchases or sales.[158]

Similarly, other commenters asked for clarification regarding whether the existing enumerated bona fide hedge for unfilled anticipated requirement extends to scenarios that involve unfixed-price contracts that many electric generators enter into to address their anticipated supply requirements.[159] These commenters asked for clarification that unfixed-price purchase commitments do not "fill" an anticipated requirement such that

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[154] ACSA at 12-14; Several commenters concurred with ACSA regarding exposure to calendar spread. Mallory Alexander at 2; DECA at 2; CMC at 4; IMC at 2; Olam at 2; SW Ag at 2; White Gold at 2; Walcot at 2.

[155] ACSA at 4-7; CMC at 4; Mallory Alexander at 2; DECA at 2; IMC at 2; Olam at 2; SW Ag at 2; White Gold at 2; Walcot at 2.

[156] ACSA at 5.

[157] MGEX at 2; IMC at 2; Mallory Alexander at 2; Walcot at 2; White Gold at 2; Olam at 2; LDC at 1; Canale at 2; Moody Compress at 1; Gerald Marshall at 2; SW Ag at 2; DECA at 2; Chevron at 12; Suncor at 11; CEWG at 21.

[158] Chevron at 11.

[159] EPSA at 5; IECA at 8.

the market participant would be able to still qualify for the enumerated unfilled anticipated requirement bona fide hedge.[160]

d. Discussion of Final Rule - Treatment of Unfixed Price Transactions

As discussed above, the Commission is affirming and broadening the application of the interpretation articulated in Staff Letter No. 12-07. As a result, commercial market participants in the physical marketing channel that enter into unfixed price transactions may qualify for bona fide hedge treatment under the enumerated bona fide hedges for anticipatory merchandising, anticipated unsold production, or anticipated unfilled requirements because, as discussed below, unfixed price transactions do not give rise to outright price risk and do not otherwise fix an outright price.[161]

Consistent with Staff Letter No. 12-07, commercial market participants in the physical marketing channel that enter into unfixed-price transactions may continue to qualify for the enumerated bona fide hedge for unfilled anticipated requirements for those unfixed price transactions. Further, the Commission is broadening this rationale to additionally include the existing enumerated bona fide hedge for "unsold anticipated production"[162] and the new enumerated bona fide hedge for anticipated merchandising.[163] A commercial market participant that enters into an unfixed-price transaction may qualify for one of these enumerated anticipatory bona fide hedges as long as the commercial entity otherwise satisfies all requirements for such anticipatory bona fide hedge, including demonstrating its anticipated need in the physical marketing channel related to either its unsold production, unfilled requirements, and/or merchandising, as applicable.[164]

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[160] *Id*.

[161] As a result, based on this rationale, a commercial market participant that has an unfixed-price commitment is treated the same as a commercial market participant that has no unfixed-price commitment for purposes of determining whether one qualifies for these enumerated anticipatory bona fide hedges.

[162] For further discussion regarding the enumerated bona fide hedge for "unsold anticipated production," *see* Section II.A.1.vi.d.

[163] For further discussion regarding the new enumerated bona fide hedge for "anticipated merchandising," *see* Section II.A.1.vi.f.

[164] As such, merely entering into an unfixed-price transaction is not alone sufficient to demonstrate compliance with one of the enumerated anticipatory bona fide hedges. The specific requirements associated with each enumerated bona fide hedge, including each anticipatory bona fide hedge, are described in detail further below.

Under this Final Rule, the Commission is clarifying that a commercial market participant may still qualify for an enumerated anticipatory bona fide hedge for an anticipated need, based on a good-faith expectation of that need, even if the market participant has entered into an unfixed-price transaction, since the Commission does not deem the unfixed-price transaction to "fill" or "address" the anticipated need. This rationale is predicated on the fact that an unfixed-price commitment does not offset the price risk associated with an anticipated need (*i.e.*, anticipated unsold production, anticipated unfilled requirements, and/or anticipated merchandising, as applicable). This is because unfixed-price transactions do not give rise to outright price risk and therefore do not alter the outright price risks faced by a commercial market participant, even though the market participant has contractually assured either a supply of the commodity (in the case of anticipated unfilled requirements), the sale of its output (in the case of anticipated unsold production), or the purchase or sale of the commodity to be merchandised (in the case of anticipated merchandising).[165]

In other words, a trader with an unfixed-price commitment still has price risk related to its anticipated need until the price is fixed. Once the price has become fixed, the market participant may no longer avail itself of the enumerated anticipatory bona fide hedge, but may potentially avail itself of another enumerated bona fide hedge, (such as the bona fide hedges for fixed-price purchase contracts or for fixed-price sales contracts, as applicable), provided all applicable requirements of such other enumerated bona fide hedges are satisfied.

Under the Final Rule, a commercial market participant must continue to be able to demonstrate an anticipated need related to unsold production, unfilled requirements, and/or merchandising.

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[165] Consistent with the existing Federal position limits framework, under the Final Rule, commercial market participants may not qualify for any anticipatory bona fide hedge merely to offset risks associated with non-commercial (*i.e.*, financial) activities.

Accordingly, the Commission determines that the commercial market participant engaged in unfixed-price transactions in the BFH Petition's example #3 (unpriced physical purchase or sale commitments) and example #7 (scenario 2) (use of physical delivery referenced contracts to hedge physical transactions using calendar month average pricing) can qualify for one of the enumerated anticipatory bona fide hedges under the Final Rule to the extent the market participant otherwise complies with the applicable conditions of the relevant enumerated anticipatory bona fide hedge in connection with the market participant's commercial activities

For clarity, the Commission also underscores that under the Commission's existing portfolio hedging policy, market participants, including vertically-integrated firms (*i.e.*, those firms that may qualify as more than one of a producer; processor, manufacturer, or utility; and/or merchandiser), may continue to manage their price risks by utilizing more than one enumerated bona fide hedge (including more than one anticipatory bona fide hedge).

The Commission recognizes that there are many ways in which market participants both structure their organizations and engage in commercial hedging practices. As such, market participants may manage the price risk from their various commercial activities by utilizing multiple enumerated bona fide hedge exemptions in the manner that is most suitable to their particular circumstances. Nevertheless, for illustrative purposes, the Commission provides a general example of how market participants may utilize the enumerated anticipatory bona fide hedges in connection with their unfixed price transactions:

For example, Producer X has the physical capacity to produce 100,000 barrels of physical WTI crude oil on an annual basis. Producer X agrees to sell 80,000 barrels of WTI crude oil to Merchandiser Y via a floating/unfixed-price contract in which the delivery will be priced at the NYMEX March 2020 WTI crude oil futures final settlement

price. Producer X still does not have a buyer for its remaining 20,000 barrels, but anticipates selling all of its production, as it has in previous years. Under this scenario, Producer X may utilize the enumerated unsold anticipated production enumerated hedge to offset the price risk from its unsold production, which includes both the 80,000 barrels of oil sold to Merchandiser Y at an unfixed price, as well as the unsold 20,000 barrels.[166] On the other hand, Merchandiser Y may utilize the enumerated hedge for anticipated merchandising to hedge its anticipated merchandising transactions, which include the 80,000 barrels it purchased from Producer X at an unfixed price. Because Merchandiser Y has a history of merchandising more than 80,000 barrels a year, and it anticipates merchandising more than 80,000 barrels in the next twelve months, Merchandiser Y's anticipated merchandising hedge may include the 80,000 barrels it purchased from Producer X at an unfixed price and its remaining anticipated twelve-months' merchandising. Separately, assuming Merchandiser Y also has crude oil it purchased at a fixed price in a storage tank, Merchandiser Y may also utilize the enumerated hedge for inventory and cash-commodity fixed-price purchase contracts to hedge the price risk from those fixed price purchases of crude oil.

In response to commenters requesting that the Commission create a new enumerated bona fide hedge for unfixed-price transactions, the Commission does not believe that this is necessary because, as described above, commercial market participants may qualify for the enumerated anticipatory bona fide hedges while also entering into unfixed-price transactions. Further, the Commission believes that it is not suitable to create a new enumerated bona fide hedge expressly covering all unfixed price transactions to accomplish the same since there is an inherent difficulty in evaluating the propriety of a hedge of an unfixed price obligation with a fixed-price futures contract as

[166] In the case where Producer X fixes the price of its sale before delivery, while it no longer holds an anticipatory hedge, Producer X may qualify for the enumerated hedge for fixed price sales, assuming all applicable requirements for that hedge are satisfied.

there is basis risk until the unfixed price obligation is fixed. Given differences among markets, creating a new enumerated bona fide hedge for any unfixed price transaction could, under certain circumstances, harm market integrity, enable potential market manipulation, and/or allow excessive speculation by potentially affording bona fide hedging treatment for speculative transactions.

For example, assume a market participant enters into an unfixed-price sales contract (*e.g.*, priced at a fixed differential to a deferred month futures contract), and immediately enters into a calendar month spread to reduce the risk of the fixed basis moving adversely. It may not be economically appropriate to recognize as bona fide a long futures position in the spot (or nearby) month and a short futures position in a deferred calendar month matching the market participant's cash delivery obligation, in the event the spot (or nearby) month price is higher than the deferred contract month price (referred to as backwardation, and characteristic of a spot cash market with supply shortages), because such a calendar month futures spread would lock in a loss. A position locking in a loss generally is not economically appropriate to the reduction of risk, as it increases risk by generating a loss, and such a transaction may be indicative of an attempt – or at the very least provides inappropriate incentives – to manipulate the spot (or nearby) futures price.[167]

Finally, the Commission emphasizes that to the extent that a market participant does not qualify for an enumerated anticipatory bona fide hedge in connection with an unfixed-price transaction, the market participant could still avail itself of the process under §§ 150.3 and 150.9 for requesting approval of non-enumerated bona fide hedges.

v. The Enumerated Bona Fide Hedge Exemptions, Generally

a. Background - Bona Fide Hedge Exemptions, Generally

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[167] *See* 81 FR at 96750.

As discussed earlier in this release, the list of bona fide hedges explicitly contained in paragraph (2) of the existing bona fide hedging definition in § 1.3 of the Commission's regulations lists (or "enumerates") seven bona fide hedges, which are generally referred to as the "enumerated bona fide hedges," in four general categories. These four existing categories of enumerated hedges include: (1) sales of futures contracts to hedge (i) ownership or fixed-price cash commodity purchases and (ii) unsold anticipated production; (2) purchases of futures contracts to hedge (i) fixed-price cash commodity sales and (ii) unfilled anticipated requirements; (3) offsetting sales and purchases of futures contracts to hedge offsetting unfixed-price cash commodity sales and purchases; and (4) cross-commodity hedges.[168]

The list of enumerated bona fide hedges found in paragraph (2) of the existing bona fide hedging definition was developed at a time when only agricultural commodities were subject to Federal position limits, and has not been updated since 1987.[169] The Commission believes, as discussed further below, that such list is too narrow to reflect common commercial hedging practices, including for metal and energy contracts. Numerous market and regulatory developments have taken place since 1987, including, among other things, increased futures trading in the metals and energy markets, the development of the swaps markets, and the shift in trading from pits to electronic platforms. In addition, the Commodity Futures Modernization Act of 2000[170] and the Dodd-Frank Act introduced various regulatory reforms, including the enactment of position limits core principles.[171] The Commission thus proposed in the 2020 NPRM to update its bona fide hedging definition to better conform to the current state of the law and to better reflect market developments over time.

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[168] 17 CFR 1.3.

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

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

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

b. Summary of the 2020 NPRM - Bona Fide Hedge Exemptions, Generally

So as not to reduce any of the clarity provided by the existing list of enumerated bona fide hedges, the Commission proposed to maintain the existing enumerated bona fide hedges, with some modifications, and to expand this list.

The existing definition of "bona fide hedging transactions and positions" enumerates the following hedging transactions:

a. hedges of inventory and cash commodity fixed-price purchase contracts;

b. hedges of cash commodity fixed-price sales

c. hedges of the cash commodity's cash products and byproducts;

d. hedges of offsetting unfixed price cash commodity sales and purchases

e. hedges of unsold anticipated production;

f. hedges of unfilled anticipated requirements; and

g. cross-commodity hedges.

The following additional hedging practices are not enumerated in the existing regulation, but were included in the 2020 NPRM as additional enumerated bona fide hedges:

a. hedges by agents;

b. short hedges of anticipated mineral royalties;

c. hedges of anticipated services;

d. offsets of commodity trade option; and

e. hedges of anticipated merchandising.

The Commission also proposed the elimination, for purposes of Federal position limits, of both the Five-Day Rule and the twelve-month restriction. However, under the 2020 NPRM, exchanges would be able to establish their own five-day rule and/or twelve-month restriction, as applicable for any or all of their respective referenced contracts.

c. Commission Determination - Bona Fide Hedge Exemptions, Generally

First, the Commission is adopting the proposed expanded list of enumerated bona fide hedges, with the modifications described, as applicable, in the discussions of the relevant bona fide hedges below. Second, the Commission is adopting, as proposed, the elimination of both the existing Five-Day Rule and the twelve-month restriction.[172] The comments received, and the Commission's corresponding responses, in connection with these changes are discussed further below in the corresponding section discussing the applicable enumerated bona fide hedge.

With respect to the treatment of the enumerated bona fide hedges under the Final Rule, the Commission notes that positions in referenced contracts subject to Federal position limits that meet any of the enumerated bona fide hedges will, for purposes of Federal position limits, be deemed to meet the bona fide hedging definition in CEA section 4a(c)(2)(A), as well as the Commission's bona fide hedging definition in § 150.1 under the Final Rule. As a result, enumerated bona fide hedges are self-effectuating for purposes of Federal position limits, provided the market participant separately requests an exemption from the applicable exchange-set limit established pursuant to § 150.5(a).[173]

The enumerated hedges are each described below, followed by a discussion of the Five-Day Rule. When first proposed, the Commission viewed the enumerated bona fide hedges as conforming to the general definition of bona fide hedging "without further consideration as to the particulars of the case."[174] Similarly, the list of enumerated bona fide hedges under the Final Rule reflects categories of bona fide hedges for which the Commission has determined, based on experience over time, that no case-by-case determination or review of additional details by the Commission is needed to determine

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[172] As discussed further below, the Final Rule eliminates the existing twelve-month restriction with respect to the anticipatory unsold production and the anticipated unfilled requirements bona fide hedges. However, the new anticipated merchandising bona fide hedge would be subject to its own twelve-month restriction.

[173] For further discussion of the exchange exemption process, *see* Section II.D.3.i.b.

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

that the position or transaction is a bona fide hedge. This Final Rule does not foreclose the recognition of other hedging practices as bona fide hedges, as discussed below.

While the enumerated bona fide hedges adopted herein are self-effectuating for purposes of Federal position limits,[175] the Commission and the exchanges will continue to exercise close oversight over such positions to confirm that market participants' claimed exemptions are consistent with their cash-market activity. In particular, because all contracts subject to Federal position limits are also subject to exchange-set limits, all traders seeking to exceed Federal position limits must request an exemption from the relevant exchange for purposes of the exchange position limit, regardless of whether the position falls within one of the enumerated hedges. In other words, enumerated bona fide hedge exemptions that are self-effectuating for purposes of Federal position limits are not self-effectuating for purposes of exchange-set position limits.

Exchanges have well-established programs for granting exemptions, including, in some cases, experience granting exemptions for anticipatory merchandising for certain traders in markets not currently subject to Federal position limits. As discussed in greater detail below, § 150.5 as adopted herein helps ensure that such programs conform to standards established by the Commission.[176] The Commission expects exchanges will continue to be thoughtful and deliberate in granting exemptions, including anticipatory exemptions. The Commission predicates this expectation on its decades of experience working together with the relevant exchanges and observations generally of the applicable exchange-traded futures markets.

The Commission and the exchanges also have a variety of other tools designed to help prevent misuse of self-effectuating bona fide hedge exemptions. For example,

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[175] *See infra* Section II.C. (discussing § 150.3) and Section II.G. (discussing § 150.9).

[176] *See infra* Section II.D. For example, § 150.5 requires, among other things, that: exemption applications filed with an exchange include sufficient information to enable the exchange and the Commission to determine whether the exchange may grant the exemption, including an indication of whether the position qualifies as an enumerated hedge for purposes of Federal limits and a description of the applicant's activity in the underlying cash markets; and the exchange provides the Commission with a monthly report showing the disposition of all exemption applications, including cash-market information justifying the exemption.

market participants who apply to an exchange as required pursuant to § 150.5 under the Final Rule are subject to the Commission's false statements authority, which carries substantial penalties under both the CEA and Federal criminal statutes. Similarly, the Commission currently employs – and will continue to use under the Final Rule – surveillance tools, special call authority, rule enforcement reviews, and other formal and informal avenues for obtaining additional information from exchanges and market participants in order to distinguish between true bona fide hedging needs and speculative trading masquerading as a bona fide hedge.

While positions that fall within the enumerated bona fide hedges, each discussed in further detail below, are the type of positions that comply with the bona fide hedging definition, the Commission recognizes that there may be other positions or hedging strategies that are not "enumerated" that similarly could satisfy the bona fide hedge definition.[177] These "non-enumerated" bona fide hedges may be granted today under existing §§ 1.47 and 1.48, and the Commission can continue to recognize non-enumerated bona fide hedges under the Final Rule. For further discussion of the recognition of non-enumerated bona fide hedges, *see infra* Sections II.C. and II.G.

With the exception of risk management positions previously recognized as bona fide hedges, and assuming all regulatory requirements continue to be satisfied, market participants' existing bona fide hedging recognitions under existing Federal position limits are grandfathered upon the Final Rule's Effective Date (*i.e.*, bona fide hedge exemptions that are currently recognized for purposes of Federal position limits, other than risk management positions, will continue to be recognized under the Final Rule).

Last, before describing each individual enumerated hedge, the Commission also notes that it is adopting certain non-substantive, technical changes, and such changes are intended only to provide clarifications. For example, the Commission is making a

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[177] *See infra* Section II.G. (discussing § 150.9).

technical change to the bona fide hedging definition by adopting the term in the singular tense in order to conform to the phrasing in CEA section 4a(c)(2).[178] The Commission is also re-ordering the enumerated bona fide hedges to place related enumerated bona fide hedges closer together.

vi. Enumerated Bona Fide Hedge Exemptions for Physical Commodities

This Final Rule adopts the list of enumerated bona fide hedge exemptions as proposed in the 2020 NPRM, with certain amendments discussed below.[179]

a. Hedges of Inventory and Cash Commodity Fixed-Price Purchase Contracts

(1) Background - Inventory and Cash Commodity Fixed-Price Purchase Contracts

Inventory and fixed-price cash commodity purchase contracts have long served as the basis for a bona fide hedging position.[180] This bona fide hedge is enumerated in paragraph (2)(i)(A) of the existing bona fide hedging definition in § 1.3, and recognizes as a bona fide hedge sales of any commodity for future delivery on a contract market which do not exceed in quantity ownership (*i.e.* inventory) or fixed-price purchase of the same commodity by the same person.

Since 2011, the Commission has included hedges of inventory and cash commodity fixed-price purchase contracts in each of its position limits rulemakings, with minor proposed modifications to improve clarity.[181]

(2) Summary of the 2020 NPRM - Inventory and Cash Commodity Fixed-Price Purchase Contracts

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[178] The existing definition in § 1.3 of the Commission's regulations is in the plural: "bona fide hedging transactions and positions." The 2020 NPRM's proposed definition was similarly plural.

[179] Appendix A to part 150 lists the following enumerated bona fide hedges: (a)(1) Hedges of Inventory and Cash Commodity Fixed-Price Purchase Contracts; (a)(2) Hedges of Cash Commodity Fixed-Price Sales Contracts; (a)(3) Hedges of Offsetting Unfixed Price Cash Commodity Sales and Purchases; (a)(4) Hedges of Unsold Anticipated Production; (a)(5) Hedges of Unfilled Anticipated Requirements; (a)(6) Hedges of Anticipated Merchandising; (a)(7) Hedges by Agents; (a)(8) Short Hedges of Anticipated Mineral Royalties; (a)(9) Hedges of Anticipated Services; (a)(10) Offsets of Commodity Trade Options; (a)(11) Cross-Commodity Hedges. As previously mentioned, the Commission has also reorganized the order of the list of enumerated hedges. The Final Rule reorders Appendix A so that the bona fide hedges are listed by hedges of purchases, sales, anticipated activities, or other new types of hedges.

[180] *See, e.g.*, 7 U.S.C. 6(a)(3) (1970). That statutory definition of bona fide hedging included sales of, or short positions in, any commodity for future delivery on or subject to the rules of any contract market made or held by such person to the extent that such sales or short positions are offset in quantity by the ownership or purchase of the same cash commodity by the same person.

[181] 81 FR at 96964; 78 FR at 75713; 76 FR at 11609.

This proposed enumerated bona fide hedge recognized that a commercial enterprise is exposed to price risk if it has obtained inventory in the normal course of business or has entered into a fixed-price spot or forward purchase contract calling for delivery in the physical marketing channel of a cash-market commodity (or a combination of the two), and has not offset that price risk exposure (*e.g.*, that the market price of the inventory could decrease). In connection with the proposed enumerated hedge, any such inventory, or a fixed-price purchase contract, must be on hand, as opposed to a non-fixed purchase contract or an anticipated purchase.

An appropriate hedge to offset the price risk arising from inventory or a fixed-price purchase contract under the 2020 NPRM would be to establish a short position in a commodity derivative contract. The Commission also stated in the 2020 NPRM that an exchange may require such short position holders to demonstrate the ability to deliver against the short position in order to demonstrate a legitimate purpose for holding a position deep into the spot month.[182]

(3) Summary of the Commission Determination - Inventory and Cash Commodity Fixed-Price Purchase Contracts

The Commission is adopting the enumerated bona fide hedge of inventory and cash commodity fixed-price purchase contracts as proposed.

(4) Comments - Inventory and Cash Commodity Fixed-Price Purchase Contracts

Aside from ASR, which expressed support for this enumerated hedge, the Commission did not receive any other specific comments on this enumerated hedge.[183]

b. Hedges of Cash Commodity Fixed-Price Sales Contracts

(1) Background – Cash Commodity Fixed-Price Sales Contracts

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[182] 85 FR at 11609-11610. For example, it would not appear to be economically appropriate to hold a short position in the spot month of a commodity derivative contract against fixed-price purchase contracts that provide for deferred delivery in comparison to the delivery period for the spot month commodity derivative contract. This is because the commodity under the cash contract would not be available for delivery on the commodity derivative contract.

[183] ASR at 2.

Fixed-price cash commodity sales have long served as the basis for a bona fide hedging position.[184] This bona fide hedge is enumerated in paragraphs (2)(ii)(A) and (B) of the existing bona fide hedging definition in § 1.3. This enumerated bona fide hedge recognizes as a bona fide hedging transaction or position hedges against 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; and (B) the quantity equivalent of fixed-price sales of the cash products and by-products of such commodity by the same person. Since 2011, the Commission has included hedges of cash commodity fixed-price sales contracts in its position limits rulemakings, with no substantive modifications.[185]

(2) Summary of the 2020 NPRM – Cash Commodity Fixed-Price Sales Contracts

This proposed enumerated bona fide hedge made minor modifications to the existing bona fide hedge, and recognized that a commercial enterprise is exposed to price risk if it has entered into a spot or forward fixed-price sales contract calling for delivery in the physical marketing channel of a cash-market commodity, and has not offset that price risk exposure (*i.e.*, that the market price of a commodity might be higher than the price of its fixed-price sales contract for that commodity). Under the 2020 NPRM, an appropriate hedge of a fixed-price sales contract would be to establish a long position in a commodity derivative contract to offset such price risk.[186]

(3) Summary of the Commission Determination – Cash Commodity Fixed-Price Sales Contracts

The Commission is adopting the enumerated hedge for hedges of cash commodity fixed-price sales contracts as proposed.

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[184] *See, e.g.*, 7 U.S.C. 6a(3)(1970). That statutory definition of bona fide hedging includes purchases of, or long positions in, any commodity for future delivery on or subject to the rules of any contract market made or held by such person to the extent that such purchases or long positions are offset by sales of the same cash commodity by the same person.

[185] 81 FR at 96964; 78 FR at 75824; 76 FR at 71689.

[186] 85 FR at 11610.

(4) Comments – Cash Commodity Fixed-Price Sales Contracts

Aside from ASR, which expressed support for this enumerated hedge, the Commission did not receive any other specific comments on this enumerated hedge.[187]

c. Hedges of Offsetting Unfixed Price Cash Commodity Sales and Purchases

(1) Background – Offsetting Unfixed Price Cash Commodity Sales and Purchases

Hedges of offsetting unfixed price cash commodity sales and purchases is currently enumerated in paragraph (2)(iii) of the existing bona fide hedging definition in § 1.3 and is subject to the Five-Day Rule. This enumerated hedge is the only existing enumerated hedge that expressly recognizes hedging the price risk arising from cash commodity unfixed-price transactions.

This enumerated bona fide hedge allows a market participant to use commodity derivatives in excess of Federal position limits to offset an unfixed-price cash commodity purchase coupled with an unfixed-price cash commodity sale. Specifically, this enumerated bona fide hedge allows for "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.

While not part of the original regulatory bona fide hedge definition, the Commission adopted this enumerated bona fide hedge in 1987 to "remove any doubt" that certain cotton and soybean crush inter-month spreads were covered under the Commission's bona fide hedge definition.[188] Since 2011, the Commission has included this enumerated bona fide hedge in each of its position limits rulemakings.[189]

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[187] ASR at 2.

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

[189] 81 FR at 96964; 78 FR at 75714; 76 FR at 71689.

(2) Summary of the 2020 NPRM – Offsetting Unfixed Price Cash Commodity Sales and Purchases

The Commission proposed to maintain this bona fide hedge, with a few modifications.

The 2020 NPRM proposed to expand the existing bona fide hedge, which currently requires the offsetting purchase and sale to be at basis to different delivery months of the same commodity derivative contract, to additionally permit hedges of offsetting unfixed sales and unfixed purchases for different commodity derivative contracts in the same commodity (*e.g.* Brent/WTI), regardless of whether the contracts are in the same delivery month. This proposed change would permit the cash commodity to be bought and sold at unfixed prices at a basis to different commodity derivative contracts in the same commodity, even if the commodity derivative contracts were in the same calendar month (*i.e.*, buy Brent in January; sell WTI in January).[190] The Commission proposed this change to allow a commercial enterprise to enter into the described derivatives transactions to reduce the risk arising from either (or both) a location differential or a time differential in unfixed-price purchase and sale contracts in the same cash commodity.[191]

To be eligible for this enumerated hedge, both an unfixed-price cash commodity purchase "and" an offsetting unfixed-price cash commodity sale would have to be in hand, because having both the unfixed-price sale and purchase in hand would allow for an objective evaluation of the hedge.[192]

(3) Summary of the Commission Determination - Offsetting Unfixed Price Cash Commodity Sales and Purchases

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[190] 85 FR at 11608.

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

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

The Commission is adopting the enumerated bona fide hedge for offsetting unfixed price cash commodity sales and purchases as proposed.

(4) Comments - Offsetting Unfixed Price Cash Commodity Sales and Purchases

There were minimal comments on the proposed amendments to this hedge. IFUS explicitly supported the allowance of hedges against cash positions in the same delivery month.[193] CMC and ACSA requested that the Commission modify the language of this enumerated bona fide hedge to include "offsetting sales *or* purchases."[194] CMC and FIA stated that because merchants often sell commodities well in advance of purchasing them, such merchants are exposed to the exact same calendar spread price risk as merchants that have executed both unfixed price legs of a transaction, because any futures market calendar spread convergence or divergence will "affect both scenarios in exactly the same manner."[195] These commenters contended that changing the language of the enumerated hedge from "*and*" to "*or*" would allow merchants to hedge against this exposure.[196]

In addition, because this is the only existing enumerated hedge that expressly recognizes hedging for unfixed price transactions, several commenters cited to this hedge when requesting that the Commission explicitly endorse that commercial transactions with unfixed- prices may serve as the basis for, and satisfy, the bona fide hedging definition.[197]

(5) Discussion of Final Rule - Offsetting Unfixed Price Cash Commodity Sales and Purchases

The Commission is adopting the enumerated bona fide hedge for offsetting unfixed price cash commodity sales and purchases as proposed. The Commission considered the comments requesting the Commission to change this bona fide hedge's

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[193] IFUS at 4.
[194] CMC at 4; ACSA at 6.
[195] CMC at 4; FIA at 16.
[196] *Id.*
[197] The Commission's determination on the treatment of unfixed-price transactions under this Final Rule is in Section II.A.1.iv.

language from referring to offsetting unfixed-price purchase "*and*" sale transactions (which requires both an unfixed purchase price transaction and an unfixed sale price transaction) to instead refer to unfixed-price purchase "*or*" sales transactions (which would require only either a single unfixed-price purchase transaction *or* an unfixed-price sale transaction) to facilitate hedging calendar spread price risk for those market participants that have executed only one leg of an unfixed-price physical transaction (*i.e.*, only a physical purchase or a physical sale).

The Commission continues to believe that the enumerated bona fide hedge for offsetting unfixed price cash commodity sales and purchases should continue to require both an unfixed-price cash commodity purchase and an offsetting unfixed-price cash commodity sale. For this particular bona fide hedge, absent either the unfixed-price purchase leg or the unfixed-price sale leg (or absent both legs), it would be less clear, and require a facts and circumstances analysis, to determine how the transaction could be classified as a bona fide hedge, that is, a transaction that reduces price risk.[198]

Under the Final Rule, a single-sided unfixed price physical transaction (*i.e.*, a physical transaction involving an unfixed price purchase or an unfixed price sale, but not both) cannot be offset with derivatives in excess of position limits using this particular enumerated bona fide hedge. However, a market participant with an unfixed price purchase in the absence of an unfixed-price sale, or vice versa, could potentially qualify for one or more of the enumerated anticipatory bona fide hedges.[199] Additionally, depending on the facts and circumstances, a single-sided unfixed price contract could potentially be the basis for a non-enumerated bona fide hedge.

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[198] The contemplated derivative positions will offset the risk that the difference in the expected delivery prices of the two unfixed-price cash contracts in the same commodity will change between the time the hedging transaction is entered and the time of fixing of the prices on the purchase and sales cash contracts. Therefore, the contemplated derivative positions are economically appropriate to the reduction of risk.

[199] Specifically, as discussed above, because the Commission does not view an unfixed-price commitment as filling, or satisfying, an anticipated need, market participants with unfixed-price commitments may qualify for an enumerated anticipatory bona fide hedge, provided the market participant meets all applicable requirements and conditions. *See* Section II.A.1.iv.

While the Commission acknowledges concerns from commenters that market participants that have executed only one leg of a physical transaction (*i.e.*, only an unfixed-price purchase or an unfixed-price sale) may need to hedge calendar spread price risk, the Commission believes the Final Rule offers several avenues for hedging such risks.[200] For example, under the offsetting unfixed price cash commodity sales and purchases enumerated bona fide hedge, upon fixing the price of, or taking delivery on, the purchase contract, the owner of the cash commodity no longer has offsetting unfixed priced transactions, but may continue to hold the short derivative leg of the spread as a hedge against that fixed-price purchase or as inventory under the enumerated hedge for fixed price transactions.

Alternatively, under this Final Rule, if the market participant fixes the price the sales contract first, he or she may continue to hold the long derivative leg of the spread by qualifying for bona fide hedge treatment for that long position under another enumerated bona fide hedge. For example, a market participant who otherwise meets all applicable requirements of one of the anticipatory bona fide hedges may qualify for such hedge(s) regardless of whether the market participant holds an unfixed-price purchase transaction.

d. Hedges of Unsold Anticipated Production

(1) Background – Unsold Anticipated Production

Unsold anticipated production has long served as the basis for an enumerated bona fide hedging position.[201] This bona fide hedge is currently enumerated in paragraph (2)(i)(B) of the bona fide hedging definition in existing § 1.3, and is subject to the Five-Day Rule. This existing enumerated bona fide hedge includes hedges against the sales of any commodity for future delivery on a contract market which does not exceed in

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[200] The Final Rule also expands the "spread transaction" definition, so a market participant with an unfixed price purchase or sale may also qualify for a calendar spread exemption, for example, with one leg in the spot month. For further discussion of the Final Rule's treatment of spread transactions, *see* Section II.A.20.

[201] *See* 7 U.S.C. 6a(3)(A) (1940). That statutory definition of bona fide hedging, enacted in 1936, included the amount of such commodity such person is raising, or in good faith intends or expects to raise, within the next twelve months, on land (in the United States or its Territories) which such person owns or leases.

quantity twelve months' unsold anticipated production of the same commodity by the same person.

The bona fide hedge of unsold anticipated production is one of two existing enumerated anticipatory bona fide hedges currently included in § 1.3, the other being unfilled anticipated requirements (discussed further below). The unsold anticipated production bona fide hedge allows a market participant who anticipates production, but who has not yet produced anything, to enter into a short derivatives position in excess of Federal position limits to hedge the price risk arising from that anticipated production. Since 2011, the Commission has included hedges of unsold anticipated production in each of its position limits rulemakings, with some modifications.[202] The regulatory text for this existing enumerated bona fide hedge is silent about whether it applies to unsold anticipated production that is contracted to be sold under an unfixed-price transaction.

(2) Summary of the 2020 NPRM - Unsold Anticipated Production

The Commission proposed to maintain the existing enumerated bona fide hedge of unsold anticipated production, with modifications as follows. First, the Commission proposed to remove the twelve-month restriction.[203] Second, consistent with the treatment for the other anticipatory bona fide hedges under the 2020 NPRM, the Commission proposed to eliminate the existing restrictions during the last five days of trading (*i.e.*, eliminate the "Five-Day Rule").[204]

(3) Summary of the Commission Determination – Unsold Anticipated Production

The Commission is adopting the enumerated bona fide hedge of unsold anticipated production as proposed.

(4) Comments - Unsold Anticipated Production

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[202] 81 FR at 96964; 78 FR at 75714; 76 FR at 71689.

[203] 85 FR at 11608.

[204] For further discussion of the Five-Day rule, *see* Section II.A.1.viii, Elimination of Federal Restriction Prohibiting Holding a Bona Fide Hedge Exemption During Last Five Trading Days, the "Five-Day Rule," below.

Several commenters, including ASR, ADM, and ICE, supported eliminating the twelve-month restriction.[205] ASR, for example, noted that the lifecycle of sugarcane extends beyond a twelve-month period.[206]

Conversely, Better Markets and IATP opposed the elimination of the twelve-month restriction.[207] IATP stated that commercial market participants such as storage facilities should instead use insurance policies to manage their risks.[208] Further, IATP stated that if the Commission extends the duration up to 24 months, the Commission should retain discretion to require market participants to demonstrate a production level proportionate to the amount in excess of the Federal position limit throughout the duration of the bona fide hedge exemption.[209]

(5) Discussion of Final Rule - Unsold Anticipated Production

The Commission is adopting the enumerated bona fide hedge of unsold anticipated production as proposed. This enumerated bona fide hedge allows a market participant who anticipates production, but who has not yet produced anything, to enter into a short derivatives position in excess of Federal position limits to hedge the anticipated unsold production.[210]

The Commission clarifies, as discussed above under Section II.A.1.iv., that the enumerated bona fide hedge for unsold production is available to a market participant who satisfies all applicable requirements regardless of whether the market participant has entered into an unfixed-price sales transaction in connection with its anticipated unsold production. However, acquiring an unfixed-price sales contract alone is not a basis for qualifying for this bona fide hedge. Rather, under the Final Rule, entering into an

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[205] ASR at 2; ADM at 2; ICE at 2; IECA at 2; and IFUS at 2.

[206] ASR at 2.

[207] IATP at 15-17; Better Markets at 57-58.

[208] IATP at 15-17.

[209] *Id*.

[210] Once a market participant finishes its production, the market participant will no longer qualify for this enumerated bona fide hedge since its production is no longer anticipatory. Instead, its completed production is now part of its inventory. However, the enumerated bona fide hedge for inventory and cash commodity fixed-price purchase contracts (discussed below) would become available to the market participant.

unfixed-price sales transaction will not prevent a market participant from qualifying for the unsold anticipated production bona fide hedge.

As the Commission explains above, an unfixed-price sales commitment does not address the bona fide hedging need related to anticipated unsold production because the market participant's price risk to its anticipated production has not been fixed (*i.e.*, the unfixed-price sales contract may fall below the cost of production). In other words, a producer with an unfixed-price sales commitment for its production still has an anticipated need related to its price risk until the price of the commitment is fixed. However, once the market participant enters into a fixed-price sales contract, the market participant no longer has price risk that needs to be hedged (*i.e.* its short futures contract is no longer necessary as a hedge for its anticipated production).

Accordingly, the market participant that enters into the fixed-price transaction no longer has an anticipated need to hedge the price risk associated with its unsold production (*i.e.*, the anticipated production is deemed to be "sold" by fixed-price sales transaction) and would not qualify for this anticipated unsold production bona fide hedge.

Consequently, if the market participant no longer qualifies for the unsold anticipated production bona fide hedging recognition (*e.g.*, it has entered into a fixed-price sales contract), its derivative position, to the extent the position is above an applicable position limit, must be reduced in an orderly manner in accordance with sound commercial practices. However, if the market participant entered into a fixed-price transaction, while it could not continue to qualify for the unsold anticipated production bona fide hedge, the market participant may be able to qualify for the enumerated bona fide hedge for cash commodity fixed-price sales contracts, assuming all applicable requirements are met.[211]

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[211] For further discussion of the enumerated bona fide hedge for cash commodity fixed-price sales contracts, *see* Section II.A.1.vi.b.

While the Commission acknowledges the comments from Better Markets and IATP opposing the removal of the twelve-month restriction, the Commission believes that this twelve-month restriction may be unsuitable in connection with additional core referenced futures contracts with the underlying agricultural and energy commodities that would be subject to Federal position limits for the first time under this Final Rule since these non-legacy commodities may have longer growth and/or production cycles than the nine legacy agricultural contracts. The existing twelve-month restriction may thus be unnecessarily short in comparison to the expected life of investment in production facilities. While this enumerated bona fide hedge for unsold production does not have an associated twelve-month restriction under the Final Rule, the Commission notes that because all bona fide hedges must be economically appropriate to the reduction of price risk pursuant to the CEA, a market participant may only qualify for this enumerated bona fide hedge for anticipated unsold production to the extent the market participant has a good faith anticipation of legitimate anticipated unsold production giving rise to such price risk.

Further, additional provisions finalized herein under the Final Rule will help ensure that all bona fide hedges, including bona fide hedges of unsold anticipated requirements, comport with the CEA and the Commission's regulations, and are objectively verifiable and free from abuse.[212]

e. Hedges of Unfilled Anticipated Requirements

(1) Background - Unfilled Anticipated Requirements

The existing bona fide hedge for unfilled anticipated requirements is currently enumerated in paragraph (2)(ii)(C) of the existing bona fide hedging definition in § 1.3. This bona fide hedge includes hedges against purchases of any commodity for future delivery on a contract market which do not exceed in quantity twelve months' unfilled

[212] *See infra* §§ 150.5 and 150.9 (reporting and recordkeeping obligations); Appendix B to part 150.

anticipated requirements of the same cash commodity for processing, manufacturing, or feeding by the same person.

Consistent with the existing enumerated bona fide hedge for anticipated unsold production, as discussed above, the existing bona fide hedge for unfilled anticipated requirements is similarly subject to the twelve-month restriction as well as a less-restrictive version of the "Five-Day Rule." With respect to the Five-Day Rule, under existing § 1.3, the unfilled anticipated requirements bona fide hedge provides that the size of a market participant's position held "in the five last trading days" must not exceed the person's unfilled anticipated requirements of the same cash commodity for that month and for the next succeeding month.[213]

However, the regulatory text in existing § 1.3 is silent about whether the bona fide hedge applies to unfilled anticipated requirements that are contracted to be supplied under an unfixed-price transaction or whether such unfixed-price supply transaction would "fill" the anticipated requirements.

As discussed above, staff previously has addressed this question through Staff Letter No. 12-07, in which staff clarified that a commercial entity may qualify for the existing enumerated bona fide hedge for unfilled anticipated requirements even if the commercial entity has entered into long-term, unfixed-price supply or requirements contracts because, as staff explained, the unfixed-price purchase contract does not "fill" the commercial entity's anticipated requirements.[214] As explained in Staff Letter No. 12-07, the price risk of such "unfilled" anticipated requirements is not offset by the unfixed-price forward contract because the price risk remains with the commercial entity, even though the entity has contractually assured a supply of the commodity. Staff Letter No.

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

[214] CFTC Letter No. 12-07, Interpretation, Request for guidance regarding meaning of "unfilled anticipated requirements" for purposes of bona fide hedging under the Commission's position limits rules (Aug. 16, 2012).

12-07 had the practical effect of affirming that market participants with firm commitments at unfixed prices may still be able to avail themselves of this enumerated anticipatory hedge for unfilled requirements.

(2) Summary of the 2020 NPRM - Unfilled Anticipated Requirements

The Commission proposed several amendments to the unfilled anticipated requirements bona fide hedge. First, the Commission proposed to remove the twelve-month restriction because the Commission recognized that market participants may have a legitimate commercial need to hedge unfilled anticipated requirements for a period longer than twelve months.[215]

Second, the Commission proposed to remove from the regulatory text the agricultural-specific term "feeding," and to replace that word with a reference to "use by that person."

Third, recognizing that utilities are not the entities who "use" the commodity, the Commission also proposed to add as a permissible hedge the unfilled anticipated requirements for the contract's underlying cash commodity for the resale by a utility to meet the anticipated demand of its customers. This proposed provision is analogous to the existing unfilled anticipated requirements provision "for processing, manufacturing or use by the same person[.]"[216] Under this proposed new provision, however, the commodity is not for use by the same person—that is, the utility—but rather the commodity is for anticipated use by the utility to fulfill its obligation to serve retail customers.

Finally, consistent with the treatment for the other anticipatory bona fide hedges under the 2020 NPRM, the Commission proposed to eliminate the existing restrictions during the last five last days of trading.

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[215] *See, e.g.*, 85 FR at 11610.
[216] 17 CFR 1.3.

(3) Summary of the Commission Determination - Unfilled Anticipated Requirements

The Commission is adopting the unfilled anticipated requirements enumerated bona fide hedge as proposed.

(4) Comments - Unfilled Anticipated Requirements

Commenters supported continuing to include this bona fide hedge as part of the Commission's amended suite of enumerated anticipatory bona fide hedges.[217] As described below, commenters also requested the Commission clarify certain aspects of the proposed version.

(i) Elimination of Requirement to Hedge Only Twelve Months' Quantity of Unfilled Anticipated Requirements

Only a small group of commenters directly commented on the elimination of the twelve-month restriction. ICE, IFUS, IECA, AGA, ADM and NOPA supported eliminating the twelve-month restriction,[218] with ADM stating that there may be times this anticipatory hedge is needed for "commercial purposes beyond twelve-months."[219] In contrast, Better Markets opposed the removal of the restriction, stating that such removal would make the hedge less reasonably verifiable and open the hedge to potential abuse.[220]

(a) Discussion of Final Rule – Twelve-Month Restriction

After considering public comments, the Commission has determined that the commercial need to hedge unfilled anticipated requirements for a period longer than twelve months, along with the Commission's experience in overseeing exemptions[221] under this enumerated bona fide hedge, suggest in favor of eliminating the twelve-month restriction. While the Commission acknowledges the comments from Better Markets

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[217] *e.g.,* AGA at 6-7; ADM at 2; CEWG at 4; EEI and EPSA jointly at 5; IECA at 2; NOPA at 2; NGSA at 3.

[218] AGA at 6-7, ADM at 2, NOPA at 2, IFUS at 2, ICE at 2, and IECA at 2.

[219] ADM at 2.

[220] Better Markets at 58-59.

[221] The Commission and its predecessor agency, the Commodity Exchange Authority, has decades of expertise in granting bona fide exemptions. See 21 FR 6913 (Sep 13, 1956).

opposing the removal of the twelve-month restriction, the Commission notes that, a twelve-month limitation in connection with this particular enumerated bona fide hedge may be unsuitable in connection with commodities other than the nine legacy agricultural commodities. For example, a processor or utility relying on the unfilled anticipated requirements bona fide hedge has a physical limit on processing, or energy generation, respectively, which should generally result in relatively predictable levels of activity that will not vary much year to year. Further, additional provisions finalized herein will help ensure that all bona fide hedges, including hedges of unfilled anticipated requirements, comport with the CEA and the Commission's regulations, and are reasonably verifiable and free from abuse.

For example, under § 150.5(a)(2)(ii)(A), finalized herein, all market participants seeking a bona fide hedge exemption for referenced contracts subject to Federal position limits, including those market participants with enumerated bona fide hedges that are self-effectuating for purposes of Federal position limits, must still file an application to the exchange requesting an exemption from the applicable exchange-set position limits prior to exceeding the exchange-set limits. The application for an exemption from exchange-set limits must include information the exchange needs to determine, and the Commission can use that information to independently determine, whether the facts and circumstances support the exchange granting such an exemption. The market participant must include a description of the applicant's activity in the cash markets and swaps markets for the commodity underlying the position for which the application is submitted, including, but not limited to, information regarding the offsetting cash positions.[222] The exchange is required to take into account whether the exemption would result in positions that would not be in accord with sound commercial practices and whether the position would exceed an amount that may be established and liquidated in

[222] 150.5(a)(2)(ii)(A).

an orderly fashion.[223] Accordingly, if hedging more than twelve months' quantity of unfilled anticipated requirements would not be in accord with sound commercial practices, or would exceed an amount that may be established and liquidated in an orderly fashion, the exchange would be prohibited from granting the exemption.

Even in the absence of a Federal twelve-month restriction, when administering exchange-set limits, exchanges may, as they do today, implement a variety of restrictions and limitations on position size to maintain orderly markets and to fulfill their regulatory obligations. As described in further detail below, the Commission is finalizing guidance in paragraph (b) of Appendix B to part 150 to help exchanges determine when any such restrictions during the spot month might be appropriate, and when such restrictions may not be needed. For example, consistent with the guidance in Appendix B to part 150, paragraph (b), an exchange may consider adopting rules to require that during the lesser of the last five days of trading (or such time period for the spot month), such positions must not exceed the person's unfilled anticipated requirements of the underlying cash commodity for that month and for the next succeeding month.[224] Depending on the specific facts and circumstances, and particular market dynamics, any such quantity limitation may prevent the use of long futures to source large quantities of the underlying cash commodity. The Commission may be able to determine that an exchange's adoption of a two-month limitation would allow for an amount of activity that is economically appropriate and in line with common commercial hedging practices, without jeopardizing any statutory objectives.

(ii) Scope of Unfilled Anticipated Requirements and Unfixed-Price Transactions

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[223] 150.5(a)(2)(ii)(G).

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

Commenters questioned the extent to which anticipated requirements may be considered to be "filled" by unfixed-price purchase supply contracts under the proposed enumerated bona fide hedge for unfilled anticipated requirements. COPE, IECA, EPSA and EEI requested clarification on whether this enumerated hedge covers anticipated requirements "filled" by an unfixed-price purchase contract common to many electric generators.[225]

IECA recommended the Commission should either (i) adopt a broad definition of the word "unfilled" that would include anticipated requirements that are "filled" by unfixed-price transactions, or (ii) expand this bona fide hedge to include both "unfilled" and "unpriced"[226] anticipated requirements.[227]

AGA also requested clarification[228] regarding the 2020 NPRM's statement that this bona fide hedge would recognize a position where a utility is "required or encouraged" by its public utility commission to hedge.[229] AGA noted that while the "required or encouraged" language is not in the proposed regulatory text, clarification of the scope for the exemption would result in more certainty for those utilities in states where the public utility commission may not directly address or require hedging activities, but instead may allow or permit hedging for the potential benefits to customers.[230]

(a) Discussion of Final Rule – Scope of Unfilled Anticipated Requirements

Regarding the requests for clarification on the scope of the term "unfilled" in this enumerated hedge, the Commission clarifies that anticipated "unfilled" requirements are not "filled" by unfixed-price transactions. Accordingly, a market participant with a

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[225] COPE at 6; IECA at 7-8; EPSA and EEI jointly at 5.

[226] The Commission recognizes that market participants may utilize different nomenclature to refer to unfixed-price contracts. For example, some commenters may refer to these contracts as "unpriced" contracts, while others may refer to these physical contracts as being at an unfixed spot index price. *See* FIA at 17, 31; COPE at 6.

[227] IECA at 7-8.

[228] AGA at 6-7.

[229] *See* 7 U.S.C. 6a(c)(2)(A)(iii); 85 FR at 11610 ("This would recognize a bona fide hedging position where a utility is required or encouraged by its public utility commission to hedge").

[230] AGA at 6-7.

purchase or sale of a physical commodity, entered into at an unfixed price, may continue to avail itself of this anticipatory hedge even though the participant has entered into a firm, albeit unfixed-price, commitment, and provided all applicable requirements are satisfied.[231]

As discussed above under Section II.A.1.iv., the Commission adopts the interpretation of Staff Letter No. 12-07.[232] That is, commercial entities that enter into unfixed-price transactions may continue to qualify for the enumerated bona fide hedge for unfilled anticipated requirements as long as the commercial entity otherwise satisfies the criteria for this hedge. This rationale is predicated on the fact that an unfixed-price purchase commitment does not fill an anticipated requirement in that the market participant's price risk to the input has not been fixed.

The Commission continues to believe that unfilled anticipated requirements are those anticipated inputs that are estimated in good faith and that have not been filled. As such, an anticipated requirement may be filled by fixed-price purchase commitments, holdings of commodity inventory, or unsold anticipated production of the market participant.[233] Unfixed-price transactions, however, do not fill an anticipated requirement.

Under this anticipatory hedge, once the price is fixed on a supply contract, the market participant holding the anticipatory hedge position must, to the extent the position is above an applicable Federal position limit, liquidate the position in an orderly manner in accordance with sound commercial practices. Nevertheless, subject to the specific facts and circumstances, the market participant at that point may have established the basis for a different bona fide hedge exemption to offset the price risk arising from its fixed price exposure.

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[231] The Commission clarifies that unfixed-price contracts include physical fuel agreements for power production for security of supply that are priced at an unfixed spot index price.

[232] CFTC Staff Letter No. 12-07.

[233] 81 FR at 96752.

Finally, the Commission agrees with the commenters' request for clarification that a utility qualifies for the unfilled anticipated requirements enumerated hedge even if the utility is not "required or encouraged" by its public utility commission to hedge.

f. Hedges of Anticipated Merchandising

(1) Background - Anticipated Merchandising

The existing bona fide hedge definition in § 1.3 includes enumerated bona fide hedges that recognize offsets of certain anticipated activities,[234] but does not currently include an enumerated bona fide hedge for anticipated merchandising. While the Commission's 2011 Final Rule included an enumerated hedge for anticipated merchandising, it was a narrow hedge focused on the leasing of storage capacity,[235] and that rulemaking was ultimately vacated.

(2) Summary of the 2020 NPRM - Anticipated Merchandising

The Commission proposed a new enumerated bona fide hedge for anticipated merchandising. The proposed anticipated merchandising hedge recognized long or short positions in commodity derivative contracts that offset the anticipated change in value of the underlying commodity that a person anticipates purchasing or selling.[236]

While the proposed enumerated anticipated merchandising bona fide hedge would operate as a self-effectuating bona fide hedge, the proposed bona fide hedge was subject to the following conditions: (1) the position offsets the anticipated change in value of the underlying commodity that a person anticipates purchasing or selling; (2) the position does not exceed in quantity twelve months' of current or anticipated purchase or sale requirements of the same cash commodity that is anticipated to be purchased or sold; (3) the person holding the position is a merchant handling the underlying commodity that is

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[234] *See, e.g.*, §§ 1.3(z)(2)(i)(B) (unsold anticipated production) and 1.3(z)(2)(ii)(C) (unfilled anticipated requirements).

[235] The 2011 Final Rule was the first time the Commission recognized that in some circumstances, a market participant that owns or leases an asset in the form of storage capacity could establish positions to reduce the risk associated with returns anticipated from owning or leasing that capacity. In those narrow circumstances, the Commission found that those transactions satisfied the statutory definition of a bona fide hedging transaction.

[236] 85 FR at 11727.

subject to the anticipated merchandising hedge; (4) that such merchant is entering into the position solely for purposes related to its merchandising business; and (5) the person has a demonstrated history of buying and selling the underlying commodity for its merchandising business.[237]

(3) Summary of the Commission Determination – Anticipated Merchandising

The Commission is adopting the anticipated merchandising enumerated hedge as proposed, and makes certain clarifications below to respond to specific questions from commenters summarized below.

The Commission recognizes that anticipated merchandising is a hedging practice commonly used by some commodity market participants, and that merchandisers play an important role in the physical supply chain. The Commission also recognizes that the derivative transactions utilized by commercial participants to manage such merchandising activity are beneficial to price discovery.

(4) Comments - Anticipated Merchandising

(i) Generally

A majority of commenters strongly supported the addition of an enumerated bona fide hedge for anticipatory merchandising.[238] In particular, market participants from the energy industry strongly supported the inclusion of this enumerated hedge, subject to certain clarifications described in detail further below.[239] On the other hand, Better Markets indicated that the enumerated anticipatory bona fide hedges generally, and particularly the enumerated hedge for anticipatory merchandising, pose a regulatory avoidance risk.[240] Better Markets expressed concern that market participants could

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[237] *Id*.

[238] AGA at 1, 8; AFR at 2; Cargill at 4-6; NGSA at 2, 4; CMC at 4-5,7-8; ADM at 3; NCFC at 2-4; Chevron at 2,5; Suncor at 3,5; IFUS at 2 (Exhibit 1 RFC 4); ICEA at 2; NGFA at 4,7; CCI at 7-9; ASR at 2; FIA at 16; CEWG at 14.

[239] AGA at 8; AFR at 2; Cargill at 5-6; NGSA at 4; CMC at 5, 7; ADM at 3; NCFC at 3-4; Chevron at 5; Suncor at 5; IFUS at Exhibit 1 RFC 4; ICEA at 2; NGFA at 7; CCI at 7-9.

[240] Better Markets at 3, 59-60 (stating that "…an identical conceptual avoidance risk continues to exist across all of these anticipatory hedges—namely, that firms may claim an underlying risk is anticipated in order to justify positions well over the speculative limits in Referenced Contracts").

attempt to claim an underlying risk is anticipated in a cash commodity in order to justify positions in referenced contracts that exceed Federal position limits.[241]

In addition to expressing support for the inclusion of this enumerated bona fide hedge, most commenters also requested clarity or guidance on the scope of the proposed anticipated merchandising bona fide hedge. For example, CMC stated that the Commission must be clear with the exchanges and the end-user community about what activity is included in the enumerated anticipated merchandising bona fide hedge.[242] Similarly, Cargill and NGFA supported the addition of the enumerated anticipated merchandising bona fide hedge, but urged the Commission to provide more clarity on how the enumerated bona fide hedge would be applied.[243] Cargill and NGFA also requested that the Commission address language that appeared in footnote 105 of the 2020 NPRM,[244] which implied that certain storage hedges and hedges of assets owned or anticipated to be owned would be evaluated through the non-enumerated bona fide hedge process, rather than as a self-effectuating enumerated anticipated merchandising bona fide hedge.[245]

(ii) Requirements for Anticipated Merchandising

(a) Requirement to Hedge Only Twelve Months' Worth of Anticipated Requirements

Although many public comments addressed the new anticipated merchandising bona fide hedge, only a few commenters opposed the proposed requirement to limit this hedge to only twelve months' worth of current or anticipated purchase or sale requirements of the same cash commodity that is anticipated to be purchased or sold. FIA opposed the twelve-month restriction, stating that CEA section 4a(c)(2) does not tie

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[241] *Id*.

[242] CMC at 5 (stating that n.105 of the 2020 NPRM casts a significant shadow of uncertainty and that if the Commission believes limits are necessary, it must be clear with the exchanges and the end-user community about what activities are enumerated).

[243] Cargill at 5-6; NGFA at 7.

[244] 85 FR at 11612. Footnote 105 from the 2020 NPRM provided: "Similarly, other examples of anticipatory merchandising that have been described to the Commission in response to request for comment on proposed rulemakings on position limits (*i.e.*, the storage hedge and hedges of assets owned or anticipated to be owned) would be the type of transactions that market participants may seek through one of the proposed processes for requesting a non-enumerated bona fide hedge recognition."

[245] Cargill at 5-6; NGFA at 7.

the validity of a bona fide hedge to the duration of the commercial requirement being hedged.[246] FIA also provided an example pointing out that market participants often need hedges of anticipated purchases or sales longer than twelve months, such as when a merchant has a reasonable expectation of anticipated sales beyond a twelve-month quantity.[247]

Similarly, ADM stated that anticipatory merchandising transactions should be considered similar to "hedges of anticipated requirements" and therefore not subject to the twelve-month restriction.[248]

(b) Discussion of Final Rule – Twelve-Month Restriction

After considering the comments on the requirement to hedge only twelve months' worth of anticipated requirements, the Commission is adopting the twelve-month restriction as proposed. The Commission continues to believe that, as stated in the 2020 NPRM, this requirement is intended to ensure that merchants are hedging their legitimate anticipated merchandising exposure to the value change of the underlying commodity, while calibrating the anticipated need within a reasonable timeframe and subject to the limitations in physical commodity markets, such as annual production or processing capacity.[249] A twelve-month restriction for anticipated merchandising is suitable in connection with contracts that are based on anticipated activity on yet-to-be established cash positions due to the uncertainty of forecasting such activity and, all else being equal, the increased risk of excessive speculation on the price of a commodity the longer the time period before the actual need arises.

Regarding FIA's comment opposing the twelve-month restriction based on FIA's interpretation of CEA section 4a(c)(2), the Commission is comfortable that hedging

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[246] FIA at 16-17.

[247] *Id*.

[248] ADM at 3. The 2020 Proposal would remove the existing 12-month restriction applicable to the existing enumerated hedge for unfilled anticipated requirements. *See* 85 FR at 11610.

[249] 85 FR at 11611.

twelve months' or less of current or anticipated purchase or sale requirements of the same cash commodity that is anticipated to be purchased or sold is consistent with the CEA section 4a(c)(2)(A)(ii) requirement that bona fide hedges be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise.[250] However, hedging more than twelve months' anticipated purchase or sale requirements could in some cases be inconsistent with that statutory requirement. Accordingly, bona fide hedges involving more than twelve months' worth of anticipated requirements for anticipated merchandising are best evaluated on a case-by-case basis under the non-enumerated process adopted herein. The Commission understands that commercial firms may seek to manage the price risk of more than twelve months' anticipated merchandising activities; where such situations arise, the Commission believes a non-enumerated bona fide hedge could be appropriate.

The Commission also considered comments that stated that the Commission should treat the proposed anticipated merchandising bona fide hedge similar to the other anticipatory bona fide hedges adopted herein (*i.e.,* the enumerated bona fide hedges for unsold anticipated production and unfilled anticipated requirements), which are no longer subject to the twelve-month restriction.[251] However, the Commission believes that the enumerated bona fide hedge for anticipated merchandising, which is a new enumerated bona fide hedge, is distinguishable from the enumerated bona fide hedges for unsold anticipated production and unfilled anticipated requirements, which both have been part of the Federal position limits framework for decades.

In particular, the Commission has determined that a twelve-month restriction is unnecessary for bona fide hedges of unfilled anticipated requirements and unsold anticipated production in part because anticipated production and requirements, unlike

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[250] *See* 7 U.S.C. 6a(c)(2)(A)(ii).

[251] ADM at 3.

merchandising, are linked and subject to inherent physical limits. For example, a processor has a physical limit on production capacity to support claims of anticipated unsold production. Likewise, a manufacturer, processor or utility has a physical limit on manufacturing, processing, or energy generation, respectively, for similar reasons to tie any claim of anticipated requirements. In each case, anticipated production or requirements generally should result in relatively predictable levels of activity that will not vary much year to year. In contrast, the amount a given market participant could claim to anticipate merchandising is potentially unlimited and less connected to physical production capacity.[252]

(iii) Request for Clarification – Meaning of "Merchant"

Comments from energy market participants requested that the Commission clarify the meaning of the term "merchant" as such term is used in the regulatory text of the proposed anticipated merchandising hedge.[253] Specifically, market participants from the energy industry expressed concern about whether the Commission would construe the term "merchant" such that only entities that are solely merchants, and not engaged in other business activities, would qualify for the anticipated merchandising bona fide hedge.[254] These commenters explained that large energy companies with vertically integrated corporate structures typically have several legal entities that perform individual business functions, including merchandising.[255] As such, these commenters requested the Commission clarify that integrated energy companies routinely engaged in merchandising activities, as well as other activities such as production, processing,

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[252] To verify market participants' bona fide hedging needs, the Final Rule's recordkeeping requirements require persons availing themselves of enumerated bona fide hedge recognitions to maintain complete books and records concerning all relevant information on their anticipated requirements, production, and merchandising activities. *See* 17 CFR 150.3(d)(1). Furthermore, the Commission notes that as part of the exemption application process under final § 150.5, persons seeking exemptions from exchange-set position limits are required to include a description of its activities in the cash markets and swap markets for the commodity underlying the position for which the application is submitted.

[253] CMC at 5; Shell at 8; Chevron at 5-6; Suncor at 5-6; CEWG at 15–16.

[254] Shell at 8; Chevron at 5-6; Suncor at 5-6; CEWG at 15–16.

[255] *Id*.

marketing and power generation, may utilize the enumerated hedge for anticipated merchandising in addition to other bona fide hedges.[256]

(a) Discussion of Final Rule – Meaning of "Merchant"

The Commission is adopting the term "merchant" in the final anticipated merchandising bona fide hedge as proposed, but clarifies here the intended meaning of that term.

In particular, the Commission is clarifying that the term "merchant" in the anticipated merchandising enumerated bona fide hedge is not limited to those entities exclusively engaged in the business of merchandising. Instead, the term "merchant" may include physical commodity market participants that, in addition to offering or entering into transactions solely for purposes related to their merchandising business, may otherwise also be a producer, processor, or commercial user of the commodity that underlies the anticipated merchandising transaction.

The Commission's use of the term "merchant" is intended to capture commercial market participants who participate in the physical commodity market, and does not exclude such participants simply because they have a vertically integrated corporate structure. That is, energy, agricultural, or metal companies in the physical commodity market with vertically-integrated or complex corporate structures are not excluded as merchants, so long as they otherwise satisfy all applicable requirements related to the anticipated merchandising bona fide hedge.

The condition requiring the person to be a merchant to qualify for this enumerated hedge is consistent with the Commission's longstanding practice of providing commercial market participants relief from certain regulatory requirements as a way of reducing regulatory compliance obligations that would otherwise burden a commercial market participant's physical commodity business.

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[256] *Id.*

The Commission has taken a similar approach under the trade option exemption by exempting the physically delivered commodity options purchased by commercial users of the commodities underlying the options. Under the trade option relief, the Commission recognized that commercial market participants needed relief by generally exempting qualifying commodity options from the swap requirements of the CEA and the Commission's regulations.[257] Unlike in the trade option requirements, there is no requirement under the anticipated merchandising enumerated bona fide hedge that both counterparties qualify as merchants. The anticipated merchandising enumerated bona fide hedge, however, is intended to generally benefit the same type of market participants as the trade option exemption, that is, commercial market participants who participate in the physical commodity market for the underlying commodity being merchandised. As such, the text of the anticipated merchandising enumerated bona fide hedge excludes a party who is not entering into the anticipated merchandising activity solely for commercial purposes related to its merchandising business, but instead, to speculate on the price of the underlying commodity. For example, non-commercial market participants who employ various arbitrage strategies, including sometimes trading arbitrage positions in cash commodity markets to speculate on the price of the underlying commodity, and those market participants with highly leveraged derivatives portfolios of non-physical commodities, would not qualify as merchants.

Finally, the Commission has determined that it is not necessary to amend the regulatory text's reference to merchant to expressly include producers or processors. As clarified above, a producer and a processor may qualify for the anticipated merchandising bona fide hedge as a merchant if a part of their business involves merchandising. Furthermore, such entities that are also producers or processors may otherwise rely on the enumerated anticipated unsold anticipated production or unfilled anticipated requirements

[257] Trade Options, Final Rule, 81 FR 14966 (March 21, 2016).

bona fide hedges, where applicable. Thus, the Commission is providing these market participants with ample flexibility to manage the price risks arising from their anticipated merchandising activity using an expanded suite of anticipatory bona fide hedges.

(iv) Requirement for a History of Merchandising

The Commission did not receive any specific comments on the proposed requirement to demonstrate a history of merchandising activity.

(a) Discussion of Final Rule – History of Merchandising Requirement

The Commission is adopting the requirement to demonstrate a history of merchandising as proposed.

Such demonstrated history must include a history of making and taking delivery of the underlying commodity, and a demonstrated ability to store and move the underlying commodity.[258] A merchandiser that lacks the requisite history of anticipated merchandising activity could still potentially receive bona fide hedge recognition under the non-enumerated process, so long as the merchandiser can otherwise demonstrate compliance with the bona fide hedging definition and other applicable requirements, including demonstrating activities in the physical marketing channel, including, for example, arrangements to take or make delivery of the underlying commodity.[259]

(v) Scope of Anticipated Merchandising Activity

In response to comments from the exchanges and market participants, the Commission is providing further clarity on the scope of the enumerated anticipated merchandising bona fide hedge. The Commission discusses below certain non-exclusive types of activities that are covered by the enumerated anticipated merchandising bona fide hedge.

(a) Request for Clarification – Unfixed-Price Contracts and Enumerated Anticipated

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[258] 85 FR at 11611.

[259] *Id*.

Merchandising Hedge

Commenters requested clarification on whether the enumerated bona fide hedge for anticipated merchandising may be used to manage price risk arising from unfixed-price physical commodity transactions. Specifically, several commenters requested clarification on whether a firm may use the anticipated merchandising bona fide hedge to manage the risk associated with a single-sided unfixed purchase or sale at a moment when the same firm does not have an offsetting sale or purchase.[260] In addition to commercial market participants, ICE and CME Group also requested that the Commission recognize single-sided hedges of unfixed-price purchases or sales. Similar to energy market participants, ICE noted that pricing physical energy commodity transactions at unfixed prices is a common pricing mechanism in the energy markets.[261] CME Group provided a hypothetical example of a single-side floating or unfixed-price purchase or sale to demonstrate that derivatives positions entered into to effectuate that single-sided unfixed-price purchase or sale would reduce the price risk arising for each counterparty.[262]

Some commenters requested the Commission clarify that market participants can utilize the enumerated anticipatory merchandising hedge to manage the price risks arising from unfixed-price transactions.[263]

Other commenters suggested the Commission could create a new enumerated bona fide hedge category solely to recognize hedges of unfixed-price transactions.[264]

(*1*) Discussion of Final Rule - Unfixed-Price Contracts and Enumerated Anticipated Merchandising Hedge

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[260] NCFC at 3-4; CMC at 4; IFUS at 4-5; NGSA at 6 (requesting the Commission unambiguously recognize hedges of index-price risk (not just fixed-price risk), noting that exchanges currently recognize these types of hedges).

[261] ICE at 4.

[262] CME Group at 8.

[263] CEWG at 19; CMC at 8; Shell at 7-8; ACSA at 6; ICE at 5; CME Group at 8; Ecom at 1; Southern Cotton at 2; Canale Cotton at 2; Moody Compress at 1; IMC at 2; Mallory Alexander at 2; ACA at 2; East Cotton at 2; Jess Smith at 2; Olam at 2; McMeekin at 2; Memtex at 2; Omnicotton at 2; Toyo at 2; Texas Cotton at 2; NCC at 1; Walcot at 2; White Gold at 2.

[264] ACSA at 6-7; NCC at 2.

As discussed above under Section II.A.1.iv., the Commission is clarifying that market participants that enter into unfixed-price transactions may still be able to qualify for the enumerated bona fide hedge for anticipated merchandising. In other words, a commercial entity that enters into an unfixed-price transaction may qualify for an anticipated merchandising bona fide hedge as long as the market participant satisfies the other requirements, discussed above and below, of the final anticipated merchandising bona fide hedge (*e.g.*, qualifies as a merchant, demonstrates a history of merchandising and satisfies the twelve-month restriction). This rationale is predicated on the fact that an unfixed-price transaction does not address a merchant's anticipated merchandising need in that the merchant's price risk to the merchandise has not been fixed. Accordingly, a merchant may use the anticipated merchandising hedge to manage the risk associated with a single sided unfixed purchase or sale at a moment when the same firm does not have an offsetting sale or purchase. The Commission's treatment of unfixed-price transactions is discussed in more detail in Section II.A.1.iv.[265]

While the Commission understands market participants' desire for a standalone exemption for unfixed-price transactions, the Commission finds that such an exemption is unnecessary. The Commission notes that the modified and expanded suite of enumerated bona fide hedges, including enumerated anticipatory bona fide hedges, adequately facilitates the hedging needs of qualified commercial market participants.

Finally, the Commission believes that the enumerated anticipated merchandising bona fide hedge provides for ample flexibility for hedging. Similar to the enumerated unfilled anticipated requirements and unsold production bona fide hedges, this bona fide hedge may be used even when the merchant simply anticipates purchasing or selling the commodity, and even when the merchant may have yet to enter into an unfixed-price

[265] *See* Section II.A.1.iv, addressing the treatment of unfixed price transactions.

transaction, as long as the merchant has a good faith belief that it will enter into the anticipated merchandising transaction.

(b) Analysis of Examples Preliminarily Recognized as Hedges of Anticipated Merchandising in the 2020 NPRM

As discussed earlier in this release, in the 2020 NPRM, the Commission addressed several requests that had been submitted in CEWG's BFH Petition in response to the 2011 Final Rule, to obtain exemptive relief for several transactions described by CEWG as bona fide hedging positions. In the 2020 NPRM, the Commission preliminarily determined that two CEWG BFH Petition examples complied with the proposed hedge of anticipated merchandising: example #4 (Binding, Irrevocable Bids or Offers); and example #5 (Timing of Hedging Physical Transactions).[266]

On the other hand, as discussed in Section II.A.1.iv., the Commission preliminarily determined in the 2020 NPRM that the positions described in the CEWG's BFH Petition examples #3 (unpriced physical purchase *or* sale commitments) and #7 (scenario 2) (use of physical delivery referenced contracts to hedge physical transactions using calendar month average pricing) did not satisfy any of the proposed enumerated hedges.[267]

(*1*) Comments - Examples Preliminarily Recognized as Hedges of Anticipated Merchandising in the 2020 NPRM

The Commission received comments supporting the Commission's preliminary determination in the 2020 NPRM that CEWG's BFH Petition example #4 (Binding, Irrevocable Bids or Offers)[268] and example #5 (Timing of Hedging Physical Transactions) are permitted under the 2020 NPRM's proposed enumerated hedge for

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[266] 85 FR at 11611.

[267] 85 FR at 11611-11612.

[268] FIA at 16. FIA supported the Commission's preliminary determination that Examples #4 (Binding, Irrevocable Bids or Offers) and #5 (Timing of Hedging Physical Transactions) fit within the newly proposed anticipatory merchandising hedge.

anticipated merchandising.[269] The public comments related to examples #3 and #7 (scenario 2) are discussed in the preamble at Section II.A.1.iv., addressing the treatment of unfixed price transactions.

(*2*) Discussion of Final Rule - Examples Preliminarily Recognized as Hedges of Anticipated Merchandising in the 2020 NPRM

The Commission has considered the public's response to its preliminary determination that several of the CEWG BFH Petition examples fit within the 2020 NPRM. The Commission determines in this Final Rule that BFH Petition example #4 (Binding, Irrevocable Bids or Offers) and example #5 (Timing of Hedging Physical Transactions) comply with the enumerated hedge for anticipated merchandising, so long as all applicable conditions are met.

In accordance with the Commission's treatment of unfixed-price transactions under this Final Rule, discussed in Section II.A.1.iv., the Commission has determined that BFH Petition examples #3 and #7 (scenario 2) are also permitted under the Final Rule, so long as the position or transaction complies with the applicable conditions of the enumerated anticipatory hedge.

(c) Anticipated Merchandising Includes Hedges of Anticipated Storage and Assets Owned or Anticipated to be Owned

Several commenters requested the Commission clarify the scope of the proposed anticipated merchandising bona fide hedge in light of the Commission's observation in footnote 105 of the 2020 NPRM.[270] That footnote stated that certain hedges of storage and hedges of assets owned or anticipated to be owned would not be within the scope of the proposed anticipated merchandising enumerated bona fide hedge.[271] However, the plain language of the proposed anticipatory merchandising bona fide hedge appeared to

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[269] CEWG at 19.
[270] Cargill at 5; CMC at 5; NGFA at 7.
[271] 85 FR at 11612 n.105.

be broad enough to cover such activity. Commenters were thus unsure whether the proposed enumerated anticipated merchandising hedge would apply to storage transactions and to hedges of assets owned or anticipated to be owned.

Most commenters from the energy industry requested the Commission allow for anticipated storage positions to be considered as falling within the enumerated hedge exemption for anticipated merchandising, contending that such hedges are recognized as bona fide hedge exemptions by the exchanges.[272] Chevron and Castleton requested that the Final Rule clarify that hedges of storage may qualify for the enumerated bona fide hedge for anticipated merchandising if applicable conditions are met.[273]

In the alternative, Chevron requested the Commission identify and clarify that storage hedges of this nature qualify for another enumerated exemption, notably the enumerated bona fide hedge for unfilled anticipated requirements.[274] Citadel similarly requested recognition of offsetting positions related to anticipated changes in the value of the underlying commodity to be stored in facilities on lease, and up to the full storage capacity on lease, rather than only the currently utilized level of leased capacity.[275] Citadel argued that storage facilities owned, but not those leased, by the merchant would be covered by the proposed anticipated merchandising enumerated bona fide hedge, and that such different treatment depending on whether the facility was owned or leased did not make sense.[276]

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[272] NGSA at 7; CHS at 4 (requesting to include a winter storage hedge in the list of enumerated hedges); FIA at 16, 31 (requesting to include a storage hedge as a separate enumerated BFH); Shell at 7-8 (stating that assets used for the transport and storage of energy are a critical part of the energy value chain, including fuel storage tanks and pipeline assets as examples where time spreads or location basis spreads are used to lock-in the values of the assets. This commenter stated that with respect to such infrastructure assets, the Commission should clarify that the use of the hedges of anticipated storage or other physical assets is the type of risk activity that falls within the enumerated BFH for anticipated merchandising); Chevron at 9-11 (requesting that a final rule clarify that hedges of storage may qualify for the enumerated BFH for anticipated merchandising if applicable conditions are met. In the alternative, Chevron requests the Commission identify and clarify that storage hedges of this nature qualify for another enumerated exemption, notably the enumerated BFH for unfilled anticipated requirements); Suncor at 9-10 (requesting that a final rule clarify that hedges of storage may qualify for the enumerated BFH for anticipated merchandising if applicable conditions are met); CCI at 7-9; and CEWG at 16-19 (requesting that the Commission clarify that the enumerated BFH for anticipatory merchandising applies to hedges of storage).

[273] Chevron at 5; CCI at 8-9.

[274] Chevron at 11.

[275] Citadel at 9.

[276] *Id*.

(*1*) Discussion of Final Rule - Anticipated Merchandising Includes Hedges of Anticipated Storage and Assets Owned or Anticipated to be Owned

In response to public comments, the Commission determines that both hedges of storage and hedges of assets owned or anticipated to be owned can potentially qualify for the enumerated hedge for anticipated merchandising if the applicable conditions are met.

In footnote 105 of the 2020 NPRM, the Commission observed that market participants could use the non-enumerated process (rather than a self-effectuating enumerated hedge) to receive bona fide hedge recognition for storage hedges and hedges of assets owned or anticipated to be owned.[277] This observation was predicated on the Commission's recognition that different commodities have different storage roles, manners, and procedures. For example, the use of some storage facilities is not exclusive to a specific commodity and not all storage is necessarily tied to anticipated merchandising activity. As such, the Commission believed that an analysis of facts and circumstances under the non-enumerated bona fide hedge process would facilitate a determination on whether to recognize hedges of storage or assets owned or anticipated to be owned under the proposed enumerated anticipated merchandising hedge.

The Commission has considered comments with respect to the appropriate treatment of storage transactions and hedges of assets owned or anticipated to be owned under the Commission's anticipated merchandising enumerated hedge. The Commission agrees that commercial market participants may utilize storage hedges or hedges of assets owned or anticipated to be owned as risk reducing practices.[278] The Commission believes that such risk reducing hedges may be recognized as anticipated merchandising bona fide hedges, if all the applicable conditions of the anticipated merchandising hedge are satisfied. The Commission clarifies that commercial market participants in the

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[277] 85 FR at 11612.
[278] CEWG at 16.

physical marketing channel that utilize storage hedges or hedges of assets owned or anticipated to be owned may continue to qualify for the anticipated merchandising enumerated bona fide hedge, whether the commercial market participant owns or leases the storage or asset, so long as the all other applicable requirements for the bona fide hedge are satisfied.

g. Hedges by Agents

(1) Background – Hedges by Agents

Existing § 1.3(z)(3) includes certain hedges by agents as an example of a potential non-enumerated bona fide hedge.[279] Since 2011, the Commission has included an enumerated hedge for hedges by agents in each of its position limits rulemakings.[280]

Under the existing non-enumerated hedge process, the Commission has recognized non-enumerated bona fide hedges for parties acting as agents who had the responsibility to trade cash commodities on behalf of another party for which such positions qualified as bona fide hedging positions. Such agents could obtain bona fide hedge treatment to offset, on a long or short basis, the risks arising from those underlying cash positions. For example, this hedge has been recognized in circumstances where a party traded or managed a farmer's, producer's, or a government entity's inventory in the party's capacity as agent. In such circumstances, the agent providing services in the physical marketing channel, such as a commercial firm, did not take ownership of the commodity and was eligible as an agent for an exemption to hedge the risks associated with such cash positions.

(2) Summary of the 2020 NPRM - Hedges by Agents

The Commission proposed to include hedges by agents as an enumerated hedge. The proposed hedge would grant an enumerated hedge to an agent who (1) did not own

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[279] 17 CFR 1.3(z)(3) ("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.").

[280] 81 FR at 96964; 78 FR at 75714; 76 FR at 71689.

or was not contracted to sell or purchase the offsetting cash commodity at a fixed price, (2) was responsible for merchandising the cash positions being offset, and (3) had a contractual agreement with the person who (i) owned the commodity or (ii) held cash-market positions being offset.

The proposed hedge of agents would substantively adopt the Commission's existing practice under the non-enumerated process in existing § 1.3(z)(3).[281] The Commission, however, proposed to include hedges of agents in the list of enumerated hedges because it preliminarily determined this was a common hedging practice and that positions which satisfy the requirements of this enumerated hedge conformed to the general definition of bona fide hedging without further consideration as to the particulars of the case.[282]

(3) Summary of the Commission Determination - Hedges by Agents

The Commission is adopting the enumerated bona fide hedge for hedges by agents as proposed.

(4) Comments - Hedges by Agents

The Commission received several comments supporting recognition of the hedge by agents, particularly as included in an expanded list of enumerated hedges.[283] ASR identified hedges of agents as a type of hedge that is of particular importance to them because it is used daily within its business.[284] The Commission did not receive any comments opposed to the enumerated hedge for hedges by agents.

(5) Discussion of Final Rule - Hedges by Agents

The Commission recognizes that agents provide important services in the physical marketing channel across different commodity markets. For example, in the agricultural

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

[282] 85 FR at 11610.

[283] FIA at 16; IECA at 2; and ASR at 2.

[284] ASR at 2.

sector, this enumerated hedge will accommodate a common hedging practice in the cotton industry. This hedge will be particularly useful in connection with cotton equities purchased by a cotton merchant from a producer, which is commonly done under the U.S. Department of Agriculture's loan program to facilitate marketing tools for cotton producers.

Another example of when the enumerated hedge by agents adopted herein will apply is for those agents who are in the business of merchandising (selling) the cash grain owned by multiple warehouse operators and forwarding the merchandising revenues back to the warehouse operators less the agent's fees. Such agents that satisfy the requirements of this enumerated hedge, such as not owning any cash commodity but being responsible for merchandising the cash grain positions of the warehouse operators pursuant to contractual agreements, will be able to hedge the price risks arising from their merchandising activity under those agreements as a bona fide hedge by agents.

h. Short Hedges of Anticipated Mineral Royalties

(1) Background - Anticipated Mineral Royalties

The Commission's existing bona fide hedging definition does not include an enumerated hedge for anticipated mineral royalties. Since 2011, the Commission has, however, included such a bona fide hedge in each of its position limits rulemakings.[285] While the Commission's 2011 Final Rule initially recognized the hedging of anticipated royalties generally, each proposal since then, including the latest 2020 NPRM, has proposed that this exemption apply to: (i) short positions (ii) that arise from production (iii) in the context of mineral extraction.

(2) Summary of the 2020 NPRM - Anticipated Mineral Royalties

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[285] 81 FR at 96964; 78 FR at 75715; 76 FR at 71689. In the 2011 Final Rule, the Commission recognized anticipatory royalty transactions as a bona fide hedge, provided the following conditions were met: (1) The royalty or services contract arose out of the production, manufacturing, processing, use, or transportation of the commodity underlying the Referenced Contract; (2) The hedge's value was "substantially related" to anticipated receipts or payments from a royalty or services contract; and (3) No such position was 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.

The Commission proposed a new enumerated bona fide hedge for short hedges of anticipated mineral royalties that are not currently enumerated in existing § 1.3. The proposed provision would permit an owner of rights to a future mineral royalty to lock in the price of anticipated mineral production by entering into a short position in a commodity derivative contract to offset the anticipated change in value of the mineral royalty rights that were owned by that person and arose out of the production of a mineral commodity (*e.g.*, oil and gas).[286] The owner of the rights to the future mineral royalty could be a producer, or, for example, could also be a bank that holds the relevant royalty rights and that is financing, for example, a drilling well operation for a producer. The Commission preliminarily believed that this represents a common hedging practice, and that positions that satisfied the requirements of this enumerated bona fide hedge conformed to the general definition of bona fide hedging without further consideration as to the particulars of the case.[287]

The Commission proposed to limit this enumerated bona fide hedge only to *mineral* royalties, noting that while royalties have been paid for use of land in agricultural production, the Commission did not receive any evidence of a need for a bona fide hedge recognition from owners of *agricultural* production royalties.[288] The Commission requested comment on whether and why such an exemption might be needed for owners of agricultural production or other royalties.[289]

(3) Summary of the Commission Determination – Anticipated Mineral Royalties

For the reasons discussed in the NPRM, the Commission is adopting the enumerated hedge for anticipated mineral royalties as proposed.

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[286] 85 FR at 11608-11609. A short position fixes the price of the anticipated receipts, removing exposure to change in value of the person's share of the production revenue. A person who has issued a royalty, in contrast, has, by definition, agreed to make a payment in exchange for value received or to be received (*e.g.*, the right to extract a mineral). Upon extraction of a mineral and sale at the prevailing cash-market price, the issuer of a royalty remits part of the proceeds in satisfaction of the royalty agreement. The issuer of a royalty, therefore, does not have price risk arising from that royalty agreement.

[287] 85 FR at 11609.

[288] *Id.*

[289] *Id.*

(4) Comments - Anticipated Mineral Royalties

The Commission did not receive any comments either opposing the addition of an enumerated bona fide hedge for anticipated mineral royalties or requesting modifications to the hedge as proposed. Further, no commenters requested extending the enumerated hedge to other types of royalties other than mineral royalties. Several commenters expressed support for the new enumerated hedge.[290]

i. Hedges of Anticipated Services

(1) Background - Anticipated Services

The Commission's existing bona fide hedging definition does not include an enumerated hedge of anticipated services. Since 2011, however, the Commission has included an enumerated bona fide hedge exemption for hedges of anticipated services in each of its position limits rulemakings.[291]

Further, in 1977, the Commission noted that the existence of futures markets for both source and product commodities, such as soybeans, soybean oil, and soybean meal, affords business firms increased opportunities to hedge the value of services.[292]

(2) Summary of the 2020 NPRM - Anticipated Services

The Commission proposed a new enumerated bona fide hedge for anticipated services, not currently enumerated in existing § 1.3. The proposed provision would recognize as a bona fide hedge a long or short derivative contract position used to hedge the anticipated change in value of receipts or payments due or expected to be due under an executed contract for services arising out of the production, manufacturing, processing, use, or transportation of the commodity underlying the commodity derivative contract.[293]

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[290] FIA at 16; IECA at 2.
[291] 81 FR at 96810; 78 FR at 75715. *See* 76 FR at 71646.
[292] 42 FR 14832, 14833 (Mar. 16, 1977).
[293] 85 FR at 11609.

(3) Summary of the Commission Determination - Anticipated Services

The Commission is adopting the enumerated bona fide hedge for anticipated services as proposed.

(4) Comments - Anticipated Services

The Commission received four comments on the proposed enumerated anticipated services bona fide hedge. ASR and FIA expressed support for its inclusion as a new enumerated bona fide hedge.[294] In contrast, IATP and Better Markets urged the Commission to exclude this hedge from the list of enumerated bona fide hedges.[295] IATP stated that the anticipated services bona fide hedge is "presumably connected to hedges of anticipated production" and that, as a result, it views the enumerated hedge as "more vulnerable to deliverable supply estimate disruption."[296] IATP also contended that, absent a stronger argument for inclusion of this enumerated bona fide hedge aside from "such exemptions are granted by exchanges," the proposed bona fide hedge of anticipated services merits greater Commission review before being included as an enumerated bona fide hedge.[297] Better Markets stated that the definition was too vague, and that absent a time limitation, the hedge could be used as a loophole for speculation.[298]

(5) Discussion of the Final Rule – Anticipated Services

The Commission is adopting the enumerated bona fide hedge for anticipated services as proposed.

In response to IATP, the Commission believes that hedging of anticipated services may be useful to commercial market participants in a variety of commonly-occurring scenarios. For example, one scenario may be when a contract for services involves the production of a commodity such as a risk service agreement to drill an oil

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[294] ASR at 2; FIA at 16.
[295] IATP at 17; Better Markets at 58.
[296] IATP at 17.
[297] *Id.*
[298] Better Markets at 58.

well between two companies where the risk service agreement between the parties provides that a portion of the revenue receipts to one of the counterparties depends on the value of the oil produced. To reduce the risk of lower anticipated revenues resulting from an anticipated lower price of oil, the company may enter into a short position in the NYMEX Light Sweet Crude Oil referenced contract.

Under this enumerated bona fide hedge of services, such a short position fixes the price at the entry price to the commodity derivative contract. For any decrease in price of the commodity that is the subject of the executed contract for services, the expected receipts from the contract for services would decline in value, but the short commodity derivative contract position would increase in value—offsetting the price risk from the expected receipts under contract for services.

On the other hand, this enumerated hedge of anticipated services may also be utilized when a contract for services involves a contract where one of the counterparties is responsible for the cost of the commodity used to provide the service. Such a scenario may occur when a city contracts with a firm 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 would pay for the cost of the natural gas used to transport the solid waste by the waste disposal company. In the event that natural gas prices rise, the city's waste transport expenses would rise. To mitigate this risk, the city establishes a long position in the NYMEX natural gas referenced contract that is equivalent to the expected use of natural gas over the life of the service contract.

In this case, the long position fixes the exit price of the commodity derivative contract. For any increase in the commodity that is the subject of the executed contract for services, the payment due or expected to be due would increase in value, but the long commodity derivative contract would decrease in value—offsetting the price risk from the payments under the contract for services. Under both of these examples, the

transactions meet the general requirements for a bona fide hedging transaction and the specific provisions for hedges of anticipated services.

Regarding comments contending that deliverable supply estimates are more vulnerable to disruption under this hedge, the Commission does not believe that bona fide hedges for anticipated services will impact actual deliverable supplies. This is because this bona fide hedge allows a market participant to hedge the anticipated change in value of receipts or payments due or expected to be due under an executed contract for services, and is not an alternative means of procuring or selling the underlying commodity.

In addition, the Commission will continue to have sufficient access to position and cash-market data to verify all exemptions granted. The reporting and recordkeeping obligations under §§ 150.5 and 150.9 will require exchanges to submit justifications, amendments, and other necessary information to the Commission on a monthly basis. As such, exchanges and the Commission will have visibility into the amount of demand there is for a commodity in the spot month via the delivery notices. In the rare event that an exchange observes an imbalance, it has the ability under its rules to require the trader to reduce its positions.

Finally, the Commission notes that a time limitation is unnecessary because, among other things, when administering exchange-set limits, under the Final Rule, exchanges may rely on the Commission's guidance in Appendix B to part 150 to protect price convergence and ensure an orderly spot period. Under the guidance in Appendix B adopted herein, an exchange may adopt rules to impose a restriction on holding a position in a physically delivered referenced contract during the lesser of either the last five days of trading or the time period for the spot month in order to limit such positions to only those that are economically appropriate for that person's specific anticipated or real needs.

j. Offsets of Commodity Trade Options

(1) Background - Offsets of Commodity Trade Options

Commodity trade options are not subject to Federal position limits under existing regulations.[299] Generally, a commodity trade option is a physically-delivered commodity option purchased by commercial users of the commodities underlying the options. In the 2016 trade options final rule, the Commission stated that Federal position limits should not apply to trade options.[300] Further, in that trade options final rule, the Commission indicated it would address the applicability of position limits to trade options in the context of any final rulemaking on position limits.[301]

(2) Summary of the 2020 NPRM - Offsets of Commodity Trade Options

The Commission proposed a new enumerated hedge for offsets of commodity trade options not currently enumerated in § 1.3. Under the 2020 NPRM, a qualifying commodity trade option under § 32.3[302] would be treated as a cash position, on a futures-equivalent basis,[303] and serve as the basis for a bona fide hedge position. Treating qualifying commodity trade options as cash positions, either as a cash commodity purchase or sales contract, would allow the Commission to extend the existing enumerated hedge exemptions for cash positions to the offsets of commodity trade options. That is, the offsets of qualifying commodity trade options would be treated like

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[299] *See* 17 CFR 32.3(c).

[300] Trade Options, 81 FR at 14966, 14971 (Mar. 21, 2016). Under the trade options final rule, trade options are generally exempted from the rules otherwise applicable to swaps, subject to the conditions enumerated in § 32.3. For example, trade options do not factor into the determination of whether a market participant is an SD or MSP; trade options are exempt from the rules on mandatory clearing; and trade options are exempt from the rules related to real-time reporting of swaps transactions.

[301] *Id*.

[302] 17 CFR 32.3. In order to qualify for the trade option exemption, § 32.3 requires, among other things, that: (1) the offeror is either (i) an eligible contract participant, as defined in section 1a(18) of the Act, or (ii) offering or entering into the commodity trade option solely for purposes related to its business as a "producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the" trade option; and (2) the offeree is offered or entering into the commodity trade option solely for purposes related to its business as "a producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity" trade option.

[303] It may not be possible to compute a futures-equivalent basis for a trade option that does not have a fixed strike price. As discussed in the Section II.A.1.iv., under the Commission's existing portfolio hedging policy, market participants may manage their price risks by utilizing more than one enumerated bona fide hedge (including a commodity trade option hedge and other anticipatory bona fide hedges, if necessary based on the market participant's applicable facts and circumstances). For example, a commodity trade option with a fixed strike price may be converted to a futures-equivalent basis, and, on that futures-equivalent basis, deemed a cash commodity sale contract, in the case of a short call option or long put option, or a cash commodity purchase contract, in the case of a long call option or short put option.

the enumerated hedges for cash commodity fixed-price purchase contracts or hedges of cash commodity fixed-price sales contracts.[304]

(3) Summary of the Commission Determination - Offsets of Commodity Trade Options

The Commission continues to believe that Federal position limits should not apply to trade options. Thus, the Commission is adopting the enumerated bona fide hedge for offsets of commodity trade options as proposed, with a few clarifying, non-substantive technical edits in the regulatory text.

(4) Comments - Offsets of Commodity Trade Options

The Commission did not receive any comments opposing the addition of an enumerated hedge for offsets of commodity trade options. The Commission received comments generally supporting the bona fide hedge for offsets of commodity trade options, particularly as included in an expanded list of enumerated bona fide hedges.[305] NGSA stated that defining bona fide hedging in a way that recognizes that trade options, adjusted on a futures-equivalent basis, constitute cash commodity purchase or sale contracts that underlie bona fide hedge positions should "facilitate hedging rather than restrict it."[306]

k. Cross-Commodity Hedges

(1) Background - Cross-Commodity Hedges

The Commission has long recognized cross-commodity bona fide hedging under paragraph (2)(iv) of the bona fide hedging definition in existing § 1.3, which has allowed cross-commodity bona fide hedging in connection with all of the enumerated bona fide hedges included in the existing bona fide hedge definition.[307]

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[304] 85 FR at 11610.
[305] IECA at 1; CCI at 2; CEWG at 4; Chevron at 3; Suncor at 3; FIA at 16; and NGSA at 4.
[306] NGSA at 4.
[307] 42 FR 14832, 14834 (March 16, 1977).

The existing enumerated cross-commodity bona fide hedge recognizes that risk from some cash commodity price exposures can be practically and effectively managed through commodity derivative contracts on a related commodity. As such, positions in any of the existing enumerated bona fide hedges may be offset by a cash position held in a different commodity than the commodity underlying the futures contract.

The existing cross-commodity enumerated hedge, however, is subject to two conditions. First, the fluctuations in value of the position in the futures contract must be "substantially related" to the fluctuations in value of the actual or anticipated cash position. Second, under the cross-commodity enumerated bona fide hedge exemption, a position may not be held in excess of the Federal position limit during the last five trading days for that futures contract.

Cross-commodity hedging also allows market participants to hedge the price exposure arising from the products and byproducts of a commodity where there is no futures contract for those products or byproducts, but there is a futures contract for the source commodity of those products or byproducts. Since 2011, the Commission has included an enumerated cross-commodity bona fide hedge in each of its position limits rulemakings.[308]

(2) Summary of the 2020 NPRM - Cross-Commodity Hedges

The Commission proposed to include cross-commodity hedges as an enumerated bona fide hedge, and to expand the application of this bona fide hedge such that it could be used to establish compliance with: (1) each of the proposed enumerated bona fide hedges listed in Appendix A to part 150 except for unfilled anticipated requirements and anticipated merchandising, which were excluded from the regulatory text of the cross-commodity enumerated hedge;[309] and (2) the proposed pass-through provisions under

[308] 81 FR at 96752-96753; 78 FR at 75716; 76 FR at 71689.

[309] Specifically, the 2020 NPRM allowed for cross-commodity hedging for any of the following proposed enumerated hedges: (i) hedges of unsold anticipated production, (ii) hedges of offsetting unfixed-price cash commodity sales and purchases, (iii) hedges of

paragraph (2) of the proposed bona fide hedging definition discussed further below; provided, in each case, that the position satisfied each element of the relevant enumerated bona fide hedge.[310] In addition, the Commission also proposed to eliminate the Five-Day Rule in connection with the proposed cross-commodity bona fide hedge (*i.e.*, the 2020 NPRM eliminated the restriction from holding a position in excess of the Federal position limit under the enumerated cross-commodity bona fide hedge during the last five days of trading).

The proposed cross-commodity enumerated bona fide hedge was conditioned on the existence of a "substantial relationship" between the commodity derivative contract and the related cash commodity position. Specifically, the fluctuations in value of the position in the commodity derivative contract, that is, of the underlying cash commodity of that derivative contract, were required to be "substantially related"[311] to the fluctuations in value of the actual or anticipated cash commodity position or pass-through swap.[312] This was intended to be a qualitative analysis, rather than quantitative.

For example, the 2020 NPRM stated that there is a substantial relationship between grain sorghum, which is used as a food grain for humans or as animal feedstock, and the corn referenced contracts. Because there is not a futures contract for grain sorghum grown in the United States listed on a U.S. DCM,[313] corn represents a substantially related commodity to grain sorghum in the United States.[314] The 2020

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anticipated mineral royalties, (iv) hedges of anticipated services, (v) hedges of inventory and cash commodity fixed-price purchase contracts, (vi) hedges of cash commodity fixed-price sales contracts, (vii) hedges by agents, and (viii) offsets of commodity trade options.

[310] 85 FR at 11609. For example, an airline that wishes to hedge the price of jet fuel may enter into a swap with a swap dealer. In order to remain flat, the swap dealer may offset that swap with a futures position, for example, in ULSD. Subsequently, the airline may also offset the swap exposure using ULSD futures. In this example, under the pass-through swap language of proposed § 150.1, the airline would be acting as a bona fide hedging swap counterparty and the swap dealer would be acting as a pass-through swap counterparty. In this example, provided each element of the enumerated hedge in paragraph (a)(5) of Appendix A, the pass-through swap provision in § 150.1, and all other regulatory requirements are satisfied, the airline and swap dealer could each exceed limits in ULSD futures to offset their respective swap exposures to jet fuel. *See infra* Section II.A.1.c.v. (discussion of proposed pass-through language).

[311] *See* 85 FR at 11726-11727.

[312] 85 FR at 11609.

[313] This remains true at the publication of this rulemaking.

[314] 85 FR at 11609. Grain sorghum was previously listed for trading on the Kansas City Board of Trade and Chicago Mercantile Exchange, but because of liquidity issues, grain buyers continued to use the more liquid corn futures contract, which suggests that the basis risk between corn futures and cash sorghum could be successfully managed with the corn futures contract.

NPRM noted that, in contrast, there did not appear to be a reasonable commercial relationship between a physical commodity, say copper, and a broad-based stock price index, such as the S&P 500 Index, because these commodities were not reasonable substitutes for each other in that they had very different pricing drivers.[315] That is, the price of a physical commodity is based on supply and demand, whereas the stock price index is based on various individual stock prices for different companies.[316]

The 2020 NPRM also preliminarily determined that CEWG BFH Petition example #9 (Holding a cross-commodity hedge using a physical delivery contract into the spot month) and example #10 (Holding a cross-commodity hedge using a physical delivery contract to meet unfilled anticipated requirements) were permitted as cross-commodity enumerated hedges.[317]

(3) Summary of the Commission Determination - Cross-Commodity Hedges

The Commission is finalizing the cross-commodity enumerated bona fide hedge largely as proposed, with amendments to expand the ability to use cross-commodity hedges.

(4) Comments - Cross-Commodity Hedges

Commenters generally supported the proposed cross-commodity enumerated bona fide hedge, and a few commenters explicitly supported the Commission's decision not to propose a quantitative test requirement for the proposed enumerated cross-commodity bona fide hedge.[318]

Better Markets stated that it views some cross-commodity hedges as "appropriate, normal, and legitimate market practices," but claimed that there is a potential for abuse if the bona fide hedge exemption requires less than a "demonstrable price relationship"

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[315] 85 FR at 11609.

[316] *Id.*

[317] 85 FR at 11611.

[318] ADM at 2; NGSA at 3-4; NOPA at 2; and ICE at 7. Prior position limits proposals included a quantitative test, whereas the 2020 NPRM included a qualitative "substantially related" requirement.

between the two commodities.[319] ICE recommended that the Commission include a non-exclusive list of commonly-used cross-commodity hedges that satisfy the "substantially related" requirement, which ICE believes should include the natural gas core referenced futures contract and its linked referenced contracts as bona fide hedges of electricity price exposure, and vice versa.[320]

The majority of energy market participants commented on a separate item: that the express language of proposed paragraph (a)(5) of Appendix B to part 150, which sets forth the proposed cross-commodity bona fide hedge, inappropriately failed to cover bona fide hedges for unfilled anticipated requirements and anticipated merchandising.[321] Chevron, Suncor, CCI, and the CEWG requested that the Commission revise the proposed cross-commodity enumerated bona fide hedge to specifically clarify that enumerated bona fide hedges for unfilled anticipated requirements and anticipated merchandising may be utilized as cross-commodity bona fide hedges in energy markets.[322] IECA also requested that the cross-commodity enumerated hedge include bona fide hedges of anticipated requirements, which would capture bona fide hedges of anticipated requirements commonly used by many electric utilities that enter into heat-rate transactions.[323]

Suncor and Chevron highlighted an internal inconsistency in the 2020 NPRM. These commenters pointed out that while the 2020 NPRM preliminarily determined that CEWG BFH Petition Example #10 (Holding a cross-commodity hedge using a physical delivery contract to meet unfilled anticipated requirements) satisfies the proposed cross-

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[319] Better Markets at 58.
[320] ICE at 7.
[321] Chevron at 8-9; Suncor at 6-8; NOPA 2; CCI at 5-9; CEWG at 10-14; NGSA at 4; ICE at 2, 4; Shell at 7-8; ADM at 2; and IECA at 8.
[322] Chevron at 8; Suncor at 8; NOPA at 2; CCI at 5-7; CEWG at 10-14; NGSA at 4; and IECA at 8.
[323] IECA at 7-8.

commodity hedge, the proposed cross-commodity hedge excluded unfilled anticipated requirements.[324]

(5) Discussion of Final Rule – Cross-Commodity Hedges

The Commission is finalizing the cross-commodity enumerated bona fide hedge largely as proposed, with amendments to expand the ability to use cross-commodity hedges. Specifically, the Commission is amending the express language of the cross-commodity enumerated hedge in Appendix B to include the enumerated hedges of unfilled anticipated requirements and hedges of anticipated merchandising so that the cross-commodity provision applies to all enumerated hedges adopted herein. The 2020 NPRM excluded the enumerated bona fide hedges for unfilled anticipated requirements and for anticipated merchandising from the cross-commodity provision. As a result, any internal inconsistency related to example #10 has been resolved.

Separately, as stated in the 2020 NPRM, the Commission reaffirms that the requirement that the value fluctuations of the commodity derivatives contract used to hedge and the value fluctuations of the commodity cash position being hedged must be "substantially related" is an important factor in determining whether a cross-commodity hedge satisfies the requirements to be a bona fide hedge. Accordingly, the Commission believes that the "substantially related" requirement sufficiently ties derivative and cash positions between two different, but comparable, commodities that have a reasonable commercial relationship as a result of their ability to serve as reasonable substitutes for each other, due to, for example, similar pricing drivers.

The Commission agrees with commenters who stated that market participants use cross-commodity hedging to manage their price risk, particularly when a cash commodity is not necessarily deliverable under the terms of any derivative contract or the cash-market transactions are not in the same commodity underlying the futures contract. For

[324] Chevron at 7; Suncor at 7.

example, an airline that uses a predictable volume of jet fuel every month may cross hedge its anticipated jet fuel requirements with the ultralow sulfur diesel ("ULSD") heating oil commodity derivative contract because there are no physically-settled jet fuel commodity derivative contracts available. The value fluctuations in jet fuel are substantially related to the value fluctuations in the ULSD "HO" futures contract.

The Commission believes that a determination of whether commodities are "substantially related" for purposes of the cross-commodity bona fide hedge depends on a facts and circumstances analysis and that the relationship between the two is not static, as it may change over time depending on market factors. Accordingly, the Commission's position is not to publish a list of cross-commodity hedges satisfying the "substantially related" requirement at this time.

vii. Location and Regulatory Treatment of the Enumerated Bona Fide Hedges

a. Background – Location and Regulatory Treatment of the Enumerated Bona Fide Hedges

As noted above, the existing enumerated bona fide hedges are explicitly incorporated in the regulatory bona fide hedging definition in § 1.3 of the Commission's regulations.

b. Summary of the 2020 NPRM – Location and Regulatory Treatment of the Enumerated Bona Fide Hedges

In the 2020 NPRM, the Commission proposed to move the expanded list of the enumerated bona fide hedges from the bona fide hedging definition in regulation § 1.3 to the proposed acceptable practices in Appendix A to part 150. The Commission stated that the list of enumerated bona fide hedges should appear as acceptable practices in an appendix, rather than as regulations in the regulatory bona fide hedging definition, because each enumerated bona fide hedge represents just one way, but not the only way,

to satisfy the proposed bona fide hedging definition and § 150.3(a)(1).[325] The Commission requested comment on whether the list of enumerated hedges should be included in the regulatory text or in an appendix as acceptable practices.[326]

c. Summary of the Commission Determination – Location and Regulatory Treatment of the Enumerated Bona Fide Hedges

The Commission has determined to incorporate the enumerated bona fide hedges as part of the regulatory text. While the Final Rule will maintain the enumerated bona fide hedges in Appendix A to part 150, Appendix A will be incorporated into final § 150.3, and therefore under the Final Rule the enumerated bona fide hedges in Appendix A will be deemed to be part of the regulatory text rather than treated as acceptable practices.

d. Comments – Location and Regulatory Treatment of the Enumerated Bona Fide Hedges

FIA and MGEX supported moving the list of enumerated bona fide hedges to the rule text.[327] FIA stated that "including the list in the regulatory text would provide market participants greater regulatory certainty by making it clear that it could not be amended absent notice and comment rulemaking."[328]

On the other hand, CMC and the Joint Associations (*i.e.*, EEI and EPSA) preferred keeping the enumerated hedges in Appendix A to part 150. CMC stated its understanding that an amendment to either Appendix A or the rule text would require the same formal rulemaking procedures.[329] The Joint Associations based their support of Appendix A because it allows for "for flexibility" in their view.[330]

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[325] As discussed below, proposed § 150.3(a)(1) would allow a person to exceed position limits for bona fide hedging transactions or positions, as defined in proposed § 150.1.
[326] 85 FR at 11622.
[327] MGEX at 2; FIA at 15-16.
[328] FIA at 16.
[329] CMC at 6.
[330] EEI/ EPSA at 5.

e. Discussion of Final Rule – Location and Regulatory Treatment of the Enumerated Bona Fide Hedges

Under the Final Rule, the enumerated bona fide hedges are incorporated as part of the regulatory text. While the Final Rule will maintain the enumerated bona fide hedges in Appendix A to part 150, Appendix A will be incorporated in final § 150.3 as positions that are deemed to be bona fide hedges that are self-effectuating for purposes of Federal position limits. In other words, while the Final Rule will maintain the enumerated bona fide hedges in Appendix A, Appendix A will be deemed to be part of the regulatory text rather than treated as acceptable practices as the Commission proposed in the 2020 NPRM.

The Commission agrees that including the enumerated bona fide hedges as part of the regulations, rather than as acceptable practices, provides market participants with greater regulatory certainty. To reflect that Appendix A to part 150 is part of the regulatory text, the Commission is amending the introductory language to the Appendix to remove any references to acceptable practices.

In addition, while not a substantive change, the Commission has also re-ordered the list of enumerated hedges. The Final Rule reorders Appendix A so that the bona fide hedges are listed by hedges of purchases, sales, anticipated activities, or other new types of hedges. Finally, the cross-commodity hedge, which applies to all the enumerated hedges in the appendix, is listed last.

viii. Elimination of Federal Restriction Prohibiting Holding a Bona Fide Hedge Exemption During Last Five Trading Days, the "Five-Day Rule;" Proposed Guidance in Appendix B, Paragraph (b)

a. Background – Elimination of the "Five-Day Rule;" Proposed Guidance in Appendix B, Paragraph (b)

Some of the existing enumerated bona fide hedge exemptions in § 1.3 include a restriction on the market participant holding a commodity derivative contract position in excess of Federal position limits during the last five days of trading (generally referred to as the "Five-Day Rule"). The restriction limits the applicability of exemptions during the last five days of trading because for many agricultural commodity derivative contracts, those last five days of trading coincide with the physical-delivery process. The practical effect of the Five-Day Rule is a winnowing of the universe of market participants who maintain large positions throughout the last five days of trading to only those market participants who actually intend to make or take delivery at the end of the spot period. Narrowing the universe of market participants in this way helps ensure an orderly trading environment and maintains the integrity of the physical-delivery process for those market participants who rely on price convergence between the cash and futures markets during the last days of trading.

When the Commission adopted the Five-Day Rule, it believed that, as a general matter, there was little commercial need to maintain a large position that exceeds position limits during or through the last five days of trading.[331]

b. Summary of the 2020 NPRM – Elimination of the "Five-Day Rule;" Proposed Guidance in Appendix B, Paragraph (b)

The Commission proposed to eliminate the restriction on holding a bona fide hedge exemption during the last five days of trading from all the enumerated hedges to which such five-day rule restriction applies under existing § 1.3.[332] Instead, under proposed § 150.5(a)(2)(ii)(D), exchanges could apply a restriction against holding positions under a bona fide hedge in excess of limits during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract, or

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

[332] The existing enumerated hedges limited by the Five-Day rule are as follows: unsold anticipated production, unfilled anticipated requirements, offsetting sales and purchases, and cross-commodity hedges.

otherwise limit the size of such position. The exchanges would thus have the ability and discretion, but not an obligation, to apply a five-day rule or similar restriction to exemptions on any contracts subject to Federal position limits, regardless of whether such contracts have been subject to Federal position limits before.

The 2020 NPRM also included guidance for exchanges on factors to consider when applying a restriction against holding physically delivered futures contracts into the spot month. The proposed guidance set forth in Appendix B, paragraph (b) provided that a position held during the spot period may still qualify as a bona fide hedging position, provided that: (1) the position complies with the bona fide hedging transaction or position definition; and (2) there is an economically appropriate need to maintain such position in excess of Federal speculative position limits during the spot period, and that need relates to the purchase or sale of a cash commodity.[333]

In addition, the guidance provided several factors the exchange should weigh when evaluating whether a person wishing to exceed Federal position limits should be able to do so during the spot period. For example, whether the person: (1) intends to make or take delivery during that period; (2) provided materials to the exchange supporting the waiver of the Five-Day Rule; (3) demonstrated supporting cash-market exposure in-hand that is verified by the exchange; (4) demonstrated that, for short positions, the delivery is feasible, meaning that the person has the ability to deliver against the short position;[334] and (5) demonstrated that, for long positions, the delivery is feasible, meaning that the person has the ability to take delivery at levels that are economically appropriate.[335]

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

[334] That is, the person has inventory on-hand in a deliverable location and in a condition in which the commodity can be used upon delivery and that it represents the best sale for that inventory.

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

c. Summary of the Commission Determination – Elimination of the "Five-Day Rule;" Proposed Guidance in Appendix B, Paragraph (b)

The Commission is finalizing the proposal to eliminate the restriction on holding a bona fide hedge exemption during the last five days of trading from all the enumerated hedges to which such Five-Day Rule restriction applies under existing § 1.3.

Additionally, the Commission has carefully considered the various comments regarding the proposed guidance in Appendix B, paragraph (b) and has determined to finalize the guidance, subject to several amendments and clarifications.

The Commission discusses and addresses comments on the proposed elimination of the Five-Day Rule immediately below, followed by a discussion of comments on the proposed guidance further below.

d. Comments – Elimination of the "Five-Day Rule;" Proposed Guidance in Appendix B, Paragraph (b)

(1) Elimination of the "Five-Day Rule"

Several public interest commenters opposed the elimination of the Five-Day Rule.[336] IATP viewed allowing the exchanges to impose a five-day rule or similar restriction as relegating the Commission's function to merely monitoring "DCM decisions and their consequences for market participants and the public after the fact."[337] Conversely, commercial market participants and exchanges generally supported the proposal to eliminate the Five-Day Rule and instead afford the exchanges the discretion whether to impose restrictions on holding physically-delivered contracts.[338]

(i) Discussion of the Final Rule – Elimination of the "Five-Day Rule"

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[336] IATP at 17-18; Better Markets at 61 (contending that if the CFTC does eliminate the Five-Day rule, it should at least formalize the proposed guidance in the rule text).

[337] IATP at 18.

[338] ADM at 3; Cargill at 8; CCI at 2, 9; CEWG at 4, 24; Chevron at 3, 9; CMC at 5; CME Group at 9; ICE at 2, 8; IFUS at 2; FIA at 3; NGFA at 9; NGSA at 2; Shell at 3; Suncor at 3, 12.

The Commission is finalizing the proposal to eliminate the restriction on holding a bona fide hedge exemption during the last five days of trading from all the enumerated hedges to which such Five-Day Rule restriction applies under existing § 1.3.

In place of the "Five-Day Rule," the Commission is finalizing proposed § 150.5(a)(2)(ii)(D), which provides that an exchange may grant exemptions, subject to terms, conditions, or restrictions against holding large positions in physically delivered futures contracts, as a bona fide hedge in excess of limits during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract, or otherwise limit the size of such position under that exemption.

For the legacy agricultural contracts, the Five-Day Rule has been an important way to help ensure that futures and cash-market prices converge. Price convergence helps protect the integrity of the price discovery function and facilitates an orderly delivery process, which overlaps with the last days of trading. As stated in the 2020 NPRM, however, a strict five-day rule may be inappropriate and unnecessary, as the Commission expands its Federal position limits beyond the nine legacy agricultural contracts.[339]

In particular, while the Commission continues to believe that the justifications described above for the existing Five-Day Rule remain valid for contracts subject to Federal position limits, the exchanges—subject to Commission oversight—are better positioned to decide whether to apply a restriction, such as the Five-Day Rule, in connection with exemptions to their own exchange-set limits, or whether to apply other tools that may be equally effective. This Final Rule affords exchanges with the discretion to apply, and when appropriate, grant exemptions subject to terms, conditions or limitations like the Five-Day Rule (or similar restrictions) for purposes of their own exchange-set limits. Allowing for such discretion when granting exemptions will afford

[339] 85 FR at 11612.

exchanges flexibility to quickly impose, modify, or waive any such limitation as circumstances dictate. While a strict Five-Day Rule may be inappropriate in certain circumstances, including when applied to energy contracts that typically have a shorter spot period than agricultural contracts,[340] the flexible approach adopted herein may allow for the development and implementation of additional solutions other than a Five-Day Rule that protect convergence, while minimizing the impact on market participants.

This approach allows exchanges to design and tailor a variety of limitations to protect convergence during the spot period. For example, in certain circumstances, a smaller quantity restriction, rather than a complete restriction on holding positions in excess of limits during the spot period, may be effective at protecting convergence. Similarly, exchanges currently utilize other tools to achieve similar policy goals, such as by requiring market participants to "step down" the levels of their exemptions as they approach the spot period, or by establishing exchange-set speculative position limits that include a similar step-down feature. Since § 150.5(a) as adopted herein would require that any exchange-set limits for contracts subject to Federal position limits must be less than or equal to the Federal limit, any exchange application of the Five-Day Rule, or a similar restriction, would have the same effect as if administered by the Commission for purposes of Federal speculative position limits, but could be administered by the exchange in a more tailored and efficient manner.

In response to commenters who stated this approach would relegate the Commission's functions to merely monitoring the DCMs' decisions after the fact, the Commission points out that regardless of whether there is a Federal Five-Day Rule, the Commission will continue to exercise oversight over exchanges before, during, and after exchange action relating to position limits. For example, all exchange rules, including those establishing/modifying exchange-set position limits, accountability levels, step

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

downs, and five-day rules and similar restrictions, must be submitted to the Commission in advance pursuant to part 40 of the Commission's regulations.

Additionally, any exemption granted by an exchange from its own position limits must meet standards established by the Commission in § 150.5(a)(ii)(C) of this Final Rule, including considering whether the requested exemption would result in positions that would not be in accord with sound commercial practices and/or would exceed an amount that may be established and liquidated in an orderly fashion. Further, any waiver of an exchange five-day rule or similar restriction should consider the Appendix B guidance adopted herein. Additionally, the Commission will continue to leverage its own market surveillance and oversight functions to ensure that exchanges continue to comply with their legal obligations, including with respect to Core Principles 2, 3, 4, and 5, among others.[341] Finally, under § 150.3(b)(6) finalized herein, the Commission continues to have the authority to revoke any bona fide hedge exemption.

(2) Proposed Guidance in Appendix B, Paragraph (b)

There were several comments on the proposed guidance in Appendix B, paragraph (b) regarding the circumstances when an exchange may grant waivers from any exchange-set five-day rule or similar restriction. A few commenters requested that the Commission eliminate the proposed guidance altogether.[342] IFUS stated that the proposed guidance is unnecessary and should be removed, contending that the guidance "reflects many of the considerations currently taken by [e]xchange staff when reviewing exemptions and spot month positions."[343] CME Group expressed a similar view, stating that in lieu of the proposed guidance, "the Commission should allow exchanges to

[341] 7 U.S.C. 7B-3(f)(4)(B); 7 U.S.C. 7B-3(f)(2); 7 U.S.C. 7B-3(f)(3); 7 U.S.C. 7B-3(f)(5).
[342] CMC at 5; CME Group at 9; IFUS at 10.
[343] IFUS at 3.

continue to rely on their established market surveillance expertise and regular interactions to make decisions around exemptions."[344]

Most commercial market participants and Better Markets,[345] however, did not request to eliminate the proposed guidance in Appendix B, paragraph (b), but instead requested certain changes or clarifications. These commenters focused on whether the guidance: (i) only applies to physically-settled contracts expressly designated by an exchange as subject to a five-day rule or similar restriction;[346] and (ii) is too prescriptive by imposing new documentation requirements on exchanges.[347] CME Group requested clarification on whether the proposed guidance applies to all exemptions or only those exemptions previously subject to a five-day rule.[348] Several energy market participants requested the Commission expressly clarify that the restrictions or guidance do not apply to markets for energy commodity derivatives.[349] Alternatively, these energy market participants stated that if the Commission declined to include in a final rule an express prohibition on the application of the Five-Day Rule to energy commodity derivative contracts, the Commission should clarify that an exchange is not bound to apply the waiver guidance to any physically-settled referenced contract that has not been expressly designated as subject to the Five-Day Rule.[350]

(i) Discussion of Final Rule – Appendix B, Paragraph (b)

The Commission has carefully considered the various comments regarding the guidance in Appendix B, paragraph (b) and has determined to finalize the guidance, subject to several amendments and clarifications, discussed below.

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[344] CME Group at 9.
[345] Better Markets supported the proposed guidance. Better Markets at 46-48.
[346] Chevron at 13-14; Suncor at 13-14; CCI at 9-10; CEWG at 25-26.
[347] CME Group at 9.
[348] *Id*.
[349] Chevron at 13.
[350] Chevron at 13; Suncor at 14; CCI at 9-10; CEWG at 25-26.

The Commission is not persuaded by requests to eliminate the guidance based on arguments that exchanges have current market surveillance practices or procedures to review the appropriateness of an exemption during the relevant referenced contract's spot period. The Commission continues to believe that the justifications described above for the existing Five-Day Rule remain valid. The Commission has determined, however, that with an expanded list of contracts subject to Federal position limits, it is best to provide the exchanges additional discretion when granting exemptions to protect their markets using tools other than a Five-Day Rule, and to supplement that discretion with guidance highlighting the importance of the spot month to ensure price convergence and an orderly delivery process.

For certain referenced contract markets, rather than imposing a complete restriction on holding positions in excess of limits during the spot period, an exchange may, when appropriate, grant an exemption which allows exceeding the position limit by a small increment. Such approach would be an effective way of protecting convergence while still maintaining orderly trading. Similarly, exchanges currently utilize other tools in administering their position limits. For example, CME and CBOT establish certain exchange-set speculative position limits that include a "step down" feature so that the permitted position limit level is lower each day as the contract nears its last trading days. Further, when granting position limit exemptions, exchanges may grant such exemptions subject to a "step down" level restriction as well. The Commission expects that exchanges would closely scrutinize any participant who requests recognition during the last five days of the spot period or in the time period for the spot month.

The Commission clarifies that any exchange, for the purposes of exchange-set position limits, that elects to grant an exemption subject to terms, conditions, or limitations, that restrict the size of a position during the time period for the spot month of a physically-settled contract under § 150.5(a)(2)(ii)(H) may do so on any referenced

contract subject to Federal position limits under the Final Rule, not just the nine legacy agricultural contracts. As such, the Commission clarifies for the avoidance of doubt that exemptions in energy contracts may be subject to an exchange's restriction aimed to monitor the spot period for that energy contract.

Since price convergence and an orderly trading environment serve as a deterrent or mitigate certain types of market manipulation schemes such as corners and squeezes, the guidance is intended to include a non-exclusive list of considerations the Commission expects the exchanges to consider when determining whether to allow a position in excess of limits throughout the spot month.

Regarding various comments contending that the proposed guidance was too prescriptive, the Commission reiterates the appendix is not intended to be used as a mandatory checklist. Further, the Commission is finalizing various amendments to Appendix B, paragraph b, to respond to commenters' requests.

First, the Commission is amending the introductory paragraph of the guidance to clarify that under § 150.5(a)(2)(ii)(H) as finalized herein, exchanges may impose restrictions on bona fide hedge exemptions in the spot month. This discretion does not require any express designation by the exchange.

Second, the Commission is modifying the proposed guidance to clarify that the guidance may be used when considering either an enumerated or non-enumerated bona fide hedge exemption. Third, the Commission clarifies here that the guidance imposes no additional reporting requirements on market participants as the factors described in the guidance apply simply to the exchanges' evaluation of the specific contract market when considering whether an exemption shall be granted subject to any condition or limitation in the spot month. Fourth, the Commission is eliminating the proposed factor which would have required a market participant to provide materials to the exchange supporting a classification of the position as a bona fide hedge. The Commission notes that the

exchange application requirements already require market participants to provide relevant cash-market information. In addition, the Commission is amending language throughout the guidance to clarify that exchanges have flexibility when considering applying the guidance. For example, the Commission is removing proposed language that would have required the exchange to verify the market participant's cash-market exposure. The Commission is comfortable removing this language because the cash-market information is already required as part of the exemption application process described elsewhere in this release.[351] Finally, the Commission is making technical edits to clarify that any delivery under a physical delivery contract is economically appropriate and the "most economical" source for that commodity.

ix. Guidance on Measuring Risk

a. Background – Measuring Risk

In prior proposals, the Commission discussed the issue of whether to recognize as bona fide both "gross hedging" and "net hedging."[352] While the Commission has previously expressed a willingness to consider gross hedging in certain limited circumstances, such proposals reflected the Commission's longstanding preference for net hedging.[353] That preference, although not stated explicitly in prior releases, has been underpinned by a concern that unfettered recognition of gross hedging could potentially allow for the cherry picking of positions in a manner that subverts the position limits rules.[354]

b. Summary of the 2020 NPRM – Measuring Risk

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[351] *See* Sections II.D. and II.G.

[352] 81 FR at 96747-96747.

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

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

The Commission recognized in the 2020 NPRM that additional flexibility to hedge on a gross basis may be warranted given that there are myriad ways in which organizations, particularly those not currently subject to Federal position limits, are structured and engage in commercial hedging practices.[355] For example, in the energy space, it is common for market participants to use multi-line business strategies where risks are managed by trading desk or business line rather than on a global basis. Accordingly, in an effort to clarify its view on this issue, the Commission proposed guidance on gross hedging positions in paragraph (a) to Appendix B.

The proposed guidance provided flexibility for a person to measure risk either on a net or gross basis, provided that: (A) the manner in which the person measures risk is consistent over time and follows the person's regular, historical practice (meaning the person is not switching between net hedging and gross hedging on a selective basis simply to justify an increase in the size of the person's derivatives positions); (B) the person is not measuring risk on a gross basis to evade the limits set forth in proposed § 150.2 and/or the aggregation rules currently set forth in § 150.4; (C) the person is able to demonstrate (A) and (B) above to the Commission and/or an exchange upon request; and (D) an exchange that recognizes a particular gross hedging position as a bona fide hedge pursuant to proposed § 150.9 documents the justifications for doing so and maintains records of such justifications in accordance with proposed § 150.9(d).

c. Summary of the Commission Determination – Measuring Risk

The Commission is adopting the proposed guidance with modifications and clarifications to address commenter concerns.

d. Comments – Measuring Risk

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[355] *See* 85 FR at 11613.

While Better Markets expressed concern that gross hedging could be used to conduct an "end-run" around position limits,[356] many other commenters expressed support for flexibility to hedge on a net or gross basis.[357] Multiple commenters who expressed support for such flexibility also requested discrete changes to the proposed guidance and/or associated preamble, including: (i) elimination of the requirement that exchanges document their justifications when allowing gross hedging;[358] (ii) clarification that gross hedging is permissible for both enumerated and non-enumerated hedges;[359] and (iii) clarification that market participants do not need to develop procedures setting forth when gross vs. net hedging is appropriate.[360] Finally, IFUS requested that the Commission eliminate the proposed guidance on the grounds that the guidance reflects considerations currently taken by exchange staff when reviewing exemptions.[361]

e. Discussion of Final Rule – Measuring Risk

The Commission continues to believe that the guidance on gross hedging is important because it will allow market participants to measure risk in the manner most suited to their particular circumstances, while preventing the use of gross hedging to subvert the Federal position limits regime.[362]

First, the Commission is eliminating proposed prong (D) of the guidance, which provided that an exchange that recognizes a gross position as a non-enumerated bona fide hedge pursuant to § 150.9 documents the justifications for doing so. Prong (D) is

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[356] Better Markets at 60.

[357] ASR at 2; LDC at 2; NGSA at 3; COPE at 3; Chevron at 4; Suncor at 4.

[358] MGEX at 3; FIA at 14; CEWG at 4.

[359] Chevron at 4-5; Suncor at 4-5; CCI at 4-5; CEWG at 7-10.

[360] FIA at 14-15 (stating that risk managers decide on a case-by-case basis whether to hedge on a net or gross basis).

[361] IFUS at 3.

[362] The guidance will help ensure the integrity of the position limits regime for the reasons discussed below in response to comments from Better Markets. The Commission thus disagrees with IFUS that the guidance is unnecessary, but agrees with IFUS that the proposed guidance reflects considerations currently taken by exchange staff. In particular, the guidance is consistent in many ways with the manner in which exchanges require their participants to measure and report risk, which is consistent with the Commission's requirements with respect to the reporting of risk. For example, under § 17.00(d), futures commission merchants ("FCMs"), clearing members, and foreign brokers are required to report certain reportable net positions, while under § 17.00(e), such entities may report gross positions in certain circumstances, including if the positions are reported to an exchange or the clearinghouse on a gross basis. 17 CFR 17.00. The Commission's understanding is that certain exchanges generally prefer, but do not require, their participants to report positions on a net basis. For those participants that elect to report positions on a gross basis, such exchanges require such participants to continue reporting that way, particularly through the spot period. Such consistency is a strong indicator that the participant is not measuring risk on a gross basis simply to evade regulatory requirements.

unnecessary given that the Commission and exchanges have other tools for accessing such information. In particular, prong (C) of the guidance allows the Commission and exchanges to request, on an as-needed basis, information about the manner in which market participants are measuring risk.[363] To ensure the Commission and exchanges have access to sufficient information in light of the removal of prong (D), the Commission is expanding prong (C) to require that a person also demonstrate, upon request by the Commission or an exchange, justifications for measuring risk on a gross basis. Additionally, the proposed prong (D) reference to the non-enumerated process in § 150.9 may have created confusion regarding the applicability of the proposed gross hedging guidance to enumerated hedges. Thus, the Commission is also revising the introductory language of the guidance to clarify that the guidance applies equally to enumerated and non-enumerated bona fide hedges.

Second, the Commission is clarifying that the guidance does not require market participants to develop written policies or procedures setting forth when gross or net hedging is appropriate. However, having such policies or procedures may help market participants demonstrate compliance with prongs (A), (B), and (C) of the guidance as finalized herein.

Finally, the Commission believes the concerns regarding subversion of position limits raised by Better Markets are already addressed by a combination of the guardrails in prongs (A)-(C) of the guidance as well as other Commission provisions, including some finalized herein. First, to receive recognition as a bona fide hedge, a position must comply with the bona fide hedging definition, regardless of whether the underlying risk is measured on a net or gross basis. A market participant thus may not use gross hedging to

[363] Additionally, market participants seeking exemptions remain subject to a variety of recordkeeping requirements, including Commission regulation § 1.31, and the Commission will receive information about all exchange-granted exemptions, including cash-market information, via the monthly spreadsheet submission required by § 150.5(a)(4).

receive bona fide hedge treatment for a speculative position,[364] and measuring risk on a gross basis to willfully circumvent or evade speculative position limits would potentially run afoul of the § 150.2(i)(2) anti-evasion provision finalized herein. Similarly, market participants must comply with the Commission's aggregation requirements regardless of whether the participants are measuring risk on a net or gross basis.[365]

Second, concerns about cherry-picking are addressed by the guidance. By focusing on consistency and historical practice with respect to the manner in which a person measures risk, the guidance enables market participants to measure risk on a gross basis when dictated by the nature of the exposure,[366] but not simply when utilizing gross hedging will yield a larger exposure than net hedging or will otherwise subvert Federal position limit or aggregation requirements. Use of gross or net hedging that is inconsistent with an entity's historical practice, or a change from gross to net hedging (or vice versa), could be an indication that an entity is seeking to evade position limits regulations.[367]

Third, all market participants seeking to exceed Federal position limits must request hedge exemptions at the exchange level, regardless of whether they are measuring risk on a gross or net basis, and regardless of whether they are seeking an enumerated or non-enumerated exemption at the Federal level. Under the Final Rule, the exchanges would have an opportunity to confirm whether such participants' use of gross

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[364] The introductory language to the guidance provides in relevant part that a person's "gross hedging positions may be deemed in compliance…*provided that* all applicable regulatory requirements are met, including that the position is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise and otherwise satisfies the bona fide hedging definition…"

[365] Under § 150.4, unless an exemption applies, a person's positions must be aggregated with positions for which the person controls trading or for which the person holds a 10% or greater ownership interest. Commission Regulation § 150.4(b) sets forth several permissible exemptions from aggregation. *See* Final Rule, Aggregation of Positions, 81 FR 91454, (December 16, 2016).

[366] The Commission continues to believe that a gross hedge may be a bona fide hedge in circumstances where net cash positions do not necessarily measure total risk exposure due to differences in the timing of cash commitments, the location of stocks, and differences in grades or types of the cash commodity. *See, e.g.*, Bona Fide Hedging Transactions or Positions, 42 FR at 14834. However, the Commission clarifies that these may not be the only circumstances in which gross hedging may be recognized as bona fide. Like the analysis of whether a particular position satisfies the proposed bona fide hedge definition, the analysis of whether gross hedging may be utilized would involve a case-by-case determination made by the Commission and/or by an exchange using its expertise and knowledge of its participants.

[367] If an entity's (including a vertically-integrated entity's) practice is to switch between net and gross hedging based on particular circumstances, and those circumstances do not involve evading position limits or aggregation requirements, then such switching would not run afoul of prong (A). *See* Section II.B.9. (discussing anti-evasion).

hedging is consistent with the proposed guidance, including by reviewing detailed position information. The Commission will also have access to such information through a variety of means, including: records maintained by market participants pursuant to Commission regulation § 1.31; the monthly spreadsheets that exchanges must submit to the Commission under § 150.5(a)(4) summarizing exchange-granted exemptions and related cash-market information; and the ability for the Commission to request such information directly from a market participant pursuant to prong (C) of the gross hedging guidance.

x. Pass-Through Swap and Pass-Through Swap Offset Provisions

a. Background - Pass-Through Swap and Pass-Through Swap Offset

As the Commission has noted above, CEA section 4a(c)(2)(B)[368] contemplates bona fide hedges that by themselves do not meet the criteria of CEA section 4a(c)(2)(A), but that are used to offset the swap exposure of a market participant (*e.g.*, a dealer) to the extent that the swap exposure does satisfy CEA section 4a(c)(2)(A) for such market participant's counterparty (*e.g.*, a commercial end user).[369] The Commission believes that, in affording bona fide hedging recognition for such offsets, Congress in CEA section 4a(c)(2)(B) intended to: (1) encourage the provision of liquidity to commercial entities that are hedging physical commodity price risk in a manner consistent with the bona fide hedging definition; and (2) only recognize risk management positions as bona fide hedges when such positions are opposite a bona fide hedging swap counterparty.[370] The Commission has proposed a pass-through swap provision in each of its position limits rulemakings since 2011.

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[368] 7 U.S.C. 6a(c)(2)(B).

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

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

b. Summary of the 2020 NPRM - Pass-Through Swap and Pass-Through Swap Offset

The Commission proposed to implement the statutory pass-through swap provision in paragraph (2) of the bona fide hedging definition for physical commodities in proposed § 150.1. Proposed paragraph (2)(i) of the 2020 NPRM's bona fide hedging definition addressed a situation where: (a) a particular swap qualifies as a bona fide hedge by satisfying the temporary substitute test, the economically appropriate test, and the change in value requirement under proposed paragraph (1) of the bona fide hedging definition for one of the counterparties (the "bona fide hedging swap counterparty"), but not for the other counterparty; and (b) the bona fide hedge treatment "passes through" from the bona fide hedging swap counterparty to the other counterparty (the "pass-through swap counterparty"). The pass-through swap counterparty could be an entity that provides liquidity to the bona fide hedging swap counterparty (such as a swap dealer or a non-dealer that offers swaps).

Under the 2020 NPRM, the pass-through of the bona fide hedge treatment from the bona fide hedging swap counterparty to the pass-through swap counterparty was contingent on: (1) the pass-through swap counterparty's ability to demonstrate upon request from the Commission and/or from an exchange that the pass-through swap is a bona fide hedge;[371] and (2) the pass-through swap counterparty entering into a futures, option on a futures, or swap position in the "same physical commodity" as the pass-through swap to offset and reduce the price risk attendant to the pass-through swap.

If the two conditions above were satisfied, then the bona fides of the bona fide hedging swap counterparty "pass through" to the pass-through swap counterparty for

[371] While the 2020 NPRM's proposed paragraph (2)(i) of the bona fide hedging definition in § 150.1 required the pass-through swap counterparty to be able to demonstrate the bona fides of the pass-through swap upon request, the 2020 NPRM did not prescribe the manner by which the pass-through swap counterparty obtains the information needed to support such a demonstration. The 2020 NPRM noted that the pass-through swap counterparty could base such a demonstration on a representation made by the bona fide hedging swap counterparty, and such determination may be made at the time when the parties enter into the swap, or at some later point. The 2020 NPRM also stated that for the bona fides to pass-through as described above, the swap position need only qualify as a bona fide hedging position at the time the swap was entered into.

purposes of recognizing as a bona fide hedge any futures position, option on futures position, or swap position entered into by the pass-through swap counterparty to offset the pass-through swap (*i.e.* to offset and reduce the risks of the swap opposite the bona fide hedging swap counterparty). The pass-through swap counterparty could thus exceed Federal position limits for both: (1) the swap opposite the bona fide hedging swap counterparty, if applicable; and (2) an offsetting futures position, option on a futures position, or swap position in the same physical commodity, even though any such offsetting position on its own would not qualify as a bona fide hedge for the pass-through swap counterparty under proposed paragraph (1) of the bona fide hedging transaction or position definition. The Commission clarified that once the original bona fide pass-through swap is settled, positions held under the pass-through swap provision must be liquidated in an orderly manner in accordance with sound commercial practices. Further, under proposed § 150.3(d)(2), a pass-through swap counterparty would be required to maintain any representation it relied on regarding the bona fide hedge status of the swap for at least two years.

Proposed paragraph (2)(ii) of the bona fide hedging definition addressed a situation where a market participant who qualifies as a bona fide hedging swap counterparty (*i.e.*, a counterparty with a position in a previously-entered into swap that qualified, at the time the swap was entered into, as a bona fide hedge under paragraph (1)) seeks, at some later time, to offset that bona fide hedge swap position using a futures position, option on a futures position, or a swap in excess of Federal position limits. Such step might be taken, for example, to respond to a change in the bona fide hedging swap counterparty's risk exposure in the underlying commodity.[372] Proposed paragraph (2)(ii) would allow such a bona fide hedging swap counterparty to use a futures position,

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

option on a futures position, or a swap in excess of Federal position limits to offset the price risk of the previously-entered into swap, even though the offsetting position itself does not qualify for that participant as a bona fide hedge under paragraph (1).

The proposed pass-through exemption under paragraph (2) of the bona fide hedging or transaction definition would only apply to the pass-through swap counterparty's offset of the bona fide hedging swap, and/or to the bona fide hedging swap counterparty's offset of its bona fide hedging swap. Any further offset would not be eligible for a pass-through exemption under paragraph (2) unless the offsetting position itself meets paragraph (1) of the proposed bona fide hedging definition.

The Commission stated in the 2020 NPRM that it believes the pass-through swap provision may help mitigate some of the potential impact resulting from the removal of the "risk management" exemptions that are currently in effect.[373]

c. Summary of the Commission Determination - Pass-Through Swap and Pass-Through Swap Offset; Related Recordkeeping Requirement; Cross-Commodity Hedging Under the Pass-Through Swap Provision

The Commission is finalizing the pass-through swap and pass-through swap offset provision of the "bona fide hedging transaction or position" definition largely as proposed, with certain amendments in response to commenters' requests discussed below:

First, the Commission is amending the 2020 NPRM's proposed provision that would have required that the pass-through swap counterparty demonstrate upon request that its offsetting position is attendant to a position resulting from a bona fide hedging pass-through swap. Instead, under the Final Rule, in order for a pass-through swap counterparty to treat a pass-through swap offset as a bona fide hedge, the pass-through swap counterparty must receive from the bona fide hedging swap counterparty a written

[373] *See supra* Section II.A.1.iii.a. (discussion of the temporary substitute test).

representation that the pass-through swap qualifies as a bona fide hedge. Under the Final Rule, the Commission is also amending the proposed regulatory text to add that the pass-through swap counterparty may rely in good faith on such written representation(s) made by the bona fide hedging swap counterparty, unless the pass-through swap counterparty has information that would cause a reasonable person to question the accuracy of the representation.

Second, the Commission is adopting a revised paragraph (i)(B) of the bona fide hedging transaction or position definition in §150.1 to delete the language in the pass-through swap provision that requires the offset to be in the "same physical commodity" as the pass-through swap.

d. Comments – Application of Pass-Through Swap Offset to Affiliates; Recordkeeping; Cross-Commodity Hedging Under the Pass-Through Swap Provision

Comments generally fell into three categories, each discussed in turn below: (1) application of pass-through swap offsets to affiliates; (2) pass-through recordkeeping requirements; and (3) pass through swaps and cross-commodity hedging.

(1) Application of Pass-Through Swap Offset to Affiliates

Commenters generally supported amending the bona fide hedge definition in accordance with the statutory language in CEA section 4a(c)(2)(B) to include a pass-through swap and pass-through swap offset.[374] Some commenters requested clarification on the application of the pass-through swap offset exemption to corporate affiliates. For example, Shell stated that an overly strict interpretation of "pass-through swap counterparty" may limit the application of the pass-through swap offset exemption to only one entity within a corporate structure, and such entity may not be the affiliate entity used by the firm for its market-facing activities or to execute transactions with exchanges

[374] CEWG at 4; CMC at 5-6; FIA at 3; ICE at 6-7; ISDA at 12-13; and Shell at 2, 4-5.

to manage portfolios and position limits on an aggregated basis.[375] NGSA similarly requested that the Commission's interpretation of a pass-through swap counterparty apply to affiliates who may pass through their bona fide hedge position exemption to a market-facing, "treasury-affiliate" subsidiary within a corporate structure.[376]

(i) Discussion of Final Rule - Application of Pass-Through Swap Offset to Affiliates

The Commission clarifies that within a group of entities that aggregates its positions under § 150.4[377] (such as an aggregated corporate group), any entity that is part of the aggregated group may avail itself of the pass-through swap offset exemption. For example, the pass-through swap offset provision extends to market-facing affiliates that are part of an aggregated group pursuant to § 150.4, such as treasury affiliate subsidiaries that firms commonly use to manage market-facing activities and portfolios. In such circumstances, recognition of a secondary pass-through swap transaction would not be necessary among an aggregated group because an aggregated group is treated as one person for purposes of Federal position limits.

Separately, in response to commenter requests to allow secondary pass throughs (*i.e.*, the further "pass-through" of a pass-through exemption from one entity to another), the Commission clarifies that outside the context of an aggregated group, additional positions entered into as an offset of a pass-through swap would not be eligible for a pass-through exemption under paragraph (2) of the bona fide hedging definition unless the offsetting position itself meets the bona fide hedging definition. Accordingly, the bona fides of a transaction will not extend to a third-party through the pass-through swap counterparty. For instance, if Producer A enters into an OTC swap with Swap Dealer B, and the OTC swap qualifies as a bona fide hedge for Producer A, then Swap Dealer B could be eligible for a pass-through exemption to offset that swap in the futures market.

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[375] Shell at 4.

[376] NGSA at 8.

[377] Aggregation of Positions, 81 FR 91454 (Dec. 16, 2016).

However, if Swap Dealer B offsets its swap opposite Producer A using an OTC swap with Swap Dealer C, Swap Dealer C would not be eligible for a pass-through exemption.

(2) Pass-Through Swap Provision and Recordkeeping

Commenters raised concerns with the 2020 NPRM's requirements that the pass-through swap counterparty document, and upon request, demonstrate the bona fides of the pass-through swap.[378] Commenters also requested that the Commission clarify the nature of the required documentation,[379] and/or eliminate the required demonstration/documentation altogether, provided that the pass-through swap counterparty has a legitimate, good-faith belief the swap is a bona fide hedge.[380]

(i) Discussion of Final Rule - Pass-Through Swap Provision and Recordkeeping

The Commission is amending the 2020 NPRM's proposed provision that would have required that the pass-through swap counterparty demonstrate upon request that its offsetting position is attendant to a position resulting from a bona fide hedging pass-through swap. For the Final Rule, the Commission is amending the pass-through swap provision's regulatory text to clarify that in order for a pass-through swap counterparty to treat a pass-through swap as a bona fide hedge, the pass-through swap counterparty must receive from the bona fide hedging swap counterparty a written representation that the pass-through swap qualifies as a bona fide hedge. The Commission is further amending the regulatory text to add that the pass-through swap counterparty may rely in good faith on such written representation(s) made by the bona fide hedging swap counterparty, unless the pass-through swap counterparty has information that would cause a reasonable person to question the accuracy of the representation. The Commission is adding the written representation requirement to enable to Commission to verify that only market

[378] Cargill at 10; FIA at 11-12; CMC at 5; Shell at 6-7; ICE at 6-7; and ISDA at 11-12.
[379] ICE at 6-7; Shell at 6.
[380] Cargill at 10; CMC at 5; FIA at 11-12; and ISDA at 11-12.

participants with bona fide hedge exemptions are able to pass-through those exemptions to their swap counterparties.

The Commission agrees with commenters who stated that the bona fide hedging counterparty is the suitable party to determine the bona fide hedging status of the pass-through swap. This is because the bona fide hedging status is determined based upon the bona fide hedging counterparty's confidential, proprietary information. The Commission clarifies that the Commission is not requiring the bona fide hedging counterparty to share the proprietary, confidential information upon which it is basing its determination with its counterparties.

Similar to the 2020 NPRM, this Final Rule does not prescribe the form or manner by which the pass-through swap counterparty obtains the written representation. The Commission recognizes that the bona fide hedging counterparty may make such representations on a relationship basis through counterparty relationship documentation (*e.g.*, through ISDA documentation or other forms of documentation as agreed upon by the parties) or on a transaction basis (*e.g.*, through trade confirmations or in other forms as agreed upon by the parties).[381]

For example, if agreed to by the counterparties, the pass-through swap counterparty may rely on a written representation made by the bona fide hedging swap counterparty that an original pass-through swap and any subsequent pass-through swaps entered into by and between the bona fide hedging swap counterparty and the pass-through swap counterparty are bona fide hedges, unless the bona fide hedging swap counterparty provides written notice to the pass-through swap counterparty that a particular swap is not a bona fide hedge. The Commission believes providing market participants with flexibility recognizes counterparties' ongoing relationships, while

[381] The Commission believes that allowing market participants to determine the form and manner of how they will document the written representation by the bona fide hedging counterparty and allowing the pass-through swap counterparty to rely on such representation addresses NRECA's comments on the pass-through swap provision recordkeeping obligations. NRECA at 23.

enabling the Commission to verify that the pass-through swap offset reduces the risks of a bona fide hedging swap.

The Commission considered comments requesting the elimination of the pass-through swap provision recordkeeping requirement in § 150.3(d) based on arguments that requiring this recordkeeping was not practical. The Commission is not persuaded by those arguments as the recordkeeping requirements assist the Commission in verifying that the pass-through swap provision is only being utilized to offset risks arising from bona fide hedges. Accordingly, the Commission is finalizing the proposed pass-through swap recordkeeping requirement in § 150.3(d), subject to certain conforming changes to reflect amendments to the pass-through swap paragraph of the bona fide hedging definition.

Since not all swaps entered into by a commercial entity would qualify as a bona fide hedge, the Commission declines commenters' requests that a pass-through swap counterparty may reasonably rely solely upon the fact that the counterparty is a commercial end user and, absent an agreement between the counterparties, that the swap appears to be consistent with hedges entered into by end users in the same line of business.

(3) Comments – Pass-Through Swap Provision and Cross-Commodity Hedging

Commenters requested amending paragraph (i)(B) of the proposed bona fide hedge definition to permit the pass-through swap provision to apply to cross-commodity hedges by eliminating the proposed requirement that the pass-through swap offset must be in the "same physical commodity" as the pass-through swap.[382]

(i) Discussion of Final Rule – Pass-Through Swap Provision and Cross-Commodity Hedging

[382] FIA at 13 (quoting 85 FR at 11614); Shell at 5 (quoting 85 FR at 11614).

The Commission is adopting a revised paragraph (i)(B) of the bona fide hedging transaction or position definition in §150.1 to delete the language in the pass-through swap provision that requires the offset to be in the "same physical commodity" as the pass-through swap. The Commission's enumerated cross-commodity bona fide hedge adopted herein thus applies to all the enumerated hedges, as well as to the pass-through swap provision in the bona fide hedge definition. The revised regulatory text confirms the Commission's intent to allow a pass-through swap counterparty to utilize the pass-through swap offset exemption when the offset itself is a cross-commodity hedge of the underlying pass-through swap, provided that such cross-commodity hedge meets all applicable requirements, including being substantially related to the commodity being offset.

2. "Commodity Derivative Contract"

i. Summary of the 2020 NPRM - Commodity Derivative Contract

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

ii. Comments and Summary of the Commission Determination - Commodity Derivative Contract

No commenter addressed the proposed definition of "commodity derivative contract." The Commission is adopting the definition as proposed, with some non-substantive technical modifications.

These technical changes include the Final Rule's reference to "futures contract" rather than merely "futures," and "swap" rather than "swap contract" to conform to other uses in final §150.1.[383]

3. "Core Referenced Futures Contract"

i. Summary of the 2020 NPRM - Core Referenced Futures Contract

The Commission proposed to create the term "core referenced futures contract" as a short-hand phrase to refer to the futures contracts listed in proposed § 150.2(d) to which the Federal position limit rules would apply.[384] As per the "referenced contract" definition described below, position limits would also apply to any contract that is directly or indirectly linked to, or that has certain pricing relationships with, a core referenced futures contract.

ii. Comments and Summary of the Commission Determination - Core Referenced Futures Contract

No commenter addressed the proposed definition of "core referenced futures contract." The Commission is adopting the definition as proposed.

4. "Economically Equivalent Swap"

i. Background - Economically Equivalent Swap

The Commission's existing regulations do not currently subject swaps to Federal position limits. Similarly, the Commission is unaware of any exchange-set limits for swaps on any of the 25 core referenced futures contracts. Pursuant to CEA section 4a(a)(5), when the Commission imposes position limits on futures and options on futures pursuant to CEA section 4a(a)(2), the Commission also must develop limits

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[383] The Commission notes that these technical changes are to conform more closely to CEA section 4a(a), which refers to "*contracts* of sale of such commodity for future delivery" (7 U.S.C. 6a(a)(1) (emphasis added)), "*contracts* of sale for future delivery" (7 U.S.C. 6a(a)(2)(A) (emphasis added)), or similar phraseology. Accordingly, the Commission is making the technical change to refer to "futures *contracts*" rather than merely "futures" in order to more closely conform to the CEA's terms. Similarly, CEA section 4a(a)(6) and section 1a(47) both refer to "swap" but not " swap *contract*," and so the Commission is making a similar conforming change.

[384] The selection of the proposed core referenced futures contracts is explained below in the discussions of § 150.2 at Section II.B. and the necessity finding *infra* at Section III.C.

"concurrently" and establish limits "simultaneously" for "economically equivalent" swaps "as appropriate."[385] As the statute does not define the term "economically equivalent," the Commission must apply its expertise in construing such term, and, as discussed further below, must do so consistent with the policy goals articulated by Congress, including in CEA sections 4a(a)(2)(C) and 4a(a)(3).

ii. Summary of the 2020 NPRM - Economically Equivalent Swap

The 2020 NPRM proposed a new term, "economically equivalent swap." Under the 2020 NPRM, a swap would be deemed an "economically equivalent swap" with respect to a referenced contract so long as the swap shared identical "material" contractual specifications, terms, and conditions with the referenced contract, and provided that any differences between the swap and referenced contract with respect to the following would be disregarded: (i) lot size or notional amount; (ii) for a swap and relevant referenced contract that are both physically-settled, delivery dates diverging by less than one calendar day, except for a physically-settled natural gas swap which could diverge by less than *two* calendar days; and (iii) post-trade risk management arrangements. Because the proposed "economically equivalent swap" definition referred to "referenced contracts," under the 2020 NPRM's approach a swap could be deemed to be "economically equivalent" to not just a core referenced futures contract, but also to any cash-settled look alike futures contract or option on a futures contract.[386]

iii. Comments and Discussion of Final Rule – Economically Equivalent Swap

a. The Inclusion of Certain Swaps Within the Federal Position Limits Framework

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[385] CEA section 4a(a)(5); 7 U.S.C. 6a(a)(5). In addition, CEA section 4a(a)(4) separately authorizes, but does not require, the Commission to impose Federal position limits on swaps that meet certain statutory criteria qualifying them as "significant price discovery function" swaps. 7 U.S.C. 6a(a)(4). The Commission reiterates, for the avoidance of doubt, that the definitions of "economically equivalent" in CEA section 4a(a)(5) and "significant price discovery function" in CEA section 4a(a)(4) are separate concepts and that contracts can be economically equivalent without serving a significant price discovery function. *See* 81 FR at 96736 (the Commission noting that certain commenters may have been confusing the two definitions).

[386] As discussed under the "referenced contract" definition, the term "referenced contract" includes core referenced futures contracts, linked cash-settled futures contracts, and options thereon. For further discussion, *see* Section II.A.16.

Many commenters generally supported the proposed definition.[387] However, other commenters argued that swaps should not be subject to Federal position limits at all[388] or that subjecting swaps to position limits would increase costs without commensurate benefits.[389] Nevertheless, several of these same commenters that stated that swaps should not be subject to Federal position limits also generally supported the proposed "economically equivalent swap" definition to the extent the Commission determined to include swaps within Federal position limits.[390] Similarly, IATP stated that it was unclear why swaps are part of the 2020 NPRM given the Commission's limited information on the swaps market.[391]

In response to these comments, as an initial matter, the Commission emphasizes that Congress has determined, through the Dodd-Frank Act's amendments to CEA section 4a(a)(5), that the Commission must develop Federal position limits for economically equivalent swaps "concurrently," and must establish such limits "simultaneously," with the Federal position limits for futures and options on futures. Accordingly, the Commission has determined that, as a legal matter, a swap that qualifies as "economically equivalent" to any referenced contract must be included within the Federal position limits framework.

While it did not oppose the proposed definition, NCFC expressed a similar concern with respect to the costs that the proposed definition could impose on commercial end users and small- and mid-sized FCMs. To mitigate these costs, NCFC suggested that any swap that qualifies for an exception to the Commission's clearing requirement under existing § 50.50 of the Commission's regulations should not be deemed to be an "economically equivalent swap." According to NCFC, such "swap

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[387] *E.g.*, AQR at 10; FIA at 2-3; NCFC at 5; Suncor at 2; SIFMA AMG at 7; ISDA at 5; Chevron at 2; CEWG at 3; Citadel at 6.

[388] SIFMA AMG at 6-8; IATP at 19.

[389] CHS at 4-5; NCFC at 5; SIFMA AMG at 6-7; and ISDA at 5.

[390] Chevron at 2; FIA at 2, 3, 5; MFA/AIMA at 3; SIFMA AMG at 7; Suncor at 2; AQR at 10-11; COPE at 3; Better Markets at 4; 31; NCFC at 5; ISDA at 5; CEWG at 3; and Citadel at 6.

[391] IATP at 19.

contracts already must meet the test 'to hedge or mitigate commercial risk,' and are 'not used for a purpose that is in the nature of speculation, investing, or trading,'" pursuant to § 50.50.[392] The Commission understands NCFC's concern, but believes NCFC's alternative is unnecessary for two reasons. First, to the extent a swap described by NCFC would "hedge or mitigate commercial risk," such swap likely would qualify for an enumerated bona fide hedge under the Final Rule and therefore would not contribute to a commercial end-user's net position for Federal position limits purposes.[393] Second, commodity swaps are not required to be cleared under the Commission's existing regulations, so determining whether the end-user clearing exemption applies is not necessarily a helpful proxy in determining whether a swap is "economically equivalent" for purposes of CEA section 4a(a)(5).

b. Statutory Basis for the Commission's "Economically Equivalent Swap" Definition

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

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[392] NCFC at 5-6.

[393] To the extent an FCM would not be able to qualify for a bona fide hedge, the Commission believes that excepting such swaps for purely financial firms would functionally have the same effect as maintaining the risk-management exemption, which Congress, through the Dodd-Frank Act's amendments to the CEA, has directed the Commission to eliminate. *See* Section IV.A.4.ii.a(1) (discussing elimination of the risk management exemption).

Accordingly, any definition of "economically equivalent swap" must consider these statutory objectives. The Commission also recognizes that swaps may include customized (*i.e.*, "bespoke") terms and are largely negotiated bilaterally and traded off-exchange (*i.e.*, OTC). In contrast, futures contracts have standardized terms and are generally exchange-traded or otherwise traded subject to the rules of an exchange. As explained further below, due to these differences between swaps and exchange-traded futures and related options, the Commission has preliminarily determined that Congress's underlying policy goals in CEA section 4a(a)(2)(C) and (3)(B) are best achieved by adopting a narrow definition of "economically equivalent swap," compared to the broader definition of "referenced contract."[394]

The "referenced contract" definition adopted in § 150.1 will include "economically equivalent swaps," meaning any economically equivalent swap is subject to Federal position limits. Thus, a swap that is deemed economically equivalent would be required to be added to, and could be netted against, as applicable, an entity's other referenced contracts in the same commodity for the purpose of determining one's aggregate positions for Federal position limits.[395] Any swap that is not deemed economically equivalent is not a referenced contract, and thus could not be netted with referenced contracts nor required to be aggregated with any referenced contract for Federal position limits purposes.

The Commission has determined that the "economically equivalent swap" definition adopted herein supports the statutory objectives in CEA section 4a(a)(3)(B)(i) and (ii) by helping to prevent excessive speculation and market manipulation, including

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

[395] *See infra* Section II.B.10. (discussion of netting).

corners and squeezes, respectively, by: (1) focusing on swaps that are the most economically equivalent in every significant way to the futures contracts and options on futures contracts for which the Commission deems position limits to be necessary;[396] and (2) limiting the ability of speculators to obtain excessive positions through netting. Any swap that meets the economically equivalent swap definition offers identical risk sensitivity to its associated referenced contract with respect to the underlying commodity, and thus could be used to effect a manipulation, benefit from a manipulation, or otherwise potentially distort prices in the same or similar manner as the associated futures contract or option on the futures contract. The Commission further has determined that the relatively narrow definition supports the statutory objective in CEA section 4a(a)(2)(C) by not causing price discovery to shift to trading in foreign markets.[397]

c. The Definition Balances Competing Statutory Goals and is Neither Too Broad nor Too Narrow

Several commenters argued that the proposed "economically equivalent swap" definition was too narrow and would therefore allow market participants to avoid Federal position limits.[398] In particular, CME Group and Better Markets requested the general "referenced contract" definition that applies to futures and options on futures also apply to swaps.[399] The Commission agrees with these commenters' general concerns that the "economically equivalent swap" definition should not allow market participants to avoid Federal position limits. In fact, the Commission believes that the approach adopted in this Final Rule achieves that goal better than the approach proposed by Better Markets

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

[397] For clarity, a swap may be eligible for treatment under the pass-through swap provision as either a pass-through swap or a pass-through swap offset, discussed above under the bona fide hedge definition, and not necessarily be deemed to be an "economically equivalent swap" since the pass-through swap provision focuses on whether the swap serves as a bona fide hedge to one of the counterparties. Similarly, status as an economically equivalent swap is not dispositive for treatment under the pass-through swap provision.

[398] CME Group at 3; NEFI at 3; Better Markets at 31-33 (generally arguing that the "economically equivalent swap" and "referenced contract" definitions should be consistent to prevent loopholes).

[399] CME Group at 3-4; Better Markets at 33-34 (arguing that excluding penultimate swaps creates a technical delineation that is largely divorced from the economic realities relating to physical commodities underlying both contracts).

and CME Group, first and foremost by preventing parties from using netting of swaps to create large positions in the futures market. The Final Rule's definition, compared to the relatively broader "referenced contract" definition that applies to futures and options on futures, better prevents inappropriate netting of market participants' positions and advances Congress's underlying policy goals in CEA section 4a(a)(2)(C) and (3)(B) for the following three reasons.

First, as the Commission stated above, it believes that a narrow "economically equivalent swap" definition that focuses on swaps with identical material terms and conditions reduces the ability of market participants to structure tangentially-related (*i.e.*, non-identical) swaps simply to net down large, speculative positions in excess of Federal position limits in futures or options on futures. Because referenced contracts in the same commodity are generally netted,[400] and because OTC swaps are bilaterally negotiated and customizable, market participants could structure swaps that do not necessarily offer identical risk or economic exposure or sensitivity simply to net down large positions in other referenced contracts. This is less of a concern with exchange-traded futures and related options, which are subject to exchange rules and oversight, and which have standardized terms, meaning they cannot be structured simply to net down large speculative positions in core referenced futures contracts.

The Commission recognizes as reasonable the concerns of CME Group and Better Markets that a relatively narrow "economically equivalent swap" definition, compared to a broader definition, could enable market participants to build excessive speculative risk exposure on one side of the market through OTC swap transactions. As discussed herein, the Commission is equally concerned that a broader definition similarly would permit a market participant to acquire a large position in a core referenced futures contract through

[400] *See* Section II.B.10. (discussing the application of netting).

inappropriate netting.[401] However, the Commission believes that a broader "economically equivalent swap" definition as advocated by these commenters also would be more likely to lead to the additional harms discussed below. Accordingly, while the Commission shares the same ultimate concerns as CME Group and Better Markets with respect to protecting market integrity, the Commission has determined that the relatively narrow definition concurrently protects market integrity while also better supporting the statutory directives in CEA sections 4a(a)(2)(C) and 4a(a)(3)(B) as discussed below.

Second, the Commission believes that the Final Rule's definition addresses statutory objectives by focusing Federal position limits on those swaps that pose the greatest threat for facilitating corners and squeezes. That is, the Final rule addresses those swaps with similar delivery dates and identical material economic terms to futures and options on futures subject to Federal position limits while also minimizing market impact and liquidity for bona fide hedgers for other positions and transactions. For example, if the Commission were to adopt a broader economically equivalent swap definition that included delivery dates that diverge by one or more calendar days, perhaps by several days or weeks, a liquidity provider (including a market maker or a speculator) with a large portfolio of swaps may be more likely to be constrained by the applicable position limits and therefore may have incentive either to minimize its swaps activity or move its swaps activity to foreign jurisdictions, resulting in reduced liquidity. If there were many similarly situated market participants, the market for such swaps could become less liquid, which in turn could harm liquidity for bona fide hedgers. As a result,

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[401] For example, a broader economically equivalent swap definition would allow a market participant to hold a long position in a physically-settled futures contract that exceeds the applicable Federal position limit levels by netting down with an "offsetting" short OTC swap, even if the swap has a different material term than the futures contract. That is, the "offsetting" short swap could have different delivery location(s), delivery date(s), quality differential(s), or even a different underlying commodity (depending on how broad the definition would be) than the physically-settled futures contract. Such an "offsetting" short swap would allow the market participant to more profitably engage in – and therefore more likely to successfully effect – a corner or squeeze in two respects. First, the "offsetting" short swap would allow the market participant to obtain a larger long futures position, thus creating a more dominant position on the long side of the market. Second, the "offsetting" short swap would allow the market participant to more easily "dispose" of or "bury the corpse" at smaller expense by enabling the market participant to deliver the underlying physical commodity, which the market participant received pursuant to its long physically-settled futures positions, under more profitable circumstances compared to the terms specified in the futures contract. For example, the "offsetting" short swap could allow the market participant to deliver the commodity (*i.e.*, "dispose of" or "bury the corpse") at a different, more profitable (or at least for less of a loss) delivery location and/or wait for more favorable delivery dates with more favorable prices.

the Commission has determined that the relatively narrow scope of the Final Rule's definition reasonably balances the factors in CEA section 4a(a)(3)(B)(ii) and (iii) by decreasing the possibility of illiquid markets for bona fide hedgers on the one hand while, on the other hand, focusing on the prevention of market manipulation during the most sensitive period of the spot month.

Third, the "economically equivalent swap" definition helps prevent regulatory arbitrage as required by CEA section 4a(a)(2)(C) and additionally will strengthen international comity. For example, if the Commission instead adopted a broader definition, U.S.-based swaps activity could potentially migrate to other jurisdictions with a narrower definition, such as the European Union ("EU"). In this regard, the Final Rule's definition is similar in certain ways to the EU definition for OTC contracts that are "economically equivalent" to commodity derivatives traded on an EU trading venue.[402] The Commission's "economically equivalent swap" definition thus furthers the statutory goals set forth in CEA section 4a(a)(2)(C), which requires the Commission to strive to ensure that any Federal position limits are "comparable" to foreign exchanges and will not cause "price discovery . . . to shift to trading" on foreign exchanges.[403] Further,

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[402] *See* EU Commission Delegated Regulation (EU) 2017/591, 2017 O.J. (L 87). The applicable EU regulations define an OTC derivative to be "economically equivalent" when it has "identical contractual specifications, terms and conditions, excluding different lot size specifications, delivery dates diverging by less than one calendar day and different post trade risk management arrangements." While the Final Rule's "economically equivalent swap" definition is similar, the Final Rule's definition requires "identical *material*" terms rather than merely "identical" terms. Further, the Final Rule's definition excludes different "lot size specifications or *notional amounts*" rather than referencing only "lot size" since swaps terminology usually refers to "notional amounts" rather than to "lot sizes." The Commission notes that SIFMA AMG argued in its comment letter that the Commission should adopt the economically equivalent swap definition proposed by the EU. *See* SIFMA AMG at 7. However, while the Commission's definition will be similar to the EU's definition, to the extent that the Commission's definition differs from the EU's by requiring "*material* identical" rather than merely "identical" terms, the Commission discusses its reasoning below.

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

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

[403] 7 U.S.C. 6a(a)(2)(C).

market participants trading in both U.S. and EU markets should find the Commission's and the EU's respective definitions to be familiar, which may help reduce compliance costs for those market participants that already have systems and personnel in place to identify and monitor such swaps.

Each element of the Final Rule's definition, including the exclusions from the definition, and related comments, is discussed below.

d. Scope of Identical Material Terms

Under the Final Rule's definition, only "material" contractual specifications, terms, and conditions are relevant to the analysis of whether a particular swap qualifies as an economically equivalent swap. The definition thus does not require that a swap be identical in all respects to a referenced contract in order to be deemed "economically equivalent" to that referenced contract. Under the Final Rule, "material" specifications, terms, and conditions are limited to those provisions that drive the economic value of a swap, including with respect to pricing and risk. Examples of "material" provisions include, for example: the underlying commodity, including commodity reference price and grade differentials; maturity or termination dates; settlement type (*i.e.*, cash-settled versus physically-settled); and, as applicable for physically delivered swaps, delivery specifications, including commodity quality standards and delivery locations.[404]

In addition, a swap that either references another referenced contract, or incorporates by reference the other referenced contract's terms, is deemed to share identical terms with the referenced contract and therefore qualifies as an economically

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

equivalent swap.[405] Any change in the material terms of such a swap, however, could render the swap no longer economically equivalent for Federal position limits purposes.

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

Accordingly, the Commission generally considers those swap contractual terms, provisions, or terminology (*e.g.,* ISDA terms and definitions) that are unique to swaps (whether standardized or bespoke) not to be material for purposes of determining whether a swap is economically equivalent to a particular referenced contract, even though such terms may be important when negotiating the swap or contribute to the valuation and/or the counterparties' risk analysis. For example, the following swap provisions or terms are generally unique to swaps and/or otherwise not material, and therefore are not to be dispositive for determining whether a swap is economically equivalent: designating business day or holiday conventions; day count (*e.g.,* 360 or actual); calculation agent; dispute resolution mechanisms; choice of law; or representations and warranties.[406]

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

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

Because the Commission considers settlement type to be a material "contractual specification, term, or condition," a cash-settled swap could only be deemed to be economically equivalent to a cash-settled referenced contract, and a physically-settled swap could only be deemed to be economically equivalent to a physically-settled referenced contract. However, a cash-settled swap that initially did not qualify as "economically equivalent" due to no corresponding cash-settled referenced contract (*i.e.*, no cash-settled look-alike futures contract) could subsequently become an "economically equivalent swap" if a cash-settled futures contract market were to develop.

Commenters had various views on the treatment of cash-settled and physically-settled swaps. First, certain commenters requested the Commission exclude physically-settled swaps from Federal position limits[407] or at least clarify the class of instruments that would be deemed to be physically-settled swaps.[408] Second, other commenters requested the opposite – that the Commission instead exclude cash-settled swaps from Federal position limits.[409] Third, Better Markets argued that differentiating between cash-settled and physically-settled swaps by including settlement type as a material term would "incentivize[] speculative liquidity formation away from more liquid, more transparent, and more restrictive futures exchanges and to the swaps markets."[410]

i. Treatment of Physically-Settled Swaps Under the Final Rule

Several commenters requested that the Commission exclude physically-settled swaps from Federal position limits,[411] or at least clarify the scope of physically-settled swaps that would be subject to Federal position limits.[412] However, the Commission has determined that doing so is inconsistent with the statutory goals in CEA section 4a(a)(3)(B), especially the mandates to deter corners and squeezes and to ensure

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[407] COPE at 4-5.
[408] ICEA at 3-5; NRECA at 19-20, 27.
[409] SIFMA AMG at 7; PIMCO at 3; and ISDA at 5.
[410] Better Markets at 32.
[411] COPE at 4-5.
[412] IECA at 3-5; NRECA at 1, 28.

sufficient market liquidity for bona fide hedgers enumerated in CEA section 4a(a)(3)(B)(ii) and (iii), respectively. For example, excluding physically-settled swaps could potentially incentivize liquidity to move from physically-settled core referenced futures contracts to physically-settled swaps, which could both harm market liquidity for bona fide hedgers and also enable potential manipulators to accumulate large directional positions in physically-settled contracts to effect a corner and squeeze more easily.

The Commission also received several comments requesting clarification regarding the Commission's use of the term "physically-settled" swaps in the 2020 NPRM's discussion of the definition.

First, COPE opined that since the 2020 NPRM excluded trade options from the "referenced contract" definition, as a result, only cash-settled swaps would be deemed to be "economically equivalent swaps" for purposes of Federal position limits. The Commission confirms that under the Final Rule, any swap that qualifies as a trade option under § 32.3 is *ipso facto* not subject to Federal position limits.[413] However, the Commission does not believe this means that only cash-settled swaps could be deemed "economically equivalent swaps." For example, it is possible that a physically-settled swap may not qualify as a trade option, and if it were to otherwise satisfy the "economically equivalent swap" definition, it therefore would be subject to Federal position limits.

Second, IECA and NRECA requested the Commission clarify what it means when using language referring to a "physically-settled swap," and suggested the Commission instead refer to a "swap that allows for physical settlement or delivery."[414] IECA stated that "using this term in place of the term 'physically-settled swaps' in the Commission's proposed rulemaking will help to avoid confusion and misinterpretation in

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[413] As discussed under Section II.A.16., the "referenced contract" definition explicitly excludes any "trade options that meets the requirements of § 32.3" of the Commission's regulations. Accordingly, a "trade option" is not subject to Federal position limits under the Final Rule, even if the trade option otherwise would satisfy the "economically equivalent swap" definition.

[414] IECA at 3-5; NRECA at 1, 28.

the future."[415] While the Commission is adopting the "economically equivalent swap" definition as proposed (which includes the reference to "delivery date"), the Commission agrees with IECA's statement and confirms that when the Commission refers to "physically-settled swaps" for the purpose of this definition, the Commission means a "swap that allows for physical settlement or delivery." The Commission agrees with IECA that referring to "swaps that allow for physical settlement or delivery" does not alter the Commission's intended meaning and may avoid confusion and misinterpretation.[416] However, the Commission will continue to refer to "physically-settled swaps" in this preamble discussion because the Commission believes that changing the term for discussion purposes herein, compared to the 2020 NPRM's preamble discussion, could raise additional confusion. Further, the Commission distinguishes between "cash-settled" and "physically-settled" referenced contracts throughout this preamble discussion, and using different terms to refer to swaps also could increase confusion.

IECA was concerned that the term "physically-settled swap" could suggest that the Commission was seeking to regulate a commodity for deferred delivery as a swap, which is otherwise excluded from the "swap" definition under CEA section 1a(47)(B)(ii). The Commission confirms that neither the use of "delivery dates" in the definition adopted herein nor the Commission's use of the term "physically-settled swaps" for the purposes of this preamble discussion is intended to capture instruments that are excluded from the Commission's jurisdiction either by statute (*e.g.*, the CEA's statutory exclusion of the sale of a non-financial commodity for deferred shipment or delivery that is intended to be physically-settled)[417] or otherwise not deemed to be swaps pursuant to the

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[415] IECA at 5.
[416] IECA at 4-5.
[417] *See* CEA section 1a(47)(B)(ii).

Commission's rules and regulations, interpretations, exemption orders, or other guidance.[418]

NRECA additionally requested the Commission clarify that the "economically equivalent swap" definition does not include any "customary commercial agreement, contract or transaction entered into as part of operations (so long as it is entered into off-facility and not involving a financial intermediary)."[419] As noted, to the extent such customary commercial agreement, contract, or transaction is exempt or excluded from either treatment as, or from the definition of, a "swap" by either statute or by the Commission's rules and regulations, interpretations, exemption orders, or other guidance, the Commission does not deem it to be an economically equivalent swap or otherwise subject to Federal position limits under the Final Rule.[420]

ii. Treatment of Cash-settled Swaps Under the Final Rule

The Commission also received several comments discussing the treatment of cash-settled swaps under the proposed "economically equivalent swap" definition. Several financial industry commenters argued that the Final Rule should include only physically-settled swaps and should exclude cash-settled swaps, contending that cash-settled swaps do not affect price discovery or contribute to manipulation.[421]

The Commission disagrees with the commenters' request to exclude cash-settled swaps from the final definition, as doing so could incentivize liquidity to move from cash-settled referenced contracts to cash-settled OTC swaps, potentially harming the liquidity in the futures markets, including liquidity for bona fide hedgers. At the very

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[418] *See* NRECA at 18-19. For clarity, and as requested by NRECA, the Commission notes that these "rules and regulations" include the Commission's trade option rule in § 32.3 as well as the Commission's forward contract exclusion (*i.e.*, the Brent forward exclusion) in 55 FR 39188-92 and 77 Fed. Reg. 48,208, 48,246 (August 13, 2012).

[419] NRECA at 16-20.

[420] For example, the Commission's swap definition excludes certain capacity contracts and peaking supply contracts that qualify as forward contracts with "embedded volumetric optionality." *See* Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48,246. Since such instruments are excluded from the Commission's regulatory "swap" definition, they *ipso facto* will not be deemed to be "economically equivalent swaps" for purposes of Federal position limits.

[421] SIFMA AMG at 7; PIMCO at 3; and ISDA at 5 (PIMCO and ISDA each believe neither cash-settled swaps nor cash-settled futures should be subject to position limits).

least, the Commission does not want to preference OTC cash-settled swaps at the expense of corresponding exchange-traded cash-settled futures or options on futures contracts.

In contrast, Better Markets objected to the proposed definition because, according to Better Markets, under the 2020 NPRM cash-settled swaps would not be able to qualify as economically equivalent to a physically-settled core referenced futures contract.[422] As Better Markets commented, distinguishing between cash-settled and physically-settled swaps and futures contracts by deeming settlement type (*i.e.*, cash-settled vs. physically-settled settlement) to be a material term would "incentivize[] speculative liquidity formation away from more liquid, more transparent, and more restrictive futures exchanges and to the swaps markets."[423]

The Commission believes Better Markets' concern is mitigated since under the Final Rule, cash-settled swaps are subject to Federal position limits only if there is a corresponding (*i.e.*, "economically equivalent") cash-settled futures contract or option on a futures contract.[424] That is, cash-settled swaps are not subject to Federal position limits if there are no corresponding cash-settled futures contracts or options on a futures contract. In these situations, if no corresponding futures contract or option thereon exists, then there is no liquidity formation in cash-settled futures and options on futures contracts with which a cash-settled swap would be competing for liquidity in the first place.

FIA argued that cash-settled swaps should be subject to a separate spot-month limit.[425] However, as discussed in II.A.16.ii.a., the Commission has determined that FIA's request to establish separate Federal position limits for cash-settled swaps is not, as a default rule, consistent with the statutory goals in CEA section 4a(a)(3)(B). In

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[422] Better Markets at 32 (stating that cash-settled swaps would be "essentially excluded from Federal position limits).

[423] *Id*.

[424] The Commission notes that a swap could be deemed to be "economically equivalent" to any referenced contract, including cash-settled look-alikes, and that the "economically equivalent swap" definition is not limited to core referenced futures contracts.

[425] FIA at 7-8.

particular, separate position limits for cash-settled swaps would make it easier for potential manipulators to engage in market manipulation, such as "banging" or "marking" the close, by effectively permitting higher Federal position limits in cash-settled referenced contracts. For example, a market participant would be able to double its cash-settled positions by maintaining positions in both cash-settled futures and cash-settled economically equivalent swaps since positions in each class would not be required to be aggregated for purposes of Federal position limits.

Furthermore, the Commission is concerned that class limits could impair liquidity in futures contracts or swaps, as the case may be. For example, a market participant (including a market maker or speculator) with a large portfolio of swaps (or futures contracts) near a particular class limit would be assumed to have a strong preference for executing futures contracts (or swaps) transactions in order to maintain a swaps (or futures contracts) position below the class limit. If there were many similarly situated market participants, the market for such swaps (or futures contracts) could become less liquid. The absence of class limits should decrease the possibility of illiquid markets for referenced contracts subject to Federal position limits. Because economically equivalent swaps and the corresponding futures contracts and option on futures contracts are close substitutes for each other, the absence of class limits should allow greater integration between the economically equivalent swaps and corresponding futures and options markets for referenced contracts and should also provide market participants with more flexibility whether hedging, providing liquidity or market making, or speculating.

e. Exclusions from the Definition of "Economically Equivalent Swap."

As noted above, the Final Rule's definition provides that differences in lot size or notional amount, delivery dates diverging by less than one calendar day (or less than two calendar days for natural gas), or post-trade risk management arrangements do not

disqualify a swap from being deemed "economically equivalent" to a particular referenced contract.

i. Delivery Dates Diverging by Less Than One Calendar Day

The definition as it applies to commodities (other than natural gas) encompasses swaps with delivery dates that diverge by less than one calendar day from that of a referenced contract.[426] As a result, a swap with a delivery date that differs from that of a referenced contract by one calendar day or more is not deemed economically equivalent under the Final Rule, and such swaps are not required to be added to, nor permitted to be netted against, any referenced contract when calculating compliance with Federal position limits.[427] For example, these include contracts commonly referred to as "penultimate" contracts, which settle on the trading day immediately preceding the final trading day of the corresponding core referenced futures contract.

In response to the definition's proposed exclusion of physically-settled penultimate swaps, Better Markets argued, among other things, that excluding penultimate swaps "creates technical delineations that are largely divorced from the economic realities relating to physical commodities underlying both contracts."[428] In response, the Commission recognizes that while a penultimate contract may be significantly correlated to its corresponding spot-month contract, a penultimate contract does not necessarily offer identical economic or risk exposure to the spot-month contract, and depending on the underlying commodity and market conditions, a market participant may open itself up to material basis risk by moving from the spot-month contract to a penultimate contract.[429]

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

[427] A swap as so described that is not "economically equivalent" would not be subject to a Federal speculative position limit under the Final Rule.

[428] Better Markets at 32.

[429] As discussed under Sections II.A.16.iii.a(2)(iii) and II.B.3.vi.c, the Final Rule includes penultimate look-alike futures contracts and options on futures contracts as "referenced contracts." Since futures contracts and options on futures contracts are standardized and exchange-traded, the Commission is less concerned about the potential for manipulation or evasion through inappropriate netting in this context.

Accordingly, the Commission has determined that it is not appropriate *ex ante* to permit market participants to net such penultimate swap positions (other than natural gas) against their core referenced futures contract positions since such positions do not necessarily reflect equivalent economic or risk exposure. However, the Commission underscores that under the Final Rule, a penultimate swap still could be deemed economically equivalent to the extent that another penultimate referenced contract exists (assuming the swap and other referenced contract share identical material terms and the swap otherwise satisfies the economically equivalent swap definition). For example, if a core referenced futures contract has a corresponding penultimate futures contract that qualifies as a referenced contract, then a penultimate swap could be deemed economically equivalent to the penultimate futures contract. In such cases, the penultimate swap would be an economically equivalent swap subject to Federal position limits.

The Commission acknowledges that liquidity could shift from the core referenced futures contract to penultimate swaps in cases where there are no corresponding penultimate futures contracts or options contracts (and therefore the swap would not be deemed to be an economically equivalent swap), but the Commission believes that this concern is mitigated for two reasons. First, basis risk may exist between the penultimate swap and the referenced contract, and so the Commission believes that a market participant is less likely to hold a penultimate swap the greater the economic difference compared to the corresponding referenced contract. Second, the absence of penultimate futures contracts or options contracts may indicate lack of appropriate penultimate liquidity to hedge or offset one's penultimate swap position and therefore may militate against entering into penultimate swaps. However, as discussed below, these reasons do not necessarily apply to penultimate swaps for natural gas.

ii. Post-Trade Risk Management

The Commission is specifically excluding differences in post-trade risk management arrangements, such as clearing or margin, in determining whether a swap is economically equivalent. As noted above, many commodity swaps are traded OTC and may be uncleared or cleared at a different clearing house than the corresponding referenced contract.[430] Moreover, since the core referenced futures contracts, along with futures and options on futures contracts in general, are traded on DCMs with vertically integrated clearing houses, as a practical matter, it is unlikely that OTC commodity swaps, which historically have been uncleared, would share identical post-trade clearing house or other post-trade risk management arrangements with their associated core referenced futures contracts. However, to the extent an OTC commodity swap does share the same clearing arrangements as a corresponding referenced contract, the Commission does not want to incentivize the switching of cleared swap contracts to non-cleared status for the sake of avoiding Federal position limits.

Therefore, if differences in post-trade risk management arrangements were sufficient to exclude a swap from economic equivalence to a core referenced futures contract, then such an exclusion could otherwise render ineffective the Commission's statutory directive under CEA section 4a(a)(5) to include economically equivalent swaps within the Federal position limits framework. Accordingly, the Commission has determined that differences in post-trade risk management arrangements should not prevent a swap from qualifying as economically equivalent with an otherwise materially identical referenced contract.[431]

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

[431] In addition, CEWG asked for clarification that the Commission would not extend certain preamble language in the 2020 NPRM addressing the exclusion of post-trade risk management arrangements from consideration when determining whether a swap is economically equivalent to support a finding that such swaps are actually off-exchange futures contracts rather than swaps. CEWG at 31. The Commission confirms that excluding post-trade risk management arrangements from the determination that a swap is economically equivalent does not extend to supporting a finding that such swaps are actually off-exchange futures contracts rather than swaps

iii. Lot Size or Notional Amount

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

f. Economically Equivalent Natural Gas Swaps

Market dynamics in natural gas are unique in several respects including, among other things, that ICE and NYMEX both list high volume contracts, whereas liquidity in other commodities tends to pool at a single DCM. As expiration approaches for natural gas contracts, volume tends to shift from the NYMEX NG core referenced futures contract that is physically-settled, to an ICE look-alike contract that is cash settled. This trend reflects certain market participants' desire for exposure to natural gas prices without having to make or take delivery.[432] NYMEX and ICE also list several "penultimate" cash-settled referenced contracts that use the price of the physically-settled NYMEX contract as a reference price for cash settlement on the day before trading in the physically-settled NYMEX contract terminates.[433]

In order to recognize the existing natural gas markets, which include active and vibrant markets in penultimate natural gas contracts, the Final Rule includes a slightly broader economically equivalent swap definition for natural gas so that physically-settled swaps with delivery dates that diverge by less than two calendar days from an associated

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

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

referenced contract could still be deemed economically equivalent and would be subject to Federal position limits. The Commission intends for this provision to prevent and disincentivize manipulation and regulatory arbitrage and to prevent volume from shifting away from the NYMEX NG core referenced futures contract to penultimate natural gas contract futures and/or penultimate swap markets in order to avoid Federal position limits.

As noted above, the Commission is adopting a relatively narrow "economically equivalent swap" definition in order to prevent market participants from inappropriately netting positions in referenced contracts against swap positions further out on the curve. The Commission acknowledges that liquidity could shift to penultimate swaps as a result but believes that, with the exception of natural gas, this concern is mitigated since there may be basis risk between the penultimate swap and the referenced contract and lack of liquidity to specifically hedge or offset one's penultimate swap position. However, compared to other contracts, the Commission believes that natural gas has a relatively liquid penultimate futures market that enables a market participant to hedge or set-off its penultimate swap position. The Commission believes that without the exception to the economically equivalent swap definition for natural gas swaps, liquidity otherwise could be incentivized to shift from the NYMEX NG core referenced futures contract to penultimate natural gas swaps in order to avoid Federal position limits.

CME Group stated in its comment letter that that these concerns also may apply to other energy core referenced futures contracts.[434] As a result, the Commission intends to observe the behavior in these other markets in response to the Final Rule, but the Commission understands that the natural gas markets are likely the most sensitive to these concerns based on the size of the corresponding natural gas penultimate market. As a result, the Commission is adopting the proposed exception for natural gas, but

[434] CME Group at 4.

emphasizes that it will continue to observe the other energy markets in order to determine the proper course of action with respect to those markets.

g. Determination of Economic Equivalence

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

MFA/AIMA requested that the Commission facilitate compliance by providing clearer guidance on terms that would be deemed material for determining which swaps are "economically equivalent."[435] Similarly, NCFC requested that the Commission adopt a "safe harbor" under which "demonstrable good faith compliance with respect to inadvertent violations would not serve as the basis for an enforcement action."[436] In response, the Commission emphasizes that under the Final Rule, a market participant will have the discretion to make such determination as long as the market participant makes a reasonable, good faith effort in reaching such determination. The Commission will not pursue any enforcement action for violating Federal position limits against such market participant with respect to such swaps positions as long as the market participant (i)

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[435] MFA/AIMA at 9.

[436] NCFC at 6.

performed the necessary due diligence and is able to provide sufficient evidence, if requested, to support its reasonable, good faith determination that the swap is or is not an economically equivalent swap and (ii) comes into compliance with the applicable Federal position limits within a commercially reasonable time, as determined by the Commission in consultation with the market participant, and if applicable, any relevant exchange.[437] The Commission anticipates that this should provide a greater level of certainty to provide market participants with the comfort they need to enter into swap positions, in contrast to the alternative in which market participants would be required to first submit swaps to the Commission staff and wait for feedback before entering into swaps.[438]

While the Commission will primarily rely on market participants to initially determine whether their swaps meet the proposed "economically equivalent swap" definition, the Commission is adopting paragraph (3) to the "economically equivalent swap" definition to clarify that the Commission may determine on its own initiative that any swap or class of swaps satisfies, or does not satisfy, the economically equivalent definition with respect to any referenced contract or class of referenced contracts. The Commission believes that this provision will provide the ability to offer clarity to the marketplace in cases where uncertainty exists as to whether certain swaps would qualify (or would not qualify) as "economically equivalent," and therefore would be (or would not be) subject to Federal position limits. Similarly, where market participants hold divergent views as to whether certain swaps qualify as "economically equivalent," the Commission can ensure that all market participants treat OTC swaps with identical

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[437] As noted below, the Commission reserves the authority under the Final Rule to determine that a particular swap or class of swaps either is or is not "economically equivalent" regardless of a market participant's determination. *See infra* Section II.A.4.iii.g. (discussion of commission determination of economic equivalence). As long as the market participant made its determination, prior to such Commission determination, using reasonable, good faith efforts, the Commission would not take any enforcement action for violating the Commission's position limits regulations if the Commission's determination subsequently differs from the determination of the market participant and the market participant comes into compliance with the applicable Federal position limits within a commercially reasonable time, as determined by the Commission in consultation with the market participant, and if applicable, any relevant exchange.

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

material terms similarly, and serve as a backstop in case market participants fail to properly treat economically equivalent swaps as such. As noted above, the Commission will not take any enforcement action with respect to violating the Commission's position limits regulations if the Commission disagrees with a market participant's determination as long as the market participant is able to provide sufficient support to show that it made a reasonable, good faith effort in applying its discretion.[439]

Better Markets encouraged the release of additional guidance, suggesting that the Commission should delegate its authority to the DMO Director to issue guidance with respect to specific types of terms and conditions, and noting that the proposed process for the Commission to provide clarification is cumbersome.[440] The Commission does not believe such delegation is necessary since Commission staff will continue to have the ability to offer informal guidance as well as formal no-action relief or interpretive guidance as needed.

Better Markets also suggested that in order to ensure market participants conduct proper diligence, the Commission should clarify and codify that a swap dealer must include an appendix in its reasonably-designed policies and procedures under existing § 23.601 that identifies swaps "in any manner" referencing commodities subject to Federal position limits, regardless of whether the entity deems the swap to be "economically equivalent."[441] In contrast, ISDA believed the obligations in § 23.601 impose costs that are overly burdensome and are not commensurate with benefits.[442] ISDA stated that further guidance is necessary, but noted that even if further guidance is provided, the regime would still impose unnecessary burdens on swap dealers.[443] ISDA requested the

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[439] *See supra* Section II.A.4. (discussing market participants' discretion in determining whether a swap is economically equivalent).
[440] Better Markets at 34.
[441] Better Markets at 34.
[442] ISDA at 10.
[443] *Id*.

Commission consider including further clarification and/or interim relief for swap dealers.[444]

At this time, the Commission does not believe it is necessary to provide further detail with respect to § 23.601 because, as discussed above, the Commission will defer to a market participant's determination as long as the market participant is able to provide sufficient support to show that it made a reasonable, good faith effort in applying its discretion.[445]

h. Phased Implementation of Federal and Exchange-set Limits on Swaps

As discussed under Section I.D., the Final Rule generally gives market participants until January 1, 2022 to comply with Federal position limits for the 16 non-legacy referenced contracts that are subject to Federal position limits for the first time under the Final Rule, and the Final Rule provides an extra year to comply with respect to economically equivalent swaps (January 1, 2023). After such compliance period, economically equivalent swaps will be subject to Federal position limits. In general, commenters supported a phase-in for such swaps.[446]

As discussed further under Section II.D.4.i, final § 150.5 requires exchanges to establish and enforce exchange-set limits for any referenced contract, which includes economically equivalent swaps. The Commission has determined to permit exchanges to delay enforcing their respective exchange-set position limits on economically equivalent swaps at this time. Specifically, with respect to exchange-set position limits on swaps, the Commission notes that in two years (which generally coincides with the compliance date for economically equivalent swaps), the Commission will reevaluate the ability of exchanges to establish and implement appropriate surveillance mechanisms to implement

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[444] *Id*.

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

[446] MFA/AIMA at 8 (requesting an additional 6-12 months phase-in); SIFMA AMG at 9 (requesting an additional 6-12 months); Citadel at 9 (requesting an additional 6 months); and NGSA at 15-16 (requesting a general phase-in in order "to avoid the risk of harm to market recovery and to facilitate efficiency in market participant implementation").

DCM Core Principle 5 and SEF Core Principle 6 with respect to economically equivalent swaps. However, after the swap compliance date (January 1, 2023), the Commission underscores that it will enforce Federal position limits in connection with OTC swaps.

In response to the Commission's proposal to allow exchanges to delay enforcing exchange-set position limits on swaps, IATP opined that the Commission's decision to "[d]elay compliance with position limit requirement [sic] to avoid imposing costs on market participants makes it appear that the Commission is serving as a swap dealer booster, although swaps dealers are amply resourced to provide the necessary data to the exchanges and to the Commission. The Commission is bending over backward to avoid requiring swaps market participants from paying the costs of exchange trading."[447] However, the Commission stated in the same section of the 2020 NPRM that it would enforce Federal position limits on swaps even though it would not require exchanges to enforce position limits on swaps until the Commission determines that exchanges have had the opportunity to access swaps data and establish appropriate swaps oversight infrastructure.[448] Additionally, the Commission notes that physical commodity swaps are not subject to the Commission's trade execution mandate to trade on exchanges, and the Commission understands that most physical commodity swaps are traded OTC rather than on exchanges. Accordingly, the Commission's rationale for delaying the requirement that exchanges enforce position limits for swaps is based on *exchanges'* existing capabilities and lack of insight into the OTC swaps markets, rather than for swap dealers who will remain subject to Federal position limits and Commission oversight.[449]

i. Cross-Border Application

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[447] IATP at 20.

[448] The 2020 NPRM stated, "Nonetheless, the Commission's preliminary determination to permit exchanges to delay implementing Federal position limits on swaps could incentivize market participants to leave the futures markets and instead transact in economically-equivalent swaps, which could reduce liquidity in the futures and related options markets, although the Commission recognizes that this concern should be mitigated by the reality that *the Commission would still oversee and enforce Federal position limits on economically equivalent swaps*." (emphasis added). 85 FR at 11680.

[449] The Commission also notes that IATP quotes from the cost-benefits considerations section of the 2020 NPRM, and thus the Commission's focus on benefits and costs to exchanges and market participants in the excerpt quoted by IATP.

Several commenters opined that the Commission should address the cross-border application of the Final Rule, including in connection with OTC swaps.[450]

In response, the Commission makes three observations. First, as discussed above regarding the treatment of physically-settled swaps, if a swap is otherwise excluded from the Commission's jurisdiction either by statute or pursuant to the Commission's rules and regulations, interpretations, exemption orders, or other guidance, then the swap is not subject to Federal position limits. Accordingly, while related, this determination is distinct from the Final Rule's position limits framework. Second, the Final Rule provides a compliance period for economically equivalent swaps until January 1, 2023. Accordingly, the Commission and its staff expect to continue to discuss the status of OTC swaps with market participants during this compliance period and provide additional feedback as necessary based on the individual facts and circumstances. Third, to a certain extent, some of the comments are more related to the position limit aggregation rules in existing § 150.4, which was finalized in 2016.[451] Moreover, the 2020 NPRM did not discuss cross-border application, which is therefore beyond the scope of this rulemaking.

5. "Eligible Affiliate"

i. Summary of the 2020 NPRM - Eligible Affiliate

The Commission proposed to create the new defined term "eligible affiliate" to be used in proposed § 150.2(k). As discussed further in connection with § 150.2, an entity that qualifies as an "eligible affiliate" would be permitted to voluntarily aggregate its positions, even though it is eligible for an exemption from aggregation under § 150.4(b).[452]

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[450] FIA at 27-28; ISDA at 11; CHS at 6 ("CHS believes that global organizations should be in a position to better understand the Commission's approach with respect to the cross–border application of the rules to referenced contract positions. In CHS's view, the proposal does not address whether and how global companies must aggregate referenced contract positions of affiliates around the world. As part of the retooling of the position limit regime, CHS urges the Commission to address such an application").

[451] For further discussion related to the position limits aggregation rules, *see* Section II.B.11.

[452] *See* Section II.B.11.

ii. Comments and Summary of the Commission Determination - Eligible Affiliate

The Commission received no comments on this definition and is adopting it as proposed with certain technical changes. The Commission is making these technical changes to clarify the antecedent to the use of "its" and "such entity" in the definition. The Commission expects these changes will clarify the definition, but do not represent a substantive change in the meaning.

6. "Eligible Entity"

i. Summary of the 2020 NPRM - Eligible Entity

The Commission adopted a revised "eligible entity" definition in the 2016 Final Aggregation Rulemaking.[453] The Commission proposed no further amendments to this definition, but is including the revised definition in this Final Rule given that the definitions for part 150 are set forth or restated in § 150.1, thus ensuring that all defined terms are included. As noted above, the Commission also proposed a non-substantive change to remove the lettering from this and other definitions that appear lettered in existing § 150.1, and to list the definitions in alphabetical order.

7. "Entity"

i. Summary of the 2020 NPRM - Entity

The Commission proposed defining "entity" to mean "a 'person' as defined in section 1a of the Act."[454] The term "entity," not defined in existing § 150.1, is used throughout proposed part 150 of the Commission's regulations.

ii. Comments - Entity

The Commission received two comments that recommended clarification of the proposed definition of "entity."[455] FIA and MGEX contended the proposed definition of "entity" should not cross-reference the definition of "person" in section 1a of the CEA

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[453] *See* 17 CFR 150.1(d).
[454] 7 U.S.C. 1a(38).
[455] FIA at 26; MGEX at 2.

because the CEA defines "person" to include individuals (*i.e.*, natural persons), as well as entities.[456] MGEX argued that the definition of "entity" should not apply to individuals.[457] FIA stated that, for purposes of the 2020 NPRM, it is unclear whether the cross-reference to the definition of "person" in section 1a of the CEA is meant to be limited to non-natural persons.[458] If so, FIA recommended that the Commission amend the definition of "entity" to refer only to the non-natural persons listed in the definition of "person" under section 1a of the CEA.[459] Further, FIA suggested that provisions in part 150 that are applicable to both natural and non-natural persons should refer to "persons" and those that apply to only non-natural persons should refer to "entity."[460]

iii. Discussion of Final Rule - Entity

The Commission declines to adopt the commenters' suggestion to carve "individuals" out of the proposed definition of "entity" or to otherwise differentiate between "person(s)" and "entity(ies)" for purposes of part 150 of the Final Rule. The proposed definition of "entity" expressly included "individuals" and neither commenter explained why individuals should be excluded from the definition and why the CEA's statutory definition of "person" is inappropriate. Accordingly, the Commission is adopting the definition of "entity" as proposed.

8. "Excluded Commodity"

i. Summary of the 2020 NPRM - Excluded Commodity

The phrase "excluded commodity" is defined in CEA section 1a(19), but is not defined or used in existing part 150 of the Commission's regulations. The Commission proposed including a definition of "excluded commodity" in part 150 that references that term as defined in CEA section 1a(19).[461]

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[456] *Id.*
[457] MGEX at 2.
[458] FIA at 26.
[459] *Id.*
[460] *Id.*
[461] 7 U.S.C. 1a(19).

ii. Comments and Summary of the Commission Determination - Excluded Commodity

No commenter addressed the proposed definition of "excluded commodity." The Commission is adopting the definition as proposed.

9. "Futures-Equivalent"

i. Background - Futures-Equivalent

The phrase "futures-equivalent" is currently defined in existing § 150.1(f) and is used throughout existing part 150 of the Commission's regulations to describe the method for converting a position in an option on a futures contract to an economically equivalent amount in a futures contract. The Dodd-Frank Act amendments to CEA section 4a, in part, direct the Commission to apply aggregate Federal position limits to physical commodity futures contracts and to swap contracts that are economically equivalent to such physical commodity futures contracts.

ii. Summary of the 2020 NPRM - Futures-Equivalent

In order to aggregate positions in futures, options[462] on futures, and swaps for purposes of calculating compliance with the Federal position limits set forth in the 2020 NPRM, the Commission proposed adjusting position sizes to an equivalent position based on the size of the unit of trading of the relevant core referenced futures contract. The phrase "futures-equivalent" is used for that purpose throughout the 2020 NPRM, including in connection with the "referenced contract" definition in proposed § 150.1. The Commission also proposed broadening the existing "futures-equivalent" definition to include references to the proposed new term "core referenced futures contracts." Additionally, with respect to options, the proposed "futures-equivalent" definition also provided that a participant that exceeds Federal position limits as a result of an option assignment would be allowed a one-day grace period to liquidate the excess position.

[462] As stated in this definition, the term "option" includes an option on a futures contract and an option that is a swap.

iii. Commission Determination - Futures-Equivalent

The Commission is adopting the proposed definition of "futures-equivalent" with one substantive modification: in addition to the 2020 NPRM's grace period in connection with position limit overages dues to option assignments, under the Final Rule, the one-day grace period would also extend to an option position that exceeds Federal position limits as a result of certain changes in the option's exposure to price changes of the underlying referenced contract, as long as the applicable option contract does not exceed such position limits under the previous business day's exposure to the underlying referenced contract. This grace period does not apply on the last day of the spot month for the corresponding core referenced futures contract.

As discussed further below, the Final Rule also includes several technical changes, including referring to an option's "exposure" to price changes of the underlying referenced contract and eliminating references to an option's "risk factors" and "delta coefficient." As discussed below, the Commission believes these changes will add flexibility in assessing exposure to price changes of an option to the underlying futures contract and are not intended to reflect a substantive difference.

iv. Comments - Futures-Equivalent

Several commenters supported the proposed definition, including the one-business-day grace period related to position limit overages due to options assignments.[463] In addition to supporting the proposed definition, CME Group and ICE both supported expanding the proposed definition's one business day grace period to include Federal position limit overages resulting from changes in the option's delta coefficient, noting that such a change is consistent with their respective exchange rules.[464]

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[463] MFA/AIMA at 11; CME Group at 14; FIA at 26; and IFUS Exhibit 1 RFC 23.

[464] CME Group MRAN 1907-5 states that "[i]f a position exceeds position limits as a result of an option assignment, the person who owns or controls such position shall be allowed one business day to liquidate the excess position without being considered in violation of the limits. Additionally, if, at the close of trading, a position that includes options exceeds position limits when evaluated using the delta factors as of that day's close of trading, but does not exceed the limits when evaluated using the previous day's delta factors, then the position shall not constitute a position limit violation." *See* CME Group Market Regulation Advisory Notice RA1907-5 (Aug.

However, CME Group noted that exercising an in-the-money option that results in a position over the position limit should be treated as a violation if the futures-equivalent position was over the position limit based on both the previous and current day's delta.[465]

FIA sought clarification from the Commission on certain aspects of the proposed definition. FIA stated that it is unclear how a spread contract that qualifies as a referenced contract would be converted to a futures-equivalent position.[466] FIA also requested the Commission clarify which calculation method applies to swaps and options that are swaps.[467]

v. Discussion of Final Rule - Futures-Equivalent

The Commission agrees with CME Group and ICE that the one-business-day grace period also should apply to position overages in connection with changes in the current day's option's exposure to price changes of the underlying referenced contract (*e.g.*, option delta coefficient). The Commission understands that providing a one business day grace period for these situations is consistent with existing market practice. Further, consistent with CME Group's comment, a market participant will not have a grace period if the market participant's position also exceeded Federal position limits based on the previous day's exposure (including option delta coefficient). To alleviate concerns about delivery and to help prevent corners and squeezes, this one-day grace period does not apply on the last trading day of the spot month of the option's corresponding core referenced futures contract.

Additionally, the Commission is eliminating references to an option's "risk factor" and "delta co-efficient" and instead referring to an option's "exposure" to price changes of the underlying referenced contract.

2, 2019), available at: https://www.cmegroup.com/content/dam/cmegroup/notices/market-regulation/2019/08/RA1907-5.pdf; IFUS Rule 6.13(a) similarly provides persons one business day to bring into position limits compliance any position that exceeds limits due to changes in the deltas of the options, or as the result of an option assignment.

[465] CME Group at 14.

[466] FIA at 7.

[467] FIA at 6-7.

The Commission understands that the term "exposure" in the present context is more commonly used by market participants. Accordingly, the Commission believes that the reference to an option's "exposure" to price changes of the underlying referenced contract is the technically correct term to use over "risk factor" or "delta coefficient," which are used in the existing "futures-equivalent" definition. However, the Commission's use of "exposure" here is meant to encompass the concepts of "risk factor" and "delta co-efficient." As a result, the Commission believes that this change provides flexibility, and is consistent with existing market practice and understanding, in assessing the exposure of an option to the price movement of futures contract and is not intended to reflect a substantive change.

Additional technical changes include the Final Rule's reference to "futures contract" rather than merely "futures" and "entity" rather than "participant" since the former terms conform to other uses in final §150.1. The Final Rule also makes several technical changes in connection with the use of "computed" in the definition, and these changes are meant to clarify the meaning rather than imply a substantive change.

With respect to FIA's request for clarification regarding how a spread contract that qualifies as a referenced contract would be converted to a futures-equivalent position, the Commission recognizes the inherent challenge with converting a spread contract that qualifies as a referenced contract to a futures-equivalent position.[468] The Commission expects that a market participant will adjust such a spread contract to a futures-equivalent position consistent with existing exchange practice.

With respect to FIA's question regarding the calculation for swaps and options that are swaps, subparagraph (1) of the futures-equivalent definition applies to an option that is a swap, and subparagraph (3) of the definition applies to a swap that is not an option.

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[468] FIA at 7.

10. "Independent Account Controller"

i. Summary of the 2020 NPRM - Independent Account Controller

The Commission adopted a revised "independent account controller" definition in the 2016 Final Aggregation Rule.[469] The Commission proposed no further amendments to this definition, but included that revised definition in the 2020 NPRM so that all defined terms appeared together.

11. "Long Position"

i. Summary of the 2020 NPRM - Long Position

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

ii. Comments and Summary of the Commission Determination - Long Position

No commenter addressed the proposed definition of "long position." The Commission is adopting the definition as proposed.

12. "Physical Commodity"

i. Summary of the 2020 NPRM - Physical Commodity

The Commission proposed to define the term "physical commodity" for position limits purposes. Congress used the term "physical commodity" in CEA sections 4a(a)(2)(A) and 4a(a)(2)(B) to mean commodities "other than excluded commodities as defined by the Commission."[470] The proposed definition of "physical commodity" thus included both exempt and agricultural commodities, but not excluded commodities.

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

[470] 7 U.S.C. 6a(a)(2)(A) and (B).

ii. Comments and Summary of the Commission Determination - Physical Commodity

No commenter addressed the proposed definition of "physical commodity." The Commission is adopting the definition as proposed.

13. "Position Accountability"

i. Summary of the 2020 NPRM - Position Accountability

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

ii. Comments and Summary of the Commission Determination - Position Accountability

No commenter addressed the proposed definition of "position accountability." The Commission is adopting the definition as proposed with some non-substantive technical changes related to the numbering structure. The Commission is also changing the reference of "trader" to "entity" since "entity" is the proper defined term in § 150.1 under the Final Rule while "trader" is not a defined term under §150.1.

14. "Pre-Enactment Swap"

i. Summary of the 2020 NPRM - Pre-Enactment Swap

The Commission proposed to create the defined term "pre-enactment swap" to mean any swap entered into prior to enactment of the Dodd-Frank Act of 2010 (July 21, 2010), the terms of which had not expired as of the date of enactment of the Dodd-Frank Act. As discussed in connection with proposed § 150.3 later in this release, if acquired in good faith, such swaps would be exempt from Federal position limits, although such

swaps could not be netted with post-effective date swaps for purposes of complying with spot month Federal position limits.

ii. Comments and Summary of the Commission Determination - Pre-Enactment Swap

No commenter addressed the proposed definition of "pre-enactment swap." The Commission is adopting the definition as proposed. For further discussion of the treatment of pre-existing positions, see Sections II.B.7. and II.C.7.

15. "Pre-Existing Position"

i. Summary of the 2020 NPRM - Pre-Existing Position

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

ii. Comments and Summary of the Commission Determination - Pre-Existing Position

No commenter addressed the proposed definition of "pre-existing position." The Commission is adopting the term "pre-existing position" as proposed. However, the Commission did receive comments related to the treatment of certain pre-existing positions. For further discussion of the treatment of pre-existing positions and related comments, see Sections II.B.7. and II.C.7.

16. "Referenced Contracts"

i. Background - Referenced Contracts

When a futures contract expires, all open futures contract positions in such contract are settled by physical delivery (which the Commission refers to as "physically-settled" herein) or cash settlement (which the Commission refers to as "cash-settled"

herein), depending on the contract terms set by the exchange. The nine legacy agricultural contracts currently subject to Federal position limits are all physically-settled futures contracts. Deliveries on physically-settled futures contracts are made through the exchange's clearinghouse, and the delivery of the physical commodity must be consummated between the buyer and seller per the exchange rules and contract specifications. On the other hand, other futures contracts are "cash-settled" because they do not involve the transfer of physical commodity ownership and require that all open positions at expiration be settled by a transfer of cash to or from the clearinghouse based upon the final settlement price of the contracts.

Market participants may use the settlement price of physically delivered futures contracts as a key benchmark to price cash-market contracts and other derivatives, including so-called "look-alike" cash-settled derivatives (which could be futures, options on futures, or swaps contracts). Look-alike cash-settled derivative contracts are explicitly linked to the physically-settled futures contracts. A look-alike cash-settled derivatives contract has nearly identical specifications as its physically-settled counterpart, but rather than calling for delivery of the underlying commodity at expiration, the contract terms require a cash payment at expiration. Each look-alike cash-settled derivatives contract is linked by design to its respective physically-settled contract in that the final settlement value of the cash-settled contract is defined as the final settlement price of the physically-settled contract in the same commodity for the same month. Additionally, other types of cash-settled derivatives contracts may be similar to a look-alike, but the final settlement price of such contracts are determined based on a basis, or differential, to the final settlement price of the corresponding physically-settled contract.

Existing § 150.2 applies Federal position limits to the nine legacy agricultural contracts as well as to options thereon on a futures-equivalent basis, but the existing Federal framework does not include provisions to apply Federal position limits to

contracts that are linked in some manner to the nine physically-settled legacy agricultural contracts. As a result, the existing Federal position limits do not apply to any cash-settled contracts, including both look-alike contracts and contracts that settle at a basis or differential to a physically-settled contract, options on such cash-settled contracts, or swaps.[471]

As the Final Rule is expanding the position limits framework to cover certain cash-settled futures contracts, options on such futures contracts, and economically equivalent swaps, for the reasons discussed below, the Commission is adopting the proposed defined term "referenced contract," with modifications, for use throughout final part 150 to refer to derivatives contracts that are subject to Federal position limits.

ii. Summary of the 2020 NPRM - Referenced Contracts

The 2020 NPRM proposed a new "referenced contract" definition that included: (1) Any core referenced futures contract listed in proposed §150.2(d); (2) any other contract (futures or option on futures), on a futures-equivalent basis with respect to a particular core referenced futures contract, that is directly or indirectly linked to the price of a core referenced futures contract, or that is directly or indirectly linked to the price of the same commodity underlying a core referenced futures contract (for delivery at the same location(s)); and (3) any economically equivalent swap, on a futures-equivalent basis.

The proposed referenced contract definition thus included look-alike futures contracts and options on look-alike futures contracts (as well as economically equivalent swaps with respect to such look-alike contracts), contracts of the same commodity but different sizes (e.g., mini contracts), and penultimate contracts.[472]

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[471] Under CEA section 1a(47)(A), an option on a swap is deemed to be a swap.

[472] A penultimate contract is a cash-settled contract in which trading ceases one business day prior to the settlement date of the corresponding referenced contract with which the penultimate contract is linked. With respect to penultimate contracts, the 2020 NPRM stated that "Federal limits would apply to all cash-settled futures and options on futures contracts on physical commodities that are linked in some manner, whether directly or indirectly, to physically-settled contracts subject to Federal limits." Further to this general statement, the 2020 NPRM provided a footnote example of a penultimate contact that, because it cash-settles directly to a core referenced futures contract, the 2020 NPRM explained would therefore be included as a referenced contract. 85 FR at 11619.

Additionally, the 2020 NPRM explicitly excluded from the "referenced contract" definition: (1) commodity index contracts; (2) location basis contracts; (3) swap guarantees; and (4) trade options that satisfy the requirement of § 32.3 of the Commission's regulations. Further, while not in the proposed regulatory text, the Commission indicated in the preamble to the 2020 NPRM that a contract for which the settlement price is based on an index published by a price reporting agency (a "PRA index contract") that surveys cash-market transactions (even if the cash-market practice is to price at a differential to a futures contract) was not deemed to be "directly or indirectly" linked to a referenced contract, and thus that such PRA index contract also was excluded from the "referenced contract" definition under the 2020 NPRM.[473]

Under the 2020 NPRM, a position in a referenced contract in certain circumstances could be netted with a position in another referenced contract, including a core referenced futures contract, which as noted above is a type of referenced contract under the proposed "referenced contract" definition. However, to avoid evasion and undermining of the Federal position limits framework, the 2020 NPRM prohibited the use of non-referenced contracts to net down positions in referenced contracts.[474]

Finally, the 2020 NPRM also stated that, in an effort to provide clarity to market participants regarding which exchange-traded contracts would be subject to Federal position limits, the Commission anticipated publishing, and regularly updating, a list of such contracts on its website. The Commission thus proposed to publish a "CFTC Staff Workbook," which would provide a non-exhaustive list of referenced contracts and may be helpful to market participants in determining categories of contracts that would fit within the referenced contract definition.

iii. Commission Determination - Referenced Contracts

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[473] 85 FR at 11620.

[474] 85 FR at 11619. For further discussion of the Final Rule's treatment of the netting of positions, *see* Section II.B.10.

The Commission is adopting the proposed "referenced contract" definition with the modification discussed below, as well as one technical change that the Commission believes clarifies the "referenced contract" definition, consistent with the intent of the 2020 NPRM.[475] Like the proposed definition, the final "referenced contract" definition also includes (1) the 25 core referenced futures contracts, (2) futures and options on futures that are directly or indirectly linked either to (i) the price of any other core referenced futures contract or (ii) the same commodity underlying a core referenced futures contract[476], and (3) economically equivalent swaps. Like the 2020 NPRM, the final definition also explicitly excludes certain contract types so that these contracts may not be netted against referenced contract positions for purposes of Federal position limits (but also are not aggregated with referenced contract positions).

However, in addition to the proposed definition's exclusions of commodity index contracts, location basis contracts, swap guarantees, and trade options that satisfy the requirement of § 32.3 of the Commission's regulations, the Final Rule is modifying the 2020 NPRM's definition to also exclude two additional contract types: "outright price reporting agency index contracts" and "monthly average pricing contracts."

This section will address the following issues, including related comments, in the following order:

a. Cash-settled referenced contracts and contracts that are "directly or indirectly" linked to a core referenced futures contract, including cash-settled and penultimate contracts;

b. Contracts explicitly excluded from the "referenced contract" definition; and

c. The list of referenced contracts and the related Commission staff "Workbook."

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[475] The Commission is providing a clarifying technical change to the "referenced contract" definition in that the final definition refers to "an option on a futures contract" instead of "options on a futures contract" as proposed by the 2020 NPRM, to make clear the original intent of the Commission in the 2020 NPRM that a single option would qualify as a referenced contract.

[476] Prong (ii) encompasses physically-settled contracts that do not directly reference a core referenced futures contract but that are nonetheless based on the same commodity and delivery location as the core referenced futures contract.

The Commission is also adopting "economically equivalent swaps," as proposed, as part of the final "referenced contract" definition. However, the Commission addresses the final "economically equivalent swap" definition in Section II.A.4.

a. Contracts that Are Directly or Indirectly Linked to a Core Referenced Futures Contract

(1) Summary of the 2020 NPRM - Linked to a Core Referenced Futures Contract

Paragraph (1) of the proposed referenced contract definition provided that a contract would qualify as a referenced contract if it is a core referenced futures contract, or, with respect to a particular core referenced futures contract, if it is directly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to, the price of either (i) the core referenced futures contract itself or (ii) the same commodity underlying the core referenced futures contract for delivery at the same location or locations as specified in the core referenced futures contract's specifications. As the Commission explained in the 2020 NPRM, this provision included a cash-settled "look-alike" future or an option thereon.[477]

(2) Summary of the Commission Determination - Linked to a Core Referenced Futures Contract

The Commission is adopting as final the language in paragraph (1) of the proposed "referenced contract" definition. Accordingly, under paragraph (1) of the final "referenced contract" definition, referenced contracts include a core referenced futures contract, and any cash-settled futures and options on futures that are directly or indirectly linked either to (i) the price of any other core referenced futures contract or (ii) the same

[477] For example, the 2020 NPRM noted that ICE's Henry Penultimate Fixed Price Future, which cash-settles directly to NYMEX's Henry Hub Natural Gas core referenced futures contract, would be considered a referenced contract. 85 FR at 11620.

commodity underlying a core referenced futures contract for delivery at the same location or locations as specified in the core referenced futures contract's specifications.[478]

Further, in response to the comments described below, the Commission is reaffirming that penultimate futures contracts and options thereon qualify as referenced contracts because they satisfy paragraph (1) of the referenced contract definition under the Final Rule.

(i) Comments - Cash-settled Referenced Contracts

Commenters provided differing opinions as to whether linked cash-settled futures and related options should be subject to Federal position limits.[479] CME Group and NEFI supported the Commission's proposal to subject these contracts to Federal position limits.[480] According to CME Group, absent parity between cash and physically-settled contracts, artificial distortions on one side of the market could occur due to manipulations on the other side of the market, regulatory arbitrage, or liquidity drain.[481] CME Group warned that, ultimately, a lack of parity could undermine the statutory goals of position limits.[482] NEFI agreed, arguing that applying Federal position limits to cash-settled contracts is essential to guard against manipulation by a trader who holds positions in both physically-settled and cash-settled contracts for the same underlying commodity.[483]

Other commenters disagreed. PIMCO and SIFMA AMG contended that cash-settled referenced contracts should not be subject to Federal position limits at all because

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[478] Clause (ii) of this description comprises as referenced contracts any physically-settled contracts that are linked to the same commodity for delivery at the same location underlying a core referenced futures contract. The Commission believes as failure to do so could undermining this Federal position limits framework through the creation of physically-settled look-alike contracts by other exchanges. For example, without including clause (ii) above, an exchange could create a physically-settled look-alike contract, but unlike the existing core referenced futures contract, this new contract would be outside the Federal position limits framework. Such an outcome would clearly disadvantage the exchange with the existing core referenced futures contract and harm liquidity for bona fide hedgers by possibly dividing liquidity among competing physically-settled look-alike contracts, as well as provide significant incentives for market participants to trade contracts that subvert this Federal position limits framework.

[479] CME Group at 3-4; FIA at 7-8; ICE at 12; ISDA at 3-5; NEFI at 3; PIMCO at 3; and SIFMA AMG at 4-6.

[480] CME Group at 3-4 (stating "CME Group believes that economically and substantively alike contracts should be accorded the same regulatory treatment to prevent artificial distortions from opening doors for manipulators or shifting one market's liquidity to another… In this regard, as noted above, CME Group recommends that the Commission apply similar provisions to both cash-settled and physically settled swaps.").

[481] CME Group at 6.

[482] *Id*.

[483] NEFI at 3.

cash-settled contracts do not introduce the same risk of market manipulation. They argued that subjecting cash-settled referenced contracts to Federal position limits would reduce market liquidity and depth in these instruments.[484]

ISDA argued that cash-settled contracts should not be included in an immediate Federal position limits rulemaking, and should instead be deferred until the Commission has adopted Federal limits with respect to physically-delivered spot month futures contracts, and after which the Commission should revisit Federal limits for cash-settled contracts.[485]

FIA and ICE suggested that Federal position limits for cash-settled referenced contracts should apply per DCM (rather than in aggregate across DCMs).[486] FIA additionally suggested setting a separate Federal spot-month position limit for economically equivalent swaps.[487] FIA and ICE further argued that limits for cash-settled referenced contracts should be higher relative to Federal position limits for physically-settled referenced contracts. They similarly posited that cash-settled referenced contracts are "not subject to corners and squeezes" and higher limits for cash-settled contracts will "'ensure market liquidity for *bona fide* hedgers.'"[488]

(ii) Discussion of Final Rule – Cash-settled Reference Contracts

As a general matter, the Commission does not agree with FIA and ICE that Federal position limits should be applied at the DCM level instead of in the aggregate for the reasons discussed below under Section II.B.11. [489]

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[484] PIMCO at 3; SIFMA AMG at 4-6.

[485] ISDA at 3-5.

[486] FIA at 7-8; ICE at 12.

[487] FIA 7-8.

[488] ICE at 3, 15 (also arguing that cash-settled limits should apply per exchange, rather than across exchanges); FIA at 7-8; For further discussion on the Commission's determination to generally apply Federal position limits on an aggregate basis across exchanges, *see* Section II.B.11.

[489] As discussed below, as an initial matter, the Commission interprets CEA section 4a(a)(6) as requiring aggregate Federal position limits across exchanges. However, as discussed below, the Commission is providing an exception to this general rule for natural gas pursuant to the Commission's exemptive authority under CEA section 4a(a)(7). For further discussion, *see* Sections II.B.3.vi. and II.B.11.

Further, the Commission addresses FIA's contention that the Commission should impose a separate Federal spot-month position limit for economically equivalent swaps in further detail above under Section II.A.4.iii.

While the Commission acknowledges commenter views to the effect that cash-settled contracts are less susceptible to effectuating corners and squeezes,[490] the Commission is of the view that generally speaking, linked cash-settled and physically-settled contracts form one market, and thus should be subject to Federal position limits. Because the settlement price of a physically delivered futures contract is used as a price benchmark in many other derivative and cash-market contracts, a change in the futures settlement price can affect the value of a trader's overall portfolio of derivative and cash-market positions. Accordingly, the link between physically delivered futures and their cash-settled derivative counterparts can create incentives for manipulation. This view is informed by the Commission's experience overseeing derivatives markets, where the Commission has observed that it is common for the same market participant to arbitrage linked cash- and physically-settled contracts, and where the Commission has also observed instances where linked cash-settled and physically-settled contracts have been used together as part of an attempted manipulation.[491]

Applying position limits to both physically delivered futures and linked cash-settled contracts, including their look-alike cash-settled derivative contracts, reduces a trader's incentive and ability to manipulate futures markets. Without position limits on both types of futures contracts, traders could amass a substantial position in the cash-

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[490] FIA at 7, stating "Section 4a(a)(3)(B)(ii) directs the Commission to set limits as appropriate 'to deter and prevent market manipulation, squeezes and corners.'" The Commission notes that FIA provides an example as to the effect of squeezes and corners for cash-settled contracts---only two out of three of the points for which the Commission should set an appropriate limit—the third point, which is overlooked by the commenter (market manipulation) is also a statutory objective, and for the reasons described below, provides a basis for including cash-settled contracts within the Federal position limits regime.

[491] The Commission has previously found that traders with positions in a cash-settled contract may have an incentive to manipulate and undermine price discovery in the physically-settled contract to which the cash-settled contract is linked. *See, e.g.*, *CFTC v. Parnon Energy Inc. et al*., No. 1:11-cv-03543 (S.D.N.Y. 2014) (alleging defendants amassed sufficient quantity of physical WTI while contemporaneously purchasing cash-settled WTI derivatives positions on NYMEX and ICE with the intent to profit on those positions by manipulating the price of the physically-settled WTI contract).

settled look-alike contract and benefit their position by manipulating the settlement price of the physically delivered futures contracts.

Additionally, the absence of position limits on look-alike cash-settled derivative contracts would enable traders to manipulate a particular cash commodity price to benefit their cash-settled derivatives position. For example, where market conditions create a shortage of a particular commodity, that shortage should increase the price of the commodity. If markets are functioning properly, the price of the physically delivered futures contract will also increase. A trader could acquire a massive long position in the look-alike cash-settled derivative contract and profit by bidding up the cash price of an already scarce cash commodity. Thus, the trader's cash commodity positions would directly affect the price of the physically-settled futures contract and its look-alike cash-settled derivative. The trader's strategy to purchase the cash commodity and bid up its price could cause the value of the look-alike cash-settled derivative position to increase because of the direct links connecting all three markets (*i.e.*, the positions in the underlying cash commodity, the physically-settled derivative, and the cash-settled derivative). Accordingly, the absence of position limits in look-alike cash-settled derivative contracts would enable traders to effectively influence and manipulate cash prices to benefit their cash-settled derivatives position, which could impact the price of the physically-settled futures contract as well.

Additionally, excessive speculation in cash-settled derivative contracts can affect the price of the physically-settled futures contract and the underlying cash commodity and therefore harm the price discovery function of the underlying markets. That is, futures prices are determined by immediate cash commodity prices, and therefore the relationship between cash and futures prices also depends, in part, on the storage location of a particular commodity in relation to its delivery point, and should result in the correct amount of a particular commodity available at the delivery point. Thus, excessive

speculation in cash-settled derivative contracts can produce excessive supplies at delivery points and a disruption of the flows of money and commodities exchanged.[492]

Accordingly, the Commission considers cash-settled referenced contracts to be generally economically equivalent to physical-delivery contracts in the same commodity. In the absence of position limits, an entity with positions in both the physically delivered and cash-settled contracts may have an increased ability and an increased incentive to manipulate one of these contracts to benefit positions in the other contract. As such, the Commission believes that it is essential to apply Federal position limits to cash-settled futures and options on futures that are directly or indirectly linked to physically-settled contracts in order to further the statutory objective in CEA section 4a(a)(3)(B)(iv) to deter and prevent market manipulation.

Furthermore, the Commission has determined that including futures contracts and options on futures contracts that are indirectly linked to the core referenced futures contract under the "referenced contract" definition will help prevent the evasion of position limits through the creation of an economically equivalent futures contract or option on a futures contract, as applicable, that does not directly reference the price of the core referenced futures contract. Such contracts that settle to the price of a referenced contract but not to the price of a core referenced futures contract, for example, would be indirectly linked to the core referenced futures contract.[493]

However, a physically-settled derivative contract with a settlement price that is based on the same underlying commodity at a different delivery location would not be

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[492] For example, manipulated "higher" futures contract prices in a cash-settled futures contract can spill over into "lower" prices for a physically-settled futures contract through arbitrage trades between the two futures contracts. Traders arbitraging between the cash-settled and physically-settled futures contracts would short the "higher priced" cash-settled and long the "lower-priced" physically-settled futures contracts until an equilibrium price is achieved. However, that equilibrium price may be distorted due to the manipulation occurring in the higher priced cash-settled contract, and as a result the physically-settled contract would have an artificially higher price relative to the actual cash-market price of the underlying commodity. That higher futures contract price would then act as a false price signal to the underlying cash commodity market, thus incentivizing owners of the cash commodity to increase supplies at the delivery points for the physically-settled futures contract. Accordingly, excessive speculation in cash-settled derivative contracts can produce excessive supplies at delivery points and a disruption of liquidity, price discovery, and distribution of the underlying cash commodities.

[493] As discussed above, the Commission adopted an "economically equivalent swap" definition that is narrower than the class of futures contracts and option on futures contracts that would be included as referenced contracts. For further discussion of the "economically equivalent swap" definition, *see* Section II.A.4.

linked, directly or indirectly, to the core referenced futures contract. By way of example, a hypothetical physically-settled futures contract on ultra-low sulfur diesel delivered at L.A. Harbor instead of the NYMEX ultra-low sulfur diesel core referenced futures contract delivered in New York Harbor would not be linked, directly or indirectly, to the core referenced futures contract because NYMEX's ultra-low sulfur diesel futures contract does not include L.A. Harbor as a possible delivery point. Therefore, the contract specification price of the hypothetical physically delivered L.A. Harbor contract would reflect the L.A. Harbor market price for ultra-low sulfur diesel and not the NYMEX contract's price.

(iii) Comments and Discussion of Final Rule - Penultimate Contracts are a Subset of Cash-settled Referenced Contracts

Penultimate contracts are a type of cash-settled futures contract (or an option thereon) that settles the day before the corresponding physically-settled futures contract. Penultimate contracts therefore share the same determinative attributes as the other cash-settled look-alike referenced contracts discussed above, including the fact that the settlement price of a penultimate contract is linked to the corresponding physically-settled core referenced futures contract.

In response to certain commenters requesting that the Commission exclude penultimate contracts from the 2020 NPRM's proposed "referenced contract" definition (discussed below), the Commission is affirming that penultimate contracts, as a type of linked cash-settled look-alike contracts, fall within the Final Rule's "referenced contract" definition.

Commenters were split as to whether these penultimate contracts should be included within the "referenced contract" definition. ICE argued that penultimate contracts, and specifically its penultimate cash-settled natural gas contract, should be excluded from position limits for several reasons, including that its natural gas

penultimate contract is economically distinct from the NYMEX NG core referenced futures contract and has no ability to impact settlement of that core referenced futures contract.[494] SIFMA AMG and ISDA broadly concurred with this position.[495] In contrast, CME Group supported the inclusion of penultimate contracts within the definition of referenced contract.[496] As the Commission outlined above, its "one market" view applies to cash-settled contracts that are linked in some manner to physically-settled contracts. Penultimate futures contracts (including options thereon), as a type of linked cash-settled contract, have the same relation to their physically-settled counterparts as discussed above for other linked cash-settled contracts. The Commission therefore is applying Federal position limits to all of these instruments.

In support of its view that penultimate contracts should not be subject to Federal position limits, ICE offered the example of the Henry Hub LD1 ("H") futures contract (which has an exchange-set spot-month position limit) and the Henry Hub Penultimate ("PHH") futures contract (which has exchange-set position accountability), stating that these contracts trade side-by-side, and that there has been no evidence of a migration to the penultimate contract due to the presence of an accountability level rather than a hard spot-month position limit. According to ICE, this suggests that the Commission need not be concerned about an arbitrage opportunity between the two.[497]

However, in further support of its argument that penultimate contracts should not be subject to Federal position limits, ICE suggested that penultimate contracts "empirically" are not economically the same as the last day contract, as demonstrated by settlement prices.[498] To that end, the Commission reviewed the settlement prices of NYMEX NG (the physically settled natural gas core referenced futures contract), H (the

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[494] ICE at 13-14.

[495] ISDA at 9; SIFMA AMG at 10-11.

[496] CME Group at 3-4 (arguing that "economically and substantively alike contracts should be accorded the same regulatory treatment to prevent artificial distortions from opening doors for manipulations or shifting one market's liquidity to another.").

[497] ICE at 14.

[498] *Id.*

ICE LD1 natural gas contract cash-settled to the NYMEX NG), and PHH (the ICE natural gas penultimate contract cash-settled to the NYMEX NG).[499] Contrary to the empirical assertion made by ICE, the prices of the six near-month contracts for each of the contracts described above settled at *identical* prices on the relevant penultimate day for all contracts at all months.[500] As reinforced by this observation, the Commission agrees with the commenter that the penultimate contract is tightly correlated (and trades side-by-side) with the cash-settled contract, as well as being demonstrated here, with the physically settled futures contract.

However, it is not in spite of this tight correlation, but rather because of it, that the Commission considers these contracts to form one market, and as such, raises the importance of Federal position limits for these instruments. As noted above, the Commission believes that Federal position limits should apply to all contracts covered by the Final Rule's "referenced contract" definition, including all varieties of linked cash-settled contracts, such as linked penultimate contracts, given the linkages between the physically-settled contract, the cash-settled contract (including penultimate contracts), and the underlying cash-market commodity, and the incentives and opportunities for market manipulation that those linkages create.

b. Exclusions from the Referenced Contract Definition

(1) Summary of the 2020 NPRM – Exclusions from the Referenced Contract Definition

In the 2020 NPRM, paragraph (3) of the proposed "referenced contract" definition explicitly excluded: (1) a location basis contract; (2) a commodity index contract; (3) a swap guarantee; and (4) a trade option that meets the requirements of Commission

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[499] Commission review of these contracts as of August 4, 2020, based on data submitted to the Commission pursuant to part 16 of the Commission's regulations.

[500] The six near-month contracts reviewed by the Commission are as follows: Sep20, Oct20, Nov20, Dec20, Jan21, and Feb21, for each of NYMEX NG, H, and PHH. The Commission does not compare the spot-day price on the last day of trading of the NYMEX NG contract with the penultimate PHH contract since by definition the PHH contract settles on the penultimate day – that is, PHH settles on the day before NYMEX NG's last day of trading and therefore there is no PHH price to compare against the NYMEX NG price on NYMEX NG's last day of trading.

regulation § 32.3. The 2020 NPRM also included guidance in proposed Appendix C setting forth additional clarification regarding the types of contracts that would qualify as either a location basis contract or a commodity index contract for purposes of the proposed exclusions from the "referenced contract" definition.

(2) Summary of the Commission Determination - Exclusions from the Referenced Contract Definition

The Commission is adopting paragraph (3) of the 2020 NPRM's proposed "referenced contract" with the following changes. In addition to excluding the contracts mentioned above, the Final Rule is modifying paragraph (3) to additionally exclude "outright price reporting agency index contracts" and "monthly average pricing contracts" from the "referenced contract" definition. To the extent a contract fits within one of the excluded contracts in paragraph (3), such contract is not a referenced contract, is not subject to Federal position limits, and could not be used to net down positions in referenced contracts (but also is not required to be added to referenced contract positions when determining compliance with Federal position limits).

In order to clarify the types of contracts that qualify as location basis contracts and commodity index contracts, and thus are excluded from the "referenced contract" definition, the Commission also is adopting, with modifications described below, the guidance with respect to these instruments in Appendix C to part 150 of the Commission's regulations. This guidance includes information to help define the parameters of the terms "location basis contract" and "commodity index contract."[501] To the extent a particular contract fits within this guidance, such contract would not be a referenced contract, would not be subject to Federal position limits, and could not be used to net down positions in referenced contracts.[502] Unlike the 2020 NPRM, the final

[501] The Commission notes that the further definition of parameters regarding a commodity index contract is responsive to the Better Markets comment letter suggesting such additional clarifications. Better Markets at 34.

[502] *See infra* Section II.B.10. (discussion of netting).

guidance in Appendix C will also include additional information regarding the definition of the terms "outright price reporting agency index contracts" and "monthly average pricing contracts."

Comments on these topics, and the Commission's responses, are set forth below.

(3) Comments - Exclusions from the Referenced Contract Definition

On balance, commenters were generally supportive of the 2020 NPRM's proposed exclusions from the referenced contract definition.[503]

(i) Location Basis Contracts

Commenters that provided an explicit opinion about location basis contracts were unanimously supportive of the Commission excluding such contracts from the definition of a referenced contract.[504]

(ii) Commodity Index Contracts

Commenters were divided, however, regarding the exclusion of commodity index contracts. Better Markets and IATP opposed the exclusion,[505] while ICE and PIMCO supported it.[506] Better Markets concurred with the view expressed by the Commission in the 2020 NPRM that commodity index contracts should not be permitted to net down referenced contract positions, but in lieu of the Commission's proposal to exclude commodity index contracts as referenced contracts, Better Markets suggested in the alternative that the Commission adopt individual limits for commodity index contracts for persons also involved in physically-settled contracts on physical commodities serving as a constituent in the applicable index.[507] IATP cited several studies, including one published by Better Markets, contending that commodity index contracts have price

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[503] AGA at 9; CHS at 2; FIA at 2; ICE at 10-11; NCFC at 2.

[504] AGA at 9; ICE at 10.

[505] Better Markets at 34, 46; IATP at 7-8 (citing studies which they believe demonstrate that commodity index trading harms commercial hedgers).

[506] ICE at 2; PIMCO at 5.

[507] Better Markets at 46.

impacts that are detrimental to commercial hedgers.[508] IECA stated that the passive speculation provided by commodity index contracts is harmful to the price discovery function of the market.[509]

In contrast, PIMCO argued in favor of the exclusion for commodity index contracts, contending that commodity index contracts are useful tools for investors looking for broad-based portfolio hedging or to take a view on price trends in the commodity markets.[510]

(iii) Trade Options

All commenters offering a specific opinion regarding trade options unanimously supported the exclusion of trade options from the definition of referenced contract.[511]

(iv) Swap Guarantees

Similarly, commenters supported the exclusion of swap guarantees from the definition of reference contract.[512]

(v) Outright Price Reporting Agency Index Contracts

FIA and ICE further recommended that the Commission should exclude any outright contracts whose settlement price is based on an index published by a price reporting agency that surveys cash-market transaction prices from the "referenced contract" definition.[513]

(vi) Monthly Average Pricing Contracts

CME Group commented that because a significant amount of commerce is transacted on a monthly average basis, and that because monthly average pricing

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[508] IATP at 7-8 (citing David Frenk and Wallace Turbeville, "Commodity Index Traders: Boom and Bust in Commodity Prices," Better Markets, October 2011, at 15). https://bettermarkets.com/sites/default/files/Better%20Markets%20Commodity%20Index%20Traders%20and%20Boom-Bust%20in%20Commodities%20Prices.pdf.

[509] Industrial Energy at 3-4, suggesting a ban on natural gas commodity index contracts, which functionally equates to a Federal position limit of zero, or alternatively a limit to not exceed the current percentage of the physical market.

[510] PIMCO at 5.

[511] AGA at 8; CCI at 2; EPSA at 3-4; NGSA at 4; NRECA at 17; CEWG at 4; Chevron at 3; CHS at 2; FIA at 2; NCFC at 2; NGSA at 4; and Suncor at 3.

[512] CHS at 2; FIA at 2; NCFC at 2, offering general support for excluding swap guarantees, but not providing a specific rationale for doing so.

[513] FIA at 6; ICE at 10-11.

contracts are calculated using the daily prices during the contract month such that a final settlement price of a core referenced futures contract would have the same weight as the other twenty or more daily prices used in the monthly average price calculation, it would be extremely unlikely for monthly average pricing contracts to be used to manipulate or benefit from a manipulation during the spot period. Thus, CME Group argued monthly average pricing contracts should also be excluded from the definition of referenced contracts.[514]

(vii) Additional Basis, Differential, and Spread Contracts

ICE recommended that certain other contracts, such as additional basis and spread contracts, should generally be excluded from the definition of a referenced contract, even if the contracts reference a core referenced futures contract as one component.[515]

(4) Discussion of Final Rule - Exclusions from the Referenced Contract Definition

The Commission is finalizing as proposed the exclusions from the referenced contract definition for location basis contracts, commodity index contracts, swap guarantees, and trade options that meet the requirements of § 32.3. Further, as noted above, the Commission is expanding prong (3) of the proposed referenced contract definition to additionally exclude two other contract types: "outright price reporting agency index contracts" and "monthly average pricing contracts."

(i) Location Basis Contracts

The Commission has determined that, unless location basis contracts are excluded from the "referenced contract" definition, speculators would be able to net portions of their location basis contracts with outright positions in one of the locations comprising the core referenced futures contract, which would permit extraordinarily large speculative positions in the outright core referenced futures contract.[516] For example, the 2020

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[514] CME Group at 13.

[515] ICE at 12; *see also* FIA at 4 (recommending that the spread transaction definition should be expanded to exempt additional, commonly used spreads). For further discussion on the "spread transaction" definition, *see* Section II.A.20.

[516] *See infra* Section II.B.10. (discussion of netting).

NPRM explained that a large outright position in NYMEX Henry Hub Natural Gas (NG) futures contracts could not be netted down against a location basis contract that cash-settles to the difference in price between the Gulf Coast Natural Gas futures contract and the NYMEX NG futures contract.[517] Absent this exclusion, a market participant could increase its exposure in the outright contract by using the location basis contract to net down against its NYMEX NG futures position, thereby allowing the market participant to further increase the outright NYMEX NG futures contract position that would otherwise exceed the Federal position limits.

While excluding location basis contracts from the referenced contract definition would prevent the circumstance described above, it would also mean that location basis contracts would not be subject to Federal position limits. The Commission is comfortable with this outcome because location basis contracts generally demonstrate minimal volatility and are typically significantly less liquid than the core referenced futures contracts, meaning, in the Commission's estimation, it is less likely that a potential manipulator would be able to effect a market manipulation using these contracts. Further, excluding location basis contracts from the referenced contract definition may allow commercial end-users to more efficiently hedge the cost of commodities at their preferred location to the extent they may frequently require the physical commodity at a location other than the core referenced futures contract's specified contract delivery point.

(ii) Commodity Index Contracts

With respect to commodity index contracts, the Commission similarly has determined that excluding commodity index contracts from the "referenced contract" definition will ensure that market participants cannot use a position in a commodity index

[517] 85 FR at 11620.

contract to net down an outright position in a referenced contract that was a component of the commodity index contract.

Regarding Better Markets' and IATP's requests that the Commission alter the proposed "referenced contract" definition to include commodity index contracts (*i.e.*, to remove commodity index contracts from the list of excluded contracts in paragraph (3) of the "referenced contract" definition), the Commission notes that if it did not exclude commodity index contracts, the Commission's rules would allow speculators to take on massive outright positions in referenced contracts by netting against a position in a commodity index contract, which could lead to excessive speculation.

For example, the Commission understands that it is common for swap dealers to enter into commodity index contracts with participants for which the contract would not qualify as a bona fide hedging position (*e.g.*, with a pension fund). Failing to exclude commodity index contracts from the referenced contract definition could enable a swap dealer to use positions in commodity index contracts to net down offsetting outright futures positions in the components of the index. Additionally, this would have the effect of subverting the statutory pass-through swap provision in CEA section 4a(c)(2)(B), which is intended to foreclose the recognition of positions entered into for risk management purposes as bona fide hedges unless the swap dealer is entering into positions opposite a counterparty for which the swap position is a bona fide hedge.[518]

The Commission recognizes that although excluding commodity index contracts from the "referenced contract" definition would prevent the potentially risky netting circumstance described above, it would also mean that commodity index contracts would not be subject to Federal position limits. The Commission concludes that this is an acceptable outcome because the contracts comprising the index would themselves be

[518] 7 U.S.C. 6a(c)(2)(B).

subject to limits, and because commodity index contracts generally tend to exhibit low volatility since they are diversified across many different commodities.

With respect to Better Markets', ICEA's, and PMAA's requests to impose separate standalone, or aggregate, position limits on commodity index contracts, the Commission does not believe doing so is useful to the extent that the individual components of a commodity index contract are subject to Federal position limits under the Final Rule. The Commission also is concerned that adopting a standalone limit for a commodity index contract could inadvertently limit transactions in commodity derivatives contracts outside the Final Rule's scope. Specifically, a commodity index contract may contain components that are subject to Federal position limits, as well as additional components that are not. If the Commission were to place standalone limits on these commodity index contracts, it would impose *de facto* constraints on commodity derivative contracts that are not intended to be the subject to the Final Rule and for which the Commission has not found position limits to be necessary.

(iii) Trade Options

The Commission also is finalizing, as proposed, the exclusion of trade options that meet the requirements of § 32.3 from the definition of referenced contract. The Commission has traditionally exempted trade options from a number of Commission requirements because trade options are typically employed by end-users to hedge physical risk and thus do not contribute to excessive speculation. Trade options are not subject to position limits under current regulations, and the proposed exclusion of trade options from the referenced contract definition would simply codify existing practice.[519]

(iv) Swap Guarantees

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

The Commission additionally is excluding, as proposed, swap guarantees from the "referenced contract" definition. In connection with further defining the term "swap" jointly with the Securities and Exchange Commission in the "Product Definition Adopting Release,"[520] the Commission interpreted the term "swap" (that is not a "security-based swap" or "mixed swap") to include a guarantee of such swap, to the extent that a counterparty to a swap position would have recourse to the guarantor in connection with the position.[521] Excluding guarantees of swaps from the definition of "referenced contract" will help avoid any potential confusion regarding the application of position limits to guarantees of swaps. The Commission understands that swap guarantees generally serve as insurance, and, in many cases, swap guarantors guarantee the performance of an affiliate in order to entice a counterparty to enter into a swap with such guarantor's affiliate. As a result, the Commission believes that swap guarantees do not contribute to excessive speculation, market manipulation, squeezes, or corners. Furthermore, the Commission believes that swap guarantees were not contemplated by Congress when Congress articulated its policy goals with respect to position limits in CEA section 4a(a).[522] Accordingly, the Commission is finalizing the exclusion of swap guarantees from the definition of "referenced contract."

(v) New Exclusions from the "Referenced Contract" Definition – Price Reporting Agency Index Contracts and Monthly Average Pricing Contracts

Finally, the Commission is modifying prong (3) of the proposed "referenced contract" definition to additionally exclude from the Final Rule: (a) monthly average pricing contracts and (b) outright price reporting agency index contracts.

(a) Monthly Average Pricing Contracts

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[520] *See generally* Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208 (Aug. 13, 2012) ("Product Definitions Adopting Release").

[521] 77 FR at 48226.

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

In response to commenter suggestions, the Commission is providing non-binding guidance in Appendix C to this Final Rule to assist market participants and exchanges in determining whether a particular contract qualifies as a "monthly average pricing contract," that the Final Rule is excluding from the "referenced contract" definition. Specifically, in response to Question 15 of the 2020 NPRM, CME Group commented that contract types that are generally referred to in industry nomenclature as calendar-month average ("CMA"), trade-month average ("TMA"), and balance-of-the-month ("BALMO") contracts should be excluded from the list of referenced contracts and subject solely to exchange-set position limits.[523] CME Group explains the prevalence of these contracts in the market, and notes an example of the June 2020 monthly average contract (in which there are 22 U.S. business days and thus 22 daily referenced prices incorporated into the calendar month average), concluding that it is difficult to manipulate a CMA. CME Group thus posits that excluding CMAs would not incentivize manipulation of the underlying core referenced futures contract.[524]

As an initial matter, the Commission's addition of the new term "monthly average pricing contracts" to Appendix C of this Final Rule is intended to generally cover the types of contracts addressed in CME Group's comments, which are generally referred to in the industry as "CMAs," "TMAs," and "BALMOs." The Commission agrees with CME Group's rationale. The Commission understands that because the final settlement price of a core referenced futures contract is only one of many pricing points that constitute that monthly average, and as such generally has a relatively insignificant impact on such core referenced futures contract's monthly average price, it therefore also has a relatively insignificant impact on the settlement price of the corresponding monthly average pricing contract. Accordingly, the Commission concludes that on balance,

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[523] CME Group at 13.
[524] *Id*.

excluding monthly average pricing contracts from the definition of referenced contract is consistent with the statutory goals in CEA section 4a(a)(3), including with respect to ensuring sufficient market liquidity for bona fide hedgers due to: (1) the difficulty and expense of any entity artificially moving the price of the monthly average by manipulating one or more component prices within the contract; and (2) the widespread use and utility of these contracts to commercial entities to hedge their risk. The Commission provides non-binding guidance in Appendix C of the Final Rule to assist market participants and exchanges in determining whether a particular contract qualifies as a "monthly average pricing contract."

(b) Outright Price Reporting Agency Index Contracts

The Commission is also modifying prong (3) of the proposed "referenced contract" definition to explicitly exclude "outright price reporting agency index contracts." ICE supported the exclusion of such contracts in its comment letter.[525] Further, FIA also commented that it believed that a price reporting agency index contract is outside the definition of a referenced contract.[526]

The Commission agrees with ICE and FIA and confirms this understanding. The Commission explained in the 2020 NPRM that based on its plain reading, the "referenced contract" definition excluded such contracts because outright price reporting agency index contracts were not "directly or indirectly" linked to the price of a referenced contract.[527] The Commission reaffirms its conclusion that an "outright price reporting agency index contract," which is based on an index published by a price reporting agency that surveys cash-market transaction prices (even if the cash-market practice is to price at a differential to a futures contract), is not directly or indirectly linked to the corresponding referenced contract. The Commission is modifying the final "referenced

[525] ICE at 10.
[526] FIA at 6.
[527] 85 FR at 11620.

contract" definition to explicitly exclude such contracts for the sake of regulatory certainty. Similar to the other contracts excluded from the "referenced contract" definition, the Commission is providing non-binding guidance in Appendix C of the Final Rule to assist market participants and exchanges in determining whether a particular contract qualifies as an "outright price reporting agency index contract" and therefore is excluded as a referenced contract. The Commission underscores that this exclusion applies only to "outright" price reporting agency index contracts, and that a contract that settles to the *difference* (*i.e.,* settled at a basis) between a referenced contract and the price reporting agency index would be directly linked, and thus would qualify as a referenced contract, because it settles in part to the referenced contract price.

Since the Commission stated in the preamble to the 2020 NPRM that an outright price reporting agency index contract does not qualify as a "referenced contract," the Commission does not believe that the Final Rule's modification to explicitly exclude the term in the regulatory definition of "referenced contract" represents a change in policy. Instead, it is merely a technical change to the regulatory text to provide regulatory clarity to market participants.

(vi) Additional Basis, Differential, and Spread Contracts

Regarding ICE's comment that additional basis, differential, and spread contracts should generally be excluded from the "referenced contract" definition,[528] the Commission notes a heightened concern with potential manipulation through the use of outright positions (particularly through inappropriate netting) and spreads, compared to location basis contracts or commodity index contracts.[529] Notably, and as described in greater detail above, the Commission views the constraints on the liquidity and volatility associated with location basis and commodity index contracts as not present to an equal

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[528] ICE at 12, noting contracts that capture the differential between different grades of a commodity (*e.g.,* WTI vs. sour crude) or between different but related commodities (*e.g.,* a crack differential) as examples of contracts it believes should excluded.

[529] *See* 78 FR at 75696-75697.

degree in other basis and spread contracts. As noted above, while excluding location basis contracts and commodity index contracts from the referenced contract definition could permit large outright positions in such contracts, the Commission believes that excluding these contracts will nonetheless prevent the potentially risky and inappropriate netting of a core referenced futures contract described above. Further, as stated above, the Commission believes that location basis contracts generally demonstrate minimal volatility and are typically significantly less liquid than the core referenced futures contracts, meaning they would be more costly to try to use to manipulate a core referenced futures contract. Similarly, with respect to commodity index contracts, commodities comprising the index could themselves be subject to Federal position limits, and commodity index contracts also generally tend to exhibit low volatility since they are diversified across many different commodities.

Additionally, it is unclear from ICE's discussion what additional contract types that ICE has in mind, other than outright price reporting agency index contracts that the Commission discusses above, since several of the examples provided by ICE may already be exempt under the "spread transaction" definition (*e.g.*, the spread examples provided by ICE[530] may qualify for a spread exemption under the Final Rule as either a quality differential spread or an inter-commodity spread). ICE also stated that the requirement that a spread exemption be approved by the exchange seems unnecessary and is probably unworkable, but did not provide any arguments as to why obtaining exchange approval would be unnecessary.[531] Additionally, the Commission notes that under the Final Rule, an exemption for any spread that is included in the "spread transaction" definition is self-effectuating for purposes of Federal position limits, and, unlike the role that exchanges may play with respect to non-enumerated bona fide hedges in final §150.9, exchanges

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[530] ICE at 12.

[531] For further discussion of the "spread transaction" definition, *see* Section II.A.20.

have no analogous role with respect to spread exemptions for Federal position limits purposes under the Final Rule.

iv. List of Referenced Contracts

a. Summary of the 2020 NPRM - List of Referenced Contracts

In order to provide clarity to market participants, the Commission proposed to publish, and anticipated regularly updating, a *CFTC Staff Workbook of Commodity Derivative Contracts under the Regulations Regarding Position Limits for Derivatives* (the "Staff Workbook") on the Commission's website which would list exchange-traded products that are subject to Federal position limits. In order to ensure that the list remained accurate, the Commission also proposed changes to certain provisions of part 40 of its regulations, which pertain to the collection of position limits information through the filing of product terms and conditions.

In particular, under existing §§ 40.2, 40.3, and 40.4, DCMs and SEFs must submit certain requirements related to the listing of certain new products. Many of the required submissions include the product's "terms and conditions," as defined in § 40.1(j), which in turn includes under § 40.1(j)(1)(vii) "Position limits, position accountability standards, and position reporting requirements."

The Commission proposed to expand §40.1(j)(1)(vii), which addresses futures contracts and options contracts, to also include an indication as to whether the submitted contract meets the "referenced contract" definition in proposed § 150.1. If so, proposed §40.1(j)(1)(vii) required the submission to also include the name of the core referenced futures contract on which the submitted new product is based.

The Commission further proposed to expand § 40.1(j)(2)(vii), which addresses swaps, to require the applicant to indicate whether the submitted contract meets the proposed "economically equivalent swap" definition in § 150.1. If so, proposed

§40.1(j)(2)(vii) similarly required the submission to include the name of the referenced contract to which the swap is economically equivalent.

b. Comments and Summary of the Commission Determination - List of Referenced Contracts

The Commission is adopting as final the 2020 NPRM's amendments to part 40 of its regulations with one modification that relates to filing the name of the referenced contract on which the new product is based. Part 40 and the Commission's amendments pertain to the collection of position limits information through the filing of product terms and conditions, and the publication and regular updates of exchange-traded contracts that are subject to Federal position limits.[532] The Commission notes that the Staff Workbook is intended to provide a non-exhaustive list of exchange-traded referenced contracts that are subject to Federal position limits. Although the Commission endeavors to timely update this list of contracts, the omission of a contract from the Staff Workbook does not mean that such contract is outside the definition of a referenced contract subject to Federal position limits.

While proposed § 40.1(j)(1)(vii) required the submitted futures contract (or option thereon) to also include the name of the *core referenced futures contract* on which the submitted new product is based, final § 40.1(j)(1)(vii) instead requires that the submitted product includes the name of either the core referenced futures contract or referenced contract, as applicable, on which the contract is based. This is because, as discussed above under the "referenced contract" definition, a referenced contract could be indirectly or directly linked to another referenced contract that is not a core referenced futures contract. For example, an options contract could be based on a cash-settled look-alike or penultimate futures contract that is a referenced contract rather than on the physically-

[532] As discussed above, the Commission will provide market participants with reasonable, good-faith discretion to determine whether a swap would qualify as economically equivalent for Federal position limit purposes. Due to differences between OTC swaps and exchange-traded futures contracts and options thereon, the Staff Workbook would not include a list of economically equivalent swaps. For further discussion, *see supra* Section II.A.4. (discussion of economically equivalent swaps).

settled core referenced futures contract.

The Commission's concurrent publication of the Staff Workbook will provide a non-exhaustive list of exchange-traded referenced contracts, and will help market participants in determining categories of contracts that fit within the referenced contract definition. This effort is intended to provide clarity to market participants regarding which exchange-traded contracts are subject to Federal position limits.

The proposed amendments to part 40 to specify new referenced contracts generally received support.[533] ICE noted the need for clear guidance on how new contracts will be assessed, in order to determine whether such contracts will be referenced contracts, and make consistent determinations with respect to economically similar products.[534] Although commenters also generally supported the publication of the Workbook, many suggested modifications, including clarifications regarding which contracts are included as referenced contracts, and the basis for making such determinations.[535] The Commission believes that the amendments to part 40 will allow the Commission to consistently and accurately assess whether contracts should be included within the Staff Workbook. The Commission also believes that by providing regular updates to the Staff Workbook, market participants will have accurate and consistent information to assess whether such contracts are subject to Federal position limits. Additionally, the Staff Workbook will provide a linkage between each referenced contract, and either the core referenced futures contract or referenced contract, as applicable, to which it is linked, to aid in market participants' understanding of the Commission's determination.

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[533] AGA at 10; MFA/AIMA at 4.
[534] ICE at 12.
[535] AGA at 10; MFA/AIMA at 9; FIA at 6; Chevron at 14; Suncor at 14; and CEWG at 29-30.

Alternatively, some commenters suggested that the Staff Workbook could include a list of all contracts Commission staff finds are *not* referenced contracts,[536] and CME Group and ICE each provided a list of contracts they believe should be excluded from the Staff Workbook.[537]

The Commission believes that by providing a Staff Workbook listing core referenced futures contracts, and the referenced contracts that are directly or indirectly related to them, the Commission is presenting a list of contracts subject to Federal position limits in the clearest possible fashion. Additionally, the amendments to part 40 will allow regular and accurate updates to this list.

Some commenters expressed concern that the Staff Workbook lists contracts that are not referenced contracts,[538] or provided examples asking for clarification.[539] One commenter recommended that the Commission appoint a task force to develop a comprehensive baseline list of referenced contracts listed for trading on exchanges.[540]

The Commission believes that Commission staff (as opposed to a taskforce) is best positioned to continually refine the Workbook through accurate, timely updates, as aided by the additional information required by the newly adopted amendments to part 40 under the Final Rule.

Further, some commenters believed that the Commission should require exchanges to publish and maintain a definitive list of referenced contracts (other than economically equivalent swaps).[541] While CME Group did not believe that the Commission should impose such a requirement on exchanges, it supported coordinating

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[536] FIA at 6; MFA/AIMA at 9.

[537] CME Group at 13; ICE at 12.

[538] FIA at 6; ICE at 9-12. ICE is specifically concerned that the proposed workbook contains inconsistencies, such as including location basis contracts and PRA/Price Index Contracts.

[539] Chevron at 14; CEWG at 29.

[540] CEWG at 30.

[541] MFA/AIMA at 7; Citadel at 4-5; SIFMA AMG at 11-12.

with the Commission to ensure consistency, and publishing this information on CME Group's website.[542]

The Commission believes that publication of the Staff Workbook on the www.cftc.gov website will provide a centralized location for market participants to assess whether certain instruments are subject to Federal position limits. Although the Commission is encouraged that exchanges may provide redundancy in also publishing this list of core referenced futures contracts and related referenced contracts listed for trading on their respective exchanges, the Commission is not adopting a requirement for exchanges to publish this information at this time.

Finally, CME Group contended that for commodities with only spot month limits, financially-settled futures and options contracts should be excluded from the Staff Workbook and not subject to Federal position limits if the final settlement/expiry of the cash-settled futures or option occurs before the spot month period of its core referenced futures contract begins. CME Group additionally asserted that option contracts that exercise into physically-settled core referenced futures contracts should be included in the Staff Workbook and subject to Federal position limits even if final settlement/expiry of the option occurs before spot month period begins.

The Commission agrees with both of CME Group's assertions with one exception. While the Commission agrees that cash-settled futures contracts and options on such futures contracts that are non-legacy contracts (*i.e.*, the 16 core referenced futures contracts that will not have Federal non-spot position limits) and settle or expire prior to when the spot month limits would become effective in the spot period are not subject to Federal spot month position limits, such futures and options contracts do qualify as referenced contracts based on the settlement price being linked to a core referenced futures contract. However, because the corresponding 16 core referenced futures

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[542] CME Group at 14.

contracts are not subject to non-spot month Federal position limits, then these cash-settled futures contracts and options contracts similarly are also not subject to Federal position limits during the non-spot month. Accordingly, as contracts not subject to Federal spot or non-spot month position limits, these contracts will not be included in the Staff Workbook, even if such contracts qualify as referenced contracts. The Commission further agrees that options that exercise into the physically-settled core referenced futures contract are within the definition of referenced contract because when the options are exercised, they become positions in the core referenced futures contract.

The Commission is clarifying that it will publish a revised Staff Workbook shortly after the publication of this Final Rule on the Commission's website and before the Final Rule's Effective Date. This revised Staff Workbook will reflect the revised "referenced contract" definition, clarify CME Group's discussion with respect to options discussed in the immediately above paragraph, and generally fix any errors identified by commenters.

17. "Short Position"

i. Summary of the 2020 NPRM - Short Position

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

ii. Comments and Summary of the Commission Determination - Short Position

No commenter addressed the proposed definition of "short position." The Commission is adopting the definition as proposed.

18. "Speculative Position Limit"

i. Summary of the 2020 NPRM - Speculative Position Limit

The Commission proposed to define the term "speculative position limit" for use throughout part 150 of the Commission's regulations to refer to Federal or exchange-set

limits, net long or net short, including single month, spot month, and all-months-combined limits. This proposed definition was not intended to limit the authority of exchanges to adopt other types of limits that do not meet the "speculative position limit" definition, such as a limit on gross long or gross short positions, or a limit on holding or controlling delivery instruments.

ii. Comments and Summary of the Commission Determination - Speculative Position Limit

No commenter addressed the proposed definition of "speculative position limit." The Commission is adopting the definition as proposed with some non-substantive technical changes related to the numbering structure.

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

i. Summary of the 2020 NPRM – Spot Month, Single Month, and All Months

The Commission proposed to expand the existing definition of "spot month" to: (1) account for the fact that the proposed limits would apply to both physically-settled and certain cash-settled contracts; (2) clarify that the spot month for referenced contracts would be the same period as that of the relevant core referenced futures contract; and (3) account for variations in spot month conventions that differ by commodity.

In particular, for the ICE Sugar No. 11 (SB) core referenced futures contract, the spot month would mean the period of time beginning at the opening of trading on the second business day following the expiration of the regular option contract traded on the expiring futures contract and ending when the contract expires. For the ICE Sugar No. 16 (SF) core referenced futures contract, the spot month would mean the period of time beginning on the third-to-last trading day of the contract month and ending when the contract expires. For the CME Live Cattle (LC) core referenced futures contract, the spot month would mean the period of time beginning at the close of trading on the first

business day following the first Friday of the contract month and ending when the contract expires.

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

ii. Comments and Summary of the Commission Determination - Spot Month, Single Month, and All Months

No commenter addressed the proposed definition of "spot month" or the proposed elimination of the existing definitions of "single month" and "all months." The Commission is adopting the definition of spot month as proposed, but with a correction to reflect the proper spot month period for the Live Cattle (LC) core referenced futures contract. Final § 150.1 defines the spot month for the Live Cattle (LC) core referenced futures contract as the period of time beginning at the close of trading on the first business day following the first Friday of the contract month and ending when the contract expires. The Commission is eliminating the existing definitions of "single month" and "all months" as proposed. Finally, the Commission is adopting some non-substantive technical changes related to the numbering structure.

20. "Spread Transaction"

i. Background - Spread Transaction, Existing § 150.3(a)(3)

In existing § 150.3(a)(3), the Commission exempts from Federal position limits "spread or arbitrage positions," subject to certain restrictions, including the restriction that the spread position be outside of the spot month.[543] The existing regulations do not, however, define "spread or arbitrage positions." Further, under existing regulations, spread exemptions from Federal positions limits are self-effectuating and do not require

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[543] *See* 17 CFR 150.3(a)(3) (permitting spread or arbitrage positions that are "between single months of a futures contract and/or, on a futures-equivalent basis, options thereon, outside of the spot month, in the same crop year; provided, however, that such spread or arbitrage positions, when combined with any other net positions in the single month, do not exceed the all-months limit set forth in § 150.2.")

prior Commission approval. Rather, market participants must request spread exemptions from the relevant exchange(s) in advance of exceeding exchange limits.

ii. Summary of the 2020 NPRM - Spread Transaction

The Commission proposed a "spread transaction" definition to exempt from Federal position limits transactions normally known to the trade as "spreads." The proposed definition would explicitly include common types of spread strategies, including: calendar spreads; inter-commodity spreads; quality differential spreads; processing spreads (such as energy "crack" or soybean "crush" spreads); product or by-product differential spreads; and futures-options spreads. The proposed spread transaction definition would also eliminate the existing § 150.3(a)(3) restrictions on spread exemptions, including the restriction that spread positions be outside of the spot-month.

Under proposed § 150.3(a)(2)(i), positions that meet the "spread transaction" definition would be self-effectuating for purposes of Federal position limits. Separately, under proposed § 150.3(a)(2)(ii), the Commission would, on a case-by-case basis, be able to exempt any other spread transaction that was not included in the proposed spread transaction definition, but that the Commission has determined is consistent with CEA section 4a(a)(3)(B),[544] and exempted, pursuant to proposed § 150.3(b).

iii. Summary of the Commission Determination - Spread Transaction

The Commission is adopting the definition of "spread transaction" with certain modifications to the definition to include additional spread types, as described below, to address commenters' views and other considerations. The Commission is providing additional clarification with respect to cash-and-carry exemptions as well as the application of spread exemptions to the NYMEX NG core referenced futures contract. The Commission is also adopting Appendix G to part 150 under the Final Rule to provide

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

additional clarifications to market participants in connection with the Commission's treatment of spread exemptions under the Final Rule.

iii. Comments - Spread Transaction

Generally, commenters requested that the Commission expand or clarify the "spread transaction" definition to ensure that other commonly-used spread strategies are exempted from Federal position limits, including: (1) intra-market and inter-market spread positions;[545] (2) inter-market spread positions where the legs of the transaction are futures contracts in the same commodity and same calendar month or expiration;[546] (3) inter-market spreads in which one leg is a referenced contract and the other is a commodity derivative contract (including an OTC swap) that is not subject to Federal positions limits; [547] (4) a spread between a physically-settled position and a cash-settled position;[548] (5) a spread between two cash-settled contracts in the spot period, even if one leg is not subject to Federal position limits;[549] (6) intra-commodity spreads (including an intra-commodity spread between two cash-settled contracts or between the cash-settled and related physically-settled futures contract);[550] and (7) cash-and-carry exemptions that are currently permitted under IFUS Rule 6.29(e).[551]

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[545] MFA/AIMA at 10; CMC at 7.

[546] ICE at 7.

[547] ICE at 7; FIA at 21.

[548] CME Group at 11.

[549] *Id.*

[550] CEWG at 27; FIA at 20-21 (explaining that the intra-commodity spread would acknowledge the link between the prices of cash-settled and physical delivery futures involving the same commodity). *See also* CEWG at 27; CCI at 2-3 (requesting an exemption for intra-commodity spreads that are: (1) in the same class of referenced contract, (2) across classes of referenced contracts, or (3) across markets in referenced contracts (*i.e.*, on different exchanges) in the same or different calendar months); CEWG at 27 (providing proposed revisions to the "spread transaction" regulatory text); CME Group at 11.

[551] FIA at 21; *see also,* IFUS at 7-9 (providing an example of a cash-and-carry exemption and describing such exemption as a type of calendar month spread where a person holds a long position in the spot month and a short position in the second nearby contract month) and IFUS Rule 6.29(e) (outlining its strict procedures that set the terms by which cash-and-carry exemptions may be permitted, including the following conditions: (i) the person seeking the exemption must provide the cost of carrying the physical commodity, the minimum spread differential at which it will enter into a straddle position in order to obtain profit, and the quantity of stocks currently owned in IFUS licensed warehouses or tank facilities; (ii) when granted a cash and carry exemption, the person receiving the exemption shall agree that before the price of the nearby contract month rises to a premium to the second contract month, it will liquidate all long positions in the nearby contract month; and (iii) block trades may not be used to establish positions upon which a cash and carry exemption request is based). IFUS further explained that it has a long history of granting cash and carry exemptions for certain warehoused contracts (specifically coffee, cocoa, and FCOJ), and that where there are plentiful supplies, these exemptions serve an economic purpose in the days leading up to the first notice day and throughout the notice period, because: (1) they help maintain an appropriate economic relationship between the nearby and next successive contract month; (2) they allow commercial market participants the opportunity to compete for the ownership of certified inventories beyond the limitations of the spot-month position limit; and (3) the holder of the exemption provides liquidity so that traders that carry short positions into the notice period without capability to deliver may exit their positions in an orderly manner. According to IFUS, if the appropriate supply and price relationship exists in a given expiry, and the exchange grants the application, then proper application of the terms as expiry approaches will assist in an orderly expiration. IFUS 7-9; FIA at 21.

In addition, commenters requested that the Commission clarify that: (1) the "spread transaction" definition is a non-exhaustive list, and therefore, permit exchanges to grant spread exemptions that are not covered by § 150.3(a)(2) by using the streamlined process in § 150.9 for recognizing non-enumerated bona fide hedges;[552] and (2) a calendar spread would permit a market participant to net down its positions for the purposes of Federal spot-month and single-month limits.[553]

iv. Discussion of Final Rule - Spread Transaction

The Commission is adopting the proposed definition of "spread transaction" with certain modifications, as described below, to address commenters' views and other considerations. First, the Commission is expanding the definition to include additional types of spreads. Second, the Commission is clarifying the treatment of cash-and-carry exemptions as permissible calendar spreads and providing additional guidance to exchanges in connection with such spreads. Third, the Commission addresses the application of spread exemptions in connection with the NYMEX NG core referenced futures contract. The Commission is also providing additional guidance on the use of exempt spread transactions in Appendix G of this Final Rule.

a. The "Spread Transaction" Definition Includes Several Additional Spread Types under the Final Rule

First, the Commission is expanding the proposed "spread transaction" definition to make clear that the definition as finalized includes intra-market, inter-market, and intra-commodity spread positions in addition to the spread strategies listed in the proposed definition. The final "spread transaction" definition will cover: intra-market spreads, inter-market spreads, intra-commodity spreads, and inter-commodity spreads, including calendar spreads, quality differential spreads, processing spreads, product or

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[552] ICE at 7.

[553] Citadel at 8-9.

by-product differential spreads, and futures-options spreads.[554] The Commission intends for the spread transaction definition to be sufficiently broad to capture most, if not all, spread strategies currently granted by exchanges and used by market participants. The Commission believes this is consistent with, but provides more clarity than, its existing approach to spread exemptions in existing § 150.3(a)(3), which broadly exempts "spread or arbitrage positions."[555]

In light of the revised "spread transaction" definition, the Commission expects that most spread strategies will qualify as intra-market, inter-market, inter-commodity, or intra-commodity spreads, and is providing a non-exhaustive list of the most common specific types of spread strategies that fall within those four categories. Any requests for spread exemptions that fall outside of the spread transaction definition are required to be submitted to the Commission in advance pursuant to § 150.3(b) of the Final Rule. Accordingly, the Commission has determined not to allow exchanges to grant new types of spread exemptions using the streamlined process in § 150.9 for various reasons explained below in detail under the discussion of § 150.3.[556]

In addition, considering the significant number of requests for clarification commenters submitted regarding the spread transaction definition, the Commission is providing guidance on spread transactions in Appendix G to part 150 of the Commission's regulations, as adopted in this Final Rule, to address those questions and

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

[555] Under existing regulations, the Commission views its use of the term "spread" to mean the same as "arbitrage" or "straddle" as those terms are used in CEA section 4a(a) and existing § 150.3(a)(3) of the Commission's regulations. Consistent with existing regulations, the Commission's sole use of the term "spread" in this rulemaking is intended to also capture arbitrage or straddle strategies, and is not intended to be a substantive change from its existing regulations. The Commission notes that certain exchanges may distinguish between "spread" and "arbitrage" positions for purposes of exchange exemptions, but the Commission does not make that distinction here for purposes of its "spread transaction" definition.

[556] *See infra* Section II.C.4. (discussing statutory and policy reasons why the Commission will not permit exchanges to process requests for spread exemptions that are not included in the "spread transaction" definition using the § 150.9 process).

other considerations. In particular, paragraph (a) of the guidance provides some recommended best practices for exchanges to consider when granting spread exemptions, especially during the spot period. Paragraph (a) of the guidance also reminds exchanges of their existing obligations as self-regulatory organizations, including under DCM Core Principle 5 and SEF Core Principle 6, as applicable, to implement their exchange-set limits and exemption granting processes in a way that (consistent with the rules and procedures in final § 150.5 adopted herein)[557] reduces the potential threat of market manipulation or congestion.

Moreover, paragraph (b) of the guidance clarifies that the following spread strategies are covered by the "spread transaction" definition: (1) inter-market spread positions where the legs of the transaction are futures contracts in the same commodity and same calendar month or expiration; (2) spread positions in which one leg is a referenced contract and the other is a commodity derivative contract that is not subject to Federal positions limits (including OTC commodity derivative contracts, but not including commodity index contracts);[558] (3) a spread between a physically-settled position and a cash-settled position; (4) a spread between two cash-settled contracts; (5) certain cash-and-carry exemptions, subject to certain recommendations and considerations outlined in paragraph (c) of the Commission's guidance in Appendix G of this Final Rule; and (6) spreads that are "legged in" or carried out in two steps.

b. "Cash-and-carry" Exemptions

Second, as mentioned above, paragraph (c) of the guidance recommends certain factors for exchanges to consider when granting cash-and-carry exemptions.[559] The

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[557] *See infra* Section II.D. (discussing exchanges' obligations when setting exchange position limits and granting exemptions therefrom).

[558] To avoid subverting the Commission's policy on not allowing self-effectuating risk management exemptions (except through the pass-through swap provision), the spread transaction definition would not cover a spread position in which one leg is a referenced contract and the other leg is a commodity index contract, as clarified in Appendix G.

[559] As final Appendix G provides, the spread transaction definition in § 150.1 permits transactions commonly known as "cash-and-carry" trades whereby a market participant enters a long futures positions in the spot month and an equivalent short futures position in the following month, in order to guarantee a return that, at minimum, covers the costs of its carrying charges. With this exemption, the market participant is able to take physical delivery of the product in the nearby month and may redeliver the same product in a deferred month.

Commission understands that IFUS has granted this type of calendar spread exemption for some time, and has experience monitoring the use of such exemptions to ensure that its market operates in a manner that is consistent with the applicable DCM Core Principles.[560] The Commission has, however, previously expressed concern about these exemptions and their impact on the spot month price for a particular futures contract.[561] In particular, the Commission has explained that a large demand for delivery on cash-and-carry positions might distort the price of the expiring futures contract upwards.[562] This would particularly be a concern in those commodity markets where price discovery for the cash spot price occurred in the expiring futures contract.[563]

The Commission recognizes, however, the importance of cash-and-carry positions in the price discovery process in certain markets and reminds exchanges of their responsibility to monitor and safeguard against convergence issues that could arise related to the use of cash-and-carry exemptions. Accordingly, the Commission views these exemptions as a type of calendar spread strategy that warrants additional guidance to encourage exchanges to have suitable safeguards in place to ensure that they grant and monitor cash-and-carry exemptions in a manner that is consistent with their obligation to reduce the potential threat of market manipulation and congestion.

c. Treatment of Spread Transactions Involving NYMEX NG

Third, the Commission is providing clarification regarding the intersection of the conditional natural gas spot month limit exemption and spread exemptions permitted under § 150.3. As set forth in Appendix G, the Commission reinforces that a spread transaction exemption would not cover natural gas spot month positions that exceed the conditional natural gas spot month limit in § 150.3(a)(4) of this Final Rule. That is, a

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[560] *See* IFUS at 7-9 and ICE Futures U.S. Rule 6.29(e).
[561] *See* 81 FR at 96833.
[562] *Id.*
[563] *See* 81 FR at 96833.

market participant cannot rely on a spread transaction exemption to hold a spot month position that would exceed the equivalent of 10,000 contracts of the NYMEX Henry Hub Natural Gas core referenced futures contract per exchange that lists a natural gas cash-settled referenced contract. Additional discussion on the natural gas conditional spot month limit exemption is provided further below.[564]

As discussed further below, in § 150.3, the Commission is providing an exemption from the Federal spot month position limit level for natural gas. The natural gas conditional spot month limit exemption allows a trader to hold up to: (1) 10,000 spot month cash-settled NYMEX NG referenced contracts per exchange that lists a cash-settled NYMEX NG referenced contract (of which there are currently three—NYMEX, IFUS, and Nodal); and (2) an additional position in cash-settled economically equivalent NYMEX NG OTC swaps that has a notional amount equal to 10,000 equivalent-sized contracts; provided, that the market participant does not hold positions in the spot month of the physically-settled NYMEX NG referenced contract.[565] The Commission adopted the Federal conditional limit for natural gas in order to avoid disrupting the well-developed, unique liquidity characteristics of the natural gas derivatives markets, in which the cash-settled natural gas referenced contracts, when combined, have significantly higher liquidity than the physically-settled natural gas contracts. The Federal conditional limit requires divestiture of the spot month physically-settled NYMEX referenced contract due to concerns about, among other things, fostering an environment that incentivizes traders to manipulate the physically-settled NYMEX NG referenced contract in order to benefit a larger cash-settled position in natural gas (*i.e.,* "bang" or "mark" the close). The Commission intends for the natural gas conditional

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[564] *See infra* Section II.B.3.vi.a. (discussing the Federal spot-month limit for natural gas under § 150.2) and Section II.C.6 (discussing the conditional spot-month limit for natural gas under § 150.3(a)(4)).

[565] This is different from the final Federal spot month position limits for NYMEX NG, pursuant to which a trader may hold up to: (1) 2,000 cash-settled NYMEX NG referenced contracts per exchange that lists a cash-settled NYMEX NG referenced contract; (2) an additional position in cash-settled economically equivalent NYMEX NG OTC swaps that has a notional amount equal to 2,000 equivalent-sized contracts; and (3) 2,000 physically-settled NYMEX NG referenced contracts.

limit's position limit levels to serve as a firm cap for the maximum amount of cash-settled natural gas spot month positions a trader can hold. The Commission clarifies that a person cannot circumvent this cap using a spread transaction exemption.

That is, the Commission believes that cash-settled natural gas positions that exceed the natural gas conditional limit in the spot month would be unusually large and could potentially have a disruptive effect on the physically-settled natural gas contract, including by inhibiting convergence at expiration. Specifically, by allowing traders to layer additional cash-settled natural gas spot month positions on top of the maximum cash-settled natural gas spot month positions permitted under the natural gas conditional limit, a person could amass an extremely large cash-settled spot month position in natural gas. This extremely large cash-settled spot month position could push prices up for cash-settled spot month contracts vis-à-vis the physically-settled spot month contracts. In response, arbitrageurs may attempt to capitalize on this price discrepancy by going short the cash-settled spot month contracts, which would have a downward pressure on the price of these contracts, and going long on the physically-settled spot month contracts, which would have an upward pressure on the price of these contracts. This upward price pressure on the physically-settled contract could potentially push the price of the physically-settled contract away from the actual cash price for the natural gas commodity, which could disrupt convergence upon expiration of the physically-settled contract. As such, the Commission clarifies that a person cannot layer a spread exemption on top of the conditional spot month limit in natural gas and thereby circumvent the conditional spot month limit cap.[566]

21. "Swap" and "Swap Dealer"

i. Summary of the 2020 NPRM – Swap and Swap Dealer

[566] For the avoidance of doubt, traders who avail themselves of a spread exemption and enter into spread positions between the physically-settled NYMEX NG core referenced futures contract during the spot month and one or more cash-settled natural gas referenced contracts or cross commodity contracts, are not allowed under the Final Rule to avail themselves of the natural gas conditional limit until they exit the above-noted spread position.

The Commission proposed to incorporate the definitions of "swap" and "swap dealer" as they are defined in section 1a of the Act and § 1.3 of this chapter.[567]

ii. Comments and Summary of the Commission Determination – Swap and Swap Dealer

No commenter addressed the proposed definitions of "swap" or "swap dealer." The Commission is adopting these definitions as proposed.

22. "Transition Period Swap"

i. Summary of the 2020 NPRM – Transition Period Swap

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

ii. Comments and Summary of the Commission Determination - Transition Period Swap

No commenter addressed the proposed definition of "transition period swap." The Commission is adopting the definition as proposed, with two modifications. The Commission is clarifying that a transition period swap is a swap entered into during the period commencing "on the day of," rather than "after," the enactment of the Dodd-Frank Act of 2010 to clarify the ambiguity of the phrase "after the enactment." The Commission is also adding a phrase to clarify that the terms of such swaps "have not expired as of 60 days after the publication date." The Commission intended to include

[567] 7 U.S.C. 1a(47) and 1a(49); 17 CFR 1.3.

this in the 2020 NPRM, but the language was inadvertently omitted from the proposed definition. This modification conforms to the definition of "pre-enactment swap," which also addresses the timeframe for expiration of a swap's terms.

23. Deletion of § 150.1(i)

i. Summary of 2020 NPRM - Deletion of § 150.1(i)

The Commission proposed to eliminate existing § 150.1(i), which includes a table specifying the "first delivery month of the crop year" for certain commodities. The crop year definition had been pertinent for purposes of the spread exemption to the individual month limit in current § 150.3(a)(3), which limits spreads to those between individual months in the same crop year and to a level no more than that of the all-months limit. This provision was pertinent at a time when the single month and all-months-combined limits were different, which is no longer the case.

ii. Comments and Summary of the Commission Determination - Deletion of § 150.1(i)

No commenter addressed the proposed elimination of existing § 150.1(i). The Commission is adopting as proposed. Now that the current and proposed single month and all months combined limits are the same, and now that the Commission is adopting new enumerated bona fide hedges in § 150.1 and Appendix B to part 150 as well as a new process for granting spread exemptions in § 150.3, this provision is no longer needed.

B. § 150.2—Federal Position Limit Levels

This section will address the issues related to Federal position limit levels in final § 150.2 in the following order:[568]

(1) background of the existing Federal position limit levels;

[568] In connection with the discussion of § 150.2 that appears below, for each numbered section, the Commission generally provides a summary of the proposed approach, a brief overview of the Commission's final determination, a summary of comments, and the Commission's response to comments.

(2) identification of contracts subject to both Federal spot and non-spot month position limits, and contracts subject only to Federal spot month position limits;

(3) Federal spot month position limit levels;

(4) Federal non-spot month position limit levels;

(5) the establishment of subsequent spot month and non-spot month position limit levels;

(6) relevant contract months;

(7) limits on "pre-existing positions";

(8) positions on foreign boards of trade;

(9) anti-evasion;

(10) netting and Federal position limit levels for cash-settled referenced contracts; and

(11) "eligible affiliates" and position aggregation.

As part of the discussion of Federal spot month position limit levels (noted as issue (3) above and found in Section II.B.3. below), the Commission also will address Federal spot month position limit levels specifically for (i) ICE Cotton No. 2 (CT), (ii) NYMEX Henry Hub Natural Gas (NG), and (iii) the three wheat core referenced futures contracts. Similarly, as part of the discussion of Federal non-spot month position limit levels (noted as issue (4) above and found in Section II.B.4. below), the Commission will also address Federal non-spot month position limit levels specifically for (i) ICE Cotton No. 2 (CT) and (ii) the three wheat core referenced futures contracts.

1. Background – Existing Federal Position Limit Levels - §150.2

Federal spot month, single month, and all-months-combined position limits currently apply to the nine physically-settled legacy agricultural contracts listed in existing § 150.2, and, on a futures-equivalent basis, to options contracts thereon. Existing

Federal position limit levels set forth in § 150.2[569] apply net long or net short and are as follows:

Existing Legacy Agricultural Contract Federal Spot Month, Single Month, and All-Months-Combined Position Limit Levels		
Contract	Spot Month Position Limit Level	Single Month and All-Months-Combined Position Limit Level
Chicago Board of Trade ("CBOT") Corn (C)	600	33,000
CBOT Oats (O)	600	2,000
CBOT Soybeans (S)	600	15,000
CBOT Soybean Meal (SM)	720	6,500
CBOT Soybean Oil (SO)	540	8,000
CBOT Kansas City Hard Red Winter Wheat (KW)	600	12,000
CBOT Wheat (W)	600	12,000
ICE Cotton No. 2 (CT)	300	5,000
MGEX Hard Red Spring Wheat (MWE)	600	12,000

While not explicitly stated in § 150.2, the Commission's practice has been to set Federal spot month position limit levels at or below 25% of deliverable supply based on exchange estimates of deliverable supply ("EDS") that are verified by the Commission, and to set Federal position limit levels outside of the spot month at 10% of open interest for the first 25,000 contracts of open interest, with a marginal increase of 2.5% of open interest thereafter.

2. Application of Federal Position Limits During the Spot Month and the Non-Spot Month

i. Summary of the 2020 NPRM – Application of Federal Position Limits During the Spot Month and the Non-Spot Month

The 2020 NPRM imposed Federal position limits during all contract months for the nine legacy agricultural contracts (and their associated referenced contracts), and only during the spot month for the 16 non-legacy core referenced futures contracts (and their associated referenced contracts) that would be subject to Federal position limits for the

[569] 17 CFR 150.2.

first time.[570] For the 16 non-legacy core referenced futures contracts (and their associated referenced contracts), the 2020 NPRM also required that they be subject to exchange-set position limits or position accountability outside of the spot month.[571]

The Commission proposed to maintain (rather than remove) Federal non-spot month position limits for the nine legacy agricultural contracts, with the modifications described further below, because the Commission has observed no reason to eliminate them.[572] These non-spot month position limits have been in place for decades, and while the Commission proposed to modify the Federal non-spot month position limit levels, the Commission believed that removing them entirely could potentially result in market disruption. The Commission's position was reinforced by the feedback it received from commercial market participants trading the nine legacy agricultural contracts who requested that the Commission maintain Federal position limits outside of the spot month in order to promote market integrity.[573]

ii. Summary of the Commission Determination - Application of Federal Position Limits During the Spot Month and the Non-Spot Month

The Commission is adopting the approach that was proposed in the 2020 NPRM. Under the Final Rule, Federal position limits apply to all 25 core referenced futures contracts during the spot month. The 16 non-legacy core referenced futures contracts subject to Federal position limits for the first time under the Final Rule are subject to Federal position limits only during the spot month (and not outside of the spot month). Outside of the spot month, these 16 core referenced futures contracts are subject only to exchange-set position limits or position accountability.

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[570] As noted in further detail in Section II.A.16., their associated referenced contracts are also subject to Federal position limits.

[571] Proposed § 150.5(b)(2). For existing exchange-set position limits, *see Market Resources*, ICE Futures U.S. website, available at https://www.theice.com/futures-us/market-resources (ICE exchange-set position limits); *Position Limits*, CME Group website, available at https://www.cmegroup.com/market-regulation/position-limits.html; *Rules and Regulations of the Minneapolis Grain Exchange, Inc.*, MGEX, available at http://www.mgex.com/documents/Rulebook_051.pdf (MGEX exchange-set position limits).

[572] 85 FR at 11628.

[573] *Id*.

iii. Comments - Application of Federal Position Limits During the Spot Month and the Non-Spot Month

Many commenters generally agreed with the proposed approach and supported Federal position limits during the spot month for all 25 core referenced futures contracts, and outside of the spot month for only the nine legacy agricultural contracts.[574] The Commission did not receive any comments objecting to Federal spot month position limits for all 25 core referenced futures contracts.

On the other hand, the Commission received comments expressing concern over two related issues. First, a few commenters disagreed with the 2020 NPRM imposing Federal non-spot month position limits on only the nine legacy agricultural contracts.[575] NEFI stated that "the proposed rule arbitrarily fails to establish limits for non-spot month referenced energy contracts" and stated that "distributing limits across all months is preferable, as it would protect market convergence and mute disruptive signals from large speculative trades."[576] PMAA echoed similar concerns by stating that there was "no data or discussion provided in the proposal indicating why the Commission believes limits for non-spot months are not appropriate."[577]

Second, commenters also expressed concern that, by only having Federal non-spot month position limits for the nine legacy agricultural contracts, the Commission is relying too much on the exchanges to address excessive speculation.[578] In particular, commenters were concerned about the incentives and other conflicts of interest that exchanges may have to permit "higher trading volumes and large numbers of market

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[574] *See* MGEX at 1; CHS at 2; CME Group at 2; IFUS at 2; ICE at 2, 3-4; Chevron at 2; CMC at 6; EEI at 4; FIA at 2; MFA/AIMA at 2-3; NCFC at 4; Shell at 3; PIMCO at 4; SIFMA AMG at 4; Suncor at 2; AQR at 2, 4-5, 7-10; CCI at 2; COPE at 4; IECA at 2; NGSA at 3; CEWG at 3; and AFIA at 2.

[575] In addition to comments from NEFI and PMAA, which are discussed below, AFR and Rutkowski asserted that the 2020 NPRM will likely be "ineffective in controlling excessive speculation" due, in part, to its failure to "impose Federal position limits outside of the current spot month for most commodities (outside of legacy agricultural commodities)." AFR at 2 and Rutkowski at 2.

[576] NEFI at 3 and PMAA at 3 (with respect to energy commodity positions, "[h]istory has shown on a number of occasions that large trades in non-spot months can distort markets and increase volatility").

[577] PMAA at 3. PMAA also suggested that the Commission apply the "traditional 2.5% limit formula to energy contracts and economically equivalent energy futures, options, and swaps in non-spot months."

[578] NEFI at 3; PMAA at 3; and IATP at 10.

participants"[579] and about the exchanges' use of position accountability by alleging that it is a "voluntary" limit[580] and pointing to "recent notable failures in exchange accountability regimes."[581]

iv. Discussion of Final Rule - Application of Federal Position Limits During the Spot Month and the Non-Spot Month

The Commission is adopting the approach that was proposed in the 2020 NPRM by applying Federal position limits to all 25 core referenced futures contracts during the spot month, but only to the existing nine legacy agricultural contracts outside of the spot month for the reasons discussed below.

a. Response to Comments Opposing the 2020 NPRM's Approach to Subject Only the Nine Legacy Agricultural Contracts to Federal Non-Spot Month Position Limits

The Commission has concluded that, while it may be important and, as described below, necessary[582] to impose Federal spot month position limits on each core referenced futures contract, the analysis changes with respect to the non-spot month for the following reasons.

First, while the Final Rule only applies Federal position limits to the 16 non-legacy core referenced futures contracts during the spot month, the Final Rule requires exchanges to establish either position limit levels or position accountability outside of the spot month for all such contracts.[583] Accordingly, all 16 non-legacy core referenced futures contracts will be subject to either position limits or position accountability outside of the spot month at the exchange level. Any such exchange-set position limit and position accountability must comply with the standards established by the Commission in final § 150.5(b) including, among other things, that any such levels be "necessary and

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[579] NEFI at 3.

[580] *Id*.

[581] IATP at 10. *See also* PMAA at 3 ("[u]nfortunately, the proposal instead finds accountability limits to be sufficient to manage speculation").

[582] *See infra* Section III.E. (discussing necessity finding for spot month and non-spot month position limits).

[583] Final § 150.5(b)(2).

appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index."[584] Exchanges are also required to submit any rules adopting or modifying such position limit or position accountability to the Commission in advance of implementation pursuant to part 40 of the Commission's regulations.[585] Additionally, exchanges are subject to DCM Core Principle 5 or SEF Core Principle 6, as applicable, which establish additional protections against manipulation and congestion.[586] These tools and legal obligations, in conjunction with surveillance at both the exchange and Federal level, will continue to offer strong deterrence and protection against manipulation and disruptions outside of the spot month.[587]

Second, in response to the concerns expressed by NEFI and PMAA that a lack of Federal non-spot month position limits could harm market convergence and lead to disruptive signals from large speculative trades,[588] the Commission reiterates that corners and squeezes, and related convergence issues, do not occur outside of the spot month when there is no threat of delivery.[589] Convergence occurs during the spot month and, specifically, at the expiration of the spot month for a physically-settled contract. As a

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[584] *Id*.

[585] 17 CFR part 40. Under the final "position accountability" definition in § 150.1, exchange accountability rules must require a trader whose position exceeds the accountability level to consent to: (1) provide information about its position to the exchange; and (2) halt increasing further its position or reduce its position in an orderly manner, in each case as requested by the exchange.

[586] Commission regulation § 38.300, which mirrors DCM Core Principle 5, states: "To reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), the board of trade shall adopt for each contract of the board of trade, as is necessary and appropriate, position limitations or position accountability for speculators. For any contract that is subject to a position limitation established by the Commission, pursuant to section 4a(a), the board of trade shall set the position limitation of the board of trade at a level not higher than the position limitation established by the Commission." 17 CFR 38.300 and 7 U.S.C. 7(d)(5). Likewise, Commission regulation § 37.600, which mirrors SEF Core Principle 6, states: "(a) *In general*. To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, a swap execution facility that is a trading facility shall adopt for each of the contracts of the facility, as is necessary and appropriate, position limitations or position accountability for speculators. (b) *Position limits*. For any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a) of the Act, the swap execution facility shall: (1) Set its position limitation at a level no higher than the Commission limitation; and (2) Monitor positions established on or through the swap execution facility for compliance with the limit set by the Commission and the limit, if any, set by the swap execution facility." 17 CFR 37.600 and 7 U.S.C. 7b-3(f)(6).

[587] 85 FR at 11629.

[588] NEFI at 3 and PMAA at 3.

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

result, positions outside of the spot month have minimal impact on convergence. The Commission, however, recognizes that it is possible that unusually large positions in contracts outside of the spot month could distort the natural spread relationship between contract months. For example, if traders hold unusually large positions outside of the spot month, and if those traders exit those positions immediately before the spot month, that could cause congestion and also affect the pricing of the spot month contract. While such congestion or price distortion cannot be ruled out, exchange-set position limits and position accountability function to mitigate against such risks. Thus, the position limits framework adopted herein is able to guard against any such possibility through the tools and legal obligations applicable to exchanges that are described in the prior paragraph.

Third, limiting Federal non-spot month position limits to the nine legacy agricultural commodities may limit any market disruptions that could result from adding new Federal non-spot month position limits on certain metal and energy commodities that have never been subject to Federal position limits.[590]

b. Response to Comments Regarding the Commission's Reliance on Exchanges

In response to commenters' specific concerns about the reliance on exchanges' position accountability, the Commission views position accountability outside of the spot month as a more flexible alternative to Federal non-spot month position limits.[591] Position accountability establishes a level at which an exchange will start investigating a trader's current position. This will include, among other things, asking traders additional questions regarding their strategies and their purpose for the positions, while evaluating them under current market conditions. If a position does not raise any concerns, the exchange will allow the trader to exceed the accountability level. If the position raises concerns, the exchange has the authority to instruct the trader to stop adding to the

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[590] 85 FR at 11629.

[591] *Id*.

trader's position, or to reduce the position. Position accountability is a particularly effective tool because it provides the exchanges with an opportunity to intervene once a position hits a relatively low level (vis-à-vis the level at which a Federal or an exchange position limit level would typically be set), while still affording market participants with the flexibility to establish a position that exceeds the position accountability level if it is justified by the nature of the position and market conditions. Position accountability applies to all participants on the exchange, whether commercial or non-commercial, and regardless of whether the relevant participant would qualify for an exemption.

The Commission has decades of experience overseeing position accountability implemented by exchanges, including for all 16 non-legacy core referenced futures contracts that are not subject to Federal position limits outside of the spot month.[592] Based on the Commission's experience, position accountability has functioned effectively.[593] Furthermore, the Commission notes that position accountability is not the only tool available for exchanges. As noted previously, exchanges can also utilize exchange-set position limits. Several exchanges have set non-spot month position limits for contracts that are not subject to Federal position limits, and all of them appear to have functioned effectively based on the Commission's observation of those markets.[594]

With respect to IATP's reference to "recent notable failures" in position accountability levels, IATP appears to be referencing the events that involve Kraft Foods Group, Inc. and Mondelēz Global LLC with respect to the CBOT Wheat (W) contract in

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

[593] 85 FR at 11629.

[594] For example, exchanges have set non-spot month position limits for the following core referenced futures contracts, even though such contracts currently are not subject to Federal non-spot month position limits (and will continue to be subject only to Federal spot month position limits under this Final Rule): (1) CME Live Cattle (LC), which has an exchange-set single month position limit level of 6,300 contracts, but no all-months-combined position limit; (2) ICE FCOJ-A (OJ), which has an exchange-set single month position limit level of 3,200 contracts and an all-months-combined position limit level of 3,200 contracts; and (3) ICE Sugar No. 16, which has an exchange-set single month position limit level of 1,000 contracts and an all-months-combined position limit level of 1,000 contracts.

2011[595] and United States Oil Fund, LP ("US Oil") with respect to the WTI contract earlier this year.[596] With respect to CBOT Wheat (W), CBOT did not have position accountability for that contract at that time. With respect to the WTI contract, IATP does not describe the failure in position accountability that occurred with respect to US Oil and how such failure resulted in negative prices in the WTI contract.[597]

With respect to commenter concerns about the incentives of exchanges, the Commission believes that, although exchanges may have a financial interest in increased trading volume, whether speculative or hedging, the Commission closely oversees the establishment, modification, and implementation of exchange-set position limits and position accountability. As noted above, both exchange-set position limits and position accountability must comply with standards established by the Commission in final § 150.5(b) including, among other things, that any such levels be "necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index."[598] Exchanges are also required to submit any rules adopting or modifying exchange-set position limits or position accountability to the Commission in advance of implementation, pursuant to part 40 of the Commission's regulations.[599] Additionally, exchanges are subject to DCM Core Principle 5 or SEF Core Principle 6, as applicable, which establishes additional protections against manipulation and congestion.[600] Furthermore, exchange-set position limits and position accountability will be subject to rule enforcement reviews by the Commission.[601] Finally, the Commission notes that exchanges also have significant

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[595] CFTC Charges Kraft Foods Group, Inc. and Mondelēz Global LLC with Manipulation of Wheat Futures and Cash Wheat Prices (Apr. 1, 2015), U.S. Commodity Futures Trading Commission website, available at https://www.cftc.gov/PressRoom/PressReleases/7150-15.

[596] IATP at 5, 10, and 18.

[597] *Id.*

[598] Final § 150.5(b)(2).

[599] 17 CFR part 40.

[600] 17 CFR 38.300 and 17 CFR 37.600.

[601] The Commission conducts regular rule enforcement reviews of each exchange's audit trail, trade practice surveillance, disciplinary, and dispute resolution programs for ongoing compliance with the Core Principles. *See* Rule Enforcement Reviews of Designated Contract Markets, available at https://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/dcmruleenf.html.

financial incentives and regulatory obligations to maintain well-functioning markets. This observation, which has been supported by studies, is discussed in greater detail below.[602]

3. Federal Spot Month Position Limit Levels

i. Summary of the 2020 NPRM - Federal Spot Month Position Limit Levels

Under the 2020 NPRM, the Commission proposed applying Federal spot month position limits to all 25 core referenced futures contracts and any associated referenced contracts.[603] The spot month limits would apply separately to physically-settled and cash-settled referenced contracts, which meant that a market participant could net positions across physically-settled referenced contracts and separately net positions across cash-settled referenced contracts.[604] However, the market participant would not be permitted to net cash-settled referenced contracts with physically-settled referenced contracts.[605] Proposed § 150.2(e) provided that Federal spot month position limit levels would be set forth in proposed Appendix E to part 150.[606] The proposed spot month position limit levels were as follows:

Core Referenced Futures Contract	**2020 Proposed Federal Spot Month Position Limit Level**	**Existing Federal Spot Month Position Limit Level**	**Existing Exchange-Set Spot Month Position Limit Level**[607]
Legacy Agricultural Contracts			
CBOT Corn (C)	1,200	600	600
CBOT Oats (O)	600	600	600
CBOT Soybeans (S)	1,200	600	600

[602] Section II.B.3.iii.b.(3)(iii) (Concern over Exchanges' Conflict of Interest and Improper Incentives in Maintaining Their Markets).

[603] As described below, under the 2020 NPRM, Federal non-spot month position limit levels would only apply to the nine legacy agricultural contracts and their associated referenced contracts. The 16 non-legacy core referenced futures contracts and their associated referenced contracts would be subject to Federal position limits during the spot month, and exchange-set position limits or position accountability outside of the spot month.

[604] *See* Section II.B.10.

[605] *Id.*

[606] Proposed 150.2(e) additionally provided that market participants would not need to comply with the Federal position limit levels until 365 days after publication of the Final Rule in the *Federal Register*. For further discussion of the Final Rule's compliance and effective dates, *see* Section I.D. (Effective Date and Compliance Period).

[607] As of October 15, 2020.

CBOT Soybean Meal (SM)	1,500	720	720
CBOT Soybean Oil (SO)	1,100	540	540
CBOT Wheat (W)	1,200	600	600/500/400/300/220[608]
CBOT KC HRW Wheat (KW)	1,200	600	600
MGEX HRS Wheat (MWE)	1,200	600	600
ICE Cotton No. 2 (CT)	1,800	300	300
Other Agricultural Contracts			
CME Live Cattle (LC)	600/300/200[609]	n/a	600/300/200[610]
CBOT Rough Rice (RR)	800	n/a	600/200/250[611]
ICE Cocoa (CC)	4,900	n/a	1,000
ICE Coffee C (KC)	1,700	n/a	500
ICE FCOJ-A (OJ)	2,200	n/a	300
ICE Sugar No. 11 (SB)	25,800	n/a	5,000
ICE Sugar No. 16 (SF)	6,400	n/a	n/a[612]
Metals Contracts			
COMEX Gold (GC)	6,000	n/a	6,000
COMEX Silver (SI)	3,000	n/a	1,500
COMEX Copper (HG)	1,000	n/a	1,000
NYMEX Platinum (PL)	500	n/a	500
NYMEX Palladium (PA)	50	n/a	50

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

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

[610] CME's existing exchange-set limit for Live Cattle (LC) has the following step-down spot month position limit levels: (1) 600 contracts at the close of trading on the first business day following the first Friday of the contract month; (2) 300 contracts at the close of trading on the business day prior to the last five trading days of the contract month; and (3) 200 contracts at the close of trading on the business day prior to the last two trading days of the contract month.

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

[612] IFUS technically does not have an exchange-set spot month position limit level for ICE Sugar No. 16 (SF). However, it does have a single-month position limit level of 1,000 contracts, which effectively operates as a spot month position limit.

Energy Contracts			
NYMEX Light Sweet Crude Oil (CL)	6,000/5,000/4,000 [613]	n/a	3,000
NYMEX NYH ULSD Heating Oil (HO)	2,000	n/a	1,000
NYMEX NYH RBOB Gasoline (RB)	2,000	n/a	1,000
NYMEX Henry Hub Natural Gas (NG)	2,000[614]	n/a	1,000[615]

The proposed Federal spot month position limit levels for all referenced contracts were set at 25% or less of updated EDS and were derived from the recommendations by CME Group,[616] IFUS,[617] and MGEX[618] for each of their respective core referenced futures contracts. Federal spot month position limit levels for any contract with a proposed level above 100 contracts were rounded up to the nearest 100 contracts from the exchange-recommended limit level or from 25% of updated EDS, as applicable.

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[613] NYMEX recommended implementing the following step-down Federal spot month position limit levels with respect to its Light Sweet Crude Oil (CL) core referenced futures contract: (1) 6,000 contracts as of the close of trading three business days prior to the last trading day of the contract; (2) 5,000 contracts as of the close of trading two business days prior to the last trading day of the contract; and (3) 4,000 contracts as of the close of trading one business day prior to the last trading day of the contract.

[614] In Proposed § 150.3(a)(4), the Commission also proposed an exemption that provided a Federal conditional spot month position limit for NYMEX Henry Hub Natural Gas (NG) ("NYMEX NG") that permits a market participant that does not hold any positions in the physically-settled NYMEX NG referenced contract to hold: (1) 10,000 NYMEX NG equivalent-sized referenced contracts per exchange that lists a cash-settled NYMEX NG referenced contract; and (2) an additional position in cash-settled economically equivalent swaps with respect to NYMEX NG that has a notional amount equal to 10,000 contracts.

[615] Currently, the cash-settled natural gas contracts are subject to an exchange-set spot month position limit level of 1,000 equivalent-sized contracts *per exchange*. Currently, there are three exchanges that list cash-settled natural gas contracts—NYMEX, IFUS, and Nodal. As a result, a market participant may hold up to 3,000 equivalent-sized cash-settled natural gas contracts.

The exchanges also have a conditional position limit framework for natural gas. The conditional position limit permits up to 5,000 cash-settled equivalent-sized natural gas contracts *per exchange* that lists such contracts, provided that the market participant does not hold a position in the physically-settled NYMEX NG contract.

[616] *See* Summary DSE Proposed Limits, CME Group Comment Letter (Nov. 26, 2019), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596). CME Group formally provided recommended Federal spot month position limit levels for each of its core referenced futures contracts.

[617] *See* IFUS – Estimated Deliverable Supply – Softs Methodology, IFUS Comment Letter (May 14, 2019) and Reproposal – Position Limits for Derivatives (RIN 3038-AD99) and ICE Comment Letter (Feb. 28, 2017) (attached Sept. 28, 2016 comment letter), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596 and Proposed Rule 81 FR 96704, respectively). IFUS did not formally provide recommended Federal spot month position limit levels for each of IFUS's core referenced futures contracts. However, ICE had previously recommended setting Federal spot month position limit levels for IFUS's core referenced futures contracts at 25% of EDS in its comment letter in connection with the 2016 Reproposal and Commission staff also confirmed with ICE/IFUS's representatives that ICE/IFUS's position has remained the same with respect to the Federal spot month position limit levels since the 2016 Reproposal. The Commission notes, however, with respect to ICE Cotton No. 2 (CT), that IFUS has submitted a supplemental comment letter recommending that the Federal spot month position limit level be set at 900 contracts, instead of at 25% of EDS. *See* IFUS – Estimated Deliverable Supply – Cotton Methodology, August 2020, IFUS Comment Letter (August 27, 2020), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596).

[618] *See* Updated Deliverable Supply Data – Potential Position Limits Rulemaking, MGEX Comment Letter (Aug. 31, 2018), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596). MGEX did not formally provide a recommended Federal spot month position limit level for its core referenced futures contract (MGEX Hard Red Spring Wheat (MWE)) because it was opposed to providing a static number for the Federal spot month position limit level that was based on a fixed formula. Instead, MGEX sought to be able to adjust the Federal spot month position limit level based on updated EDS figures and market conditions. However, MGEX stated that the Federal spot month position limit level for MGEX Hard Red Spring Wheat (MWE) should be no lower than 1,000 contracts and also submitted calculations for setting the Federal spot month position limit level at 25% of EDS. Furthermore, MGEX supported setting the Federal spot month position limit level for MGEX Hard Red Spring Wheat (MWE) at 25% of EDS level in its comment letter. MGEX at 3.

As discussed in the 2020 NPRM, the existing Federal spot month position limit levels have remained constant for decades, but the markets have changed significantly during that time period.[619] As a result, some of the deliverable supply estimates on which the existing Federal spot month position limits were originally based were decades out of date.[620]

ii. Summary of the Commission Determination - Federal Spot Month Position Limit Levels

a. Federal Spot Month Position Limit Levels Adopted as Proposed, Except for ICE Cotton No. 2 (CT) and NYMEX Henry Hub Natural Gas (NG)

The Commission is adopting the Federal spot month position limit levels as proposed, except for modifications with respect to ICE Cotton No. 2 (CT) and NYMEX NG. Specifically, the Federal spot month position limit levels for all 25 core referenced futures contracts are set at or below 25% of EDS, except for the cash-settled NYMEX NG referenced contracts.

With respect to ICE Cotton No. 2 (CT), the Commission is adopting a lower Federal spot month position limit level of 900 contracts instead of the proposed 1,800 contracts. The reasons for this change are discussed in Section II.B.3.v.

With respect to NYMEX NG, the Final Rule is adopting the same Federal spot month position limit level as proposed in the 2020 NPRM, but the Final Rule is applying the cash-settled portion of the Federal spot month position limit for NYMEX NG separately for each exchange that lists a cash-settled NYMEX NG referenced contract, as well as the cash-settled NYMEX NG OTC swaps market, rather than on an aggregate basis across all exchanges and the OTC swaps market as it does for each of the other core

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[619] 85 FR at 11625.

[620] *Id*.

referenced futures contracts. The reasons for this change are discussed in Section II.B.3.vi.

(1) The Final Rule Achieves the Four Statutory Objectives in CEA Section 4a(a)(3)(B)

Before summarizing and addressing comments below regarding the proposed Federal spot month position limit levels, the Commission states at the outset that the final Federal spot month position limit levels, in conjunction with the rest of the Federal position limits framework, will achieve the four policy objectives in CEA section 4a(a)(3)(B). Namely, they will: (1) diminish, eliminate, or prevent excessive speculation; (2) deter and prevent market manipulation, squeezes, and corners; (3) ensure sufficient market liquidity for bona fide hedgers; and (4) ensure that the price discovery function of the underlying market is not disrupted.[621]

In achieving these four statutory objectives, the Commission first believes that the Federal spot month position limit levels are low enough to prevent excessive speculation and also protect price discovery. Setting the Federal spot month position limit levels at or below 25% of EDS is critically important because it would be difficult, in the absence of other factors, for a market participant to corner or squeeze a market if the participant holds less than or equal to 25% of deliverable supply.[622] This is because, among other things, any potential economic gains resulting from the manipulation may be insufficient to justify the potential costs, including the costs of acquiring and ultimately offloading the positions used to effectuate the manipulation.[623] By restricting positions to a proportion of the deliverable supply of the commodity, the Federal spot month position limits require that no one speculator can hold a position larger than 25% of deliverable supply, reducing the possibility that a market participant can use derivatives, including

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[621] 7 U.S.C. 6a(a)(3)(B).
[622] 85 FR at 11625-11626.
[623] *Id*.

referenced contracts, to affect the price of the cash commodity (and vice versa). Limiting a speculative position based on a percentage of deliverable supply also restricts a speculative trader's ability to establish a leveraged position in cash-settled derivative contracts, reducing that trader's incentive to manipulate the cash settlement price. Further, by finalizing levels that are sufficiently low to prevent market manipulation, including corners and squeezes, the levels also help ensure that the price discovery function of the underlying market is not disrupted, because markets that are free from corners, squeezes, and other manipulative activity reflect fundamentals of supply and demand, rather than artificial pressures.

The Commission also believes that the Federal spot month position limit levels adopted herein are high enough to ensure that there is sufficient market liquidity for bona fide hedgers.[624] The Commission has not observed a general lack of liquidity for bona fide hedgers in the markets for the 25 core referenced futures contracts, which are some of the most liquid markets overseen by the Commission.[625] By generally increasing the existing Federal spot month position limit levels for the nine legacy agricultural contracts based on updated data, and by adopting Federal spot month position limit levels that are generally equal to or higher than existing exchange-set levels for the 16 non-legacy core referenced futures contracts, the Commission does not expect the final Federal position limit levels to reduce liquidity for bona fide hedgers.[626]

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[624] CEA section 4a(a)(1) requires the Commission to address "[e]xcessive speculation…causing sudden or unreasonable fluctuations or unwarranted [price] changes…." Speculative activity that is not "excessive" in this manner is not a focus of CEA section 4a(a)(1). Rather, speculative activity may generate liquidity, including liquidity for bona fide hedgers, by enabling market participants with bona fide hedging positions to trade more efficiently. Setting position limits too low could result in reduced liquidity, including for bona fide hedgers. 85 FR at 11626.

[625] 85 FR at 11626. The Commission notes that it has observed a brief period of illiquidity during the early part of the spot month for ICE Cotton No. 2 (CT), which is discussed in Section II.B.3.v.

[626] *Id*. Eighteen of the core referenced futures contracts will have Federal spot month position limit levels that are higher than current exchange-set spot month position limit levels. CME Live Cattle (LC), COMEX Gold (GC), COMEX Copper (HG), CBOT Oats (O), NYMEX Platinum (PL), and NYMEX Palladium (PA) will have Federal spot month position limit levels that are equal to the current exchange-set spot month position limit levels. Finally, although currently there is technically no exchange-set spot month position limit for ICE Sugar No. 16 (SF), this contract is subject to a single month position limit level of 1,000 contracts, which effectively serves as its spot month position limit level. As a result, the Federal spot month position limit level for ICE Sugar No. 16 (SF) will effectively be higher than its current exchange-set spot month position limit level.

Furthermore, the Commission has previously stated that "there is a range of acceptable limit levels,"[627] and continues to believe that is true.[628] There is no single "correct" spot month position limit level for a given contract, and it is likely that a number of limit levels within a certain range could effectively achieve the four policy objectives in CEA section 4a(a)(3)(B).[629] The Commission believes that the spot month position limit levels adopted herein fall within a range of acceptable levels.[630] This determination is based on the Commission's experience in administering its own Federal position limits regime, overseeing exchange-set position limits, and being closely involved in determining the EDS figures underlying the position limit levels, as well as the fact that the Federal spot month position limit levels are generally set at or below 25% of EDS.[631]

In addition, the Federal spot month position limit levels are properly calibrated to account for differences between markets. For example, the Commission considered the unique delivery mechanisms for CME Live Cattle (LC) and the NYMEX metals core referenced futures contracts in calibrating the Federal spot month position limit levels for those contracts.[632] The Commission also considered the volatility of the EDS for COMEX Copper (HG) in determining its limit level.[633] Furthermore, with respect to NYMEX NG, the Commission, in fine-tuning the proposed limits, considered: the underlying natural gas infrastructure vis-à-vis commodities underlying other energy core referenced futures contracts; the relatively high liquidity in the cash-settled markets; and the public comments received in response to the 2020 NPRM.[634]

(2) Federal Position Limit Levels Operate as Ceilings

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[627] *See, e.g.*, Revision of Federal Speculative Position Limits, 57 FR 12766, 12770 (Apr. 13, 1992).
[628] 85 FR at 11627.
[629] *Id*.
[630] *Id*.
[631] The exception to this is the cash-settled NYMEX NG referenced contracts, which is discussed in detail in Section II.B.3.vi.
[632] 85 FR at 11627.
[633] *Id.* at 11628.
[634] *Id*.

Finally, consistent with the 2020 NPRM and the Final Rule's position limits framework that leverages existing exchange-level programs and expertise, the Federal position limit levels operate as ceilings. This framework, with Federal spot month limits layered over exchange-set limits, achieves the Commission's objectives in preventing market manipulation, squeezes, corners, and excessive speculation while also ensuring sufficient market liquidity for bona fide hedgers and avoiding a disruption of the price discovery function of the underlying market. This is, in part, because a layered approach facilitates more expedited responses to rapidly evolving market conditions through exchange action. Under the Final Rule, exchanges are required to set their own spot month position limit levels at or below the respective Federal spot month position limit levels.[635] They are also permitted to adjust those levels based on market conditions as long as they are set at or below the Federal spot month position limit levels. Exchanges may also impose liquidity and concentration surcharges to initial margin if they are vertically integrated with a derivatives clearing organization.[636] All of these exchange actions can be implemented significantly faster than Commission action, and an immediate response is critical in managing rapidly evolving market conditions. As a result, by having the Federal position limit levels function as ceilings, the position limits framework adopted in this Final Rule will allow exchanges to lower or raise their position limit levels across a greater range of acceptable Federal position limit levels, which will facilitate a faster response to more varied market conditions than if the Federal position limit levels did not operate as ceilings.

iii. Comments and Discussion of Final Rule - Federal Spot Month Position Limit Levels

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[635] Final § 150.5(a). For the nine legacy agricultural contracts, the Final Rule also requires exchanges to set their own non-spot month position limit levels at or below the respective Federal non-spot month position limit level. For the 16 non-legacy core referenced futures contracts, final § 150.5(b)(2) requires exchanges to implement either position limits or position accountability during the non-spot month for physical commodity derivatives that are not subject to Federal position limits "at a level that is necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index."

[636] 85 FR at 11633.

Many commenters supported the proposed Federal spot month position limit levels and the method by which the Commission determined those limit levels.[637] However, some commenters raised concerns or otherwise commented with respect to: (1) the proposed Federal spot month position limit levels and the methodology used to arrive at those levels generally; (2) the Commission's review of exchanges' EDS figures and their recommended spot month position limit levels; (3) a lack of a phase-in for Federal spot month position limit levels; (4) the proposed spot month position limit level for ICE Cotton No. 2 (CT); (5) the proposed spot month position limit level for NYMEX NG and other issues relating to NYMEX NG; and (6) the issue of parity among the proposed Federal spot month position limit levels for the three wheat core referenced futures contracts. The Commission will discuss each of these issues, the related comments, and the Commission's corresponding determination in greater detail below.

a. Federal Spot Month Position Limit Levels and the Commission's Underlying Methodology, Generally

(1) Comments - Federal Spot Month Position Limit Levels and the Commission's Underlying Methodology, Generally

Better Markets objected to the Commission's proposed Federal spot month position limit levels and suggested that there should be a presumption that the Federal spot month position limit levels be set at 10% of EDS, which could be adjusted as needed.[638] Another commenter, PMAA, requested Federal spot month position limit levels of less than 25% of EDS, but did not provide a specific level or a range of levels.[639] Other commenters believed that the proposed spot month levels were generally too high merely because they were higher than existing levels.[640]

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[637] *See* ASR at 2; CCI at 2; Shell at 3; EEI/EPSA at 3; Suncor at 2, CEWG at 3; COPE at 2, 4; SIFMA AMG at 3-4; MGEX at 1; 3; MFA/AIMA at 1; AFIA at 1; CMC at 6; NGFA at 3; PIMCO at 6; CME Group at 4-6; NOPA at 1; FIA at 2; and AQR at 8-10.

[638] Better Markets at 41.

[639] PMAA at 2.

[640] AFR at 2 and Rutkowski at 2.

In support of its suggestion, Better Markets claimed that, "speculative trading has been sufficient to accommodate legitimate hedging at currently permissible levels," noting that the Commission has previously stated that "open interest and trading volume have reached record levels" and "the 25 [core referenced futures contracts] represent some of the most liquid markets overseen by the [CFTC]."[641] Better Markets also claimed that, if the Commission conducted a study as to whether the increase in open interest for "particular [core referenced futures contracts] would warrant lower speculative position limits," those studies would have shown that substantially lower position limit levels would be warranted.[642] Better Markets also took issue with the Commission's 25% or less of EDS formula as a basis for determining Federal spot month position limit levels by stating, "while deliverable supply must be one key measure for constraining speculation, it is not sufficient to address all statutory objectives for Federal position limits."[643]

(2) Discussion of Final Rule - Federal Spot Month Position Limit Levels and the Commission's Underlying Methodology, Generally

The Commission declines to adopt a 10% of EDS across-the-board Federal spot month position limit level, or a general reduction in Federal spot month position limit levels to a level below 25% of EDS for those core referenced futures contracts with a proposed position limit level set at 25% of EDS.

In response to Better Markets' suggestion to adopt Federal spot month position limit levels set at 10% of EDS, the Commission first notes that, although Better Markets provided some arguments for why the Commission should consider lower Federal position limit levels, Better Markets did not provide any support for the 10% level that it suggested, including any support for the comment letter's implication that setting limits

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[641] Better Markets at 37-38.
[642] *Id.* at 38.
[643] *Id.* at 37.

at or below 25% of EDS is insufficient to prevent corners and squeezes. Likewise, PMAA did not provide any support for adopting Federal spot month position limit levels of less than 25% of EDS, other than claiming that a "spot month limit of 25 percent of deliverable supply is not sufficiently aggressive to deter excessive speculation" and "prevent market manipulation."[644]

The 25% or less of EDS formula that the Commission is utilizing, and has utilized for many years, is a longstanding methodology that was adopted to address corners and squeezes based on the Commission's experience.[645] Also, as described in detail above, the Commission believes that the position limits framework in both the 2020 NPRM and the Final Rule that incorporates the 25% or less of EDS formula achieves the Commission's statutory objectives in preventing market manipulation, squeezes, corners, and excessive speculation while also ensuring sufficient market liquidity for bona fide hedgers and avoiding a disruption of the price discovery function of the underlying market.

In addition, the Final Rule's position limits framework further addresses the statutory objectives of CEA section 4a(a)(3)(B) by utilizing the Federal position limit levels as a ceiling and leveraging the exchanges' expertise and experience in determining and adjusting exchange-set position limit levels for their referenced contracts as appropriate, as long as they are under the Federal position limit levels.[646] This exchange action can be effectuated significantly faster than a Federal position limit level adjustment, which requires the Commission to engage in a rulemaking process that includes a notice-and-comment period. As a result, compared to the alternative approaches suggested by commenters, this framework will generally facilitate a more

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[644] PMAA at 2.

[645] *See e.g.,* Chicago Board of Trade Futures Contracts in Corn and Soybeans; Order To Change and To Supplement Delivery Specifications, 62 FR 60831, 60838 (Nov. 13, 1997) ("The 2,400-contract level of deliverable supplies constitutes four times the speculative position limit for the contract, a benchmark historically used by the Commission's staff in analyzing the adequacy of deliverable supplies for new contracts").

[646] *See* 85 FR at 11629, 11633.

expedited response to a more varied set of market conditions, because the exchanges can lower or raise their position limit levels across a greater range of acceptable Federal position limit levels.

In response to Better Markets' claim that the Federal spot month position limit levels should not be adjusted upward as a result of the higher open interest levels and trading volumes that exist today because they demonstrate that there are sufficient levels of speculation and liquidity under the current rules, the Commission first notes that Better Markets did not provide a methodology based on open interest and/or trading volume that the Commission should consider as an alternative to the Commission's 25% or less of EDS approach.

Regardless, the Commission believes that EDS is the more appropriate basis by which the Commission should adjust Federal spot month position limit levels, rather than open interest and/or trading volume, because the likelihood of a corner or squeeze occurring in the spot month is more closely correlated with the percentage of deliverable supply that a market participant controls. Corners and squeezes are possible in the spot month only because of the imminent prospect of making or taking delivery in the physically-settled contract. Therefore, understanding the amount of deliverable supply in the spot month is critically important.[647] Accordingly, the Commission, in consultation with the exchanges, estimated the amount of the underlying commodity available at the specified delivery points in the core referenced futures contract that meet the quality standards set forth in the core referenced futures contract's terms and conditions in order to understand the size of the relevant commodity market underlying each core referenced futures contract. Once the Commission determined that information in the form of an EDS figure, the Commission was able to determine whether a Federal spot month

[647] Deliverable supply is the quantity of the commodity that meets contract specifications that is reasonably expected to be readily available to short traders and salable by long traders at its market value in normal cash-marketing channels at the contract's delivery points during the specified delivery period, barring abnormal movements in interstate commerce. 17 CFR part 38, Appendix C.

position limit level would advance the statutory objectives of CEA section 4a(a)(3)(B), including preventing corners and squeezes.

A spot month position limit methodology based on open interest and/or trading volume does not take into account the central factors that make corners and squeezes possible (*i.e.*, the imminent prospect of delivery on a physically-settled contract and the deliverable supply of an underlying commodity). Also, open interest and trading volume in an expiring physically-settled contract generally declines as the contract nears expiration, as most traders are not looking to make or take delivery of the underlying commodity. As a result, they would likely not provide additional insights that would materially inform the Commission's determination of Federal spot month position limit levels in a way that is responsive to CEA section 4a(a)(3)(B).

Furthermore, the Commission did not adjust the Federal spot month position limit levels merely by applying a percentage to EDS. As discussed in further detail below, the Commission proposed Federal spot month position limit levels only after the Commission: (1) extensively reviewed and verified the underlying methodology for each core referenced futures contract's EDS figure; and (2) reviewed the recommended Federal spot month position limit levels from exchanges that are thoroughly knowledgeable about their own respective core referenced futures contracts' markets in order to determine whether they advanced the policy objectives of CEA section 4a(a)(3)(B). Also, in adopting the final Federal spot month position limit levels, the Commission also considered comments from market participants, including comments from the end-users of these markets.

On a related note, Better Markets and PMAA appear to have misunderstood the proposed Federal spot month position limit levels and the methodology on which they were based.[648] The Commission did not propose an across-the-board Federal level set at

[648] *See* Better Markets at 39-40 and PMAA at 2.

25% of EDS. As noted above, the Commission's methodology sets Federal spot month position limit levels at *or below* 25% of EDS for each particular commodity.[649] As a result, under the Final Rule, only seven of 25 core referenced futures contracts have Federal spot month position limit levels at 25% of EDS. With respect to the 18 remaining core referenced futures contracts, all 18 are set below 20% of EDS, 14 are below 15% of EDS, and eight are already below the 10% of EDS threshold recommended by Better Markets.[650] With respect to the petroleum core referenced futures contracts with which PMAA is most likely concerned (*i.e.*, NYMEX Light Sweet Crude Oil (CL), NYMEX NYH ULSD Heating Oil (HO), and NYMEX RBOB Gasoline (RB)), all three levels are at or below 11.16% of EDS.

b. Commission Review of Exchanges' EDS Figures and Recommended Federal Spot Month Position Limit Levels

(1) Additional Background Information - Commission Review of Exchanges' EDS Figures and Recommended Federal Spot Month Position Limits

In connection with the 2020 NPRM, the Commission received deliverable supply estimates and recommended Federal spot month position limit levels from CME Group, ICE, and MGEX for their respective core referenced futures contracts.[651] Commission staff reviewed these recommendations and conducted its own analysis of them using its own experience, observations, and knowledge.[652] This included closely and independently assessing the EDS figures upon which the recommended limit levels were based.[653] In reviewing the recommended spot month position limit levels, the Commission considered the four policy objectives in CEA section 4a(a)(3)(B) and preliminarily determined that none of the recommended levels appeared improperly

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[649] 85 FR at 11624.

[650] For CME Live Cattle (LC) and NYMEX Light Sweet Crude Oil (CL), which have step-down Federal spot month position limit levels, these percentages were calculated using the first and highest step.

[651] *See supra* n.616, n.617, and n.618.

[652] 85 FR at 11625.

[653] *Id*. at 11625-11626.

calibrated such that they might hinder liquidity for bona fide hedgers or invite excessive speculation, manipulation, corners, or squeezes, including activity that could impact price discovery.[654] As a result, the Commission proposed to adopt each of the exchange-recommended spot month position limit levels as Federal spot month position limit levels.[655]

(2) Comments - Commission Review of Exchanges' EDS Figures and Recommended Federal Spot Month Position Limit Levels

The Commission received several comments concerning the Commission's review and verification of the EDS figures and the rationale used by the Commission in accepting the spot month position limit levels that were recommended by exchanges.

One commenter, EPSA, supported adopting CME Group's EDS figures for energy commodities, stating that exchanges are in the "best position to provide accurate and current information on the markets."[656] However, other commenters expressed concerns. Better Markets commented that the Commission failed to "explain the means by which the DCM-provided data was collected and later 'verified' in arriving at proposed spot month position limits, nor the dependencies of the DCM methodologies employed to arrive at those estimates."[657] Similarly, IATP commented that the 2020 NPRM provided insufficient detail about how the Commission concluded that the exchange-recommended spot month position limit levels were appropriate and how the Commission determined that the EDS figures submitted by the exchanges were reasonable.[658] On a related note, PMAA commented that the exchanges should not be providing EDS figures and that the Commission instead should "retain exclusive discretion in determining 'deliverable supply' for the purposes of establishing speculative

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[654] *Id*. at 11625.

[655] *Id*. Also, a more detailed discussion about the methodology employed by the Commission in determining proposed Federal spot month position limit levels can be found at 85 FR at 11625-11628.

[656] EPSA at 3.

[657] Better Markets at 36.

[658] IATP at 9.

position limits" and "consult with…market experts when determining 'deliverable supply' and formulating limits."[659] Furthermore, CME Group recommended "that the Commission not adopt final spot month position limit levels at 25% of deliverable supply as a rigid formula and…work with the exchange to determine an appropriate limit based on the market dynamics."[660] Likewise, MGEX commented that it "fundamentally disagrees with the 25% formulaic calculation for the spot month position, especially if a limit is codified by rule and does not allow for adjustments as deliverable supply changes."[661]

Finally, Better Markets also raised concerns about the incentives of exchanges as public, for-profit enterprises, presumably, in part, because the exchanges submitted the EDS figures, upon which the Federal spot month position limit levels are based.[662] Specifically, Better Markets stated that exchanges "must balance the interests of their shareholders against the public interest and their commercial interests in market integrity" and, as a result, may be incentivized to permit "speculation—even excess speculation," because it "is a key revenue driver."[663]

(3) Discussion of Final Rule - Commission Review of Exchanges' EDS Figures and Recommended Federal Spot Month Position Limit Levels

The Commission declines to utilize a different methodology and process for determining EDS figures and Federal spot month position limit levels.

(i) Determination of EDS Figures

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[659] PMAA at 2-3 (these market experts include governmental entities, such as the Department of Energy's Energy Information Administration and the U.S. Department of Agriculture, academics, and representatives of industries that produce, refine, process, store, transport, market, and consume the underlying commodity).

[660] CME Group at 5-6. Specifically, CME Group believed that using a 25% of EDS formula "as a fixed formula for establishing recommended limits…is unsound as a matter of policy and incompatible with the Commission's statutory authority to determine that a specific position limit is necessary and set it at an appropriate level."

[661] Updated Deliverable Supply Data – Potential Position Limits Rulemaking, MGEX Comment Letter (Aug. 31, 2018) at 2, available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596).

[662] Better Markets at 22.

[663] *Id.* at 22-23. Better Markets referenced CME Group Inc.'s Form 10-K filings, which stated that "[t]he adoption and implementation of position limits rules…could have a significant impact on our commodities business if Federal rules for position limit management differ significantly from current exchange-administered rules."

In response to comments concerning the Commission's EDS determinations, the Commission notes that its process for reviewing and verifying the EDS figures provided by exchanges entailed extensive independent review and analysis of each EDS figure and its underlying methodology, and the Commission retained exclusive discretion to determine the reasonableness of the EDS figures. This review and analysis by Commission staff occurred prior to the exchanges' formal EDS submissions, during which time Commission staff verified that each exchange's EDS figure for each commodity underlying a core referenced futures contract was reasonable. In doing so, Commission staff confirmed that the methodology and the data[664] for the underlying commodity for each core referenced futures contract reflected the commodity characteristics[665] described in the core referenced futures contract's terms and conditions, while also recognizing that more than one methodology and one set of assumptions, allowances, and data sources could result in a reasonable EDS figure for a commodity. In addition, Commission staff replicated the exchanges' EDS figures using the methodology provided. For some commodities, Commission staff also determined the reasonableness of an exchange's EDS by constructing an alternate EDS using an alternate methodology using other available data and comparing that internal EDS with the exchange's EDS. In some cases, Commission staff consulted industry experts and market participants to verify that the assumptions and allowances used by the EDS methodology were reasonable and that the EDS figure itself was reasonable.

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[664] The data underlying the EDS figures are from sources that Commission staff had determined as accurately representing the underlying commodity. These were typically from publicly available sources. For example, these include data published by the U.S. Department of Energy for NYMEX Light Sweet Crude Oil (CL), data published by the U.S. Department of Agriculture for CBOT Soybeans (S), data published by the Florida Department of Citrus for ICE FCOJ–A (OJ), and data published by CME Group concerning the gold inventories at its approved depositories for COMEX Gold (GC). Furthermore, most data sources were also adjusted based on interviews with market experts and market participants in order to better reflect the actual deliverable supply by taking into consideration the amount of time it takes to move the commodity to/from the delivery points, quality standards, and supplies that are not readily available due to being tied up in long-term contracts.

[665] These characteristics are provided in the guidance in section (b)(1)(i) of Appendix C to part 38, and include, among other things, the commodity's quality and grade specifications, delivery points (including storage capacity), historic storage levels, processing capacity, and adjustments to remove supply that is committed for long-term contracts and not available to underlie a futures contract. The verified EDS for each commodity reflects the quantity of the commodity that can be reasonably expected to be readily available to short traders and salable by long traders at its market value in normal cash-marketing channels at the contract's delivery points during the specified delivery period, barring abnormal movements in interstate commerce.

When Commission staff identified any issues during the review process, they raised those concerns with the exchanges in order to revise the methodologies, including the assumptions, allowances, and data sources used therein. As a result, when the exchanges formally submitted their EDS figures, both the EDS figures and the methodologies underlying their calculations had been thoroughly reviewed and analyzed by Commission staff, and some had been refined based on input from Commission staff. The EDS figures and the methodologies used were published in the comment section of the 2020 NPRM on the Commission's website and have been available for review by the public.[666]

Additionally, for the past 10 years, commenters to previous Federal position limits rule proposals have consistently recommended that the EDS figures should be supplied by exchanges, given the exchanges' expertise with their own contract markets and because of the experience they have in producing such figures.[667] The Commission has agreed and continues to agree with those comments. As a result, Commission staff has also previously worked in collaboration with the exchanges as part of an iterative process to review and refine the methodologies, assumptions, allowances, and data sources used in calculating the EDS figure for each commodity underlying a core referenced futures contract.

(ii) Determination of Federal Spot Month Position Limit Levels

In response to comments concerning the Commission's determination of the Federal spot month position limit levels, the Commission first notes that exchanges were invited to submit their recommended Federal spot month position limit levels for their

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[666] *See* IFUS – Estimated Deliverable Supply – Softs Methodology, IFUS Comment Letter (May 14, 2019); Updated Deliverable Supply Data – Potential Position Limits Rulemaking, MGEX Comment Letter (Aug. 31, 2018); and Summary DSE Proposed Limits, CME Group Comment Letter (Nov. 26, 2019) (CME Group also provided separate EDS methodology submissions for each of its 18 core referenced futures contracts, which can also be found in the comment file), all available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596).

[667] *See e.g.* 81 FR at 96754, n.495 (listing the commenters that expressed the view that exchanges are best able to determine appropriate spot month position limits and that the Commission should defer to their expertise).

respective core referenced futures contracts. In response, CME Group,[668] ICE,[669] and MGEX[670] provided recommended levels for their core referenced futures contracts.

When deciding whether to adopt, reject, or modify the exchange-recommended position limit levels, the Commission considered a variety of factors, including whether the recommended level: (i) was consistent with the 25% or less of EDS formula, as provided in the guidance in Appendix C to part 38; (ii) reflected changes in the EDS of the underlying commodity and trading activity in the core referenced futures contract; and (iii) achieved the four policy objectives in CEA section 4a(a)(3)(B). Furthermore, as described in detail above, the Commission also thoroughly reviewed the methodologies for determining the EDS figures upon which the exchange-recommended spot month position limit levels are based.

Finally, the Commission also considered input from market participants concerning the EDS figures and the exchange-recommended Federal position limit levels in recalibrating the Federal position limit levels, as it has done for ICE Cotton No. 2 (CT) and NYMEX Henry Hub Natural Gas (NG) in this Final Rule, as discussed further below.

(iii) Concern over Exchanges' Conflict of Interest and Improper Incentives in Maintaining Their Markets

In response to Better Markets' concern about the incentives of exchanges as public, for-profit businesses, as a preliminary matter, the Commission acknowledges that exchanges have a financial interest in increased trading volume, whether speculative or hedging, and, as a result, may be incentivized to increase EDS figures and recommend higher position limit levels. However, as previously discussed, the Commission independently assessed and verified the exchanges' EDS estimates. Specifically, the Commission: (1) worked closely with the exchanges to independently verify that all EDS

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[668] *See supra* n.616.
[669] *See supra* n.617.
[670] *See supra* n.618.

methodologies and figures were reasonable;[671] and (2) reviewed each exchange-recommended level for compliance with the requirements established by the Commission and/or by Congress, including those in CEA section 4a(a)(3)(B).[672] Also, as discussed at length above, the Commission conducted its own analysis of the exchange-recommended Federal spot month position limit levels and determined that the levels adopted herein: (1) are low enough to diminish, eliminate, or prevent excessive speculation and also protect price discovery; (2) are high enough to ensure that there is sufficient market liquidity for bona fide hedgers; (3) fall within a range of acceptable limit levels; and (4) are properly calibrated to account for differences between markets. Thus, the Commission believes that the impact, if any, of such financial incentives were sufficiently mitigated through the Commission's close review of the methodology underlying the EDS figures, the EDS figures themselves, and the recommended Federal position limit levels.

The Commission also notes that exchanges have significant incentives and obligations to maintain well-functioning markets as self-regulatory organizations that are themselves subject to regulatory requirements. Specifically, the DCM and SEF Core Principles, as applicable, require exchanges to, among other things, list contracts that are not readily susceptible to manipulation, and surveil trading on their markets to prevent market manipulation, price distortion, and disruptions of the delivery or cash-settlement process.[673] Exchanges also have significant incentives to maintain well-functioning markets to remain competitive with other exchanges. Market participants may choose exchanges that are less susceptible to sudden or unreasonable fluctuations or unwarranted changes caused by excessive speculation or corners, squeezes, and manipulation, which

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[671] As discussed in detail above, the verification involved: confirming that the methodology and data for the underlying commodity reflected the commodity characteristics described in the core referenced futures contract's terms and conditions; replicating exchange EDS figures using the methodology provided by the exchange; and working with the exchanges to revise the methodologies as needed.

[672] *See* Section II.B.3.iii.b.(3).

[673] 17 CFR 38.200; 17 CFR 38.250; 17 CFR 37.300; and 17 CFR 37.400.

could, among other things, harm the price discovery function of the commodity derivative contracts and negatively impact the delivery of the underlying commodity, bona fide hedging strategies, and market participants' general risk management.[674] Furthermore, several academic studies, including one concerning futures exchanges and another concerning demutualized stock exchanges, support the conclusion that exchanges are able to both satisfy shareholder interests and meet their self-regulatory organization responsibilities.[675]

iv. Phase-in of Federal Spot Month Position Limit Levels

a. Summary of the 2020 NPRM - Phase-in of Federal Spot Month Position Limit Levels

The 2020 NPRM did not include a phase-in mechanism in which the Commission would gradually adjust the Federal position limit levels over a period of time. As a result, under the 2020 NPRM, the proposed Federal spot month position limit levels for all core referenced futures contracts would immediately go into effect on the proposed effective date.

b. Summary of the Commission Determination - Phase-in of Federal Spot Month Position Limit Levels

The Commission declines to adopt a formal phase-in for the Federal spot month position limit levels, because it believes that the markets would operate in an orderly fashion with the Federal position limit levels adopted under this Final Rule. However, as a practical matter, the Commission notes that the operative spot month position limit levels for market participants trading in exchange-listed referenced contracts will be the

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[674] Kane, Stephen, *Exploring price impact liquidity for December 2016 NYMEX energy contracts*, n.33, available at https://www.cftc.gov/sites/default/files/idc/groups/public/@economicanalysis/documents/file/oce_priceimpact.pdf.

[675] *See* David Reiffen and Michel A. Robe, *Demutualization and Customer Protection at Self-Regulatory Financial Exchanges*, Journal of Futures Markets, Vol. 31, 126-164, Feb. 2011 (in many circumstances, an exchange that maximizes shareholder (rather than member) income has a greater incentive to aggressively enforce regulations that protect participants from dishonest agents); and Kobana Abukari and Isaac Otchere, *Has Stock Exchange Demutualization Improved Market Quality? International Evidence*, Review of Quantitative Finance and Accounting, Dec 09, 2019, https://doi.org/10.1007/s11156-019-00863-y (demutualized exchanges have realized significant reductions in transaction costs in the post-demutualization period).

exchange-set spot month position limit levels, which will continue to remain at their existing levels unless and until an exchange affirmatively modifies its exchange-set spot month position limit levels pursuant to part 40 of the Commission's regulations.[676]

c. Comments - Phase-in of Federal Spot Month Position Limit Levels

The Commission received comments requesting that the Commission "consider phasing in these adjustments for agricultural commodities to assess the impacts of increasing limits on contract performance."[677] CMC also noted that, "A phased approach could provide market participants, exchanges, and the Commission a way to build in scheduled pauses to evaluate the effects of increased limits, thereby fostering confidence and trust in the markets."[678]

d. Discussion of the Final Rule - Phase-in of Federal Spot Month Position Limit Levels

In response to comments, the Commission first notes that, although the Federal spot month position limit levels will generally be higher than existing Federal and/or exchange-set spot month position limit levels, the Commission believes that the referenced contract markets will be able to function in an orderly fashion when the final Federal spot month position limit levels go into effect.[679] This is because, among other things, these final Federal spot month position limit levels are supported by the updated EDS figures and are set at or below 25% of EDS.[680]

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[676] 17 CFR part 40.

[677] AFIA at 2 and CMC at 6.

[678] CMC at 6. Although commenters did not provide specific details about what they meant by "phase-in," the Commission understands these comments to mean that they are requesting a gradual, step-up increase in Federal spot month and non-spot month position limit levels over time for agricultural core referenced futures contracts, instead of having an abrupt change to the new Federal position limit levels. This section only addresses the Commission's response to commenters' request for phased-in Federal spot month position limit levels. The Commission separately addresses commenters' request for phased-in Federal non-spot month position limit levels below in Section II.B.4.iv.a.(2)(v).

[679] A phase-in is unnecessary with respect to the Federal spot month position limit level for CBOT Oats (O), because the Federal spot month position limit level for the contract remains at the current level.

[680] The final Federal spot month position limit levels for cash-settled NYMEX NG referenced contracts may exceed 25% of EDS because the Federal spot month position limit level is being applied separately for each exchange and OTC swaps market, but the Commission believes that this approach will not cause any issues, in part, because of the highly liquid nature of that particular market. For additional details concerning the NYMEX NG market, *see* Section II.B.3.vi.a.

However, as a practical matter, the operative spot month position limit level for market participants with respect to exchange-listed referenced contracts is not the Federal spot month position limit levels, but the exchange-set spot month position limit levels, which must be set at or below the corresponding Federal spot month position limit levels. As a result, despite the changes in the Federal spot month position limit levels (or the imposition of a Federal spot month position limit level for the first time) in this Final Rule, there will be no practical impact on market participants trading in exchange-listed referenced contracts unless and until an exchange affirmatively modifies its exchange-set spot month position limit levels through a rule submission to the Commission pursuant to part 40 of the Commission's regulations.[681]

v. ICE Cotton No. 2 (CT) Federal Spot Month Position Limit Level

a. Summary of the 2020 NPRM - ICE Cotton No. 2 (CT) Federal Spot Month Position Limit Level

The Commission proposed to increase the Federal spot month position limit level for ICE Cotton No. 2 (CT) from the existing Federal position limit of 300 contracts to 1,800 contracts. Like all of the Federal spot month position limit levels, the Commission's proposed level for ICE Cotton No. 2 (CT) was based on Commission staff's review, analysis, and verification of IFUS's updated EDS figure and Commission staff's review and analysis of IFUS's initial recommended Federal spot month position limit level.[682]

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[681] 17 CFR part 40.

[682] *See* IFUS – Estimated Deliverable Supply – Softs Methodology, IFUS Comment Letter (May 14, 2019) and Reproposal – Position Limits for Derivatives (RIN 3038-AD99); ICE Comment Letter (Feb. 28, 2017) (attached Sept. 28, 2016 comment letter), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596 and Proposed Rule 81 FR 96704, respectively). IFUS did not formally provide recommended Federal spot month position limit levels for each of its core referenced futures contracts. However, ICE had previously recommended setting Federal spot month position limit levels for IFUS's core referenced futures contracts at 25% of EDS in its comment letter in connection with the 2016 Reproposal and Commission staff also confirmed with ICE/IFUS's representatives that ICE/IFUS's position has remained the same with respect to the Federal spot month position limit levels since the 2016 Reproposal. The Commission notes, however, with respect to ICE Cotton No. 2 (CT), IFUS submitted an updated recommended Federal spot month position limit level recommending a Federal spot month position limit level of 900 contracts. *See* IFUS – Estimated Deliverable Supply – Cotton Methodology, August 2020, IFUS Comment Letter (August 27, 2020), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596).

b. Summary of the Commission Determination – ICE Cotton No. 2 (CT) Federal Spot Month Position Limit Level

In the Final Rule, the Commission is adopting a Federal spot month position limit level of 900 contracts instead of the proposed level of 1,800 contracts for ICE Cotton No. 2 (CT). The reasons for this change are based on the comments received in response to the 2020 NPRM.

c. Comments - ICE Cotton No. 2 (CT) Federal Spot Month Position Limit Level

The Commission received numerous comments objecting to the higher proposed Federal spot month position limit level for ICE Cotton No. 2 (CT) in the 2020 NPRM.[683] The commenters requested that the Commission either maintain the current 300 contract limit level or drastically lower the limit from the proposed 1,800 contract limit level.[684] In doing so, commenters argued that they disagreed with the EDS figure for ICE Cotton No. 2 (CT) because it does "not reflect the cotton industry's historical ability to deliver the physical commodity."[685] AMCOT similarly noted that the "methodology used in determining the limits is flawed and lacks consideration of the industry's intricacies including the non-fungible quality as well as warehousing, location, and logistical challenges."[686] Furthermore, AMCOT believed that the Federal spot month position limit level "would likely be disruptive to orderly market flows."[687] Likewise, ACSA noted that, "[i]n a smaller market like cotton, such a drastic increase and high limit will cause excessive volatility and hinder convergence in the spot month."[688]

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[683] AMCOT at 1-2; ACSA at 8; Ecom at 1; Southern Cotton at 2; NCC at 1; Mallory Alexander at 2; Canale Cotton at 2; IMC at 2; Olam at 3; DECA at 2; Moody Compress at 1; ACA at 2; Choice at 1; East Cotton at 2; Jess Smith at 2; McMeekin at 2; Memtex at 2; NCC at 2; Omnicotton at 2; Toyo at 2; Texas Cotton at 2; Walcot at 2; White Gold at 1; LDC at 1; SW Ag at 2; NCTO at 2; and Parkdale at 2.

[684] *Id.*

[685] *See, e.g.*, ACA at 2.

[686] AMCOT at 1.

[687] *Id*.

[688] ACSA at 8.

In addition to the market participants, IFUS also submitted a comment letter with respect to ICE Cotton No. 2 (CT), in which it provided an updated recommended Federal spot month position limit level of 900 contracts.[689]

d. Discussion of Final Rule - ICE Cotton No. 2 (CT) Federal Spot Month Position Limit Level

As a preliminary matter, and as discussed previously, the Commission believes that there is a range of acceptable Federal position limit levels that will achieve the objectives of CEA section 4a(a)(3)(B). Thus, the Commission acknowledges that there may be other acceptable Federal spot month position limit levels in addition to the proposed 1,800 contract level for ICE Cotton No. 2 (CT). Commenters to the 2020 NPRM suggested three alternatives to the proposed Federal spot month position limit level for ICE Cotton No. 2 (CT): (1) 300 contracts; (2) 900 contracts; or (3) a level "drastically lower" than 1,800 contracts. All of these alternatives are below 25% of EDS. The Commission considered the two specifically enumerated levels (*i.e.*, 300 contracts and 900 contracts) and the proposed 1,800 contract level, and has determined that the 900 contract level is the most appropriate among the three for ICE Cotton No. 2 (CT).

(1) ICE Cotton No. 2 (CT) Federal Spot Month Position Limit Level Should Be Above 300 Contracts

The Commission believes that it is more appropriate to raise the Federal spot month position limit level than to maintain its existing level of 300 contracts, as long as that level is set at or below 25% of EDS. One reason is because the current 300 contract Federal spot month position limit level for ICE Cotton No. 2 (CT) has been in place since at least 1987 while the size of the ICE Cotton No. 2 (CT) market has significantly

[689] IFUS – Estimated Deliverable Supply – Cotton Methodology, August 2020, IFUS Comment Letter (Aug. 14, 2020), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596)

increased over the years, as evidenced by the material increases in deliverable supply and open interest.[690]

A second reason why the Commission believes that it is appropriate to raise the Federal spot month position limit level above the existing level of 300 contracts for ICE Cotton No. 2 (CT) is because of potential liquidity concerns. At 300 contracts, the Federal spot month position limit level for ICE Cotton No. 2 (CT) would be set at 4.32% of EDS, which would be the lowest Federal spot month position limit level, by far, in terms of percentage of EDS among all core referenced futures contracts.[691] At such a low level, the Commission is concerned that this could hamper liquidity in the market, especially if the ICE Cotton No. 2 (CT) market continues to grow as it has done over the years. This concern is supported by the Commission's observation that there has been a lack of liquidity at the start of the spot month period in recent years as speculative traders exited the market or reduced their positions to the Federal spot month position limit level of 300 contracts. The Commission's observation is based on its assessment of the daily price impact liquidity in basis points with the gauge.[692]

$$BP_d = \sum_{i=2}^{N_d} \frac{Q_i}{TV_d} \left| \frac{P_i - P_{i-1}^*}{P_{i-1}^*} \right|.$$

Raising the limit level above 300 contracts to a higher level, such as 900 contracts, should help alleviate some of the liquidity problems that market participants have experienced because they will not have to reduce their positions to such a low level (*i.e.*, 300 contracts).

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[690] For example, between the periods of 1994-1999 and 2015-2018, the maximum open interest in ICE Cotton No. 2 (CT) increased from 122,989 contracts to 344,302 contracts. Also, the EDS for ICE Cotton No. 2 (CT) increased from 6,005 contracts to 6,948 contracts between 2016 and 2019.

[691] CBOT KC HRS Wheat (KW) generally has the lowest Federal spot month position limit level in terms of percentage of EDS at 6.82%, which is 58% higher than 4.32%. However, following the close of trading on the business day prior to the last two trading days of the contract month, CME Live Cattle (LC) has the lowest Federal spot month position limit level in terms of percentage of EDS at 5.29%, which is 22% higher than 4.32%.

[692] P_i is the price of trade i. P_i^* is the proxy for the current market price (the price of the last trade, P_{i-1}). Q_i is the quantity traded (the number of futures contracts traded in trade i). See Kane, Stephen, *Exploring price impact liquidity for December 2016 NYMEX energy contracts*, p.5-6, available at https://www.cftc.gov/sites/default/files/idc/groups/public/@economicanalysis/documents/file/oce_priceimpact.pdf.

A third reason for raising the Federal spot month position limit level above its existing level of 300 contracts is because a 300 contract level may not provide adequate headroom under which exchanges may set and adjust their own position limit levels, up or down, in response to market conditions within this position limits framework. This is an especially acute issue because, as noted above, a Federal spot month position limit level of 300 contracts is extremely low in terms of percentage of EDS when compared to other core referenced futures contracts, and there is no market-based reason (*e.g.*, higher susceptibility for corners and squeezes) for why the level should be set so low.

A final reason for supporting a Federal spot month position limit level higher than 300 contracts is because IFUS, which is the exchange that lists ICE Cotton No. 2 (CT), has recommended a level higher than 300 contracts.[693] This is significant because exchanges have deep knowledge about their markets and are particularly well-positioned to recommend position limit levels for the Commission's consideration.[694]

The Commission recognizes that the comments from the end-users of ICE Cotton No. 2 (CT) unanimously requested that the Commission consider, among other options, maintaining the 300 contract Federal position limit level. The main justifications underlying this request are that: (1) the ICE Cotton No. 2 (CT) market is small; and (2) the EDS figure is extremely high. In response to commenters' claim about the size of the market, the Commission notes that the market for ICE Cotton No. 2 (CT) is not as small as suggested. Open interest data indicate that the ICE Cotton No. 2 (CT) futures market had a larger average notional open interest in 2019 than nine other core referenced futures

[693] IFUS – Estimated Deliverable Supply – Cotton Methodology, August 2020, IFUS Comment Letter (Aug. 14, 2020), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596).

[694] 85 FR at 11598. However, as noted before, the Commission independently reviewed and analyzed the exchange-recommended levels, including the EDS figures that support such levels.

contracts.[695] Six of these contracts have higher Federal position limit levels in terms of percentage of EDS in this Final Rule.[696]

In response to commenters' issue with the EDS, the Commission notes that the cotton merchants may have focused on too narrow of a scope in their comment letters. The commenters appear to focus on the actual cotton that was delivered pursuant to holding the physically-settled ICE Cotton No. 2 (CT) core referenced futures contract to expiration, and they use that data as evidence that the EDS is extremely high.[697] The Commission's EDS figures are not meant to reflect the actual commodity delivered. Rather, as the term estimated *deliverable supply* indicates, it is the quantity of the commodity that meets contract specifications that is reasonably expected to be readily available to short traders and salable by long traders at its market value in normal cash-marketing channels at the contract's delivery points during the specified delivery period, barring abnormal movements in interstate commerce.[698] The Commission believes that limiting a speculative trader from controlling more than 25% of this supply, and not the actual commodity delivered, is critical for ensuring that corners and squeezes do not happen.[699]

Furthermore, commenters did not provide specific issues with respect to the methodology used to determine EDS for ICE Cotton No. 2 (CT), which has been available for review by the public since the 2020 NPRM was published.[700] As a result,

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[695] These are CBOT Oats (O), CBOT KC HRW Wheat (KW), MGEX HRS Wheat (MWE), CBOT Rough Rice (RR), ICE Cocoa (CC), ICE FCOJ-A (OJ), ICE Sugar No. 16 (SF), NYMEX Platinum (PL), and NYMEX Palladium (PA). *See* Section III.C.

[696] These are CBOT Oats (O), MGEX HRS Wheat (MWE), ICE Cocoa (CC), ICE FCOJ-A (OJ), ICE Sugar No. 16 (SF), and NYMEX Platinum (PL).

[697] *See* ACSA at 7-8.

[698] 17 CFR part 38, Appendix C.

[699] Generally, only a small percentage of futures contracts actually go to delivery. Basing a speculative position limit on past deliveries for a futures contract would be far too limiting for a speculative position limit and would not reasonably achieve the four policy objectives of CEA section 4a(a)(3)(B).

[700] IFUS – Estimated Deliverable Supply – Softs Methodology, IFUS Comment Letter (May 14, 2019), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596).

the Commission believes that the EDS for ICE Cotton No. 2 (CT) is appropriate and reasonable based on its review and analysis of the methodology used.[701]

(2) ICE Cotton No. 2 (CT) Federal Spot Month Position Limit Level Should Be Below 1,800 Contracts

However, the Commission believes that it is appropriate to lower the Federal spot month position limit for ICE Cotton No. 2 (CT) from the proposed 1,800 contract level. First, as noted previously, the Commission received an updated recommended Federal spot month position limit level from IFUS that is lower than 1,800 contracts.[702] Second, although the Commission believes that there are issues with the cotton industry commenters' justifications for lowering the Federal spot month position limit level, the Commission still believes that their comments are informative. Specifically, the Commission believes that the unanimous comments from the end-users of the ICE Cotton No. 2 (CT) core referenced futures contract suggest that lowering the Federal spot month position limit level from 1,800 contracts will not have a material detrimental effect on liquidity for bona fide hedgers in the market. All things being equal, a lower spot month position limit level will better protect the markets against corners and squeezes, but at the expense of a reduction in liquidity for bona fide hedgers as positions held by speculators will be more constrained. However, in this instance, the Commission believes that it could improve protections against corners and squeezes without materially impacting liquidity for bona fide hedgers by adopting a Federal spot month position limit level that is lower than 1,800 contracts, based on the comments received.[703]

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[701] Specifically, the estimate took into account cotton certified stocks, which are reported daily for the five delivery points specified in the contract specifications, as well as the exchange estimated deliverable stocks close to the delivery points that are not included as certified stocks based on the USDA's Weekly Bales Made Available to Ship ("BMAS") Summary report. The exchange estimated the deliverable stocks contained in or near exchange warehouses, both certified and non-certified, during notice and delivery periods for the futures contract. BMAS deliverable stocks data was also adjusted to exclude cotton at locations that were far away from the delivery points.

[702] IFUS – Estimated Deliverable Supply – Cotton Methodology, August 2020, IFUS Comment Letter (Aug. 14, 2020), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596).

[703] However, for the reasons discussed previously, the Commission does not believe that lowering the Federal spot month position limit level to 300 contracts is appropriate, given the observed issues in liquidity during the early part of the spot month period.

(3) ICE Cotton No. 2 (CT) Federal Spot Month Position Limit Level Should Be Set at 900 Contracts

Given that the Commission believes that it is preferable to set a Federal spot month position limit level higher than 300 contracts but lower than 1,800 contracts for the aforementioned reasons, the Commission believes that a Federal position limit level of 900 contracts is preferable to those alternatives. Specifically, the Commission notes that IFUS, which has deep knowledge about the ICE Cotton No. 2 (CT) market and is particularly well-positioned to recommend the position limit level for the Commission's consideration, has recommended a Federal spot month position limit level of 900 contracts. This is also supported by commenters who requested a "drastically lower" Federal spot month position limit level as an alternative to maintaining a Federal spot month position limit level of 300 contracts.

The Commission also believes that a level of 900 contracts is sufficiently high to address concerns about a lack of liquidity. This is, in part, because a Federal spot month position limit level of 900 contracts would result in a level that is set at 12.95% of EDS, which would coincidentally place ICE Cotton No. 2 (CT) exactly at the median among the legacy agricultural contracts and all core referenced futures contracts in terms of percentage of EDS. Finally, based on the comments received and because, all things being equal, lower spot month position limit levels provide better protection against corners and squeezes, the Commission believes that a level of 900 contracts will provide stronger protection against corners and squeezes without materially impacting liquidity for bona fide hedgers vis-à-vis a level of 1,800 contracts.[704]

vi. NYMEX Henry Hub Natural Gas (NG)

[704] The Commission recognizes that this will limit the range through which an exchange may set and adjust its own exchange-set position limit level. However, based on the comments received, the Commission believes that the stronger protections against corners and squeezes is appropriate.

This section will address the following issues concerning NYMEX NG: (i) the Federal spot month position limit level for NYMEX NG; (ii) the conditional spot month position limit exemption for positions in natural gas referenced contracts, which is located in final § 150.3(a)(4); and (iii) NYMEX NG penultimate referenced contracts. The Commission is addressing the latter two issues in this section in order to allow the reader to review all discussions regarding natural gas in one place in this Final Rule.

a. NYMEX Henry Hub Natural Gas (NG) Federal Spot Month Position Limit Level

(1) Summary of the 2020 NPRM and Additional Background Information - NYMEX NG Federal Spot Month Position Limit Level

Under the existing Federal position limits framework, there are no Federal position limits for NYMEX NG in either the spot month or the non-spot month. There is, however, an exchange-set spot month position limit for NYMEX NG, which is set at 1,000 contracts for the physically-settled NYMEX NG contract and 1,000 contracts *per exchange* for cash-settled equivalent-sized natural gas contracts. Because there are three exchanges that list such cash-settled natural gas contracts (NYMEX, IFUS, and Nodal), a market participant can currently hold up to 3,000 such cash-settled contracts during the spot month.

In the 2020 NPRM, the Commission proposed a Federal spot month position limit level of 2,000 contracts for NYMEX NG. The 2,000 contract level was determined based on 25% of updated EDS and was recommended by CME Group. Consistent with the other core referenced futures contracts, the proposed netting and aggregation requirements permitted a market participant to hold up to 2,000 physically-settled NYMEX NG referenced contracts and another 2,000 cash-settled NYMEX NG referenced contracts across all exchanges and in the OTC swaps market.[705]

[705] For further discussion of netting and aggregation, *see* Section II.B.10. (Application of Netting and Related Treatment of Cash-settled Referenced Contracts).

(2) Summary of the Commission Determination – NYMEX NG Federal Spot Month Position Limit Level

The Commission is adopting its proposed approach with respect to physically-settled NYMEX NG referenced contracts, but is modifying its proposed approach with respect to cash-settled NYMEX NG referenced contracts, as discussed below.

(3) Comments - NYMEX NG Federal Spot Month Position Limit Level

With respect to the proposed NYMEX NG Federal spot month position limit level, NGSA requested that the Commission "increase the spot month limit on the NG Contract by recognizing the transportation capacity available now at Henry Hub provided by displacement and the increasing capacity which is coming from future but imminent displacement."[706] In support, NGSA noted that CME Group's EDS figure has "incorporated displacement into its estimate of deliverable supply at Henry Hub for years."[707]

MFA/AIMA, Citadel, and SIFMA AMG requested that the Commission raise the Federal spot month position limit level for NYMEX NG referenced contracts to at least 3,000 contracts, because the 2020 NPRM effectively decreases the total number of exchange-traded cash-settled NYMEX NG referenced contracts that a market participant may hold in the spot month from the current level of 3,000 contracts to 2,000 contracts.[708] In support of this request, MFA/AIMA argued that the 2020 NPRM "could adversely affect the ability of traders to optimize the proportion of physically-settled and cash-settled natural gas contracts that they wish to hold in their portfolio."[709] SIFMA AMG

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[706] NGSA at 10-11.

[707] *Id.* at 11.

[708] MFA/AIMA at 11-12; Citadel at 7-8; and SIFMA AMG at 10-11 (SIFMA AMG supported the 2,000 contract limit level for physically-settled NYMEX NG referenced contracts, but requested at least a 3,000 contract limit level for the cash-settled NYMEX NG referenced contracts).

[709] MFA/AIMA at 11-12.

argued that the 2020 NPRM "would disrupt existing trading practices and business models without any corresponding regulatory or policy benefit."[710]

(4) Discussion of Final Rule – NYMEX NG Federal Spot Month Position Limit Level

Under the Final Rule, market participants may hold up to 2,000 cash-settled NYMEX NG referenced contracts *per exchange* during the spot month and an additional 2,000 cash-settled economically equivalent OTC swaps, rather than being subject to an aggregate position limit level of 2,000 cash-settled NYMEX NG referenced contracts across all exchanges and the OTC swaps market as proposed under the 2020 NPRM. Because there are currently three exchanges that list natural gas referenced contracts, this will allow market participants to hold a total of 8,000 cash-settled NYMEX NG referenced contracts between positions held in cash-settled futures and in cash-settled economically equivalent OTC swaps.[711] This is in addition to the 2,000 physically-settled NYMEX NG referenced contracts a market participant may hold during the spot month. These amendments to the proposal are reflected in a revised Appendix E to part 150 that the Commission is adopting in this Final Rule.

(i) Request to Increase the Federal Spot Month Position Limit Level to Account for Displacement

In response to NGSA's request, the Commission first notes that CME Group provided the EDS figure that was used as a basis for determining its exchange-recommended Federal spot month position limit level, which the Commission ultimately used as a basis for its own proposed Federal spot month position limit level for NYMEX NG after independently reviewing and assessing the methodology underlying the EDS

[710] SIFMA AMG at 11.

[711] 2,000 cash-settled referenced contracts multiplied by three exchanges plus 2,000 cash-settled economically equivalent OTC swaps equals 8,000 cash-settled NYMEX NG referenced contracts.

figure and the EDS figure itself.[712] As NGSA noted, CME Group's EDS has "incorporated displacement into its estimate of deliverable supply at Henry Hub for years,"[713] which means that the EDS figure on which the proposed Federal spot month position limit level was based already "recogniz[ed] the transportation capacity available now at Henry Hub provided by displacement."[714] As a result, the proposed Federal spot month position limit level took this into account as well. With respect to future increases in EDS based on "future but imminent displacement,"[715] in the event that this occurs, CME Group may submit an updated EDS figure pursuant to § 150.2(f), at which time the Commission would consider whether to modify the Federal spot month position limit level.

(ii) Request to Increase the Cash-Settled Federal Spot Month Position Limit Level

As previewed above, in response to comments from MFA/AIMA, Citadel, and SIFMA AMG, the Commission is modifying the proposed NYMEX NG Federal spot month position limit level for cash-settled NYMEX NG referenced contracts, so that the Federal spot month position limit applies separately per each exchange and the OTC swaps market, rather than across exchanges and the OTC swaps market.

The Commission believes that this modification is warranted in order to avoid disrupting the well-developed, unique liquidity characteristics of the natural gas derivatives markets. As detailed below, the cash-settled natural gas market is significantly more liquid than the physically-settled natural gas market during the spot month. This is in contrast with typical commodity markets, in which the physically-

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[712] *Summary DSE Proposed Limits*, CME Group Comment Letter (Nov. 26, 2019), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596).

[713] NGSA at 11.

[714] *Id.* at 10. Furthermore, CME Group's methodology for determining EDS for NYMEX NG explicitly states, "Additionally, the Exchange has taken into consideration backhaul in estimating the deliverable supply." NEW YORK MERCANTILE EXCHANGE, INC., ANALYSIS OF DELIVERABLE SUPPLY HENRY HUB NATURAL GAS FUTURES, DECEMBER 2018 (Dec. 1, 2018), available at https://comments.cftc.gov (comment file for Proposed Rule 85 FR 11596).

[715] NGSA at 10.

settled contracts are generally more liquid than the cash-settled contracts during the spot month.[716]

The unique nature of the natural gas markets is reflected in the current exchange-set natural gas position limit framework, in which market participants may hold up to 1,000 cash-settled natural gas contracts per exchange, which can result in a position of up to 3,000 cash-settled natural gas contracts (instead of 1,000 cash-settled natural gas contracts altogether), despite only being able to hold up to 1,000 physically-settled NYMEX NG contracts. The Commission believes that, absent the modification adopted herein to apply the spot month limit to NYMEX NG on a per exchange basis, the proposed Federal spot month position limit level could disrupt the cash-settled natural gas markets, in part, because, as commenters have noted: (1) market participants would be able to hold fewer cash-settled NYMEX NG referenced contracts (*i.e.*, 2,000 contracts) than they were previously permitted under the exchange-set position limit framework (*i.e.*, 3,000 contracts); and (2) some market participants may not be able to hold the same proportion of physically-settled to cash-settled NYMEX NG referenced contracts that they are currently able to hold if they wish to maximize their positions in physically-settled NYMEX NG referenced contracts. The Commission also believes that it is appropriate to maintain consistency vis-à-vis the exchange-set position limit framework in order to minimize disruptions, since the Commission has not observed any issues with the exchange-set position limit framework with respect to natural gas.

Accordingly, under the Final Rule, market participants (that are not availing themselves of the Federal spot month conditional position limit exemption for NYMEX NG, which is discussed below) may hold up to 2,000 cash-settled NYMEX NG referenced contracts on each exchange that lists a cash-settled NYMEX NG referenced

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[716] Typically, this is because the physically-settled contract is established first and the natural formation of liquidity in the physically-settled contract historically stays in the established contract due to first mover advantage. More liquid markets provide for better bid/ask spreads and can execute larger transaction sizes without substantial effects on the price of the contract. Thus, in the past, cash-settled look-alike contracts historically have not been as liquid as the original physically-settled futures contract.

contract (which is currently NYMEX, IFUS, and Nodal), for a total position of 6,000 exchange-listed cash-settled NYMEX NG referenced contracts.[717] Furthermore, under the Final Rule, traders may also hold an additional position in cash-settled economically equivalent NYMEX NG OTC swaps that has a notional amount of up to 2,000 equivalent-sized contracts. The Commission is separately permitting up to 2,000 referenced contracts in the NYMEX NG OTC swaps market in order to avoid disruptions to that market, given that traders may be currently participating in that market as well. As a result, under the Final Rule, traders may hold up to a total of 8,000 cash-settled NYMEX NG referenced contracts[718] and 2,000 physically-settled NYMEX NG referenced contracts.[719]

The Commission notes that, as discussed further below, as an initial legal matter, the Commission interprets CEA section 4a(a)(6) as generally requiring aggregate Federal position limits across exchanges.[720] Notwithstanding the requirements of CEA section 4a(a)(6), the Commission is adopting this approach with respect to NYMEX NG referenced contracts pursuant to its exemptive authority in CEA section 4a(a)(7). In doing so, the Commission believes that, based on the foregoing reasons, applying the Federal spot month position limit level for cash-settled NYMEX NG referenced contracts separately per exchange and the OTC swaps market does not undermine the purposes of the Federal position limits framework pursuant to CEA section 4a.

b. NYMEX NG Federal Spot Month Conditional Position Limit Level

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[717] The Commission notes that market participants are not permitted to net cash-settled NYMEX NG referenced contract positions across exchanges or the OTC swaps market for Federal spot month position limit purposes.

[718] 2,000 cash-settled NYMEX NG referenced contracts multiplied by three exchanges plus 2,000 cash-settled economically equivalent NYMEX NG OTC swaps equals 8,000 cash-settled NYMEX NG referenced contracts.

[719] CME Group also commented that it "objects to any disparities in the spot-month limits and would rigorously disagree if the Commission adopts any other disparities in treatment between physically-settled and cash-settled contracts," in the context of the proposed Federal conditional limit, which is discussed in the section below. CME Group at 6. This comment could also be viewed as an objection to the Final Rule's Federal spot month position limit level for cash-settled NYMEX NG referenced contracts. The Commission believes that the rationale set forth in this section and the Federal conditional limit section below is responsive to CME Group's possible concern with respect to the Final Rule's Federal spot month position limit level for cash-settled NYMEX NG referenced contracts.

[720] For further discussion of the Commission's aggregation and netting rules, *see* Section II.B.10. (application of netting section).

(1) Summary of 2020 NPRM and Additional Background Information - NYMEX NG Federal Spot Month Conditional Position Limit Level

In addition to the proposed 2,000 contract Federal spot month position limit level for NYMEX NG, proposed § 150.3(a)(4) also included a spot month conditional position limit exemption ("Federal conditional limit") from the standard Federal spot month position limit level for NYMEX NG for market participants that do not hold a position in the physically-settled NYMEX NG referenced contract.[721] The proposed Federal conditional limit would allow, during the spot month, market participants that do not hold a position in the physically-settled NYMEX NG referenced contract to hold: (1) up to 10,000 cash-settled NYMEX NG referenced contracts per exchange that lists a cash-settled NYMEX NG referenced contract; and (2) an additional position in cash-settled economically equivalent NYMEX NG OTC swaps that has a notional amount of up to 10,000 equivalent-sized contracts. As a result, the proposed Federal conditional limit would permit a market participant that does not hold a physically-settled NYMEX NG referenced contract to hold a total of 40,000 cash-settled NYMEX NG referenced contracts (up to 10,000 contracts on each of the three exchanges (NYMEX, IFUS, and Nodal) that lists a cash-settled NYMEX NG referenced contract and in the OTC swaps market) during the spot month.

The proposed framework for the Federal conditional limit was derived from the existing exchange-set spot month conditional position limit framework that has been in place for approximately a decade. This existing conditional position limit framework permits, during the spot month, up to 5,000 equivalent-sized cash-settled natural gas contracts per exchange that lists a cash-settled natural gas contract, provided that the market participant does not hold a position in the physically-settled NYMEX NG

[721] The Commission is adopting the Federal conditional limit pursuant to its exemptive authority in CEA section 4a(a)(7). 7 U.S.C. §6a(a)(7).

contract.[722] The 5,000 contract conditional spot month position limit level equals five-times the existing exchange-set 1,000 contract spot month position limit level for the physically-settled NYMEX NG contract.[723] Noting the unique circumstances of the natural gas futures markets, the Commission's proposed Federal conditional limit level applied the same multiplier of five to its proposed Federal spot month position limit level for the physically-settled NYMEX NG contract in order to arrive at the 10,000 contract Federal conditional limit level that applies for each exchange and OTC swaps market.

The 2020 NPRM included the Federal conditional limit to accommodate certain trading dynamics unique to the natural gas contracts.[724] For example, the Commission has observed that, as the physically-settled NYMEX NG core referenced futures contract approaches expiration, open interest tends to decline in NYMEX NG and tends to increase rapidly in ICE's cash-settled Henry Hub LD1 contract.[725] This is in contrast with other commodities in which the physically-settled markets are more liquid than the cash-settled markets during the spot month. These dynamics suggest that cash-settled natural gas contracts serve an important function for hedgers and speculators who wish to recreate and/or hedge the physically-settled NYMEX NG contract price during the spot month without being required to make or take delivery.[726] In addition, the Commission also proposed the divestiture requirement in the Federal conditional limit in order to address historical concerns over the potential for manipulation of physically-settled

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[723] *See* IFUS Rule 6.20(c), NYMEX Rule 559.F, and Nodal Rule 6.5.7. The spot month for such contracts is three days. *See also* Position Limits, CMG Group website, available at https://www.cmegroup.com/market-regulation/position-limits.html (NYMEX position limits spreadsheet); Market Resources, IFUS website, available at https://www.theice.com/futures-us/market-resources (IFUS position limits spreadsheet). NYMEX rules establish an exchange-set spot month limit of 1,000 contracts for its physically-settled NYMEX NG core referenced futures contract and a separate spot month limit of 1,000 contracts for its cash-settled Henry Hub Natural Gas Last Day Financial Futures contract. IFUS's natural gas contract is one quarter the size of the NYMEX contract. IFUS thus has rules in place establishing an exchange-set spot month limit of 4,000 contracts (equivalent to 1,000 NYMEX NG contracts) for its cash-settled Henry Hub LD1 Fixed Price Futures contract.

[724] 85 FR at 11641.

[725] *Id*.

[726] *Id*.

natural gas contracts during the spot month in order to benefit positions in cash-settled natural gas contracts.[727]

(2) Summary of the Commission Determination – NYMEX NG Federal Spot Month Conditional Position Limit Level

The Commission is adopting the Federal conditional limit as proposed.

(3) Comments – NYMEX NG Federal Spot Month Conditional Position Limit Level

With respect to the proposed Federal conditional limit, several commenters generally supported its adoption.[728] COPE believed that the proposed conditional limit "permits market liquidity…without sacrificing the benefits of position limits."[729] ICE supported the Federal conditional limit, noting that "cash-settled contracts present a reduced potential for manipulation of the price of the physically-settled contract."[730] CME Group, on the other hand, objected to the proposal, arguing that it could "drain liquidity for bona fide hedgers in the physically-settled market and could prevent physical delivery markets from serving the price discovery function that they have long provided" and believed that it "could incentivize the manipulation of a cash commodity price in order to benefit a position in a cash-settled contract."[731]

A number of commenters also requested that the Federal conditional limit levels be available to market participants that do not exit positions in the physically-settled NYMEX NG referenced contract during the spot month, which would effectively establish the Federal conditional limit level as the operative Federal spot month limit level for cash-settled NYMEX NG referenced contracts. In support of this request, several commenters argued that the 2020 NPRM's approach to the Federal conditional limit would result in liquidity leaving the physically-settled NYMEX NG referenced

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[727] *Id*.
[728] COPE at 2-3; EEI/EPSA at 4; and ICE at 13.
[729] COPE at 2-3.
[730] ICE at 13 (referencing a sentiment previously expressed by the Commission).
[731] CME Group at 6.

contract when it is needed the most.[732] EEI/EPSA also commented that the Federal conditional limit framework in the 2020 NPRM is "excessive and is an overly rigid solution that may unnecessarily restrict legitimate trading activity."[733] NGSA commented that the 2020 NPRM "removes important hedging optionality for physical market participants."[734] Citadel argued that the 2020 NPRM would limit flexibility and impair market efficiency by preventing "market participants with a meaningful position in the cash-settled market from participating in the physically-settled market—limiting flexibility and impairing market efficiency."[735] CCI also believed that the 2020 NPRM would "impair price discovery" and "negatively impact price convergence."[736]

Finally, ICE requested that "the Commission revert back to the five-time conditional limit for cash settled contracts…instead of the conditional limit of 10,000 contracts in the Proposed Rule," because "[a]pplying a five-time multiplier versus a hard limit, would allow the conditional limit to track any changes in the spot month limits over time, which in turn will reflect changes in deliverable supply."[737]

(4) Discussion of Final Rule - NYMEX NG Federal Spot Month Conditional Position Limit Level

(i) Availability of the Federal Conditional Limit for NYMEX NG

In response to CME Group's comment supporting the elimination of the Federal condition limit, the Commission is concerned that eliminating the proposed conditional limit could result in potential market disruptions, given that a conditional limit framework for natural gas has been in place at the exchange level for many years. For example, eliminating the existing conditional limit structure could restrict the positions that market participants may hold in cash-settled NYMEX NG referenced contracts

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[732] ISDA at 8; SIFMA AMG at 10-11; FIA at 7-8; NGSA at 12-14; Citadel at 7; and CCI at 4.
[733] EEI/EPSA at 4.
[734] NGSA at 12.
[735] Citadel at 7.
[736] CCI at 4.
[737] ICE at 13.

during the spot month, resulting in reduced liquidity, including for commercial hedgers seeking to offset price risks but not necessarily looking to make or take delivery. Additionally, since it was instituted approximately a decade ago, the exchange-set conditional limit framework has functioned well.[738] The Commission has not observed any of the concerns raised by CME Group come to fruition, and the physically-settled NYMEX NG referenced contract remains highly liquid. Furthermore, as discussed above, other commenters supported the availability of the Federal conditional limit.

(ii) Federal Conditional Limit's Divestiture Requirement

In response to comments requesting that the Federal conditional limit be available to market participants that do not exit the spot month physically-settled NYMEX NG referenced contract, the Commission first notes that the requirement that market participants exit the physically-settled NYMEX NG referenced contract has been reflected in exchange rulebooks for many years, in part because the requirement is critically important to discouraging manipulation.[739] Without this requirement, a trader could hold up to 40,000 cash-settled NYMEX NG referenced contracts (or more, if additional exchanges list cash-settled NYMEX NG referenced contracts in the future), which is at 500% of EDS, and 2,000 physically-settled NYMEX NG referenced contracts, which is at 25% of EDS. At these levels, it may not require much movement in the physically-settled markets to disproportionately benefit the cash-settled holdings. As a result, the requirement to exit the physically-settled contract is critical for reducing the market participant's incentive to manipulate the cash settlement price by, for example, banging-the-close or distorting physical delivery prices in the physically-settled contract to benefit leveraged cash-settled positions.[740]

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[738] 85 FR at 11640.
[739] 85 FR at 11641.
[740] *See* 85 FR 11626, 11641.

With respect to commenters' concerns about removing flexibility and options for market participants, as well as a potential decrease in liquidity in the physically-settled NYMEX NG referenced contract, the Commission notes that the physically-settled NYMEX NG referenced contract remains highly liquid even in spite of the implementation of the exchange-set conditional limit framework instituted approximately a decade ago. Also, market participants should have more flexibility and options than before because the Federal spot month position limit level for NYMEX NG adopted herein will now permit up to 8,000 cash-settled NYMEX NG referenced contracts, even if the market participant holds 2,000 physically-settled NYMEX NG referenced contracts.[741] Finally, the Commission reiterates that Federal position limit levels only apply to speculative positions and, as a result, bona fide hedging positions will continue to be allowed to exceed the Federal position limit levels, including the Federal conditional limit level, from the Federal position limits perspective.[742]

(iii) Application of a Five-Times Multiplier for the Federal Conditional Limit Level

The Commission clarifies that, in accordance with historical practice, if the Federal spot month position limit level for the physically-settled NYMEX NG referenced contract is updated in the future through rulemaking, the Commission expects to simultaneously adjust the Federal conditional limit in the same rulemaking, such that the Federal conditional limit level is set at a multiple of five of the new Federal spot month

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[741] Under the Final Rule's Federal spot month position limit level for NYMEX NG, a trader may hold 2,000 physically-settled NYMEX NG referenced contracts, 2,000 cash-settled NYMEX NG referenced contracts per exchange that lists such contracts, and 2,000 cash-settled economically equivalent NYMEX NG OTC swaps. Currently, there are three exchanges that list cash-settled NYMEX NG referenced contracts—NYMEX, IFUS, and Nodal. As a result, a trader may hold up to 6,000 exchange-listed cash-settled NYMEX NG referenced contracts and 2,000 cash-settled economically equivalent NYMEX NG OTC swaps, which brings the total number of cash-settled NYMEX NG referenced contracts a trader may hold to 8,000 under the Federal spot month position limit level.

[742] This also answers EEI/EPSA's request to confirm "that a participant may rely upon the conditional limit in the first instance but may also utilize a hedge exemption to exceed the conditional limit." EEI/EPSA at 4. However, the Commission notes that exchanges have rarely, if ever, allowed a market participant to exceed the exchange-set natural gas conditional limit by layering a bona fide hedge position on top of the cash-settled natural gas contract position permitted under the natural gas conditional limit. Similar to this existing practice, the Commission expects that, under the Final Rule, a market participant will rarely be permitted to hold: (1) a bona fide hedge position in the physically-settled NYMEX NG referenced contract while taking advantage of the conditional limit for cash-settled NYMEX NG referenced contracts; or (2) a bona fide hedge position in cash-settled NYMEX NG referenced contracts on top of the maximum position permitted under the conditional limit for cash-settled NYMEX NG referenced contracts.

position limit level for NYMEX NG, provided that the Commission does not observe any issues in the markets.

c. NYMEX NG Penultimate Referenced Contracts

(1) Summary of the 2020 NPRM and Additional Background Information - NYMEX NG Penultimate Referenced Contracts

With respect to NYMEX NG, the Commission proposed that penultimate contracts, which are cash-settled contracts that settle on the trading day immediately preceding the final trading day of the corresponding referenced contract, are also considered referenced contracts that are subject to Federal spot month position limits.[743] The Commission also proposed a slightly broader economically equivalent swap definition for natural gas, so that swaps with delivery dates that diverge by less than two calendar days (instead of one calendar day) from an associated referenced contract could still be deemed economically equivalent and therefore subject to Federal position limits. The Commission made these adjustments to: recognize the active and vibrant penultimate natural gas contract markets; prevent and disincentivize manipulation and regulatory arbitrage; and prevent volume from shifting away from non-penultimate cash-settled NYMEX NG markets to penultimate NYMEX NG contract futures and/or penultimate NYMEX NG swaps markets in order to avoid Federal position limits. [744]

(2) Comments - NYMEX NG Penultimate Referenced Contracts

In response to this part of the 2020 NPRM, ICE requested "that the Commission continue to allow exchanges to impose spot month accountability levels which expire

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

[744] The Commission proposed a relatively narrow "economically equivalent swap" definition in order to prevent market participants from inappropriately netting positions in core referenced futures contracts against swap positions further out on the curve. The Commission acknowledges that liquidity could shift to penultimate swaps as a result, but believes that, with the exception of natural gas, this concern is mitigated since certain constraints exist that militate against this from occurring, including basis risk between the penultimate swap and the core referenced futures contract. However, this constraint does not necessarily apply to the natural gas futures markets, because natural gas has a relatively liquid penultimate futures market that enables a market participant to hedge or off-set its penultimate swap positions. As a result, the Commission believes that liquidity may be incentivized to shift from NYMEX NG to penultimate natural gas swaps in order to avoid Federal position limits in the absence of the Commission's exception for natural gas in the "economically equivalent swap" definition.

during the period when spot month limits for the Henry Hub core-referenced futures contract are in effect and to not aggregate penultimate options into the Henry Hub LD1 cash-settled limit."[745] One of the ways in which ICE supported this request was by claiming that, "The Commission states that penultimate contracts are economically the same as the last day contract, however, empirically, this statement is not correct as settlement prices have demonstrated."[746]

(3) Discussion of Final Rule - NYMEX NG Penultimate Referenced Contracts

The Commission declines to exclude NYMEX NG penultimate contracts from Federal position limits for the reasons set forth in this Final Rule's section addressing "Referenced Contract."[747] In doing so, the Commission notes, in particular, that ICE's specific assertion that penultimate natural gas contracts are not economically the same as last day contracts based on settlement prices runs counter to the Commission's review of a sample of the daily settlement prices for NYMEX NG (the physically-settled natural gas contract), ICE Henry Hub LD1 (the ICE natural gas contract cash-settled to NYMEX NG), and ICE Henry Hub Penultimate (the ICE penultimate natural gas contract cash-settled to NYMEX NG).[748]

vii. Wheat Core Referenced Futures Contracts' Federal Spot Month Position Limit Levels

a. Summary of the 2020 NPRM and Additional Background Information - Wheat Federal Spot Month Position Limit Levels

The Commission proposed to increase the Federal spot month position limit levels for all three wheat core referenced futures contracts (CBOT Wheat (W), CBOT KC HRW Wheat (KW), and MGEX HRS Wheat (MWE)) from 600 contracts to 1,200 contracts.

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[745] ICE at 14.

[746] *Id*.

[747] For further discussion of the Commission's determination to include penultimate contracts within the Federal position limits framework, *see* Section II.A.16.iii.a.(2)(iii).

[748] *Id.*

The proposed Federal limit levels were based on the underlying EDS figures for each wheat core referenced futures contract and CME's and MGEX's recommended Federal spot month position limit levels of 1,200 contracts for each of their respective wheat core referenced futures contracts.

b. Summary of the Commission Determination – Wheat Federal Spot Month Position Limit Levels

The Commission is adopting the Federal spot month position limit levels for all three wheat core referenced futures contracts as proposed.

c. Comments – Wheat Federal Spot Month Position Limit Levels

The Commission received one comment, from MGEX, fully supporting the 2020 NPRM's Federal spot month parity among the three wheat core referenced futures contracts.[749]

4. Federal Non-Spot Month Position Limit Levels

i. Background - Federal Non-Spot Month Position Limit Levels

The Commission most recently updated the Federal non-spot month position limit levels in 2011.[750] At that time, the Commission utilized a formula that was called the "10/2.5% formula,"[751] which calculated the Federal non-spot month position limit levels by multiplying the first 25,000 contracts in open interest by 10% and multiplying the remaining contracts by 2.5% and adding the two numbers together.[752] The 10/2.5%

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[749] MGEX at 3.

[750] The Commission notes that the 2011 Final Rulemaking that adopted the most recent Federal non-spot month position limit levels was vacated by an order of the U.S. District Court for the District of Columbia on September 28, 2012. However, that order did not apply with respect to the 2011 Final Rulemaking's amendments to the Federal non-spot month position limit levels in § 150.2. *ISDA*, 887 F.Supp.2d 259 (2012).

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

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

formula was first adopted in 1999 based on two primary factors: growth in open interest and the size of large traders' positions.[753] The existing Federal non-spot month position limit levels that were adopted in 2011 have not been updated to reflect changes in open interest data in over a decade.[754]

ii. Summary of the 2020 NPRM - Federal Non-Spot Month Position Limit Levels

Proposed § 150.2(e) provided that Federal non-spot month position limit levels were set forth in proposed Appendix E to part 150 and were as follows: [755]

Core Referenced Futures Contract	**2020 Proposed Federal Single Month and All-Months-Combined Position Limit Level**	**Existing Federal Single Month and All-Months-Combined Position Limit Level**	**Existing Exchange-Set Single Month and All-Months-Combined Position Limit Level**
CBOT Corn (C)	57,800	33,000	33,000
CBOT Oats (O)	2,000	2,000	2,000
CBOT Soybeans (S)	27,300	15,000	15,000
CBOT Soybean Meal (SM)	16,900	6,500	6,500
CBOT Soybean Oil (SO)	17,400	8,000	8,000
CBOT Wheat (W)	19,300	12,000	12,000
CBOT KC HRW Wheat (KW)	12,000	12,000	12,000
MGEX HRS Wheat (MWE)	12,000	12,000	12,000
ICE Cotton No. 2 (CT)	11,900	5,000	5,000

In generally calculating the above levels, the Commission proposed to maintain the existing 10/2.5% formula for non-spot month position limit levels, but with the following limited changes: (1) the 10% rate would apply to the first 50,000 contracts of open interest (instead of the first 25,000 contracts); (2) the 2.5% rate would apply to open

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

[754] In setting the Federal non-spot month position limit levels in 2011, the Commission used open interest data from 2009. 76 FR at 71642.

[755] 85 FR at 11624. As discussed above, the proposed Federal non-spot month position limits would apply to only the nine legacy agricultural contracts and any associated referenced contracts. All other referenced contracts subject to Federal position limits would be subject to Federal position limits only during the spot month, as specified above, and would only be subject to exchange-set position limits or position accountability levels outside of the spot month.

interest above 50,000 contracts (rather than above the current level of 25,000 contracts); and (3) the modified 10/2.5% formula would apply to updated open interest data for the applicable futures and delta-adjusted options for the periods from July 2017 to June 2018 and July 2018 to June 2019.[756] All Federal non-spot month position limit levels that were calculated based on the 10/2.5% formula (*i.e.,* all legacy agricultural contracts, with the exception of CBOT Oats (O), CBOT KC HRW Wheat (KW), MGEX HRS Wheat (MWE), and the single month position limit level for ICE Cotton No. 2 (CT)) were rounded up to the nearest 100 contracts.

As outlined in the table above, the proposed Federal non-spot month position limit levels are generally higher than the existing Federal non-spot month position limit levels, with the exception of CBOT Oats (O), CBOT KC HRW Wheat (KW), and MGEX HRS Wheat (MWE), for which the proposed limit levels would remain at existing levels. As described in detail below, this proposed general increase is primarily due to the increases in open interest that have occurred since the Federal non-spot month position limit levels were last updated approximately a decade ago.[757]

iii. Summary of the Commission Determination - Federal Non-Spot Month Position Limit Levels

The Commission is adopting each of the Federal non-spot month position limit levels as proposed in § 150.2(e) and Appendix E to part 150, with the exception of setting a lower single month position limit for ICE Cotton No. 2 (CT). The Commission will first describe the general rationale for the final Federal non-spot month position limit levels that are being adopted. Next, the Commission will describe the comments it received in connection with the proposed Federal non-spot month position limit levels.

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[756] The 12-month period yielding the higher open interest level is selected as the basis for the Federal non-spot month position limit level.

[757] *See* 85 FR at 11630. The 2020 NPRM's proposed modification to the 10/2.5% formula from 25,000 to 50,000 contracts results in a modest increase in the Federal non-spot month position limit level of 1,875 contracts over what the limit level would be if the 10/2.5% formula were applied at 25,000 contracts, assuming that the market for the core referenced futures contract has an open interest of at least 50,000 contracts.

Finally, the Commission will provide responses to such comments, including further rationale for the Commission's position concerning the final Federal non-spot month position limit levels.

a. Rationale for the Final Federal Non-Spot Month Position Limit Levels

As explained below, the Commission believes that the final Federal non-spot month position limit levels, in conjunction with the rest of the Federal position limits framework, will achieve the four policy objectives in CEA section 4a(a)(3)(B). Namely, they will: (1) diminish, eliminate, or prevent excessive speculation; (2) deter and prevent market manipulation, squeezes, and corners; (3) ensure sufficient market liquidity for bona fide hedgers; and (4) ensure that the price discovery function of the underlying market is not disrupted.[758]

As a preliminary matter, the Commission continues to believe that a formula based on a percentage of open interest, such as the 10/2.5% formula, will permit position limit levels to better reflect the changing needs and composition of the futures markets.[759] Open interest is a measure of market activity that reflects the number of contracts that are "open" or live, where each contract of open interest represents both a long and a short position.[760] The Commission believes that limiting positions to a percentage of open interest: (1) helps ensure that positions are not so large relative to observed market activity that they risk disrupting the market; (2) allows speculators to hold sufficient contracts to provide a healthy level of liquidity for bona fide hedgers; and (3) allows for increases in position limits and position sizes as markets expand and become more active.[761]

(1) Modification of the 10/2.5% Formula

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[758] 7 U.S.C. 6a(a)(3)(B).
[759] 85 FR at 11630.
[760] *Id*.
[761] *Id*.

However, the Commission believes that the current 10/2.5% formula should be updated based on market developments since it was adopted in 1999. As a result, the Commission proposed modifying the 10/2.5% formula by adjusting the inflection point between the 10% rate and the 2.5% rate from 25,000 contracts to 50,000 contracts.[762] The Commission also proposed applying updated open interest data to the modified 10/2.5% formula.

The Commission is adopting these changes as proposed because: (1) open interest has increased significantly since the 10/2.5% formula was originally adopted in 1999; and (2) futures market composition has changed significantly since 1999. The Commission discusses both developments in turn below.

(i) Increases in Open Interest

As noted in the 2020 NPRM, there has generally been a significant increase in maximum open interest for each of the legacy agricultural contracts (except for CBOT Oats (O)) since the existing 10/2.5% formula was first adopted in 1999.[763] Under the existing 10/2.5% formula, because the 2.5% incremental increase applies after the first 25,000 contracts of open interest, limit levels with respect to contracts with open interest above 25,000 contracts (*i.e.*, all applicable core referenced futures contracts other than CBOT Oats (O)) continue to increase at the much slower rate of 2.5% rather than the 10% rate that's applicable for the first 25,000 contracts. As a result, the existing 10/2.5% formula has become proportionally more restrictive as the percentage of open interest above 25,000 contracts increased.

The table below provides data that describes the market environment during the period prior to, and subsequent to, the adoption of the existing 10/2.5% formula by the Commission in 1999. The data includes futures contracts and the delta-adjusted options

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[762] This results in a modest increase in the Federal non-spot month position limit level of 1,875 contracts over what the limit level would be if the 10/2.5% formula were applied at 25,000 contracts, assuming that the market for the core referenced futures contract has an open interest of at least 50,000 contracts.

[763] 85 FR at 11631.

on futures open interest.[764] The first column of the table provides the maximum open interest in the nine legacy agricultural contracts over the five year period ending in 1999. The CBOT Corn (C) contract had a maximum open interest of approximately 463,000 contracts, and the CBOT Soybeans (S) contract had a maximum open interest of approximately 227,000 contracts. The other seven contracts had maximum open interest figures that ranged from less than 20,000 contracts for CBOT Oats (O) to approximately 172,000 for CBOT Soybean Oil (SO). Hence, when adopting the 10/2.5% formula in 1999, the Commission's experience in these markets was of aggregate futures and options on futures open interest well below 500,000 contracts.

Table: Maximum Futures and Options on Futures Open Interest, 1994—2018

	1994-1999	**2000-2004**	**2005-2009**	**2010-2014**	**2015-2018**
CBOT Corn (C)	463,386	828,176	1,897,484	2,052,678	2,201,990
ICE Cotton No. 2 (CT)	122,989	140,240	388,336	296,596	344,302
CBOT Oats (O)	18,879	17,939	16,860	15,375	11,313
CBOT Soybeans (S)	227,379	327,276	672,061	991,258	997,881
CBOT Soybean Meal (SM)	155,658	183,255	241,917	392,265	544,363
CBOT Soybean Oil (SO)	172,424	191,337	328,050	395,743	547,784
CBOT Wheat (W)	163,193	187,181	507,401	576,333	621,750
CBOT Wheat: Kansas City Hard Red Winter (KW)	76,435	87,611	159,332	189,972	311,592
MGEX Wheat: Minneapolis Hard Red Spring (MWE)	24,999	36,155	57,765	68,409	80,635

The table also displays the maximum open interest figures for subsequent periods up to, and including, 2018. The maximum open interest for all legacy agricultural contracts, except for CBOT Oats (O), generally increased over the period. By the 2015-

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

2018 period covered in the last column of the table, five of the contracts had maximum open interest greater than 500,000 contracts. Also, the contracts for CBOT Corn (C), CBOT Soybeans (S), and CBOT Hard Red Winter Wheat (KW) saw maximum open interest increase by a factor of four to five times the maximum open interest observed during the 1994-1999 period when the Commission adopted the 10/2.5% formula in 1999.

As open interest has increased, the current Federal non-spot month position limit levels have become significantly more restrictive over time. In particular, as discussed above, because the 2.5% incremental increase applies after the first 25,000 contracts of open interest under the existing 10/2.5% formula, Federal non-spot month position limit levels on legacy agricultural contracts with open interest above 25,000 contracts (*i.e.,* all contracts other than CBOT Oats (O)) continue to increase at a much slower rate of 2.5% rather than the 10% that applies for the first 25,000 contracts.

The existing 10/2.5% formula's inflection point of 25,000 contracts was less of a problem in the latter part of the 1990s, for example, when open interest in each of the nine legacy agricultural contracts was below 500,000, and in many cases below 200,000. More recently, however, open interest has grown above 500,000 for a majority of the legacy agricultural contracts. The existing 10/2.5% formula has thus become more restrictive for market participants, including, as discussed immediately below, certain banks and dealers with positions that may not be eligible for a bona fide hedging exemption, but who might otherwise provide valuable liquidity to commercial firms.

(ii) Changes in Market Composition

The potentially restrictive nature of the existing Federal non-spot month position limit levels has become more problematic over time because dealers play a much more significant role in the market today than at the time the Commission adopted the 10/2.5% formula. Prior to 1999, the Commission regulated physical commodity markets where

the largest participants were often large commercial interests who held short positions. The offsetting positions were often held by small, individual traders, who tended to be long.[765]

Several years after the Commission adopted the 10/2.5% formula, the composition of futures market participants changed as dealers began to enter the physical commodity futures market in larger size. These dealers, including ones affiliated with banks or large financial institutions that are now provisionally registered and regulated as swap dealers, sometimes held significant positions in these markets by acting as aggregators or market makers and providing swaps to commercial hedgers and to other market participants.[766] The existing 10/2.5% formula has thus become particularly restrictive for dealers, including those with positions that may not be eligible for a bona fide hedging exemption, but that might otherwise provide valuable liquidity to commercial firms.[767]

The table below demonstrates the trend of increased dealer participation by presenting data from the Commission's publicly available "Bank Participation Report" ("BPR"), as of the December report for 2002-2018.[768] The table displays the number of banks holding reportable positions for the seven futures contracts for which Federal position limits apply and that were reported in the BPR.[769] The report presents data for every market where five or more banks hold reportable positions. The BPR is based on

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[765] Stewart, Blair, *An Analysis of Speculative Trading in Grain Futures*, Technical Bulletin No. 1001, U.S. Department of Agriculture (Oct. 1949). *See also* Draper, Dennis, "The Small Public Trader in Futures Markets", pp. 211-269, Futures Markets: Regulatory Issues (ed. Anne Peck, 1985): American Enterprise Institute.

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

[767] The Commission notes that this issue with respect to swap dealers is being addressed through a combination of a modification of the 10/2.5% formula and the pass-through swap provision, the latter of which is described in Section II.A.1.x. (Pass-Through Swap and Pass-Through Swap Offset Provisions).

[768] Bank Participation Reports, available at https://www.cftc.gov/MarketReports/BankParticipationReports/index.htm.

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

the same large-trader reporting system database used to generate the Commission's Commitments of Traders ("COT") report.[770]

No data was reported for the seven futures contracts in December 2002, indicating that fewer than five banks held reportable positions at the time of the report. The December 2003 report shows that five or more banks held reportable positions in four of the commodity futures. The number of banks with reportable positions generally increased in the early to mid-2000s, which included dealers that operated in the swaps markets by acting as aggregators or market makers, providing swaps to commercial hedgers and to other market participants while using the futures markets to hedge their own exposures.[771] When the Commission adopted the 10/2.5% formula in 1999, it had limited experience with physical commodity derivatives markets in which such banks were significant participants.

Table: Number of Reporting Commercial Banks with Long Futures Positions

Year	Corn	Cotton	Soybeans	Soybean Meal	Soybean Oil	Wheat	Wheat KCBT
2002	NR	NR	NR	NR	NR	NR	NR
2003	5	6	7	NR	NR	5	NR
2004	5	10	7	NR	NR	7	NR
2005	10	8	6	NR	5	9	9
2006	11	11	9	NR	7	14	7
2007	13	8	12	NR	6	14	6
2008	17	13	16	NR	6	14	9
2009	8	8	8	NR	NR	13	NR
2010	7	7	7	NR	NR	11	NR
2011	10	11	9	5	5	10	NR
2012	8	10	11	6	6	13	5
2013	11	11	13	10	6	11	5
2014	15	12	15	10	9	15	6
2015	12	13	13	12	9	16	9
2016	15	14	15	12	10	15	6
2017	16	13	12	11	9	16	8
2018	16	15	18	15	13	18	12

[770] Commitments of Traders, available at www.cftc.gov/MarketReports/CommitmentsofTraders/index.htm. Commitments of Traders reports indicate that there are generally still as many large commercial traders in the markets today as there were in the 1990s.

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

NR = "Not Reported"

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

Table: Percent of Futures Long Open Interest Held by Commercial Banks

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

NR = "Not Reported"

The Commission believes that the application of the modified 10/2.5% formula adopted herein to updated open interest data will prevent the Federal non-spot month limits from becoming overly restrictive by providing an appropriate increase in the non-spot month position limit levels for most contracts to better reflect the above-described changes in market dynamics observed since the late 1990s.

(2) Non-Spot Month Position Limit Levels for CBOT Oats (O), CBOT KC HRW Wheat (KW), and MGEX HRS Wheat (MWE)

The Commission is adopting the proposed Federal non-spot month position limit levels with respect to CBOT Oats (O), CBOT KC HRW Wheat (KW), and MGEX HRS Wheat (MWE). These remain at the current Federal non-spot month position limit levels, which are 2,000 contracts for CBOT Oats (O) and 12,000 contracts for both CBOT KC HRW Wheat (KW) and MGEX HRS Wheat (MWE). These Federal non-spot month position limit levels are higher than the levels that would have been determined using the modified 10/2.5% formula and updated open interest data, which would have resulted in 700 contracts for CBOT Oats (O), 11,900 contracts for CBOT KC HRW Wheat (KW), and 5,700 contracts for MGEX HRS Wheat (MWE). However, the Commission saw no reason to reduce these Federal non-spot month position limit levels in accordance with the 10/2.5% formula because the Commission has observed that the existing limit levels have functioned well for these core referenced futures contracts and the Commission believes that strictly following the 10/2.5% formula to determine Federal non-spot month position limit levels could harm liquidity in those markets.

(3) Single Month Position Limit Level for ICE Cotton No. 2 (CT)

The Commission is adopting a modified single month Federal position limit level for ICE Cotton No. 2 (CT). The Commission proposed a uniform single month and all-months-combined position limit for the ICE Cotton No. 2 (CT) contract, as well as uniform single month and all-months-combined position limits for the eight other legacy agricultural contracts. However, in the 2020 NPRM the Commission requested comments from the public concerning whether the Commission should adopt a lower single month position limit level for ICE Cotton No. 2 (CT) compared to the all-months-combined position limit level.[772]

The Commission received numerous comments from the end users of ICE Cotton No. 2 (CT) in the cotton industry, including growers and merchants, who requested that

[772] 85 FR 11637 (Request for Comment #26).

the Commission establish a lower Federal single month position limit level for ICE Cotton No. 2 (CT) compared to the all-months-combined position limit level, including establishing the single month position limit level at 50% of the all-months-combined position limit level.[773] The Commission did not receive any comments from commercial end-users opposing a lower Federal single month position limit level for ICE Cotton No. 2 (CT) compared to the all-months-combined position limit level. In response to the comments received, the Commission is adopting a lower Federal single month position limit level of 5,950 contracts for ICE Cotton No. 2 (CT), which is 50% of the proposed Federal non-spot month position limit level. However, the Commission is adopting the proposed all-months-combined position limit level of 11,900 contracts, which is based on the modified 10/2.5% formula. This change is discussed further below.

(4) The Final Rule's Federal Non-Spot Month Position Limits Achieve the Four Statutory Objectives in CEA Section 4a(a)(3)(B)

As noted above, in the Final Rule, the Commission is not reducing Federal non-spot month position limit levels for any of the legacy agricultural contracts and will be raising them for six of the nine such contracts in accordance with the updated open interest data and the modified 10/2.5% formula.[774] As a result, the Commission believes that the final Federal non-spot month position limit levels will generally improve liquidity for bona fide hedgers and, at the very least, not harm liquidity compared to the status quo.

The Commission also believes that the final Federal non-spot month position limit levels remain low enough to diminish, eliminate, or prevent excessive speculation, and to deter and prevent market manipulation. This is because, as discussed above, by taking into account the amount of observed market activity through open interest, the modified

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[773] ACSA at 2, 8; LDC at 2; Olam at 2; Ecom at 1; ACA at 2; Canale Cotton at 2; Choice at 2; Jess Smith at 2; East Cotton at 2; Memtex at 2; NCC at 1-2; Southern Cotton at 2-3; Texas Cotton at 2; Toyo Cotton Co. at 2; WCSA at 2; and Omnicotton at 2.

[774] As noted previously, the Commission is not following the modified 10/2.5% formula for determining the single month position limit level for ICE Cotton No. 2 (CT). However, the Final Rule still increases that limit level compared to its existing limit level.

10/2.5% formula adopted herein helps ensure, among other things, that positions are not so large relative to observed market activity that they risk disrupting the market.[775] This, in turn, also helps ensure that the price discovery function of the underlying market is not disrupted, because markets that are free from manipulative activity reflect fundamentals of supply and demand rather than artificial pressures. The Commission also notes that the 10/2.5% formula has functioned well, based on the Commission's decades of experience administering the formula.[776]

The Commission reiterates that the modified 10/2.5% formula provided in this Final Rule is generally a continuation of the same approach the Commission has taken for decades. The increased levels adopted herein are primarily driven by utilizing updated open interest figures. With respect to the slight modification to the 10/2.5% formula, the Commission does not believe that the modification will negatively impact the formula's effectiveness in ensuring that the Federal non-spot month position limit levels remain low enough to diminish, eliminate, or prevent excessive speculation, and to deter and prevent market manipulation. This is because the difference between utilizing the existing 10/2.5% formula and the modified 10/2.5% formula results in a modest increase in Federal non-spot month position limit level of 1,875 contracts, which is generally counterbalanced by the increased amount of open interest that is subject to the 2.5% rate.[777] Additionally, the Commission has previously studied prior increases in Federal non-spot month position limit levels and concluded that the overall impact was modest,

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[775] 85 FR at 11630.

[776] *Id.* at 11675.

[777] When the Commission adopted the existing Federal non-spot month position limit levels in 2011, the Federal non-spot month position limit levels for four of the nine legacy agricultural contracts were based on the existing 10/2.5% formula and utilized open interest data from 2009. These were CBOT Corn (C), CBOT Soybeans (S), CBOT Wheat (W), and CBOT Soybean Oil (SO). For those four contracts, the ratio of Federal non-spot month position limit level to open interest changes as follows: CBOT Corn (C) (the ratio increases from 0.026 to 0.027); CBOT Soybeans (S) (the ratio increases from 0.028 to 0.029); CBOT Wheat (W) (the ratio increases from 0.029 to 0.031); and CBOT Soybean Oil (SO) (the ratio increases from 0.030 to 0.032).

The other five legacy agricultural contracts' Federal non-spot month position limit levels deviated from the 10/2.5% formula. The ratio changes for these five contracts are as follows (based on 2009 open interest data): ICE Cotton No. 2 (CT) (the ratio increases from 0.025 to 0.037 for the all-months-combined and decreases from 0.025 to 0.018 for the single month); CBOT Soybean Meal (SM) (the ratio decreases from 0.038 to 0.032); CBOT Oats (O) (the ratio increases from 0.130 to 0.291); MGEX Hard Red Spring Wheat (MWE) (the ratio decreases from 0.323 to 0.162); and CBOT KC Hard Red Winter Wheat (KW) (the ratio decreases from 0.113 to 0.037).

and that any changes in market performance were most likely attributable to factors other than changes in the Federal position limit rules.[778] The Commission has since gained additional experience which supports that conclusion, including by monitoring amendments to position limit levels by exchanges. Further, given the significant increases in open interest and changes in market composition that have occurred since the 1990s, the Commission is comfortable that the Federal non-spot month position limit levels adopted herein will adequately address each of the policy objectives set forth in CEA section 4a(a)(3)(B), including preventing manipulation and excessive speculation.

(5) Federal Non-Spot Month Position Limits as Ceilings

The Commission reiterates that, under this position limits framework, the Federal non-spot month position limit levels serve as ceilings. Exchanges are required to establish their own non-spot month position limit levels with respect to the nine legacy agricultural contracts pursuant to final § 150.5(a)(1). A discussion of the implications of this approach is provided above in Section II.B.3.ii.a(2).

iv. Comments and Discussion of Final Rule - Federal Non-Spot Month Position Limit Levels

Most commenters did not express concerns with respect to the proposed Federal non-spot month position limit levels and the method by which the Commission determined those levels.[779] However, some commenters raised concerns with respect to: (1) the Federal non-spot month position limit levels, generally; (2) the proposed non-spot month position limit level for ICE Cotton No. 2 (CT); and (3) the issue of partial parity for the three wheat core referenced futures contracts with respect to their Federal non-spot month position limit levels. The Commission will discuss each of these issues, the

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[778] 64 FR at 24039.

[779] *See, e.g.,* COPE at 2; CMC at 6; CCI at 2; and CHS at 2.

related comments, and the Commission's corresponding determination in greater detail below.

a. Federal Non-Spot Month Position Limit Levels, Generally

(1) Comments - Federal Non-Spot Month Position Limit Levels, Generally

Several commenters raised concerns about the proposed Federal non-spot month position limit levels generally. Two commenters, NGFA and LDC, advocated for lowering the Federal non-spot month position limit levels for the nine legacy agricultural contracts.[780] NGFA stated that the proposed increases are "very large" and that the Commission should not view increasing non-spot month position limit levels as a "tradeoff" for eliminating the risk management exemption, but should instead establish limits that "will telescope down to relatively much-smaller spot-month limits in an orderly fashion."[781] LDC and several others believed that adopting lower Federal single month position limit levels would "prevent speculative activity from concentrating in a single contract month and thus jeopardizing convergence."[782] NGFA and LDC also offered the following alternatives to the proposed Federal non-spot month position limit levels: (1) set single-month limits at some percentage of the all-months-combined limit, such as 50%; or (2) maintain existing single-month limits while adopting the proposed all-months-combined limits.[783] NGFA also offered a third alternative, which was to adopt a phased-in approach to the higher non-spot month position limits, "together with

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[780] NGFA at 3 and LDC at 2.

[781] NGFA at 3. NGFA also commented that, "NGFA still is not completely convinced that open interest is the best yardstick for this exercise," because "[a]s volume and open interest grow, Federal non-spot limits expand correspondingly…which leads to yet higher volume and open interest…which again prompts expanded Federal non-spot limits…and so on." However, NGFA did not provide any alternatives to utilizing open interest for determining Federal non-spot month position limit levels. As discussed previously, the Commission believes that open interest is an appropriate means of measuring market activity for a particular contract and that a formula based on open interest, such as the 10/2.5% formula: (1) helps ensure that positions are not so large relative to observed market activity that they risk disrupting the market; (2) allows speculators to hold sufficient contracts to provide a healthy level of liquidity for hedgers; and (3) allows for increases in position limits and position sizes as markets expand and become more active. Furthermore, the Commission notes that under the Final Rule, Federal non-spot month position limit levels do not automatically increase with higher open interest levels. In order to make any amendments to the Federal position limit levels, the Commission is required to engage in notice-and-comment rulemaking.

[782] LDC at 2. *See also e.g.,* Moody Compress at 1; ACA at 2; Jess Smith at 2; McMeekin at 2; Memtex at 2; Mallory Alexander at 2; Walcot at 2; and White Gold at 1.

[783] NGFA at 4 and LDC at 2.

very active monitoring of contract performance, though NGFA does not favor this option."[784]

On the other hand, ISDA requested higher Federal non-spot month position limit levels.[785] ISDA stated that the proposed levels "for the legacy agricultural contracts are not high enough to provide [] significant liquidity to these markets based on the experience of market participants and anticipated growth in these markets."[786] ISDA also appeared to suggest that higher levels could "help markets offset any liquidity that may be lost if the risk management exemption is not retained."[787] Finally, ISDA also provided a table with suggested Federal non-spot month position limit levels that ranged from 18% to 191% higher than the proposed levels, except for CBOT Oats (O), which remained the same.[788]

Another commenter, MGEX, disagreed with the 10/2.5% formula, stating that "a formulaic approach is too rigid and inflexible" and that the "Commission needs to be flexible in the future and should not preclude further limits or discussion."[789]

(2) Discussion of Final Rule - Federal Non-Spot Month Position Limit Levels, Generally

With the exception of ICE Cotton No. 2 (CT), as discussed below, the Commission declines to modify the proposed Federal non-spot month position limit levels or the general methodology underlying the determination of those levels for the remaining legacy agricultural contracts, and also declines to adopt a phase-in for Federal non-spot month position limit levels.

(i) Request to Generally Lower Federal Non-Spot Month Position Limits

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[784] NGFA at 4. IATP also provided a similar suggestion, by stating that, "it is prudent to phase in new non-spot month limit levels so that the Commission can acquire data and experience with how the new Federal non-spot limits are working for the commercial hedging of those legacy contracts." IATP at 11.

[785] ISDA at 7.

[786] *Id*.

[787] *Id*.

[788] *Id*.

[789] MGEX at 3.

In response to these comments, the Commission believes that the modified 10/2.5% formula is generally an appropriate way to calculate Federal non-spot month position limit levels. The Commission also believes that the final non-spot month position limit levels are supported by updated open interest data, some of which have increased significantly since 2009.

The Commission continues to believe that a formula based on a percentage of open interest, such as the 10/2.5% formula, is appropriate for establishing limit levels outside of the spot month, as discussed above and in the 2020 NPRM.[790] The Commission believes that limiting positions to a percentage of open interest, such as through the 10/2.5% formula: (1) helps ensure that positions are not so large relative to observed market activity that they risk disrupting the market; (2) allows speculators to hold sufficient contracts to provide a healthy level of liquidity for bona fide hedgers; and (3) allows for increases in position limits and position sizes as markets expand and become more active.[791] Furthermore, the 10/2.5% formula has functioned well for Federal non-spot month position limit purposes for many years.[792] Also, the Commission does not believe that the slight modification to the 10/2.5% formula materially impacts the formula's efficacy in determining an appropriate Federal non-spot month position limit level as well,[793] because the modification is modest and is supported by the general increase in open interest among the legacy agricultural contracts and the change in the composition of market participants in those markets, as discussed above.[794]

(ii) Request to Generally Lower Single Month Position Limit Levels

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[790] *See* 85 FR at 11630-11633.

[791] *Id*.

[792] *See id.* at 11675.

[793] The Commission notes, as discussed elsewhere in this Final Rule, that CBOT KC HRW Wheat (KW), MGEX HRS Wheat (MWE), CBOT Oats (O), and ICE Cotton No. 2 (CT) (single month limit only) are subject to unique circumstances or other factors that counsel in favor of deviating from the 10/2.5% formula.

[794] The modification results in a modest increase in the Federal non-spot month position limit level of 1,875 contracts over what the limit level would be if the inflection point for the 10/2.5% formula was set at 25,000 contracts, assuming that the market for the core referenced futures contract has an open interest of at least 50,000 contracts.

In response to comments generally requesting lower single month position limit levels, the Commission first acknowledges that it has set single-month position limit levels lower than all-months-combined position limit levels in the past. However, since the Commission set both single month and all-months-combined levels set at the same level in 2011, the Commission has not observed any issues with respect to the nine legacy agricultural contracts as a result of that change.

In response to commenters' concern about possible convergence issues from setting the single-month and all-months-combined levels set at the same level, the Commission notes that positions in the non-spot months have minimal impact on convergence. This is because convergence occurs in the spot month, and, specifically, at the expiration of the physically-settled spot month contract.[795]

Furthermore, the Commission notes that an important benefit of having a single Federal non-spot month limit level for both the single-month and all-months-combined is the ability for market participants to enter into calendar spread transactions that would normally be constrained by the lower single month position limit level. However, the Commission notes that, in response to comments received, it is adopting a lower Federal single month position limit level for ICE Cotton No. 2 (CT), the reasons for which is discussed below.

(iii) Request to Increase Federal Non-Spot Month Position Limit Levels

In response to ISDA's comment that the proposed Federal non-spot month position limit levels should be higher to compensate for the proposed loss of risk management exemptions for swap dealers, the Commission believes that any potential impact on existing risk management exemption holders may be mitigated by the finalized

[795] The Commission, however, recognizes that it is possible that unusually large positions in contracts outside of the spot month could distort the natural spread relationship between contract months. For example, if traders hold unusually large positions outside of the spot month, and if those traders exit those positions immediately before the spot month, that could cause congestion and also affect the pricing of the spot month contract. While such congestion or price distortion cannot be ruled out, exchange-set position limits and position accountability function to mitigate against such risks.

pass-through swap provision, to the extent swap dealers can utilize it.[796] The Commission believes that this is a preferable approach to either a hypothetical alternative formula or ISDA's own suggested Federal non-spot month position limit levels that would allow higher limit levels beyond those adopted in this Final Rule for all market participants. This is because, while the pass-through swap provision adopted herein is narrowly-tailored to enable liquidity providers to continue providing liquidity to bona fide hedgers, higher limit levels beyond those adopted in this Final Rule for all market participants could also permit excessive speculation and increase the possibility of market manipulation or harm to the underlying price discovery function.[797]

(iv) Concern with the Commission's "Formulaic" Approach

In response to MGEX's concern that the Commission's approach is too formulaic and rigid, the Commission notes that the Federal non-spot month position limit levels will operate as ceilings within a broader Federal position limits framework in which exchanges, including MGEX, are always free to determine their own exchange-set position limit levels and position accountability levels below the Federal position limit levels as they see fit based on market conditions. In fact, by having the Federal position limit levels operate as ceilings, this framework will enable exchanges to respond to market conditions through a greater range of acceptable position limit levels than if the Federal position limit levels did not operate as ceilings.

In addition, as described further below, the Commission has deviated from the 10/2.5% formula with respect to CBOT Oats (O), ICE Cotton No. 2 (CT) (single month only), CBOT KC HRW Wheat (KW), and MGEX HRS Wheat (MWE) based on the unique circumstances concerning those core referenced futures contracts. Furthermore, the Commission also notes that this Final Rule does not "preclude further limits or

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[796] *See* 85 FR at 11676. *See also* Section II.A.1.x. (Pass-Through Swap and Pass-Through Swap Offset Provisions).
[797] *See* 85 FR at 11676.

discussion."[798] The Commission is also continually monitoring market conditions to evaluate whether different Federal position limit levels may be warranted.

(v) Request to Implement a Phase-in Period

The Commission declines to adopt a formal phase-in period for Federal non-spot month position limits, in which the Commission gradually implements the Federal non-spot month position limit levels over a period of time. The Commission believes that the markets will operate in an orderly fashion with the Federal position limit levels adopted under this Final Rule, because the final Federal non-spot month position limit levels are supported by increased open interest and are generally set pursuant to the modified 10/2.5% formula, which, as discussed above, achieves the policy objectives set forth in CEA section 4a(a)(3)(B).[799]

However, as noted in the Federal spot month position limit level phase-in discussion above, as a practical matter, the Commission emphasizes that the operative non-spot month position limit levels for a market participant trading in exchange-listed referenced contracts is not the Federal non-spot month position limit levels, but the exchange-set non-spot month position limit levels. As a result, despite the changes in the Federal non-spot month position limit levels in this Final Rule, there will be no practical impact on market participants trading in exchange-listed referenced contracts unless and until an exchange affirmatively modifies its exchange-set non-spot month position limit levels through a rule submission to the Commission pursuant to part 40 of the Commission's regulations.[800]

c. ICE Cotton No. 2 (CT) Federal Non-Spot Month Position Limit Level

(1) Summary of the 2020 NPRM and Additional Background Information – ICE Cotton No. 2 (CT) Federal Non-Spot Month Position Limit Level

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[798] MGEX at 3.

[799] A phase-in is not necessary with respect to the Federal non-spot month position limit levels for CBOT Oats (O), KC HRW Wheat (KW), and MGEX HRS Wheat (MWE), because the Federal non-spot month position limit levels will remain at the current levels.

[800] 17 CFR part 40.

In the 2020 NPRM, the Commission proposed to increase both the Federal single month and all-months-combined position limit levels for ICE Cotton No. 2 (CT) from the existing Federal level of 5,000 contracts to 11,900 contracts by applying the updated open interest data into the proposed modified 10/2.5% formula. The Commission also solicited comments asking whether the Commission should consider lowering the Federal single month position limit level to a percentage of the Federal all-months-combined position limit level for ICE Cotton No. 2 (CT), and if so, what percentage of the all-months-combined position limit level should be used.[801]

(2) Comments - ICE Cotton No. 2 (CT) Federal Non-Spot Month Position Limit Level

In response to the 2020 NPRM, numerous commenters from the cotton industry, including growers and merchants, requested that the Commission "maintain its single-month limit, particularly for smaller markets like cotton,"[802] or, in the alternative, set a Federal single month position limit level of 50% of the all-months-combined limit (*i.e.*, 5,950 contracts).[803] In support, commenters also noted that the proposed non-spot month position limit level for ICE Cotton No. 2 (CT) was "not in line with historical limits."[804] One commenter also stated, "Experience with modern trading has shown a propensity by speculators to focus too heavily on the nearest futures contract, leaving later months with poor liquidity from time to time."[805] In contrast, ISDA argued that the proposed Federal non-spot month position limit levels, including that for ICE Cotton No. 2 (CT), were too

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[801] 85 FR at 11637 (Request for Comment #26).

[802] *See e.g.,* East Cotton at 2; Omnicotton at 2; Choice at 2; Canale Cotton at 2; Ecom at 1; Olam at 2; Texas Cotton at 2; Toyo Cotton at 2; Walcot Trading at 2; White Gold at 2; and NCTO at 2. *See also* ACA at 2; Gerald Marshall at 1-2; Jess Smith at 2; LDC at 2; Mallory Alexander at 2; McMeekin at 2; MemTex at 2; Moody Compress at 2; Parkdale at 2; Southern Cotton at 2-3; SW Ag at 2; and ACSA at 8.

[803] ACSA at 8; LDC at 2; and Olam at 2. The following commenters also supported ACSA's comment letter: ACA at 2; Ecom at 1; East Cotton at 2; Jess Smith at 2; IMC at 2; Mallory Alexander at 2; McMeekin at 2; Memtex at 2; Moody Compress at 2; Omnicotton at 2; Canale Cotton at 2; SW Ag at 2; Texas Cotton at 2; Toyo Cotton at 2; Walcot at 2; and White Gold at 2.

[804] AMCOT at 1-2 and Parkdale at 2.

[805] Gerald Marshall at 2.

low and asserted that the level for ICE Cotton No. 2 (CT) should be increased to 24,000 contracts to make up for the elimination of the risk management exemption.[806]

(3) Discussion of Final Rule – ICE Cotton No. 2 (CT) Federal Non-Spot Month Position Limit Level

The Commission is adopting the proposed all-months-combined position limit level of 11,900 contracts, but is adopting a modified single month position limit level of 5,950 contracts for ICE Cotton No. 2 (CT).

The Commission is adopting the proposed 11,900 contract Federal all-months-combined position limit level for ICE Cotton No. 2 (CT) because, as discussed earlier, the Commission believes that a formula based on a percentage of open interest—specifically the modified 10/2.5% formula—is an appropriate tool for establishing limits outside of the spot month. However, the Commission does not believe that it is appropriate to raise either the Federal single month or all-months-combined position limit level for ICE Cotton No. 2 (CT) to 24,000 contracts as suggested by ISDA, because the open interest levels do not support such a drastic increase and there is no other reason to deviate so significantly upward from the modified 10/2.5% formula.[807]

On the other hand, the Commission believes that it is appropriate to adopt a lower Federal single month position limit level at this time. As noted in the Commission's request for comment in the 2020 NPRM, the Commission believed that there could be concerns with respect to the Federal single month position limit level for ICE Cotton No. 2 (CT), especially from the commercial end-users of the core referenced futures contract.[808] In response to the Commission's request for comment, the Commission received approximately 25 comment letters from the cotton industry (out of

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[806] ISDA at 7 (providing specific alternative levels).

[807] The Commission acknowledges ISDA's comment that the proposed Federal non-spot month position limit levels should be higher to compensate for the proposed loss of risk management exemptions for swap dealers. However, as noted previously, the Commission believes that any potential impact on existing risk management exemption holders may be mitigated by the pass-through swap provision adopted herein, and that this is a preferable and more tailored approach than increasing the non-spot month position limit levels for all market participants.

[808] 85 FR 11637 (Request for Comment #26).

approximately 75 comment letters on the 2020 NPRM from all commenters) unanimously requesting a lower Federal single month position limit level compared to the Federal all-months-combined position limit level for ICE Cotton No. 2 (CT). The Commission believes that these unanimous comments from the commercial end-users of the ICE Cotton No. 2 (CT) core referenced futures contract are informative, because they suggest that lowering the 2020 NPRM's Federal single month position limit level from the proposed 11,900 contract level to either the existing 5,000 contract level or a 5,950 contract level (which is 50% of the all-months-combined position limit level of 11,900 contracts) may not have a material detrimental effect on liquidity for bona fide hedgers in the market.

All things being equal, a lower single month position limit level will better protect the markets against manipulation and price distortion,[809] but at the expense of reduced liquidity for bona fide hedgers. However, in this instance, in light of the comments received, the Commission believes that it could improve protections against manipulation and price distortion without materially impacting liquidity for bona fide hedgers by adopting a lower Federal single month position limit level of either 5,000 contracts or 5,950 contracts. Of these two suggested levels, the Commission believes that it is more appropriate to adopt the 5,950 contract level over the existing 5,000 contract level to account, in part, for the increase in open interest levels since the single month position limit level of 5,000 contracts was adopted in 2011.[810]

d. Wheat Core Referenced Futures Contracts' Federal Non-Spot Month Position Limit Levels

(1) Summary of the 2020 NPRM and Additional Background Information – Wheat Federal Non-Spot Month Position Limit Levels

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[809] Specifically, the Commission is referring to the price distortion that could be caused by a speculative trader who, after amassing a large position during the non-spot month, exits the entire position immediately before the spot month.

[810] The maximum open interest for ICE Cotton No. 2 (CT) was 197,191 contracts in 2009, 161,582 contracts in 2011, and 324,952 contracts in 2019.

There are three wheat contracts: CBOT Wheat (W), CBOT KC HRW Wheat (KW), and MGEX HRS Wheat (MWE). Currently, the Federal non-spot month position limit levels for all three are set at 12,000 contracts. This has been referred to as "full wheat parity."

In the 2020 NPRM, the Commission proposed "partial wheat parity" by increasing the Federal non-spot month position limit level for CBOT Wheat (W) from 12,000 contracts to 19,300 based on the application of the modified 10/2.5% formula and updated open interest levels, while maintaining the existing levels of 12,000 contracts for CBOT KC HRW Wheat (KW) and MGEX HRS Wheat (MWE). The 12,000 contract Federal non-spot month position limit levels for CBOT KC HRW Wheat (KW) and MGEX HRS Wheat (MWE) are above the levels that would be calculated based on the application of the modified 10/2.5% formula and recent open interest levels, which would be 11,900 contracts for CBOT KC HRW Wheat (KW) and 5,700 contracts for MGEX HRS Wheat (MWE).

The Commission proposed partial wheat parity between CBOT KC HRW Wheat (KW) and MGEX HRS Wheat (MWE) at 12,000 contracts for two reasons. First, both contracts provide exposure to hard red wheats. As a result, the Commission believed that drastically decreasing the Federal non-spot month position limit level for MGEX HRS Wheat (MWE) vis-à-vis CBOT KC HRW Wheat (KW) by following the 10/2.5% formula could impose liquidity costs on the MGEX HRS Wheat (MWE) market and harm bona fide hedgers, which could further harm liquidity for bona fide hedgers in the related CBOT KC HRW Wheat (KW) market.[811] Second, the existing Federal non-spot month position limit levels for CBOT KC HRW Wheat (KW) and MGEX HRS Wheat

[811] 85 FR at 11633.

(MWE) appear to have functioned well, and the Commission saw no market-based reason to reduce those levels based on recent open interest data.[812]

(2) Comments – Wheat Federal Non-Spot Month Position Limit Levels

The Commission received several comments concerning the proposed Federal non-spot month position limit levels with respect to the three wheat core referenced futures contracts. One commenter, MGEX, stated that it "supports maintaining partial wheat parity by keeping the existing non-spot month limits for [MGEX HRS Wheat (MWE)] and CBOT KC Hard Red Wheat at 12,000."[813] Another commenter agreed "with the increase in the non-spot month for CBOT Wheat (W)."[814]

However, other commenters requested that the Federal non-spot month position limit level for CBOT KC HRW Wheat (KW) be at least the same as CBOT Wheat (W) (*i.e.*, raise it to 19,300 contracts).[815] In support, commenters contended that the "physical market for the wheat crop that is deliverable under [CBOT KC HRW Wheat (KW)] is much larger than the wheat crop that is deliverable under [CBOT Wheat (W)]."[816] Also, commenters stated that the "characteristics of the physical wheat that is deliverable under [CBOT KC HRW Wheat (KW)] is more similar to the global wheat crop than the wheat that is deliverable under [CBOT Wheat (W)]."[817] As a result, commenters stated that, "[CBOT KC HRW Wheat (KW)] may be important for hedging for many market participants."[818] Similarly, MFA/AIMA stated that "open interest data and supply data published by the USDA for hard red winter wheat, which is the underlying commodity for [CBOT KC HRW Wheat (KW)], would also justify an increase in the [CBOT KC HRW Wheat (KW)] non-spot month limit."[819]

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[812] *Id.* at 11632.
[813] MGEX at 3.
[814] MFA/AIMA at 12.
[815] SIFMA AMG at 3-4; ISDA at 12; PIMCO at 4-5; MFA/AIMA at 12; and Citadel at 6-7.
[816] PIMCO at 4. *See also* ISDA at 12 and SIFMA AMG at 3-4.
[817] SIFMA AMG at 3. *See also* ISDA at 12 and PIMCO at 4.
[818] SIFMA AMG at 4. *See also* ISDA at 12.
[819] MFA/AIMA at 12. *See also* Citadel at 6-7.

(3) Discussion of Final Rule – Wheat Federal Non-Spot Month Position Limit Levels

The Commission declines to raise the proposed 12,000 contract Federal non-spot month position limit level for CBOT KC HRW Wheat (KW) to match the final Federal non-spot month position limit level of CBOT Wheat (W) at 19,300 contracts.

First, as noted earlier, the Federal non-spot month position limit level for CBOT KC HRW Wheat (KW) is already set higher, albeit slightly, than the limit level calculated under the updated open interest figure and 10/2.5% formula, which, as discussed previously, is a formula that the Commission believes is generally proper for determining Federal non-spot month position limit levels.[820] Raising the Federal non-spot month position limit level for CBOT KC HRW Wheat (KW) to 19,300 contracts would be a drastic increase over the existing level that is not supported by the 10/2.5% formula or by the Commission's observations of how that market has functioned under the 12,000 contract Federal non-spot month position limit level. As a result, the Commission is concerned that this could result in excessive speculation and increase the possibility of market manipulation or harm to the underlying price discovery function with respect to that contract.

Second, the Commission believes that maintaining partial wheat parity between CBOT KC HRW Wheat (KW) and MGEX HRS Wheat (MWE) is appropriate because the commodities underlying both of those wheat core referenced futures contracts are hard red wheats that, together, represent the majority of the wheat grown in both the United States and Canada, which results in those markets being closely intertwined.[821] This is in contrast with CBOT Wheat (W), which typically sees deliveries of soft white wheat varieties (even though it allows for delivery of hard red wheat).[822]

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[820] 85 FR at 11630.
[821] *Id.* at 11632.
[822] *Id*.

Finally, the Commission reiterates that bona fide hedging positions will continue to be allowed to exceed the Federal position limit levels. Intermarket spreading is also permitted as well, which should address any concerns over the potential for loss of liquidity in the spread trades among the three wheat core referenced futures contracts during the non-spot months.[823]

5. Subsequent Spot and Non-spot Month Limit Levels

i. Summary of the 2020 NPRM - Subsequent Spot and Non-spot Month Limit Levels

Unlike in previous iterations of the position limit rules, the 2020 NPRM did not require the Commission to periodically review and revise EDS figures or adjust the Federal spot month position limit levels.[824] Instead, under proposed § 150.2(f), an exchange listing a core referenced futures contract would be required to provide EDS figures only if requested by the Commission. Proposed § 150.2(j) delegated the authority to make such requests to the Director of the Division of Market Oversight.[825] The 2020 NPRM also allowed exchanges to voluntarily submit EDS figures to the Commission at any time, and encouraged them to do so.[826] When submitting EDS figures, exchanges would be required to provide a description of the methodology used to derive the EDS figures, as well as all data and data sources used to calculate the estimate, so that the Commission could verify that the EDS figures are reasonable.[827]

Likewise, the 2020 NPRM also did not require the Commission to periodically review the open interest data and update the non-spot month position limit levels for the legacy agricultural core referenced futures contracts, unlike in previous iterations of the position limit rules.[828]

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[823] *Id.* at 11633.
[824] *See e.g.*, 81 FR at 96769-96771.
[825] 85 FR at 11633.
[826] *Id.* at 11633-11634.
[827] *Id.* at 11634.
[828] *See e.g.*, 81 FR at 96769, 96771-96773.

ii. Summary of the Commission Determination - Subsequent Spot and Non-spot Month Limit Levels

The Commission is adopting § 150.2(f) as proposed and will not include a formal mechanism to periodically renew or revise EDS figures or otherwise review and update the Federal spot month or non-spot month position limit levels. The Commission is also adopting the delegation provision in § 150.2(j) as proposed.[829]

iii. Comments - Subsequent Spot and Non-spot Month Limit Levels

The Commission received several comments concerning updates to the Federal position limit levels, with commenters requesting that the Commission periodically review the levels and revise them if appropriate.[830] One commenter was concerned that the Federal position limit levels could become too high over time,[831] while the rest were concerned that the levels could become too low.[832] In addition, CME Group also suggested that exchanges should update the EDS figures "every two years [and]…DCMs should be provided the opportunity to submit data voluntarily to the Commission on a more frequent basis."[833]

iv. Discussion of Final Rule - Subsequent Spot and Non-spot Month Limit Levels

The Commission declines to implement a periodic, predetermined schedule to review Federal position limits because the Commission believes that it is more appropriate to retain flexibility for both the exchanges and the Commission itself in updating the Federal position limit levels.

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[829] The Commission did not receive any comments on proposed § 150.2(j).

[830] MFA/AIMA at 5 ("the Commission should direct exchanges to periodically monitor the proposed new position limit levels"); PIMCO at 6 ("we urge the CFTC to include…a mandatory requirement to regularly (and at least annually) review and update limits as markets grow and change"); SIFMA AMG at 10 (the Final Rule should require "that the Commission regularly consult with exchanges and review and adjust position limits when it is necessary to do so based on relevant market factors"); ISDA at 10 ("the Commission must regularly convene and consult with exchanges on deliverable supply and, if appropriate, propose notice and comment rulemaking to adjust limit levels"); and IATP at 16-17 (the Commission should engage in "an annual review of position limit levels to give [commercial hedgers] legal certainty over that period" and also retain "the authority to revise position limits…if data monitoring and analysis show that those annual limit levels are failing to prevent excessive speculation and/or various forms of market manipulation").

[831] IATP at 16-17.

[832] MFA/AIMA at 5-6; PIMCO at 6; SIFMA AMG at 10; and ISDA at 10.

[833] CME Group at 5.

Reviewing and adjusting the Federal spot month position limit levels requires the Commission to review, among other things, updated EDS figures for the core referenced futures contracts. Having worked closely with exchanges to analyze and independently verify the methodology underlying the EDS figures and the EDS figures themselves, the Commission recognizes that estimating deliverable supply can be a time and resource consuming process for both the exchanges and the Commission.[834] Furthermore, periodic, predetermined review intervals may not always align with market changes or other events resulting in material changes to deliverable supply that would warrant adjusting Federal spot month position limit levels. As a result, the Commission believes that it would be more efficient, timely, and effective to review the EDS figure and the Federal position limit level for a core referenced futures contract if warranted by market conditions, including changes in the underlying cash market, which the Commission and exchanges continually monitor.

Reviewing and adjusting the Federal non-spot month position limit levels requires the Commission to review, among other things, open interest data for the relevant core referenced futures contracts. Unlike EDS figures, open interest is easily obtainable because it is regularly updated by the exchanges. As a result, the output of the 10/2.5% formula can be quickly calculated. However, the Commission does not believe that it is appropriate to update the Federal non-spot month position limit levels separately from the Federal spot month position limit levels. The Commission has historically reviewed all of the Federal position limit levels—spot month and non-spot month—together for a particular contract because all months of a particular contract are part of the same market. As a result, updating both the spot and non-spot month position limits levels at the same time provides a holistic and integrated position limit regime for each commodity contract

[834] 85 FR at 11633.

because the limits are based upon updated data covering the same or overlapping time period.

Final § 150.2(f) provides flexibility and authority for the Commission to be able to request an updated EDS figure, along with the methodology and underlying data, for a core referenced futures contract whenever market conditions suggest that a change in Federal position limit levels may be warranted. The exchanges are also encouraged to submit such information at any time as well under final § 150.2(f).[835] Once the Commission receives the updated EDS figures, then the Commission can undertake the appropriate review and analysis of the EDS figures and any additional information, such as exchange recommendations, to adjust the Federal spot month position limit levels, if necessary, through rulemaking. At that time, the Commission would also review the open interest data for the core referenced futures contract and undertake the necessary analysis to ensure that the Federal non-spot month position limit levels are set at appropriate levels as well.

Finally, the Commission notes that, under this position limits framework, the exchanges always have the freedom to set their exchange-set position limit levels lower than the Federal position limit levels. Adjusting the Federal position limit levels necessarily requires the Commission to engage in rulemaking with notice-and-comment, which can take a significant amount of time.[836] Thus, an exchange may adjust its exchange-set position limit levels lower in response to market conditions, while waiting for the Commission to adjust the Federal position limit levels.[837]

6. Relevant Contract Month

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[835] In providing an updated EDS figure, exchanges should consult the guidance concerning estimating deliverable supply set forth in section (b)(1)(i) ("Estimating Deliverable Supplies") of 17 CFR part 38, Appendix C.

[836] Market participants may petition the Commission to adjust Federal position limit levels, subject to the Commission's notice-and-comment rulemaking, under existing § 13.1, which provides that any "person may file a petition with. . . the Commission…for the issuance, amendment or repeal of a rule of general application."

[837] However, an exchange cannot set its exchange-set position limit levels above the Federal position limit levels, even if market conditions may warrant raising the levels. Thus, in order to allow market participants to hold positions higher than the Federal position limit levels (absent an exemption), the Commission would need to raise the Federal position limit levels through rulemaking.

Proposed § 150.2(c) clarified that the spot month and single month for any given referenced contract is determined by the spot month and single month of the core referenced futures contract to which that referenced contract is linked.

The Commission did not receive any comments and is adopting as proposed. Final § 150.2(c) requires that referenced contracts be linked to the core referenced futures contract in order to be netted for position limit purposes.

For example, for the NYMEX NY Harbor ULSD Heating Oil (HO) core referenced futures contract, the spot month period starts at the close of trading three business days prior to the last trading day of the contract. The spot month period for the NYMEX NY Harbor ULSD Financial (MPX) futures referenced contract would thus start at the same time—the close of trading three business days prior to the last trading day of the core referenced futures contract.

7. Limits on "Pre-Existing Positions"

i. Summary of the 2020 NPRM - Pre-Existing Positions

Under proposed § 150.2(g)(1) Federal spot month position limits applied to "pre-existing positions, other than pre-enactment swaps and transition period swaps," each defined in proposed § 150.1. Accordingly, Federal spot month position limits would not apply to any pre-existing positions in economically equivalent swaps. The 2020 NPRM defined "pre-existing positions" in proposed § 150.1 as positions established in good faith prior to the effective date of a final Federal position limits rulemaking.

In contrast, proposed § 150.2(g)(2) provided that Federal non-spot month limits would *not* apply to pre-existing positions, *including* pre-enactment swaps and transition period swaps, if acquired in good faith prior to the effective date of such limit. However, other than pre-enactment swaps and transition period swaps, any pre-existing positions held outside the spot month would be attributed to such person if the person's position is increased after the effective date of a final Federal position limits rulemaking.

The 2020 NPRM's disparate treatment of pre-existing positions during and outside the spot month was predicated on the concern that failing to apply spot month limits to such pre-existing positions could result in a large, preexisting position either intentionally or unintentionally causing a disruption to the price discovery function of the core referenced futures contract as positions are rolled into the spot month. In contrast, outside the spot month, large, pre-existing positions may have a relatively less disruptive effect given that physical delivery occurs only during the spot month.

ii. Summary of the Commission Determination - Pre-Existing Positions

The Commission is adopting § 150.2(g)(1) as proposed, and is adopting § 150.2(g)(2) with the following two changes:

First, the Commission is amending proposed § 150.2(g)(2) to provide that non-spot month limits shall apply to pre-existing positions, other than pre-enactment swaps and transition period swaps. As noted above, proposed § 150.2(g)(2) in the 2020 NPRM exempted pre-existing positions from the Final Rule's Federal non-spot month position limits. However, as discussed below, the nine legacy agricultural contracts currently are subject to the Commission's existing non-spot month position limits, and the Commission did not intend to exclude existing non-spot month positions in the nine legacy agricultural contracts that would otherwise qualify as "pre-existing positions" under the Final Rule. As discussed, the other 16 non-legacy core referenced futures contracts that are subject to Federal position limits for the first time under the Final Rule are not subject to Federal non-spot month position limits and therefore proposed § 150.2(g)(2) would not have applied to these contracts in any event.

The Commission based the language in proposed § 150.2(g) on similar language found in the 2016 Reproposal, which imposed Federal non-spot month position limits on all of the proposed core referenced futures contracts (as opposed to only on the nine legacy agricultural contracts under the Final Rule). In the context of the 2016

Reproposal, the Commission believed it made sense to exempt pre-existing positions in non-spot months in core referenced futures contracts that would have been subject to Federal position limits for the first time under the 2016 Reproposal. However, as noted above, such core referenced futures contracts that are subject to Federal position limits for the first time under the Final Rule are not subject to Federal non-spot month position limits. Accordingly, the Commission is modifying § 150.2(g) so that pre-existing positions in the nine legacy agricultural contracts remain subject to Federal non-spot month position limits under the Final Rule, as the Commission had originally intended.

Second, since the Commission is clarifying that pre-existing positions in the nine legacy agricultural contracts, other than pre-enactment swaps and transition period swaps, are subject to Federal non-spot month position limits under the Final Rule, the language in proposed § 150.2(g)(2) that would attribute to a person any increase in their non-spot month positions after the effective date of the Final Rule's non-spot month limits is no longer necessary. The Commission is therefore removing this language from final § 150.2(g)(2).

iii. Comments - Pre-Existing Positions

Commenters generally supported proposed § 150.2(g), although several commenters asked for additional clarity.[838] MGEX and FIA both argued that the provision could be simplified by creating only two categories: "pre-existing swaps" (exempt from all spot/non-spot Federal position limits) and "pre-existing futures" (exempt from all non-spot Federal position limits, provided there is no increase in such non-spot positions), stating that relying upon the proposed relief as structured will be "operationally challenging" for market participants.[839] MGEX and FIA also requested that the Commission clarify that a market participant is not required to rely upon the

[838] MGEX at 4; FIA at 9; ISDA at 8.
[839] FIA at 8-9; MGEX at 4.

exemption so that its pre-existing positions could be netted, as applicable, with the market participant's other referenced contracts.[840] ISDA encouraged the Commission to provide that the Final Rule's new Federal position limits do not apply to any pre-existing positions, whether in futures contracts or swaps.[841] Finally, CHS encouraged the Commission to adopt a "safe harbor" provision where participants could demonstrate a "good-faith" effort at compliance so "inadvertent" violations would not trigger possible enforcement action.[842]

iv. Discussion of Final Rule - Pre-Existing Positions

As stated in the 2020 NPRM, the Commission believes that the absence of spot-month limits on pre-existing positions, other than pre-existing swaps and transition period swaps, could render the Federal spot month position limits ineffective. Failure to apply spot month limits to such pre-existing positions, particularly for the 16 commodities that are not currently subject to Federal position limits and where market participants may have pre-existing positions in excess of the spot-month position limits adopted herein, could result in a large, pre-existing position either intentionally or unintentionally causing a disruption to the price discovery function of the core referenced futures contract as positions are rolled into the spot month.[843] The Commission is particularly concerned about protecting the spot month in physically delivered futures contracts from price distortions or manipulation that would disrupt the hedging and price discovery utility of the futures contract.[844]

With respect to non-spot month position limits, only the nine legacy agricultural contracts are currently subject to such limits under the existing Federal position limits framework and will continue to be subject to Federal non-spot month position limits

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[840] MGEX at 3-4; FIA at 8-9, 18-19.
[841] ISDA at 2, 8.
[842] CHS at 5.
[843] 85 FR at 11634.
[844] *Id*.

under the Final Rule. The Commission did not intend in the 2020 NPRM to exclude such pre-existing positions in the nine legacy agricultural contracts from non-spot month limits. Accordingly, for the Final Rule the Commission is modifying final § 150.2(g)(2) to make clear that Federal non-spot month position limits do apply to these pre-existing positions. However, as noted above, the 16 non-legacy core referenced futures contracts that are subject to Federal position limits for the first time under this Final Rule are not subject to Federal non-spot month position limits and so are not affected by the Commission's change in final § 150.2(g)(2).

The Commission agrees with MGEX's and FIA's comments that pre-existing positions can be netted. The Commission confirms that market participants may continue to net their pre-existing positions, as applicable, with market participants' post-effective date referenced contract positions. In the 2020 NPRM, the Commission made explicit in proposed § 150.3(a)(5) that market participants would be permitted to net pre-existing swap positions with post-effective date referenced contract positions (to the extent such pre-existing swap positions qualify as "economically equivalent swaps" under the Final Rule).[845] The Commission adopted this clarification in final § 150.3(a)(5) for the avoidance of doubt. The Commission believes this explicit clarification with respect to swaps is helpful to market participants since swaps are subject to Federal position limits for the first time under this Final Rule and since it may not otherwise be clear whether a market participant could net a pre-enactment swap or transition period swap given that such pre-enactment and transition period swaps are exempt from Federal position limits under final § 150.3(a)(5).

However, the Commission similarly intended that market participants also would be able to net pre-existing futures contracts and option on futures contracts against post-

[845] Pre-existing swap positions (*i.e.*, pre-enactment swaps and transition period swaps) would otherwise be exempt from Federal position limits.

effective date positions. The Commission did not feel such a clarification was necessary since futures contracts and options thereon have been subject to the existing Federal position limits framework. Accordingly, for the avoidance of doubt, the Commission is affirming that market participants may continue to net pre-existing futures contracts and option on futures contracts with post-effective date positions in referenced contracts.

In response to ISDA's request for clarification, the Commission notes that Federal non-spot month position limits will apply to pre-existing positions in the nine legacy agricultural contracts (but not to the 16 non-legacy core referenced futures contracts). However, for the reasons articulated above, Federal position limits will apply during the spot month for futures contracts and options on futures contracts for all 25 core referenced futures contracts, other than pre-enactment swaps and transition period swaps.

While the Commission is not adopting a "safe harbor" provision, it is providing a transition period, as requested by CHS,[846] so that market participants will have until January 1, 2022 (or January 1, 2023 for economically-equivalent swaps or positions relying on the risk-management exemption) to comply with the Final Rule. The Commission believes this will provide sufficient time for market participants to implement and test new systems and processes that have been established to comply with the Final Rule.

8. Positions on Foreign Boards of Trade

i. Background

CEA section 4a(a)(6)(B) directs the Commission to establish limits on the aggregate number of positions in contracts based upon the same underlying commodity that may be held by any person across contracts traded on a foreign board of trade

[846] CHS at 5.

("FBOT") with respect to a contract that settles against any price of at least one contract listed for trading on a registered entity.[847]

ii. Summary of the 2020 NPRM - Foreign Boards of Trade

Proposed § 150.2(h) applied the proposed Federal position limits to a market participant's aggregate positions in referenced contracts executed on a DCM or SEF and on, or pursuant to the rules of, an FBOT, provided that (1) the referenced contracts settle against a price of a contract listed for trading on a DCM or SEF and (2) the FBOT makes such contract available in the United States through "direct access."[848] In other words, a market participant's positions in referenced contracts listed on a DCM or SEF and on an FBOT registered to provide direct access would collectively have to stay below the Federal position limit for the relevant core referenced futures contract.

iii. Summary of the Commission Determination – Foreign Boards of Trade

The Commission is adopting § 150.2(h) as proposed.

iv. Comments - Foreign Boards of Trade

The Commission received comments from CEWG, Chevron, and Suncor regarding proposed § 150.2(h) and its possible effects with respect to certain contracts listed on ICE Futures Europe ("IFEU") that are price-linked to the energy core referenced futures contracts.[849] Each of the commenters expressed concern that the extension of the proposed Federal position limits regime to referenced contracts listed for trading on IFEU could have unintended consequences, such as: (1) requiring U.S.-based market participants to comply with potentially conflicting requirements of multiple regulators and position limits regimes; and (2) incentivizing foreign regulators to extend their reach into the Commission's jurisdictional markets.[850]

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[847] 7 U.S.C. 6a(a)(6)(B). The CEA's definition of "registered entity" includes DCMs and SEFs. 7 U.S.C. 1a(40).

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

[849] CEWG at 28-29; Chevron at 15-16; Suncor at 14-15.

[850] CEWG at 28; Chevron at 16; Suncor at 15.

Chevron and Suncor requested that the Commission reconsider what they perceive to be the potential regulatory conflicts and burdens that could be imposed on market participants who transact referenced contracts listed on IFEU, and adopt a policy of substituted compliance to minimize such conflicts.[851] CEWG recommended that the Commission adopt an approach based on substituted compliance with respect to referenced contracts listed on FBOTs similar to that adopted for swaps under CEA section 2(i).[852]

v. Discussion of Final Rule - Foreign Boards of Trade

As stated above, the Commission is adopting § 150.2(h) as proposed. As stated in the 2020 NPRM,[853] CEA section 4a(a)(6)(B) requires the Commission to establish limits on the aggregate number or amount of positions in contracts based upon the same underlying commodity that may be held by any person across certain contracts traded on an FBOT with linkages to a contract traded on a registered entity. Final § 150.2(h) simply codifies requirements set forth in CEA section 4a(a)(6)(B), and will lessen regulatory arbitrage by eliminating a potential loophole whereby a market participant could accumulate positions on certain FBOTs in excess of limits in referenced contracts.[854]

Accordingly, the Commission believes that § 150.2(h) is consistent with the goal set forth in CEA section 4a(a)(2)(C) to ensure that liquidity does not move to foreign jurisdictions or place U.S. exchanges at a competitive disadvantage to foreign competitors. If the Commission did not attribute positions held in referenced contracts on FBOTs, the Commission inadvertently could incentivize market participants to shift

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[851] Chevron at 16; Suncor at 15.

[852] CEWG at 29.

[853] 85 FR at 11634.

[854] In addition, CEA section 4(b)(1)(B) prohibits the Commission from permitting an FBOT to provide direct access to its trading system to its participants located in the United States unless the Commission determines, in regards to any FBOT contract that settles against any price of one or more contracts listed for trading on a registered entity, that the FBOT (or its foreign futures authority) adopts position limits that are comparable to the position limits adopted by the registered entity. 7 U.S.C. 6(b)(1)(B).

trading and liquidity in referenced contracts to FBOTs in order to avoid Federal position limits.

9. Anti-Evasion

i. Summary of the 2020 NPRM - Anti-Evasion

Pursuant to the Commission's rulemaking authority in section 8a(5) of the CEA,[855] the Commission proposed § 150.2(i), which was intended to deter and prevent a number of potential methods of evading Federal position limits. The proposed anti-evasion provision provided: (1) a commodity index contract and/or location basis contract, which would otherwise be excluded from the proposed referenced contract definition, would be considered a referenced contract subject to Federal position limits if used to willfully circumvent position limits; (2) a bona fide hedge recognition or spread exemption would no longer apply if used to willfully circumvent speculative position limits; and (3) a swap contract used to willfully circumvent speculative position limits would be deemed an economically equivalent swap, and thus a referenced contract, even if the swap does not meet the economically equivalent swap definition set forth in proposed § 150.1.

ii. Summary of the Commission Determination - Anti-Evasion

The Commission is adopting § 150.2(i) as proposed with conforming changes that reflect revisions to the "referenced contract" definition adopted herein in which the Final Rule additionally is excluding "monthly average pricing contracts" and "outright price reporting agency index contracts" from the "referenced contract" definition.[856] A discussion of these conforming changes appears immediately below, followed by a summary of the comments, which addressed different aspects of the proposed anti-evasion provision.

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[855] 7 U.S.C. 12a(5).

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

a. Discussion of Conforming Changes - Anti-Evasion

The Commission is revising proposed § 150.2(i)(1), which addressed evasion of Federal position limits by using commodity index contracts and location basis contracts, to also cover monthly average pricing contracts and outright price reporting agency index contracts. This change is needed to conform the anti-evasion provision to the "referenced contract" definition adopted herein. In particular, while the 2020 NPRM would exclude commodity index contracts and location basis contracts from the "referenced contract" definition, the Final Rule excludes those contracts as well as monthly average pricing contracts and outright price reporting agency index contracts from the "referenced contract definition".[857]

Because contracts that are excluded from the final "referenced contract" definition are not subject to Federal position limits, the Commission intends that final § 150.2(i)(1) will prevent a potential loophole whereby a market participant who has reached its limits could otherwise utilize these contract types to willfully circumvent or evade speculative position limits. For example, a market participant could purchase a commodity index contract in a manner that allowed the participant to exceed limits when taking into account the weighting in the component commodities of the index contract. The Final Rule also will avoid creating what could otherwise be similar potential loopholes with respect to monthly average pricing contracts, outright price reporting agency index contracts, and location basis contracts.

Additionally, the Commission is adopting § 150.2(i)(2) as proposed. This provision provides that a bona fide hedge recognition or spread exemption will no longer apply if used to willfully circumvent speculative position limits. This provision is intended to help ensure that bona fide hedge recognitions and spread exemptions are granted and utilized in a manner that comports with the CEA and Commission

[857] *See* Section II.A.16.iii.b.

regulations, and that the ability to obtain bona fide hedge recognitions and spread exemptions does not become an avenue for market participants to inappropriately exceed speculative position limits.

The Commission is also adopting § 150.2(i)(3) as proposed. Under this provision, a swap contract used to willfully circumvent speculative position limits is deemed an economically equivalent swap, and thus a referenced contract, even if the swap does not meet the economically equivalent definition set forth in final § 150.1. This provision is intended to deter and prevent the structuring of a swap in order to willfully evade speculative position limits.

iii. Comments - Anti-Evasion

Several commenters stated that the anti-evasion provision is prudent, but would be difficult to apply in practice, in part due to the subjective "willful circumvention" standard.[858] FIA recommended that, instead, the anti-evasion analysis should be based on the presence of "deceit, deception, or other unlawful or illegitimate activity" so market participants will be better equipped to evaluate the surrounding facts and circumstances in making an evasion determination.[859] FIA further expressed that, because markets evolve, it is inadvisable to consider "historical practices behind the market participant and transaction in question."[860] FIA also asked the Commission to confirm that it is not evasion for a market participant to consider "costs or regulatory burdens, including the avoidance thereof," if that participant has a legitimate business purpose for a transaction.[861]

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[858] SIFMA AMG at 7, n.16 (noting that the anti-evasion provision makes the application of the proposed "economically equivalent swap" definition less clear because it incorporates a subjective measure of intent); *see also* FIA at 25 (questioning how a participant would distinguish a strategy that minimizes position size with an evasive strategy); Better Markets at 33 (describing the anti-evasion provision as a "useful deterrent," but noting that the willful circumvention standard would be difficult to meet and partially turns on the Commission's consideration of the legitimate business purpose analysis).

[859] FIA at 25-26.

[860] *Id.*

[861] *Id.*

Specific to swaps, ISDA encouraged the Commission to expressly acknowledge and confirm that an out-of-scope swap transaction would not be considered evasion under any set of circumstances.[862] FIA recommended that, for structured swaps, the anti-evasion analysis should ask whether the swap serves the market participant's commercial needs or objectives.[863] Finally, FIA suggested that the Final Rule should provide an automatic safe harbor from a retroactive evasion determination for all swaps entered into prior to the compliance date.[864]

iv. Discussion of Final Rule - Anti-Evasion

The Final Rule's anti-evasion provision is not intended to capture a trading strategy merely because the strategy may result in a smaller position size for purposes of position limits. Instead, the anti-evasion provision is intended to deter and prevent cases of willful evasion of speculative position limits, the specifics of which the Commission may be unable to anticipate. The Federal position limit requirements adopted herein will apply during the spot month for all referenced contracts subject to Federal position limits, while non-spot month Federal position limit requirements will only apply for the nine legacy agricultural contracts. Under this framework, and because the threat of corners and squeezes is the greatest in the spot month, the Commission anticipates that it may focus its attention on anti-evasion activity during the spot month.

The determination of whether particular conduct is intended to circumvent or evade requires a facts and circumstances analysis. In interpreting these anti-evasion rules, the Commission is guided by its interpretations of anti-evasion provisions appearing elsewhere in the Commission's regulations, including the interpretation of the anti-evasion rules that the Commission adopted in its rulemakings to further define the

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[862] ISDA at 5, n.7

[863] FIA at 25.

[864] *Id.*

term "swap" and to establish a clearing requirement under section 2(h)(1)(A) of the CEA.[865]

Generally, consistent with those interpretations, in evaluating whether conduct constitutes evasion, the Commission will consider, among other things, the extent to which the person lacked a legitimate business purpose for structuring the transaction in that particular manner. For example, an analysis of how a swap was structured could reveal that a person or persons crafted derivatives transactions, structured entities, or conducted themselves in a manner without a legitimate business purpose and with the intent to willfully evade position limits by structuring one or more swaps such that such swap(s) would not meet the "economically equivalent swap" definition in final § 150.1.

In response to FIA's comment that the Commission should confirm that it is not evasion for a market participant with a legitimate business purpose for a transaction to consider "costs or regulatory burdens,[866] the Commission acknowledges that it fully expects that a person acting for legitimate business purposes within its respective industry will naturally consider a multitude of costs and benefits associated with different types of financial transactions, entities or instruments, including the applicable regulatory obligations.[867] As stated in a prior rulemaking, a person's specific consideration of, for example, costs or regulatory burdens, including the avoidance thereof, is not, in and of itself, dispositive that the person is acting without a legitimate business purpose in a particular case.[868]

In response to FIA's comment[869] that an anti-evasion analysis of a structured swap should evaluate whether the transaction serves the market participant's commercial

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[865] *See* Further Definition of "Swap, "Security-Based Swap," and "Security-Based Swap Agreement;" Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208, 48297–48303 (Aug. 13, 2012); Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284, 74317–74319 (Dec. 13, 2012).

[866] FIA at 25.

[867] *See* 77 FR at 48301.

[868] *See* 77 FR at 74319.

[869] FIA at 25.

needs or objectives, as stated in the 2020 NPRM, the Commission will view legitimate business purpose considerations on a case-by-case basis in conjunction with all other relevant facts and circumstances. Additionally, the Commission disagrees with FIA's comment[870] that an historical practices inquiry is inadvisable. Because transactions and instruments are regularly structured, and entities regularly formed, in a particular way and for various, often times multiple, reasons, the Commission believes it is essential that all relevant facts and circumstances be considered, including historical practices.[871] While historical practice is a factor the Commission will consider as part of its facts and circumstances analysis, it is not dispositive in determining whether particular conduct constitutes evasion.

As part of its facts and circumstances analysis, the Commission will look at factors such as the historical practices behind the market participant and transaction in question. For example, with respect to § 150.2(i)(2) (*i.e.*, bona fide hedges or spreads used to evade), the Commission is adopting guidance in Appendix B to part 150 with respect to gross versus net hedging. As discussed elsewhere in this release, the Commission believes that measuring risk on a gross basis to willfully circumvent or evade speculative position limits would potentially run afoul of § 150.2(i)(2).[872] Use of gross or net hedging that is inconsistent with an entity's historical practice, or a change from gross to net hedging (or vice versa), could be an indication that an entity is seeking to evade position limits regulations.[873] With respect to § 150.2(i)(3) (*i.e.,* swaps used to evade), the Commission will consider whether a market participant has a history of structuring its swaps one way, but then starts structuring its swaps a different way around the time the participant risked exceeding a speculative position limit as a result of its

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[870] *Id.* at 25-26.
[871] *See* 77 FR at 48302.
[872] *See* Section II.A.1.ix.
[873] *Id.*

swap position, such as by modifying the delivery date or other material terms and conditions such that the swap no longer meets the definition of an "economically equivalent swap."

Consistent with interpretive language in prior rulemakings addressing evasion,[874] when determining whether a particular activity constitutes willful evasion, the Commission will consider the extent to which the activity involves deceit, deception, or other unlawful or illegitimate activity. Although it is likely that fraud, deceit, or unlawful activity will be present where willful evasion has occurred, the Commission disagrees with FIA's comment[875] that these factors should be a prerequisite to an evasion finding. A position that does not involve fraud, deceit, or unlawful activity could still lack a legitimate business purpose or involve other indicia of evasive activity. The presence or absence of fraud, deceit, or unlawful activity is one fact the Commission will consider when evaluating a person's activity. That said, the final anti-evasion provision does require willfulness, *i.e.* "scienter." In response to commenters[876] who expressed concern regarding the practical application of this intent standard, the Commission will interpret "willful" consistently with how the Commission has done so in the past, *i.e.*, that acting either intentionally or with reckless disregard constitutes acting "willfully."[877]

In determining whether a transaction has been entered into or structured willfully to evade position limits, the Commission will not consider the form, label, or written documentation as dispositive. The Commission also is not requiring a pattern of evasive transactions as a prerequisite to prove evasion, although such a pattern may be one factor in analyzing whether evasion has occurred. In instances where one party willfully

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[874] *See* 77 FR at 48297–48303; 77 FR at 74317–74319.

[875] FIA at 25.

[876] SIFMA AMG at 7, n.16; *see also* FIA at 25; Better Markets at 33.

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

structures a transaction to evade but the other counterparty does not, § 150.2(i) will apply to the party who willfully structured the transaction to evade.

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

The Commission declines to adopt ISDA's request[878] to carve out-of-scope swap transactions from the anti-evasion provision. This request was unsupported and did not address whether an out-of-scope swap could be used to evade position limits.

Finally, the Commission declines to adopt FIA's request[879] that all swaps entered into prior to the compliance date be granted an automatic safe harbor from a retroactive finding of evasion. This change is unnecessary given that under final § 150.3, pre-enactment swaps and transition period swaps will not be subject to Federal position limits at all during or outside the spot month.[880]

10. Application of Netting and Related Treatment of Cash-Settled Referenced Contracts

i. Background

Under the existing Federal framework, Federal position limits apply only to the nine legacy agricultural contracts, which are all physically-settled. However, existing part 150 does not include the equivalent concept of a "referenced contract," and therefore existing Federal position limits do not apply to any cash-settled look-alike contracts as they would under the Final Rule. Accordingly, the issue of netting across look-alike

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[878] ISDA at 5, n.7.
[879] FIA at 25.
[880] *See* final § 150.3(a)(5).

contracts that may be located across different exchanges is not addressed under the existing framework.

ii. Summary of the 2020 NPRM - Netting and Related Treatment of Cash-Settled Referenced Contracts

Under the 2020 NPRM, the referenced contract definition in proposed § 150.1 included, among other things, (i) cash-settled contracts that are linked, either directly or indirectly, to a core referenced futures contract, and (ii) "economically equivalent swaps."[881]

Proposed § 150.2(a) provided that during the spot month, Federal position limits would apply "separately" to physically delivered referenced contracts and cash-settled referenced contracts. Under the 2020 NPRM, positions in a physically-settled core referenced futures contract would not be required to be added to, nor permitted to be netted down by, positions in corresponding cash-settled referenced contracts (and vice-versa).

Proposed § 150.2(b), in contrast, provided that during the non-spot months, including the single month and all-months-combined, Federal position limits would apply in the aggregate to both physically-delivered referenced contracts and cash-settled referenced contracts. This meant that for the purposes of determining whether a market participant complies with the Federal non-spot month position limits, a person's physically-settled and cash-settled referenced contract positions would be added together and could net against each other.

Under both proposed §§ 150.2(a) and (b), positions in referenced contracts would be aggregated across exchanges for purposes of determining one's net position for Federal position limit purposes.

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

iii. Summary of the Commission Determination - Netting and Related Treatment of Cash-Settled Referenced Contracts

The Commission is finalizing §150.2(a) and (b) of the 2020 NPRM as proposed.[882]

iv. Comments - Netting and Related Treatment of Cash-Settled Referenced Contracts

PIMCO, SIFMA AMG, and ISDA contended that cash-settled referenced contracts should not be subject to Federal position limits at all because cash-settled contracts do not introduce the same risk of market manipulation. They argued that subjecting cash-settled referenced contracts to Federal position limits would reduce market liquidity and depth in these instruments.[883]

FIA and ICE argued that limits for cash-settled referenced contracts should be higher relative to Federal position limits for physically-settled referenced contracts. They similarly argued that cash-settled referenced contracts are "not subject to corners and squeezes" and will "'ensure market liquidity for *bona fide* hedgers.'"[884] FIA and ICE further suggested that Federal position limits for cash-settled referenced contracts should apply per DCM (rather than in aggregate across DCMs).[885] FIA additionally suggested setting a separate Federal spot-month position limit for economically equivalent swaps.[886]

In contrast, CME Group supported the Commission's approach for spot-month parity for physically-settled and cash-settled referenced contracts across all commodity markets. CME Group explained that absent such parity, one side of the market could be vulnerable to: artificial distortions from manipulations on the other side of the market;

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[882] As discussed above, the Commission is making an exception for natural gas referenced contracts to the general netting rules discussed below. For further discussion on the Final Rule's treatment of natural gas referenced contracts, *see* Section II.B.3.vi.

[883] PIMCO at 3; SIFMA AMG at 4-7; ISDA at 3-5. These entities did not specifically argue that cash-settled contracts should be excluded from the "referenced contract" definition, but rather in general that such instruments should not be subject to Federal position limits. The Commission noted that this is technically a different argument since cash-settled instruments could be exempt from position limits while still technically qualifying as "referenced contracts," but the end result is the same as a practical matter.

[884] ICE at 3, 15 (also arguing that cash-settled limits should apply per exchange, rather than across exchanges); FIA at 7-8.

[885] FIA at 7-8; ICE at 13.

[886] FIA 7-8.

regulatory arbitrage; and liquidity drain to the other side of the market.[887] CME Group warned that, ultimately, a lack of parity could undermine the statutory goals of position limits.[888] NEFI agreed, arguing similarly that "this move is essential to guard against manipulation by a trader who holds positions in both physically-settled and cash-settled contracts for the same underlying commodity."[889]

v. Discussion of Final Rule - Netting and Related Treatment of Cash-Settled Referenced Contracts

The Commission is finalizing §§ 150.2(a) and (b) as proposed. Under final § 150.2(a), Federal spot month limits apply to physical-delivery referenced contracts "separately" from Federal spot month limits applied to cash-settled referenced contracts, meaning that during the spot month, positions in physically-settled contracts may not be netted with positions in linked cash-settled contracts but also are not required to be added to linked cash-settled contracts for the purposes of determining compliance with Federal position limits. Specifically, all of a trader's positions (long or short) in a given physically-settled referenced contract (across all exchanges and OTC as applicable)[890] are netted and subject to the spot month limit for the relevant commodity, and all of such trader's positions in any cash-settled referenced contracts (across all exchanges and OTC as applicable) linked to such physically-settled core referenced futures contract are netted and independently (rather than collectively along with the physically-settled positions) subject to the Federal spot month limit for that commodity.[891]

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[887] CME Group at 3-4.

[888] *Id.* at 6.

[889] NEFI at 3.

[890] In practice, the only physically-settled referenced contracts subject to the Final Rule will be the 25 core referenced futures contracts, none of which are listed on multiple DCMs, although there could potentially be physically-settled OTC swaps that would satisfy the "economically equivalent swap" definition and therefore would also qualify as referenced contracts. For further discussion on economically equivalent swaps, *see* Section II.A.4.

[891] Consistent with CEA section 4a(a)(6), this would include positions across exchanges. However, for the reasons discussed in Section II.B.3.vi., the Commission is exercising its exemptive authority under CEA section 4a(a)(7) to provide an exception for natural gas to the general aggregation rule in CEA section 4a(a)(6). As discussed above, the Commission has concluded that the natural gas market is well-established with contracts that currently trade across several exchanges, and is relatively liquid with significant open interest. Accordingly, the Commission is exercising its judgment to establish Federal position limits on a per-exchange (and OTC as applicable) basis in order to maintain the status quo rather than risk disturbing the existing natural gas market.

Additionally, a position in a commodity contract that is not a referenced contract, and therefore is not subject to Federal position limits, as a consequence, cannot be netted with positions in referenced contracts for purposes of Federal position limits.[892] For example, a swap that is not a referenced contract because it does not meet the economically equivalent swap definition could not be netted with positions in a referenced contract.

Allowing the netting of linked physically-settled and cash-settled contracts during the spot month could lead to disruptions in the price discovery function of the core referenced futures contract or allow a market participant to manipulate the price of the core referenced futures contract. Absent separate spot month position limits for physically-settled and cash-settled contracts, the spot month position limit would be rendered ineffective, as a participant could maintain large positions in excess of limits in both the physically-settled contract and the linked cash-settled contract, enabling the participant to disrupt the price discovery function as the contracts go to expiration by taking large opposite positions in the physically-settled core referenced futures and cash-settled referenced contracts, or potentially allowing a participant to effect a corner or squeeze.[893] Consistent with current and historical practice, the Federal position limits adopted herein apply to positions throughout each trading session (*i.e.*, on an intra-day basis during each trading session), as well as at the close of each trading session.[894]

In response to the comments from PIMCO, SIFMA AMG, and ISDA that cash-settled referenced contracts should not be subject to position limits at all because such contracts do not introduce the same risk of market manipulation, as discussed above

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[892] Proposed Appendix C to part 150 provides guidance regarding the referenced contract definition, including that the following types of contracts are not deemed referenced contracts, meaning such contracts are not subject to Federal position limits and cannot be netted with positions in referenced contracts for purposes of Federal position limits: location basis contracts; commodity index contracts; swap guarantees; trade options that meet the requirements of 17 CFR 32.3; monthly average pricing contracts; and outright price reporting agency index contracts.

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

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

under Section II.A.16.iii.a., the Commission has concluded that cash-settled referenced contracts should be subject to Federal position limits since they form one market with their corresponding physically-settled core referenced futures contracts.[895]

In response to ISDA's recommendation that the Final Rule only include physically-settled referenced contracts and that the Commission apply Federal position limits on cash-settled referenced contracts at a later time, the Commission notes that as discussed under Section I.D., the Final Rule will be subject to a general compliance period until January 1, 2022. During this period, exchanges may choose to implement exchange-set position limits that provide for a different phased-in approach for cash-settled versus physically-settled referenced contracts as the exchanges may find appropriate for their respective markets. Additionally, the compliance period will be further extended until January 1, 2023 for economically equivalent swaps and positions held in reliance on a risk-management exemption, which in each case the Commission notes include mostly cash-settled positions. Accordingly, as a practical matter, many cash-settled contracts will be subject to a longer compliance period. However, as discussed further above under Section II.A.16.iii.a, the Commission has determined that it is appropriate to include cash-settled referenced contracts in Federal position limits under this Final Rule.[896]

FIA and ICE similarly argued that cash-settled referenced contracts should be subject to higher Federal position limits compared to the physically-settled core referenced futures contracts. Their arguments were predicated, in part, on their conclusions that market participants cannot use cash-settled contracts to effect a corner or squeeze.[897]

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[895] For further discussion, *see* Section II.A.16.iii.a(2).

[896] For further discussion of the Commission's rationale for including cash-settled referenced contracts under the Final Rule, *see* Section II.A.16.iii.a.

[897] FIA at 7; ICE at 12-13.

The Commission declines to adopt higher Federal position limits for cash-settled referenced contracts for several reasons. First, as an initial matter, the Commission acknowledges that preventing corners and squeezes is a crucial focus of the Commission. However, in response to FIA's and ICE's arguments that cash-settled referenced contracts should be subject to higher Federal position limits compared to physically-settled futures contracts because cash-settled contracts cannot be used to effect a corner or squeeze, the Commission notes that there are other forms of manipulation, such as "banging" or "marking" the close, that cash-settled referenced contracts can effect, and the Commission emphasizes that it endeavors to prevent all such market manipulation, consistent with CEA section 4a(a)(3)(B)(ii).[898] While CEA section 4a(a)(3)(B)(ii) specifically references corners and squeezes, the CEA section also references "manipulation" generally, and neither FIA nor ICE recognized the existence of other types of market manipulation, such as "banging" the close, in their analysis.

Second, the Commission believes that FIA's and ICE's arguments for higher Federal position limits for cash-settled referenced contracts is intrinsically related to the comments from PIMCO, SIFMA AMG, and ISDA discussed above arguing that cash-settled referenced contracts should not be subject to Federal position limits at all. That is, the higher the Federal position limits for cash-settled referenced contracts that FIA or ICE recommend establishing, the closer, as a practical matter, it is to having no Federal position limits for cash-settled referenced contracts.[899] As a result, the Commission believes that its general rationale for including cash-settled referenced contracts within the Federal position limits framework similarly supports parity between cash-settled and physically-settled referenced contracts.

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[898] For further discussion, *see* Sections II.A.16., II.A.4.iii.d(2), and II.B.10.iv.
[899] *See* Section II.A.16.iii.a.

Third, the Commission generally agrees with the reasons articulated in the comments from CME Group and NEFI that it is appropriate to establish spot-month parity for physically-settled and cash-settled referenced contracts across all commodity markets. While FIA argued that higher position limits for cash-settled referenced contracts could ensure liquidity for bona fide hedgers,[900] the Final Rule has established the Federal position limit levels in general for the 25 core referenced futures contracts (including increases for many of the nine legacy agricultural contracts) and has expanded the enumerated bona fide hedges and streamlined the related application process under final §§ 150.3 and 150.9 in order to ensure sufficient liquidity for bona fide hedgers.

FIA and ICE similarly argued that market participants should not be required to aggregate cash-settled positions across all exchanges but rather should be subject to a disaggregated Federal position limit that applies per-exchange. In other words, as the Commission understands FIA's and ICE's request, if the Federal position limit is 1,000 contracts, FIA and ICE believe that a market participant should be able to hold 1,000 cash-settled referenced contracts per exchange rather than being required to aggregate positions across all exchanges. Under this approach, a long position of 1,000 contracts on Exchange A would not be aggregated with a long position of 1,000 contracts on Exchange B. However, under this approach, a long position on Exchange A also would not net with a short position on Exchange B.

ICE specifically argued that a single, aggregate Federal position limit for all referenced contracts across exchanges may make it difficult for an exchange to launch a new referenced contract since the hypothetical new referenced contract would be aggregated with an existing referenced contract for purposes of Federal position limits.[901] According to ICE, establishing new exchanges and/or new contracts is made more

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[900] FIA at 7-8.

[901] ICE at 12-13.

difficult under the Commission's aggregated approach, since it is purportedly more difficult to attract sufficient liquidity to establish a sustainable exchange or contract.[902] ICE also references the Commission's obligations under CEA section 15 to consider the public interest and antitrust laws.[903] ICE recommends a more flexible approach to allow an exchange to develop its own liquidity and establish its own limits, even for similar or look-alike cash-settled referenced contracts, to help develop robust and liquid markets while protecting against excessive speculation.[904]

In response to FIA and ICE, as discussed immediately below, the Commission believes that, as a general matter, establishing aggregate limits across exchanges promotes competition and innovation while also better addressing the statutory goals in CEA section 4a(a)(3) as compared to ICE's request to establish disaggregated, per-exchange position limits. However, before discussing the Commission's underlying policy rationale supporting aggregate Federal position limits, the Commission has determined that as an initial legal matter that CEA section 4a(a)(6)(B) requires the Commission to establish the "*aggregate* number or amount of positions . . . that maybe held by any person . .. for each month *across* . . . contracts listed by [DCMs] . . . ." (emphasis added).[905] While ICE cites CEA section 15 in its comment letter, ICE does not address CEA section 4a(a)(6)'s requirement that the Commission generally must establish aggregate position limits across exchanges. Accordingly, in addition to the policy rationale discussed immediately below, the Commission further has determined that the Final Rule's requirement to aggregate positions across exchanges does not on its face violate CEA section 15.[906]

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[902] ICE at 12-13.

[903] *Id*.

[904] *Id*.

[905] 7 U.S.C. §6a(a)(6); CEA 4a(a)(6).

[906] *See* Section IV.D. As discussed elsewhere in this release, the Commission is exercising its exemptive authority pursuant to CEA Section 4a(a)(7) to establish an exception to this rule in connection with, and based on the particular circumstances of the natural gas market. See Section II.B.3.iv (discussing natural gas).

As noted above, the Commission also believes it is appropriate to aggregate positions across exchanges for Federal position limit purposes for the same general reasons that the Commission has determined both to include cash-settled referenced contracts within the Federal position limits framework and also to maintain parity for Federal position limit levels between physically-settled and cash-settled referenced contracts. For example, applying a per-exchange Federal position limit, rather than aggregating across exchanges, effectively increases the applicable Federal position limit. Accordingly, the Commission likewise believes it generally is inappropriate to permit per-exchange Federal position limits for cash-settled referenced contracts.

In response to ICE's concern regarding liquidity formation and that aggregating cash-settled positions across exchanges would harm competitiveness and innovation by making it more difficult to attract enough liquidity to become sustainable on an ongoing basis,[907] the Commission believes that to the extent Federal position limit levels under the Final Rule have been correctly calibrated, the Federal position limits framework should promote – or at least not disincentivize – liquidity formation.

However, ICE's proposal to allow Federal position limits to apply on a disaggregated, per-exchange basis risks dividing liquidity among several liquidity pools, which itself could harm liquidity for bona fide hedgers and reduce price discovery. The Commission also observes that, as a practical matter, ICE's request to disaggregate positions across exchanges would significantly increase the applicable position limit (possibly by a multiple of two or three – or more – depending on the number of exchanges that list referenced contracts). Consequently, if the Commission assumes, *in arguendo*, that Federal position limit levels are reasonably calibrated under the Final Rule, then applying a per-exchange limit by definition would increase the potential risks of excessive speculation and possible manipulation as market participants are permitted

[907] ICE at 12-13.

to hold larger directional positions in referenced contracts. Moreover, to the extent Federal position limits under this Final Rule are not reasonably calibrated to ensure necessary liquidity for bona fide hedgers, then the Commission, as a general matter, would prefer to address the lack of liquidity by adjusting the Federal position limit levels to appropriate levels rather than applying Federal position limits on a per-exchange basis for the reasons discussed in the paragraphs above and as discussed in the paragraph immediately below.

Last, the Commission believes that ICE's approach could actually harm innovation since under ICE's rationale, Federal position limit levels would need to be set lower than the Federal levels adopted herein. For example, if the Commission were to allow disaggregated netting across exchanges as a general rule, then it would likely lead to increased excessive speculation and possible manipulation, as discussed above.

Accordingly, in order to avoid the threat of excessive speculation and manipulation, the Commission would be obligated to set Federal position limits sufficiently low in order to compensate for a per-exchange position limit disaggregated approach. However if the Commission were to establish Federal position limits sufficiently low to prevent these concerns from happening, then innovation could be adversely affected since it means that the concomitant lower Federal position limit levels likely would make it difficult for exchanges to develop sufficient liquidity for a new product – unless other competing exchanges offered linked contracts to add sufficient liquidity to the market. In such a case, the success of any new product offered by the initial exchange could be dependent upon competing exchanges offering competing look-alike contracts to allow for sufficient liquidity. In contrast, the Commission believes that the Final Rule's approach to make the full aggregated Federal position limit available to the contract is more responsive to the needs of the market compared to a disaggregated approach, and the Commission believes that the Final Rule's aggregated approach

promotes innovation and competition in the marketplace. Accordingly, the Commission does not believe that applying netting on an aggregate basis harms competition and innovation. Rather, the Commission believes its approach supports healthy competition and innovation while ICE's approach could harm liquidity and innovation.

While the Commission believes the above rationale generally applies, the Commission notes that for the reasons discussed in Section II.B.3.vi., the Commission is exercising its exemptive authority under CEA section 4a(a)(7) to provide an exception for natural gas to the general aggregation rule in CEA section 4a(a)(6). The Commission does not believe that the rationale above necessarily applies to the natural gas market. As discussed above, the natural gas market has existing natural gas commodity derivatives contracts that are well-established with liquidity, trading, and open interest currently across several exchanges. Accordingly, the Commission is exercising its judgment to establish Federal position limits on a per-exchange basis in order to maintain the status quo rather than risk disturbing the structure of the existing natural gas market, which could harm liquidity for bona fide hedgers or price discovery.

In response to FIA's suggestion that economically equivalent swaps should be subject to separate Federal spot-month position limits, as discussed under Section II.A.4.iii., the Commission does not believe doing so would be appropriate.[908] As discussed above, the Commission believes that establishing separate class position limits for futures contracts and swaps could harm liquidity formation while establishing a single Federal position limit promotes integration between the futures and swaps markets.

11. "Eligible Affiliates" and Position Aggregation

i. Background

[908] FIA 7-8.

In 2016, the Commission amended § 150.4 to adopt new rules governing the aggregation of positions for purposes of compliance with Federal position limits.[909] These aggregation rules currently apply only to the nine legacy agricultural contracts previously subject to Federal position limits, but now will also apply to the 16 new contracts subject to Federal position limits for the first time under this Final Rule. Under the existing aggregation rules, unless an exemption applies, all of the positions held and trading done by the person must be aggregated with positions for which the person controls trading or for which the person holds a 10% or greater ownership interest. DMO has issued time-limited no-action relief through August 12, 2022 ("NAL 19-19") from some of the aggregation requirements contained in that rulemaking.[910]

ii. Summary of the 2020 NPRM - Eligible Affiliates and Position Aggregation

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

iii. Summary of the Commission Determination - Eligible Affiliates and Position Aggregation

The Commission is adopting § 150.2(k) as proposed.

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[909] *See* 81 FR at 91454.

[910] *See* CFTC Letter No. 19–19 (July 31, 2019), available at https://www.cftc.gov/csl/19-19/download. NAL 19-19 extends NAL 17-37 and provides an additional three-year period of no-action relief from compliance with certain position aggregation requirements under Commission Regulation 150.4 by streamlining the compliance requirements that must be satisfied for a person or entity to rely on an exemption from aggregation.

iv. Comments - Eligible Affiliates and Position Aggregation

Although the Commission did not receive any comments on this provision, it received a number of comments related to position aggregation in general. These commenters urged the Commission to amend the Federal position limits aggregation rules in existing § 150.4 by codifying existing NAL 19-19.[911] Some commenters further requested that the Commission revisit certain aspects of NAL 19-19 and the aggregation rules, such as the threshold ownership percentage set forth in existing § 150.4 that triggers the requirement to aggregate positions or rely upon an exemption.[912] Conversely, IATP argued that before applying the existing aggregation rules, and accompanying exemptions, to additional commodities, the Commission should study whether the existing exemptions from aggregation have resulted in increased speculation.[913]

v. Discussion of Final Rule - Eligible Affiliates and Position Aggregation

The Commission declines to codify NAL 19-19[914] in this rulemaking since NAL 19-19's relief from some of the aggregation requirements contained in 2016 Final Aggregation Rulemaking[915] continues to apply until August 12, 2022. DMO extended this relief for three years to provide sufficient time to "evaluate whether the relief granted is hindering Commission staff's ability to conduct surveillance; assess the impact of the relief; and consider long-term solutions that must, appropriately, be implemented by a notice and comment rulemaking."[916] Accordingly, the Commission believes it is appropriate to first monitor the application of the existing position aggregation requirements before considering amendments to those aggregation requirements, and the Commission will address the aggregation rules, including whether to codify NAL 19-19, as needed, after this Final Rule goes into effect.

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[911] FIA at 28; ISDA at 11; PIMCO at 6; CMC at 12-13; and SIFMA AMG at 2, 9.
[912] CMC at 12-13; FIA at 28.
[913] IATP at 18-19.
[914] *See* CFTC Letter No. 19–19 (July 31, 2019), available at https://www.cftc.gov/csl/19-19/download.
[915] 81 FR 91454 (December 16, 2016).
[916] *See* CFTC Letter No. 19–19 at 4.

C. § 150.3—Exemptions from Federal Position Limits

1. Background - Existing §§ 150.3, 1.47, and 1.48—Exemptions from Federal Position Limits

Existing § 150.3(a), which pre-dates the Dodd-Frank Act, lists positions that may, under certain circumstances, exceed Federal position limits, including: (1) bona fide hedging transactions, as defined in the current bona fide hedging definition in § 1.3; and (2) spread or arbitrage positions, subject to certain conditions.[917] Existing § 150.3(b) provides that the Commission or certain Commission staff may make a "call" to demand certain information from exemption holders so that the Commission can effectively oversee the use of such exemption. Section § 150.3(b) also provides that any such call may request information relating to positions owned or controlled by that person, trading done pursuant to that exemption, the futures, options or cash-market positions that support the claimed exemption, and the relevant business relationships supporting a claim of exemption.[918]

The current bona fide hedge definition in existing § 1.3 requires applicants who wish to receive bona fide hedging recognition and exceed Federal position limits to apply for non-enumerated bona fide hedges under § 1.47 and to apply for anticipatory bona fide hedges under § 1.48 of the Commission's existing regulations. Under § 1.47, persons seeking recognition by the Commission of a non-enumerated bona fide hedging transaction or position must file certain initial statements with the Commission at least 30 days in advance of the date that such transaction or position would be in excess of Federal position limits.[919] Similarly, persons seeking recognition by the Commission of certain anticipatory bona fide hedges must submit their application 10 days in advance of

[917] 17 CFR 150.3(a).
[918] 17 CFR 150.3(b).
[919] 17 CFR 1.47.

the date that such transactions or positions would be in excess of Federal position limits.[920]

With respect to spread exemptions, the Commission's authority and existing regulation for exempting certain spread positions can be found in CEA section 4a(a)(1) and existing § 150.3(a)(3) of the Commission's regulations. In particular, CEA section 4a(a)(1) authorizes the Commission to exempt from Federal position limits transactions "normally known to the trade as 'spreads' or 'straddles' or 'arbitrage.'" Similarly, in existing § 150.3(a)(3), the Commission exempts "spread or arbitrage positions," and allows such exemptions to be self-effectuating for the nine legacy agricultural contracts currently subject to Federal position limits. The Commission does not specify a formal process, in § 150.3(a)(3), for granting spread exemptions.[921]

2. Overview of Proposed § 150.3, Commenters' Views, and the Commission's Final Rule Determination

This section provides a brief overview of proposed § 150.3, commenters' general views, and the Commission's determination. The Commission will summarize and address each sub-section of § 150.3 in greater detail further below. The Commission proposed several changes to § 150.3. First, the Commission proposed to update § 150.3 to conform to the proposed bona fide hedging definition in § 150.1 (described above) and the new streamlined process in proposed § 150.9 for recognizing non-enumerated bona fide hedging positions (described further below). The Commission also proposed to amend § 150.3 to include new exemption types not explicitly listed in existing § 150.3, including: (i) exemptions for financial distress situations; (ii) conditional exemptions for certain spot month positions in cash-settled natural gas contracts; and (iii) exemptions for

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[920] 17 CFR 1.48.

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

pre-enactment swaps and transition period swaps.[922] Proposed § 150.3(b)–(g) respectively addressed: non-enumerated bona fide hedge and spread exemption requests submitted directly to the Commission; previously-granted risk management exemptions to Federal position limits; exemption-related recordkeeping and reporting requirements; the aggregation of accounts; and the delegation of certain authorities to the Director of the Division of Market Oversight.

The most substantive comments on proposed § 150.3 relate to the spread transaction exemption in proposed § 150.3(a)(2) and to the natural gas conditional position limit exemption in proposed § 150.3(a)(4), as described in detail below and under the discussion of § 150.2, above.[923] In addition, one commenter expressed general support for the Commission's proposed approach to recognizing exemptions under § 150.3.[924]

The Commission has determined to adopt § 150.3 largely as proposed, with certain modifications and clarifications in response to commenters' views and other considerations, as described in detail below.

3. Section 150.3(a)(1) - Exemption for Bona Fide Hedging Transaction or Position

i. Summary of the 2020 NPRM - Exemption for Bona Fide Hedging Transaction or Position

First, under proposed § 150.3(a)(1)(i), a bona fide hedging transaction or position that falls within one of the proposed enumerated hedges set forth in proposed Appendix A to part 150, discussed above, would be self-effectuating for purposes of Federal position limits. A market participant thus would not be required to request Commission approval prior to exceeding Federal position limits for such transaction or position.

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[922] The Commission revised § 150.3(a) in 2016, relocating the independent account controller aggregation exemption from § 150.3(a)(4) in order to consolidate it with the Commission's aggregation requirements in § 150.4(b)(4). *See* Final Aggregation Rulemaking, 81 FR at 91489–91490.

[923] *See supra* Section II.B.3.vi.a. (discussing the spot-month limit for natural gas).

[924] *See* CMC at 6.

However, this does not affect a market participant's obligations under proposed § 150.5(a) and under the relevant exchange's rules and thus, the market participant would be required to request a bona fide hedge exemption from the relevant exchange for purposes of exchange-set limits established pursuant to proposed § 150.5(a), and submit required cash-market information to the exchange as part of that request.[925] The Commission also proposed to allow the existing enumerated anticipatory bona fide hedges (some of which are not currently self-effectuating, and must be approved by the Commission, under existing § 1.48) to be self-effectuating for purposes of Federal position limits (and thus would not require prior Commission approval).

Second, under proposed § 150.3(a)(1)(ii), for positions in referenced contracts that do not satisfy one of the proposed enumerated hedges in Appendix A, (*i.e.*, non-enumerated bona fide hedges), a market participant must request approval from the Commission either directly, or indirectly through an exchange, prior to exceeding Federal position limits. Such exemptions thus would not be self-effectuating and a market participant in such cases would have one of the following two options for requesting such a non-enumerated bona fide hedge recognition: (1) apply directly to the Commission in accordance with § 150.3(b) (described below), and, separately, also apply to an exchange pursuant to exchange rules established under proposed § 150.5(a);[926] or (2) apply through an exchange pursuant to proposed § 150.9 for a non-enumerated bona fide hedge recognition that could ultimately be valid both for purposes of Federal and exchange-set position limit requirements, unless the Commission (and not staff, which would not have delegated authority) denies the application within a limited period of time.[927] As discussed in the 2020 NPRM, market participants relying on enumerated or non-

[925] *See infra* Section II.D.3. *See also* 85 FR at 11644 (proposed § 150.5(a)(2)(ii)(A)).
[926] *See infra* Section II.D.3. (discussion of proposed § 150.5).
[927] *See infra* Section II.G. (discussion of proposed § 150.9).

enumerated bona fide hedge recognitions would no longer have to file the monthly Form 204/304 with supporting cash-market information.[928]

ii. Comments and Discussion of Final Rule - Exemption for Bona Fide Hedging Transactions or Positions

The Commission did not receive any comments on proposed § 150.3(a)(1). As such, the Commission is finalizing § 150.3(a)(1) with a few grammatical and organizational changes to improve readability. The Commission is also finalizing the introductory text in § 150.3(a) with a clarification that "each" of a person's transactions or positions must satisfy at least one of the exemptions in § 150.3(a) in order to exceed Federal limits. None of the technical revisions are intended to change the substance of proposed § 150.3(a)(1).

4. Section 150.3(a)(2) - Spread Exemptions

i. Summary of the 2020 NPRM – Spread Exemptions

Under proposed § 150.3(a)(2)(i), a spread position would be self-effectuating for purposes of Federal position limits, provided that the position fits within at least one of the types of spread strategies listed in the "spread transaction" definition in proposed § 150.1,[929] and provided further that the market participant separately requests a spread exemption from the relevant exchange's limits established pursuant to proposed § 150.5(a).

Under proposed § 150.3(a)(2)(ii), for a spread strategy that does not meet the "spread transaction" definition in proposed § 150.1, a market participant must apply for a spread exemption directly from the Commission in accordance with proposed § 150.3(b). The market participant must also receive a notification of the approved spread exemption under proposed § 150.3(b)(4) before exceeding the Federal speculative position limits for

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

[929] *See supra* Section II.A.20. (proposed definition of "spread transaction" in § 150.1, which would cover: intra-market, inter-market, intra-commodity, or inter-commodity spreads, including calendar spreads, quality differential spreads, processing spreads (such as energy "crack" or soybean "crush" spreads), product or by-product differential spreads, and futures-options spreads.)

that spread position. The Commission thus did not propose a process akin to § 150.9 for spreads that do not meet the proposed "spread transaction" definition.

ii. Comments - Spread Exemptions

Several commenters advocated for the Commission to expand the proposed § 150.9 process, which would allow exchanges to process applications for non-enumerated bona fide hedge exemptions for purposes of both Federal and exchange limits, to also allow exchanges to grant "non-enumerated" spread exemptions for spread positions that do not meet the "spread transaction" definition.[930] Commenters also requested that the Commission provide an explanation for why the Commission would not expand § 150.9 to cover "non-enumerated" spread exemptions.[931] Finally, commenters requested that market participants be able to apply for spread exemptions on a late or retroactive basis the same way they would be permitted to apply for bona fide hedge exemptions within five days of exceeding Federal position limits under proposed §§ 150.3 and 150.9.[932]

iii. Discussion of Final Rule - Spread Exemptions

The Commission has determined to adopt § 150.3(a)(2) with non-substantive revisions to address technical edits or improve readability. For the reasons discussed immediately below, the Commission has determined not to expand § 150.3(a)(2) as requested by commenters to allow market participants to apply to exchanges for "non-enumerated" spread exemptions that are not covered in the "spread transaction" definition in § 150.1.

First, as discussed above,[933] the Commission has determined to expand the "spread transaction" definition so that it covers most, if not all, of the most common spread exemptions used by market participants. With this expansion, the Commission

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[930] *See* MFA/AIMA at 10; FIA at 21; Citadel at 8-9; ISDA at 9; ICE at 7-8 (suggesting that if the list of spread positions in the spread transaction definition is determined to be an exhaustive list, then the Commission should permit additional flexibility for an exchange to grant additional spread exemptions – that are not covered in the spread transaction definition – using the proposed § 150.9 process).

[931] *See* MFA/AIMA at 10.

[932] *See* ICE at 8.

[933] *See supra* Section II.A.20. (discussing changes to expand the spread transaction definition).

expects that most spread exemption requests will fall within the scope of the "spread transaction" definition. Accordingly, the Commission expects that most spread exemptions will thus be self-effectuating for purposes of Federal position limits. Also, the Commission expects that any spread exemption requests falling outside of the "spread transaction" definition are likely to be novel exemption requests that the Commission—and not exchanges—should review, considering certain statutory considerations in CEA section 4a(a)(3)(B). As explained immediately below, the Commission cannot authorize exchanges to conduct this analysis because exchanges would lack clear standards for assessing whether a particular spread position satisfies the requirements of the CEA.

Second, bona fide hedge recognitions and spread exemptions are subject to different legal standards. That is, under CEA section 4a(a)(c)(2), Congress provided clear criteria to the Commission for determining what constitutes a bona fide hedging transaction or position. In turn, the Commission has defined in detail the term bona fide hedging transaction or position in § 150.1. As a result, under final § 150.9, the Commission is permitting exchanges to evaluate applications for non-enumerated bona fide hedges for purposes of exchange-set limits in accordance with the same clear criteria used by the Commission.

In contrast, the CEA does not include clear criteria for granting spread exemptions. Instead, CEA section 4a(a)(1) generally permits the Commission to exempt "transactions normally known to the trade as "spreads" or "straddles" or "arbitrage" from position limits[934] and requires the Commission to administer Federal position limits in a manner that comports with certain policy considerations in CEA section 4a(a)(3)(B).[935] Analyzing novel spread exemption requests in accordance with these general principles requires the Commission to use its judgment to conduct a highly fact-specific analysis.

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[934] 7 U.S.C. 6a(a)(1).

[935] 7 U.S.C. 6a(a)(3)(b).

And, in the absence of any detailed statutory or regulatory criteria, the Commission is not comfortable, at this time, with leveraging an exchange's analysis and determination with respect to novel spread exemption requests. As such, the Commission has determined that the Commission should conduct a direct review of any spread exemptions that do not meet the "spread transaction" definition, and the Commission thus will not expand § 150.9 to cover spreads because exchanges would lack clear standards for assessing whether a particular spread position satisfies the requirements of the CEA. In the future, the Commission may, however, consider developing regulatory criteria for spread exemptions such that novel spread exemptions could be considered through a more streamlined process, such as § 150.9.

Finally, unlike for certain bona fide hedge recognitions as discussed below, the Commission has determined not to permit retroactive applications for spread exemptions or other exemptions permitted under this § 150.3(a). The Commission believes that the Federal position limits framework adopted herein provides sufficient flexibility through expanded speculative limits, and a clear, comprehensive set of exemptions, most of which are self-effectuating and thus do not require prior Commission approval. As such, the Commission believes that market participants will be able to identify their exemption needs based on these clear regulatory requirements and apply for all such exemptions ahead of time. In addition, the Commission believes that allowing retroactive spread exemptions and other types of retroactive exemptions (such as the financial distress or conditional natural gas spot month exemption) could potentially be harmful to the market as these types of strategies may involve non-risk-reducing or speculative activity that should be evaluated prior to a person exceeding Federal position limits.

5. Section 150.3(a)(3) - Financial Distress Exemptions

i. Summary of the 2020 NPRM - Financial Distress Exemptions

Proposed § 150.3(a)(3) would allow for a financial distress exemption in certain situations, including the potential default or bankruptcy of a customer or a potential acquisition target. For example, in periods of financial distress, such as a customer default at an FCM or a potential bankruptcy of a market participant, it may be beneficial for a financially-sound market participant to take on the positions and corresponding risk of a less stable market participant, and in doing so, exceed Federal speculative position limits. Pursuant to authority delegated under §§ 140.97 and 140.99, Commission staff previously granted exemptions in these types of situations to avoid sudden liquidations required to comply with a position limit.[936] Such sudden liquidations could otherwise potentially hinder statutory objectives, including by reducing liquidity, disrupting price discovery, and/or increasing systemic risk.[937]

The proposed exemption would be available for the positions of "a person, or related persons," meaning that a financial distress exemption request should be specific to the circumstances of a particular person, or to persons affiliated with that person, and not a more general request by a large group of unrelated people whose financial distress circumstances may differ from one another. The proposed exemption would be granted on a case-by-case basis in response to a request submitted to the Commission pursuant to § 140.99, and would be evaluated based on the specific facts and circumstances of a particular person or a related person or persons. Any such financial distress position would not be a bona fide hedging transaction or position unless it otherwise met the substantive and procedural requirements set forth in proposed §§ 150.1, 150.3, and 150.9, as applicable.

ii. Comments and Summary of the Commission Determination - Financial Distress Exemptions

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

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

The Commission did not receive any substantive comments on proposed § 150.3(a)(3), although one commenter expressed general support for the financial distress exemption.[938] As such, the Commission has determined to finalize § 150.3(a)(3) as proposed, for the reasons discussed above and in the 2020 NPRM.

6. Section 150.3(a)(4) - Conditional Spot Month Exemption in Natural Gas

i. Summary of the 2020 NPRM - Conditional Spot Month Exemption in Natural Gas

Certain natural gas contracts are currently subject to exchange-set position limits, but not Federal position limits.[939] In the 2020 NPRM, the Commission proposed applying Federal position limits to certain natural gas contracts for the first time by including the physically-settled NYMEX Henry Hub Natural Gas ("NYMEX NG") contract as a core referenced futures contract listed in proposed § 150.2(d). The Commission also proposed, consistent with existing exchange practice, establishing a conditional spot month exemption for Federal position limit purposes that would permit larger positions during the spot month for cash-settled natural gas referenced contracts so long as the market participant held no physically-settled NYMEX NG.

ii. Summary of the Commission Determination - Conditional Spot Month Exemption in Natural Gas

For the Final Rule, the Commission is adopting the conditional spot month exemption in natural gas, as proposed. The Commission discusses this conditional spot month exemption, as well as other issues in connection with NYMEX NG, above under the discussion of § 150.2.[940] The Commission is discussing all the issues related to the

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[938] CCI at 2.

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

[940] *See supra* Section II.B.3.vi.a. (discussing the Federal spot-month limit for natural gas).

NYMEX NG core referenced futures contract, including this conditional spot month exemption, together in one place in this release for the reader's convenience.

7. Section 150.3(a)(5) - Exemption for Pre-Enactment Swaps and Transition Period Swaps

i. Background and Summary of the 2020 NPRM - Exemption for Pre-Enactment Swaps and Transition Period Swaps

Currently, swaps are not subject to the existing Federal position limits framework, and the Commission is unaware of any exchange-set limits on swaps with respect to any of the 25 core referenced futures contracts.

In order to promote a smooth transition to compliance for swaps, which were not previously subject to Federal speculative position limits, in the 2020 NPRM, the Commission proposed to exempt pre-enactment swaps and transition period swaps from Federal position limits. Proposed § 150.3(a)(5) provided that Federal position limits would not apply to positions acquired in good faith in any pre-enactment swaps or in any transition period swaps, in either case as defined by § 150.1.[941] Under the 2020 NPRM, any pre-enactment swap or transition period swap would be exempt from Federal position limits—even if the swap would qualify as an economically equivalent swap under the 2020 NPRM. This proposed exemption would be self-effectuating and would not require a market participant to request relief from the Commission.

For purposes of complying with the proposed Federal non-spot month limits, the 2020 NPRM would also allow both pre-enactment swaps and transition period swaps (to the extent such swaps qualify as "economically equivalent swaps") to be netted with post-Effective Date commodity derivative contracts. The 2020 NPRM did not permit

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[941] "Pre-enactment swap" would mean any swap entered into prior to enactment of the Dodd-Frank Act of 2010 (July 21, 2010), the terms of which have not expired as of the date of enactment of that Act.

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

such positions to be netted during the spot month so as to avoid rendering spot month limits ineffective. Specifically, the Commission explained that it was particularly concerned about protecting the spot month in physically-delivered futures contracts from price distortions or manipulation to protect against disrupting the hedging and price discovery utility of the futures contract.

ii. Comments and Summary of the Commission Determination - Exemption for Pre-Enactment Swaps and Transition Period Swaps

The Commission did not receive any comments specifically addressing the exemption for pre-enactment swaps and transition period swaps addressed in proposed § 150.3(a)(5). The Commission is adopting § 150.3(a)(5) as proposed with certain limited grammatical and technical changes that are not intended to reflect a change in the substantive meaning. For comments generally related to the exemption for pre-enactment swaps and transition period swaps, please refer to the discussion of pre-existing positions in general and comments thereto, in § 150.2(g) above,[942] and § 150.5(a)(3)(ii) below.[943]

8. Section 150.3(b) - Application for Relief and Removal of Existing Commission Application Processes

i. Summary of the 2020 NPRM - Application for Relief and Removal of Existing Commission Application Processes

The Commission proposed two avenues for a market participant to request a non-enumerated bona fide hedge recognition: § 150.3(b), described below, which would allow market participants to apply directly to the Commission; and § 150.9, which, as described in detail further below, would allow market participants to apply to exchanges for a non-enumerated bona fide hedge exemption for purposes of both Federal and exchange limits.[944] The Commission proposed to remove its existing processes for applying for

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[942] *See supra* Section II.B.7. (discussing § 150.2 Federal position limits on pre-existing positions).
[943] *See infra* Section II.D.3. (discussing § 150.5 requirements for exchange limits on pre-existing positions in a non-spot month).
[944] *See infra* Section II.G.

such exemptions under §§ 1.47 and 1.48. The Commission also proposed to remove existing § 140.97, which delegates to the Director of the Division of Enforcement or his designee authority regarding requests for classification of positions as bona fide hedges under existing §§ 1.47 and 1.48.[945]

In the 2020 NPRM, the Commission explained that it did not intend the proposed replacement of §§ 1.47 and 1.48 to have any bearing on bona fide hedges previously recognized under those provisions. With the exception of certain recognitions for risk management positions discussed below, positions that were previously recognized as bona fide hedges under §§ 1.47 or 1.48 would continue to be recognized, provided such positions continue to meet the statutory bona fide hedging definition and all other existing and proposed requirements.

With respect to a § 150.3(b) application for a bona fide hedge recognition, the Commission proposed that such application must include: (i) a description of the position in the commodity derivative contract for which the application is submitted, including the name of the underlying commodity and the position size; (ii) information to demonstrate why the position satisfies CEA section 4a(c)(2) and the definition of bona fide hedging transaction or position in proposed § 150.1, including "factual and legal analysis;" (iii) a statement concerning the maximum size of all gross positions in derivative contracts for which the application is submitted (in order to provide a view of the true footprint of the position in the market); (iv) information regarding the applicant's activity in the cash markets and the swaps markets for the commodity underlying the position for which the application is submitted;[946] and (v) any other information that may help the Commission

[945] 17 CFR 140.97.

[946] The Commission stated that it would expect applicants to provide cash-market data for at least the prior year.

determine whether the position meets the requirements of CEA section 4a(c)(2) and the definition of bona fide hedging transaction or position in § 150.1.[947]

In addition, under the 2020 NPRM, a market participant would be required to apply to the Commission using the application process in § 150.3(b) for exemptions for any spread positions that do not meet the proposed "spread transaction" definition. With respect to a § 150.3(b) application for a spread exemption, the Commission proposed that such application must include: (i) a description of the spread transaction for which the exemption application is submitted;[948] (ii) a statement concerning the maximum size of all gross positions in derivative contracts for which the application is submitted; and (iii) any other information that may help the Commission determine whether the position is consistent with CEA section 4a(a)(3)(B).

Under proposed § 150.3(b)(2), the Commission (or Commission staff pursuant to delegated authority proposed in § 150.3(g)) could request additional information from the applicant and would provide the applicant with ten business days to respond. Under proposed § 150.3(b)(3) and (4), the applicant, however, could not exceed Federal position limits unless it receives a notice of approval from the Commission or from Commission staff pursuant to delegated authority proposed in § 150.3(g)—with one exception. That is, due to demonstrated sudden or unforeseen increases in a person's bona fide hedging needs, the person could request a recognition of a bona fide hedging transaction or position within five business days after the person established the position that exceeded the Federal speculative position limit.[949]

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

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

[949] Where a person requests a bona fide hedge recognition within five business days after exceeding Federal position limits, such person would be required to demonstrate that they encountered sudden or unforeseen circumstances that required them to exceed Federal position limits before submitting and receiving approval of their bona fide hedge application. These applications submitted after a person has exceeded Federal position limits should not be habitual and would be reviewed closely. If the Commission reviews such application and finds that the position does not qualify as a bona fide hedge, then the applicant would be required to bring its

Under this proposed process, market participants would be encouraged to submit their requests for bona fide hedge recognitions and spread exemptions as early as possible since proposed § 150.3(b) would not set a specific timeframe within which the Commission must make a determination for such requests. Further, under the 2020 NPRM, all approved bona fide hedge recognitions and spread exemptions would need to be renewed if there are any changes to the information submitted as part of the request, or upon request by the Commission or Commission staff.[950] Finally, under proposed § 150.3(b)(6), the Commission (and not staff) could revoke or modify any bona fide hedge recognition or spread exemption at any time if the Commission determines that the bona fide hedge recognition or spread exemption, or portions thereof, are no longer consistent with the applicable statutory and regulatory requirements.[951]

In the 2020 NPRM, the Commission noted that it anticipates that most market participants would utilize the streamlined process set forth in proposed § 150.9 rather than the process proposed in § 150.3(b) because: exchanges would generally be able to make an initial determination more efficiently than Commission staff; and market participants are likely already familiar with the proposed processes set forth in § 150.9 (which are intended to leverage the processes currently used by exchanges to address requests for exemptions from exchange-set limits). Nevertheless, proposed § 150.3(a)(1) and (2) clarify that market participants could request non-enumerated bona fide hedge recognitions and spread exemptions that do not meet the "spread transaction" definition directly from the Commission. After receiving any approval of a bona fide hedge

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position into compliance within a commercially reasonable time, as determined by the Commission in consultation with the applicant and the applicable DCM or SEF. If the applicant brings the position into compliance within a commercially reasonable time, then the applicant would not be considered to have violated the position limits rules. Further, any intentional misstatements to the Commission, including statements to demonstrate why the bona fide hedging needs were sudden and unforeseen, would be a violation of sections 6(c)(2) and 9(a)(2) of the Act. 7 U.S.C. 9(2) and 13(a)(2).

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

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

recognition or spread exemption from the Commission under proposed § 150.3(b), the market participant would still be required to request a bona fide hedge recognition or spread exemption from the relevant exchange for purposes of exchange-set limits established pursuant to proposed § 150.5(a).

ii. Comments - Application for Relief and Removal of Existing Commission Application Processes

The Commission received one comment on proposed § 150.3(b) requesting that the Commission remove the requirement proposed in § 150.3(b)(1)(i)(B) that an applicant provide a "factual and legal analysis" as part of an exemption application for a non-enumerated bona fide hedge.[952]

iii. Discussion of Final Rule - Application for Relief and Removal of Existing Commission Application Processes

The Commission has determined to finalize its proposal to remove existing §§ 1.47, 1.48, and 140.97.[953] The Commission has also determined to finalize § 150.3(b) largely as proposed but with the following modifications in response to commenters and other considerations.

Generally, the information required to be submitted as part of the § 150.3(b) application is necessary to allow the Commission to evaluate whether the applicant's position satisfies the requirements in § 150.3(b)(1), as applicable. The Commission has determined to modify the requirement, as it appears in both § 150.3(b) and § 150.9(c), that an applicant provide a "factual and legal analysis" as part of its non-enumerated bona fide hedge exemption application. As explained further below, in proposing this

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[952] CME Group at 10.

[953] Although §§ 1.47 and 1.48 are currently reflected in the Code of Federal Regulations ("CFR") as "[Reserved]", §§ 1.47 and 1.48 that existed prior to the 2011 Final Rulemaking are currently in effect. The 2011 Final Rulemaking removed and reserved §§ 1.47 and 1.48. However, the U.S. District Court for the District of Columbia in *ISDA* subsequently vacated the 2011 Final Rulemaking on September 28, 2012. As a result, §§ 1.47 and 1.48 that existed prior to the 2011 Final Rulemaking went back into effect, though they were not recodified in the CFR. This Final Rule removes §§ 1.47 and 1.48 as they are currently in effect (*i.e.*, as they existed prior to the 2011 Final Rulemaking) and leaves those two sections reserved in the CFR. As this action does not result in a change to the currently codified CFR, there is no corresponding amendment in the regulatory text of this document.

requirement, the Commission did not intend to require that applicants engage legal counsel to complete their applications for non-enumerated bona fide hedge recognitions. Rather, the purpose of this proposed requirement was to ensure that applicants explain their hedging strategies and provide sufficient information to demonstrate why a particular position satisfies the bona fide hedge definition in proposed § 150.1 and CEA section 4a(c)(2).[954]Accordingly, the Commission has revised § 150.3(b)(1)(i)(B) to replace the requirement to provide "factual and legal" analysis with the requirement that an applicant provide: (1) an explanation of the hedging strategy, including a statement that the applicant's position complies with the applicable requirements of the bona fide hedge definition, and (2) information that demonstrates why the position satisfies the applicable requirements.

The Commission is also making several other clarifications to § 150.3(b). First, in § 150.3(b)(3)(ii)(C), the Commission proposed that, for a retroactive application submitted to the Commission after a person has already exceeded Federal position limits, the Commission would not hold an applicant accountable for a position limits violation during the period of the Commission's review, nor once the Commission has issued its determination. The Commission is revising this provision to clarify that the Commission "will not pursue an enforcement action" in these circumstances. The Commission is also revising this provision to clarify that the provision applies so long as the applicant submitted its application in good faith and, if required, the applicant brings its position below the Federal position limits. This revision is simply intended to make explicit an implicit presumption that the applicant should have a reasonable and good faith basis for determining that its position meets the requirements of § 150.3(b) and for submitting the retroactive application. This requirement is also intended to deter the filing of frivolous retroactive exemption applications. Finally, the Commission is making a few technical

[954] *See infra* Section II.G.5. (providing a more detailed discussion of this requirement as it appears in § 150.9(c)).

revisions to clarify that this section is referring to the retroactive application provisions in § 150.3(b)(3)(ii), and to correct a cross-reference in this paragraph to correctly reference paragraph § 150.3(b)(3)(ii)(B).

In addition, the Commission is modifying proposed § 150.3(b)(5) to clarify that an applicant who received its original approval of a recognition of a non-enumerated bona fide hedge or spread exemption through the Commission's § 150.3(b) process is required to submit a renewal application if there are any "material" changes to the original application, but is not required to submit a renewal application as a result of circumstances involving any minor or non-substantive changes to the information underlying the original application. If a market participant using the § 150.3(b) process has any questions regarding what qualifies as a material change to the original application, the Commission encourages the market participant to contact DMO staff for guidance on a case-by-case basis.

Next, the Commission is revising its revocation authority under § 150.3(b)(6) to expressly require that the Commission provide a person with an opportunity to respond after the Commission notifies such person that the Commission believes their transactions or positions no longer satisfy the bona fide hedge definition or spread exemption requirements, as applicable. The Commission is also revising § 150.3(b)(6) to clarify that the Commission will discuss with the applicant and consult with the relevant exchange when determining what is a commercially reasonable amount of time for the applicant to bring its position below the Federal position limits. The Commission also reorganized this section to improve readability.

Finally, the Commission made several grammatical and technical changes to § 150.3(b) that are not intended to change the substance of the remaining sections, unless discussed above.

9. Section 150.3(c) - Previously-granted Risk Management Exemptions

i. Summary of the 2020 NPRM - Previously-Granted Risk Management Exemptions

As discussed above, the Commission previously recognized, as bona fide hedges under § 1.47, certain risk-management positions in physical commodity futures and/or option on futures contracts held outside of the spot month that were used to offset the risk of commodity index swaps and other related exposures, but that did not represent substitutes for transactions or positions to be taken in a physical marketing channel.[955] However, the 2020 NPRM interpreted the Dodd-Frank Act amendments to the CEA as eliminating the Commission's authority to grant such relief unless the position satisfies the pass-through provision in CEA section 4a(c)(2)(B).[956] Accordingly, to ensure consistency with the Dodd-Frank Act, the Commission proposed that it would not recognize further risk management positions as bona fide hedges, unless the position otherwise satisfies the requirements of the pass-through provisions.[957]

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

ii. Comments and Discussion of Final Rule - Previously-granted Risk Management Exemptions

The Commission has addressed any comments on risk management exemptions in the discussion of § 150.1 above.[958] As discussed above, to ensure consistency with the

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[955] *See supra* Section II.A.1.iii. (discussing the temporary substitute test and risk management exemption under § 150.1).
[956] *Id*.
[957] 85 FR at 11641.
[958] *See supra* Section II.A.1.iii (discussing risk management exemptions and comments received in greater detail).

Dodd-Frank Act, the Commission will not recognize risk management positions as bona fide hedges under the Final Rule, unless the position otherwise satisfies the requirements of the Final Rule's pass-through swap provisions.[959] Consequently, the Commission is adopting § 150.3(c) largely as proposed, which provides that such previously-granted risk management exemptions issued pursuant to § 1.47 shall no longer be recognized.[960] However, the Final Rule is also providing for a compliance date of January 1, 2023 with respect to the elimination of the risk management exemption by which risk management exemption holders must reduce their risk management exemption positions to comply with Federal position limits under the Final Rule.[961]

Section 150.3(c) uses the phrase "positions in financial instruments" to refer to such commodity index swaps and related exposure and would have the effect of revoking the ability to use previously-granted risk management exemptions once the Final Rule's Federal position limits in § 150.2 become effective. However, the Final Rule will also include an extended compliance date until January 1, 2023 with respect to positions entered into upon reliance of an existing risk management exemption.[962]

The Final Rule also deletes the sentence in proposed § 150.3(c), which stated that nothing in § 150.3(c) shall preclude the Commission, a DCM, or SEF from recognizing a bona fide hedging transaction or position for the former holder of such a risk management exemption if the position complies with the definition of bona fide hedging transaction or position under this part, including appendices hereto. This sentence was intended to clarify what has been explained above – risk management exemptions that meet the pass-through swap provisions are permitted under the Final Rule.[963] The Commission has determined that this sentence is unnecessary.

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[959] *See supra* Section II.A.1.x. (discussing the proposed pass-through swap provisions).

[960] Under this Final Rule, however, exchanges may continue to grant risk management exemptions (that do not otherwise meet the bona fide hedge definition in § 150.1) up to the applicable Federal position limit.

[961] *See supra* Section I.D. (discussing the effective and compliance dates).

[962] *Id.*

[963] *See supra* Section II.A.1.x. (discussing the proposed pass-through language).

The Commission is making several technical changes to proposed § 150.3(c), including to clarify that the provision covers risk management exemptions previously granted by the Commission or by Commission staff. The Commission also reorganized § 150.3(c) to improve readability.

10. Section 150.3(d) - Recordkeeping

i. Summary of the 2020 NPRM – Recordkeeping

Proposed § 150.3(d) would establish recordkeeping requirements for persons who claim any exemption under proposed § 150.3. Proposed § 150.3(d) is intended to help ensure that any person who claims any exemption permitted under proposed § 150.3 could demonstrate compliance with the applicable requirements by providing all relevant records to support the claim of a particular exemption. That is, under proposed § 150.3(d)(1), any persons claiming an exemption would be required to keep and maintain complete books and records concerning all details of their related cash, forward, futures, options on futures, and swap positions and transactions, including anticipated requirements, production and royalties, contracts for services, cash commodity products and by-products, cross-commodity hedges, and records of bona fide hedging swap counterparties.

Proposed § 150.3(d)(2) would address recordkeeping requirements related to the pass-through swap provision in the proposed definition of bona fide hedging transaction or position in proposed § 150.1.[964] Under proposed § 150.3(d)(2), a pass-through swap counterparty, as contemplated by proposed § 150.1, that relies on a representation received from a bona fide hedging swap counterparty that a swap qualifies in good faith as a bona fide hedging position or transaction under proposed § 150.1, would be required to: (i) maintain any written representation for at least two years following the expiration of the swap; and (ii) furnish the representation to the Commission upon request.

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[964] *See supra* Section II.A.1.x. (discussion of proposed pass-through swap provision).

ii. Comments - Recordkeeping

Several commenters requested clarification that the recordkeeping requirements in proposed § 150.3(d)(1) would not impose an additional recordkeeping obligation on commercial end-users beyond the records that are kept in the normal course of business and are typical for the relevant industry.[965]

In addition, commenters recommended that the Commission delete the pass-through swap recordkeeping requirements in proposed § 150.3(d)(2).[966] Commenters were concerned that the pass-through swap provision in § 150.1 places all compliance burdens on the pass-through swap counterparty offering the swap, and not on the bona fide hedging counterparty using the swap.[967] Commenters expressed that this recordkeeping provision would require the pass-through swap counterparty to maintain records of each representation made by the bona fide hedging counterparty on a trade-by-trade basis—a practice commenters view as onerous and unnecessary.[968] Commenters suggested that the Commission will have access to records from anyone availing themselves of any exemption from speculative limits, and thus does not need the additional recordkeeping requirement in proposed § 150.3(d)(2).[969] One commenter also requested that the Commission clarify that the pass-through swap counterparty can rely on the bona fide hedging counterparty's good faith representation that a record of an agreement or confirmation of the transaction containing the bona fide hedge pass-through representation would satisfy the record retention requirements set forth in proposed § 150.3(d)(2).[970]

iii. Discussion of Final Rule - Recordkeeping

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[965] Cope at 5-6; EEI/EPSA at 7-8.
[966] Cargill at 6; Shell at 6.
[967] *Id.*
[968] Shell at 7; CMC at 5.
[969] COPE at 5-6.
[970] Shell at 6.

The Commission has determined to finalize § 150.3(d), for the reasons stated in the 2020 NPRM, with certain clarifications discussed below.

First, the Commission clarifies that the recordkeeping requirements in § 150.3(d)(1) are not intended to impose any additional recordkeeping obligations on market participants beyond the records they are required to keep in the normal course of business. The Commission notes, however, that, consistent with the general recordkeeping obligations in Commission regulation 1.31, and as explained in the 2020 NPRM, § 150.3(d)(1) is intended to capture records market participants should be maintaining with respect to each of their exemptions from Federal position limits. The Commission is revising § 150.3(d)(1) to clarify that market participants that avail themselves of exemptions under this section are required to keep the relevant "books and records" of "each of their exemptions" and any related position or transaction information for such applications, including any books and records market participants create for related "merchandising activity" or other relevant aspects of a particular exemption (including the items listed in § 150.3(d)(1)), as applicable.

Next, regarding the pass-through swap recordkeeping requirements, in § 150.2(d)(2), the Commission intended for this requirement to be an extension of market participants' existing obligations to maintain swap data records under Part 45 and regulatory records under § 1.31.[971] That is, under § 150.1, the Commission has revised paragraph (2) of the bona fide hedging transaction or position definition to require that a pass-through swap counterparty receive a written representation from its bona fide hedging swap counterparty that the swap "qualifies as a bona fide hedging transaction or position" pursuant to paragraph (1) of the definition of a bona fide hedging transaction or position in § 150.1 in order for the pass-through swap to qualify as a bona fide hedge. The pass-through swap counterparty may rely in good faith on such written

[971] 17 CFR 1.31(a)-(b).

representation from the bona fide hedging swap counterparty, unless the pass-through swap counterparty has information that would cause a reasonable person to question the accuracy of the representation. Thus, the recordkeeping requirements in § 150.3(d)(2) are intended to capture any "written" record created for purposes of making such demonstration. The Commission provides additional explanation above on how a pass-through swap counterparty can demonstrate good faith reliance.[972] For the avoidance of doubt, the Commission is revising § 150.3(d)(2) to clarify that a person relying on the pass-through swap provision is required to maintain any records created for purposes of demonstrating a good faith reliance on that provision in accordance with § 150.1.

The Commission also clarifies that, pursuant to the swap recordkeeping requirements in § 45.2(b)[973] and the general recordkeeping requirements in § 1.31,[974] the bona fide hedging swap counterparty to the pass-through swap is required to maintain a record of such pass-through swap. The Commission considers any written representation the bona fide hedging swap counterparty provides to the pass-through swap counterparty as being part of the full, complete, and systematic records that the bona fide hedging swap counterparty is required to keep pursuant to § 45.2(b), with respect to each pass-through swap to which it is a counterparty. The bona fide hedging swap counterparty is required to keep such records according to the form and duration requirements of § 1.31. Such records are also subject to the inspection and production requirements of both § 1.31(d)[975] and § 45.2(h).[976] As such, the Commission reminds bona fide hedging swap counterparties to a pass-through swap that they are responsible for maintaining an accurate and true record of any written representations they make to the pass-through

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[972] *See supra* Section II.A.1.x. (discussing the pass-through swap provision in greater detail).

[973] 17 CFR 45.2(b) (requiring that all non-swap dealer/non-major swap participant counterparties keep full, complete, and systematic records, together with all pertinent data and memoranda, with respect to each swap in which they are a counterparty).

[974] 17 CFR 1.31 (regulatory records, retention, and production requirements).

[975] 17 CFR 1.31(d) (requirement for a records entity, as defined in § 1.31(a), to produce or make accessible for inspection all regulatory records).

[976] 17 CFR 45.2(h) (swap record inspection requirements).

swap counterparty regarding the bona fides of the pass-through swap. Further, any such records and written representations that a bona fide hedging swap counterparty makes may, upon request, be filed with the Commission as part of an inspection, pursuant to §§1.31(d) and 45.2(h), and would be subject to the Commission's prohibition regarding false statements in section 6(c)(2) of the Act, as well as any other applicable provisions regarding false information.[977]

11. Section 150.3(e) - Call for Information

i. Summary of the 2020 NPRM - Call for Information

The Commission proposed to move existing § 150.3(b), which currently allows the Commission or certain Commission staff to make calls to demand certain information regarding positions or trading, to proposed § 150.3(e), with some technical modifications.

Together with the recordkeeping provision of proposed § 150.3(d), proposed § 150.3(e) should enable the Commission to monitor the use of exemptions from speculative position limits and help to ensure that any person who claims any exemption permitted by proposed § 150.3 can demonstrate compliance with the applicable requirements.

ii. Comments and Summary of Commission Determination - Call for Information

The Commission did not receive comments on proposed § 150.3(e). Accordingly, the Commission is adopting § 150.3(e) with one grammatical edit that is not intended to reflect a substantive change to this section.

12. Section 150.3(f) - Aggregation of Accounts

i. Summary of the 2020 NPRM - Aggregation of Accounts

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[977] 7 U.S.C. 9(2) (prohibition on making a false or misleading statement of material fact to the Commission); *see also* 7 U.S.C. 9(4) (general enforcement authority of the Commission).

Proposed § 150.3(f) would clarify that entities required to aggregate under § 150.4 would be considered the same person for purposes of determining whether they are eligible for a bona fide hedge recognition under § 150.3(a)(1).[978]

ii. Comments and Summary of Commission Determination - Aggregation of Accounts

The Commission did not receive comments on proposed § 150.3(f). Accordingly, the Commission is adopting § 150.3(f) as proposed.[979]

13. Section § 150.3(g) - Delegation of Authority

i. Summary of the 2020 NPRM - Delegation of Authority

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

ii. Comments and Summary of the Commission Determination - Delegation of Authority

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[978] *See* 17 CFR 150.4 (providing the Commission's existing aggregation requirements for Federal position limits); *See also supra* Section II.B.11. (discussing eligible affiliates and position aggregation requirements).

[979] The Commission did receive general comments on position aggregation discussing existing no-action relief in connection with the position aggregation requirement in existing § 150.4. For a discussion on comments received in connection with existing staff no-action relief for position aggregation requirements, *see supra* Section II.B.11.

The Commission did not receive comments on proposed 150.3(g). Accordingly, the Commission is adopting § 150.3(g) with one technical edit to correct a punctuation error, which is not intended to reflect a change in the substance of this section.

14. Request for a New Exemption in § 150.3(a) for Certain Energy Utility Entities

i. Summary of the 2020 NPRM and Comments – New Exemption for Certain Energy Utility Entities

Although the 2020 NPRM did not include a new exemption explicitly applicable to certain energy utility entities, it did include a request for comment regarding the possibility of such an exemption.[980] In response, NRECA (which encompasses several not-for-profit energy associations)[981] along with other commenters,[982] requested that the Commission use its authority in CEA section 4a(a)(7) to exempt certain not-for-profit electric and natural gas utility entities ("NFP Energy Entities") from position limits.

These commenters (in particular, NRECA) argued that Congress did not intend for the Commission's position limits regime to apply to commercial market participants engaged in hedging and mitigating commercial risk, such as the NFP Energy Entities.[983] The commenters also provided several reasons why the Commission's position limits regulatory regime is incongruous with the operations of NFP Energy Entities, including that NFP Energy Entities: (a) operate on a not-for-profit basis; (b) have unique public service obligations to provide reliable, affordable utility services to residential, commercial, and industrial customers; (c) have governance structures with oversight by elected or appointed government officials or cooperative members/consumers; (d) do not engage in speculative trading in derivatives markets; and (e) enter into energy commodity swaps and trade options only to hedge or mitigate commercial risk arising from ongoing

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[980] *See* 85 FR at 11642.
[981] NRECA at 3-14.
[982] *See* IECA at 5; LIPA at 1; NFPEA at 6.
[983] NRECA at 19.

business operations.[984] NRECA expressed concern that the effort required for NFP Energy Entities to analyze and identify every transaction as non-speculative would be purely academic and would unnecessarily increase the cost of electricity, natural gas and other fuels for generation for American consumers and businesses served by the NFP Energy Entities.[985]

ii. Discussion of the Commission Determination - New Exemption for Certain Energy Utility Entities

The Commission has considered these comments and believes that many of the concerns raised by NFP Energy Entities are addressed through the Final Rule's pass-through swap provision and the expanded list of enumerated bona fide hedge exemptions. That is, the Commission believes that most, if not all, of the hedging needs of NFP Energy Entities will be considered enumerated, self-effectuating bona fide hedges that will not be subject to Federal position limits. Further, NFP Energy Entity counterparties that are not bona fide hedgers would receive pass-through bona fide hedging treatment for any swaps with NFP Energy Entities, or any offsetting positions as a result of such swaps with NFP Energy Entities. This expanded flexibility should significantly alleviate the compliance burdens and cost concerns voiced by NFP Energy Entities.

The Commission recommends that NFP Energy Entities assess the impact of the Final Rule on their operations, and if needed, pursue the requested exemption separate from this Final Rule. The Commission also believes that the extended compliance date for the Final Rule of January 1, 2022 in connection with the Federal position limits for the 16 non-legacy core referenced futures contracts, and the further extended compliance date of January 1, 2023 for swaps that are subject to Federal position limits under the

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[984] *Id.*

[985] *Id.*

Final Rule, should give commenters and the Commission sufficient time to continue to discuss this request if necessary.

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

For the avoidance of confusion, this discussion of § 150.5 addresses exchange-set limits and exemptions therefrom, not Federal position limits. For a discussion of the proposed processes by which an exemption may be recognized for purposes of Federal position limits, please see the discussion of proposed § 150.3 above and § 150.9 below.[986]

1. Background - Existing Requirements for Exchange-set Position Limits

i. Applicable DCM and SEF Core Principles

Under DCM Core Principle 5, a DCM shall adopt for each contract, as is necessary and appropriate, position limitations or position accountability for speculators. In addition, for any contract that is listed on a DCM and subject to a Federal position limit, the DCM must establish exchange-set limits for such contract no higher than the Federal limit level.[987] Finally, DCMs are required to monitor their markets and enforce compliance with their rules.[988]

Similarly, under SEF Core Principle 6, a SEF that is a trading facility must adopt for each contract, as is necessary and appropriate, position limitations or position accountability for speculators.[989] Such SEF must also, for any contract that is listed on the SEF and subject to a Federal position limit, establish exchange-set limits for such contract no higher than the Federal limit.[990] Finally, such SEF must monitor positions established on or through the SEF for compliance with the limit set by the Commission and the limit, if any, set by the SEF.[991] Beyond these and other statutory and certain

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[986] *See supra* Section II.C. (discussing § 150.3 exemptions from Federal position limits). *See also infra* Section II.G. (discussing the § 150.9 streamlined process for recognizing non-enumerated bona fide hedges for purposes of both exchange and Federal position limits).

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

[988] *See* 7 U.S.C. 7(d)(2).

[989] *See* 7 U.S.C. 7b-3(f)(6).

[990] *Id.*

[991] *Id.*

specified Commission requirements, unless otherwise determined by the Commission, DCM Core Principle 1 and SEF Core Principle 1 afford DCMs and SEFs, respectively, "reasonable discretion" in establishing the manner in which they comply with the core principles.[992]

The current regulatory provisions governing exchange-set position limits and exemptions therefrom appear in § 150.5.[993] To align § 150.5 with statutory changes made by the Dodd-Frank Act,[994] and with other changes in the 2020 NPRM,[995] the Commission proposed a new version of § 150.5. This new proposed § 150.5 would generally afford exchanges the discretion to decide how best to set limit levels and grant exemptions from such limits in a manner that best reflects their specific markets.

ii. Existing § 150.5

As noted above, existing § 150.5 pre-dates the Dodd-Frank Act and addresses the establishment of DCM-set position limits for all contracts not subject to Federal position limits under existing § 150.2 (aside from certain major foreign currencies).[996] First, existing § 150.5(a) authorizes DCMs to set different limits for different contracts and contract months, and permits DCMs to grant exemptions from DCM-set limits for spreads, straddles, or arbitrage trades. Existing § 150.5(b) provides a limited set of methodologies for DCMs to use in establishing initial limit levels, including separate maximum spot-month limit levels for physical-delivery contracts and cash-settled contracts,[997] as well as separate non-spot month limits for tangible commodities (other

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

[993] 17 CFR 150.5.

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

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

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

[997] *See* 17 CFR 150.5(b)(1) (providing that, for physical delivery contracts, the spot month limit level must be no greater than one-quarter of the estimated spot month deliverable supply, calculated separately for each month to be listed, and for cash settled contracts, the spot month limit level must be no greater than necessary to minimize the potential for manipulation or distortion of the contract's or the underlying commodity's price).

than energy),[998] and for energy products and non-tangible commodities, including financials.[999] Existing § 150.5(c) provides guidelines for how DCMs may adjust their speculative initial levels.

Next, existing § 150.5(d) addresses bona fide hedging exemptions from DCM-set limits, including an exemption application process, providing that exchange-set speculative position limits shall not apply to bona fide hedging positions as defined by a DCM in accordance with the definition of bona fide hedging transactions and positions for excluded commodities in § 1.3. Existing § 150.5(d) also addresses factors for DCMs to consider in recognizing bona fide hedging exemptions (or position accountability), including whether such positions "are not in accord with sound commercial practices or exceed an amount which may be established and liquidated in an orderly fashion."[1000]

As an alternative to exchange-set position limits set in accordance with the provisions described above, existing § 150.5(e) permits a DCM, in certain circumstances, to submit for Commission approval a rule requiring traders "to be accountable for large positions" (or position accountability levels). That is, under certain circumstances, the DCM would require traders to, upon request, provide information about their position to the exchange, and/or consent to halt further increasing a position if so ordered by the exchange.[1001] Among other things, this provision includes open interest and volume-based parameters for determining when DCMs may do so.[1002]

In addition, existing § 150.5(f) provides that DCM speculative position limits adopted pursuant to § 150.5 shall not apply to certain positions acquired in good faith prior to the effective date of such limits or to a person that is registered as an FCM or as a

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[998] *See* 17 CFR 150.5(b)(2) (providing that individual non-spot or all-months-combined levels must be no greater than 1,000 contracts for tangible commodities other than energy products).

[999] *See* 17 CFR 150.5(b)(3) (providing that individual non-spot or all-months-combined levels must be no greater than 5,000 contracts for energy products and nontangible commodities, including contracts on financial products).

[1000] *See* 17 CFR 150.5(d)(1).

[1001] 17 CFR 150.5(e).

[1002] 17 CFR 150.5(e)(1)–(4).

floor broker under the CEA except to the extent that transactions made by such person are made on behalf of, or for the account or benefit of, such person.[1003] This provision also provides that in addition to the express exemptions specified in § 150.5, a DCM may propose such other exemptions from the requirements of § 150.5 as are consistent with the purposes of § 150.5, and submit such rules for Commission review.[1004] Finally, existing § 150.5(g) addresses aggregation of positions for which a person directly or indirectly controls trading.

2. Overview of the 2020 NPRM, Commenters' Views, and Commission Final Rule Determination - Exchange-Set Position Limits and Exemptions Therefrom

This section provides a brief overview of proposed § 150.5, commenters' general views, and the Commission's determination. The Commission will summarize and address each sub-section of § 150.5 in greater detail further below.

Pursuant to CEA sections 5(d)(1) and 5h(f)(1), the Commission proposed a new version of § 150.5.[1005] Proposed § 150.5 is intended to allow DCMs and SEFs to set limit levels and grant exemptions in a manner that best accommodates activity particular to their markets, while promoting compliance with DCM Core Principle 5 and SEF Core Principle 6. Proposed § 150.5 is also intended to ensure consistency with other changes proposed herein, including the process for exchanges to administer applications for non-enumerated bona fide hedge exemptions for purposes of Federal position limits proposed in § 150.9.[1006]

Proposed § 150.5 contains two main sub-sections, with each sub-section addressing a different category of contract: (i) § 150.5(a) proposed rules governing

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[1003] 17 CFR 150.5(f).

[1004] *Id.*

[1005] While proposed § 150.5 included references to swaps and SEFs, the proposed rule would initially only apply to DCMs, as requirements relating to exchange-set limits on swaps would be phased in at a later time.

[1006] To avoid confusion created by the parallel Federal and exchange-set position limit frameworks, the Commission clarifies that proposed § 150.5 deals solely with exchange-set position limits and exemptions therefrom, whereas proposed § 150.9 deals solely with a streamlined process for the Commission to recognize non-enumerated bona fide hedges for purposes of Federal position limits by leveraging exchanges.

exchange-set limits for referenced contracts subject to Federal position limits; and (ii) § 150.5(b) proposed rules governing exchange-set limits for physical commodity derivative contracts that are not subject to Federal position limits.

Notably, with respect to exchange-set limits on swaps, the Commission proposed to delay compliance with DCM Core Principle 5 and SEF Core Principle 6, as compliance would otherwise be impracticable, and, in some cases, impossible, at this time. In the 2020 NPRM, the Commission explained that this delay was based largely on the fact that exchanges cannot view positions in OTC swaps across the various places they are trading, including on competitor exchanges.

The Commission has determined to finalize § 150.5 largely as proposed, with certain modifications and clarifications in response to commenters and other considerations, as discussed below.

The Commission will oversee swaps in connection with compliance with Federal position limits under the Final Rule. The Commission has also determined to delay compliance for the requirement for exchanges to set position limits on swaps at this time. Specifically, with respect to exchange-set position limits on swaps, the Commission notes that in two years, the Commission will reevaluate the ability of exchanges to establish and implement appropriate surveillance mechanisms with respect to swaps and to implement DCM Core Principle 5 and SEF Core Principle 6, as applicable.

The Commission believes that delayed implementation of exchange-set position limits on swaps at this time is not inconsistent with the statutory objectives outlined in section 4a(a)(3) of the CEA for several reasons. First, as explained above, at this time, it would be impracticable and, in some cases, impossible for exchanges to comply with any requirement for establishing exchange-set limits on swaps. Next, the Commission is adopting in this Final Rule Federal position limits on economically equivalent swaps, which the Commission will monitor. These factors, coupled with the Commission's

existing ability to surveil swap exposure across markets in a manner that at this time would be impracticable for the exchanges, will help ensure that the Commission meets its statutory obligations. Accordingly, while § 150.5 as finalized herein will apply to DCMs and SEFs, the Final Rule's requirements associated with exchange oversight of swaps, including with respect to exchange-set position limits, will be enforced at a later time. In other words, upon the compliance date, exchanges must comply with final § 150.5 only with respect to futures and options on futures traded on DCMs.

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

The following section discusses the 2020 NPRM, comments received, and the Commission's final determination with respect to each sub-section of § 150.5(a), which addresses exchange-set position limits on contracts that are subject to Federal position limits.

i. Section § 150.5(a)(1) - Requirements for Exchange-set Limits on Contracts Subject to Federal Position Limits

a. Summary of the 2020 NPRM - Requirements for Exchange-set Limits on Contracts Subject to Federal Position Limits

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

limits that are lower than the Federal limit. An exchange would also be permitted to adopt position accountability levels that are lower than the Federal position limits, in addition to any exchange-set position limits it adopts that are equal to or less than the Federal position limits.

b. Comments - Requirements for Exchange-set Limits on Contracts Subject to Federal Position Limits

With respect to requirements for exchange-set limits under proposed § 150.5(a)(1), some commenters expressed concern that if an exchange determines to set a position limit for a particular contract significantly below the Federal position limit for that contract, then market participants could be restricted in their ability to provide liquidity, hedge activity, and otherwise pursue their trading objectives.[1007] ISDA recommended that to the extent that an exchange determines to set position limits significantly below Federal position limits, CFTC staff, through its exchange examination process, should make transparent the exchange's reasoning and analysis underlying any lower position limits.[1008] Likewise, SIFMA AMG encouraged the Commission to require exchanges to explain and justify any exchange-set limits that are below Federal position limits, and to work with exchanges to ensure that exchange limits do not discourage liquidity.[1009]

c. Discussion of Final Rule - Requirements for Exchange-set Limits on Contracts Subject to Federal Position Limits

The Commission is adopting § 150.5(a)(1) as proposed. In response to comments on § 150.5(a)(1) requesting that the Commission require transparency into exchanges' reasoning for when they set limits well below Federal position limits, the Commission believes market participants already have sufficient transparency under part 40 of the

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[1007] ISDA at 11; SIFMA AMG at 4.
[1008] ISDA at 11.
[1009] SIFMA AMG at 4.

Commission's regulations. When exchanges seek to implement rules to establish new or amended exchange-set limits, exchanges are required to submit those rules through the Commission's part 40 process, and the rules are made publicly available on the CFTC's website.[1010] Exchanges are also required to post such submissions on their own websites.[1011]

Further, regarding the request that the Commission work with exchanges on exchange-set limits that are below Federal position limits, exchanges are permitted to establish exchange-set limits in a manner that is most appropriate for their own marketplaces and in a manner that allows them to comply with the applicable DCM and SEF core principles. The Commission views this process as a business and compliance decision that is best left in the discretion of each exchange. However, pursuant to DCM Core Principle 5 and SEF Core Principle 6, exchanges must implement exchange-set position limits in a manner that reduces market manipulation and congestion.

ii. Section 150.5(a)(2) - Exemptions to Exchange-set Limits for Contracts Subject to Federal Position Limits

a. Summary of the 2020 NPRM - Exemptions to Exchange-set Limits for Contracts Subject to Federal Position Limits

Under the 2020 NPRM, § 150.5(a)(2)(ii) would permit exchanges to grant exemptions from exchange-set limits according to the guidelines outlined below.

First, if such exemptions from exchange-set limits conform to the types of exemptions that may be granted for purposes of Federal position limits under proposed sections: (1) 150.3(a)(1)(i) (enumerated bona fide hedge recognitions), (2) 150.3(a)(2)(i) (spread exemptions that meet the "spread transaction" definition in § 150.1), (3) 150.3(a)(4) (exempt conditional spot month positions in natural gas), or (4) 150.3(a)(5)

[1010] *See* CFTC Industry Filings available at https://www.cftc.gov/IndustryOversight/IndustryFilings/index.htm.
[1011] *See* 17 CFR 40.2(a)(3)(vi), 40.3(a)(9), 40.5(a)(6), 40.6(a)(2).

(pre-enactment and transition period swaps), then the level of the exemption may exceed the applicable Federal position limit under proposed § 150.2. Because the proposed exemptions listed in the four provisions above are self-effectuating for purposes of Federal position limits, exchanges may grant such exemptions pursuant to proposed § 150.5(a)(2)(i) without prior Commission approval.

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

Third, if such exemptions conform to the exemptions from Federal position limits that may be granted under proposed § 150.3(a)(3) (financial distress positions), then the level of the exemption may exceed the applicable Federal position limit under proposed § 150.2, provided that the Commission has first issued a letter or other notice approving such exemption pursuant to a request submitted under § 140.99.[1012]

Finally, for purposes of exchange-set limits only, under the 2020 NPRM, exchanges may grant exemption types that are not listed in § 150.3(a). However, in such cases, the exemption level would have to be capped at the level of the applicable Federal position limit, so as not to undermine the Federal position limits framework, unless the Commission has first approved such exemption for purposes of Federal position limits pursuant to § 140.99 or proposed § 150.3(b).

[1012] Under the 2020 NPRM, requests for exemptions for financial distress positions would be submitted directly to the Commission (or delegated staff) for consideration, and any approval of such exemption would be issued in the form of an exemption letter from the Commission (or delegated staff) pursuant to § 140.99.

The 2020 NPRM also explained that exchanges that wish to offer exemptions from their own limits other than the types listed in proposed § 150.3(a) could also submit rules for the Commission's review, pursuant to part 40, allowing for such exemptions. The Commission would carefully review any such exemption types for compliance with applicable standards, including any statutory requirements[1013] and Commission regulations.[1014]

Under proposed § 150.5(a)(2)(ii)(A)(1), exchanges that wish to grant exemptions from their own limits would have to require traders to file an application. The 2020 NPRM explained that, generally, exchanges would have flexibility to establish the application process as they see fit, but subject to the requirements discussed below, including the requirement that the exchange collect cash-market and swaps market information from the applicant.

For all exemption types, exchanges would have to generally require that such applications be filed in advance of the date such position would be in excess of the limits. However, under proposed § 150.5(a)(2)(ii)(B) and (C), exchanges would be given the discretion to adopt rules allowing traders to file retroactive applications for bona fide hedges within five business days after a trader established such position so long as the applicant demonstrates a sudden and unforeseen increase in its hedging needs. Further, under proposed § 150.5(a)(2)(ii)(D), if the exchange denies a retroactive application, it would require that the applicant bring its position into compliance with exchange-set limits within a commercially reasonable amount of time (as determined by the exchange).

[1013] For example, an exchange would not be permitted to adopt rules allowing for risk management exemptions for positions in physical commodities that exceed Federal limits because the Commission interprets the Dodd-Frank Act amendments to CEA section 4a(c)(2) as prohibiting risk management exemptions in such commodities (unless such position is considered a pass-through swap under paragraph (2) of the bona fide hedging definition in § 150.1). *See supra* Section II.A.1. (discussing of the temporary substitute test, risk-management exemptions, and the pass-through swap provision).

[1014] For example, as discussed below, proposed § 150.5(a)(2)(ii)(C) would require that exchanges consider whether the requested exemption would result in positions that are not in accord with sound commercial practices in the relevant commodity derivative market and/or would not exceed an amount that may be established and liquidated in an orderly fashion in that market.

Finally, pursuant to proposed § 150.5(a)(2)(ii)(A)(5), neither the Commission nor the exchange would enforce a position limits violation for such retroactive applications.

Proposed § 150.5(a)(2)(ii)(B) provided that an exchange would require that a trader reapply for the exemption granted under proposed § 150.5(a)(2) at least annually so that the exchange and the Commission can closely monitor exemptions for contracts subject to Federal position limits, and to help ensure that the exchange and the Commission remain aware of the trader's activities.

Proposed § 150.5(a)(2)(ii)(C) would authorize an exchange to deny, limit, condition, or revoke any exemption request in accordance with exchange rules,[1015] and would set forth a principles-based standard for doing so. Specifically, under proposed § 150.5(a)(2)(ii)(C), exchanges would be required to take into account: (i) whether granting the exemption request would result in a position that is "not in accord with sound commercial practices" in the market in which the DCM is granting the exemption; and (ii) whether granting the exemption request would result in a position that would "exceed an amount that may be established or liquidated in an orderly fashion in that market." The 2020 NPRM explained that exchanges' evaluation of exemption requests against these standards would be a facts and circumstances determination.

The 2020 NPRM further explained that activity may reflect "sound commercial practice" for a particular market or market participant but not for another market or market participant. Similarly, activity may reflect "sound commercial practice" outside the spot month, but not in the spot month. Further, activity with manipulative intent or effect, or that has the potential or effect of causing price distortion or disruption, would be inconsistent with "sound commercial practice," even if it is common practice among

[1015] Currently, DCMs review and set exemption levels annually based on the facts and circumstances of a particular exemption and the market conditions at that time. As such, a DCM may decide to deny, limit, condition, or revoke a particular exemption, typically, if the DCM determines that certain conditions have changed and warrant such action. This may happen if, for example, there are droughts, floods, embargoes, trade disputes, or other events that cause shocks to the supply or demand of a particular commodity and thus impact the DCM's disposition of a particular exemption.

market participants. While an exemption granted to an individual market participant may reflect "sound commercial practice" and may not "exceed an amount that may be established or liquidated in an orderly fashion in that market," the 2020 NPRM clarified that the Commission expects exchanges to also evaluate whether the granting of a particular exemption type to multiple participants could have a collective impact on the market in a manner inconsistent with "sound commercial practice" or in a manner that could result in a position that would "exceed an amount that may be established or liquidated in an orderly fashion in that market."

In the 2020 NPRM, the Commission explained that it understands that the above-described parameters for exemptions from exchange-set limits are generally consistent with current practice among DCMs. Bearing in mind that proposed § 150.5(a) would apply to contracts subject to Federal position limits, the Commission proposed codifying such parameters, as they would establish important, minimum standards needed for exchanges to administer, and the Commission to oversee, a robust program for granting exemptions from exchange-set limits in a manner that does not undermine the Federal position limits framework. Proposed § 150.5(a) also would afford exchanges the ability to generally oversee their programs for granting exemptions from exchange-set limits as they see fit, including to establish different application processes and requirements to accommodate the unique characteristics of different contracts.

Finally, proposed § 150.5(a)(2)(ii)(D) would permit an exchange, in its discretion, to require a person relying on an exchange-granted exemption (for contracts subject to Federal position limits) to exit or limit the size of any position in excess of exchange-set limits during the lesser of the last five days of trading or the time period for the spot month in a physical-delivery contract. The Commission has traditionally referred to such requirements as a "Five-Day Rule."

b. Comments - Exemptions to Exchange-set Limits for Contracts Subject to Federal Position Limits

With respect to permitted exemptions from exchange-set limits under proposed § 150.5(a)(2), CMC requested that the Commission clarify that each exchange has discretion to determine what information is required of applicants when applying for a spread exemption from exchange-set limits, and that an exchange is not responsible for monitoring the use of spread positions for purposes of Federal position limits.[1016]

In addition, regarding the retroactive application provision in proposed § 150.5(a)(2)(ii)(A)(5), CME Group recommended that the Commission should implement a standard that permits exchanges to impose position limits violations in cases where a person has exceeded Federal position limits and filed a late or retroactive application that the exchange then denies.[1017]

The Commission also received several comments regarding the provision that allows exchanges to impose a Five-Day Rule in proposed § 150.5(a)(2)(ii)(D). In particular, commenters requested that the Commission expressly clarify that the Five-Day Rule does not apply to markets for energy commodity derivatives.[1018] Commenters also requested clarification about whether, in cases where an exchange opts not to apply the Five-Day Rule, the Commission expects the exchange to follow the waiver guidance in proposed Appendix B, or whether the exchange can simply take no further action.[1019]

c. Discussion of Final Rule - Exemptions to Exchange-set Limits for Contracts Subject to Federal Position Limits

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[1016] CMC at 7.

[1017] *See* CME Group at 10 (explaining that today at the exchange level, CME Group considers firms to be in violation of a position limit if the firms exceed a limit and the exemption application is denied. CME Group believes the Commission should implement this standard, rather than permitting the proposed grace period for denial of an exemption application. CME Group explains that, otherwise, market participants with excessively large speculative positions could exploit the grace period accompanying an application for an exemption and intentionally go over the applicable limit without consequences—all the while disrupting orderly market operations. In CME Group's experience, the prospect of having an application denied and being found in violation of position limits has worked to deter market participants from attempting to exploit the retroactive exemption process).

[1018] Chevron at 13; Suncor at 12.

[1019] CCI at 9-10; CEWG at 25-26. *See also supra* Section II.A.1.viii. (explaining Appendix B, which provides guidance the Commission believes exchanges should consider when determining whether to apply the Five-Day Rule restriction).

The Commission has determined to finalize § 150.5(a)(2) largely as proposed and with the clarifications and modifications, described below, in response to commenters and other considerations.

Regarding comments on application information exchanges are required to collect under § 150.5(a)(2), as explained in the 2020 NPRM, the Commission is providing exchanges great flexibility to create an application process for exemptions from exchange-set limits as they see fit. This means an exchange has discretion to determine what information is required of applicants applying for a spread exemption, or any other exemption from exchange-set limits, except for instances where the exchange is processing a non-enumerated bona fide hedge application in accordance with the application requirements of § 150.9. The Commission is making one modification to clarify the Commission's posture when reviewing exchange-granted exemptions. In proposed § 150.5(a)(2)(ii)(A), the Commission proposed to require exchanges to collect sufficient information for the exchange to determine and the Commission to "verify" that the facts and circumstances demonstrate that the exchange may grant the exemption. In final § 150.5(a)(2)(ii)(A), the Commission is revising this provision to make clear that the Commission will conduct an independent evaluation of any application it reviews to "determine" (not verify) whether the facts and circumstances demonstrate that the exchange may grant the exemption.

Further, regarding monitoring spread exemptions, exchanges are required to administer and monitor their position limits and any exemptions therefrom in accordance with DCM Core Principle 5 and SEF Core Principle 6, as applicable. To the extent, however, that an exchange grants an inter-market spread exemption where part of the spread position is executed on another exchange or OTC, although an exchange is not responsible for monitoring a trader's position on other exchanges or OTC, an exchange should request information from the spread exemption applicant about the entire

composition of the spread position so that the exchange is best informed about whether to grant the exemption. Ultimately, the person relying on the spread exemption is responsible for monitoring for compliance with the applicable Federal position limits. The Commission reminds market participants that an approved exemption does not preclude the Commission from finding that a person has otherwise disrupted or manipulated the market.

Next, regarding comments on the retroactive application provision in proposed § 150.5(a)(2)(ii)(A)(5), the Commission believes that exchanges are in the best position to determine whether to pursue enforcement actions for violations of exchange-set limits. Accordingly, the Commission has determined to revise this provision so that exchanges have discretion to determine whether to impose a position limits violation for any retroactive exemption request for exchange-set limits that the exchange ultimately denies. The Commission, however, retains its position that the Commission will not pursue a position limits violation in those circumstances, provided that the application was submitted in good faith and the applicant brings its position within the DCM or SEF's speculative position limits within a commercially reasonable time, as determined by the DCM or SEF.[1020] This revision is simply intended to make explicit an implicit presumption that the applicant should have a reasonable and good faith basis for determining that its position meets the requirements of § 150.5(a)(2)(ii)(A) and for submitting the retroactive application.

Next, regarding various comments on the provision that allows exchanges to impose the Five-Day Rule, or a similar requirement, in proposed § 150.5(a)(2)(ii)(D), for the avoidance of doubt, the Commission reiterates that exchanges are not required to impose the Five-Day Rule. Further, the Commission is adopting Appendix B and

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[1020] The Commission notes that, under Section 4a(e) of the Act, the Commission could pursue violations of exchange position limit rules; however, the Commission, as a matter of policy, will not pursue such violations so long as the conditions of § 150.5(a)(2)(ii)(E) are met.

Appendix G to provide guidance for exchanges to consider when determining whether to impose the Five-Day Rule or similar requirements in the spot period with respect to bona fide hedge exemptions or spread exemptions, respectively.[1021] The Final Rule permits exchanges to determine whether any such restriction on trading in the spot period is necessary given the facts and circumstances of a particular exemption request. Further, when an exchange determines not to impose the Five-Day Rule or similar requirement for an approved exemption, it is not obligated to take any additional steps. The Commission has revised § 150.5(a)(2)(ii)(H) to make these points clear.

Finally, the Commission is making various non-substantive technical and grammatical changes to § 150.5(a)(2) to improve readability. The Commission has also updated the outline numbering of § 150.5(a)(2)(ii). These changes are not intended to change the substance of this section.

iii. Section 150.5(a)(3) - Exchange-Set Limits on Pre-existing Positions for Contracts Subject to Federal Position Limits

a. Summary of the 2020 NPRM - Exchange-Set Limits on Pre-existing Positions for Contracts Subject to Federal Position Limits

In the 2020 NPRM, the Commission recognized that the proposed Federal position limits framework may result in certain "pre-existing positions" being subject to speculative position limits, even though the positions predated the adoption of such limits. So as not to undermine the Federal position limits framework during the spot month, and to minimize disruption outside the spot month, proposed § 150.5(a)(3) would require that during the spot month, for contracts subject to Federal position limits, exchanges impose limits no larger than Federal levels on "pre-existing positions," other than for pre-enactment swaps and transition period swaps. However, outside the spot month, an exchange would not be required to impose limits on any such position,

[1021] *See supra* Sections II.A.1.viii. (discussing Appendix B) and II.A.20 (discussing Appendix G). *See also infra* Appendices B and G.

provided the position is acquired in good faith consistent with the "pre-existing position" definition of proposed § 150.1, and provided further that if the person's position is increased after the effective date of the limit, such pre-existing position (other than pre-enactment swaps and transition period swaps) along with the position increased after the effective date, would be attributed to the person. This provision is consistent with the proposed treatment of pre-existing positions for purposes of Federal position limits set forth in proposed § 150.2(g), and was intended to prevent spot-month limits from being rendered ineffective.

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

b. Comments - Exchange-Set Limits on Pre-existing Positions for Contracts Subject to Federal Position Limits

The Commission addressed comments on pre-existing positions under its discussion of § 150.2(g)(2) above.[1022]

c. Discussion of Final Rule - Exchange-Set Limits on Pre-existing Positions for Contracts Subject to Federal Position Limits

The Commission is adopting § 150.5(a)(3) with two modifications to conform to the changes made to § 150.2(g)(2), described below.

First, the Commission is amending § 150.5(a)(3)(ii) to clarify that non-spot month limits shall apply to pre-existing positions, other than pre-enactment swaps and transition period swaps. As discussed above in Section II.B.7., the Commission did not intend in

[1022] *See supra* Section II.B.7. (further discussing limits on pre-existing positions).

the 2020 NPRM to exclude existing non-spot month positions in the nine legacy agricultural contracts that would otherwise qualify as "pre-existing positions." As discussed, the other 16 non-legacy core referenced futures contracts that are subject to Federal position limits for the first time under the Final Rule are not subject to Federal non-spot month position limits and therefore proposed § 150.5(a)(3)(ii) would not have applied to these contracts in any event.[1023]

Second, the Commission is eliminating the language in proposed § 150.5(a)(3)(ii) that would attribute to a person any increase in their position after the effective date of the non-spot month limit. This language is no longer necessary since final § 150.5(a)(3)(ii) clarifies that pre-existing positions, other than pre-enactment swaps and transition period swaps, are subject to non-spot month limits.

For further discussion on pre-existing positions in general and comments thereto, please refer to §§ 150.2(g).[1024]

iv. Section 150.5(a)(4) - Monthly Report Detailing Exemption Applications for Contracts Subject to Federal Limits

a. Summary of the 2020 NPRM - Monthly Report Detailing Exemption Applications for Contracts Subject to Federal Limits

In the 2020 NPRM, the Commission explained that it seeks a balance between having sufficient information to oversee the exchange-granted exemptions, and not burdening exchanges with excessive periodic reporting requirements. The Commission thus proposed under § 150.5(a)(4) to require one monthly report by each exchange providing certain information about exchange-granted exemptions for contracts that are subject to Federal position limits. Certain exchanges already voluntarily file these types of monthly reports with the Commission, and proposed § 150.5(a)(4) would standardize

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[1023] *See supra* Section II.B.7. (discussing § 150.2 Federal position limits on pre-existing positions).
[1024] *Id*.

such reports for all exchanges that process applications for bona fide hedges, spread exemptions, and other exemptions from exchange-set limits for contracts that are subject to Federal position limits. The proposed report would provide information regarding the disposition of any application to recognize a position as a bona fide hedge (both enumerated and non-enumerated) or to grant a spread or other exemption, including any renewal, revocation of, or modification to the terms and conditions of, a prior recognition or exemption.[1025]

As specified under proposed § 150.5(a)(4), the report would provide certain details regarding any application to recognize a bona fide hedging position, or grant a spread exemption or other exemption, including: the effective date and expiration date of any recognition or exemption; any unique identifier assigned to track the application or position; identifying information about the applicant; the derivative contract or positions to which the application pertains; the maximum size of the commodity derivative position that is recognized or exempted by the exchange (including any "walk-down" requirements);[1026] any size limitations the exchange sets for the position; and a brief narrative summarizing the applicant's relevant cash-market activity.

With respect to any unique identifiers to be included in the proposed monthly report, the exchange's assignment of a unique identifier would assist the Commission's tracking process. Accordingly, the Commission suggested that, as a "best practice," the exchange's procedures for processing bona fide hedging position and spread exemption applications contemplate the assignment of such unique identifiers.[1027] The proposed

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[1025] Under the 2020 NPRM, in the monthly report, exchanges may elect to list new recognitions or exemptions, and modifications to or revocations of prior recognitions and exemptions each month. Alternatively, exchanges may submit cumulative monthly reports listing all active recognitions and exemptions (*i.e.*, including exemptions that are not new or have not changed).

[1026] An exchange could determine to recognize as a bona fide hedge or spread exemption all, or a portion, of the commodity derivative position for which an application has been submitted, provided that such determination is made in accordance with the requirements of proposed § 150.5 and is consistent with the Act and the Commission's regulations. In addition, an exchange could require that a bona fide hedging position or spread position be subject to "walk-down" provisions that require the trader to scale down its positions in the spot month in order to reduce market congestion as needed based on the facts and circumstances.

[1027] The unique identifier could apply to each of the bona fide hedge or spread exemption applications that the exchange receives, and, separately, each type of commodity derivative position that the exchange wishes to recognize as a bona fide hedge or spread exemption.

report would also be required to specify the maximum size and/or size limitations by contract month and/or type of limit (*e.g.*, spot month, single month, or all-months-combined), as applicable. The proposed monthly report would be a critical element of the Commission's surveillance program by facilitating the Commission's ability to track bona fide hedging positions and spread exemptions approved by exchanges. The proposed monthly report would also keep the Commission informed as to the manner in which an exchange is administering its application procedures, the exchange's rationale for permitting large positions, and relevant cash-market activity. The Commission expected that exchanges would be able to leverage their current exemption processes and recordkeeping procedures to generate such reports.

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

Proposed § 150.5(a)(4) would require an exchange, unless instructed otherwise by the Commission, to submit such monthly reports according to the form and manner

requirements the Commission specifies. In order to facilitate the processing of such reports, and the analysis of the information contained therein, the Commission would establish reporting and transmission standards. The 2020 NPRM would also require that such reports be submitted to the Commission using an electronic data format, coding structure, and electronic data transmission procedures specified on the Commission's Forms and Submissions page of its website.

b. Comments - Monthly Report Detailing Exemption Applications for Contracts Subject to Federal Limits

With respect to the monthly reporting requirement in proposed § 150.5(a)(4), ICE requested that the Commission clarify that the monthly report is only required to capture positions that are subject to Federal position limits and does not apply to other exchange-set non-enumerated exemptions.[1028] ICE also requested that the Commission codify when the monthly reports are required to be submitted, and that any regular reports can be made at the discretion of the exchange.[1029] Other commenters expressed that they prefer that the Commission not specify a particular day each month as a deadline for exchanges to submit their monthly reports pursuant to § 150.5(a)(4).[1030] Finally, ICE requested that the Commission clarify how factual and legal justifications for exemptions should be provided in the monthly report, and the level of granularity required.[1031]

c. Discussion of Final Rule - Monthly Report Detailing Exemption Applications for Contracts Subject to Federal Limits

The Commission is finalizing § 150.5(a)(4) as proposed, with minor technical revisions. The Commission clarifies, as stated in the proposed and final regulation text, that the monthly reporting requirement only applies to exemptions an exchange grants for

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[1028] ICE at 14.
[1029] *Id*.
[1030] CME Group at 14; IFUS at 13.
[1031] ICE at 14.

contracts that are subject to Federal position limits. Further, in consideration of comments and the Commission's past with collecting voluntary monthly reports from exchanges, the Commission has determined not to prescribe a particular day of the month or monthly deadline for exchanges to submit the monthly reports. Rather, the Commission defers to exchanges on the best timing for submitting their reports so long as the reports are submitted on a monthly basis in accordance with § 150.5(a)(4). Finally, the Commission clarifies that § 150.5(a)(4) does not require exchanges to provide factual and legal analysis in the monthly report. The monthly report is intended to give the Commission a snapshot of all exemptions the exchange has granted from exchange-set limits for contracts that are subject to Federal position limits. The Commission's expectation is that in circumstances when it needs additional information on the exchange's analysis for a particular exemption application, it will work with the exchange to obtain such additional information.

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

i. Summary of the 2020 NPRM - Exchange-Set Limits on Commodity Derivative Contracts in a Physical Commodity Not Subject to the Limits Set Forth in § 150.2

Under proposed § 150.5(b), for physical commodity derivative contracts that are <u>not</u> subject to Federal position limits, whether cash-settled or physically-settled, exchanges would be subject to flexible standards for setting exchange limits during the contract's spot month and non-spot month.

During the spot month, under proposed § 150.5(b)(1)(i), exchanges would be required to establish position limits, and such limits would have to be set at a level that is no greater than 25 percent of deliverable supply. As described in detail in connection with the proposed Federal spot-month limits described above, it would be difficult, in the

absence of other factors, for a participant to corner or squeeze a market if the participant holds less than or equal to 25 percent of deliverable supply, and the Commission has long used deliverable supply as the basis for spot month position limits due to concerns regarding corners, squeezes, and other settlement-period manipulative activity.[1032]

In the 2020 NPRM, the Commission recognized, however, that there may be circumstances where an exchange may not wish to use the 25% formula, including, for example, if the contract is cash-settled, does not have a measurable deliverable supply, or if the exchange can demonstrate that a different parameter is better suited for a particular contract or market.[1033] Accordingly, proposed § 150.5(b)(1) would afford exchanges the ability to submit to the Commission alternative potential methodologies for calculating spot month limit levels, provided that the limits are set at a level that is "necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index." This standard has appeared in existing § 150.5 since its adoption in connection with spot-month limits on cash-settled contracts.

As noted above, existing § 150.5 includes separate parameters for spot-month limits in physical-delivery contracts and for cash-settled contracts, but does not include flexibility for exchanges to consider alternative parameters. In an effort to both simplify the regulation and provide the ability for exchanges to consider multiple parameters that may be better suited for certain products, the Commission proposed the above standard as a principles-based requirement for both cash-settled and physically-settled contracts subject to proposed § 150.5(b).

Outside of the spot month, where, historically, attempts at certain types of market manipulation is generally less of a concern, proposed § 150.5(b)(2)(i) would allow

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[1032] *See supra* Section II.B. (discussing proposed § 150.2).

[1033] Guidance for calculating deliverable supply can be found in Appendix C to part 38. 17 CFR part 38, Appendix C.

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

To help exchanges efficiently demonstrate compliance with this standard for physical commodity contracts outside of the spot month, the Commission proposed separate acceptable practices for exchanges that wish to adopt non-spot month position limits and exchanges that wish to adopt non-spot month accountability.[1034] For exchanges that choose to adopt non-spot month position limits, rather than position accountability, proposed paragraph (a)(1) to Appendix F of part 150 would set forth non-exclusive acceptable practices. Under that provision, an exchange would be deemed in compliance with proposed § 150.5(b)(2)(i) if the exchange sets non-spot limit levels for each contract subject to § 150.5(b) at a level no greater than: (1) the average of historical position sizes held by speculative traders in the contract as a percentage of the contract's open interest;[1035] (2) the spot month limit level for the contract; (3) 5,000 contracts (scaled up proportionally to the ratio of the notional quantity per contract to the typical cash-market transaction if the notional quantity per contract is smaller than the typical cash-market transaction, or scaled down proportionally if the notional quantity per contract is larger than the typical cash-market transaction);[1036] or (4) 10% of open interest

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[1034] The acceptable practices in Appendix F to part 150 of the 2020 NPRM reflected non-exclusive methods of compliance. Accordingly, the language of these proposed acceptable practices, used the word "shall" not to indicate that the acceptable practice is a required method of compliance, but rather to indicate that in order to satisfy the acceptable practice, a market participant must (*i.e.*, shall) establish compliance with that particular acceptable practice.

[1035] For example, if speculative traders in a particular contract typically make up 12 percent of open interest in that contract, the exchange could set limit levels no greater than 12 percent of open interest.

[1036] Under the 2020 NPRM, for exchanges that choose to adopt a non-spot month limit level of 5,000 contracts, this level assumes that the notional quantity per contract is set at a level that reflects the size of a typical cash-market transaction in the underlying commodity. However, if the notional quantity of the contract is larger/smaller than the typical cash-market transaction in the underlying commodity, then the DCM must reduce/increase the 5,000 contract non-spot month limit until it is proportional to the notional quantity of the contract relative to the typical cash-market transaction. These required adjustments to the 5,000-contract

in that contract for the most recent calendar year up to 50,000 contracts, with a marginal increase of 2.5% of open interest thereafter.[1037] When evaluating average position sizes held by speculative traders, the Commission expected exchanges: (i) to be cognizant of speculative positions that are extraordinarily large relative to other speculative positions, and (ii) to not consider any such outliers in their calculations.

These proposed parameters have largely appeared in existing § 150.5 for many years in connection with either initial or subsequent levels.[1038] The Commission was of the view that these parameters would be useful, flexible standards to carry forward as acceptable practices. For example, the Commission expected that the 5,000-contract acceptable practice would be a useful benchmark for exchanges because it would allow them to establish limits and demonstrate compliance with Commission regulations in a relatively efficient manner, particularly for new contracts that have yet to establish open interest. Similarly, for purposes of exchange-set limits on physical commodity contracts that are not subject to Federal position limits, the Commission proposed to maintain the baseline 10/2.5 percent formula as an acceptable practice. Because these parameters are simply acceptable practices, exchanges may, after evaluation, propose higher limits or accountability levels.

Along those lines, the Commission recognized that other parameters may be preferable and/or just as effective, and was open to considering alternative parameters submitted pursuant to part 40 of the Commission's regulations, provided, at a minimum, that the parameter complies with § 150.5(b)(2)(i). The Commission encouraged

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metric are intended to avoid a circumstance where an exchange could allow excessive speculation by setting excessively large notional quantities relative to typical cash-market transaction sizes. For example, if the notional quantity per contract is set at 30,000 units, and the typical observed cash-market transaction is 2,500 units, the notional quantity per contract would be 12 times larger than the typical cash-market transaction. In that case, the non-spot month limit would need to be 12 times smaller than 5,000 (*i.e.*, at 417 contracts.). Similarly, if the notional quantity per contract is 1,000 contracts, and the typical observed cash-market transaction is 2,500 units, the notional quantity per contract would be 2.5 times smaller than the typical cash-market transaction. In that case, the non-spot month limit would need to be 2.5 times larger than 5,000, and would need to be set at 12,500 contracts.

[1037] In connection with the proposed Appendix F to part 150 acceptable practices, open interest should be calculated by averaging the month-end open positions in a futures contract and its related option contract, on a delta-adjusted basis, for all months listed during the most recent calendar year.

[1038] 17 CFR 150.5(b) and (c). Proposed § 150.5(b) would address physical commodity contracts that are not subject to Federal position limits.

exchanges to submit potential new parameters to Commission staff in draft form prior to submitting them under part 40.

For exchanges that choose to adopt position accountability, rather than limits, outside of the spot month, proposed paragraph (a)(2) of Appendix F to part 150 would set forth a non-exclusive acceptable practice that would permit such exchanges to comply with proposed § 150.5(b)(2)(i) by adopting rules establishing "position accountability" as defined in proposed § 150.1. "Position accountability" would mean rules that the exchange submits to the Commission pursuant to part 40 that require a trader, upon request by the exchange, to consent to: (i) provide information to the exchange about their position, including, but not limited to, information about the nature of the positions, trading strategies, and hedging information; and (ii) halt further increases to their position or to reduce their position in an orderly manner.[1039]

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

[1039] While existing § 150.5(e) includes open-interest and volume-based limitations on the use of position accountability, the Commission opted not to include such limitations in the 2020 NPRM. Under the 2020 NPRM, if an exchange submitted a part 40 filing seeking to adopt position accountability, the Commission would determine on a case-by-case basis whether such rules are consistent with the Act and the Commission's regulations. The Commission did not want to use one-size-fits-all volume-based limitations for making such determinations.

contracts, and to limits during and outside of the spot month, as applicable.[1040] Proposed § 150.5(b)(3) was intended to help ensure that position limits established on one exchange would not jeopardize market integrity or otherwise harm other markets. Further, proposed § 150.5(b)(3) would be consistent with the Commission's proposed approach to generally apply equivalent Federal position limits to linked contracts, including linked contracts listed on multiple exchanges.[1041]

Finally, under proposed § 150.5(b)(4), exchanges would be permitted to grant exemptions from any limits established under proposed § 150.5(b). As noted, proposed § 150.5(b) would apply to physical commodity contracts not subject to Federal position limits; thus, exchanges would be given flexibility to grant exemptions in such contracts, including exemptions for both intra-market and inter-market spread positions,[1042] as well as other exemption types (including risk management exemptions) not explicitly listed in proposed § 150.3.[1043] However, such exchanges must require that traders apply for the exemption. In considering any such application, the exchanges would be required to consider whether the exemption would result in a position that would not be in accord with "sound commercial practices" in the market for which the exchange is considering the application, and/or would "exceed an amount that may be established and liquidated in an orderly fashion in that market."

While exchanges would be subject to the requirements of § 150.5(a) and (b) described above, such proposed requirements are not intended to limit the discretion of exchanges to utilize other tools to protect their markets. Among other things, an exchange would have the discretion to: impose additional restrictions on a person with a long position in the spot month of a physical-delivery contract who stands for delivery,

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[1040] For reasons discussed elsewhere in the 2020 NPRM, this provision would not apply to natural gas contracts. *See supra* Section II.C.6. (discussion of proposed conditional spot month exemption in natural gas).

[1041] *See supra* Section II.A.16. (discussion of the proposed referenced contract definition and linked contracts).

[1042] *See* Appendix G (providing additional guidance on spread exemptions).

[1043] As noted above, proposed § 150.3 would allow for several exemption types, including: bona fide hedging positions; certain spreads; financial distress positions; and conditional spot month limit exemption positions in natural gas.

takes that delivery, and then re-establishes a long position; establish limits on the amount of delivery instruments that a person may hold in a physical-delivery contract; and impose such other restrictions as it deems necessary to reduce the potential threat of market manipulation or congestion, to maintain orderly execution of transactions, or for such other purposes consistent with its responsibilities.

ii. Comments - Exchange-Set Limits on Commodity Derivative Contracts in a Physical Commodity Not Subject to the Limits Set Forth in § 150.2

Better Markets recommended revisions for proposed § 150.5(b)(2) if the Commission decides to finalize the proposed approach to only implement spot month limits on contracts that are not subject to Federal position limits.[1044] Proposed § 150.5(b)(2) requires exchanges to have either non-spot month position limits or accountability levels, as necessary and appropriate, to reduce manipulation and price distortions for contracts that are not subject to limits in § 150.2. Better Markets' recommendation goes a step further and would require exchanges to set position limits *and* position accountability levels outside of the spot month to reduce the potential threat of market manipulation or price distortion *and* the potential for sudden or unreasonable fluctuations or unwarranted changes.[1045]

iii. Discussion of Final Rule - Exchange-Set Limits on Commodity Derivative Contracts in a Physical Commodity Not Subject to the Limits Set Forth in § 150.2

The Commission is adopting § 150.5(b), as proposed, with a few technical or grammatical revisions to improve readability and the following explanation. Of note, the Commission is revising the beginning of § 150.5(b)(1) to clarify that this section applies to exchange-set limits on cash-settled and physically-settled commodity derivative contracts in a physical commodity that are not subject to the Federal position limits set

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[1044] Better Markets at 47-48.

[1045] *Id.*

forth in § 150.2. Although this point is made clear in the preamble and the introductory title of § 150.5(b), the Commission has added the additional clarification for the avoidance of any confusion.

In response to comments from Better Markets, and as explained in detail earlier in this release, the Commission believes that outside the spot month, either exchange-set position limits or exchange-set accountability levels will be sufficient for exchanges to reduce the potential threat of market manipulation and price distortions and manage fluctuations and changes in their markets.[1046] Accordingly, the Commission has determined to finalize the position limits and accountability requirements as proposed.

5. Section 150.5(c) - Requirements for Security Futures Products

i. Background and Summary of the 2020 NPRM - Requirements for Security Futures Products

As the Commission has previously noted, security futures products and security options may serve economically equivalent or similar functions to one another.[1047] Therefore, when the Commission originally adopted position limits regulations for security futures products in part 41, it set levels that were generally comparable to, although not identical with, the limits that applied to options on individual securities.[1048] The Commission has pointed out that security futures products may be at a competitive disadvantage if position limits for security futures products vary too much from those of security options.[1049] As a result, the Commission in 2019 adopted amendments to the position limitations and accountability requirements for security futures products, noting that one goal was to provide a level regulatory playing field with security options.[1050]

[1046] *See supra* Section II.B.2.iv. (providing a detailed discussion of the Commission's extensive experience monitoring position accountability levels, which have been effective at exchanges).

[1047] *See* Position Limits and Position Accountability for Security Futures Products, 83 FR at 36799, 36802 (July 31, 2018).

[1048] *Id. See also* Listing Standards and Conditions for Trading Security Futures Products, 66 FR at 55078, 55082 (Nov. 1, 2001) (explaining the Commission's adoption of position limits for security futures products).

[1049] *See* 83 FR at 36802.

[1050] *See* Position Limits and Position Accountability for Security Futures Products, 84 FR at 51005, 51009 (Sept. 27, 2019).

The Commission proposed § 150.5(c), therefore, to include a cross-reference clarifying that for security futures products, position limitations and accountability requirements for exchanges are specified in § 41.25.[1051] This would allow the Commission to take into account the position limits regime that applies to security options when considering position limits regulations for security futures products.

ii. Comments and Summary of the Commission Determination - Requirements for Security Futures Products

The Commission did not receive comments on § 150.5(c) and is adopting this section as proposed.

6. Section 150.5(d) - Rules on Aggregation

i. Summary of the 2020 NPRM - Rules on Aggregation

As noted earlier in this release, the Commission adopted in 2016 final aggregation rules under § 150.4 that apply to all contracts subject to Federal position limits. The Commission recognized that with respect to contracts not subject to Federal position limits, market participants may find it burdensome if different exchanges adopt different aggregation standards. Accordingly, under proposed § 150.5(d), all DCMs, and, ultimately, SEFs, that list any physical commodity derivatives, regardless of whether the contract is subject to Federal position limits, would be required to adopt position aggregation rules for such contracts that conform to § 150.4.[1052] Exchanges that list excluded commodities would be encouraged to also adopt position aggregation rules that conform to § 150.4. Aggregation policies that otherwise vary from exchange to exchange would increase the administrative burden on a trader active on multiple exchanges, as

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[1051] *See* 17 CFR 41.25. Rule § 41.25 establishes conditions for the trading of security futures products.

[1052] Under § 150.4, unless an exemption applies, a person's positions must be aggregated with positions for which the person controls trading or for which the person holds a 10% or greater ownership interest. Commission Regulation § 150.4(b) sets forth several exemptions from aggregation. *See* Final Aggregation Rulemaking, 81 FR at 91454. The Division of Market Oversight has issued time-limited no-action relief from some of the aggregation requirements contained in that rulemaking. *See* CFTC Letter No. 19-19 (July 31, 2019), available at https://www.cftc.gov/csl/19-19/download.

well as increase the administrative burden on the Commission in monitoring and enforcing exchange-set position limits.

ii. Comments and Summary of the Commission Determination - Rules on Aggregation

The Commission did not receive comments on § 150.5(d) and is adopting this section as proposed.

7. Section 150.5(e) - Requirements for Submissions to the Commission

i. Summary of the 2020 NPRM - Requirements for Submissions to the Commission

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

Proposed § 150.5(e) further provides that exchanges would be required to review regularly[1053] any position limit levels established under proposed § 150.5 to ensure the level continues to comply with the requirements of those sections. For example, in the case of § 150.5(b), exchanges would be expected to ensure the limits comply with the requirement that limits be set "at a level that is necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the

[1053] Under the 2020 NPRM, an acceptable, regular review regime would consist of both a periodic review and an event-specific review (*e.g.*, in the event of supply and demand shocks such as unanticipated shocks to supply and demand of the underlying commodity, geo-political shocks, and other events that may result in congestion and/or other disruptions).

underlying commodity's price or index." Exchanges would also be required to update such levels as needed, including if the levels no longer comply with the proposed rules.

ii. Comments and Summary of the Commission Determination - Requirements for Submissions to the Commission

The Commission did not receive comments on § 150.5(e) and is adopting this section with a few non-substantive revisions to address grammatical issues and improve the readability and organization of the section. These revisions are not intended to change the substance of this section.

8. Section 150.5(f) - Delegation of Authority to the Director of the Division of Market Oversight

i. Summary of the 2020 NPRM - Delegation of Authority to the Director of the Division of Market Oversight

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

ii. Comments and Summary of the Commission Determination - Delegation of Authority to the Director of the Division of Market Oversight

The Commission did not receive comments on § 150.5(f) and is adopting this section as proposed.

9. Commission Enforcement of Exchange-Set Limits

As discussed throughout this Final Rule, the framework for exchange-set limits operates in conjunction with the Federal position limits framework. The Futures Trading

Act of 1982 gave the Commission, under CEA section 4a(5) (since re-designated as section 4a(e)), the authority to directly enforce violations of exchange-set, Commission-approved speculative position limits in addition to position limits established directly by the Commission.[1054] Since 2008, it has also been a violation of the Act for any person to violate an exchange position limit rule certified to the Commission by such exchange pursuant to CEA section 5c(c)(1).[1055] Thus, under CEA section 4a(e), it is a violation of the Act for any person to violate an exchange position limit rule certified to or approved by the Commission, including to violate any subsequent amendments thereto, and the Commission has the authority to enforce those violations.

The Commission did not receive comments on its authority to enforce exchange-set position limits.

E. § 150.6 - Scope

Existing § 150.6 provides that nothing in this part shall be construed to affect any provisions of the CEA relating to manipulation or corners nor to relieve any contract market or its governing board from responsibility under the CEA to prevent manipulation and corners.[1056]

1. Summary of the 2020 NPRM - Scope

Proposed § 150.6 was intended to make clear that fulfillment of specific part 150 requirements alone does not necessarily satisfy other obligations of an exchange. Proposed § 150.6 provided that part 150 of the Commission's regulations would only be construed as having an effect on position limits set by the Commission or an exchange including any associated recordkeeping and reporting requirements. Proposed § 150.6

[1054] *See* Futures Trading Act of 1982, Public Law 97-444, 96 Stat. 2299-30 (1983).

[1055] *See* CFTC Reauthorization Act of 2008, Food, Conservation and Energy Act of 2008, Public Law No. 110–246, 122 Stat. 1624 (June 18, 2008) (also known as the "Farm Bill") (amending CEA section 4a(e), among other things, to assure that a violation of exchange-set position limits, regardless of whether such position limits have been approved by or certified to the Commission, would constitute a violation of the Act that the Commission could independently enforce). *See also* Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 FR at 4144, 4145 (Jan. 26, 2010) (summarizing the history of the Commission's authority to directly enforce violations of exchange-set speculative position limits).

[1056] 17 CFR 150.6. The Commission notes that while existing § 150.6 references "section 5(4) of the [CEA]" no such CEA section currently exists. The Final Rule instead references section 5(d)(4) of the CEA.

provided further that nothing in part 150 would affect any other provisions of the CEA or Commission regulations including those relating to actual or attempted manipulation, corners, squeezes, fraudulent or deceptive conduct, or to prohibited transactions. For example, proposed § 150.5 would require DCMs, and, ultimately, SEFs, to impose and enforce exchange-set speculative position limits. The fulfillment of the requirements of § 150.5 alone would not satisfy any other legal obligations under the CEA or Commission regulations applicable to exchanges to prevent manipulation and corners. Likewise, a market participant's compliance with position limits or an exemption thereto would not confer any type of safe harbor or good faith defense to a claim that the participant had engaged in an attempted or perfected manipulation.

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

2. Comments and Discussion of Final Rule – Scope

The Commission received no comments on proposed §150.6 and is adopting as proposed.

As the Commission explained in the 2020 NPRM, position limits are meant to diminish, eliminate, and prevent excessive speculation and to deter and prevent market manipulation, squeezes, and corners. The Commission stresses that nothing in the Final Rule's revisions to part 150 would impact the anti-disruptive, anti-cornering, and anti-manipulation provisions of the CEA and Commission regulations, including but not limited to CEA sections 6(c) or 9(a)(2) regarding manipulation, CEA section 4c(a)(5) regarding disruptive practices including spoofing, or sections 180.1 and 180.2 of the Commission's regulations regarding manipulative and deceptive practices. It may be possible for a trader to manipulate or attempt to manipulate the prices of futures contracts

or the underlying commodity with a position that is within the Federal position limits. It may also be possible for a trader holding a bona fide hedge, as recognized by the Commission or an exchange, to manipulate or attempt to manipulate the markets. The Commission would not consider it a defense to a charge under the anti-manipulation provisions of the CEA or the regulations that a trader's position was within position limits.

F. § 150.8—Severability

Final § 150.8 provides that should any provision(s) of part 150 be declared invalid, including the application thereof to any person or circumstance, all remaining provisions of part 150 shall not be affected to the extent that such remaining provisions, or the application thereof, can be given effect without the invalid provisions.

The Commission did not receive comments on proposed § 150.8, and is adopting it as proposed.

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

1. Background - Non-enumerated Bona Fide Hedging Transactions or Positions

The Commission's authority and existing processes for recognizing bona fide hedges can be found in CEA section 4a(c), and §§ 1.3, 1.47, and 1.48 of the Commission's regulations.[1057] In particular, CEA section 4a(c)(1) provides that no CFTC rule issued under CEA section 4a(a) applies to "transactions or positions which are shown to be bona fide hedging transactions or positions."[1058] Under the existing definition of "bona fide hedging transactions and positions" in § 1.3,[1059] paragraph (1) provides the Commission's general definition of bona fide hedging transactions or positions; paragraph (2) provides a list of enumerated bona fide hedging positions that,

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[1057] 7 U.S.C. 6a(c); 17 CFR 1.3, 1.47, and 1.48.

[1058] 7 U.S.C. 6a(c)(1).

[1059] As described above, the Commission is moving an amended version of the bona fide hedging definition from § 1.3 to § 150.1. *See supra* Section II.A.1. (discussion of § 150.1).

generally, are self-effectuating, and must be reported (along with supporting cash-market information) to the Commission monthly on Form 204 after the positions are taken;[1060] and paragraph (3) provides a procedure for market participants to seek recognition from the Commission for non-enumerated bona fide hedging positions. Under paragraph (3), any person that seeks a Commission recognition of a position as a non-enumerated bona fide hedge must apply to the Commission in advance of taking on the position, and pursuant to the processes outlined in § 1.47 (30 days in advance for non-enumerated bona fide hedges) or § 1.48 (10 days in advance for enumerated anticipatory hedges), as applicable.

For the nine legacy agricultural contracts currently subject to Federal position limits, the Commission's current process for recognizing non-enumerated bona fide hedge positions exists in parallel with exchange processes for granting exemptions from exchange-set limits, as described below. The exchange processes for granting exemptions vary by exchange, and generally do not mirror the Commission's processes.[1061] Thus, when requesting a non-enumerated bona fide hedging position recognition, currently market participants must submit two applications--one application submitted to the Commission in accordance with § 1.47 for purposes of compliance with Federal position limits, and another application submitted to the relevant exchange in accordance with the exchange's rules for purposes of exchange-set position limits.

2. Overview of the 2020 NPRM, Comments, and the Commission's Determination

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[1060] As described below, the Commission is eliminating Form 204 and relying instead on the cash-market information submitted to exchanges pursuant to §§ 150.5 and 150.9. *See infra* Section II.H. (discussion of amendments to part 19).

[1061] As discussed in the 2020 NPRM, exchanges typically use one application process to grant all exemption types, whereas the Commission has different processes for different bona fide hedge exemption types. That is, the Commission currently has different processes for permitting enumerated bona fide hedges and for recognizing positions as non-enumerated bona fide hedges or anticipatory bona fide hedges. Generally, for bona fide hedges enumerated in paragraph (2) of the bona fide hedge definition in § 1.3, no formal process is required by the Commission. Instead, such enumerated bona fide hedge recognitions are self-effectuating and Commission staff reviews monthly reporting of cash-market positions on existing Form 204 and part 17 position data to monitor such positions. Requests for recognitions of non-enumerated bona fide hedging positions and for certain enumerated anticipatory bona fide hedge positions, as explained above, must be submitted to the Commission pursuant to the processes in existing §§ 1.47 and 1.48 of the regulations, as applicable. Further, exchanges generally do not require the submission of monthly cash-market information; instead, they generally require exemption applications to include cash-market information supporting positions that exceed the limits, to be filed prior to exceeding a position limit, and to be updated on an annual basis. On the other hand, the Commission has various monthly reporting requirements under Form 204 and part 17 of the Commission's regulations as described above.

Generally, the Commission is adopting § 150.9 largely as proposed, but with certain clarifications and modifications to address commenters' views and other considerations. This section provides an overview of, and addresses general comments regarding, proposed § 150.9. Further below, the Commission summarizes each sub-section of § 150.9 and comments relevant to that sub-section, and provides a more detailed discussion of the Commission's determination and any changes to each sub-section of § 150.9.

i. General Overview of the 2020 NPRM

The Commission proposed § 150.9 to establish a new framework whereby a market participant seeking a non-enumerated bona fide hedge recognition could file one application with an exchange to receive a non-enumerated bona fide hedge recognition for purposes of both exchange-set limits and Federal position limits.[1062] The proposed framework was intended to be independent of, and serve as an alternative to, the Commission's process for reviewing exemption requests under proposed § 150.3. The proposed framework was also intended to help: (1) streamline the process by which non-enumerated bona fide hedge applications are addressed; (2) minimize disruptions by leveraging existing exchange-level processes with which many market participants are already familiar;[1063] and (3) reduce inefficiencies created when market participants are required to comply with different Federal and exchange-level processes.

In the 2020 NPRM, the Commission emphasized that proposed § 150.9 would serve as a separate, self-contained process that is related to, but independent of, the proposed regulations governing: (1) the process in proposed § 150.3 for traders to apply

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[1062] Alternatively, under the proposed framework, a trader could submit a request directly to the Commission pursuant to proposed § 150.3(b). A trader that submitted such a request directly to the Commission for purposes of Federal position limits would have to separately request an exemption from the applicable exchange for purposes of exchange-set limits. As discussed earlier in this release, the Commission proposed to separately allow for enumerated hedges and spreads that meet the "spread transaction" definition to be self-effectuating. *See supra* Section II.C. (discussing proposed § 150.3).

[1063] In particular, the Commission recognizes that, in the energy and metals spaces, market participants are familiar with exchange application processes and are not familiar with the Commission's processes since, currently, there are no Federal position limits for those commodities.

directly to the Commission for a bona fide hedge recognition; and (2) exchange processes for establishing exchange-set limits and granting exemptions therefrom in proposed § 150.5. The Commission also emphasized that proposed § 150.9 would serve as a voluntary process that exchanges could implement to provide additional flexibility for their market participants to file one non-enumerated bona fide hedge application with an exchange to receive a recognition for purposes of both exchange-set limits and Federal speculative position limits. Finally, the 2020 NPRM made clear that an exchange's determination to recognize a non-enumerated bona fide hedge in accordance with proposed § 150.9 with respect to exchange-set limits would serve to inform the Commission's own decision as to whether to recognize the exchange's determination for purposes of Federal speculative position limits set forth in proposed § 150.2, and would not be a substitute for the Commission's determination.

Under the proposed procedural framework, an exchange's determination to recognize a non-enumerated bona fide hedge in accordance with proposed § 150.9 with respect to exchange-set limits would serve to inform the Commission's own decision as to whether to recognize the exchange's determination for purposes of Federal position limits set forth in proposed § 150.2. Among other conditions, the exchange would be required to base its determination on standards that conform to the Commission's own standards for recognizing bona fide hedges for purposes of Federal position limits.

Further, the exchange's determination with respect to its own position limits and application process would be subject to Commission review and oversight. These requirements were proposed to facilitate the Commission's independent review and determination by ensuring that any bona fide hedge recognized by an exchange for purposes of exchange-set limits in accordance with proposed § 150.9 conforms to the Commission's standards. For a given referenced contract, proposed § 150.9 would allow a person to exceed Federal position limits if the exchange listing the contract recognized

the position as a bona fide hedge with respect to exchange-set limits, unless the Commission denies or stays the application within ten business days (or two business days for applications, including retroactive applications, filed due to sudden or unforeseen circumstances) (the "10/2-day review"). Under the 2020 NPRM, if the Commission does not intervene during that 10/2-day review period, then the exemption would be deemed approved for purposes of Federal position limits. The Commission provides a more detailed discussion of each sub-section of proposed § 150.9 further below.

ii. General Comments - Non-enumerated Bona Fide Hedging Transactions or Positions, Generally

Generally, the majority of commenters supported the Commission's proposed approach in § 150.9.[1064] In particular, one commenter expressed that § 150.9 represents a "fair and balanced" approach,[1065] and another commenter expressed that § 150.9 offers an "efficient and timely process for hedgers to obtain permission to mitigate their risk."[1066] On the other hand, certain commenters opposed the streamlined process in § 150.9 and requested that the Commission reduce or eliminate the role of exchanges in processing non-enumerated bona fide hedge exemptions.[1067]

In particular, certain commenters expressed concerns regarding the proposed role of exchanges in § 150.9. That is, certain commenters were concerned that the streamlined approach in proposed § 150.9 would create conflicts of interest for exchanges (which commenters note are for-profit entities) where exchanges could benefit from granting non-compliant non-enumerated bona fide hedge exemptions to boost trading

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[1064] ICE at 8; CCI at 2; IECA at 1-2; NGFA at 9; MGEX at 4; AGA at 11; CME Group at 7; FIA at 2; CMC at 10-11; EPSA at 6-7; Suncor at 2; COPE at 4; Shell at 3-4; and CEWG at 3; *See also* ASR at 3 (noting that proposed § 150.9 effectively leverages existing exchange frameworks).

[1065] Suncor at 2.

[1066] COPE at 4.

[1067] Rutkowski at 1; AFR at 2; IECA at 2-3; Public Citizen at 2-3; NEFI at 4; Better Markets at 3, 62; IATP at 13-14; NEFI at 4; and PMAA at 4 (noting a concern that non-enumerated bona fide hedges would be granted outside of the notice and comment rulemaking process).

volume and profits.[1068] Other commenters expressed concern that § 150.9 delegates too much discretion to exchanges to determine what qualifies as a non-enumerated bona fide hedge without well-defined criteria, and that such discretion could lead to an unlimited universe of new non-enumerated bona fide hedge exemptions that could adversely impact markets.[1069] Finally, several commenters shared the view that § 150.9 would erode the Commission's authority over exchange-granted exemptions, and that the Commission should retain all authority to grant non-enumerated bona fide hedge exemptions.[1070]

iii. Discussion of Final Rule - Non-enumerated Bona Fide Hedging Transactions or Positions, Generally - General Concerns and Comments on § 150.9

First, the Commission reiterates, as stated in the 2020 NPRM, that an exchange's determination to recognize a non-enumerated bona fide hedge in accordance with proposed § 150.9 with respect to exchange-set limits would serve to inform the Commission's decision whether to recognize such position as a non-enumerated bona fide hedge for purposes of Federal position limits set forth in proposed § 150.2. The Commission is not delegating or ceding its authority to exchanges to make the determination for purposes of Federal position limits to recognize a position as a non-enumerated bona fide hedge for applications submitted under § 150.9. In that regard, the exchange's determination to recognize a bona fide hedge with respect to exchange-set limits established under § 150.5 is not a substitute for the Commission's independent

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[1068] Rutkowski at 1; *see also* AFR at 2 (stating concerns that proposed § 150.9 would be ineffective at controlling speculation due, in part, to the substantially increased flexibility of exchanges and market participants to determine whether positions qualify for bona fide hedge exemptions or to propose and institute new non-enumerated hedge exemptions, despite clear conflicts posed by exchanges' incentive to directly profit from trading volume); IECA at 2-3 and NEFI at 4 (stating that proposed § 150.9 would perpetuate a concern, raised by Congress in the Dodd-Frank Act, that exchanges may be motivated by profit to allow broad hedge exemptions that may include non-commercial market participants); Public Citizen at 2-3 (stating that proposed § 150.9 puts for-profit exchanges in the driver's seat of making decisions on granting exemptions, and that customer incentive programs offered by exchanges to increase trading volumes would undermine the exchanges' efforts to determine hedge exemptions; arguing that certain exchanges have experienced difficulty in "cooperating" with current laws and regulations, thus casting doubt on their ability to enforce the proposed rule; and arguing that no additional authority should be granted to CME pending resolution of *CFTC v. Byrnes*, Case. No. 13-cv-01174 (SDNY) (alleging a violation of internal firewalls and sales of confidential trading information to an outside broker). Regarding Public Citizen's comment on *CFTC v. Byrnes*, the Commission notes that this case has been resolved and is not a condition precedent to this Final Rule.

[1069] PMAA at 4; *see also* Better Markets at 63 (arguing that the standards for exchanges to grant non-enumerated bona fide hedge recognitions are too flexible and lack meaningful constraints).

[1070] PMAA at 4 (noting a concern that non-enumerated bona fide hedges would be granted outside of the notice and comment rulemaking process); IATP at 13-14; NEFI at 4.

review of, and determination with respect to, non-enumerated bona fide hedge applications submitted pursuant to § 150.9.

As described in detail below, under § 150.9 as adopted herein, exchanges that elect to review non-enumerated bona fide hedge applications under § 150.9 are required to establish and maintain standards and processes for such review, approved by the Commission pursuant to § 40.5. Section 150.9 requires, among other things, that the exchanges base their determinations on standards that conform to the Commission's own standards for recognizing bona fide hedges for purposes of Federal position limits. The Final Rule also requires an exchange to directly notify the Commission of any determinations to recognize a non-enumerated bona fide hedge for purposes of exchange-set limits, and, upon such notification, the Commission will make its determination as to such applications for purposes of Federal position limits. The Commission also reserves authority to, at a later date and after providing an opportunity to respond, revoke a non-enumerated bona fide hedge recognition that is approved through the § 150.9 process and require a participant to lower its position below the Federal position limit level within a commercially reasonable time if the Commission finds that the position no longer meets the bona fide hedge definition in § 150.1.

In response to general concerns that § 150.9 would create conflicts of interest for exchanges, the Commission does not believe that § 150.9 creates incentives for exchanges to grant non-enumerated bona fide hedge exemptions in order to boost trading volume and profits.[1071] On the contrary, the Commission believes there are several requirements and obligations that incentivize and require exchanges to implement § 150.9 in a manner that protects their markets.

[1071] *See generally supra* Sections II.B.2.iv.b. and II.G.2. (discussing studies that indicate that exchanges are incentivized to maintain market integrity).

First, under § 150.9, exchanges may only grant non-enumerated bona fide hedges that meet the Commission's bona fide hedging definition, and each non-enumerated bona fide hedge approved by an exchange for purposes of its own limits is separately and independently reviewed by the Commission for purposes of Federal position limits.

Next, under § 150.5(a)(2)(ii)(G) finalized herein, exchanges are required to consider whether approving a particular exemption request would result in positions that would not be in accord with sound commercial practices in the relevant commodity derivatives market and/or whether the position resulting from an approved exemption would exceed an amount that may be established and liquidated in an orderly fashion in that market.[1072]

Finally, under DCM Core Principle 5 and SEF Core Principle 6, exchanges are accountable for administering position limits in a manner that reduces the potential threat of market manipulation or congestion.[1073] The Commission believes that these requirements, working in concert, provide sufficient guardrails to mitigate any potential conflicts of interest for exchanges.

Further, the Commission does not agree that § 150.9 improperly delegates discretion to exchanges or erodes the Commission's authority over exchanges and the non-enumerated bona fide hedge recognition process because, as discussed above, the Commission is not delegating its decision-making authority with respect to the granting of bona fide hedge recognitions for purposes of Federal position limits. Rather, the Commission is allowing exchanges to offer traders the opportunity to submit their applications for a bona fide hedge recognition pursuant to a consolidated review process under which the Commission will conduct its own review and make an independent determination for purposes of Federal speculative position limits.

[1072] *See infra* Final Rule § 150.5(a)(2)(ii)(G).
[1073] *See* 17 CFR 37.600 and 38.300.

The Commission has thus determined to adopt § 150.9 largely as proposed, but with certain modifications and clarifications, as described further below, to address commenters' views and other considerations. The following discussions summarize each sub-section of proposed § 150.9, as well as comments received and the Commission's final determination with respect to each sub-section of § 150.9.

3. Section 150.9(a)—Approval of Exchange Rules Related to the Application Submission Process for Non-enumerated Bona Fide Hedging Transactions or Positions

i. Summary of 2020 NPRM - Approval of Rules

Proposed § 150.9(a) would require an exchange to have rules, adopted pursuant to the existing rule-approval process in § 40.5 of the Commission's regulations, that establish standards and processes in accordance with proposed § 150.9 as described below. The Commission would review such rules to ensure that the exchange's standards and processes for recognizing bona fide hedges for its own exchange-set limits conform to the Commission's standards and processes for recognizing bona fide hedges for Federal position limits.

ii. Comments - Approval of Exchange Rules Related to the Application Submission Process for Non-enumerated Bona Fide Hedging Transactions or Positions

Although the Commission did not receive comments directly about the requirements under proposed § 150.9(a), the Commission did receive comments related to when an exchange could start implementing § 150.9, which is contingent on the exchange having approved rules in place. That is, several commenters recommended a phased implementation for starting the § 150.9 process to avoid a concentration of non-enumerated bona fide hedge applications at one time.[1074] Commenters suggested starting the process either six months prior to the effective date or permitting phased compliance

[1074] *See* ICE at 9; IFUS at 7; CMC at 12; Shell at 4; FIA at 18; Chevron at 16; and CEWG at 27. *See also* CME Group at 8 (supporting a 12-month compliance date, but suggesting that the Commission work with exchanges to implement a rolling process where market participants are "grandfathered into current exchange approved exemptions they hold today, permitting them to file for those exemptions on the same annual schedule").

for six months after the effective date of the Final Rule.

iii. Discussion of Final Rule - Approval of Exchange Rules Related to the Application Submission Process for Non-enumerated Bona Fide Hedging Transactions or Positions

The Commission is finalizing § 150.9(a) with the clarifications and rewording changes described below. As explained in the Proposal, the Commission's pre-approval of an exchange's standards and process for review of non-enumerated bona fide hedge applications ensures that the exchange's determination is based on the Commission's applicable standards and process, allowing the Commission to leverage off exchange determinations in conducting the Commission's own, independent review.

While the Commission has determined, as described above, to extend the compliance period with respect to certain obligations under this Final Rule,[1075] exchanges may start, but are not required, to implement and begin processing non-enumerated bona fide hedge applications under § 150.9 as early as the Effective Date of the Final Rule.[1076] The Commission reminds exchanges that, to implement § 150.9, they will first need to submit new or amended rules to the Commission, pursuant to the existing rule-approval process in § 40.5 (which could take up to 45-90 days or longer, as agreed to by the exchange) before they exchanges can begin processing applications under § 150.9.

Finally, the Commission clarifies that market participants with existing Commission-granted non-enumerated or anticipatory bona fide hedge recognitions (other than risk management exemptions) are <u>not</u> required to reapply to the Commission for a new recognition under the Final Rule. That is, if the Commission previously issued a non-enumerated or anticipatory bona fide hedge recognition for one of the nine legacy agricultural contracts pursuant to existing § 1.47 or § 1.48, as applicable, a market

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[1075] *See supra* Section I.D. (discussing the effective and compliance dates for the Final Rule).
[1076] *Id.*

participant is not required, under the Final Rule, to reapply to the Commission for such recognition pursuant to final § 150.3 or § 150.9.

In addition, the Commission is making a technical change by rewording § 150.9(a) to clarify that exchanges must seek approval, using the Commission's rule approval process in existing § 40.5, to implement their rules establishing application processes under § 150.9.

4. Section 150.9(b) - Prerequisites for an Exchange to Recognize Non-enumerated Bona Fide Hedges in Accordance with this Section

i. Summary of 2020 NPRM - Prerequisites for an Exchange to Recognize Non-enumerated Bona Fide Hedges

Proposed § 150.9(b) set forth conditions that would require an exchange-recognized bona fide hedge to conform to the corresponding definitions and standards the Commission uses in proposed §§ 150.1 and 150.3 for purposes of the Federal position limits regime. Proposed § 150.9(b) would require the exchange to meet the following conditions: (i) the exchange lists the applicable referenced contract for trading; (ii) the position is consistent with both the definition of bona fide hedging transaction or position in proposed § 150.1 and existing CEA section 4a(c)(2); and (iii) the exchange does not recognize as bona fide hedges any positions that include commodity index contracts and one or more referenced contracts, including exemptions known as risk management exemptions.[1077]

ii. Comments and Summary of Commission Determination - Prerequisites for an Exchange to Recognize Non-enumerated Bona Fide Hedges

The Commission did not receive any comments on proposed § 150.9(b) and is finalizing this section as proposed, for reasons stated above with respect to § 150.9(b),

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[1077] The Commission finds that financial products are not substitutes for positions taken or to be taken in a physical marketing channel. Thus, the offset of financial risks arising from financial products would be inconsistent with the definition of bona fide hedging transactions or positions for physical commodities in proposed § 150.1. *See supra* Section II.A.1. (discussion of the temporary substitute test and risk-management exemptions).

and with only minor grammatical edits to change certain words to a singular tense.

5. Section 150.9(c) - Application Process

Proposed § 150.9(c) set forth the information and representations that the exchange, at a minimum, would be required to obtain from applicants as part of the § 150.9 application process. Proposed § 150.9(c) would permit exchanges to rely upon their existing application forms and processes in making such determinations, provided that they collect the information outlined below. The following sections summarize each sub-section of proposed § 150.9(c) as well as comments received and the Commission's determination on each sub-section.

i. Section 150.9(c)(1) - Required Information for Non-enumerated Bona Fide Hedging Positions

a. Summary of 2020 NPRM - Required Information for Non-enumerated Bona Fide Hedging Positions

With respect to bona fide hedging positions in referenced contracts, proposed § 150.9(c)(1) would require that any application include: (i) a description of the position in the commodity derivative contract for which the application is submitted (which would include the name of the underlying commodity and the position size); (ii) information to demonstrate why the position satisfies CEA section 4a(c)(2) and the definition of bona fide hedging transaction or position in proposed § 150.1, including "factual and legal analysis;" (iii) a statement concerning the maximum size of all gross positions in derivative contracts for which the application is submitted (in order to provide a view of the true footprint of the position in the market); (iv) information regarding the applicant's activity in the cash markets for the commodity underlying the position for which the application is submitted;[1078] and (v) any other information the exchange requires, in its discretion, to enable the exchange and the Commission to determine whether such

[1078] The Commission expects that exchanges would require applicants to provide cash-market data for at least the prior year.

position should be recognized as a bona fide hedge.[1079]

In the 2020 NPRM, the Commission noted that exchanges would not need to require the identification of a hedging need against a particular identified category, but that the requesting party must satisfy all applicable requirements in proposed § 150.9, including demonstrating with a factual and legal analysis that a position would fit within the bona fide hedge definition. The 2020 NPRM was not intended to require the hedging party's books and records to identify the particular type of hedge being applied.

b. Comments - Required Information for Non-enumerated Bona Fide Hedging Positions

The Commission received few comments related to the application requirements exchanges must implement under proposed § 150.9(c)(1). Some commenters requested that the Commission remove the requirement that the exchange applications implemented under proposed § 150.9(c)(1)(ii) require a "factual and legal analysis" from applicants.[1080] Another commenter requested that the Commission clarify any additional factors exchanges should consider when granting non-enumerated bona fide hedge applications pursuant to proposed § 150.9.[1081]

c. Discussion of Final Rule - Required Information for Non-enumerated Bona Fide Hedging Positions

The Commission is adopting § 150.9(c)(1), with certain revisions and clarifications, explained below. The information required to be submitted as part of the

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[1079] Under proposed § 150.9(c)(1)(iv) and (v), exchanges, in their discretion, could request additional information as necessary, including information for cash-market data similar to what is required in the Commission's existing Form 204. *See infra* Section II.H.2. (discussion of Form 204 and amendments to part 19). Exchanges could also request a description of any positions in other commodity derivative contracts in the same commodity underlying the commodity derivative contract for which the application is submitted. Other commodity derivatives contracts could include other futures contracts, option on futures contracts, and swaps (including OTC swaps) positions held by the applicant.

[1080] CME Group at 10 (noting its concern that this requirement could be interpreted as requiring applicants to engage legal counsel to complete their applications. CME Group stated that by way of background, CME Group exchanges have never required detailed legal or economic analysis to demonstrate compliance with regulatory requirements. Instead, CME Group requires the applicant to explain its strategy, and CME Group considers and analyzes this explanation using the exchange's expertise. CME Group recommends that the CFTC instead require an applicant to "explain its strategy and state that it complies with the regulatory requirements for a bona fide hedge exemption without having to provide a legal analysis." The exchange can solicit additional information from the applicant as needed.) and CMC at 11 (providing that, in the alternative, the Commission could clarify that exchanges or the Commission might request legal analyses at their discretion, which may be in the form of analysis provided by in-house counsel).

[1081] *See* ISDA at 9 (requesting that the final rule include factors exchanges should consider, such as "sound commercial practices" or "necessary and appropriate to reduce potential threat of market manipulation").

application is necessary to allow the exchange and the Commission to evaluate whether the applicant's hedging position satisfies the bona fide hedge definition in proposed § 150.1 and CEA section 4a(c)(2).

The Commission is making one modification to clarify the Commission's posture when reviewing non-enumerated bona fide hedge applications under the § 150.9 process. In proposed § 150.9(c)(1) the Commission proposed to require exchanges to collect sufficient information for the exchange to determine and the Commission to "verify" that the facts and circumstances demonstrate that the exchange may recognize a position as a bona fide hedge. In final § 150.9(c)(1), the Commission is revising this provision to make clear that the Commission will conduct an independent evaluation of any application it reviews to "determine" (not verify) whether the facts and circumstances demonstrate that the exchange may recognize the position as a bona fide hedge. Likewise, the Commission is also revising final § 150.9(c)(1)(v), to require that exchanges collect any other information they deem necessary to "determine" (not "verify" as proposed) whether a particular position meets the bona fide hedge definition. The term "determine" more accurately describes the exchange's responsibility to conduct an independent evaluation of each application, as opposed to a verification, as proposed.

In final § 150.9(c)(1)(ii), the Commission is modifying the requirement from proposed § 150.9(c)(1)(ii) that exchanges request a "factual and legal" analysis from applicants for non-enumerated bona fide hedge recognitions. In proposing this requirement, the Commission did not intend for exchanges to require that applicants engage legal counsel to complete their applications for non-enumerated bona fide hedge recognitions. Rather, the purpose of this proposed provision was to ensure that applicants provide an explanation and information that sufficiently demonstrates why a particular position qualifies as bona fide hedge, as defined in § 150.1 and CEA section 4a(c)(2). Instead of requiring a "factual and legal analysis," the Commission has revised §

150.9(c)(1)(ii) in the Final Rule accordingly so that an applicant must provide an explanation of the hedging strategy, including a statement that the applicant's position complies with the applicable requirements of the bona fide hedge definition, and information to demonstrate why the position satisfies the applicable requirements. This revision is intended to clarify that the applicant is not required to provide a detailed legal analysis or engage legal counsel to complete their application. Rather, the applicant must provide: (1) a simple explanation or description of the hedging strategy (and include a statement that the strategy complies with the bona fide hedge definition requirements); and (2) the relevant information that shows why or how the strategy meets the bona fide hedge definition requirements. The exchange can then consider this explanation and information in light of its expertise with the relevant market in performing its own analysis.

Also, under § 150.9(c)(1), regarding the request that the Commission provide additional factors that exchanges should consider when granting non-enumerated bona fide hedge recognitions, the Commission believes that the requirements under final § 150.9(c) provide sufficient criteria for exchanges to consider when evaluating applications. As stated in the 2020 NPRM, the Commission believes the information an exchange is required to collect under § 150.9(c) is sufficient for the exchange and the Commission to determine whether a particular transaction or position satisfies the definition of bona fide hedging transaction for purposes of Federal position limits. The Commission further highlights that, under final § 150.9(c)(1)(v), an exchange has the authority to collect any additional information that, in its discretion, would help it assess whether to approve a request for a non-enumerated bona fide hedge recognition. Further, in response to ISDA's request, an exchange is required by § 150.5(a)(2)(ii)(G) to consider some of the factors ISDA recommended when determining whether to grant an exemption, including whether the approval of an exemption would result in positions that

are in accord with sound commercial practices, among other considerations.[1082] In summary, the Commission believes that the final regulations strike the proper balance by providing sufficient guidance to the exchanges for their review and determination in the context of exchange-set limits, while preserving the exchanges' discretionary authority to determine what types of additional information, if any, to collect.

In addition to the revisions and explanations above, the Commission is adding the word "needed" to § 150.9(c)(1) to clarify that exchanges may collect all information needed to conduct their analysis of a particular application.

ii. Section 150.9(c)(2) - Timing of Non-enumerated Bona Fide Hedge Application

a. Summary of 2020 NPRM - Timing of Non-enumerated Bona Fide Hedge Application

The Commission did not propose to prescribe timelines (*e.g.*, a specified number of days) for exchanges to review applications because the Commission believed that exchanges are in the best position to determine how to best accommodate the needs of their market participants. Rather, under proposed § 150.9(c)(2), an applicant must submit its application in advance of exceeding the applicable Federal position limits for any given referenced contract.

However, the 2020 NPRM would permit a person to submit a bona fide hedge application within five days after the person has exceeded Federal speculative limits (commonly referred to as retroactive applications) if such person exceeds the limits due to "demonstrated sudden or unforeseen increases in its bona fide hedging needs." Where an applicant claims a sudden or unforeseen increase in its bona fide hedging needs, the 2020 NPRM would require exchanges to require that the person provide materials demonstrating that the person exceeded the Federal speculative limit due to sudden or

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[1082] *See supra* Section II.D.3. (addressing other factors exchanges must consider, under § 150.5(a)(2)(ii)(G), when granting exemptions for contracts that are subject to Federal position limits).

unforeseen circumstances. Further, in the 2020 NPRM, the Commission cautioned exchanges that applications submitted after a person has exceeded Federal position limits should not be habitual and would be reviewed closely. Finally, if the Commission found that the position did not qualify as a bona fide hedge, then the applicant would be required to bring its position into compliance, and could face a position limits violation if it did not reduce the position within a commercially reasonable time.

b. Comments - Timing of Non-enumerated Bona Fide Hedge Application

The Commission received several comments regarding the retroactive application provision in proposed § 150.9(c)(2)(ii). CME preferred allowing retroactive application exemptions that are not limited to circumstances involving sudden/unforeseen increases in bona fide hedging needs.[1083] Instead, CME Group recommended that the Commission (i) allow retroactive applications regardless of the circumstances, and (ii) impose a position limits violation upon an applicant if the exchange denies the retroactive application.[1084] ICE recommended that the Commission permit retroactive exemptions for other types of exemptions (including spread exemptions and pass-through-swap exemptions) as well as for position limit overages that occur as a result of operational or incidental issues where the applicant did not intend to evade position limits.[1085] Finally, IFUS supported the retroactive application provision as it was proposed.[1086] IFUS noted that it follows a similar approach under its existing rules.[1087]

c. Discussion of Final Rule - Timing of Non-enumerated Bona Fide Hedge Application

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[1083] CME Group at 9-10 (explaining that in its experience, position limit violations "often occur unintentionally due to operational or administrative oversight, not because the market participant needed to enter into a hedge quickly in response to changing market conditions" and that over the past three years, CME Group has received at least 49 retroactive exemption applications to address some type of administrative oversight issue); *See also* CMC at 11 (agreeing with CME Group), and FIA at 18 (recommending the Commission allow retroactive exemptions within five business days for any reason).

[1084] CME Group at 9-10 (explaining that without the threat of a potential position limits violation, market participants could exploit the retroactive provision and intentionally exceed position limits without consequences--"all while disrupting orderly market operations." According to CME Group, the prospect of having an application denied and being found in violation of position limits has worked to deter market participants from attempting to exploit the retroactive exemption process).

[1085] ICE at 10.

[1086] IFUS at 13-14.

[1087] *Id.*

The Commission is adopting § 150.9(c) largely as proposed, with certain modifications and clarifications to reflect commenters' views and other considerations.

First, the Commission is revising Final Rule § 150.9(c)(2)(i) so that it is consistent with changes the Commission is making to § 150.9(e)(3), discussed further below.[1088] As explained below, under Final Rule § 150.9(e)(3),[1089] applicants may elect (at their own risk)[1090] to exceed Federal position limits after an exchange notifies the Commission of the exchange's approval of the application for purposes of exchange-set limits,[1091] and during the Commission's 10-day review period. This is a change from the 2020 NPRM under which a person would be required to wait until the Commission's 10-day review period expired before exceeding Federal position limits. Proposed § 150.9(c)(2)(i) was drafted in a manner that reflects this proposed requirement. Accordingly, the Commission is revising § 150.9(c)(2)(i) to clarify that an applicant may exceed Federal position limits after receiving a notice of approval from the relevant designated contract market or swap execution facility.

Next, the Commission has determined not to expand the retroactive application provision in § 150.9(c)(2)(ii) to be available in any circumstances (*i.e.*, not just for sudden or unforeseen hedging needs) or for other exemption types. The Final Rule provides broad flexibility to market participants in the form of various exemptions from Federal position limits. In particular, this Final Rule significantly expands the list of self-effectuating enumerated bona fide hedges available to market participants,[1092] provides an expansive spread transaction exemption provision,[1093] and provides new exemptions for relief for financial distress positions and conditional spot month limits for certain

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[1088] *See infra* Section II.G.7. (discussing when a person may exceed Federal position limits).

[1089] *Id.*

[1090] *See infra* Section II.G.7.ii. (explaining that an applicant bears the risk that the Commission could deny the application and require the person to bring their position into compliance with Federal position limits).

[1091] The Commission clarifies, for the avoidance of doubt, that an exchange approval of a non-enumerated bona fide hedge (for purposes of exchange limits) issued under § 150.9 is not a Commission approval of the non-enumerated bona fide hedge.

[1092] *See supra* Section II.A.1. (discussing the expanded list of enumerated bona fide hedges in Appendix A).

[1093] *See supra* Section II.A.20. (discussing the expanded spread transaction definition in § 150.1).

natural gas positions.[1094] This Final Rule also grants additional flexibility for market participants to exceed Federal position limits during the pendency of the Commission's review of the application. Given these additional enhancements to the Federal position limits framework for bona fide hedges and other exemptions, the Commission expects that there will be a limited number of non-enumerated bona fide hedge requests submitted through the § 150.9 process and that it is reasonable to expect that market participants will be able to file any such non-enumerated bona fide hedge requests ahead of needing to exceed limits.

The Commission is willing to permit the limited exception for retroactive applications that occur due to sudden or unforeseen bona fide hedging needs, as described above. Otherwise, market participants would be penalized and prevented from assuming appropriate hedges even though their hedging need arises from circumstances beyond their control. Beyond that exception, the Commission believes that market participants are able, and should be required, to file timely applications. The Commission believes this is particularly true for trading strategies that are not enumerated bona fide hedges and thus may involve some element of non-risk reducing activity. Expanding the exception beyond bona fide hedging needs that arise due to sudden or unforeseen circumstances may dis-incentivize market participants from properly monitoring their hedging activities and filing exemption applications in a timely manner.

iii. Section 150.9(c)(3) - Renewal of Applications for Non-enumerated Bona Fide Hedges

a. Summary of 2020 NPRM - Renewal of Applications for Non-enumerated Bona Fide Hedges

Proposed § 150.9(c)(3) would require that the exchange require persons with

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[1094] *See supra* Section II.C.5-6. (discussing the financial distress exemption and the conditional spot month limit exemption in natural gas).

approved non-enumerated bona fide hedges that were previously granted pursuant to proposed § 150.9 to reapply to the exchange at least on an annual basis by updating their original applications. Proposed § 150.9(c)(3) would also require that the exchange require applicants to receive a notice of approval of the renewal from the exchange prior to exceeding the applicable position limit.

b. Comments – Renewal of Applications for Non-enumerated Bona Fide Hedges

Several commenters requested a clarification that an applicant (i) would only be subject to the Commission's 10/2-day review process in § 150.9(e) (described below) for initial applications for non-enumerated bona fide hedge recognitions, and (ii) would not be subject to such review for annual renewal applications, unless the facts and circumstances materially change from those presented in the initial application.[1095]

c. Discussion of Final Rule – Renewal of Applications for Non-enumerated Bona Fide Hedges

The Commission is adopting § 150.9(c)(3) with modifications to clarify that the Commission's review and determination conducted under final § 150.9(e) is required only for initial applications for non-enumerated bona fide hedge recognitions. The Commission is also clarifying that, except as provided below, renewals of previously-approved non-enumerated bona fide hedge applications are not required to be submitted to the Commission under § 150.9, and need only be submitted to and approved by the relevant exchange at least on an annual basis for the applicant to continue relying on such recognition for purposes of Federal position limits. Such renewal application serves the purpose of confirming that the facts and circumstances underlying the original application approved by the Commission remain operative. However, if the facts and circumstances underlying a renewal application are materially different than the initial

[1095] CEWG at 27; MGEX at 3; CME Group at 8; FIA at 17; ICE at 9; and IFUS at 7 (further requesting that if a non-enumerated bona fide hedge is granted, a participant should be able to treat similar positions as bona fide hedges so long as they re-apply to the exchange through the annual renewal process).

application, then such application should be treated as a new request that should be submitted through the § 150.9 process and subject to the Commission's 10/2-day review process in § 150.9(e).

iv. Section 150.9(c)(4) - Exchange Revocation Authority

a. Summary of the 2020 NPRM - Exchange Revocation Authority

Proposed § 150.9(c)(4) would require that an exchange retain its authority to limit, condition, or revoke, at any time, any recognition previously issued pursuant to proposed § 150.9, for any reason, including if the exchange determines that the recognition is no longer consistent with the bona fide hedge definition in proposed § 150.1 or section 4a(c)(2) of the Act.

b. Comments and Summary of the Commission Determination – Exchange Revocation Authority

The Commission did not receive comments on proposed § 150.9(c)(4) and is finalizing this section as proposed.

6. Section 150.9(d) - Recordkeeping

i. Summary of the 2020 NPRM – Recordkeeping

Proposed § 150.9(d) would require exchanges to maintain complete books and records of all activities relating to the processing and disposition of applications in a manner consistent with the Commission's existing general regulations regarding recordkeeping.[1096] Such records would need to include: all information and documents submitted by an applicant in connection with its application; records of oral and written communications between the exchange and the applicant in connection with the application; and information and documents in connection with the exchange's analysis of, and action on, such application. Exchanges would also be required to maintain any

[1096] Requirements regarding the keeping and inspection of all books and records required to be kept by the Act or the Commission's regulations are found at § 1.31. 17 CFR 1.31. DCMs are already required to maintain records of their business activities in accordance with the requirements of § 1.31 and § 38.951. 17 CFR 38.951.

documentation submitted by an applicant after the disposition of an application, including, for example, any reports or updates the applicant files with the exchange.

ii. Comments - Recordkeeping

The Commission received one comment regarding exchange recordkeeping requirements under proposed § 150.9. NGSA requested that any exchange recordkeeping/reporting requirements that apply to the proposed § 150.9 process do not require matching applicants' hedge positions to their underlying cash positions on a one-to-basis, but should instead allow for recordkeeping/reporting of positions on an aggregate basis.[1097]

iii. Discussion of Final Rule - Recordkeeping

The Commission is adopting § 150.9(d) as proposed, and with only one minor grammatical edit to change the term "designated contract market" to the correct possessive tense. The Commission also clarifies here, in response to comments, that the § 150.9(d) recordkeeping requirements do not prescribe the manner in which exchanges record how they match applicants' bona fide hedge positions to applicants' underlying cash positions. Rather, final § 150.9(c)(1)(iv) requires that an exchange collect the necessary information regarding an applicant's cash-market activity and offsetting cash positions, and final § 150.9(d) simply requires the exchange to keep a record of such application materials and information collected. However, an exchange's records should be sufficient to demonstrate that any approved non-enumerated bona fide hedges meet the requirements of § 150.9(b). The Commission also reiterates, as explained in the 2020 NPRM, that exchanges are required to store and produce records pursuant to existing § 1.31,[1098] and will be subject to requests for information pursuant to other applicable

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[1097] *See* NGSA at 9 (noting that allowing matching on an aggregate basis would accommodate the practical needs of many market participants to hedge their risks on a portfolio basis).

[1098] Consistent with existing § 1.31, the Commission expects that these records would be readily available during the first two years of the required five-year recordkeeping period for paper records, and readily accessible for the entire five-year recordkeeping period for electronic records. In addition, the Commission expects that records required to be maintained by an exchange pursuant to this section would be readily accessible during the pendency of any application, and for two years following any disposition that did not recognize a derivative position as a bona fide hedge.

Commission regulations, including, for example, existing § 38.5.[1099]

7. Section 150.9(e) - Process for a Person to Exceed Federal Position Limits

The following discussion summarizes proposed § 150.9(e), comments received, and the Commission's determination according to each sub-section, or a combination of certain subsections, of § 150.9(e).

i. Section 150.9(e)(1)-(2) - Notification to the Commission and Notification Requirements

a. Summary of the 2020 NPRM - Notification to the Commission and Notification Requirements

Under proposed § 150.9(e)(1), once an exchange recognizes a non-enumerated bona fide hedge with respect to its own exchange-set position limits established pursuant to § 150.5(a), the exchange would be required to notify the Commission concurrently with the approval notice it provides to the applicant. Under proposed § 150.9(e)(2), such notification to the Commission would need to include a copy of the application and any supporting materials, as well as certain basic information, outlined in § 150.9(e)(2)(i)-(vi), about the exemption. The exchange would only be required to provide this notice to the Commission with respect to its initial (and not renewal) determination for a particular application.

b. Comments - Notification to the Commission and Notification Requirements

While proposed § 150.9(e)(1) would require an exchange to notify the Commission upon making an initial determination to recognize a non-enumerated bona fide hedge, that rule would not require the exchange to notify the public of any such determination. Commenters submitted several general requests related to the publication of non-enumerated bona fide hedges and the future expansion of the list of enumerated

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[1099] *See* 17 CFR 38.5 (requiring, in general, that upon request by the Commission, a DCM must file responsive information with the Commission, such as information related to its business, or a written demonstration of the DCM's compliance with one or more core principles).

bona fide hedges in Appendix A to the proposed regulatory text in the 2020 NPRM. Specifically, certain commenters requested that exchanges be required to publicize approved non-enumerated bona fide hedge recognitions so that market participants are aware of the types of recognitions they can receive.[1100]

c. Discussion of Final Rule - Notification to the Commission and Notification Requirements

The Commission has determined to finalize § 150.9(e)(1)-(2) as proposed. While the Final Rule does not require exchanges to publicize approved non-enumerated bona fide hedge recognitions, an exchange may elect, in its discretion, to provide such a list. The Commission understands, however, that in the past, exchanges and market participants have raised concerns that publicizing information about approved non-enumerated bona fide hedges could divulge confidential information (such as trade secrets, intellectual property, the market participant's identity or position).[1101]

To the extent that an exchange elects to publicize descriptions of approved non-enumerated bona fide hedges, the Commission cautions that any such data published should not disclose the identity of, or confidential information about, the applicant. Rather, any published summaries are expected to be general (generic facts and circumstances). While the decision whether to publicize descriptions of approved non-enumerated bona fide hedges is at the discretion of the exchange, the exchange remains subject to all applicable laws and regulations (including exchange bylaws) governing the protection of confidential trade and trader information. The Commission also cautions exchanges to make clear that any descriptions or lists of approved non-enumerated bona fide hedges they elect to publish are for informational purposes only and do not bestow

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[1100] *See* COPE at 5 (noting that such notice should provide market participants the facts upon which the recognition is based, and would save the Commission from repeatedly processing requests for the same hedging strategy); FIA at 15, 19 (requesting that exchanges be required to publish anonymized descriptions of non-enumerated hedging recognitions granted by the exchange); EPSA at 5-7.

[1101] *See* 81 FR at 96824.

any rights upon applicants to a claim that a particular strategy is a non-enumerated bona fide hedge simply because it aligns with a published example or description provided by the exchange.

ii. Section 150.9(e)(3)-(4) - Exceeding Federal Speculative Position Limits and the Commission's 10/2-day Review Process

a. Summary of the 2020 NPRM - Exceeding Federal Speculative Position Limits and the Commission's 10/2-day Review Process

Under proposed § 150.9(e)(3), a person could exceed Federal position limits ten business days after the exchange notifies the Commission in accordance with proposed § 150.9(e)(2) that the exchange has approved the non-enumerated bona fide hedge application for purposes of exchange limits, provided that the Commission does not notify the exchange or applicant that the Commission has determined to stay or deny the application during its ten-day review.

Under proposed § 150.9(e)(4), if a person exceeds Federal position limits due to sudden or unforeseen bona fide hedging needs and then files a retroactive application pursuant to proposed § 150.9(c)(2)(ii), then such application would be deemed approved by the Commission two business days after the exchange issues the required notification, provided that the Commission does not notify the exchange or applicant that the Commission has determined to stay or deny the application during its two-day review.

Under the 2020 NPRM, once those ten (or two) business days have passed, the person could rely on the bona fide hedge recognition both for purposes of exchange-set and Federal position limits, with the certainty that the Commission (and not Commission staff) would only revoke that determination in the limited circumstances set forth in proposed § 150.9(f)(1) and (2) described further below.

b. Comments - Exceeding Federal Speculative Position Limits and the Commission's 10/2-day Review Process

The bulk of the comments the Commission received on proposed § 150.9 relate to the Commission's proposed ten-day or two-day period for reviewing a non-enumerated bona fide hedge application after an exchange has already approved the application for purposes of the exchange-set limits (as noted above,[1102] the 10/2-day review). In particular, the Commission received several comments on the sufficiency of the proposed review periods, including that the Commission's proposed 10/2-day review period is: (1) too long;[1103] (2) too short;[1104] and (3) just right.[1105]

In addition, several commenters suggested that the Commission permit applicants to exceed Federal position limits during the Commission's ten-day review period (which occurs after an exchange issues its approval with respect to exchange-set limits).[1106] Commenters also suggested that rather than the CFTC reviewing each non-enumerated bona fide hedge exemption application after each exchange determination, the CFTC should monitor exchanges at a higher level (such as through the rule enforcement review process).[1107]

c. Discussion of Final Rule - Exceeding Federal Speculative Position Limits and the Commission's 10/2-day Review Process

The Commission is adopting § 150.9(e)(3)-(4) with certain revisions and clarifications as discussed below.

First, regarding general comments on the length of the Commission's 10/2-day review periods, the Commission acknowledges commenters' concerns regarding whether

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[1102] *See supra* Section II.G.

[1103] ADM at 6 (suggesting a five/one business day review period); ICE at 9 (explaining that the 10-day review period would impose unnecessary burdens and delay and create uncertainty for market participants); IFUS at 14 (explaining that the 10-day review period potentially conflicts with the exchange's spot-month exemption review process, as contracts could expire before the review period ends, and noting that a two day review, although not ideal, is preferred); NGFA at 9 (suggesting a two-business-day review period).

[1104] IATP at 13-14 (contending that the 10/2-day review period would burden an under-resourced Commission); Better Markets at 3, 63 (asserting that, under proposed § 150.9, it is impossible for Commission staff to, within the prescribed amount of time: review and collect additional information on non-enumerated bona fide hedge applications; draft orders; receive the Chairman's approval for a seriatim process; and secure the necessary Commissioner votes).

[1105] CME Group at 7 (also agreeing that a timeline for exchanges' review of applications should not be prescribed).

[1106] ADM at 6; ICE at 9; IFUS at 7; CME Group at 7-8 (explaining that exchanges have "strong incentives to grant exemptions only after careful review" because they have statutory obligations to prevent manipulation); CMC at 12 (noting that it is currently unclear whether an applicant can enter into a position during the Commission's 10/2-day review).

[1107] ICE at 9; IFUS at 7 (questioning whether it is necessary for the Commission to routinely review each non-enumerated bona fide hedge application); CEWG at 26-27 (suggesting an annual exchange rule enforcement review process instead of the 10/2-day review).

the Commission will have enough time to review and act on non-enumerated bona fide hedge applications. However, the Commission will continue to develop internal processes and systems to respond to § 150.9 applications as needed and within those timeframes. In addition, the § 150.9 process enables the Commission to leverage the exchange's review and analysis, which would serve to inform the Commission's own review. The Commission believes that this streamlined approach will reduce the amount of time required for the Commission's review each application.

In addition, regarding comments suggesting that the 10/2-day review periods are too long and will impose unnecessary delays on market participants, and the request that market participants be able to exceed Federal position limits during the Commission's 10-day review, the Commission is revising proposed § 150.9(e)(3) to provided additional flexibility. Under § 150.9(e)(3), applicants may elect to exceed Federal position limits once they receive a notice of approval from the relevant exchange and during the Commission's 10-day review period, but will do so at their own risk.

That is, if an applicant exceeds Federal position limits before the Commission's 10-day review period ends, the applicant bears market risk for that position, in that the Commission could, in accordance with § 150.9(e)(6) described below, deny the application for purposes of Federal position limits and require the applicant to bring its position back into compliance with the Federal position limits within a commercially reasonable amount of time, as determined by the Commission in consultation with the relevant exchange and applicant. As discussed below in connection with § 150.9(e)(6), in these circumstances where an applicant is required to lower its position, as a matter of policy, the Commission will not pursue an enforcement action against the applicant so long as the application was filed in good faith (meaning the applicant and exchange have a reasonable and good faith basis for determining that the position meets the requirements

of § 150.9(b)) and the applicant brings its position into compliance within a commercially reasonable amount of time.

Further, regarding general comments that the length of the 10/2-day review period is too long, the Commission believes allowing applicants to exceed Federal position limits during the Commission's ten-day review period addresses many commenter concerns. As described above, the Final Rule also affords applicants the ability to file retroactive applications in certain limited circumstances, and to hold positions above Federal position limits during the Commission's two-day review of such retroactive application. The Commission believes that these avenues adequately accommodate market participants' needs to hedge in a timely manner, and are well-balanced with the Commission's need to maintain adequate oversight of non-enumerated bona fide hedge applications through its limited 10/2-day review periods.

Furthermore, the Commission would consider it to be a reasonable and helpful practice if exchanges elect to provide information to the Commission on non-enumerated bona fide hedge applications as the exchange is considering such applications. That is, the Commission would find it helpful to receive an advance courtesy copy of any § 150.9 applications the exchange receives. The exchange is not, however, required to provide such advance copies, and would not be required to obtain an opinion on such applications from the Commission before making its determination. Rather, providing such application information as the exchange receives it could facilitate a more rapid Commission evaluation of § 150.9 applications. This would help facilitate additional regulatory certainty for market participants and would aid the Commission in its review of applications processed under § 150.9.

Also, while commenters requested that the Commission should not review each non-enumerated bona fide hedge application, the Commission is of the view that it must review each application in order to conform to the legal limits on what an agency may

delegate to persons outside the agency.[1108] Under the new model finalized herein, the Commission will be informed by the exchanges' determinations to make the Commission's own determination for purposes of Federal position limits before the 10/2-day review period expires. Accordingly, the Commission will retain its decision-making authority with respect to the Federal position limits and provide legal certainty to market participants of their determinations.

Finally, in § 150.9(e)(3) and (4), the Commission is making one technical correction to clarify that a person may exceed Federal position limits or rely on an approved retroactive application after the 10/2-day review period, as applicable, unless the Commission notifies the person and relevant exchange that it has determined to stay or deny the application, pursuant to § 150.9(e)(5) or (e)(6). In the 2020 NPRM, the Commission only referred to its stay authority in § 150.9(e)(5), discussed in detail below. However, as clarified in the Final Rule, the Commission could also notify the applicant and exchange of its determination to deny the application for purposes of Federal position limits under § 150.9(e)(6), also discussed below. This change is a technical correction and does not change the substance of § 150.9(e)(3) or (4).

iii. Section 150.9(e)(5) - Commission Stay of Pending Applications and Requests for Additional Information

a. Summary of the 2020 NPRM - Commission Stay of Pending Applications and Requests for Additional Information

Under proposed § 150.9(e)(5), the Commission could stay a non-enumerated bona fide hedge application that an exchange has approved, pursuant to § 150.9(e)(2), for purposes of exchange-set limits. Under the 2020 NPRM, if, during the ten (or two)

[1108] In *U.S. Telecom Ass'n v. FCC*, the D.C. Circuit held ''that, while Federal agency officials may sub-delegate their decision-making authority to subordinates absent evidence of contrary congressional intent, they may not sub-delegate to outside entities—private or sovereign—absent affirmative evidence of authority to do so.'' *U.S. Telecom Ass'n v. FCC*, 359 F.3d 554, 565–68 (D.C. Cir. 2004) (citations omitted). Nevertheless, there are three circumstances that the agency may ''delegate'' its authority to an outside party because they do not involve sub-delegation of decision-making authority: (1) Establishing a reasonable condition for granting Federal approval; (2) fact gathering; and (3) advice giving. *Id*. at 568.

business day timeframe in § 150.9(e)(3) or (4), the Commission notifies the exchange and applicant that the Commission (and not staff) has determined to stay the application, the applicant would not be able to rely on the exchange's approval of the application for purposes of exceeding Federal position limits, unless the Commission approves the application after further review. The proposed stay provision did not include a time limitation on the duration of a Commission stay.

Separately, under proposed § 150.9(e)(5), the Commission (or Commission staff) could request additional information from the exchange or applicant in order to evaluate the application, and the exchange and applicant would have an opportunity to provide the Commission with any supplemental information requested to continue the application process. Any such request for additional information by the Commission (or staff), however, would not stay or toll the ten (or two) business day application review period.

b. Comments - Commission Stay of Pending Applications and Requests for Additional Information

With respect to instances where the Commission has stayed an exchange-granted non-enumerated bona fide hedge application or elects to review a previously approved-application, several commenters requested that the Commission limit the duration of its review period, which was unlimited in the 2020 NPRM.[1109]

c. Discussion of Final Rule - Commission Stay of Pending Applications and Requests for Additional Information

The Commission has determined to finalize § 150.9(e)(5) with certain modifications and clarifications in response to commenters and other considerations.

In response to commenters' requests, the Commission is modifying its stay authority under proposed § 150.9(e)(5). Under the Final Rule, any Commission stay

[1109] ICE at 9; FIA at 18; CME Group at 7 (suggesting that the Commission's stay or review of an application should not exceed 30 calendar days); IFUS at 15 (noting that any Commission stay will almost certainly conflict with IFUS procedures for reviewing exemptions in the spot month, where certain exemptions may be in effect for less than 10 days).

issued pursuant to § 150.9(e)(5) will be limited to 45 days. The Commission has a long history of conducting other extensive regulatory reviews within a 45-day period.[1110] The Commission has found that this timeframe provides sufficient time for the Commission to conduct an adequate review while also providing certainty to market participants that the review will not be indefinite.

The Commission is also clarifying in final § 150.9(e)(5) that if the Commission stays a pending application where the applicant has not yet exceeded Federal position limits, then the applicant may not exceed Federal position limits until the Commission issues a final determination. Further, if the Commission stays a pending application and the applicant has already exceeded Federal position limits (either during the Commission's 10-day review period or as part of a retroactive application), then the applicant may continue to maintain its position unless the Commission notifies the designated contract market or swap execution facility and the applicant otherwise, pursuant to § 150.9(e)(6).

In addition to the changes above, the Commission is making several technical edits to improve readability, none of which impact the substance of the section.

iv. Section 150.9(e)(6) - Commission Determination for Applications During the 10/2-day Review

The following discussion addresses § 150.9(e)(6), which deals with any Commission determinations that are issued for pending applications and during the Commission's 10/2-day review.

a. Summary of the 2020 NPRM - Commission Determination for Applications During the 10/2-day Review

Under proposed § 150.9(e)(6), if the Commission determined that an application does not meet the conditions set forth in proposed § 150.9(b), the Commission would

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[1110] *See* 17 CFR 40.3 and 40.5 (providing the Commission's 45-day review period for new product and rule approval applications).

notify the exchange and the applicant and provide an opportunity for the applicant to respond. After doing so, the Commission could, in its discretion, deny the application for purposes of Federal position limits, and require the person to reduce the position within a commercially reasonable amount of time, as determined by the Commission in consultation with the applicant and the exchange.

In such a case, the applicant would not be subject to any finding of a position limits violation during the Commission's review of a pending application or after the Commission makes its determination. A person would also not be subject to a violation if they already exceeded Federal position limits and filed a retroactive application, and the Commission then determined that the bona fide hedge is not approved for purposes of Federal position limits. In either case, the 2020 NPRM provided that the Commission would not find that the person had committed a position limits violation so long as the person brings the position into compliance within a commercially reasonable time.

b. Comments - Commission Determination for Applications During the 10/2-day Review

Commenters requested that the Commission allow traders sufficient time to exit a position if the Commission denies an exchange-approved non-enumerated bona fide hedge application before the end of the 10/2-day review period.[1111]

c. Discussion of Final Rule - Commission Determination for Applications During the 10/2-day Review

The Commission has determined to finalize § 150.9(e)(6) with certain modifications and clarifications in response to commenters and other considerations.

First, for the avoidance of doubt and in response to comments, the Commission clarifies and reiterates how it will handle any determination to deny an application under

[1111] CMC at 12 (requesting a commercially reasonably amount of time to exit positions); ADM at 6 (requesting, in addition, that the Commission consult exchanges on what is a commercially reasonable amount of time for an applicant to exit a position); CME Group at 7-8.

final § 150.9(e)(6). Generally, if the Commission denies an application under § 150.9(e)(6), and the applicant consequently is required to reduce its position below the applicable Federal position limit, the Commission will allow the applicant a commercially reasonable amount of time to do so. The Commission will determine the commercially reasonable amount of time in consultation with the relevant exchange and the applicant. The Commission intends for the applicant and the relevant exchange to have input regarding what amount of time is sufficient.

Further, the Commission is clarifying for final § 150.9(e)(6) that it expects all applicants to submit their applications in good faith. As part of that good faith submission, the Commission expects each applicant will have a reasonable basis for determining that the purported non-enumerated bona fide hedge meets the requirements of § 150.9(b). Accordingly, the Commission is revising § 150.9(e)(6) to clarify that the Commission will not pursue an enforcement action for a position limits violation for the applicant holding the position if the applicant exceeds Federal position limits during the 10/2-day review and the Commission subsequently determines to deny the application, so long as: (1) the application was submitted to the exchange pursuant to § 150.9 in good faith, and (2) if required, the applicant reduces its positions within a commercially reasonable amount of time.

In addition, the Commission is making several non-substantive clarifications to final § 150.9(e)(6). The Commission is clarifying that this section deals with any Commission determination issued for pending applications during the 10/2-day review period (as opposed to Commission determinations issued under § 150.9(f) after the 10/2-day review period). The Commission is also adding language to clarify that the Commission must notify the applicant and relevant exchange of any determination within the 10/2-day review period. In addition, the Commission is adding language to clarify that § 150.9(e)(6) is not limited to Commission denials of applications; rather, the

Commission could also determine to issue an approval with certain conditions or limitations that may be different from the approval issued by the exchange for purposes of exchange-set limits. Finally, the Commission is making various non-substantive technical and organizational changes to make the section more readable.

v. Section 150.9(e) – Recognition of Additional Enumerated Bona Fide Hedges

a. Summary of the 2020 NPRM – Recognition of Additional Enumerated Bona Fide Hedges

Proposed Appendix A to the Final Rule identified each of the enumerated bona fide hedges, and under the 2020 NPRM, the Commission's recognition of a non-enumerated bona fide hedge, pursuant to § 150.3 or § 150.9, would not add new bona fide hedges to the list of enumerated bona fide hedges in Appendix A.

b. Comments – Recognition of Additional Enumerated Bona Fide Hedges

Commenters requested that the Commission codify a path to move commonly granted non-enumerated bona fide hedge recognitions to the list of enumerated bona fide hedge recognitions in Appendix A.[1112]

c. Discussion of Final Rule – Recognition of Additional Enumerated Bona Fide Hedges

The Commission has determined to finalize the approach as proposed.

Regarding a path forward for the Commission to expand the list of enumerated bona fide hedges to include certain non-enumerated bona fide hedges that are commonly granted, the Commission notes that it has an existing rulemaking process (which requires public notice and comment) to accomplish this. The Commission also clarifies, for the avoidance of doubt, that it remains open to expanding the list of enumerated hedges, as appropriate, but that the Commission would be required to do so under its existing

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[1112] *See* MGEX at 4; EPSA at 5-7; COPE at 5; FIA at 19 (noting that the process should be subject to the notice and comment rulemaking process); ICE at 10; and IFUS at 7 (requesting that such process also require Commission staff to provide an annual report to the Commission recommending non-enumerated bona fide hedges that should be enumerated).

rulemaking process subject to public notice and comment. Market participants are welcome to request that the Commission take up future rulemakings to amend the list of enumerated bona fide hedges.[1113]

8. Section 150.9(f) – Commission Revocation of an Approved Application

i. Summary of 2020 NPRM - Commission Revocation of an Approved Application

Proposed § 150.9(f) set forth the limited circumstances under which the Commission would revoke a previously-approved non-enumerated bona fide hedge recognition granted pursuant to proposed § 150.9. First, under proposed § 150.9(f)(1), if an exchange limits, conditions, or revokes its recognition of a non-enumerated bona fide hedge that was previously approved under § 150.9, then such bona fide hedge would also be deemed limited, conditioned, or revoked for purposes of Federal position limits.

Next, under proposed § 150.9(f)(2), if the Commission determines that an application that has been approved or deemed approved by the Commission is no longer consistent with the applicable sections of the Act and the Commission's regulations, the Commission could revoke the non-enumerated bona fide hedge recognition and/or require the person to reduce its position within a commercially reasonable time, or otherwise come into compliance.

Under proposed § 150.9(f)(2), if the Commission makes such determination, it would need to first notify the person holding the position and provide them with an opportunity to respond. The Commission would also provide a notification briefly explaining the nature of the issues raised and the regulatory provision with which the position is inconsistent. If the Commission requires the person to reduce the position, the Commission would allow the person a commercially reasonable amount of time to do so, as determined by the Commission in consultation with the applicable exchange and

[1113] Market participants may petition the Commission to expand the list of enumerated bona fide hedges under existing § 13.1, which provides that any "person may file a petition with . . . the Commission . . . for the issuance, amendment or repeal of a rule of general application."

applicant. Finally, under the 2020 NPRM, the Commission would not find that the person has committed a position limit violation so long as the person comes into compliance within the commercially reasonable time.

ii. Comments - Commission Revocation of an Approved Application

Commenters' views on proposed § 150.9(f) tended to overlap with their views on the Commission's determination authority under § 150.9(e)(6) (discussed above). In particular, commenters requested that the Commission allow traders sufficient time to exit a position if the Commission revokes a previously approved non-enumerated bona fide hedge recognition.[1114] Commenters also requested that the Commission further clarify that an applicant will not be penalized for relying on an approved non-enumerated bona fide hedge recognition if the Commission later revokes such approval after the 10/2-day review period.[1115]

iii. Discussion of Final Rule - Commission Revocation of an Approved Application

The Commission has determined to finalize § 150.9(f) with certain modifications and clarifications in response to commenters and other considerations.

First, under the Final Rule, if the Commission limits, conditions, or revokes a previously approved non-enumerated bona fide hedge recognition under § 150.9(f)(2), and the applicant consequently is required to reduce its position below the applicable Federal position limit, the Commission will allow the applicant a commercially reasonable amount of time to do so. The Commission will determine the commercially reasonable amount of time in consultation with the relevant exchange and the applicant. The Commission intends for the applicant and the relevant exchange to have input regarding what amount of time is sufficient.

Further, if the Commission limits, conditions, or revokes a previously approved

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[1114] CMC at 12 (requesting a commercially reasonable amount of time to exit positions); ADM at 6 (requesting, in addition, that the Commission consult exchanges on what is a commercially reasonably amount of time for an applicant to exit a position).

[1115] CMC at 12; ADM at 6.

non-enumerated bona fide hedge recognition under § 150.9(f)(2), the Commission will not pursue an enforcement action for a position limits violation for the person holding the position in excess of Federal position limits so long as the person: (1) submitted its application pursuant to § 150.9 in good faith,[1116] and (2) if required, reduces the position within a commercially reasonable amount of time as determined by the Commission in consultation with the person and the relevant exchange.

The Commission is revising the title of final § 150.9(f) to clarify that this section is limited to revocations of non-enumerated bona fide hedges previously approved by the Commission. The Commission is also adding language to final § 150.9(f)(2)(i) (consistent with language in § 150.9(f)(1)) to clarify that, in addition to revoking a previously-granted non-enumerated bona fide hedge recognition, the Commission could alternatively determine to limit or condition a previously-granted recognition. The Commission believes that there could be circumstances where it would not need to completely revoke a previously-granted recognition, but instead may determine a less drastic measure is more appropriate to enable a market participant to achieve compliance with the applicable requirements. Finally, the Commission is revising § 150.9(f)(2)(iii) to include the same language that it added to § 150.9(e)(6) to explicitly make clear an underlying premise that the Commission will not pursue Federal position limits violations so long as any applications are filed in good faith. Finally, the Commission is making a number of technical and grammatical corrections in § 150.9(f) that are not substantive revisions.

In addition to the clarifications and modifications above, the Commission would like to reiterate the following explanations and guidance from the 2020 NPRM. The Commission expects for persons to be able to rely on non-enumerated bona fide hedge

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[1116] *See supra* Section II.G.7. (providing additional discussion of the premise that a person submit their § 150.9 application in good faith).

recognitions granted pursuant to § 150.9 with the certainty that the final determination would only be limited, conditioned, or revoked in very limited circumstances. The Commission expects that it (and not Commission staff) would only exercise such authority under rare circumstances where the disposition of an application has resulted, or is likely to result, in price anomalies, threatened manipulation, actual manipulation, market disruptions, or disorderly markets. The Commission also expects that any action compelling a market participant to reduce its position pursuant to § 150.9(f)(2) would be a rare Commission action, and such action is not delegated to Commission staff. In determining requirements for a person to reduce a position, the Commission may consult the person and relevant exchange, and may also consider factors such as current market conditions and the protection of price discovery in the market. Finally, for the avoidance of doubt, the Commission expects that its exercise of its authorities under § 150.9(f)(2) would not be subject to the requirements of CEA section 8a(9), that is, the Commission would not be compelled to find that a CEA section 8a(9) emergency condition exists prior to requiring that a market participant reduce certain positions.

9. Section 150.9(g)—Delegation of Authority to the Director of the Division of Market Oversight

i. Summary of the 2020 NPRM - Delegation of Authority to the Director of the Division of Market Oversight

The Commission proposed to delegate certain of its authorities under proposed § 150.9 to the Director of the Commission's Division of Market Oversight, or such other employee(s) that the Director may designate from time to time. Proposed § 150.9(g)(1) would delegate the Commission's authority, in § 150.9(e)(5), to request additional information from the exchange and applicant.

The Commission did not propose, however, to delegate its authority, in proposed § 150.9(e)(5) and (6) to stay or deny a non-enumerated bona fide hedge application. The

Commission also did not delegate its authority in proposed § 150.9(f)(2) to revoke a non-enumerated bona fide hedge recognition granted pursuant to § 150.9, or to require an applicant to reduce its positions or otherwise come into compliance. The Commission stated that if an exchange's disposition of an application raises concerns regarding consistency with the CEA, presents novel or complex issues, or requires remediation, then the Commission (and not Commission staff) would make the final determination, after taking into consideration any supplemental information provided by the exchange or the applicant.

As with all authorities delegated by the Commission to staff, under the 2020 NPRM, the Commission would maintain the authority to consider any matter which has been delegated. The Commission stated in the 2020 NPRM that it intended to closely monitor staff administration of the proposed processes for granting non-enumerated bona fide hedge recognitions.

ii. Comments and Summary of the Commission Determination - Delegation of Authority to the Director of the Division of Market Oversight

The Commission did not receive comments on proposed § 150.9(g). The Commission is finalizing § 150.9(g) with one revision to reorganize certain text to improve readability. This update is not intended to change the substance of this section.

H. Part 19 and Related Provisions—Reporting of Cash-Market Positions

1. Background

Key reports currently used for purposes of monitoring compliance with Federal position limits include Form 204[1117] and Parts I and II of Form 304,[1118] known collectively as the "series '04" reports. Under existing § 19.01, market participants that

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[1117] *CFTC Form 204: Statement of Cash Positions in Grains, Soybeans, Soybean Oil, and Soybean Meal*, available at https://www.cftc.gov/sites/default/files/idc/groups/public/@forms/documents/file/cftcform204.pdf (existing Form 204).

[1118] *CFTC Form 304: Statement of Cash Positions in Cotton*, available at http://www.cftc.gov/ucm/groups/public/@forms/documents/file/cftcform304.pdf (existing Form 304). Parts I and II of Form 304 address fixed-price cash positions used to justify cotton positions in excess of Federal position limits. As described below, Part III of Form 304 addresses unfixed-price cotton "on-call" information, which is not used to justify cotton positions in excess of limits, but rather to allow the Commission to prepare its weekly cotton on-call report.

hold bona fide hedging positions in excess of limits for the nine legacy agricultural contracts currently subject to Federal position limits must justify such overages by filing the applicable report each month: Form 304 for cotton, and Form 204 for the other commodities.[1119] These reports are: generally filed after exceeding the Federal position limit; show a snapshot of such trader's cash positions on one given day each month; and are used by the Commission to determine whether a trader has sufficient cash positions to justify futures and options on futures positions above the speculative limits.

The existing series '04 reports are both duplicative of, and inconsistent with, the processes market participants use to report cash-market information to the exchanges. When granting exemptions from their own limits, exchanges do not use a monthly cash-market reporting framework akin to the '04 reports. Instead, exchanges generally require market participants who wish to exceed exchange-set limits, including for bona fide hedging positions, to submit an annual exemption application form in advance of exceeding the limits.[1120] Such applications are typically updated annually and generally include a month-by-month breakdown of cash-market positions for the previous year supporting any position-limits overages during that period.[1121]

2. Elimination of Form 204 and Cash-Reporting Elements of Form 304

i. Summary of the 2020 NPRM - Elimination of Form 204 and Cash-Reporting Elements of Form 304

The Commission proposed to eliminate existing Form 204. The Commission also proposed to eliminate Parts I and II of existing Form 304, which request information on cash-market positions for cotton akin to the information requested in Form 204.[1122] As discussed in the 2020 NPRM, the Commission believed that eliminating these forms

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[1119] 17 CFR 19.01.

[1120] *See, e.g.,* ICE Rule 6.29 and CME Rule 559.

[1121] For certain physically-delivered agricultural contracts, some exchanges may require that spot month exemption applications be renewed several times a year for each spot month, rather than annually.

[1122] Part III of Form 304, which addresses cotton-on-call, is discussed below.

would reduce duplicative reporting requirements for market participants without hindering the Commission's ability to access cash-market information, which the exchanges would be required to collect and provide to the Commission under proposed §§ 150.3, 150.5, and 150.9.[1123]

For a market participant accustomed to filing series '04 reports the 2020 NPRM would result in a slight change in practice. Under the 2020 NPRM, such participant's bona fide hedge recognitions could still be self-effectuating for purposes of Federal position limits, provided that the market participant also separately applies for a bona fide hedge exemption from exchange-set limits established pursuant to proposed § 150.5(a), discussed above, and provided further that the participant submits the requisite cash-market information to the exchange as required by proposed § 150.5(a)(2)(ii)(A).

ii. Summary of the Commission Determination - Elimination of Form 204 and Cash-Reporting Elements of Form 304

The Commission has carefully considered the comments received and is eliminating existing Form 204 and Parts I and II of existing Form 304 as proposed.

iii. Comments - Elimination of Form 204 and Cash-Reporting Elements of Form 304

Numerous commenters supported the elimination of the Form 204 and Parts I and II of the Form 304.[1124] In particular, several commenters supported the proposed streamlined process that eliminates duplicative reporting requirements to both the Commission and the exchanges.[1125] ISDA additionally recommended that the Commission rely on its special call authority and relevant exchange authority to request additional information on an as-need basis.[1126]

[1123] 78 FR at 11694, 11655-11656.

[1124] *See*, *e.g.*, ACSA at 3; AMCOT at 2-3; ACA at 3; Canale Cotton at 3; Cargill at 9-10; CCI at 2; CEWG at 4; Chevron at 3; CHS at 2, 6; CMC at 12; COPE at 3-4; DECA at 2; East Cotton at 3; Ecom at 1; EEI at 7; EPSA at 7; FIA at 3; IMC at 3; ISDA at 9-10; Jess Smith at 3; LDC at 2; Mallory Alexander at 2; McMeekin at 2-3; Memtex at 2-3; Moody Compress at 2; Namoi at 1; NCFC at 2; Olam at 3; Omnicotton at 2-3; Parkdale at 2; SEMI at 3; Shell at 4; SCA at 3; SW Ag at 2-3; Texas Cotton at 2-3; Toyo at 2-3; Walcot at 3; WCSA at 3; White Gold at 2-3.

[1125] *See*, *e.g.*, Cargill at 9-10; CCI at 2; CEWG at 4; COPE at 3-4; ISDA at 10.

[1126] ISDA at 10.

Three commenters opposed the elimination of the series '04 reports. In particular, AFR and Rutkowski expressed concern that eliminating Form 204 will delegate position limit oversight and enforcement responsibilities to the exchanges.[1127] These commenters contended that the exchanges are financially disincentivized from imposing limits on speculation because the exchanges profit from trading volume.[1128] Similarly, Better Markets also opposed the elimination of the series '04 reports, contending that Federal law provides more substantial deterrents for misreporting information on a form provided to Federal agencies such as the Commission.[1129]

Better Markets also commented that the reporting changes would increase the industry's overall reporting burdens because market participants would have to report information to multiple exchanges.[1130] Better Markets suggested that the Commission should instead "ensure that all cash positions reporting is automated" and "amenable to aggregation" in order to provide such information to the exchanges.[1131]

iv. Discussion of Final Rule - Elimination of Form 204 and Cash-Reporting Elements of Form 304

The Commission is eliminating Form 204 and Sections I and II of existing Form 304, as proposed. For the reasons described below and as discussed in the 2020 NPRM, the Commission believes that the elimination of these forms will reduce duplication and inefficiency resulting from market participants submitting cash-market information to both the Commission and the exchanges under the existing framework.[1132] As described below, under the approach adopted herein, the Commission will receive any necessary information related to market participants' recognized bona fide hedges by leveraging

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[1127] AFR at 2-3; Rutkowski at 2.
[1128] *Id.*
[1129] Better Markets at 59-60.
[1130] *Id*. at 59.
[1131] *Id*. at 60.
[1132] 85 FR at 11694.

existing expertise and processes at the exchanges, as well as information that market participants will be required to submit to exchanges under the Final Rule.

The Commission finds comments that the elimination of the series '04 reports would require the Commission to delegate authority to the exchanges to be misplaced for several reasons. First, by eliminating the series '04 reports, the Commission is not delegating any oversight or enforcement responsibilities to the exchanges. The CEA establishes the statutory framework under which the Commission operates.[1133] Even without the series '04 reports, the Commission will continue to administer the CEA to monitor and protect the derivatives markets, market users, and the public from fraud, manipulation, and other abusive practices that are prohibited by the CEA and Commission regulations. The Commission will continue to do so through its market surveillance program,[1134] rule enforcement reviews,[1135] and other regulatory tools. The Commission will also continue to investigate and prosecute persons who violate the CEA and Commission regulations in connection with derivatives trading on exchanges and related conduct in cash-market commodities.[1136]

Second, the elimination of Form 204 and the cash-market reporting portions of Form 304 will not hinder the Commission's access to the cash-market information needed for the Commission to effectuate its oversight and enforcement responsibilities. Instead, the Commission is ensuring that it will continue to have access to sufficient cash-market information by adopting several reporting and recordkeeping requirements in final

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[1133] *See* 7 U.S.C. 2(a)(1).

[1134] *CFTC Market Surveillance Program*, U.S. Commodity Futures Trading Commission website, available at https://www.cftc.gov/IndustryOversight/MarketSurveillance/CFTCMarketSurveillanceProgram/index.htm#P5_912. The Commission's Market Surveillance Program is responsible for collecting market data and position information from registrants and large traders, and for monitoring the daily activities of large traders, key price relationships, and relevant supply and demand factors in a continuous review for potential market problems. *Id*.

[1135] The Commission conducts regular rule enforcement reviews of each exchange's audit trail, trade practice surveillance, disciplinary, and dispute resolution programs for ongoing compliance with the Core Principles. *See Rule Enforcement Reviews of Designated Contract Markets*, U.S. Commodity Futures Trading Commission website, available at https://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/dcmruleenf.html.

[1136] *Enforcement*, U.S. Commodity Futures Trading Commission website, available at https://www.cftc.gov/LawRegulation/Enforcement/ OfficeofDirectorEnforcement.html.

§§ 150.3, 150.5, and 150.9.[1137] In particular, under § 150.5, an exchange will be required to collect applications, which must be updated at least on an annual basis, for purposes of granting bona fide hedge recognitions from exchange-set limits for contracts subject to Federal position limits,[1138] and for recognizing bona fide hedging positions for purposes of Federal position limits.[1139] Among other things, each application will be required to include: (1) information regarding the applicant's activity in the cash markets for the underlying commodity; and (2) any other information to enable the exchange and the Commission to determine whether the exchange may recognize such position as a bona fide hedge.[1140] Additionally, consistent with existing industry practice for certain exchanges, exchanges will be required to file monthly reports to the Commission showing, among other things, for all bona fide hedges (whether enumerated or non-enumerated), a concise summary of the applicant's activity in the cash markets.[1141]

Collectively, final §§ 150.5 and 150.9 will provide the Commission with the same substantive information from monthly reports about all recognitions granted for purposes of contracts subject to Federal position limits, including cash-market information supporting the applications, and annual information regarding all month-by-month cash-market positions used to support a bona fide hedging recognition. These reports will help the Commission determine whether any person who claims a bona fide hedging position can demonstrate satisfaction of the relevant requirements. This information will also help the Commission perform market surveillance in order to detect and deter manipulation and abusive trading practices in physical commodity markets.

[1137] As discussed earlier in this Final Rule, Final § 150.9 also includes reporting and recordkeeping requirements pertaining to spread exemptions. Those requirements will not be discussed again in this Section of the Final Rule, which addresses cash-market reporting in connection with bona fide hedges.

[1138] *See* Final § 150.5(a)(2)(ii)(A).

[1139] As discussed above in connection with Final § 150.9, market participants who wish to request a bona fide hedge recognition under § 150.9 will not be required to file such applications with both the exchange and the Commission. They will only file the applications with the exchange, which will then be subject to recordkeeping requirements in Final § 150.9(d), as well as Final §§ 150.5 and 150.9 requirements to provide certain information to the Commission on a monthly basis and upon demand.

[1140] *See* Final § 150.5(a)(2)(ii)(G).

[1141] *See* Final § 150.5(a)(4).

While the Commission will no longer receive the monthly snapshot data currently included on the series '04 reports, the Commission will have broad access, at any time, to the cash-market information described above, as well as any other data or information exchanges collect as part of their application processes.[1142] This will include any updated application forms and periodic reports that exchanges may require applicants to file regarding their positions. To the extent that the Commission observes market activity or positions that warrant further investigation, § 150.9 will also provide the Commission with access to any supporting or related records the exchanges will be required to maintain.[1143]

Furthermore, the Final Rule will not impact the Commission's existing provisions for gathering information through special calls relating to positions exceeding limits and/or to reportable positions. As discussed further below, under the Final Rule, all persons exceeding the Federal position limits set forth in final § 150.2, as well as all persons holding or controlling reportable positions pursuant to § 15.00(p)(1), must file any pertinent information as instructed in a special call.[1144]

In response to commenter concerns that elimination of the series '04 reports may increase reliance on exchanges which may lack incentives to impose position limits, the Commission does not view the question of whether exchanges impose speculative position limits in this context as a matter of incentives. Even with the elimination of the series '04 reports, exchanges will be under statutory and regulatory obligations, as they are today, to establish speculative position limits for all contracts subject to Federal position limits.[1145] Additionally, as discussed above, the Commission does not believe that exchanges generally lack proper incentives to maintain the integrity of their markets;

[1142] *See, e.g.,* Final § 150.9(d) (requiring that all such records, including cash-market information submitted to the exchange, be kept in accordance with the requirements of § 1.31), and Final § 19.00(b) (requiring, among other things, all persons exceeding speculative position limits who have received a special call to file any pertinent information as specified in the call).

[1143] *See* Final § 150.9(d).

[1144] *See* Final § 19.00(b).

[1145] *See* 7 U.S.C. 7(d)(5) and § 150.5(a).

to the contrary, they are subject to various statutory core principles and regulatory obligations that require them to maintain integrity in their markets.[1146] Further, exchanges will remain subject to regulatory oversight and enforcement responsibilities required for DCMs by CEA section 5(d) and part 38 of the Commission's regulations and for SEFs by CEA section 5h and part 37 of the Commission's regulations.[1147] Specifically, several existing Commission regulations in parts 38 and 37 require exchanges to monitor for violations of exchange-set position limits,[1148] and detect and prevent manipulation, price distortions and, where possible, disruptions of the physical-delivery or cash-settlement process.[1149]

In response to Better Markets' concern that eliminating the '04 reports will reduce deterrents for misreporting, the Commission believes that the false reporting provision in Section 9(a)(4) of the CEA, which makes it a felony to make any false statements to an exchange, is sufficient to deter market participants from misreporting cash-market information to exchanges.[1150]

Further, the Commission disagrees with Better Markets' concerns about increased burdens. Given that market participants are currently required both to file the series '04 reports with the Commission, and to submit cash-market information to the exchanges, eliminating the series '04 reports will reduce burdens on market participants.[1151] In fact, the Commission did not receive any comments opposing the elimination of the series '04 reports from traders who currently have an obligation to file such forms. While the Commission supports streamlined and automated reporting requirements whenever

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[1146] For further discussion, *see* Section II.B.3.iii.b(3)(iii) (addressing comments from Better Markets related to conflicts-of-interest).

[1147] *See* 7 U.S.C. 7(d); 17 CFR 38; 7 U.S.C. 7b-3(f); 17 CFR 37.

[1148] *See* 17 CFR 38.251(d); 17 CFR 37.205(b).

[1149] *See* 17 CFR 38.251(a); 17 CFR 37.205(a).

[1150] 7 U.S.C. 13(a)(4). The Commission has not hesitated to impose severe penalties on market participants that mislead exchanges about cash positions. *See, e.g., In the Matter of EMF Financial Products LLC*, CFTC Docket No. 10-02, U.S. Commodity Futures Trading Commission Website, available at https://www.cftc.gov/PressRoom/PressReleases/5751-09 (imposing a $4,000,000 civil monetary penalty on a firm that misled an exchange about the firm's cash positions in treasury futures). *See also supra* Section II.D.9. (discussing Commission enforcement of exchange-set position limits).

[1151] *See infra* Section IV.A.5.iii. (discussing the benefits of elimination of Form 204 and amendment of Form 304).

possible, Better Markets has not identified any practicable method or program that would permit the automated reporting of the kinds of disparate cash-market information currently reflected in Forms 204 and 304.

In addition to the justifications for eliminating the series '04 reports described above, the Commission has also determined that Form 204, including the timing and procedures for its filing, is inadequate for the reporting of cash-market positions relating to certain energy contracts, which will be subject to Federal position limits for the first time under the Final Rule. For example, when compared to agricultural contracts, energy contracts generally expire more frequently, have a shorter delivery cycle, and have significantly more product grades. The information required by Form 204, as well as the timing and procedures for its filing, reflects the way agricultural contracts trade, but is inadequate for purposes of reporting cash-market information involving energy contracts.

Finally, the Commission understands that the exchanges maintain regular dialogue with their participants regarding cash-market positions, and that it is common for exchange surveillance staff to make informal inquiries of market participants, including if the exchange has questions about market events or a participant's use of an exemption or recognition. The Commission encourages exchanges to continue this practice. Similarly, the Commission anticipates that its own staff will engage in dialogue with market participants, either through the use of informal conversations or, in limited circumstances, via special call authority.

3. Changes to Parts 15 and 19 to Implement the Elimination of Form 204 and Portions of Form 304

i. Background - Changes to Parts 15 and 19 to Implement the Elimination of Form 204 and Portions of Form 304

The market and large-trader reporting rules are contained in parts 15 through 21 of the Commission's regulations. Collectively, these reporting rules effectuate the

Commission's market and financial surveillance programs by enabling the Commission to gather information concerning the size and composition of the commodity derivative markets and to monitor and enforce any established speculative position limits, among other regulatory goals.

ii. Summary of the 2020 NPRM - Changes to Parts 15 and 19 to Implement the Elimination of Form 204 and Portions of Form 304

To effectuate the proposed elimination of Form 204 and the cash-market reporting components of Form 304, the Commission proposed to eliminate: (a) existing § 19.00(a)(1), which requires persons holding reportable positions which constitute bona fide hedging positions to file a Form 204; and (b) existing § 19.01, which, among other things, sets forth the cash-market information required on Forms 204 and 304.[1152] Based on the proposed elimination of existing §§ 19.00(a)(1) and 19.01 and Form 204, the Commission proposed conforming technical changes to remove related reporting provisions from: (i) the "reportable position" definition in § 15.00(p); (ii) the list of "persons required to report" in § 15.01; and (iii) the list of reporting forms in § 15.02.

iii. Comments and Summary of the Commission Determination - Changes to Parts 15 and 19 to Implement the Elimination of Form 204 and Portions of Form 304

The Commission did not receive any comments on the conforming changes to parts 15 and 19 that implement the elimination of Form 204 and Sections I and II of Form 304, and is adopting the changes as proposed.

4. Special Calls

i. Summary of the 2020 NPRM – Special Calls

Notwithstanding the proposed elimination of the series '04 reports, the Commission did not propose to make any significant substantive changes to information requirements relating to positions exceeding limits and/or to reportable positions.

[1152] 17 CFR 19.01.

Accordingly, in proposed § 19.00(b), the Commission proposed that all persons exceeding the proposed limits set forth in § 150.2, as well as all persons holding or controlling reportable positions pursuant to § 15.00(p)(1), must file any pertinent information as instructed in a special call. This proposed provision is similar to existing § 19.00(a)(3), but would require any such person to file the information as instructed in the special call, rather than to file the information on a series '04 report.[1153]

The Commission also proposed to add language to existing § 15.01(d) to clarify that persons who have received a special call are deemed "persons required to report" as defined in § 15.01.[1154] The Commission proposed this change to clarify an existing requirement found in § 19.00(a)(3), which requires persons holding or controlling positions that are reportable pursuant to § 15.00(p)(1) who have received a special call to respond.[1155] The proposed changes to part 19 operate in tandem with the proposed additional language for § 15.01(d) to reiterate the Commission's existing special call authority without creating any new substantive reporting obligations. Finally, proposed § 19.03 delegated authority to issue such special calls to the Director of the Division of Enforcement, and proposed § 19.03(b) delegated to the Director of the Division of Enforcement the authority in proposed § 19.00(b) to provide instructions or to determine the format, coding structure, and electronic data transmission procedures for submitting data records and any other information required under part 19.

ii. Comments and Summary of the Commission Determination – Special Calls

The Commission did not receive any comments on these changes and is adopting the changes to §§ 15.01(d), § 19.00(b), and 19.03(b) as proposed.

5. Form 304 Cotton On-Call Reporting

i. Summary of the 2020 NPRM - Form 304 Cotton On-Call Reporting

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[1153] 17 CFR 19.00(a)(3).
[1154] 17 CFR 15.01.
[1155] 17 CFR 19.00(a)(3).

With the proposed elimination of the cash-market reporting portions of Form 304 as described above, Form 304 would be used exclusively to collect the information needed to publish the Commission's weekly cotton on-call report, which shows the quantity of unfixed-price cash cotton purchases and sales that are outstanding against each cotton futures month.[1156] While the Commission did not propose to eliminate the cotton on-call portions of Form 304, or to stop publishing the cotton on-call report, the Commission did request comment about the implications of doing so.[1157]

In addition to requesting comment regarding continued collection of the Form 304 and publication of the cotton-on-call report, the Commission proposed a number of technical changes to the Form 304. Under the 2020 NPRM, the requirements pertaining to that report would remain in proposed §§ 19.00(a) and 19.02, with minor modifications to existing provisions. In particular, the Commission proposed to update cross references (including to renumber § 19.00(a)(2) as § 19.00(a)) and to clarify and update the procedures and timing for the submission of Form 304. Specifically, proposed § 19.02(b) would require that each Form 304 report be made weekly, dated as of the close of business on Friday, and filed not later than 9 a.m. Eastern Time on the third business day following that Friday using the format, coding structure, and electronic data transmission procedures approved in writing by the Commission. The Commission also proposed some modifications to the Form 304 itself, including conforming and technical changes to the organization, instructions, and required identifying information.[1158]

[1156] *Cotton On-Call*, U.S. Commodity Futures Trading Commission website, available at https://www.cftc.gov/MarketReports/CottonOnCall/index.htm (weekly report).

[1157] Specifically, the Commission requested comments on the following issues: To what extent, and for what purpose, do market participants and others rely on the information contained in the Commission's weekly cotton on-call report; Whether publication of the cotton on-call report creates any informational advantages or disadvantages, and/or otherwise impact competition in any way; Whether the Commission should stop publishing the cotton on-call report, but continue to collect, for internal use only, the information required in Part III of Form 304 (Unfixed-Price Cotton ''On-Call''); Or alternatively, whether the Commission should stop publishing the cotton on-call report and also eliminate the Form 304 altogether, including Part III. *See* 85 FR at 11657.

[1158] Among other things, the proposed changes to the instructions would clarify that traders must identify themselves on Form 304 using their Public Trader Identification Number, in lieu of the CFTC Code Number required on previous versions of Form 304. This change will help Commission staff to connect the various reports filed by the same market participants. This release includes a representation of the final Form 304, which is to be submitted in an electronic format published pursuant to this Final Rule, either via the Commission's web portal or via XML-based, secure FTP transmission.

ii. Summary of the Commission Determination - Form 304 Cotton On-Call Reporting

The Commission has determined to maintain the status quo as proposed by not eliminating the cotton on-call portions (currently Part III) of the Form 304, and by continuing to publish the cotton on-call report. The Commission is also adopting the proposed technical changes described above.

iii. Comments - Form 304 Cotton On-Call Reporting

Commenters were divided on the questions posed by the Commission on whether to retain Part III of the Form 304 and to continue publishing the weekly cotton on-call report.

CMC, along with numerous commenters from the cotton industry, believed the Commission should eliminate Form 304 in its entirety and stop publishing the cotton on-call report.[1159] For example, Namoi and ACSA both argued that the cotton on-call report allows market participants to see proprietary cash-market information for every other participant in the cotton market, which among other things, creates an opportunity for speculators to profit by trading against this publicly disclosed unfixed-price positions.[1160] Additionally, Namoi and ACSA each highlighted that the Commission does not collect or publish similar information for any other commodities.[1161] ACSA also argued that the cotton on-call report causes competitive harm to the U.S. cotton industry because, according to ACSA, foreign mills believe that the report imposes risks and costs and are therefore more likely to purchase cotton from outside of the United States in order to avoid completing Part III of Form 304.[1162] The NCTO suggested that textile mills are particularly harmed when speculators trade against the cash-market positions disclosed in

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[1159] ACA at 3; ACSA at 3, 9-11; Cargill at 10; CMC at 12; East Cotton at 3; McMeekin at 2-3; Namoi at 1-2; Omnicotton at 2-3; Texas Cotton at 2-3; Toyo at 2-3; Walcot at 3; and White Gold at 2 .

[1160] Namoi at 1-2; ACSA at 9-11.

[1161] Namoi at 1-2.

[1162] ACSA at 9-11.

the cotton on-call report because textile mills purchase the majority of their cotton on call.[1163]

Conversely, several commenters, including other cotton industry members, stated that the Commission should continue to collect the information required by Form 304 and to publish the cotton on-call report.[1164] For example, Glencore argued that discontinuing the report would reduce transparency, open the market to more manipulation, and harm smaller participants due to asymmetrical information.[1165] Similarly, AMCOT argued that without the report, large participants, who account for a significant amount of the cotton bought or sold on call, would have an informational advantage over small producers who have less visibility into a large portion of the cotton market.[1166]

iv. Discussion of Final Rule - Form 304 Cotton On-Call Reporting

After reviewing the comments discussed above, the Commission has decided to retain the cotton-on call portions (currently Section III) of existing Form 304 and to continue publishing its weekly cotton on- call report. Because the comments from cotton industry firms were divided, and because the cotton on-call report has been a part of the cotton market for more than 80 years, the Commission believes that it would be imprudent to eliminate the report based solely on the information provided in the comment letters, which do not include any concrete data, studies, or quantifiable financial harms. The Commission further notes that continued publication of the cotton on-call report will not change the existing dynamics of the cotton market.

In the future, the Commission may solicit comments to determine whether the cotton on-call report continues to benefit the market and whether the report hinders the competitiveness of U.S. firms in the global cotton market. The Commission may seek

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[1163] NCTO at 1-2.

[1164] VLM Comment Text; Eric Matsen Comment Text; AMCOT at 2-3; Gerald Marshall at 3; Lawson/O'Neill at 1; Glencore at 2; and Dunavant at 1.

[1165] Glencore at 2; Dunavant at 1.

[1166] AMCOT at 2.

input from cotton market participants in the form of additional comments, data, studies, or information about specific financial harms that would warrant discontinuing the report. The Commission emphasizes that it remains open to continuing to discuss this important issue with market participants and to receive additional data and information that may more concretely demonstrate the competitive harms discussed by commenters above.

6. Proposed Technical Changes to Part 17

i. Summary of the 2020 NPRM - Proposed Technical Changes to Part 17

Part 17 of the Commission's regulations addresses reports by reporting markets, FCMs, clearing members, and foreign brokers.[1167] The Commission proposed to amend existing § 17.00(b), which addresses information to be furnished by FCMs, clearing members, and foreign brokers, to delete certain provisions related to position aggregation, because those provisions have become duplicative of aggregation provisions that were adopted in § 150.4 in the 2016 Final Aggregation Rulemaking.[1168] The Commission also proposed to add a new provision, § 17.03(i), which delegates certain authority under § 17.00(b) to the Director of the Office of Data and Technology.[1169]

ii. Comments and Summary of the Commission Determination - Proposed Technical Changes to Part 17

The Commission did not receive any comments addressing these changes and is adopting these technical changes as proposed.

I. Removal of Part 151

1. Summary of the 2020 NPRM – Removal of Part 151

[1167] 17 CFR part 17.

[1168] *See* Final Aggregation Rulemaking, 81 FR at 91455. Specifically, the Commission proposes to delete paragraphs (1), (2), and (3) from § 17.00(b). 17 CFR 17.00(b).

[1169] Under § 150.4(e)(2), which was adopted in the 2016 Final Aggregation Rulemaking, the Director of the Division of Market Oversight is delegated authority to, among other things, provide instructions relating to the format, coding structure, and electronic data transmission procedures for submitting certain data records. 17 CFR 150.4(e)(2). A subsequent rulemaking changed this delegation of authority from the Director of the Division of Market Oversight to the Director of the Office of Data and Technology, with the concurrence of the Director of the Division of Enforcement. *See* 82 FR at 28763 (June 26, 2017). The proposed addition of § 17.03(i) would conform § 17.03 to that change in delegation.

Finally, the Commission proposed to remove and reserve part 151 in response to its *vacatur* by the U.S. District Court for the District of Columbia,[1170] as well as in light of the proposed revisions to part 150 that conform part 150 to the amendments made to CEA section 4a by the Dodd-Frank Act.

2. Comments and Summary of the Commission Determination – Removal of Part 151

The Commission did not receive any comments regarding these changes and is adopting these conforming changes as proposed.

III. Legal Matters

This section of the release sets forth certain legal determinations by the Commission that underlie the determinations regarding the specifics of the Final Rule set forth previously in this preamble, as well as the reasons for those legal determinations and consideration of relevant comments. Specifically, Part A sets forth the Commission's determination that, in a rulemaking pursuant to CEA section 4a(a)(2), the Commission must find position limits to be "necessary" within the meaning of paragraph 4a(a)(1). Part B sets forth the Commission's interpretation of the criteria for finding position limits to be necessary within the meaning of the statute. Part C sets forth the Commission's necessity findings for the 25 core referenced futures contracts. Part D sets forth the Commission's necessity finding for futures contracts and options on futures contracts linked to a core referenced futures contract. Finally, Part E sets forth the Commission's necessity finding for spot and non-spot months.

A. Interpretation of Statute Regarding Whether Necessity Finding is Required for Position Limits Established Pursuant to CEA section 4a(a)(2)

1. The Commission's Preliminary Interpretation in the 2020 NPRM

[1170] *See supra* notes 10-11 and accompanying discussion.

In the 2020 NPRM the Commission considered whether CEA section 4a, as amended, requires the Commission to issue Federal position limits for all physical commodities other than excluded commodities without making its own antecedent finding that such position limits are necessary. This was in response to *ISDA*, in which the U.S. District Court for the District of Columbia held that the CEA was ambiguous in that respect. Specifically, the court held that where CEA section 4a(a)(2) ("paragraph 4a(a)(2)") states that the Commission shall issue such position limits "[i]n accordance with the standards set forth in paragraph (1),"[1171] it is unclear whether the "standards" include the requirement in paragraph (1) of CEA section 4a(a) ("paragraph 4a(a)(1)") that the Commission establish such limits as it "finds are necessary to diminish, eliminate, or prevent" specified burdens on interstate commerce.[1172] In the 2020 NPRM, the Commission preliminarily determined that paragraph 4a(a)(2) should be interpreted as incorporating the necessity requirement of paragraph 4a(a)(1).[1173] For the Final Rule, the Commission herein adopts that determination as final, along with the reasoning set forth in the 2020 NPRM.

The Commission's preliminary determination was based on a number of considerations, set forth in detail in the 2020 NPRM.[1174] Consistent with the district court's instructions, [1175] the Commission based its determination both on analysis of the CEA's statutory language and on application of the Commission's experience and

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[1171] Paragraph 4a(a)(1) of the CEA states, in relevant part:

"Excessive speculation in any commodity under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets or derivatives transaction execution facilities, or swaps that perform or affect a significant price discovery function with respect to registered entities 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. 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 on the amounts of trading which may be done or positions which may be held by any person, including any group or class of traders, under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility, or swaps traded on or subject to the rules of a designated contract market or a swap execution facility, or swaps not traded on or subject to the rules of a designated contract market or a swap execution facility that performs a significant price discovery function with respect to a registered entity as the Commission finds are necessary to diminish, eliminate, or prevent such burden."

[1172] Paragraphs 4a(a)(1) and 4a(a)(2)(A); *ISDA*, 887 F. Supp. 2d at 280-81.

[1173] 85 FR at 11659.

[1174] *Id*. at 11659-11661.

[1175] The court directed the Commission, on remand, to resolve the ambiguity not by "rest[ing] simply on its parsing of the statutory language" but by "bring[ing] its experience and expertise to bear in light of the competing interests at stake." 85 FR at 11659, quoting *ISDA*, 887 F. Supp. 2d at 281.

expertise to relevant facts and policy concerns.[1176] Among the most important factual and policy concerns relied upon by the Commission in the 2020 NPRM were:

a. Absent the necessity-finding requirement, the language of paragraph 4a(a)(2) would evidently require the imposition of some level of position limits for a physical commodity even if limits at any level would be likely to do more harm than good, including with respect to public interests specifically identified in paragraph 4a(a)(1) and elsewhere in section 4a or the CEA generally.[1177] In addition to being inconsistent with the thrust of section 4a taken as a whole, this approach makes little sense as a matter of policy.[1178]

b. Subparagraph 4a(a)(2)(A) requires that position limits be set "as appropriate." At a minimum, this language requires the Commission to use its best judgment in determining the levels at which position limits are set. In addition, there is authority from case law that the word "appropriate" in a regulatory statute requires agencies to take into account the costs of regulation, if only in a rough or approximate way, and that consideration may preclude the considered action if the costs are highly disproportionate.[1179] The statute thus allows for the possibility that, in establishing position limit levels for some commodities or contracts, the Commission, in its judgment, may determine that the optimal level is no limit at all. This possibility does not harmonize with a requirement to impose limits for all physical commodities, but is consistent with a requirement to impose limits where they are necessary.

c. Requiring position limits without a necessity finding would be a "sea change" in derivatives regulation since it would involve a shift from Federal limits on a small number of agricultural commodities to limits on all physical commodities.[1180] The

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[1176] 85 FR at 11659-11661.

[1177] *Id*. at 11659, citing as examples CEA sections 5, 4a(a)(2)(C), and 4a(a)(3)(B).

[1178] *Id*. at 11660.

[1179] *See Michigan v. EPA*, 132 S.Ct. 2699, 2707-08, 2711 (2015) (agency could not disregard major costs under statute requiring that regulation be "appropriate," but use of this word did not require formal cost-benefit analysis).

[1180] 85 FR at 11660.

Commission was skeptical that Congress would have made such a change through ambiguous language.[1181] The Commission noted that there are currently over 1,200 listed futures contracts on physical commodities and that there is no indication that Congress had concerns about, or even considered, all of them.[1182] To the contrary, the legislative history suggests that enactment of paragraph 4a(a)(2) was driven, in part, by studies of potential excessive speculation in a small number of particularly important commodities.[1183] This history is consistent with an interpretation of the statute as requiring position limits for commodities where controlling excessive speculation is most important, absent statutory language that unambiguously requires limits for all commodities.

d. A necessity finding allows the Commission to apply its experience and expertise to impose position limits where they are likely to do the most good, taking into consideration the fact that even well-crafted position limits create compliance costs and potentially may have a negative effect on liquidity and forms of speculation that benefit the market.[1184]

In the 2020 NPRM, the Commission recognized that it was proposing to change its interpretation regarding whether paragraph 4a(a)(2) incorporates a requirement to find position limits necessary.[1185] The Commission noted that, in the preamble to the 2011 Final Rulemaking as well as the Commission's subsequent position limits proposals,[1186] the Commission had interpreted paragraph 4a(a)(2) to mandate the imposition of position limits without the need for a necessity finding.[1187] As part of its preliminary determinations in the 2020 NPRM that the CEA *does* require a necessity finding, the

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[1181] *Id*.
[1182] *Id*.
[1183] 85 FR at 1160 (discussing Congressional staff studies of potential excessive speculation in oil, natural gas, and wheat).
[1184] 85 FR at 11660.
[1185] *Id*. at 11658.
[1186] *See supra* Section I.A.
[1187] 85 FR at 11658.

Commission explained in detail why the reasons it had previously given for the "mandate" approach do not compel that interpretation of the statute. Taken as a whole, such reasons are insufficiently persuasive to outweigh the factors that favor a necessity finding.[1188]

2. Comments on the Commission's Preliminary Interpretation in the 2020 NPRM and Commission Responses

In response to the Commission's preliminary interpretation provided in the 2020 NPRM, a number of commenters stated that the Commission must make a necessity finding before establishing position limits under paragraph 4a(a)(2).[1189] These commenters generally asserted that this result was required by the language of the statute, although they did not provide a detailed analysis of that language beyond that set forth in the 2020 NPRM.[1190] Some commenters also asserted that a necessity finding is important to avoid imposing unwarranted costs on market participants, a position consistent with the policy concerns that entered into the Commission's preliminary determination that paragraph 4a(a)(2) requires a necessity finding.[1191]

A number of other commenters stated that the statute does not require a necessity finding for the establishment of position limits pursuant to paragraph 4a(a)(2).[1192] These commenters made the following points:

a. Some commenters asserted that the language of paragraph 4a(a)(2) requires the Commission to establish position limits for all physical commodities without first determining that limits are necessary.[1193] Commenters making this point emphasized the

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[1188] 85 FR at 11661-64. CEA Section 4a(a)(2), which was enacted as part of the Dodd-Frank Act, directs the Commission to "establish" limits on positions. The Commission does not interpret this directive to apply to the nine legacy agricultural contracts included in the list of core referenced futures contracts because they are already subject to Federal position limits that have existed for decades based on prior necessity findings pursuant to CEA Section 4a(a)(1). Nevertheless, as discussed *infra* at Section III.C, the Commission has determined that such limits are necessary.

[1189] *E.g.*, Citadel at 2; EEI at 2-3; ISDA at 3; MFA/AIMA at 1, 14; SIFMA AMG at 1-2.

[1190] *Id*.

[1191] *E.g.*, EEI at 3.

[1192] *E.g.*, AFR at 1; Better Markets at 3-4, 64; IATP at 4; NEFI at 2-3.

[1193] *E.g.*, Better Markets at 64 (incorporating by reference amicus brief by Senators Levin et al. in the *ISDA* litigation). The statute applies to all physical commodities "other than excluded commodities." 7 U.S.C. 6a(a)(2). The Commission here refers to "all physical commodities" for purposes of brevity only, and does not mean to imply that the statute covers excluded commodities.

language of subparagraph 4a(a)(2)(A) stating that the Commission "shall" impose position limits on physical commodities and the language of subparagraph 4a(a)(2)(B) referring to position limits "required" by subparagraph 4a(a)(2)(A).[1194] However, while these words are suggestive of a mandatory requirement of some kind, they do not dictate the conclusion that paragraph 4a(a)(2) requires position limits across-the-board without a necessity finding, and to conclude otherwise would contradict the holding in *ISDA* that the statutory text is ambiguous.[1195] The requirements of paragraph 4a(a)(2) are subject to the condition that position limits be imposed "[i]n accordance with the standards set forth in paragraph [4a(a)(1)]." The meaning of *that* text, and specifically the meaning of "the standards," is the primary issue for the Commission to resolve here. For reasons explained above and in the 2020 NPRM, these standards are best interpreted as including the paragraph 4a(a)(1) necessity requirement.[1196]

b. Some commenters asserted that the legislative history of paragraph 4a(a)(2) supports imposing limits on all physical commodities without requiring a necessity finding.[1197] Among the points emphasized by commenters were that (1) certain bill language that ultimately became paragraph 4a(a)(2) evolved from using the permissive word "may" to the mandatory word "shall"; and (2) the House Committee on Agriculture voted out a predecessor bill containing language similar to that of paragraph 4a(a)(2), and there are indications that members of the committee viewed this language as requiring limits for all physical commodities.[1198] In the view of the Commission, neither of these points is sufficient to resolve the ambiguity in the language of paragraph 4a(a)(2) or

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[1194] *E.g.*, Better Markets at 64; NEFI at 1. Better Markets stated that the Commission should adopt the legal views set forth in the amicus brief filed by certain U.S. Senators in the *ISDA* case. Better Markets at 64. However, in *ISDA*, the district court stated that "[g]iven the fundamental ambiguities in the statute," it was "not persuaded by their arguments." *ISDA*, 887 F. Supp. 2d at 283.

[1195] *ISDA*, 887 F. Supp. 2d at 274.

[1196] Other arguments against a necessity requirement made by commenters based on the statutory wording have previously been addressed in the 2020 NPRM. Compare Better Markets at 64 (incorporating by reference amicus brief by Senators Levin et al. in the *ISDA* litigation) with 85 FR at 11661-64.

[1197] *E.g.*, Better Markets at 64 (incorporating by reference amicus brief by Senators Levin et al. in the *ISDA* litigation).

[1198] *Id*.

dictate the conclusion that the statute mandates position limits without a necessity finding.

With regard to the first point, there is no question that the final version of paragraph 4a(a)(2) states that the Commission "shall" impose position limits. But, as explained above, this mandatory language is explicitly subject to a requirement that limits be imposed in accordance with the standards of paragraph 4a(a)(1), and that condition is ambiguous. The commenters' second point was addressed in detail in the 2020 NPRM.[1199] Briefly, the House Committee on Agriculture bill described by commenters was never approved by the full House of Representatives.[1200] Its language on position limits was included in the Dodd-Frank Act, but discussion of this language in the floor debate and conference committee report did not characterize it as requiring limits for all physical commodities.[1201] And nothing in the legislative history specifies that the word "standards" in paragraph 4a(a)(2) excludes the paragraph 4a(a)(1) necessity requirement. As a result, the legislative history, taken as a whole, does not resolve the ambiguity in the statute.

c. Some commenters asserted that to require a necessity finding construes the Dodd-Frank Act's amendment to section 4a as narrowing the Commission's power to impose position limits, which is implausible as an interpretation given the overall thrust of the Dodd-Frank Act and the legislative history of paragraph 4a(a)(2).[1202] However, the CEA already required the Commission to find position limits necessary before the Dodd-Frank Act, so continuing to require such a finding is not a new constraint on the Commission.[1203] And, even with a necessity requirement, paragraph 4a(a)(2) imposes an

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[1199] 85 FR at 11663.

[1200] *Id.*

[1201] *Id.*

[1202] *E.g.* AFR at 1.

[1203] *See* paragraph 4a(a)(1). The House Committee on Agriculture summarized this provision as giving the government "the power, after due notice and opportunity for hearing and a finding of a burden on interstate commerce caused by such speculation, to fix and proclaim limits on futures trading …" H.R. Rep. No. 421, 74th Cong., 1st Sess. 5 (1935), stated more specifically in the statutory text as authority to diminish, eliminate, or prevent burdens that are "undue and unnecessary." P.L. 74-675 section 5.

important new duty on the Commission: to affirmatively proceed to establish position limits for physical commodities where limits are necessary, within a specified period of time, including as to economically equivalent swaps, and to report to Congress on the effects of those limits, if any.[1204] So the Commission's preliminary interpretation of the statute is consistent with legislative history indicating that Congress wanted the Commission to take action on the subject of position limits.

d. Some commenters asserted that a necessity finding creates unnecessary administrative obstacles to establishing position limits.[1205] In the view of the Commission, any extra needed administrative activity is a reasonable tradeoff for the flexibility and public policy benefits of imposing position limits only where they are economically justified as an efficient means of addressing the concerns Congress expressed in section 4a(a)(1). One commenter went further and suggested that a requirement to find necessity could make implementation and enforcement of position limits "nigh to impossible."[1206] However, that commenter premised this assertion on a different necessity standard, that the Commission is not adopting in this rulemaking.[1207] In the view of the Commission, the necessity standard it is adopting herein is both consistent with the statute and workable in practice, as demonstrated by the necessity findings below. The workability of the Commission's standard is supported by a commenter who was opposed to a requirement to find necessity but nevertheless acknowledged that the necessity standard preliminarily adopted in the 2020 NPRM is "unlikely to limit the CFTC's practical ability to impose Federal position limits."[1208]

[1204] *See* paragraphs 4a(a)(2) and 4a(a)(5), 7 U.S.C. 6a(a)(2), 6a(a)(5); P.L. 111-203 § 719(a).

[1205] *E.g.*, Better Markets at 4.

[1206] IATP at 5.

[1207] *Id*. IATP assumed the use of a necessity standard, which it attributed to an industry group, requiring the Commission to, among other things, "determine the likelihood that a specific limit would curtail excessive speculation in a specific market." *Id*. The Commission has determined that the statute does not require that. 85 FR at 11664-66 and *infra*.

[1208] Better Markets at 4.

Commenters who opposed a necessity-finding requirement also set forth a number of justifications for broad use of Federal position limits without asserting specifically that these concerns require limits for all physical commodities or justify imposing limits without finding them to be necessary. For example, commenters pointed out that unjustified volatility in derivatives markets can have negative consequences for price discovery and hedging in related non-financial markets.[1209] The Commission agrees with this point and agrees that preventing these consequences is the major reason why the CEA provides for position limits.[1210] However, this observation does not justify limits for all physical commodities since (a) the importance of the link between derivatives markets and associated cash markets can vary for different commodities; and (b) good policy requires consideration of the costs and burdens associated with position limits as well as their potential preventative effects.[1211] These points are discussed further in sections of this release dealing with the Commission's legal standard for necessity, necessity findings, and consideration of costs and benefits pursuant to CEA section 15(a).

Commenters opposed to a necessity-finding requirement also asserted that exchanges cannot always be relied upon to establish optimal position limits since they may benefit from revenue generated from high levels of speculation, including, in some instances, high levels of speculation by individual market participants.[1212] To the extent that this is so, it is a reason for Congress to authorize, and the Commission to implement, position limits where needed. But it is not a reason to apply them to physical commodities across the board for the reasons just stated: the importance of unjustified volatility in derivatives markets for the non-financial economy can vary, and position limits have associated costs and burdens. Moreover, as discussed earlier in the preamble,

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[1209] *Id*. at 25-29.

[1210] *See* Congressional finding in first sentence of paragraph 4a(a)(1), 7 U.S.C. 6a(a)(1).

[1211] In reaching this conclusion, the Commission draws upon its experience and expertise in considering costs and benefits before promulgating a rule, pursuant to 7 U.S.C. 19(a). The Commission believes that such consideration (which need not be mathematical) leads to better outcomes.

[1212] Better Markets at 22-24.

exchanges are subject to statutory and regulatory obligations to establish position limits or position accountability and must do so in accordance with standards established by the Commission. Further, any incentives for exchanges to impose suboptimal position limits are reduced because an exchange that leaves itself open to an enhanced risk of excessive speculation, manipulation, or other forms of unjustified pricing is likely to lose business from traders seeking a stable market that reflects fundamental conditions.[1213]

3. Commission Determination

Having reviewed the comments and further considered the issue, the Commission has determined that the interpretation of paragraph 4a(a)(2) as incorporating the requirement of paragraph 4a(a)(1) to find position limits necessary before imposing them is the best interpretation of the statute, and the Commission adopts this interpretation as its interpretation under the Final Rule. This determination is based on the reasons set forth above and in the relevant portion of the 2020 NPRM.[1214] The Commission further recognizes that this determination is a change from the Commission's earlier interpretation of paragraph 4a(a)(2) as not requiring a necessity finding. The Commission has determined that the reasons previously given for such an interpretation of paragraph 4a(a)(2) are not compelling for the reasons stated above and in the relevant portion of the 2020 NPRM.[1215] The specifics of what the term "necessary" means in this context are discussed in the next section, followed by the Commission's final necessity finding.

B. Legal Standard for Necessity Finding

For the reasons discussed above, paragraph 4a(a)(2) requires the Commission to establish position limits to the extent they are "necessary" to "diminish, eliminate, or prevent" the burden on interstate commerce in a commodity from "sudden or

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[1213] *See supra* Section II.B.2.iv.b., for additional discussion of exchange incentives and related statutory and regulatory obligations to maintain market integrity.

[1214] 85 FR at 11658-61.

[1215] *Id*. at 11661-64.

unreasonable fluctuations or unwarranted changes in the price" of the commodity caused by excessive speculation in futures contracts (and options thereon) or swaps.[1216] In the 2020 NPRM the Commission preliminarily interpreted this requirement and preliminarily reached several conclusions about what sort of necessity finding the statute requires. This section of the preamble (1) reviews the preliminary conclusions set forth in the 2020 NPRM with some additional clarification and elaboration; [1217] (2) reviews and evaluates important points made in comments regarding the CEA's statutory standard for finding necessity; and (3) sets forth the Commission's conclusions for this Final Rule on the legal standard for finding position limits to be necessary within the meaning of CEA section 4a.

1. Preliminary Legal Standard for Necessity in 2020 NPRM

In the 2020 NPRM, the Commission reached a number of conclusions:

First, the CEA does not require the Commission to determine whether excessive speculation in general may create a risk of sudden or unreasonable fluctuations or unwarranted changes in the price of a commodity or whether position limits are an effective tool for controlling or preventing these potential effects.[1218] Section 4a(a)(1) of the CEA contains a Congressional finding that "[e]xcessive speculation … causing sudden or unreasonable fluctuations or unwarranted changes in … price … is an undue and unnecessary burden on interstate commerce in such commodity" and prescribes position limits for the purpose of "diminishing, eliminating, or preventing" that

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[1216] The first sentence of paragraph 4a(a)(1) is a Congressional finding that "excessive speculation in any commodity" under futures contracts or certain 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." 7 U.S.C. 6a(a)(1). The second sentence of paragraph 4a(a)(1), referring back to the burden on interstate commerce found in the first sentence, states that the Commission shall establish such position limits "as the Commission finds are necessary to diminish, eliminate, or prevent such burden." *Id*.

[1217] Certain points relevant to the legal standard for necessity that were made in a number of different sections of the NPRM are integrated into the discussion of the legal standard here.

[1218] 85 FR at 11664.

burden.[1219] The analysis in the 2020 NPRM accepted those premises as established by Congress.

Second, the word "necessary" has a spectrum of legal meanings from absolute physical necessity to merely useful or convenient.[1220] The 2020 NPRM explained that it is unlikely Congress intended either extreme.[1221] The Commission preliminarily determined in the 2020 NPRM that the necessity requirement is best interpreted as a directive to establish position limits where they are economically justified as an efficient mechanism to advance the Congressional goal of preventing undue burdens on commerce in an underlying commodity caused by excessive speculation in the associated futures or swaps markets.[1222]

Under this approach, the Commission explained, position limits are necessary where diminishing, eliminating, or preventing burdens on commerce in a commodity caused by excessive speculation in the associated derivatives market is likely to offer the greatest benefits to the cash market for the commodity and the economy, and not where the benefit of controlling or preventing such burdens is likely to be less significant or to be accompanied by disproportionate costs or negative consequences, including negative consequences with respect to Congress's stated purpose, to prevent the burdens of sudden or unreasonable fluctuations or unwarranted changes in price that burden interstate commerce.[1223] For example, it may be that for a given commodity, high levels of sudden or unreasonable fluctuation or unwarranted changes in the price of a commodity would have little overall impact on commerce in the cash commodity market or the national economy. If the burdens or negative economic consequences associated with position

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[1219] *See Commodity Futures Trading Com'n v. Hunt*, 592 F.2d 1211, 1215 (7th Cir. 1979) ("Congress concluded that excessive speculation in commodity contracts for future delivery can cause adverse fluctuations in the price of a commodity, and authorized the Commission to restrict the positions held or trading done by any individual person or by certain groups of people acting in concert.").

[1220] 85 FR at 11664.

[1221] *Id*.

[1222] *Id*. at 11665.

[1223] 85 FR at 11665.

limits for that commodity, as discussed in the Commission's consideration of costs and benefits, are out of proportion to the likely economic benefits of position limits, it would be unwarranted to impose them.[1224] However, there are markets in which sudden or unreasonable fluctuations or unwarranted changes in the price of a commodity caused by excessive speculation would have significantly negative effects on the cash commodity market or the broader economy. Even if such disruptions would be unlikely due to the particular characteristics of the relevant derivatives market, the Commission may nevertheless determine that position limits are necessary as a prophylactic measure given the potential magnitude or impact of the unlikely event.[1225]

The Commission's proposed test in the 2020 NPRM thus focused on the Congressional purpose implicit in the finding in the first sentence of paragraph 4a(a)(1): protecting the cash commodity markets from such sudden or unreasonable fluctuations or unwarranted changes in the price. The Commission specified that this standard cannot be determined by a mathematical formula, but requires judgment by the Commission, taking into account available facts but also based on the Commission's experience and expertise.[1226] The Commission further specified that this standard includes consideration of costs and benefits under CEA section 15(a), insofar as the Commission is required by that section to consider the costs and benefits of its discretionary choices.[1227]

In applying this necessity standard in the 2020 NPRM, the Commission identified two primary factors to be used in identifying commodities where using position limits in derivatives markets to control or prevent injury to the underlying commodity market would be most valuable:

[1224] *Id*.

[1225] *Id*.

[1226] 85 FR at 11665.

[1227] *Id*. For further discussion of the cost-benefit implications of the Commission's necessity finding with respect to the 25 core referenced futures contracts, *see infra* Section IV.A.2. For further discussion of the cost-benefit implications of Federal position limits in light of existing exchange-set limits, *see infra* Section IV.A.6.

The first primary factor is the importance of the derivatives market for a commodity to the operation of the market for the cash commodity itself.[1228] Examples of links between derivatives markets and cash markets that exemplify this factor include:

a. The extent to which volatility in the derivatives market is likely to result in sudden or unreasonable fluctuations or unwarranted changes in the price in the cash commodity market including, in particular, the extent to which participants in the cash market rely on the derivatives market as a price discovery mechanism. This includes the use of futures prices for pricing cash-market transactions and the use of futures prices for planning purposes, such as when farmers decide what crops to plant or manufacturers estimate the cost of inputs to their production processes.[1229]

b. The extent to which participants in the cash market use the derivatives market for hedging.[1230]

The second primary factor specified in the 2020 NPRM is the importance of the underlying commodity to the economy as a whole.[1231] In the view of the Commission, evidence demonstrating either one of these primary factors is sufficient to establish that position limits are necessary. This is so because each primary factor identifies circumstances that present an undue risk that disruptions to derivatives markets for a commodity will have consequences for industries that produce and use the relevant commodity and, ultimately, the general public that invests in and is employed by those industries and purchases their end-products.[1232] Thus, each of the primary factors relates to the statutory objective of diminishing, eliminating, or preventing undue and unnecessary burdens on interstate commerce in a commodity arising from excessive

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[1228] 85 FR at 11665, 11666.
[1229] 85 FR at 11665, 11666.
[1230] *Id*. at 11666.
[1231] *Id*. at 11665, 11666.
[1232] *See Id*. at 11664, fn. 471, 11666-11670 (giving examples as part of necessity finding).

speculation in associated derivatives contracts. Of course, to the extent that both factors are present, a necessity finding will be strengthened.

In the 2020 NPRM, the Commission emphasized that a necessity determination cannot be reduced to a mathematical formula, though data may of course be highly relevant. To the extent that the primary factors identified by the Commission cannot be directly measured, the Commission, in the exercise of its judgment, may look to market data or qualitative information that correlates with these factors for guidance in applying them.[1233]

With respect to futures contracts and options contracts linked to core referenced futures contracts, the Commission determined that position limits are necessary for linked contracts because such position limits are likely to make position limits for core referenced futures contracts more effective in preventing manipulation and other sources of sudden or unreasonable fluctuations or unwarranted changes in the price in the underlying commodity.[1234]

The Commission's preliminary necessity finding in the 2020 NPRM also took into consideration economic differences between derivatives positions held during spot months and those held during other months that affect the extent to which position limits are an efficient mechanism for controlling or preventing sudden or unreasonable fluctuations or unwarranted changes in the price in underlying commodities. Specifically, the Commission stated that corners and squeezes can occur only during the spot month.[1235] Thus, certain important sources of sudden or unreasonable fluctuations or unwarranted changes in the price are present only during the spot month. While the fact that certain types of disruptions in a given market may be unlikely is not dispositive of

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[1233] See discussion in findings section below

[1234] 85 FR at 11619-11620. *See also supra* at Section II.A.16.iii.

[1235] 85 FR at 11629.

the necessity question,[1236] the Commission judged that the impossibility of corners and squeezes in non-spot months diminished the likelihood of excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in the price in underlying commodities to such an extent as to reduce the benefit of position limits for those months below the point where, in the Commission's judgment, position limits would be justified under the necessity standard. [1237] Nevertheless, the Commission did not rescind existing non-spot month limits for legacy agricultural contracts, because it did not observe problems that would give a reason to eliminate them at this time. [1238]

2. Comments and Commission Responses

Relatively few commenters addressed the substance of the Commission's legal interpretation of what CEA section 4a requires in order for the Commission to determine that position limits are necessary for a particular commodity or contract. Major points made by commenters, and the Commission's evaluation of these points include:

a. Several commenters stated that the necessity finding must be "robust and data-driven."[1239] The Commission agrees that the agency is required to consider available data, to the extent that it is relevant, in determining whether to establish position limits. At the same time, the Commission interprets the statute as requiring it to exercise judgment regarding the need for position limits where data is not available. The statute does not specify the use of any particular methodology, quantitative or otherwise, in determining whether position limits are necessary.

In addition, the Commission must implement CEA section 4a in a fashion consistent with the finding regarding excessive speculation and its effects on commerce

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[1236] *Id*. at 11665.

[1237] 85 FR at 11628. The Commission also believes that the relevant benefits and burdens indicate that no level of new non-spot-month limits is "appropriate" as that term is used in Section 4a(a)(2)(A). *See* discussion at Section IV.A.6.iii.b.

[1238] 85 FR at 11628. Specifics of the Commission's findings with regard to the need for limits during spot and non-spot months are in the 2020 NPRM at 85 FR 11596, 11628, and *supra* at Sections II.B.3. and II.B.4.

[1239] *E.g.* ISDA at 3; SIFMA AMG at 2. *See also* MFA/AIMA at 4 (advocating for individualized necessity findings based on detailed analyses for each contract).

in the first sentence of paragraph 4a(a)(1) and the directive in paragraph 4a(a)(2) that the Commission "shall" promptly establish position limits for physical commodities, albeit subject to the necessity-finding requirement. These provisions imply that the Commission must act on position limits, even if available data is imperfect, so long as it has a reasonable basis for determining limits to be necessary. Other language of CEA section 4a further supports the conclusion that Congress intended the Commission to consider available data but also to exercise judgment in establishing position limits. For example, paragraph 4a(a)(2) requires that limits be established "as appropriate," which implies consideration of a broad range of relevant factors, but subject to the reasonable exercise of subjective judgment.[1240] Similarly, paragraph 4a(a)(3)(B) lists policy objectives for position limits that the Commission must achieve "to the maximum extent possible" but specifies that the Commission must do this "in its discretion." The Commission also believes it is better policy to interpret "as necessary" to permit flexibility in response to imperfect available data, so long as there is a reasonable basis for its decisions.[1241] Such flexibility may facilitate achieving the objectives of the statute, whether by determining that position limits either are necessary or not necessary in particular circumstances.

b. One commenter, MGEX, supported the Commission's general approach of focusing on the relationship between the derivatives market and the underlying commodity in making necessity determinations.[1242] This commenter stated, "As the Commission appropriately points out, it is important to focus on derivatives that are vital to price discovery and distribution of the underlying commodity so that any excessive speculation may have a small impact." [1243] The Commission agrees with that statement.

[1240] *See Michigan v. EPA*, 576 U.S. 743, 752 (2015).
[1241] 7 U.S.C. 6a(a)(3)(B).
[1242] MGEX at 1.
[1243] *Id*.

c. One commenter, Citadel, asserted that the statute required a different test for a finding of necessity than that used by the Commission.[1244] According to this commenter, for each commodity subject to position limits, the Commission must establish "when and how holding a large position in a given commodity could allow a market participant to exert undue market power or influence."[1245] The commenter criticized the Commission for relying on the role core referenced futures contracts play in price discovery and the fact that they require physical delivery.[1246] According to the commenter, the Commission proposed position limits on certain commodities "based merely on their size or importance" and "did not explain why size or importance, without more" justifies position limits.[1247] The commenter expressed concern that the Commission's standard could set a precedent for the establishment of position limits for additional commodities in the future without adequate justification and therefore could reduce investor participation in commodity markets in a fashion that would impair the use of those markets for risk management and commercial decision making.[1248]

The Commission disagrees with Citadel's interpretation of the CEA section 4a necessity requirement and criticism of the Commission's interpretation for several reasons, most of which have been stated previously.

i. The statutory language does not state a requirement to make the particular findings Citadel claims are necessary. To the contrary, it includes a Congressional finding that excessive speculation can cause sudden or unreasonable fluctuations or unwarranted changes in the price that are a burden on interstate commerce in commodities. The Commission is required to establish position limits in light of that

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[1244] Citadel at 2-4. Somewhat similar views have been expressed by other commenters in earlier phases of the Commission's efforts to promulgate a position limits rule under paragraph 4a(a)(2). *See*, *e.g.*, IATP at 5 (describing views of ISDA/SIFMA AMG in connection with *ISDA* litigation).

[1245] Citadel at 2.

[1246] *Id*.

[1247] *Id*.

[1248] *Id*.

finding, and neither Congress nor the Commission have ever required the sort of showing Citadel suggests here with respect to individual commodities.[1249] It is not reasonable to surmise that Congress intended Citadel's test to apply without saying so, particularly under the Dodd-Frank Act's amendments, which reflect a Congressional intent, or at least expectation, that the position limits regime be expanded. The Commission also notes that Citadel set forth its proposed standard for necessity in just a few sentences and did not spell out what sort of data would be needed to comply with it in practice and how such data would be used.[1250] If there were any evidence that Congress intended Citadel's approach, or if a case could be made that the Commission should prefer it, such specifics would have been readily available.

ii. The Congressional finding at the beginning of paragraph 4a(a)(1) makes clear that Congress's primary concern was the effect of excessive speculation in derivatives markets on the related cash markets for the associated commodities. The Commission's focus on the role the core referenced futures contracts play in price discovery and hedging and the importance of certain commodities to the economy as a whole therefore is directly responsive to the statutory purpose of position limits. The Commission's focus on hedging and price discovery is further supported by CEA section 3, which sets forth the purpose of the CEA. Subsection 3(a) contains a Congressional finding that the transactions subject to the CEA serve a "national public interest" by providing a means for "managing and assuming price risks" (*i.e.*, hedging and supporting hedging) "discovering prices" and "disseminating pricing information." Subsection 3(b) states that the purpose of the CEA, among other things, is to "serve the public interests" described

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[1249] The Commission has made similar determinations in connection with requirements for DCMs to impose position limits or position accountability levels by DCM rule. *E.g.*, Establishment of Speculative Position Limits, 46 FR 50938, 50940 (Oct. 16, 1981) ("it appears that the capacity of any contract market to absorb the establishment and liquidation of large speculative positions in an orderly manner is related to the relative size of such positions, i.e., the capacity of the market is not unlimited"). *See also* 2020 NPRM, 85 FR at 11665-11666 (Commission has repeatedly found that all markets in physical commodities are "susceptible to the burdens of excessive speculation" because they "have a finite ability to absorb the establishment and liquidation of large speculative positions in an orderly manner," but this characteristic of these markets is not sufficient to establish that limits are necessary within the meaning of paragraph 4a(a)(1) for all physical commodities).

[1250] Citadel at 2-3.

in subsection 3(a).[1251] The Commission's focus is thus consistent with the Congressional intent.

The Commission's consideration of the size of the futures market for the core referenced futures contracts also is consistent with the statutory purpose. As explained below,[1252] contracts with a large volume of trading, generally speaking, are contracts that are likely to be heavily used for price discovery and hedging by participants in the cash market. It is rational to conclude that position limits are unnecessary for contracts that play little role in price discovery or for commodities that have a lesser economic footprint. In addition, imposing position limits based on the size or importance of futures markets is a rational way to avoid imposing compliance costs related to position limits on futures contracts and related options contracts that are relatively inactive or otherwise a minor part of the market.

iii. As for Citadel's claim that the Commission's standard for necessity will set a precedent for imposing position limits on additional commodities in the future without adequate justification, if the Commission were to establish additional position limits in the future, it would need to justify that decision through reasoned decision making in a new rulemaking, which would be subject to public comment and judicial review to the same extent as other rules.

iv. Citadel's concern with adequate investor participation in the derivatives markets applies to varying degrees with respect to all position limits. The Commission has considered such effects, including on liquidity and bona fide hedging, throughout this rulemaking, including in its consideration of costs and benefits and in connection with the determination of position limit levels.[1253]

[1251] 7 U.S.C. 5(a), (b).

[1252] *See infra* Section III. (discussing necessity finding).

[1253] *See* 7 U.S.C. 6a(a)(3)(B)(iii) (position limits should be set at level that ensures sufficient market liquidity for bona fide hedgers to the maximum extent practicable in the discretion of the Commission).

c. One commenter, IATP, endorsed a dissenting Commissioner's criticism of the necessity standard set forth in the 2020 NPRM.[1254] The criticism was to the effect that the standard "boils down" to the assertion that the core referenced futures contracts are large and critically important to the underlying cash markets.[1255] However, for reasons set forth above and in the 2020 NPRM, this is an incomplete characterization of the Commission's standard. Moreover, as also explained above and in the 2020 NPRM, importance to the cash market is a criterion for necessity that flows directly from the statutory purpose and, for reasons explained in the necessity findings section, the amount of trading in a contract, generally speaking, is likely to correlate with factors relevant to the statutory purpose, including use of the contract for price discovery and hedging.

While critical of the Commission's standard, IATP was even more critical of a standard like that proposed by Citadel that would require the Commission to "determine the likelihood that a specific limit would curtail excessive speculation in a specific market."[1256] According to IATP, such a standard, in combination with a requirement to avoid undue costs, would make implementation of position limits "nigh to impossible."[1257] However, whether or not such a standard is possible to apply, the Commission has determined that the statute does not require it, and that the Commission's approach to the necessity finding is the one most consistent with the statutory language and purpose.

d. Many commenters asserted that necessity findings needed to be made for each contract or commodity subject to position limits.[1258] The Commission agrees with this interpretation of the statute, subject to a number of clarifications and provisos.

[1254] IATP at 4 (quoting dissenting statement of Commissioner Berkovitz).

[1255] *Id*.

[1256] IATP at 5. IATP did not refer specifically to Citadel's comment but to similar concepts in connection with the *ISDA* litigation.

[1257] IATP at 5.

[1258] *E.g.*, ISDA at 3 (necessity determination must be made "in connection with any specific position limits that are adopted"); PIMCO at 3 (necessity determination should be made on a "commodity-by-commodity and product-by-product basis"); MFA/AIMA at 4 (advocating "for individualized necessity findings based on detailed analyses for each contract … including a more specific necessity finding for each contract").

i. While the Commission must find position limits necessary for each contract, it may do so based on different criteria for different types of contracts so long as the criteria are reasonable and consistent with the Commission's overall interpretation of the necessity provision. For example, as described above, the Commission has determined that, where limits are necessary for a core referenced futures contract, position limits for contracts linked to the core referenced futures contract are also necessary to enable position limits on the associated core referenced futures contract to function as intended.[1259]

ii. The statute does not require a necessity finding for economically equivalent swaps for which position limits are required pursuant to paragraph 4a(a)(5) of the CEA.[1260] While a necessity finding is required for position limits established under paragraph 4a(a)(2) because the Commission must apply "the standards set forth in paragraph [4a(a)(1)]," no similar language appears in paragraph 4a(a)(5). To the contrary, paragraph 4a(a)(5)(A) states that position limits for economically equivalent swaps must be established "[n]otwithstanding any other provision of this section." Moreover, the statute requires the Commission to develop position limits for economically equivalent swaps "concurrently" with position limits established under paragraph 4a(a)(2), and establish those limits "simultaneously" with those established under paragraph 4a(a)(2).[1261] The necessity finding provision of paragraph 4a(a)(1) therefore does not apply to economically equivalent swaps. Rather, when position limits are necessary under paragraph 4a(a)(2), the requirement to establish them for economically equivalent swaps is automatically triggered under CEA section 4a(a)(5).

In addition to being compelled by the statutory language, this is a reasonable interpretation of the statute in policy terms because Congress could reasonably have

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[1259] For further discussion on contracts linked to core referenced futures contracts, *see* Sections II.A.16. and III.D.

[1260] 7 U.S.C. 6a(a)(5).

[1261] 7 U.S.C. 6a(a)(5)(B).

determined that the necessity finding for position limits for futures contracts (and options thereon) carries over to economically equivalent swaps by virtue of the fact that they are economically equivalent.[1262] The Commission notes that, while paragraph 4a(a)(5) does not require the Commission to make a necessity finding for economically equivalent swaps, it requires the Commission to make policy judgments with respect to such swaps in connection with the definition of what swaps are economically equivalent and the requirement that limit levels be established "as appropriate."[1263] The relevant discussion with respect to the determination of what swaps that are deemed to be "economically equivalent swaps" is set forth elsewhere in this preamble.[1264]

e. Some commenters asked the Commission to clarify that it finds position limits not to be necessary for futures contracts other than the referenced contracts specified in the rule.[1265] The Commission agrees that, for commodities falling within the scope of this rulemaking, *i.e.*, "physical commodities other than excluded commodities" for which position limits are required by paragraph 4a(a)(2), the Commission has determined that position limits are necessary only for the 25 core referenced futures contracts and any associated referenced contracts on futures contracts or options on futures contracts, but not for other futures contracts or options on futures contracts.[1266] As with any rulemaking, the necessity determinations made in connection with this rule may change in the future based on market developments, new information or analysis, or changes in Commission policy.

3. Commission Determination Regarding Necessity Standard

[1262] Some commenters stated that the statute requires a necessity finding for swaps. *E.g.*, ISDA at 4. The Commission generally agrees with this position for swaps, but not for economically equivalent swaps for the reasons stated herein.

[1263] 7 U.S.C. 6a(a)(5)(A), (B).

[1264] *See* Section II.A.4.

[1265] *E.g.* SIFMA AMG at 5 ("spot month limits should apply only to physically settled futures contracts (i.e., the core referenced futures contracts), and the Commission should not make any determinations on, or adopt final rules applicable to, financially settled futures at this time."); ISDA at 4 (stating that the Commission should start with final rules only for physically-settled contracts during the spot month.)

[1266] As discussed above, while economically equivalent swaps are encompassed within the "referenced contract" definition, such swaps are subject to Federal position limits pursuant to 7 U.S.C. 6a(a)(5) and therefore are not subject to a necessity determination.

For these reasons and those set forth in the 2020 NPRM, the Commission adopts the interpretation of "necessity" set forth in the 2020 NPRM and clarified and elaborated upon here.

C. Necessity Finding as to the 25 Core Referenced Futures Contracts

1. Introduction

This Final Rule imposes Federal position limits on 25 core referenced futures contracts, any futures contracts or options on futures contracts directly or indirectly linked to the core referenced futures contracts, and any economically equivalent swaps. As discussed above, the Commission bases its necessity analysis on the following propositions reflected in the text of CEA section 4a(a)(1). First, that excessive speculation in derivatives markets can cause sudden or unreasonable fluctuations or unwarranted changes in the price of an underlying commodity. Second, that such price fluctuations and changes are an undue and unnecessary burden on interstate commerce in that commodity. Third, that position limits can diminish, eliminate, or prevent that burden. With these propositions established by Congress, the Commission makes a further determination of whether it is necessary to use position limits, Congress's prescribed tool to address those burdens on interstate commerce, in light of the facts and circumstances.

The Commission finds that position limits on the 25 core referenced futures contracts identified in the 2020 NPRM are necessary to prevent the economic burdens on interstate commerce associated with excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in the price of the commodities underlying these contracts.[1267] As in the 2020 NPRM, this necessity determination is based on two interrelated factors: the importance of the 25 core referenced futures contracts to their respective underlying cash markets, including that they require physical

[1267] *See supra* Section III.B.

delivery of the underlying commodity; and the particular importance to the national economy of the commodities underlying the 25 core referenced futures contracts. The Commission analyzes both factors in turn below.

2. Importance of the 25 Core Referenced Futures Contracts to their Respective Underlying Cash Markets

a. Link Between the Derivatives Market and Its Underlying Cash-Market

As explained in the 2020 NPRM, the Commission has determined that position limits are necessary for physical commodities only where there exists a physically-settled futures contract for two reasons. First, physical settlement establishes a direct link between the futures market and the cash market since futures contracts, while normally closed out by offset, may be settled by delivery of the commodity itself. This link helps to force convergence between futures contract settlement prices and cash-market prices by ensuring that futures prices in the delivery period reflect supply and demand in the cash-market, whereas cash-settled futures contracts do not provide a direct link because physical-delivery is not an option.[1268] As a result, in many circumstances, commercial participants use physically-settled futures contracts for price discovery. Illustrative of this point, at the May 2020 public meeting of the Commission's Energy and Environmental Markets Advisory Committee, an industry representative discussing application of position limits to power markets observed, "In futures markets, where physically-settled contracts are established, such as natural gas or crude oil, these physical contracts effectively serve as the most important price discovery tool for the spot

[1268] *See* 85 FR at 11667. Many participants rely on the possibility of settlement by physical delivery to foster convergence at expiration of the futures contract. *Id*. Because of imperfect contract design or other factors, the convergence mechanism does not always work as hoped in practice. *Id*. at 11676, fn. 575. Such malfunctions are considered to be a public policy concern because bona fide hedgers and other participants seek to hedge cash-market prices with futures contract prices. *Id*. at 11667.

market at baseload supply and demand for the delivery month is managed with the physical futures or physical deals linked to it."[1269]

Second, physically-settled contracts may be at risk of corners and squeezes, because the settlement mechanism of the contract requires participants with short positions to deliver the underlying commodity at expiration.[1270] Physical settlement therefore may increase the sources of the risk of sudden or unreasonable fluctuations or unwarranted changes in the price of the underlying commodity arising from excessive speculation.[1271] Applying position limits to commodities where there is a physically-settled core referenced futures contract therefore is consistent with the Commission's interpretation of the paragraph 4a(a)(1) necessity requirement as directing the Commission to impose limits where they are most likely to be an efficient mechanism for achieving the statutory objectives.[1272]

b. The 25 Core Referenced Futures Contracts Are Used for Hedging and Price Discovery

In the 2020 NPRM, the Commission presented information supporting its determination that the proposed 25 core referenced futures contracts are used extensively for hedging and price discovery, thus establishing a close link between the markets for these futures contracts and commerce in the relevant commodities.[1273] The Commission's conclusions on this point are further supported by comments discussing the use of particular core referenced futures contracts for hedging and price discovery, or

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[1269] *See* Transcript of Committee Meeting at 46:19-47:06, Comment by Nodal Exchange, Inc., U.S. Commodity Futures Trading Commission Energy and Environmental Markets Advisory Committee (2020), https://www.cftc.gov/sites/default/files/2020/06/1591218221/eemactranscript050720.pdf.

[1270] 85 FR at 11672. For example, based on its general experience, the Commission recognizes that if the underlying commodity is "cornered" and the participant with the short position does not already have the commodity to deliver, then the short participant must exit its position through an offsetting long position. As a consequence, the participant will likely have to bid up the price of the futures contract to exit the market, thus "squeezing" the short to pay a higher price for the offsetting long position. Conversely, for a cash-settled contract, a market participant who has cornered the cash market for an underlying commodity cannot squeeze someone who is short the cash-settled futures contract because the short does not have to acquire the underlying commodity to make delivery to the long in a cash-settled contract.

[1271] *See* 7 U.S.C. 6a(a)(3)(B)(ii) (identifying deterrence and prevention of corners and squeezes as one of the objectives of position limits required by 7 U.S.C. 6a(a)(2)).

[1272] *See* ISDA at 3-4 (suggesting that the Commission "finalize the proposed Federal position limits rules only for physically delivered spot month futures contracts, in the first phase … as the Commission finds are necessary to … prevent [e]xcessive speculation ….")

[1273] 85 FR at 11666-71.

discussing more generally the use of futures contracts for hedging and price discovery in the context of the Commission's proposed rule.[1274]

The 25 core referenced futures contracts also serve as key benchmarks for use in pricing cash-market and other transactions.[1275] For example, NYMEX NY Harbor RBOB Gasoline (RB) is the main benchmark used for pricing gasoline in the U.S. petroleum products market, a huge physical market with total U.S. refinery capacity of approximately 9.5 million barrels per day of gasoline.[1276] Similarly, the NYMEX NY Harbor ULSD Heating Oil (HO) contract is the main benchmark used for pricing the distillate products market, which includes diesel fuel, heating oil, and jet fuel.[1277] The utility of the price discovery function for these futures contracts is thus impactful for commercial participants regardless of whether they are actively trading in the futures market.

There is also evidence that the 25 core referenced futures contracts are the physically-settled contracts in physical commodities traded on U.S. exchanges that, by

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[1274] *See, e.g.,* ASR at 1 (stating that ICE Sugar No. 11 and ICE Sugar No. 16 are commonly used by commercial participants for hedging.); NGSA at 12 ("Physical market participants currently hedge Henry Hub price risk through both physically settled and financially-settled futures contracts."); Cargill at 2 ("Commercial end-users … rely on the futures and derivatives markets to perform vital functions including price discovery and risk management related to significant physical commodity origination, production and processing, transportation, purchasing and sales, among other things."); EEI/EPSA at 2 ("The Joint Associations members are not financial entities. Rather, they are physical commodity market participants that rely on futures and swaps to hedge and mitigate their commercial risk."); ADM at 2 ("Many … [futures] transactions are critical elements of risk management, price discovery and hedging while also playing a role in the acquisition of physical commodities."); CMC at 1 (noting that commercial participants "use futures markets to hedge risk exposures related to commercial activities in physical commodities."); DECA at 2 ("The [Cotton] CT contract plays an indispensable role in the global cotton ecosystem and it is needed to provide price discovery for all market participants."); AFIA at 2 ("As commercial end-users, AFIA's members prioritize the need for [futures] markets to work well for their primary function of price discovery and risk management.); NGFA at 2 ("The NGFA's member firms are bona fide hedgers who hedge physical commodity risk and depend on futures markets for price discovery and risk management."); ACSA at 5 ("… the futures delivery process is essential to maintaining functioning agricultural markets, price discovery, and convergence."); PMAA at 1 ("For decades, petroleum marketers have been utilizing oil and refined product futures markets for their hedging needs to protect customers from volatility and price spikes. Well-functioning markets are critical to commodity price discovery."); CCI at 3 ("In addition to covering timing differentials in commodity prices, intra-commodity spreads perform an important function in energy markets by, among other things, promoting price discovery and convergence as well as providing liquidity for priced-linked, physically-settled and cash-settled Referenced Contracts in the same underlying commodity during the spot month as market participants manage their risks across markets."). *See also* NFP Electric Associations, Comment Letter on Proposed Rule on Position Limits for Derivatives and Aggregation of Positions (July 3, 2014), https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59934&SearchText= (noting that the "[energy] markets … provide commercial risk management opportunities and achieve price convergence between futures and cash-market prices for the benefit of commercial hedgers and their counterparties.").

[1275] *See, e.g.*, USDA Economic Research Service, *Contracts, Markets, and Prices: Organizing the Production and Use of Agricultural Commodities*, Agricultural Economic Report No. 837, at 6 (Nov. 2004), https://www.ers.usda.gov/webdocs/publications/41702/14700_aer837_1_.pdf?v.=*41061* (one-third of all U.S. agricultural production is produced under contracts using pricing formulas determined by reference to futures prices); *see also* Paul Peterson, *Fixing Prices and Fixing Markets*, farmdoc daily (4): 118, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign (June 25, 2014), https://farmdocdaily.illinois.edu/2014/06/fixing-prices-and-fixing-markets.html (explaining that futures markets provide price discovery for cash grain spot markets and how price discovery through negotiated prices has diminished over time).

[1276] *See* 85 FR at 11669.

[1277] *Id*.

and large, are most used for hedging and price discovery by cash-market participants. Unfortunately, the Commission does not have information that permits a direct comparative measurement of the extent to which each of the actively traded futures contracts is used for hedging and price discovery. However, available statistics from exchanges show that the 25 core referenced futures contracts, with the partial exception of CBOT Oats (O), a legacy contract, are the most actively traded physically-settled contracts in physical commodities, as measured by open interest and trading volume. As discussed in detail further below, the most actively traded futures contracts will usually be the contracts that are most used for hedging and price discovery.

To follow up on the discussion of trading activity in the 2020 NPRM,[1278] the Commission analyzed average total open interest[1279] and average notional open interest[1280] for all physically-settled futures contracts for the period between January 2019 and December 2019.[1281] From that data, the Commission assessed the 30 largest physically-settled contracts in terms of average total open interest and average notional open interest for comparison.[1282] These 30 contracts comprised the 25 core referenced futures contracts, and the five physically-settled physical commodity contracts with the next-highest amounts of average total open interest and average notional open interest. As shown in the tables below, there is a significant drop in open interest between CBOT Oats (O), which has the lowest open interest of the core referenced futures contracts, and CME Random Length Lumber (LBS), which is the 27th largest physically-settled futures

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[1278] *See id.* at 11666, 11668-70.

[1279] Open interest refers to the total number of outstanding futures contracts that have not been offset at the end of the trading day.

[1280] Notional value means the value of average open interest without adjusting for delta in options.

[1281] The 25 core referenced futures contract are all long-standing, established contracts. Generally speaking, for purposes of this Final Rule, the Commission focused on mature contract markets with at least five years of reported open interest and volume. For example, the Commission notes that the ICE Canola Futures (RS) and NYMEX WTI Houston Crude Oil Futures (HCL) contracts appear to have characteristics similar to those which the Commission has found support a necessity finding, but these contracts are both much newer, and the Commission finds that this militates against finding a position limit necessary until their respective markets mature further. The Commission may consider a position limit necessary for one or both in the future, as it revisits these issues from time to time as required by statute.

[1282] As discussed in the 2020 NPRM, the Commission also analyzed FIA end of month open interest data for December 2019 and FIA 12-month total trading volume data (January 2019 through December 2019) and reached the same conclusion as discussed herein. *See* 85 FR at 11670.

contract and has the second highest open interest of the five contracts not selected from the group of 30 contracts.[1283] Specifically, average total open interest in CBOT Oats (O) (5,630 OI) is almost twice the size of average total open interest in CME Random Length Lumber (LBS) (3,025 OI).[1284]

With the exception of CBOT Oats (O),[1285] as shown in the tables below, the average notional open interest values for the 25 core referenced futures contracts are all substantially larger and more valuable than the five contracts that were not selected. Specifically, outstanding futures average notional values range from approximately $ 33 billion for CBOT Corn (C) to approximately $ 80 million for CBOT Oats (O), with the other core referenced futures contracts on agricultural commodities all falling somewhere in between.[1286] Outstanding futures average notional values of the core referenced futures contracts on metal commodities range from approximately $ 80 billion in the case of COMEX Gold (GC), to approximately $ 3.6 billion in the case of NYMEX Platinum (PL), with the other metals core referenced futures contracts all falling somewhere in between.[1287] With regard to energy commodities, futures average notional values range from $ 116.7 billion in the case of NYMEX Light Sweet Crude Oil (CL) to $ 28.3 billion in the case of NYMEX NY Harbor RBOB Gasoline (RB).[1288]

[1283] Many commenters suggested that the Commission's final rule should demonstrate that position limits are necessary on a "commodity-by-commodity basis" as supported by empirical evidence or data. *See, e.g.* PIMCO at 3; ISDA at 3; SIFMA AMG at 2; MFA/AIMA at 4. As discussed in Section III.B.2.a., *supra*, the Commission agrees that the agency is required to consider relevant data, where available, in determining whether to establish position limits. The Commission however notes that the CEA does not specify the use of any particular methodology, quantitative or otherwise, in determining whether position limits are necessary.

[1284] During the period January 1, 2019 through December 31, 2019, the NYMEX Loop Crude Oil Storage (LPS) futures contract had higher open interest than four of the 25 core referenced futures contracts and the remaining largest contracts that were not selected, as shown in the chart below. The Commission, however, notes that the contract is a capacity allocation contract, which gives the buyer of the contract the legal right to store crude oil at a storage facility in Louisiana for a specified calendar month. The Commission further notes that the contract is a newer one, has fewer reportable traders, and significantly lower average daily trading volume (NYMEX Loop Crude Oil Storage (LPS) 131 Vol.) and average notional value than any of the 25 core referenced futures contracts during this same period. In addition, open interest in the contract has dropped precipitously between January 1, 2020 and September 30, 2020. The Commission finds that all of these reasons militate against finding a position limit necessary for this contract until its market matures further. The Commission may consider a position limit necessary for this contract in the future, as it revisits these issues from time to time as required by statute.

[1285] *See supra* Section II.B.1. (discussing CBOT Oats (O) legacy contract status).

[1286] Calculations are based on data submitted to the Commission pursuant to part 16 of the Commission's regulations.

[1287] *Id*.

[1288] *Id*.

TABLES-ALL FUTURES COMBINED OPEN INTEREST FOR 2019[1289]

Core referenced futures contract	2019 Average Total Open Interest	2019 Average Notional Open Interest
Legacy Agricultural Contracts		
CBOT Corn (C)	1,681,524	33,256,731,844
CBOT Oats (O)	5,629	80,425,033
CBOT Soybeans (S)	717,978	32,647,008,431
CBOT Soybean Meal (SM)	451,076	13,969,781,979
CBOT Soybean Oil (SO)	493,452	8,981,864,994
CBOT Wheat (W)	421,345	9,721,238,192
CBOT KC Hard Red Winter Wheat (KW)	300,269	6,746,361,931
MGEX Hard Red Spring Wheat (MWE)	62,515	1,704,862,973
ICE Cotton No. 2 (CT)	217,966	7,430,284,704
Other Agricultural Contracts		
CME Live Cattle (LC)	369,823	17,132,068,083
CBOT Rough Rice (RR)	8,245	190,068,234
ICE Cocoa (CC)	272,805	6,556,679,464
ICE Coffee C (KC)	296,343	11,755,636,294
ICE FCOJ–A (OJ)	19,443	313,912,369
ICE Sugar No. 11 (SB)	947,198	13,535,036,765
ICE Sugar No. 16 (SF)	8,485	250,447,669
Metals Contracts		
COMEX Gold (GC)	568,515	80,407,265,733
COMEX Silver (SI)	213,561	17,416,579,853
COMEX Copper (HG)	255,720	17,433,897,618
NYMEX Platinum (PL)	83,485	3,635,951,198
NYMEX Palladium (PA)	24,526	3,733,139,669
Energy Contracts		
NYMEX Henry Hub Natural Gas (NG)	1,264,698	32,528,434,977
NYMEX Light Sweet Crude Oil (CL)	2,077,213	116,730,625,086
NYMEX New York Harbor ULSD Heating Oil (HO)	413,880	33,632,235,028
NYMEX New York Harbor RBOB Gasoline (RB)	398,129	28,331,340,324
Largest Contracts Not Selected		
COMEX Aluminum (ALI)	290	12,857,652
CBOT Ethanol (EH)	1,139	45,360,015
CME Random Length Lumber (LBS)	3,025	123,368,066
NYMEX Mont Belvieu Spot Ethylene In-Well (MBE)	493	8,463,276
NYMEX Loop Crude Oil Storage (LPS)	22,995	1,188,630

In addition to open interest and notional value, the Commission analyzed average daily trading volume[1290] for the period January 1, 2019 through December 31, 2019 and notes that trading volume on the 25 core referenced futures contracts is also generally larger than trading volume on the five contracts that were not selected. For example, the CBOT Corn (C) and CBOT Soybean (S) contracts trade over 409,000 and 211,000 contracts respectively per day.[1291] The COMEX Gold (GC) contract trades

[1289] *Id.*

[1290] Daily trading volume represents the total quantity of futures contracts traded within a day.

[1291] Calculations are based on data submitted to the Commission pursuant to part 16 of the Commission's regulations.

approximately 343,288 contracts daily.[1292] The NYMEX Light Sweet Crude Oil (CL) contract, which is the world's most liquid and actively traded crude oil contract, trades nearly 1.2 million contracts a day, and the NYMEX Henry Hub Natural Gas (NG) contract trades on average approximately 409,480 contracts daily.[1293] In contrast, the CME Random Length Lumber (LBS), CBOT Ethanol (EH), COMEX Aluminum (ALI), and NYMEX Mont Belvieu Spot Ethylene In-Well (MBE) contracts, which were not selected, trade approximately 645, 315, 123, and 15.7 contracts respectively per day.[1294]

There are a number of reasons to expect that, generally speaking, the most actively traded futures contracts will usually be the contracts that are most used for hedging and price discovery. First, it is generally accepted that successful futures contracts usually require active market participation by hedgers as well as speculators.[1295] It is therefore reasonable to expect that some significant proportion of the activity in the most active futures contracts will normally consist of hedging and not solely consist of purely speculative trading. In addition, the most active futures contracts are likely to be the most liquid, at least most of the time. Such contracts are likely to be heavily relied upon as sources of price information because their prices reflect the collective opinion of more traders and are therefore likely to be a more accurate representation of the underlying cash-market price conditions.[1296] While the correlation between the magnitude of trading activity and use of a contract for hedging and price discovery is

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[1292] *Id.*

[1293] *Id.*

[1294] *Id.* The average daily trading volume for CBOT Oats (O) (645.04 Vol) is approximately the same as the average daily trading volume for CME Random Length Lumber (LBS) (645.56 Vol), which is the largest contract in terms of volume of the five contracts that were not selected. While the average daily trading volume for ICE Sugar No. 16 (SF) (307.32 Vol), which is the smallest of the 25 core contracts in terms of volume, is less than the average daily trading volume for both CME Random Length Lumber (LBS) (645.56 Vol) and CBOT Ethanol (EH) (315.7 Vol), the Commission notes that many commercial participants frequently use both ICE Sugar No. 16 (SF) and ICE Sugar No. 11 (SB) together for hedging and price discovery because the underlying commodity is the same for both contracts. *See infra* Section III.C.5. (discussing the ICE Sugar No. 16 (SF) and ICE Sugar No. 11 (SB) contracts).

[1295] *See, e.g.,* Holbrook Working, *Futures Trading and Hedging*, 43 Am. Econ. Rev. 314, 319-320 (June 1953), https://www.jstor.org/stable/1811346?seq=1&cid=pdf-reference#references_tab_contents. *See also* William L. Silber*, Innovation, Competition, and New Contract Design in Futures Markets*, 1 J. of Futures Markets 129, 131 (Summer 1981), https://onlinelibrary.wiley.com/doi/abs/10.1002/fut.3990010205.

[1296] *See, e.g.*, 85 FR at 11669, fn. 522-523. *See generally* William L. Silber, *The Economic Role of Financial Futures*, *in* Futures Markets: Their Economic Role 83, 89-90 (A. Peck ed., Am. Enter. Inst. for Pub. Pol'y Rsch. 1985), https://legacy.farmdoc.illinois.edu/irwin/archive/books/Futures-Economic/Futures-Economic_chapter2.pdf (discussing the price discovery and hedging functions of futures markets).

likely imperfect, it provides reason to expect that the 25 core referenced futures contracts are, on the whole, the physically-settled contracts in physical commodities traded on U.S. exchanges that are most used for hedging and price discovery. This is particularly true given the very large gap in activity levels between most of the 25 core referenced futures contracts and physically-settled contracts not included as core referenced futures contracts.

c. Conclusion Regarding Importance of the 25 Core Referenced Futures Contracts to Their Respective Underlying Cash Markets

Based on the information set forth in the NPRM and supplemented here, the Commission concludes that the importance of the 25 core referenced futures contracts to their respective underlying cash markets supports the conclusion that position limits are necessary for these contracts.

3. Importance of the Commodities Underlying the 25 Core Referenced Futures Contracts to the National Economy

With respect to the second factor, importance of the cash commodity to the U.S. economy as a whole, the 2020 NPRM set forth information demonstrating that each of the 25 core referenced futures contracts is important to the U.S. economy in various ways.[1297] Many of the 25 core referenced futures contracts involve commodities that are among the most important physical commodities for the U.S. economy, among those commodities for which physically-settled contracts are traded on U.S. exchanges.[1298]

For example, in the agricultural sector, three of the top five commodities in the United States, as measured by cash receipts, underlie core referenced futures contracts, including cattle, corn, and soybeans.[1299] An additional commodity that underlies several

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[1297] *See* 85 FR at 11666-11671.

[1298] *See, e.g.*, 85 FR at 11668 (discussing agricultural commodities and their downstream uses), *id*. at 11669-70 (discussing energy contracts).

[1299] USDA Economic Research Service, *Cash receipts by State, commodity ranking and share of U.S. total, 2019 Nominal (current dollars)*, https://data.ers.usda.gov/reports.aspx?ID=17843.

core referenced contracts, wheat, is in the top ten.[1300] Primary energy commodities that underlie core referenced futures contracts, specifically crude oil and natural gas, account for over half of U.S. energy production.[1301] Two additional core referenced futures contracts in the energy space, NYMEX New York Harbor ULSD Heating Oil (HO) and NYMEX New York Harbor RBOB Gasoline (RB), relate, in turn, to commodities that are among the most widely used byproducts of crude oil.[1302]

Thus, based on the information set forth in the NPRM and supplemented here, the importance of the underlying commodity to the national economy supports the conclusion that position limits are necessary for the 25 core referenced futures contracts.

4. Commodity Indices

As an independent check on its selection of core referenced futures contracts, the Commission has compared its list with the lists of commodities included in several widely-tracked third-party commodity indices: the Blomberg Commodity Index, the S&P GSCI index, and the Rogers International Commodity Index. Based on the criteria used to create these indices, inclusion of a commodity in the index is an indication that the commodity is important to the world or U.S. economy, and that futures prices for the commodity are considered to be an important source of price information. In particular, Bloomberg states that it selects commodities for its Bloomberg Commodity Index that in its view are "sufficiently significant to the world economy to merit consideration," that are "tradeable through a qualifying related futures contract" and that generally are the "subject of at least one futures contract that trades on a U.S. exchange."[1303] Similarly, S&P's GSCI index is, among other things, "designed to reflect the relative significance of

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[1300] *Id*.

[1301] U.S. Energy Information Administration, *Annual Energy Review, Primary Energy Production by Source, Table 1.2* (last updated Sept. 2020), https://www.eia.gov/totalenergy/data/monthly/pdf/sec1_5.pdf.

[1302] *See*, *e.g.*, U.S. Energy Information Administration, *U.S. petroleum flow,* 2018, https://www.eia.gov/totalenergy/data/monthly/pdf/flow/petroleum.pdf.

[1303] *The Bloomberg Commodity Index Methodology,* Bloomberg, at 16-17 (Jan. 2020), https://data.bloomberglp.com/professional/sites/10/BCOM-Methodology.pdf.

each of the constituent commodities to the world economy."[1304] Likewise, the Rogers International Commodity Index "represents the value of a basket of commodities consumed in the global economy" that are "tracked via futures contracts on 38 different exchange-traded physical commodities" and that "aims to be an effective measure of the price action of raw materials not just in the United States but also around the world."[1305]

Applying these criteria, Bloomberg, S&P, and Rogers have all deemed eligible for inclusion in their indices lists of commodities that overlap significantly with the Commission's 25 core referenced futures contracts. In particular, Bloomberg, S&P, and Rogers include 17, 15, and 22 contracts respectively per index of the 25 contracts selected by the Commission.[1306] Independent index providers thus appear to have arrived at similar conclusions to the Commission's necessity finding regarding the relative importance of certain commodity markets for the economy and price discovery. The indices, taken individually or as a whole, support the Commission's conclusion that position limits are necessary for the 25 core referenced futures contracts.

5. Comments on Proposed Necessity Finding for Core Referenced Futures Contracts

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[1304] *S&P GSCI Methodology,* S&P Dow Jones Indices, at 8 (May 2020), https://www.spglobal.com/spdji/en/indices/commodities/sp-gsci/#overview.

[1305] *The RICI Handbook*, The Guide to the Rogers International Commodity Index, at 4-5 (Aug. 2020), http://www.rogersrawmaterials.com/documents/RICIHndbk_01.31.19.pdf.

[1306] The 17 Bloomberg contracts are ICE Coffee C (KC), COMEX Copper (HG), CBOT Corn (and Mini-Corn) (C), ICE Cotton No. 2 (CT), COMEX Gold (GC), NYMEX New York Harbor ULSD Heating Oil (HO), CME Live Cattle (LC), NYMEX Henry Hub Natural Gas (NG), NYMEX New York Harbor RBOB Gasoline (RB), COMEX Silver (SI), CBOT Soybeans (and Mini-Soybeans) (S), CBOT Soybean Meal (SM), CBOT Soybean Oil (SO), ICE Sugar No. 11 (SB), CBOT Wheat (and Mini-Wheat) (W), CBOT KC HRW Wheat (KW), and NYMEX Light Sweet Crude Oil (CL). *See* https://data.bloomberglp.com/professional/sites/10/BCOM-Methodology.pdf.

The 15 S&P GSCI contracts are ICE Cocoa (CC), ICE Coffee C (KC), CBOT Corn (and Mini-Corn) (C), ICE Cotton No. 2 (CT), COMEX Gold (GC), NYMEX New York Harbor ULSD Heating Oil (HO), CME Live Cattle (LC), NYMEX Henry Hub Natural Gas (NG), NYMEX New York Harbor RBOB Gasoline (RB), COMEX Silver (SI), CBOT Soybeans (and Mini-Soybeans) (S), ICE Sugar No. 11 (SB), CBOT Wheat (and Mini-Wheat) (W), CBOT KC HRW Wheat (KW), and NYMEX Light Sweet Crude Oil (CL). *See S&P GSCI Methodology,* S&P Dow Jones Indices, at 26 (May 2020), https://www.spglobal.com/spdji/en/indices/commodities/sp-gsci/#overview. The 22 Rogers contracts are ICE Cocoa (CC), ICE Coffee C (KC), COMEX Copper (HG), CBOT Corn (and Mini-Corn) (C), ICE Cotton No. 2 (CT), COMEX Gold (GC), NYMEX New York Harbor ULSD Heating Oil (HO), CME Live Cattle (LC), NYMEX Henry Hub Natural Gas (NG), CBOT Oats (O), ICE FCOJ-A (OJ), NYMEX Palladium (PA), NYMEX Platinum (PL), NYMEX New York Harbor RBOB Gasoline (RB), CBOT Rough Rice (RR), COMEX Silver (SI), CBOT Soybeans (and Mini-Soybeans) (S), ICE Sugar No. 11 (SB), CBOT Wheat (and Mini-Wheat) (W), CBOT KC HRW Wheat (KW), MGEX Hard Red Spring Wheat (MWE), and NYMEX Light Sweet Crude Oil (CL). *See* http://www.rogersrawmaterials.com/weight.asp.

While some commenters asserted that position limits are mandatory for all physical commodities, no commenter argued that the necessity finding should apply to any particular contract other than the 25 core referenced futures contracts.[1307]

Only one commenter advocated that the Commission remove commodities from the proposed list of 25 core referenced futures contracts. That commenter, IFUS, objected to imposing Federal position limits on its Sugar No. 11 (SB) contract.[1308] IFUS argued that the Sugar No. 11 (SB) contract does not have "a major significance to U.S. interstate commerce" because the contract prices the physical delivery of raw cane sugar for more than 30 delivery points around the world and only a *de minimis* amount of the raw sugar represented by the contract can be imported into the U.S. under U.S. sugar tariff-rate quotas.[1309] In addition, IFUS stated that the Commission's necessity finding does not establish that ICE Sugar No. 11 (SB) is used for price discovery for sugar produced and consumed in the United States.[1310]

The Commission has considered the comments and is adopting the list of the 25 core referenced futures contracts as proposed, including incorporating the ICE Sugar No. 11 (SB) contract as a core referenced futures contract. In response to IFUS' comment, the Commission recognizes that "Sugar No. 11 (SB) is primarily an international benchmark."[1311] The Commission, however, disagrees with IFUS' comment that the Sugar No. 11 (SB) contract does not have a major significance to U.S. interstate

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[1307] *E.g.*, NEFI at 2 (supporting Federal position limits for all 25 core referenced futures contracts, but stating that the list is too limited because it included only four energy contracts and that Congress imposed a clear mandate to establish limits on all commercially-traded energy derivatives); Better Markets at 64.

[1308] IFUS at 3. The ICE Sugar No. 11 (SB) "contract prices the physical delivery of raw cane sugar free-on-board the receiver's vessel to a port within the country of origin of the sugar." *See* Sugar No. 11 Futures Product Specs, Intercontinental Exchange website, available at https://www.theice.com/products/23/Sugar-No-11-Futures. The United States is one of the delivery points for the ICE Sugar No. 11 (SB) contract because U.S. origin raw cane sugar is one of the 29 deliverable origins under the contract. *Id*.

[1309] IFUS at 3-4.

[1310] IFUS at Exhibit 1, No. 52.

[1311] 85 FR at 11668, fn. 507.

commerce or play a role in price discovery for sugar produced and consumed in the United States.[1312]

For several reasons, the Commission finds that the ICE Sugar No. 11 (SB) contract has sufficient connection to the domestic sugar market to warrant Federal position limits. First, USDA data reflects that roughly one-quarter of the annual U.S. raw sugar supply is imported.[1313] While U.S. imports may be a small percentage of the total sugar represented by open interest in the ICE Sugar No. 11 (SB) contract, U.S. imports still account for a significant percentage of the total U.S. raw sugar supply. As described below, Commission data suggests that the ICE Sugar No. 11 (SB) contract is used for price discovery and hedging within the United States. Thus, when the contract is being used by commercial participants for price discovery or hedging in the domestic raw sugar market, it is therefore reasonable to expect that any sudden or unreasonable fluctuations or unwarranted changes in the global price of raw sugar could impose significant disruptions or harms to the domestic raw sugar markets. Because the ICE Sugar No. 11 (SB) contract represents a material portion of the U.S. sugar market, the Commission determines that it is necessary to include it as a core referenced futures contract to protect against any sudden or unreasonable fluctuations or unwarranted changes, which could result in undue burdens on the U.S. economy. Additionally, as further discussed below, since the ICE Sugar No. 11 (SB) contract represents a material portion of the U.S. raw sugar supply, the Commission concludes that disruptions to this contract potentially could

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[1312] The Commission notes that IFUS did not object to the inclusion of ICE Sugar No. 16 (SF) as a core referenced futures contract in the 2020 NPRM. The ICE Sugar No. 16 (SF) "contract prices physical delivery of US-grown (or foreign origin with duty paid by deliverer) raw cane sugar at one of five U.S. refinery ports as selected by the receiver." *See* Sugar No. 16 Futures Product Specs, Intercontinental Exchange website, available at https://www.theice.com/products/914/Sugar-No-16-Futures. The same commodity, raw centrifugal cane sugar based on 96 degrees average polarization, underlies both ICE Sugar No. 16 (SF) and ICE Sugar No. 11 (SB) contracts. *Id*. *See also* Sugar No. 11 Futures Product Specs, Intercontinental Exchange website, available at https://www.theice.com/products/23/Sugar-No-11-Futures. Both contracts also trade on IFUS in units of 112,000 pounds per contract. *Id.*

[1313] USDA Economic Research Service, *Sugar and Sweeteners Yearbook Tables*, *World Production, Supply, and Distribution*, at Table 1 (July 19, 2018), https://www.ers.usda.gov/data-products/sugar-and-sweeteners-yearbook-tables. For example, between 2009 and 2019, the United States has imported between 22.7% and 28.6% of its raw sugar from other countries. *Id*. In 2019, the United States imported approximately 3 million metric tons of sugar from other countries whose sugar is deliverable under the ICE Sugar No. 11 (SB) contract. *See* USDA, *U.S. Sugar Monthly Import and Re-Exports, Final Report, Fiscal Year 2019* (Oct. 2019), https://www.fas.usda.gov/sites/default/files/2020-01/fy_2019_final_sugar_report.pdf.

harm both the price discovery process for the domestic sugar markets as well as the physical delivery of the underlying commodity.

Second, the ICE Sugar No. 11 (SB) contract is listed on IFUS, a DCM registered with the Commission that lists derivatives contracts for trading by U.S. participants in the United States, among others. Data reported to the Commission through Form 102s reflects that domestic firms account for approximately 20% of commercial market participants and 65%-70% of the non-commercial market participants trading in the ICE Sugar No. 11 (SB) contract.[1314] This data supports the Commission's finding that the ICE Sugar No. 11 (SB) contract is "used for price discovery and hedging within the United States."[1315]

Finally, as the Commission noted in the 2020 NPRM, the Commission believes that the ICE Sugar No. 11 (SB) and ICE Sugar No. 16 (SF) contracts together "[a]s a pair" are "crucial tools for risk management and for ensuring reliable pricing."[1316] The Commission's view is informed by the fact that both ICE Sugar No. 11 (SB) and ICE Sugar No. 16 (SF) call for delivery of the same size and quality of raw cane sugar, with the former contract calling for delivery from 29 different country origins of growth, including the United States, and the latter contract calling for delivery of domestic origin.[1317] This implies that there is likely to be a common group of market participants trading in both contracts. Based on its experience in other markets, the Commission understands that U.S. firms may utilize both contract markets to hedge cash positions and offset other related risks even if their inventories cannot be delivered against both contracts.

[1314] *See also* ASR at 1 (stating that the ICE Sugar No. 11 (SB) and ICE Sugar No. 16 (SF) contracts are commonly used by commercial participants for hedging).

[1315] 85 FR at 11668, fn. 507.

[1316] *Id.*

[1317] *See* ICE Sugar No. 16 Futures Product Specs, Intercontinental Exchange website, available at https://www.theice.com/products/914/Sugar-No-16-Futures*; see also* Sugar No. 11 Futures Product Specs, Intercontinental Exchange website, available at https://www.theice.com/products/23/Sugar-No-11-Futures.

In that regard and as discussed above in Section III.C.2.b, the Commission analyzed average open interest and average notional values for ICE Sugar No. 11 (SB) and ICE Sugar No. 16 (SF) for the period January 1, 2019 through December 31, 2019. Specifically, average open interest in ICE Sugar No. 11 (SB) (947,198 OI) is more than 100 times the size of average open interest in ICE Sugar No. 16 (SF) (8,485 OI).[1318] Similarly, the average notional value for ICE Sugar No. 11 (SB) ($13,535,036,765 Notional OI) is roughly 54 times greater than the average notional value for ICE Sugar No. 16 (SF) ($250,447,669 Notional OI).[1319] In terms of average trading volume for the same time period, the ICE Sugar No. 11 (SB) contract trades approximately 146,077 contracts per day, whereas the ICE Sugar No. 16 (SF) contract trades approximately 307 contracts per day.[1320] Accordingly, the Commission believes, and the data supports, that U.S. commercial participants use the more-liquid ICE Sugar No. 11 (SB) contract to hedge domestically sourced raw sugar or domestic inventories and for price discovery for sugar produced and consumed in the United States. [1321]

6. Commission Determination

For the reasons stated in the 2020 NPRM and further discussed here, the Commission finds that position limits are necessary for the 25 core referenced futures contracts.

D. Necessity Finding as to Linked Contracts

The Commission finds that position limits on futures and options on futures contracts that are linked to core referenced futures contracts are necessary to enable position limits to function effectively for commodities where position limits have been found to be necessary in connection with the relevant core referenced futures contracts.

[1318] Calculations are based on data submitted to the Commission pursuant to part 16 of the Commission's regulations and does not include delta adjusted option on futures contracts.

[1319] *Id*.

[1320] *Id*.

[1321] USDA data reflects that each year, U.S. commercial firms hold over 1 million metric tons of raw sugar as inventory (after accounting for all imports, production, and use during the year).

As explained in detail above at Section II.A.16, due to the nature of the linkages specified in the definition of "referenced contract" in § 150.1, and the resulting possibilities for arbitrage, contracts linked to core referenced futures contracts, including cash-settled linked contracts, function together with the linked core referenced futures contract as part of one market.[1322] As a result, without position limits on such linked contracts, excessive speculative positions in these contracts can affect associated core referenced futures contracts and cash commodity markets in a variety of ways that undermine the effectiveness of position limits on the core contracts.

For example, large positions in linked contracts can serve as a vehicle for profiting from manipulation of the prices of core referenced futures contracts and cash commodities.[1323] Conversely, excessive speculation that artificially affects the price of a linked contract can distort pricing, liquidity, and delivery in the market for the core referenced futures contract and cash commodity to which the contract is linked.[1324] Finally, physically-settled indirectly linked contracts, if not subject to position limits, can serve as a vehicle for evasion through the creation of contracts that are economically equivalent to core referenced futures contracts.[1325]

The Commission therefore finds that position limits for futures contracts and options on futures contracts that are linked to core referenced futures contracts are necessary within the meaning of paragraph 4a(a)(1) where limits are necessary for the associated core referenced futures contracts.

E. Necessity Finding for Spot/Non-Spot Month Position Limits

As discussed above in Section II.B.2. and in the 2020 NPRM, the Commission preliminarily determined that Federal position limits should only apply to spot month

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[1322] For further discussion of referenced contracts and linked contracts, *see supra* Section II.A.16.

[1323] *Id.* (discussing the use of linked contracts to manipulate prices of physically-settled contracts and the use of cash-market transactions to affect prices of physically-settled futures contracts and their linked counterparts).

[1324] *Id.*

[1325] *See supra* Section II.A.16. (discussing referenced contracts).

positions except with respect to the nine legacy agricultural contracts, where non-spot month position Federal position limits have been in place for many years. As discussed above, the Commission is adopting this aspect of the rule as proposed. Consistent with this policy determination, the Commission finds that position limits are necessary during all months for the nine legacy agricultural contracts. The Commission further finds that position limits are necessary only during the spot month for the 16 non-legacy core referenced futures contracts and unnecessary outside of the spot month.[1326]

The Commission makes this necessity finding for substantially the reasons set forth above, including in responses to comments on the spot/non-spot month issue. Briefly, certain potential sources of sudden or unreasonable fluctuations or unwarranted changes in commodity prices caused by excessive speculation, particularly corners, squeezes, and certain convergence problems, are associated primarily with large positions held during spot months.[1327] And, to the extent that these problems may arise in prior months, they are mitigated by exchange policies including exchange-set position limits and position accountability.[1328] As a result, even if position limits may have benefits outside the spot month, restricting Federal position limits to spot months for most commodities is consistent with the Commission's interpretation of the paragraph 4a(a)(1) necessity requirement as directing the Commission to impose position limits where they are most economically justified as an efficient mechanism for achieving the statutory objectives.

The Commission similarly finds position limits in non-spot months to be necessary for the legacy agricultural contracts for substantially the reasons discussed above.[1329] These limits were put in place pursuant to past statutory necessity findings and

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[1326] At least one commenter asked to Commission to explicitly clarify this point, *see* ISDA at 3.
[1327] *See supra* Section II.B.2. (discussing Final Rule provisions).
[1328] *Id*.
[1329] *See supra* Section II.B.2. (discussing Final Rule provisions).

have been in place for decades without the Commission observing problems that would give reasons to remove them.[1330] And they are generally supported by many market participants.[1331] Because no commenters argued that the Commission should eliminate Federal non-spot month position limits for the nine legacy agricultural contracts and because these limits have been in existence for decades, the Commission believes that it would be imprudent to eliminate them absent any specific reason in support thereof, particularly insofar as maintaining them, by definition, will result in no new costs or burdens. The Commission further notes that maintaining non-spot month limits for the nine legacy agricultural contracts will not change the existing dynamics of these markets.

The Commission is therefore satisfied that these limits remain an efficient mechanism for achieving the objectives of CEA section 4a.

IV. Related Matters

A. Cost-Benefit Considerations

1. Introduction

Section 15(a) of the Commodity Exchange Act ("CEA" or "Act") requires the Commodity Futures Trading Commission ("Commission") to consider the costs and benefits of its actions before promulgating a regulation under the CEA.[1332] Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations (collectively, the "section 15(a) factors").[1333]

[1330] *Id.*

[1331] *Id.* The Commission notes that while ISDA did not specifically address the nine legacy agricultural contracts, it suggested that the Commission "should finalize the proposed Federal position limits rules only for physically delivered spot month futures contracts, in the first phase." *See* ISDA at 3-4.

[1332] 7 U.S.C. 19(a).

[1333] *Id.*

The Commission interprets section 15(a) to require the Commission to consider only those costs and benefits of its changes that are attributable to the Commission's discretionary determinations (*i.e.*, changes that are not otherwise required by statute) compared to the existing status quo baseline requirements. For this purpose, the status quo requirements, which serve as the baseline for the consideration of the costs and benefits of the regulations adopted in this final position limits rulemaking ("Final Rule"), include the CEA's statutory requirements as well as any applicable existing Commission regulations.[1334] As a result, any changes to the Commission's regulations that are required by the CEA or other applicable statutes are not deemed to be discretionary changes for purposes of discussing related costs and benefits of the Final Rule.

The Commission anticipates that the Final Rule will affect market participants differently depending on their business models and scale of participation in the commodity contracts that are covered by the Final Rule.[1335] The Commission also anticipates that the Final Rule may result in "programmatic" costs to some market participants. Generally, affected market participants may incur increased costs associated with developing or revising, implementing, and maintaining compliance functions and procedures. Such costs might include those related to the monitoring of positions in the relevant referenced contracts; related filing, reporting, and recordkeeping requirements; and the costs of changes to information technology systems.

The Commission has determined that it is not feasible to quantify the costs or benefits with reasonable precision and instead has identified and considered the costs and

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[1334] This cost-benefit consideration section is divided into seven parts, including this introductory section, with respect to any applicable CEA or regulatory provisions.

[1335] For example, the Final Rule could result in increased costs to market participants who may need to adjust their trading and hedging strategies to ensure that their aggregate positions do not exceed Federal position limits, particularly those who will be subject to Federal position limits for the first time (*i.e.*, those who may trade contracts for which there are currently no Federal position limits). On the other hand, existing costs could decrease for those existing market participants whose positions would fall below the new Federal position limits and therefore such market participants would not be required to adjust their trading strategies and/or apply for exemptions from the limits, particularly if the Final Rule improves market liquidity or other metrics of market health. Similarly, for those market participants who would become subject to the Federal position limits, general costs would be lower to the extent such market participants can leverage their existing compliance infrastructure in connection with existing exchange position limit regimes, relative to those market participants that do not currently have such systems.

benefits qualitatively.[1336] The Commission believes that, for many of the costs and benefits, quantification is not feasible with reasonable precision, because quantification requires understanding all market participants' business models, operating models, cost structures, and hedging strategies, including an evaluation of the potential alternative hedging or business strategies that could be adopted under the Final Rule. Further, while Congress has tasked the Commission with establishing such Federal position limits as the Commission finds are "necessary," some of the benefits, such as mitigating or eliminating manipulation or excessive speculation, may be very difficult or infeasible to quantify. These benefits, moreover, will likely manifest over time and be distributed over the entire market.

In light of these limitations, to inform its consideration of costs and benefits of the Final Rule, the Commission in its discretion relies on: (1) its experience and expertise in regulating the derivatives markets; (2) information gathered through public comment letters[1337] and meetings with a broad range of market participants; and (3) certain Commission data, such as the Commission's Large Trader Reporting System and data reported to swap data repositories.

The Commission considers the benefits and costs discussed below in the context of international markets, because market participants and exchanges subject to the Commission's jurisdiction for purposes of position limits may be organized outside of the United States; some industry leaders typically conduct operations both within and outside the United States; and market participants may follow substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the discussion of benefits and costs below refers to the effects of the Final

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[1336] With respect to the Commission's analysis under its discussion of its obligations under the Paperwork Reduction Act ("PRA"), the Commission has endeavored to quantify certain costs and other burdens imposed on market participants related to collections of information as defined by the PRA. *See generally* Section IV.B. (discussing the Commission's PRA determinations).

[1337] While the general themes contained in comments submitted in response to prior proposals informed this rulemaking, the Commission withdrew the 2013 Proposal, the 2016 Supplemental Proposal, and the 2016 Reproposal. *See supra* Section I.A.

Rule on all activity subject to it, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with, or effect on, U.S. commerce under CEA section 2(i).[1338]

The Commission sought comments on all aspects of the cost and benefit considerations in the 2020 NPRM, including: (1) identification and assessment of any costs and benefits not discussed in the 2020 NPRM; (2) data and any other information to assist or otherwise inform the Commission's ability to quantify or qualify the costs and benefits of the 2020 NPRM; and (3) substantiating data, statistics, and any other information to support positions posited by comments with respect to the Commission's consideration of costs and benefits.[1339] The Commission also requested specific comments regarding its considerations of the benefits and costs of proposed §§ 150.3 and 150.9, as well as comments on whether a Commission-administered exemption process, such as the process in proposed § 150.3, would promote more consistent and efficient decision-making or whether an alternative to proposed § 150.9 would result in a superior cost-benefit profile.[1340] Last, the Commission requested comment on all aspects of the Commission's discussion of the 15(a) factors for the 2020 NPRM.[1341]

The Commission identifies and discusses the costs and benefits of the Final Rule organized conceptually by topic, and certain topics may generally correspond with a specific regulatory section. The Commission's discussion is organized as follows: (1) this introduction discussion section; (2) a discussion of the Commission's necessity finding with respect to the 25 core referenced futures contracts that are subject to the Federal position limits framework; (3) the Federal position limit levels (final § 150.2), and the definitions of "referenced contract" and "economically equivalent swap"; (4) the

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[1338] 7 U.S.C. 2(i).
[1339] 85 FR 11671, 11698.
[1340] 85 FR 11693.
[1341] 85 FR 11700.

Commission's exemptions from Federal position limits (final § 150.3), including the Federal bona fide hedging definition (final § 150.1); (5) the streamlined process for the Commission to recognize non-enumerated bona fide hedges (final § 150.9) and to grant other exemptions for purposes of Federal position limits (final §150.3) and related reporting changes to part 19 of the Commission's regulations; (6) the exchange-set position limits framework and exchange-granted exemptions thereto (final §150.5); and (7) the section 15(a) factors.

2. Costs and Benefits of Commission's Necessity Finding for the 25 Core Referenced Futures Contracts with Respect to Liquidity and Market Integrity and Resulting Impact on Market Participants and Exchanges

Rather than discussing the general costs and benefits of the Federal position limits framework in this section, the Commission will instead address the potential costs and benefits resulting from the Commission's necessity finding with respect to the 25 core referenced futures contracts.[1342] The discussion in this section begins with an overview of the Commission's Federal position limits framework in part one followed by an overview of the Commission's interpretation of the criteria for finding position limits necessary within the meaning of CEA section 4a(a)(1) in part two. An overview of the Commission's necessity finding for the 25 core referenced futures contracts, linked "referenced contracts," and spot/non-spot month position limits is discussed in part three. Finally, part four includes a discussion of the potential costs and benefits of the

[1342] This Section does not address the cost-benefit implications for imposing position limits on futures contracts and options thereon that are directly or indirectly linked to a core referenced futures contract. That discussion is below in Section IV.A.4. Further, this Section does not address the cost-benefit implications for maintaining non-spot month position limits on the nine legacy agricultural contracts. The Commission is of the view that the Final Rule should not have any cost-benefit consideration impacts due to the existence of Federal non-spot month position limits on the nine legacy agricultural commodities since the Commission is maintaining the status quo with respect to the existence of such limits for those contracts. As a result, the Commission does not expect there to be a change with respect to the costs and benefits of its approach by simply finding that Federal position limits continue to be necessary during the non-spot months for the nine legacy agricultural commodities. However, with the exception of CBOT Oats (O), CBOT KC HRS Wheat (KW), and MGEX HRS Wheat (MWE), the final rule will result in higher non-spot month position limit levels for the remaining legacy agricultural commodities. *See infra* Section IV.A.4. (addressing the costs and benefits of generally increased non-spot month position limit levels for the legacy agricultural contracts).

Commission's necessity finding for the 25 core referenced futures contracts with respect to (a) the liquidity and integrity of the futures and related options markets; and (b) market participants and exchanges.

i. Federal Position Limits Framework

The Commission currently enforces and sets Federal spot and non-spot month position limits only for futures and options on futures contracts on the nine legacy agricultural commodities.[1343] The Final Rule expands the scope of commodity derivative contracts subject to the Commission's existing Federal position limits framework[1344] to include (a) futures contracts and options on futures contracts on 16 additional contracts during the spot month only, for a total of 25 core referenced futures contracts,[1345] (b) futures contracts and options on futures contracts directly or indirectly linked to one of the 25 core referenced futures contracts, and (c) swaps that are "economically equivalent" to certain referenced contracts.[1346] Under this Final Rule, Federal non-spot month position limits will continue to apply only to futures and options on futures on the nine legacy agricultural commodities. As discussed above in Section III.B.2., while economically equivalent swaps are encompassed within the "referenced contract" definition, such swaps are subject to Federal position limits pursuant to CEA section 4a(a)(5) and therefore not subject to a necessity determination. The cost-benefit

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[1343] The nine legacy agricultural contracts currently subject to Federal spot and non-spot month limits are: CBOT Corn (C), CBOT Oats (O), CBOT Soybeans (S), CBOT Wheat (W), CBOT Soybean Oil (SO), CBOT Soybean Meal (SM), MGEX Hard Red Spring Wheat (MWE), ICE Cotton No. 2 (CT), and CBOT KC Hard Red Winter Wheat (KW).

[1344] 17 CFR 150.2. Because the Commission had not yet implemented the Dodd-Frank Act's amendments to the CEA regarding position limits, except with respect to aggregation (*see generally* Final Aggregation Rulemaking, 81 FR at 91454) and the vacated 2011 Position Limits Rulemaking's amendments to 17 CFR 150.2 (*see* *ISDA*, 887 F. Supp. 2d 259 (2012)), the existing baseline or status quo consisted of the provisions of the CEA relating to position limits immediately prior to effectiveness of the Dodd-Frank Act amendments to the CEA and the relevant provisions of existing parts 1, 15, 17, 19, 37, 38, 140, and 150 of the Commission's regulations, subject to the aforementioned exceptions.

[1345] The 16 new products that are subject to Federal spot month position limits for the first time include seven agricultural (CME Live Cattle (LC), CBOT Rough Rice (RR), ICE Cocoa (CC), ICE Coffee C (KC), ICE FCOJ-A (OJ), ICE Sugar No. 11 (SB), and ICE Sugar No. 16 (SF)), four energy (NYMEX Light Sweet Crude Oil (CL), NYMEX New York Harbor ULSD Heating Oil (HO), NYMEX New York Harbor RBOB Gasoline (RB), NYMEX Henry Hub Natural Gas (NG)), and five metals (COMEX Gold (GC), COMEX Silver (SI), COMEX Copper (HG), NYMEX Palladium (PA), and NYMEX Platinum (PL)) contracts.

[1346] *See supra* Section II.A.4. (defining the term "economically equivalent swap" for purposes of the Federal position limits framework under the Final Rule).

implications of the Commission's "economically equivalent swap" definition are discussed further below.

ii. The Commission's Interpretation of Section 4a

As previously discussed, the Commission interprets CEA section 4a to require that the Commission make an antecedent "necessity" finding that establishing Federal position limits is "necessary" to diminish, eliminate, or prevent certain burdens on interstate commerce with respect to the physical commodities in question.[1347] As the statute does not define the term "necessary," the Commission must apply its expertise in construing this term, and, as discussed further below, must do so consistent with the policy goals articulated by Congress, including in CEA sections 4a(a)(2)(C) and 4a(a)(3), as noted throughout this discussion of the Commission's cost-benefit considerations.[1348]

Under this Final Rule, the Commission is establishing position limits on 25 core referenced futures contracts[1349] and any futures contracts or options on futures contracts directly or indirectly linked to the core referenced futures contracts,[1350] on the basis that position limits on such contracts are "necessary" to achieve the purposes of the CEA. In reaching this conclusion, the Commission analyzed (1) the importance of these contracts to the operation of the underlying cash commodity market, including that they require physical delivery; and (2) the importance of the underlying commodity to the economy as a whole.[1351] As discussed above, the Commission is of the view that evidence demonstrating one or both of these factors is sufficient to establish that position limits are necessary because each factor relates to the statutory objective identified in paragraph

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[1347] *See supra* Section III.B. (discussing legal standard for necessity finding).

[1348] In promulgating the position limits framework, Congress instructed the Commission to consider several factors: First, CEA section 4a(a)(3) requires the Commission when establishing position limits, to the maximum extent practicable, in its discretion, to (i) diminish, eliminate, or prevent excessive speculation; (ii) deter and prevent market manipulation, squeezes, and corners; (iii) ensure sufficient market liquidity for bona fide hedgers; and (iv) ensure that the price discovery function of the underlying market is not disrupted. Second, CEA section 4a(a)(2)(C) requires the Commission to strive to ensure that any limits imposed by the Commission will not cause price discovery in a commodity subject to position limits to shift to trading on a foreign exchange.

[1349] *See supra* Section III.C. (discussing necessity finding for the 25 core referenced futures contracts).

[1350] *See supra* Section III.D. (discussing necessity finding for linked contracts).

[1351] *See supra* Section III.B. (discussing and adopting legal standard for necessity finding in 2020 NPRM).

4a(a)(1).[1352] As a result, the Commission has concluded that it must exercise its judgment in light of facts and circumstances, including its experience and expertise, in determining whether Federal position limit levels are economically justified.[1353]

iii. The Commission's Necessity Finding

With respect to the first factor of the Commission's necessity analysis, the Commission focused on physically-settled futures contracts because they perform an important price discovery function for many cash-market participants and may be affected by corners and squeezes, which can occur near the expiration of these contracts, compared to cash-settled contracts.[1354] Based on the above discussion, the Commission determined that the 25 core referenced futures contracts are important to their respective underlying cash markets because they (1) are the physically-settled contracts in physical commodities traded on U.S. exchanges that are the most used for hedging and price discovery by commercial participants, as measured by open interest, notional value, and trading volume; and (2) serve as key benchmarks for use in pricing cash-market and other transactions.[1355] Upon consideration of the second factor, as discussed in further detail above, the Commission has determined that the cash markets underlying the 25 core referenced futures contracts are all, to varying degrees, vitally important to the U.S. economy because many of the commodities underlying the 25 contracts are among the most important physical commodities, as measured by production and use, for commodities for which physically-settled futures contracts are traded on U.S. exchanges.[1356] For these reasons, the Commission finds that position limits are necessary for the 25 core referenced futures contracts to achieve the purposes of the CEA.[1357]

[1352] *Id.*

[1353] *Id.*

[1354] *See supra* Section III.C.2.a. (discussing the link between the derivatives markets and underlying cash-markets).

[1355] *See supra* Section III.C.2.b. (discussing the Commission's determination that the 25 core referenced futures contracts are used extensively for hedging and price discovery, thus establishing a close link between both markets).

[1356] *See supra* Section III.C.3. (discussing second factor of necessity analysis).

[1357] *See supra* Section III.C. (discussing necessity finding for 25 core referenced futures contracts).

As noted previously, the Commission has determined that position limits for futures and options on futures contracts that are linked to core referenced futures contracts are necessary within the meaning of paragraph 4a(a)(1) because such position limits are likely to make position limits for core referenced futures contracts more effective in preventing manipulation and other sources of sudden or unreasonable fluctuations or unwarranted changes in the price of the underlying commodity.[1358]

Further, the Commission has determined that position limits are necessary during all months for the nine legacy agricultural contracts, where non-spot month Federal position limits have been in place for decades, and only necessary during the spot month for the 16 additional core referenced futures contracts.[1359] Specifically, the Commission found that certain potential sources of sudden or unreasonable fluctuations or unwarranted changes in commodity prices caused by excessive speculation, particularly corners, squeezes, and certain convergence problems, are associated primarily with large positions held during spot months.[1360] And, to the extent that these problems may arise in prior months, they are mitigated by exchange policies including exchange-set position limits and position accountability.[1361] As a result, even if position limits may have benefits outside the spot month, restricting Federal position limits to spot months for most commodities is consistent with the Commission's interpretation of the CEA section 4a(a)(1) necessity requirement as directing the Commission to impose position limits where they are economically justified as an efficient mechanism for achieving the statutory objectives.

The Commission similarly found position limits in non-spot months to be necessary for the nine legacy agricultural contracts for the reasons previously stated

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[1358] *See supra* Section III.D. (discussing necessity finding for linked contracts).
[1359] *See supra* Section III.E. (discussing necessity finding for spot/non-spot month position limits).
[1360] *See supra* Section III.C.2.a. (discussing link between derivatives market and cash markets).
[1361] *See supra* Section III.E. (discussing necessity finding for spot/non-spot month position limits).

above.[1362] Briefly, these limits were put in place pursuant to past statutory necessity findings and have been in place for decades without the Commission observing problems or concerns by market participants that would give reasons to remove them.[1363] For these reasons, the Commission has determined that it would be imprudent to eliminate them absent any specific reason in support thereof.

iv. Potential Costs and Benefits of the Commission's Necessity Finding for the 25 Core Referenced Futures Contracts

In this section, the Commission will discuss potential costs and benefits resulting from the Commission's necessity finding with respect to: (1) the liquidity and integrity of the futures and related options markets; and (2) market participants and exchanges. The Commission discusses each factor in turn below.

a. Potential Impact of the Scope of the Commission's Necessity Findings on Market Liquidity and Integrity

The Commission has determined that the 25 core referenced futures contracts included in its necessity finding are among the most liquid physical commodity contracts, as measured by open interest and trading volume,[1364] and, therefore, imposing positions limits on these contracts may impose costs on market participants by constraining liquidity because a trader may be prevented from trading due to a position limit reducing liquidity on the other side of the contract. However, to the extent that the nine legacy agricultural contracts already are subject to existing Federal position limits, the Final Rule does not represent a change to the status quo baseline (although, as noted below, the applicable Federal position limits will increase under the Final Rule for most of the nine legacy agricultural contracts and the associated costs and benefits are discussed thereunder). Nonetheless, the Commission believes that any potential harmful effect on

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[1362] *Id*.

[1363] *Id*.

[1364] *See supra* Section III.C.2.b. (discussing average open interest and average daily trading volume for the 25 core referenced futures contracts for the period January 1, 2019 through December 31, 2019).

liquidity will be muted, as a result of the generally high levels of open interest and trading volumes of the respective 25 core referenced futures contracts. This is so because, all other things being equal, large, liquid markets tend to have more participants and tend to be less concentrated. As a result, in such markets, if position limits on some occasion restrict trading by one or a small number of large traders, it is highly likely that other traders will be participating in the market in sufficient volume for the purpose of providing liquidity on reasonable terms.

The Commission has determined that, as a general matter, focusing on the 25 core referenced futures contracts may benefit market integrity since these contracts generally are amongst the largest physically-settled contracts with respect to relative levels of open interest and trading volumes.[1365] The Commission therefore believes that excessive speculation or potential market manipulation in such contracts is more likely to affect additional market participants and therefore potentially more likely to cause an undue and unnecessary burden (*e.g.*, potential harm to market integrity or liquidity) on interstate commerce. Because each core referenced futures contract is physically-settled, as opposed to cash-settled, the Final Rule focuses on preventing corners and squeezes in those contracts where such market manipulation could cause significant harm in the price discovery process for their respective underlying commodities.[1366]

While the Commission recognizes that market participants may engage in market manipulation through cash-settled futures contracts and options on futures contracts, the Commission has determined that focusing on the physically-settled core referenced futures contracts will benefit market integrity by reducing the risk of corners and squeezes in particular. In addition, not imposing position limits on additional commodities may foster non-excessive speculation, leading to better prices and more

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[1365] *Id*.

[1366] The Commission must also make this determination in light of its limited available resources and responsibility to allocate taxpayer resources in an efficient manner to meet the goals of CEA section 4a(a)(1), 7 U.S.C. 6a(a)(1), and the CEA generally.

efficient resource allocation in these commodities. This may ultimately benefit commercial end users and possibly be passed on to the general public in the form of better pricing. As noted above, the scope of the Commission's necessity finding with respect to the 25 core referenced futures contracts allows the Commission to focus on those contracts that, in general, the Commission recognizes as having particular importance in the price discovery process for their respective underlying commodities as well as potentially acute economic burdens that would arise from excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in the commodity prices underlying these contracts.[1367]

To the extent the Commission did not include additional commodities in its necessity finding, those markets will not receive the benefits intended from the Final Rule's Federal position limits framework. It is conceivable that this could entice bad actors to turn to those markets for illegal schemes. On the other hand, markets outside the 25 core referenced futures contracts are not left totally exposed. Some of the potential harms to market integrity associated with not including additional commodities within the Federal position limits framework could be mitigated to an extent by exchanges, which can use tools other than position limits, such as margin requirements or position accountability at lower levels than the Federal position limits adopted in the Final Rule, to defend against certain market behavior.

Further, burdens related to potential market manipulation for markets outside the 25 core referenced futures contracts may be mitigated through exchanges also establishing exchange-set position limits. Under final § 150.5(a) and (b), exchanges are required to adopt exchange-set position limits both (i) for contracts subject to Federal position limits and (ii) during the spot month for physical commodity contracts not

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[1367] *See supra* Section III.C.2.b.

subject to Federal position limits.[1368] Final § 150.5(b) also requires exchanges to adopt position limits or position accountability outside the spot month for those physical commodity contracts not subject to Federal position limits outside of the spot month.

Exchange-set position limits, including amendments to existing limits, are reviewed by Commission staff via submissions under part 40 of the Commission's regulations, and must meet standards established by the Commission, including in §§ 150.1 and 150.5.[1369] While the review of exchange-set limits is focused on the adequacy of the exchange-set position limit to minimize the potential for manipulation, it isn't reviewed considering all of the CEA section 4a(a)(3)(B) factors as Federal position limits require. Thus, exchange-set limits may be set at a more restrictive level than a Federal speculative position limit might be set for the same contract if it were subject to Federal limits and therefore may have higher compliance and liquidity costs than Federal limits on the same contract for periods of time. Exchange limits may be updated much faster and more frequently than Federal limits can be updated.[1370] Therefore, any added compliance and liquidity costs may only be realized in the short-term relative to any compliance and liquidity costs from a Federal limit on the same contract.

Although the Commission does not find that exchange-set limits render Federal position limits unnecessary for the 25 core referenced futures contracts and associated markets, due to their overall importance, these tools do diminish the potential costs of refraining from imposing Federal position limits outside of the 25 core referenced futures

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[1368] As discussed earlier in this release, final § 150.5(a) requires exchange-set limits for contracts subject to Federal limits to be no higher than the Federal limit. Final § 150.5(b)(1) requires exchanges to establish position limits for spot-month contracts in physical commodities that are not subject to Federal position limits at a level that is "necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index." *See supra* Section II.D. (discussing Final § 150.5).

[1369] Further, as part of the submission process, exchanges are encouraged to determine exchange-set limits based on the guidance in Appendix C to part 38 ("Demonstration of compliance that a contract is not readily susceptible to manipulation"). *See* 17 CFR part 38, Appendix C. Appendix C provides guidance on calculating deliverable supply for physical commodity contracts based on the terms and conditions of the futures contract and also refers to part 150 for specific information regarding the establishment of speculative position limits including exchange-set speculative position limits.

[1370] Exchanges can self-certify amendments to exchange-set limits under § 40.6. Federal position limits are updated only through the rulemaking process.

contracts. Bad actors may also be deterred by the Commission's anti-manipulation authority and the Commission's authority to purse violations of exchange-set limits.[1371]

b. Potential Impact of the Scope of the Commission's Necessity Findings on Market Participants and Exchanges

The Commission acknowledges that the Final Rule's Federal position limits framework could impose certain administrative, logistical, technological, and financial burdens on exchanges and market participants, especially with respect to developing or expanding compliance systems and the adoption of monitoring policies.[1372] The Commission, however, believes that these burdens will be mostly incremental as many of the fixed costs have already been incurred by exchanges and market participants. For example, exchanges are currently required to comply with comparable requirements such as calculating average daily trading volume. Further, market participants are required to comply with existing requirements such as existing Federal position limits and exchange-set limits and accountability levels.[1373]

The Commission further believes that these potential burdens are mitigated by (1) the compliance date of January 1, 2022 in connection with the Federal position limits for the 16 non-legacy core referenced futures contracts, and (2) the compliance date of January 1, 2023 for both (a) economically equivalent swaps that are subject to Federal position limits under the Final Rule and (b) the elimination of previously-granted risk management exemptions (*i.e.*, market participants may continue to rely on their previously-granted risk management exemptions until January 1, 2023).[1374] These

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[1371] *See, e.g., In the Matter of Sukarne SA de CV,* CFTC No. 20-60, 2020 WL 5701586 (Sept. 18, 2020) (imposing a $35,000 civil monetary penalty for a one-day violation of exchange-set position limits in CME live cattle futures).

[1372] *See*, *e.g.*, ISDA at 4 ("new Federal position limits rulemaking will involve significant compliance costs and burdens … that the CFTC can mitigate … by starting with final rules only for physically-delivered spot month futures contracts in a first phase.").

[1373] *See* NFPEA at 6 and 14 (explaining that the Federal position limits framework would "place unnecessary regulatory burdens and costs on the NFP Energy Entities, without providing the Commission with useful or usable information about speculators, speculative transactions or speculative positions" and asserting that "[t]here is no regulatory benefit in terms of reducing the burdens of excessive speculation on CFTC-regulated markets to balance against the costs and burdens for NFP Energy Entities (on-speculators) to study, understand and apply the Commission's Speculative Position Limits rules to their transactions and positions"). *See also supra* Section II.C.14.i. (discussing NFPEA's request for an exemption from the Federal position limits framework and how the Final Rule addresses many of the concerns raised by NFPEA).

[1374] *See supra* Section I.D. (discussing effective date and compliance date of the Final Rule).

delayed compliance deadlines should mitigate compliance costs by permitting the update and build out of technological and compliance systems more gradually. They may also reduce the burdens on market participants not previously subject to position limits, who will have a longer period of time to determine whether they may qualify for certain bona fide hedging recognitions or other exemptions, and to possibly alter their trading or hedging strategies.[1375] Further, the delayed compliance dates will reduce the burdens on exchanges, market participants, and the Commission by providing each with more time to resolve technological and other challenges for compliance with the new regulations. In turn, the Commission anticipates that the extra time provided by the delayed compliance dates will result in more robust systems for market oversight, which should better facilitate the implementation of the Final Rule and avoid unnecessary market disruptions while exchanges and market participants prepare for its implementation. However, the delayed compliance deadlines will extend the time it will take to realize the benefits identified above.

This January 1, 2022 compliance date also applies to exchange obligations under final § 150.5, and market participants' related obligation to temporarily continue providing Forms 204/304 in connection with bona fide hedges. Furthermore, with respect to exchanges' implementation of § 150.9, the Commission is clarifying that exchanges may choose to implement the streamlined process for non-enumerated bona fide hedge applications as soon as the Final Rule's effective date,[1376] or anytime thereafter (or not at all).

CME expressed concern that it may receive an influx of exemption applications at the end of the compliance period, and therefore suggested a rolling process where market

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[1375] Commenters on the Commission's notice of a proposed rulemaking for a new position limits proposal issued on February 27, 2020 ("2020 NPRM") and prior proposals have requested a sufficient phase-in period. *See supra* Section I.D.iv. (discussing comments regarding compliance period of Final Rule); *see also* 81 FR at 96815 (implementation timeline).

[1376] The Final Rule's effective date is **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]** (the "Effective Date").

participants are grandfathered into their current exemptions, permitting them to file for those exemptions on the same annual schedule.[1377] ISDA urged the Commission to recognize the burdens associated with implementing a new set of rules, and adopt a phase-in to minimize market disruptions and increases in compliance costs.[1378] As noted above, the Commission seeks to alleviate the compliance burdens on exchanges associated with the Final Rule by providing for a compliance date of January 1, 2022 for exchanges with respect to their obligations under § 150.5. The Commission believes CME's concern is mitigated since exchanges, at their discretion, may implement final § 150.9 as soon as the Effective Date, which will allow exchanges to review non-enumerated bona fide hedges on a rolling basis between the Effective Date and the end of the compliance period rather than having to process a large number of applications at once. Furthermore, market participants with existing Commission-granted non-enumerated or anticipatory bona fide hedge recognitions are *not* required to reapply to the Commission for a new recognition under the Final Rule. The delayed compliance should better facilitate the implementation of the Final Rule by preventing unnecessary market disruptions and reducing the burdens on exchanges, market participants, and the Commission by providing each with more time to resolve technological and other challenges for compliance with the new regulations.

The 2020 NPRM did not provide a specific date as the compliance date but rather stated "365 days after publication . . . in the *Federal Register*," and did not provide a separate compliance date for economically equivalent swaps or related to previously-granted risk management exemptions. In response, several commenters requested the that Commission further extend the compliance date for swaps to provide market participants additional time to identify which swaps would be deemed economically

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[1377] CME Group at 8.
[1378] ISDA at 2.

equivalent to a referenced contract, refine their compliance systems, and manage other operational and administrative challenges.[1379] These commenters generally stressed that burdens related to economically equivalent swaps may be greater than related futures contracts and options thereon.[1380] The Commission generally agrees with commenters that additional time would reduce burdens associated with establishing compliance and monitoring systems, and has therefore extended the compliance date for economically equivalent swaps until January 1, 2023. Because the Commission understands that risk management positions tend to also involve OTC swap positions, the Commission believes that having the same compliance date as economically equivalent swaps in connection with the elimination of the risk management exemption would similarly reduce burdens.

3. Federal Position Limit Levels (Final § 150.2)

i. General Approach

Existing § 150.2 establishes Federal position limit levels that apply net long or net short to futures and, on a futures-equivalent basis, to options on futures contracts on nine legacy physically-settled agricultural contracts.[1381] The Commission has previously set separate Federal position limits for: (i) the spot month, and (ii) a single month and all-months-combined (*i.e.*, "non-spot months").[1382] For the existing spot month Federal position limit levels, the contract levels are based on, among other things, 25% or lower of the estimated deliverable supply ("EDS").[1383] For the existing non-spot month position limit levels, the levels are generally set at 10% of open interest for the first

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[1379] MFA/AIMA at 8; NCFC at 6; NGSA at 15-16; SIFMA AMG at 9-10; and Citadel at 9.

[1380] *Id*.

[1381] The nine legacy agricultural contracts subject to existing Federal spot and non-spot month position limits were: CBOT Corn (C), CBOT Oats (O), CBOT Soybeans (S), CBOT Wheat (W), CBOT Soybean Oil (SO), CBOT Soybean Meal (SM), MGEX Hard Red Spring Wheat (MWE), ICE Cotton No. 2 (CT), and CBOT KC Hard Red Winter Wheat (KW).

[1382] For clarity, limits for single and all-months-combined apply separately. However, the Commission previously has applied the same limit levels to the single month and all-months-combined. Accordingly, the Commission will discuss the single and all-months limits, *i.e.*, the non-spot month limits, together.

[1383] *See supra* Section II.B.1—Existing § 150.2 (discussing that establishing spot month levels at 25% or less of EDS is consistent with past Commission practices).

25,000 contracts of open interest, with a marginal increase of 2.5% of open interest thereafter (the "10/2.5% formula").

Final § 150.2 revises and expands the existing Federal position limits framework as follows. First, during the spot month, § 150.2: (i) subjects 16 additional core referenced futures contracts and their associated referenced contracts to Federal spot month position limits, which are based on, among other things, the Commission's existing approach of establishing limit levels at 25% or lower of EDS, for a total of 25 core referenced futures contracts (and their associated referenced contracts) subject to Federal spot month position limits (*i.e.*, the nine legacy agricultural contracts plus the 16 additional contracts);[1384] and (ii) updates the existing spot month levels for the nine legacy agricultural contracts based on, among other things, revised EDS.[1385]

Second, for non-spot month position limit levels, final § 150.2 revises the 10/2.5% formula so that: (i) the incremental 2.5% increase takes effect after the first 50,000 contracts of open interest, rather than after the first 25,000 contracts under the existing rule (the "marginal threshold level"); and (ii) the limit levels are calculated by applying the updated 10/2.5% formula to open interest data for the two 12-month periods from July 2017 to June 2018 and July 2018 to June 2019 of the applicable futures contracts and delta-adjusted options on futures contracts.[1386] The 12-month period yielding the higher limit is selected as the non-spot month limit for that legacy agricultural commodity.

[1384] The 16 new products that are subject to Federal spot month position limits for the first time include seven agricultural (CME Live Cattle (LC), CBOT Rough Rice (RR), ICE Cocoa (CC), ICE Coffee C (KC), ICE FCOJ-A (OJ), ICE Sugar No. 11 (SB), and ICE Sugar No. 16 (SF)), four energy (NYMEX Light Sweet Crude Oil (CL), NYMEX NY Harbor ULSD Heating Oil (HO), NYMEX NY Harbor RBOB Gasoline (RB), and NYMEX Henry Hub Natural Gas (NG)), and five metals (COMEX Gold (GC), COMEX Silver (SI), COMEX Copper (HG), NYMEX Palladium (PA), and NYMEX Platinum (PL)) contracts.

[1385] The Final Rule maintains the current spot month limits on CBOT Oats (O).

[1386] As discussed below, for most of the legacy agricultural commodities, this results in a higher non-spot month limit. However, the Commission is not changing the non-spot month limits for either CBOT Oats (O) or MGEX Hard Red Spring Wheat (MWE) based on the revised open interest since this would result in a reduction of non-spot month limits from 2,000 to 700 contracts for CBOT Oats (O) and 12,000 to 5,700 contracts for MGEX HRS Wheat (MWE). Similarly, the Commission also is maintaining the current non-spot month limit for CBOT KC Hard Red Winter Wheat (KW). Furthermore, the Commission is adopting a separate single month position limit level of 5,950 contracts for ICE Cotton No. 2 (CT). The all-months-combined position limit level for ICE Cotton No. 2 (CT) is set at 11,900 contracts, based on the modified 10/2.5% formula and updated open interest figures.

Third, the final Federal position limits framework expands to cover (i) any cash-settled futures and related options on futures contracts directly or indirectly linked to any of the 25 proposed physically-settled core referenced futures contracts as well as (ii) any economically equivalent swaps.

For spot month positions, the Federal position limits in final § 150.2 apply separately, net long or short, to cash-settled referenced contracts and to physically-settled referenced contracts in the same commodity. This results in a separate net long/short position for each category so that cash-settled contracts in a particular commodity are netted with other cash-settled contracts in that commodity, and physically-settled contracts in a given commodity are netted with other physically-settled contracts in that commodity; a cash-settled contract and a physically-settled contract may not be netted with one another during the spot month. Outside the spot month, cash and physically-settled contracts in the same commodity are netted together to determine a single net long/short position.

Fourth, final § 150.2 subjects pre-existing positions, other than pre-enactment swaps and transition period swaps, to Federal position limits during the spot month and non-spot months.

In setting the Federal position limit levels, the Commission seeks to advance the enumerated statutory objectives with respect to position limits in CEA section 4a(a)(3)(B).[1387] The Commission recognizes that relatively high Federal position limit levels may be more likely to support some of the statutory goals and less likely to advance others. For instance, a relatively higher Federal position limit level may be more likely to benefit market liquidity for hedgers or ensure that the price discovery of the underlying market is not disrupted, but may be less likely to benefit market integrity by

[1387] *See supra* Sections II.B.3.ii.a(1) and II.B.4.iii.a(4) (further discussing the CEA's statutory objectives for the Federal position limits framework).

being less effective at diminishing, eliminating, or preventing excessive speculation or at deterring and preventing market manipulation, corners, and squeezes. In particular, setting relatively high Federal position limit levels may result in excessively large speculative positions and/or increased volatility, especially during speculative showdowns (when two market participants disagree about the proper market price and trade aggressively in large quantities expressing their view causing the market price to be volatile), which may cause some market participants to retreat from the commodities markets due to perceived decreases in market integrity. In turn, fewer market participants may result in lower liquidity levels for hedgers and harm to the price discovery function in the underlying markets.

Conversely, setting a relatively lower Federal position limit level may be more likely to diminish, eliminate, or prevent excessive speculation, but may also limit the availability of certain hedging strategies, adversely affect levels of liquidity, and increase transaction costs.[1388] Additionally, setting Federal position limits too low may cause non-excessive speculation to exit a market, which could reduce liquidity, cause "choppy"[1389] prices and reduced market efficiency, and increase option premia to compensate for the more volatile prices. The Commission in its discretion has nevertheless endeavored to set Federal position limit levels, to the maximum extent practicable, to benefit the statutory goals identified by Congress.

As discussed above, the contracts that are subject to the Federal position limits adopted in the Final Rule are currently subject to either Federal or exchange-set position limits (or both). To the extent that the Federal position limit levels in final § 150.2 are higher than the existing Federal position limit levels for either the spot or non-spot

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[1388] For example, relatively lower Federal position limits may adversely affect potential hedgers by reducing liquidity. In the case of reduced liquidity, a potential hedger may face unfavorable spreads and prices, in which case the hedger must choose either to delay implementing its hedging strategy and hope for more favorable spreads in the near future or to choose immediate execution (to the extent possible) at a less favorable price.

[1389] "Choppy" prices often refer to illiquidity in a market where transacted prices bounce between the bid and the ask prices. Market efficiency may be harmed in the sense that transacted prices might need to be adjusted for the bid-ask bounce to determine the fundamental value of the underlying contract.

month, market participants currently trading these contracts could engage in additional trading under the Federal position limit levels in final § 150.2 that otherwise would be prohibited under existing § 150.2.[1390] On the other hand, to the extent an exchange–set position limit level is lower than its corresponding Federal position limit level in final § 150.2, the Federal position limit does not affect market participants since market participants are required to comply with the lower exchange-set position limit level (to the extent that the exchanges maintain their current levels).[1391]

ii. Spot Month Levels

The Commission is maintaining 25% of EDS as a ceiling for Federal spot month position limits, except for cash-settled NYMEX Henry Hub Natural Gas ("NYMEX NG") referenced contracts, which is discussed below. Based on the Commission's experience overseeing Federal position limits for decades, and overseeing exchange-set position limits submitted to the Commission pursuant to part 40 of the Commission's regulations, none of the Federal spot month position limit levels listed in final Appendix E of part 150 of the Commission's regulations: (i) are so low as to reduce liquidity for bona fide hedgers or disrupt the price discovery function of the underlying market;[1392] or (ii) so high as to invite excessive speculation, manipulation, corners, or squeezes because, among other things, any potential economic gains resulting from the manipulation may be insufficient to justify the potential costs, including the costs of acquiring, and ultimately offloading, the positions used to effect the manipulation.[1393]

[1390] For the spot month, all the legacy agricultural contracts other than CBOT Oats (O) have higher Federal position limit levels. For the non-spot months, all the legacy agricultural contracts other than CBOT Oats (O), MGEX HRS Wheat (MWE), and CBOT KC HRW Wheat (KW), have higher Federal position limit levels.

[1391] While the Final Rule generally either increases or maintains the Federal position limits for both the spot months and non-spot months compared to existing Federal position limits, where applicable, and exchange limits, the Federal spot month position limit level for COMEX Copper (HG) is below the existing exchange-set level. Accordingly, market participants may have to change their trading behavior with respect to COMEX Copper (HG), which could impose compliance and transaction costs on these traders, to the extent their existing trading exceeds the lower Federal spot month position limit levels.

[1392] The Federal spot month position limit levels adopted in the Final Rule are set at, or higher than, existing Federal spot month position limit levels (for the nine legacy agricultural contracts) or at, or higher than, existing exchange-set spot month position limit levels (for the 16 non-legacy core referenced futures contracts). As a result, the Commission does not believe that liquidity will be reduced with respect to the core referenced futures contracts and their associated referenced contracts. Consequently, the Commission also believes that the Federal spot month position limit levels will be less burdensome on market participants. *See* AFIA at 1.

[1393] This is driven primarily by the Federal spot month position limit levels being set at or below 25% of EDS.

The Commission considered alternative Federal spot month position limit levels provided by Better Markets, which requested a standard Federal spot month position limit level of 10% of EDS, which could be adjusted as needed.[1394] The Commission believes that this across-the-board approach fails to take into account the differences between the core referenced futures contracts and could result in material costs to certain types of referenced contracts without concomitant benefits. For example, the Commission has determined to set the Federal spot month position limit levels for eight core referenced futures contracts below 10% of EDS. Raising the levels to 10% of EDS for some of these contracts could increase the risk of market manipulation. As an example, raising the Federal position limit level to 10% of EDS would result in an increase of approximately 46% over the proposed and final Federal spot month position limit level for CBOT KC HRS Wheat (KW). The Commission believes that, despite the increased potential for market manipulation, this would result in a negligible improvement in liquidity, because the level for CBOT KC HRS Wheat (KW) is being set as a ceiling within the Federal position limits framework.

On the other end of the spectrum, for some core referenced futures contracts with proposed and final Federal position limit levels higher than 10% of EDS, decreasing the levels to 10% of EDS could have a material negative impact on liquidity. For example, this would result in a reduction in the Federal spot month position limit levels by approximately 60% for the seven core referenced futures contracts for which the Commission is adopting a Federal spot month position limit level of 25% of EDS.[1395] This could cause a significant decrease in liquidity in those markets, as speculative traders may not be of sufficient size and quantity to take the other side of bona fide

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[1394] Better Markets at 41. Other commenters, such as PMAA and AFR, generally suggested lowering Federal spot month position limit levels. However, neither provided specific levels or a formula for determining alternative levels. As a result, the Commission is unable to engage in a cost-benefit analysis with respect to their suggestions.

[1395] The seven such core referenced futures contracts are: (1) MGEX HRS Wheat (MWE); (2) ICE Cocoa (CC); (3) ICE Coffee C (KC); (4) ICE FCOJ-A (OJ); (5) ICE Sugar No. 11 (SB); (6) ICE Sugar No. 16 (SF); and (7) NYMEX Henry Hub Natural Gas (NYMEX NG).

hedgers' positions. This may impact the price discovery function and hedging utility of those contracts because hedgers could not transact at better prices provided by the presence of the speculative traders. Furthermore, it could severely restrict the breadth of exchange-set spot month position limit levels that an exchange may set, which would provide less flexibility to the exchanges to respond to rapidly changing market conditions.

The Commission also considered PMAA's statement that "the spot-month limit of 25 percent of deliverable supply is not sufficiently aggressive to deter excessive speculation."[1396] However, PMAA provides no defined alternative for the Commission to consider, which makes it difficult to compare the costs and benefits of PMAA's suggested approach. Nonetheless, the Commission acknowledges that, as a general principle, lowering position limit levels may decrease the likelihood of excessive speculation.[1397] However, that may come at the cost of liquidity for bona fide hedgers. The Commission notes that PMAA's suggestion would apply to only seven of the 25 core referenced futures contracts that have Federal spot month position limit levels set at 25% of EDS in the Final Rule.[1398] The others are all set well below 25% of EDS, with the highest being 19.29% of EDS for CBOT Oats (O). For all core referenced futures contracts, including ones that have Federal spot month position limit levels set at 25% of EDS, the Commission reviewed the methodology underlying the EDS figures and the Federal spot month position limit levels, and determined that they advance the objectives of CEA section 4a(a)(3), including preventing excessive speculation and manipulation, while also ensuring sufficient market liquidity for bona fide hedgers. Finally, the Final Rule's position limits framework also leverages the exchanges' expertise and ability to

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[1396] PMAA at 2.

[1397] However, based on the Commission's past experience in setting Federal speculative position limits, the Commission notes that it is very unlikely that there will be excessive speculation if the Federal spot month position limit level is set at 25% or less of EDS.

[1398] The seven such core referenced futures contracts are: (1) MGEX HRS Wheat (MWE); (2) ICE Cocoa (CC); (3) ICE Coffee C (KC); (4) ICE FCOJ-A (OJ); (5) ICE Sugar No. 11 (SB); (6) ICE Sugar No. 16 (SF); and (7) NYMEX Henry Hub Natural Gas (NYMEX NG).

quickly set and adjust their exchange-set spot month position limits at any level lower than the Federal spot month position limit levels in response to market conditions, which relieves some of the potential costs of setting the Federal spot month position limit levels at 25% of EDS (*i.e.,* a higher likelihood of excessive speculation compared to lower levels) for the seven core referenced futures contracts discussed above.

The Commission also considered CME Group's recommendation with respect to the non-CME Group-listed core referenced futures contracts "that the Commission not adopt final spot month position limit levels at 25% of deliverable supply as a rigid formula and, based on the factors previously described above, work with the exchange to determine an appropriate limit based on the market dynamics previously described."[1399] CME Group commented that, "[t]aking an across-the-board approach by setting a Federal limit at the full 25 percent of deliverable supply could have a significant negative impact on many markets across all asset classes…. For example, setting a uniform and high Federal limit without regard to the unique characteristics of a particular contract market can encourage exchanges to set limits for competitive reasons rather than for regulatory purposes…[and] that perverse incentive structure could lead to a race to the bottom and undermine the statutory goals of deterring manipulation and excessive speculation through position limits."[1400] The Commission agrees that mechanically applying a Federal spot month position limit level of 25% of EDS can undermine the statutory goals of CEA section 4a(a)(3). However, in proposing the Federal spot month position limit levels, the Commission did not mechanically apply 25% of EDS as a rigid formula for the non-CME Group-listed core referenced futures contracts. Instead, as it did for the CME Group-listed core referenced futures contracts, the Commission reviewed the methodology underlying the EDS figures and the Federal spot month position limit

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[1399] CME Group at 5. CME considered the following factors: contract specifications, market participation, physical market fundamentals, delivery process, convergence, market liquidity, volatility, market participant concentration, and market participant feedback.

[1400] CME Group at 5.

levels, and determined that they advance the objectives of CEA section 4a(a)(3), including preventing excessive speculation and manipulation, while also ensuring sufficient market liquidity for bona fide hedgers. The Commission also considered the Federal spot month position limit levels in the context of the Final Rule's position limits framework, which leverages the exchanges' expertise and ability to quickly set and adjust their exchange-set spot month position limits at any level lower than the Federal spot month position limit levels in response to market conditions, which relieves some of the potential costs of setting the Federal spot month position limit levels at 25% of EDS. Furthermore, the Commission considered comments received in response to the 2020 NPRM before finalizing the Federal spot month position limit levels. This is evidenced in the changes to the Federal spot month position limit levels with respect to NYMEX Henry Hub Natural Gas (NG) and ICE Cotton No. 2 (CT), the latter of which is set at 12.95% of EDS in the Final Rule.

The Commission also recognizes comments from Better Markets and NEFI, which state that exchanges have incentives to maximize shareholder profits, which could be accomplished by, among other things, maximizing trading.[1401] One way exchanges could spur trading in the context of setting Federal spot month position limit levels in this rulemaking is by taking steps to ensure that the Federal spot month position limit levels are set as high as possible by providing higher EDS figures and recommending higher Federal spot month position limit levels. A potential cost of extremely high Federal spot month position limit levels is harm to market integrity through excessive speculation and manipulation. However, the Commission believes that these costs are mitigated through a number of mechanisms. First, the Commission independently assessed and verified the exchanges' EDS estimates, which included: (1) working closely with the exchanges to

[1401] Better Markets at 22-23; NEFI at 3.

independently verify that all EDS methodologies and figures are reasonable;[1402] and (2) reviewing each exchange-recommended level for compliance with the requirements established by the Commission and/or by Congress, including those in CEA section 4a(a)(3)(B).[1403] Second, the Commission conducted its own analysis of the exchange-recommended Federal spot month position limit levels and determined that the levels adopted herein are: (1) low enough to diminish, eliminate, or prevent excessive speculation and also protect price discovery; (2) high enough to ensure that there is sufficient market liquidity for bona fide hedgers; (3) fall within a range of acceptable limit levels; and (4) are properly calibrated to account for differences between markets. Third, the Commission notes that exchanges have significant incentives and obligations to maintain well-functioning markets as self-regulatory organizations that are themselves subject to regulatory requirements. Specifically, the DCM and SEF Core Principles require exchanges to, among other things, list contracts that are not readily susceptible to manipulation, and surveil trading on their markets to prevent market manipulation, price distortion, and disruptions of the delivery or cash-settlement process.[1404] Fourth, exchanges also have significant incentives to maintain well-functioning markets to remain competitive with other exchanges. Market participants may choose exchanges that are less susceptible to sudden or unreasonable fluctuations or unwarranted changes caused by corners, squeezes, and manipulation, which could, among other things, harm the price discovery function of the commodity derivative contracts and negatively impact the delivery of the underlying commodity, bona fide hedging strategies, and market participants' general risk management.[1405] In addition, several academic studies,

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[1402] As discussed in detail in Section II.B.3.iii.b., the verification involved: confirming that the methodology and data for the underlying commodity reflected the commodity characteristics described in the core referenced futures contract's terms and conditions; replicating exchange EDS figures using the methodology provided by the exchange; and working with the exchanges to revise the methodologies as needed.

[1403] *See supra* Section II.B.3.ii.a(1).

[1404] 17 CFR 38.200; 17 CFR 38.250; 17 CFR 37.300; and 17 CFR 37.400.

[1405] Kane, Stephen, *Exploring price impact liquidity for December 2016 NYMEX energy contracts*, n.33, U.S. Commodity Futures Trading Commission website, available at https://www.cftc.gov/sites/default/files/idc/groups/public/@economicanalysis/documents/file/oce_priceimpact.pdf.

including one concerning futures exchanges and another concerning demutualized stock exchanges, support the conclusion that exchanges are able to both satisfy shareholder interests and meet their self-regulatory organization responsibilities.[1406] Finally, the Commission itself conducts general market oversight through, among other things, its own surveillance program to ensure well-functioning markets.

a. NYMEX Henry Hub Natural Gas (NYMEX NG) Cash-Settled Referenced Contracts

Based on comments received[1407] and based on the existing exchange-set practices with respect to the NYMEX NG core referenced futures contract and its associated cash-settled referenced contracts, the Commission is permitting market participants to hold a position in cash-settled NYMEX NG referenced contracts up to the Federal spot month position limit level of 2,000 referenced contracts per exchange and another position in cash-settled economically equivalent NYMEX NG OTC swaps that has a notional amount of up to 2,000 equivalent-sized contracts. This is: (i) a modification from the proposed Federal spot month position limit level for NYMEX NG referenced contracts, in which market participants would be able to hold only 2,000 cash-settled NYMEX NG referenced contracts aggregated between all exchanges and the OTC swaps market; but (ii) a continuation of the existing exchange-set spot month position limit framework that has been in place for over a decade. The Commission believes that this modification from the 2020 NPRM will, relative to the proposed approach, help minimize liquidity costs for market participants trading in both cash and physically-settled natural gas derivatives markets, in which the markets for cash-settled NYMEX NG referenced contracts is significantly more liquid than the market for the physically-settled NYMEX

[1406] *See* David Reiffen and Michel A. Robe, *Demutualization and Customer Protection at Self-Regulatory Financial Exchanges*, Journal of Futures Markets, Vol. 31, 126-164 (in many circumstances, an exchange that maximizes shareholder (rather than member) income has a greater incentive to aggressively enforce regulations that protect participants from dishonest agents); and Kobana Abukari and Isaac Otchere, *Has Stock Exchange Demutualization Improved Market Quality? International Evidence*, Review of Quantitative Finance and Accounting, Dec 09, 2019, https://doi.org/10.1007/s11156-019-00863-y (demutualized exchanges have realized significant reductions in transaction costs in the post-demutualization period).

[1407] *See* MFA/AIMA at 11-12; Citadel at 7-8; and SIFMA AMG at 10-11.

NG core referenced futures contract during the spot month. This is, in part, because this modification will continue to allow existing market participants "to optimize the proportion of physically-settled and cash-settled natural gas contracts that they wish to hold."[1408] Finally, although the Commission acknowledges that market participants may hold an aggregate position in the cash-settled NYMEX NG referenced contracts that is in excess of 25% of EDS, the Commission does not believe that this will lead to excessive speculation and volatility in the natural gas markets, because of the highly liquid nature of the cash-settled natural gas markets and the Commission's experience in overseeing the exchange-set framework with respect to cash-settled natural gas contracts.

b. ICE Cotton No. 2 (CT)

The Commission also modified the Federal spot month position limit level for ICE Cotton No. 2 (CT) by adopting a level of 900 contracts, instead of 1,800 contracts as proposed. The Commission is adopting the level of 900 contracts based on its analysis of the alternatives suggested by bona fide hedgers using the ICE Cotton No. 2 (CT) core referenced futures contract.[1409] The Commission received two defined alternatives to the proposed level of 1,800 contracts—300 contracts and 900 contracts. Specifically, based on those comments, the Commission believes that it could further improve protections against corners and squeezes without materially sacrificing liquidity for bona fide hedgers by reducing the Federal spot month position limit level from the proposed 1,800 contracts to 900 contracts. However, the Commission believes that retaining the existing Federal spot month limit level of 300 contracts may cause concerns about adequate liquidity, especially because it would be the lowest Federal spot month position limit

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[1408] MFA/AIMA at 11-12.

[1409] AMCOT at 1-2; ACSA at 8; Ecom at 1; Southern Cotton at 2; NCC at 1; Mallory Alexander at 2; Canale Cotton at 2; IMC at 2; Olam at 3; DECA at 2; Moody Compress at 1; ACA at 2; Choice at 1; East Cotton at 2; Jess Smith at 2; McMeekin at 2; Memtex at 2; NCC at 2; Omnicotton at 2; Toyo at 2; Texas Cotton at 2; Walcot at 2; White Gold at 1; LDC at 1; SW Ag at 2; NCTO at 2; Parkdale at 2; and IFUS – Estimated Deliverable Supply – Cotton Methodology, August 2020, IFUS Comment Letter (Aug. 14, 2020).

level, by far, in terms of percent of EDS, among all core referenced futures contracts, and the Commission has observed illiquidity during the early part of the spot month.[1410]

iii. Levels Outside of the Spot Month

a. The 10/2.5% Formula

The Commission has determined that the existing 10/2.5% formula generally has functioned well for the existing nine legacy agricultural contracts, and has successfully benefited the markets by taking into account the competing goals of facilitating both liquidity formation and price discovery, while also protecting the markets from harmful market manipulation and excessive speculation. However, since the existing Federal non-spot month position limit levels are based on open interest levels from 2009 (except for CBOT Oats (O), CBOT Soybeans (S), and ICE Cotton No. 2 (CT), for which existing levels are based on the respective open interest from 1999), the Commission is revising the levels based on the periods from July 2017 to June 2018 and July 2018 to June 2019 to reflect the general increases in open interest[1411] that have occurred over time in the nine legacy agricultural contracts (other than CBOT Oats (O), MGEX HRS Wheat (MWE), and CBOT KC HRW Wheat (KW)).[1412]

Since the increase for most of the Federal non-spot position limits is predicated on the increase in open interest, as reflected in the revised data reviewed by the Commission,

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[1410] At 300 contracts, the Federal spot month position limit level for ICE Cotton No. 2 (CT) would be set at 4.32% of EDS. CBOT KC HRS Wheat (KW) generally has the lowest Federal spot month position limit level in terms of percentage of EDS at 6.82%, which is 58% higher than 4.32%. However, following the close of trading on the business day prior to the last two trading days of the contract month, CME Live Cattle (LC) has the lowest Federal spot month position limit level in terms of percentage of EDS at 5.29%, which is 22% higher than 4.32%.

[1411] The Commission notes that NGFA commented "NGFA still is not completely convinced that open interest is the best yardstick for this exercise," because "[a]s volume and open interest grow, Federal non-spot limits expand correspondingly…which leads to yet higher volume and open interest…which again prompts expanded Federal non-spot limits…and so on." However, NGFA did not provide any alternatives to utilizing open interest for determining Federal non-spot month position limit levels. As discussed previously in the Final Rule, the Commission believes that open interest is an appropriate way of measuring market activity for a particular contract and that a formula based on open interest, such as the 10/2.5% formula: (1) helps ensure that positions are not so large relative to observed market activity that they risk disrupting the market; (2) allows speculators to hold sufficient contracts to provide a healthy level of liquidity for hedgers; and (3) allows for increases in position limits and position sizes as markets expand and become more active. Furthermore, the Commission notes that under the Final Rule, Federal non-spot month position limit levels do not automatically increase with higher open interest levels. In order to make any amendments to the Federal position limit levels, the Commission is required to engage in notice-and-comment rulemaking.

[1412] For most of the legacy agricultural commodities, this results in a higher non-spot month limit. However, the Commission is not changing the non-spot month limits for either CBOT Oats (O) or MGEX HRS Wheat (MWE) based on the revised open interest since this would result in a reduction of non-spot month limits from 2,000 to 700 contracts for CBOT Oats (O) and 12,000 to 5,700 contracts for MGEX HRS Wheat (MWE). Similarly, the Commission also is maintaining the current non-spot month limit for CBOT KC HRW Wheat (KW). *See supra* Section II.B.4.—Federal Non-Spot Month Position Limit Levels for further discussion.

the Commission believes that the increases may enhance, or at least should maintain, general liquidity, which the Commission believes may benefit those with bona fide hedging positions, and commercial end users in general. On the other hand, the Commission believes that many market participants, especially commercial end users, generally accept that the existing Federal non-spot month position limit levels for the nine legacy agricultural commodities function well, including promoting liquidity and facilitating bona fide hedging in the respective markets. As a result, the Final Rule may in some cases result in higher Federal non-spot month position limits, which could increase speculation without achieving any concomitant benefits of increased liquidity for bona fide hedgers compared to the status quo.

The Commission also recognizes that there could be potential costs to keeping the existing 10/2.5% formula (even if revised to reflect current open interest levels) compared to alternative formulae that would result in even higher Federal position limit levels. First, while the 10/2.5% formula may have reflected "normal" observed market activity through 1999 when the Commission adopted it, there have been changes in the markets themselves and the entities that participate in those markets. When adopting the 10/2.5% formula in 1999, the Commission's experience in these markets reflected aggregate futures and options open interest well below 500,000 contracts, which no longer reflects market reality.[1413] As the nine legacy agricultural contracts (with the exception of CBOT Oats (O)) all have open interest well above 25,000 contracts, and in some cases above 500,000 contracts, the existing formula may act as a negative constraint on liquidity formation relative to the higher revised formula. Further, if open interest continues to increase over time, the Commission anticipates that the existing

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[1413] *See* 64 FR at 24038, 24039 (May 5, 1999). As discussed in the preamble, the data show that by the 2015-2018 period, five of the nine legacy agricultural contracts had maximum open interest greater than 500,000 contracts. The contracts for CBOT Corn (C), CBOT Soybeans (S), and CBOT KC HRW Wheat (KW) saw increased maximum open interest by a factor of four to five times the maximum open interest during the years leading up to the Commission's adoption of the 10/2.5% formula in 1999. Similarly, the contracts for CBOT Soybean Meal (SM), CBOT Soybean Oil (SO), CBOT Wheat (W), and MGEX HRS Wheat (MWE) saw increased maximum open interest by a factor of three to four times. *See supra* Section II.B.4., Federal Non-Spot Month Position Limit Levels, for further discussion.

10/2.5% formula could impose even greater marginal costs on bona fide hedgers by potentially constraining liquidity formation (*i.e.*, as the open interest of a commodity contract increases, a greater relative proportion of the commodity's open interest is subject to the 2.5% limit level rather than the initial 10% limit). In turn, this may increase costs to commercial firms, which may be passed to the public in the form of higher prices.

Further, to the extent there may be certain liquidity constraints, the Commission has determined that this potential concern could be mitigated, at least in part, by the Final Rule's change to increase the marginal threshold level from 25,000 contracts to 50,000 contracts, which the Commission believes should provide an appropriate increase in the Federal non-spot month position limit levels for most contracts to better reflect the general increase observed in open interest across futures markets. The Commission acknowledges that, as an alternative, the Commission could have adopted a marginal threshold level above 50,000 contracts, but notes that each increase of 25,000 contracts in the marginal threshold level would only increase the permitted non-spot month level by 1,875 contracts (*i.e.*, (10% of 25,000 contracts) – (2.5% of 25,000 contracts) = 1,875 contracts). The Commission has observed based on current data that changing the marginal threshold to 50,000 contracts could benefit several market participants per legacy agricultural commodity who otherwise would bump up against the non-spot month position limit levels based on the status quo threshold of 25,000 contracts. As a result, the Commission has determined that changing the marginal threshold level could result in marginal benefits and costs for many of the legacy agricultural commodities, but the Commission acknowledges the change is relatively minor compared to revising the existing 10/2.5% formula based on updated open interest data.

Second, the Commission recognizes that an alternative formula that allows for higher Federal non-spot month position limit levels, compared to the existing 10/2.5%

formula, could benefit liquidity and market efficiency by creating a framework that is more conducive to the larger liquidity providers that have entered the market over time.[1414] Compared to when the Commission first adopted the 10/2.5% formula, today there are relatively more large non-commercial traders, such as banks, managed money traders, and swap dealers, which generally hold long positions and act as aggregators or market makers that provide liquidity to short positions (*e.g.*, commercial hedgers).[1415] These dealers also function in the swaps market and use the futures market to hedge their exposures. Accordingly, to the extent that larger non-commercial market makers and liquidity providers have entered the market – particularly to the extent they are able to take offsetting positions to commercial short interests – a hypothetical alternative formula that would permit higher Federal non-spot month position limit levels might provide greater market liquidity, and possibly increased market efficiency, by allowing for greater market-making activities.[1416]

However, the Commission believes that any purported benefits related to a hypothetical alternative formula, or a suggested alternative such as the one provided by ISDA,[1417] that would allow for higher Federal non-spot month position limits would be minimal at best. Liquidity providers are still able to maintain, and possibly increase, market making activities under the Final Rule since the Federal non-spot month position limits are generally still increasing under the existing 10/2.5% formula to reflect the increase in open interest. Further, to the extent that the Final Rule's elimination of the risk management exemption could theoretically force liquidity providers to reduce their

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[1414] *See supra* Section II.B.4., Federal Non-Spot Month Position Limit Levels, for further discussion.

[1415] *Id.*

[1416] For example, the Commission is aware of several market makers that either have left particular commodity markets, or reduced their market making activities. *See, e.g.*, McFarlane, Sarah, *Major Oil Traders Don't See Banks Returning to the Commodity Markets They Left*, The Wall Street Journal (Mar. 28, 2017), available at https://www.wsj.com/articles/major-oil-traders-dont-see-banks-returning-to-the-commodity-markets-they-left-1490715761?mg=prod/com-wsj (describing how "Morgan Stanley sold its oil trading and storage business . . . and J.P. Morgan unloaded its physical commodities business . . . ."); Decambre, Mark, *Goldman Said to Plan Cuts to Commodity Trading Desk: WSJ* (Feb. 5, 2019), available at https://www.marketwatch.com/story/goldman-said-to-plan-cuts-to-commodity-trading-desk-wsj-2019-02-05 (describing how Goldman Sachs "plans on making cuts within its commodity trading platform. . . .").

[1417] ISDA at 7.

trading activities, the Commission believes that certain liquidity-providing activity of the existing risk management exemption holders may still be permitted under the Final Rule, either as a result of the pass-through swap provision or because of the general increase in limits based on the revised open interest levels.[1418] Furthermore, bona fide hedgers and end-users generally have not requested a revised formula to allow for significantly higher Federal non-spot month position limits. The Commission also recognizes an additional benefit to market integrity of the Final Rule compared to a hypothetical alternative formula: While the Commission believes that the pass-through swap provision is narrowly-tailored to enable liquidity providers to continue providing liquidity to bona fide hedgers, in contrast, an alternative formula that would allow higher limit levels for all market participants would potentially permit increased excessive speculation and increase the probability of market manipulation or harm the underlying price discovery function.[1419]

Additionally, some[1420] have voiced general concern that permitting increased Federal non-spot month limits in the nine legacy agricultural contracts (at any level), especially in connection with commodity indices, could disrupt price discovery and result in a lack of convergence between futures and cash prices, resulting in increased costs to end users, which ultimately could be borne by the public. The Commission has not seen data demonstrating this causal connection, but acknowledges arguments to that effect.[1421]

[1418] *See supra* Sections II.A.1.x. (discussing pass-through swap provision), II.B.4.iii.a(1)(i) (discussing increases in open interest); *see also* NCFC at 7 (stating that NCFC is "confident that the substantial increase in the overall speculative position limits and allowances for pass-through swaps will limit any potential loss of liquidity" that might be associated with the elimination of the risk management exemption).

[1419] *See* Section II.B.4.iv.a(2)(iii).

[1420] AMCOT at 1-2; Moody Compress at 1; ACA at 2; Jess Smith at 2; McMeekin at 2; Memtex at 2; Mallory Alexander at 2; Walcot at 2; White Gold at 2; LDC at 2; Southern Cotton at 2-3; and Better Markets at 44-48.

[1421] IECA expressed similar concerns with respect to commodity index funds. IECA at 4 (stating that a June 2009 bipartisan report of the Senate Permanent Subcommittee for Investigation concluded that the "activities of commodity index traders, in the aggregate, constituted 'excessive speculation,'" and that index funds have caused an "unwarranted burden on commerce."). The Commission notes that one of the concerns that prompted the 2008 moratorium on granting risk management exemptions was a lack of convergence between futures and cash prices in wheat. Some at the time hypothesized that perhaps commodity index trading was a contributing factor to the lack of convergence, and, some have argued that this could harm price discovery since traders holding these positions may not react to market fundamentals, thereby exacerbating any problems with convergence. However, the Commission has determined for various reasons that risk management exemptions did not lead to the lack of convergence since the Commission understands that many commodity index traders vacate contracts before the spot month and therefore would not influence convergence between the spot and futures price at expiration of the contract. Further, the risk-management exemptions granted prior

Third, if the Final Rule's Federal non-spot position limits are too high for a commodity, the Final Rule might be less effective in deterring excessive speculation and market manipulation for that commodity's market. Conversely, if the Commission's Federal position limit levels are too low for a commodity, the Final Rule could unduly constrain liquidity for bona fide hedgers or result in a diminished price discovery function for that commodity's underlying market. In either case, the Commission would view these as costs imposed on market participants. However, to the extent the Commission's Federal non-spot month position limit levels could be too high, the Commission believes these costs could be mitigated because exchanges would potentially be able to establish lower non-spot month position limit levels.[1422] Moreover, these concerns may be mitigated further to the extent that exchanges use other tools for protecting markets aside from position limits, such as establishing position accountability levels below Federal position limit levels or imposing liquidity and concentration surcharges to initial margin if vertically integrated with a derivatives clearing organization. Further, as discussed below, the Commission is maintaining current Federal non-spot month position limit levels for CBOT Oats (O), MGEX HRS Wheat (MWE), and CBOT KC HRW Wheat (KW), which otherwise would be lower based on current open interest levels for these contracts.

b. Setting a Lower Single Month Position Limit Level for ICE Cotton No. 2 (CT)

The Commission is adopting a single month position limit level of 5,950 contracts, which is 50% of the proposed level of 11,900 contracts, which, in turn, was

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to 2008 remain in effect, yet the Commission is unaware of any significant convergence problems relating to commodity index traders at this time. Additionally, there did not appear to be any convergence problems between the period when Commission staff initially granted risk management exemptions and 2007. Instead, the Commission believes that the convergence issues that started to occur around 2007 were due to the contract specification underpricing the option to store wheat for the long futures holder making the expiring futures price more valuable than spot wheat.

[1422] The Commission notes that several commenters, including Better Markets, stated that exchanges may have financial incentives to increase trading volume, which could incentivize exchanges to set the highest possible exchange-set position limit levels. *See, e.g.*, Better Markets at 22-24, 46-47. While the Commission acknowledges that this is the case, the Commission also believes that such costs are sufficiently mitigated through exchange statutory and regulatory obligations, the Commission's oversight of the exchanges, and the exchanges' own financial incentives to maintain well-functioning markets. This is discussed more in depth in Sections II.B.2.iv.b and III.B.3.iii.b(3)(iii).

based on the modified 10/2.5% formula. This was in response to numerous comments from end-users suggesting that the Commission set the single month position limit level lower than the all-months-combined position limit level.[1423]

The Commission notes that there could be a benefit to setting the single month position limit level lower than the all-months-combined position limit level, because it could help diminish excessive speculation or prevent price distortions if traders hold unusually large positions in contracts outside of the spot month and those traders simultaneously exit those positions immediately before the spot month.

However, the Commission acknowledges that there could be a cost to adopting a single month limit that is half of the all-months-combined position limit levels. Specifically, it would restrict a speculative trader's ability to take opposite positions to bona fide hedgers by, for example, entering into calendar spread transactions that would normally provide liquidity to bona fide hedgers. Thus, by adopting the lower single month limit, liquidity in deferred month contracts would be reduced because the speculative trader would not be able to hold positions in excess of the single month limit. Nonetheless, the Commission believes that, based on the unanimous comments from the end-users of the ICE Cotton No. 2 (CT) contract requesting a lower single month position limit level, such costs may not materially negatively impact liquidity for bona fide hedgers.

c. Exceptions to the 10/2.5% Formula for CBOT Oats (O), MGEX Hard Red Spring Wheat (MWE), and CBOT Kansas City Hard Red Winter Wheat (KW)

Based on the Commission's experience since 2011 with Federal non-spot month position limit levels for the MGEX HRS Wheat ("MWE") and CBOT KC HRW Wheat ("KW") core referenced futures contracts, the Commission is maintaining the Federal

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[1423] *E.g.*, LDC at 2; Moody Compress at 1; ACA at 2; Jess Smith at 2; McMeekin at 2; Memtex at 2; Mallory Alexander at 2; Walcot at 2; and White Gold at 1.

non-spot month position limit levels for MWE and KW at the existing level of 12,000 contracts, rather than reducing them to the lower level that would result from applying the proposed updated 10/2.5% formula. Maintaining the status quo for the MWE and KW Federal non-spot month position limit levels results in partial wheat parity between those two wheat contracts, but not with CBOT Wheat ("W"), which increases to 19,300 contracts under the Final Rule.

The Commission believes that this benefits the MWE and KW markets since the two species of wheat are similar to one another; accordingly, decreasing the Federal non-spot month position limit levels for MWE could impose liquidity costs on the MWE market and harm bona fide hedgers, which could further harm liquidity for bona fide hedgers in the KW market. On the other hand, although commenters requested raising the Federal non-spot month position limit level for KW to match the level for W,[1424] the Commission has determined not to raise the Federal non-spot month position limit levels for KW and for MWE as well to the Federal non-spot month position limit level for W. This is because the limit level for W appears to be extraordinarily large in comparison to open interest in KW and MWE markets, and the limit levels for both the KW and the MWE contracts are already larger than the limit levels would be based on the 10/2.5% formula. While W is a potential substitute for KW and MWE, it is not similar to the same extent that MWE and KW are to one another, and so the Commission has determined that partial wheat parity outside of the spot month will maintain liquidity and price discovery while not unnecessarily inviting excessive speculation or potential market manipulation in the MWE and KW markets.

Likewise, based on the Commission's experience since 2011 with the Federal non-spot month speculative position limit for CBOT Oats (O), the Commission is maintaining the limit level at the current 2,000 contracts level, rather than reducing it to

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[1424] SIFMA AMG at 3-4; ISDA at 12; PIMCO at 4-5; MFA/AIMA at 12; and Citadel at 6-7.

the lower level that would result from applying the updated 10/2.5% formula based on current open interest. The Commission has determined that there is no evidence of potential market manipulation or excessive speculation, and so there would be no perceived benefit to reducing the Federal non-spot month position limit for the CBOT Oats (O) contract, while reducing the level could impose liquidity costs.

iv. Subsequent Spot and Non-Spot Month Position Limit Levels

The Commission received several comments concerning updates to the Federal position limit levels, with commenters requesting that the Commission periodically review the levels and revise them if appropriate.[1425] One commenter was concerned that the Federal position limit levels could become too high over time,[1426] while the rest were concerned that the levels could become too low.[1427] In addition, CME Group also suggested that exchanges should update the EDS figures "every two years [and]…DCMs should be provided the opportunity to submit data voluntarily to the Commission on a more frequent basis."[1428]

The Commission recognizes that there may be costs if Federal position limit levels become too high or low over time. For example, levels that become too high may permit excessive speculation; levels that become too low may negatively impact liquidity. However, the Commission believes that the Final Rule's position limits framework, which utilizes Federal position limit levels as ceilings and allows exchange-set position limits to operate under that ceiling, will mitigate such potential costs. Specifically, because the Federal position limits are utilized as ceilings, this framework will enable

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[1425] MFA/AIMA at 5 (stating that "the Commission should direct exchanges to periodically monitor the proposed new position limit levels"); PIMCO at 6 (urging the CFTC "to include…a mandatory requirement to regularly (and at least annually) review and update limits as markets grow and change"); SIFMA AMG at 10 (suggesting the Final Rule should require "that the Commission regularly consult with exchanges and review and adjust position limits when it is necessary to do so based on relevant market factors"); ISDA at 10 (stating that "the Commission must regularly convene and consult with exchanges on deliverable supply and, if appropriate, propose notice and comment rulemaking to adjust limit levels"); and IATP at 16-17 (proposing that the Commission should engage in "an annual review of position limit levels to give [commercial hedgers] legal certainty over that period" and also retain "the authority to revise position limits…if data monitoring and analysis show that those annual limit levels are failing to prevent excessive speculation and/or various forms of market manipulation").

[1426] IATP at 16-17.

[1427] MFA/AIMA at 5-6; PIMCO at 6; SIFMA AMG at 10; and ISDA at 10.

[1428] CME Group at 5.

exchanges to respond to market conditions through a greater range of acceptable exchange-set position limit levels than if the Federal position limit levels did not operate as ceilings. Furthermore, because such exchange actions can be effectuated significantly faster than modifying Federal position limits, the Final Rule's position limits framework is able to quickly respond to rapidly evolving market conditions through exchange-action as well.[1429]

v. Phase-In of Federal Position Limit Levels

The Commission received comments requesting that the Commission "consider phasing in these adjustments for agricultural commodities to assess the impacts of increasing limits on contract performance."[1430] CMC also noted that, "[a] phased approach could provide market participants, exchanges, and the Commission a way to build in scheduled pauses to evaluate the effects of increased limits, thereby fostering confidence and trust in the markets."[1431]

The Commission acknowledges that there could be some benefit in implementing a formal, gradual phase-in for the Federal position limit levels, because this could allow the Commission to more incrementally assess whether there are any issues with respect to the referenced contract markets.[1432] However, the Commission believes that the position limits framework that is implemented in the Final Rule effectively provides a similar, but more flexible result. Specifically, market participants will still be subject to the

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[1429] Furthermore, the Commission notes that updating EDS figures and Federal position limit levels is a resource-intensive endeavor for both the Commission and the exchanges. Also, periodic, predetermined review intervals may not always align with market changes or other events resulting in material changes to deliverable supply that would warrant adjusting Federal spot month position limit levels. As a result, the Commission believes that it would be more efficient, timely, and effective to review the EDS figure and the Federal position limit level for a core referenced futures contract if warranted by market conditions, including changes in the underlying cash market, which the Commission and exchanges continually monitor.

[1430] AFIA at 2; CMC at 6.

[1431] CMC at 6. Although commenters did not provide specific details about what they meant by "phase-in," the Commission understands these comments to mean that they are requesting a gradual, step-up increase in Federal spot month and non-spot month position limit levels over time for agricultural core referenced futures contracts, instead of having the new Federal position limit levels apply all at once.

[1432] As a preliminary matter, the Commission believes that the referenced contract markets will be able to function in an orderly fashion when the final Federal position limit levels go into effect. This is because, among other things, the final Federal spot month position limit levels are supported by the updated EDS figures and are set at or below 25% of EDS, and the final Federal non-spot month position limit levels are supported by increased open interest and are generally set pursuant to the modified 10/2.5% formula. The three core referenced futures contracts that do not strictly follow the 10/2.5% formula in the non-spot month (*i.e.*, CBOT KC HRW Wheat (KW), MGEX HRS Wheat (MWE), and CBOT Oats (O)) do not require any phase-in period, because they remain at existing Federal and exchange-set non-spot month position limit levels.

exchange-set spot month position limit levels even after the Final Rule's Federal spot month position limit levels go into effect. The existing exchange-set position limit levels are lower than the corresponding Federal levels as adopted in this Final Rule for most core referenced futures contracts[1433] and, unless and until exchanges affirmatively modify their exchange-set spot month position limit levels pursuant to part 40 of the Commission's regulations,[1434] the operative spot month position limit levels for market participants trading exchange-listed referenced contracts will be the exchange-set ones. So, if an exchange deems it appropriate to maintain its existing exchange-set position limit levels and does not choose to adopt the new applicable Federal speculative position limit level as the new exchange-set speculative limit for any relevant referenced contract listed on its exchange, then there will be no practical change from the status quo for market participants from a position limits perspective. If the exchange believes that it is appropriate to raise its exchange-set spot month position limit levels either up to the Federal position limit levels or lower levels as it deems appropriate, then the exchange may do so in a way that is tailored for each referenced contract (including through a phased-in approach) and that is informed by the exchange's knowledge of each market.

A further benefit to the Final Rule's position limits framework over a federally-mandated phase-in is that exchanges have greater flexibility (relative to the Commission) to quickly modify exchange-set levels, including modifying any phase-in levels, to respond to sudden and changing market conditions.

vi. Core Referenced Futures Contracts and Linked Referenced Contracts; Netting

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[1433] Nineteen of the core referenced futures contracts will have Federal spot month position limit levels that are higher than current exchange-set spot month position limit levels. COMEX Copper (HG), CBOT Oats (O), NYMEX Platinum (PL), and NYMEX Palladium (PA) will have Federal spot month position limit levels that are equal to the current exchange-set spot month position limit levels. The last two steps of the Federal spot month step-down position limit levels for CME Live Cattle (LC) are equal to the corresponding last two steps of exchange-set spot month step-down position limit levels. Finally, although currently there is technically no exchange-set spot month position limit for ICE Sugar No. 16, this contract is subject to a single month position limit level of 1,000 contracts, which effectively serves as its spot month position limit level. As a result, the Federal spot month position limit level for ICE Sugar No. 16 will effectively be higher than its current exchange-set spot month position limit level.

[1434] 17 CFR part 40.

The definitions of the terms "core referenced futures contract" and "referenced contract" set the scope of contracts to which Federal position limits apply. As discussed above, by applying the Federal position limits to "referenced contracts," the Final Rule expands the Federal position limits beyond the 25 physically-settled "core referenced futures contracts" listed in final Appendix E to part 150 by also including any cash-settled and physically-settled "referenced contracts" linked thereto, as well as swaps that meet the "economically equivalent swap" definition in final § 150.1 and thus qualify as "referenced contracts."[1435]

a. Referenced Contracts

The Commission has determined that including futures contracts and options thereon that are "directly" or "indirectly linked" to the core referenced futures contracts, including cash-settled contracts, under the definition of "referenced contract" in final § 150.1 helps prevent the evasion of Federal position limits – especially during the spot month – through the creation of a financially equivalent contract that references the price of a core referenced futures contract, or of the commodity underlying a core referenced futures contract. The Commission has determined that this benefits market integrity and potentially reduces costs to market participants that otherwise could result from market manipulation.

The Commission also recognizes that including cash-settled contracts within the final Federal position limits framework may impose additional compliance costs on market participants and exchanges. Further, the Federal position limits – especially outside the spot month – may not provide all of the benefits discussed above with respect to market integrity and manipulation because there is no physical delivery outside the spot month and therefore there is reduced concern for corners and squeezes. However, to

[1435] As discussed in the preamble, the position limits framework also applies to physically-settled swaps that qualify as economically equivalent swaps. However, the Commission believes that physically-settled economically equivalent swaps would be few in number.

the extent that there is manipulation or price distortion involving such non-spot, cash-settled contracts, the Commission's authority to regulate and oversee futures and related options on futures markets (other than through establishing Federal position limits) may also be effective in uncovering or preventing manipulation or distortion, especially in the non-spot cash markets, and may result in relatively lower compliance costs incurred by market participants. Similarly, the Commission acknowledges that exchange oversight could provide similar benefits to market oversight and prevention of market manipulation, but with lower costs imposed on market participants – given the exchanges' deep familiarity with their own markets and their ability to tailor a response to a particular market disruption – compared to Federal position limits.

The "referenced contract" definition in final § 150.1 also includes "economically equivalent swap," and, for the reasons discussed below, includes a narrower set of swaps compared to the set of futures contracts and options thereon that would be, under the "referenced contract" definition, captured as either "directly" or "indirectly linked" to a core referenced futures contract.[1436]

b. List of Referenced Contracts[1437]

The Commission's publication of the Staff Workbook is intended to provide a non-exhaustive list of exchange-traded referenced contracts that are subject to Federal position limits. Although the Commission expects to timely update this list of contracts, the omission of a contract from the Staff Workbook does not mean that such contract is outside the definition of a referenced contract subject to Federal position limits.

Additionally, the Staff Workbook will provide a linkage between each referenced contract, and either the core referenced futures contract or referenced contract, as

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[1436] *See infra* Section IV.A.3.vi.e. (discussing economically equivalent swaps).

[1437] Appendix C of the Final Rule provides staff guidance to assist market participants and exchanges in determining whether a particular contract qualifies as a referenced contract.

applicable to which it is linked, to aid in market participants' understanding of the Commission's determination.

Although some commenters believed that the Commission should require exchanges to publish and maintain a definitive list of referenced contracts (other than economically equivalent swaps)[1438] the Commission believes that the centralized publication of this Workbook creates efficiency by providing market participants a known access location, and minimizes costs by not requiring redundant publication.

The Commission's concurrent publication of the Staff Workbook provides a non-exhaustive list of exchange-traded referenced contracts, and will help market participants in determining categories of contracts that fit within the referenced contract definition. This effort is intended to provide clarity to market participants regarding which exchange-traded contracts are subject to Federal position limits.

c. Netting and Related Treatment of Cash-Settled Referenced Contracts

Under paragraph (1) of the final "referenced contract" definition, referenced contracts include a core referenced futures contract, and any cash-settled futures contracts and options on futures contacts that are directly or indirectly linked to a physically-settled core referenced futures contract.

PIMCO and SIFMA AMG contended that cash-settled referenced contracts should not be subject to Federal position limits at all because cash-settled contracts do not introduce the same risk of market manipulation. They argued that subjecting cash-settled referenced contracts to Federal position limits would increase transaction costs and reduce market liquidity and depth in these instruments.[1439]

[1438] MFA/AIMA at 7; Citadel at 4-5; SIFMA AMG at 11-12.

[1439] PIMCO at 3; SIFMA AMG at 4-7. These entities did not specifically argue that cash-settled contracts should be excluded from the "referenced contract" definition; rather, they contended that in general such instruments should not be subject to Federal position limits. The Commission notes that this is technically a different argument since cash-settled instruments could be exempt from position limits but still qualify as "referenced contracts." Nevertheless, the practical result is the same.

ISDA argued that cash-settled contracts should not be included in an immediate Federal position limits rulemaking, and should instead be deferred until the Commission has adopted Federal limits with respect to physically-delivered spot month futures contracts, and after which the Commission should revisit Federal limits for cash-settled contracts.[1440]

FIA and ICE argued that limits for cash-settled referenced contracts should be higher relative to Federal position limits for physically-settled referenced contracts. They similarly argued that cash-settled referenced contracts are "not subject to corners and squeezes" and will "'ensure market liquidity for *bona fide* hedgers.'"[1441]

In contrast, CME supported the Commission's approach for spot-month parity for physically-settled and cash-settled referenced contracts across all commodity markets. CME explained that absent such parity, one side of the market could be vulnerable to artificial distortions from manipulations on the other side of the market, regulatory arbitrage, and liquidity drain to the other side of the market.[1442]

The Commission believes that its parity approach, including parity with respect to the size of the Federal position limits for both cash-settled and physically-settled contracts, benefits market integrity, liquidity, and price discovery by not providing skewed incentives to a market participant to favor one group of contracts over the other, or providing avenues for manipulation that this rulemaking seeks to avoid.

The Commission is also generally adopting Federal position limits on an aggregated, instead of on a per-DCM basis.[1443] FIA and ICE suggested that Federal position limits for cash-settled referenced contracts should apply per DCM (rather than in the aggregate across DCMs).[1444] The Commission views DCM-based limits as restrictive

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[1440] ISDA at 3-5.

[1441] ICE at 3, 15 (also arguing that cash-settled limits should apply per exchange, rather than across exchanges); FIA at 7-8.

[1442] CME Group at 6.

[1443] The Commission is permitting market participants to hold a position in cash-settled NYMEX NG referenced contracts up to the Federal spot month position limit on a per exchange basis. This is discussed more in depth in Section IV.A.3.ii.a.

[1444] FIA at 7-8; ICE at 13.

and costly for the most innovative DCMs, as DCM-based limits would necessarily represent a smaller volume of contracts available than would an aggregated limit. By making the full aggregated Federal position limit available to the contract that is most responsive to the needs of the market, the Commission believes that this provides a market-wide benefit by promoting innovation and competition in the marketplace.

The Final Rule permits market participants to net positions outside the spot month in linked physically-settled and cash-settled referenced contracts, but during the spot month market participants may not net their positions in cash-settled referenced contracts against their positions in physically-settled referenced contracts. The Commission believes that final § 150.2(a) and (b) benefits liquidity formation and bona fide hedgers outside the spot months since the netting rules facilitate the management of risk on a portfolio basis for liquidity providers and market makers. In turn, improved liquidity may benefit bona fide hedgers and other end users by facilitating their hedging strategies and reducing related transaction costs (*e.g.*, improving execution timing and reducing bid-ask spreads). On the other hand, the Commission recognizes that allowing such netting could increase transaction costs and harm market integrity by allowing for a greater possibility of market manipulation since market participants and speculators can maintain larger gross positions outside the spot month. However, the Commission has determined that such potential costs may be mitigated since concerns about corners and squeezes generally are less acute outside the spot month given there is no physical delivery involved, and because there are tools other than Federal position limits for preventing and deterring other types of manipulation, including banging the close, such as exchange-set limits and accountability and surveillance both at the exchange and Federal level.

Moreover, prohibiting the netting of physical and cash positions during the spot month should benefit bona fide hedgers as well as price discovery of the underlying

markets since market makers and speculators are not able to maintain a relatively large position in the physical markets by netting it against its positions in the cash markets.[1445] While this may increase compliance and transaction costs for speculators, it may benefit some bona fide hedgers and end users. It may also impose costs on exchanges, including increased surveillance and compliance costs and lost fees related to the trading that such market makers or speculators otherwise might engage in absent Federal position limits or with the ability to net their physical and cash positions.

d. Exclusions from the "Referenced Contract" Definition

Although the "referenced contract" definition in final § 150.1 includes linked contracts, it explicitly excludes location basis contracts,[1446] commodity index contracts, swap guarantees, trade options that satisfy § 32.3 of the Commission's regulations,[1447] outright price reporting agency index contracts, and monthly average pricing contracts.

First, the "referenced contract" definition explicitly excludes location basis contracts, which are contracts that reflect the difference between two delivery locations or quality grades of the same commodity.[1448] The Commission believes that excluding location basis contracts from the "referenced contract" definition benefits market integrity by preventing a trader from obtaining an extraordinarily large speculative position in the commodity underlying the referenced contract. Absent this exclusion, a market participant could increase its exposure in the commodity underlying the

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[1445] Otherwise, a market participant could maintain large, offsetting positions in excess of limits in both the physically-settled and cash-settled contract, which might harm market integrity and price discovery and undermine the Federal position limits framework. For example, absent such a restriction in the spot month, a trader could stand for over 100% of deliverable supply during the spot month by holding a large long position in the physical-delivery contract along with an offsetting short position in a cash-settled contract, which effectively would corner the market.

[1446] ICE further recommended that additional basis and spread contracts be excluded from the referenced contract definition. ICE at 10-11. The Commission has determined not to exclude these additional contracts from the referenced contract definition, as, among other reasons discussed further above, the Commission views the constraints on the liquidity and volatility associated with other excluded contracts as not present to an equal degree in basis and spread contracts proposed to be excluded by ICE.

[1447] 17 CFR 32.3.

[1448] The term "location basis contract" generally means a derivative that is cash-settled based on the difference in price, directly or indirectly, of (1) a core referenced futures contract; and (2) the same commodity underlying a particular core referenced futures contract at a different delivery location than that of the core referenced futures contract. *See* Appendix C to final part 150. For clarity, a core referenced futures contract may have specifications that include multiple delivery points or different grades (*i.e.*, the delivery price may be determined to be at par, a fixed discount to par, or a premium to par, depending on the grade or quality). The above discussion regarding location basis contracts is referring to delivery locations or quality grades other than those contemplated by the applicable core referenced futures contract.

referenced contract by using the location basis contract to net down against its position in a referenced contract, and then further increase its position in the referenced contract that would otherwise be restricted by position limits. Similarly, the Commission believes that the exclusion of location basis contracts reduces hedging costs for hedgers and commercial end-users, as they are able to more efficiently hedge the cost of commodities at their preferred location without the risk of possibly hitting a position limits ceiling or incurring compliance costs related to applying for a bona fide hedge recognition related to such position.[1449]

Excluding location basis contracts from the "referenced contract" definition also could impose costs for market participants that wish to trade location basis contracts since, as noted, such contracts are not subject to Federal position limits and thus could be more easily subject to manipulation by a market participant that obtained an excessively large position. However, the Commission believes such costs are mitigated because location basis contracts generally demonstrate less volatility and are less liquid than the core referenced futures contracts, meaning the Commission believes that it would be an inefficient method of manipulation (*i.e.*, too costly to implement and therefore, the Commission believes that the probability of manipulation is low). Further, excluding location basis contracts from the "referenced contract" definition is consistent with existing market practice since the market treats a contract on one grade or delivery location of a commodity as different from another grade or delivery location. Accordingly, to the extent that this exclusion is consistent with current market practice, any benefits or costs already may have been realized.

[1449] AGA agrees that the exclusion of location basis contracts from the "referenced contract" definition creates certain netting benefits and may allow commercial end-users to more efficiently hedge the cost of commodities at a preferred location. AGA at 9. In general, AGA supported all of the proposed exclusions from the "referenced contract" definition in the 2020 NPRM, as it believes that market participants benefit from clear rules and definitions that help prevent "potential disagreement leading to increased transaction costs, potential loss of liquidity, and compliance strategies that generally make the markets less efficient." *Id.*

Second, the Commission has concluded that excluding commodity index contracts from the "referenced contract" definition benefits market integrity by preventing speculators from using a commodity index contract to net down an outright position in a referenced contract that is a component of the commodity index contract, which would allow the speculator to take on large outright positions in the referenced contracts and therefore result in increased speculation, undermining the Federal position limits framework.[1450] However, the Commission believes that this exclusion could impose costs on market participants that trade commodity index contracts since, as noted, such contracts are not subject to Federal position limits and thus could be more easily subject to manipulation by a market participant that obtained an excessively large position. The Commission believes such costs would be mitigated because the commodities comprising the index are themselves subject to limits, and because commodity index contracts generally tend to exhibit low volatility since they are diversified across many different commodities. Further, the Commission believes that it is possible that excluding commodity index contracts from the definition of "referenced contract" could result in some trading shifting to commodity index contracts, which may reduce liquidity in exchange-listed core referenced futures contracts, harm pre-trade transparency and the price discovery process in the futures markets, and depress open interest (as volumes shift to index positions, which would not count toward open interest calculations). However, the Commission believes that the probability of this occurring is low because the

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[1450] Further, the Commission believes that prohibiting the netting of a commodity index position with a referenced contract is required by its interpretation of the Dodd-Frank Act's amendments to the CEA's definition of "bona fide hedging transaction or position." The Commission interprets the amended CEA definition to eliminate the Commission's ability to recognize risk management positions as bona fide hedges or transactions. *See infra* Section IV.A.4, Exemptions from Federal Position Limits—Bona Fide Hedging Recognitions, Spread and Other Exemptions (Final §§ 150.1 and 150.3), for further discussion. In this regard, the Commission has observed that it is common for swap dealers to enter into commodity index contracts with participants for which the contract would not qualify as a bona fide hedging position (*e.g.*, with a pension fund). Failing to exclude commodity index contracts from the "referenced contract" definition could enable a swap dealer to use positions in commodity index contracts as a risk management hedge by netting down its offsetting outright futures positions in the components of the index. Permitting this type of risk management hedge would subvert the statutory pass-through swap language in CEA section 4a(c)(2)(B), which the Commission interprets as prohibiting the recognition of positions entered into for risk management purposes as bona fide hedges unless the swap dealer is entering into positions opposite a counterparty for which the swap position is a bona fide hedge.

Commission believes that using commodity index contracts is an inefficient means of obtaining exposure to a specific commodity.

Third, the Commission's determination to exclude trade options from the referenced contract definition is consistent with the historical practice of the Commission, in which it has exempted a number of trade options from Commission requirements. This exclusion benefits end-users who hedge their physical risk through these instruments, yet do not contribute to excessive speculation.

Fourth, the Commission's exclusion of swap guarantees from the referenced contract definition will help avoid any potential confusion regarding the application of position limits to guarantees of swaps. The Commission understands that swap guarantees generally serve as insurance, and, in many cases, swap guarantors guarantee the performance of an affiliate in order to entice a counterparty to enter into a swap with such guarantor's affiliate. As a result, the Commission believes that swap guarantees do not contribute to excessive speculation, market manipulation, squeezes, or corners. Furthermore, the Commission believes that swap guarantees were not contemplated when Congress articulated its policy goals in CEA section 4a(a).[1451]

Fifth, the Final Rule reaffirms the Commission's determination that an outright price reporting agency index contract does not qualify as a "referenced contract."[1452] To provide market participants clarity regarding this determination, the Commission modified the regulatory text of the "referenced contract" definition in final § 150.1 to explicitly exclude the term "outright price reporting agency index contracts."[1453] The exclusion of outright price reporting agency index contracts from the "referenced

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[1451] To the extent that swap guarantees may lower costs for uncleared OTC swaps in particular by incentivizing a counterparty to enter into a swap with the guarantor's affiliate, excluding swap guarantees may benefit market liquidity, which is consistent with the CEA's statutory goals in CEA section 4a(a)(3)(B) to ensure sufficient liquidity for bona fide hedgers when establishing its position limit framework.

[1452] As explained in the preamble to the Final Rule, the Commission has concluded that an "outright price reporting agency index contract," which is based on an index published by a price reporting agency that surveys cash-market transaction prices (even if the cash-market practice is to price at a differential to a futures contract), is not directly or indirectly linked to the corresponding referenced contract. *See supra* Section II.A.16.iii.b(4)(v) (discussing new exclusions from the "referenced contract" definition).

[1453] The Commission does not believe this technical change to the regulatory text represents a change in policy. *See supra* Section II.A.16.

contract" definition benefits market participants through clarity and mitigation of costs, such as costs to monitor positions for aggregation and other compliance purposes. The Commission believes that this exclusion maintains market integrity as it would be costly to employ these contracts to circumvent position limits.

Finally, the Commission has concluded that excluding "monthly average pricing contracts"[1454] from the "referenced contract" definition benefits market integrity by ensuring sufficient market liquidity for bona fide hedgers due to: (1) the difficulty and expense of any entity artificially moving the price of the monthly average by manipulating one or more component prices within the contract; and (2) the widespread use of these contracts by, and their utility to, commercial entities in hedging their risk. As with the outright price reporting agency index contracts, this exclusion benefits market participants to the extent it mitigates costs to monitor positions for aggregation and other compliance purposes.

e. Economically Equivalent Swaps

The existing Federal position limits framework does not include Federal position limit levels on swaps. The Dodd-Frank Act added CEA section 4a(a)(5), which requires that when the Commission imposes Federal position limits on futures contracts and options on futures contracts pursuant to CEA section 4a(a)(2), the Commission also establish limits simultaneously for "economically equivalent" swaps "as appropriate."[1455] As the statute does not define the term "economically equivalent," the Commission is applying its expertise in construing such term consistent with the policy goals articulated by Congress, including in CEA sections 4a(a)(2)(C) and 4a(a)(3) as discussed below.

[1454] The definition of the new term "monthly average pricing contracts" in Appendix C of this Final Rule is intended to cover the types of contracts generally referred to in the industry as calendar-month average, trade-month average, and balance-of-the-month contracts. *See supra* Section II.A.16.iii.b(4)(v) (discussing new exclusions from the "referenced contract" definition).

[1455] CEA section 4a(a)(5); 7 U.S.C. 6a(a)(5). In addition, CEA section 4a(a)(4) separately authorizes, but does not require, the Commission to impose Federal position limits on swaps that meet certain statutory criteria qualifying them as "significant price discovery function" swaps. 7 U.S.C. 6a(a)(4). The Commission reiterates, for the avoidance of doubt, that the definitions of "economically equivalent" in CEA section 4a(a)(5) and "significant price discovery function" in CEA section 4a(a)(4) are separate concepts and that contracts can be economically equivalent without serving a significant price discovery function.

Specifically, under the Commission's definition of "economically equivalent swap" set forth in final § 150.1, a swap generally qualifies as economically equivalent with respect to a particular referenced contract so long as the swap shares "identical material" contract specifications, terms, and conditions with the referenced contract. Further, any differences between the swap and referenced contract with respect to the following are disregarded for purposes of determining whether the swap qualifies as economically equivalent: (i) lot size or notional amount; (ii) for a natural gas swap and a referenced contract that are both physically-settled, delivery dates diverging by less than two calendar days, and for any other swap and referenced contract that are both physically-settled, delivery dates diverging by less than one calendar day;[1456] and (iii) post-trade risk-management arrangements.[1457]

As discussed in turn below, the Commission believes that the Final Rule's definition of "economically equivalent swaps" benefits (1) market integrity by protecting against excessive speculation and potential manipulation and (2) market liquidity by not favoring OTC or foreign markets over domestic markets. Additionally, (3) the Commission will discuss the costs and benefits related to the Final Rule's economically equivalent swap definition's treatment of natural gas swaps; and (4) the Commission will address the several proposed alternative definitions included in commenter letters.

As discussed further below, with respect to exchange-set position limits on swaps, the Commission proposed to delay compliance with DCM Core Principle 5 and SEF Core Principle 6, as compliance would otherwise be impracticable, and, in some cases, impossible, at this time. In the 2020 NPRM, the Commission explained that this delay was based largely on the fact that exchanges cannot view positions in OTC swaps across the various places they are trading, including on competitor exchanges. The Commission

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[1456] As discussed below, the definition of "economically equivalent swap" with respect to natural gas referenced contracts contains the same terms, except that it includes delivery dates diverging by less than two calendar days.

[1457] *See supra* Section II.A.4. (further discussing the Commission's definition of "economically equivalent swap").

is maintaining this approach to permit exchanges to delay compliance with respect to exchange-set position limits on swaps, although the Commission emphasizes, for the avoidance of doubt, that it will monitor and enforce swaps for compliance with Federal position limits subject to the compliance dates discussed above.[1458] However, the Commission notes that in two years, the Commission will reevaluate the ability of exchanges to establish and implement appropriate surveillance mechanisms to implement DCM Core Principle 5 and SEF Core Principle 6 with respect to swaps.

(1) Benefits and Costs Related to Market Integrity

The Commission believes that the final economically equivalent swap definition benefits market integrity in two ways. First, the final definition protects against excessive speculation and potential market manipulation by limiting the ability of speculators to obtain excessive positions through netting. As explained above, under the Final Rule, market participants may net positions across linked referenced contracts, including positions across linked referenced contracts in economically equivalent swaps and futures.[1459] Accordingly, a more inclusive "economically equivalent" definition that would encompass additional swaps (*e.g.*, swaps that may differ in their "material" terms or physically-settled swaps with delivery dates that diverge by one day or more) could make it easier for market participants to inappropriately net down against their referenced futures contracts by allowing market participants to structure swaps that do not necessarily offer identical risk or economic exposure or sensitivity as the linked futures contract, but which could still be netted under the Final Rules. In such a hypothetical case, a market participant could enter into an OTC swap with a maturity that differs by days or even weeks in order to net down a position in a referenced contract, enabling the market participant to hold an even greater position in the referenced contract.

[1458] For discussion of the relevant compliance dates for the Final Rule, *see supra* Section I.D.

[1459] *See supra* Section II.B.10. (discussing netting).

Similarly, applying Federal position limits to swaps that share identical "material" terms with their corresponding referenced contracts benefits market integrity by preventing market participants from escaping the position limits framework merely by altering non-material terms, such as holiday conventions. On the other hand, the Commission recognizes that such a narrow "economically equivalent swap" definition could impose costs on the marketplace by possibly permitting excessive speculation since market participants would not be subject to Federal position limits if they were to enter into swaps that may have different material terms (*e.g.*, penultimate swaps to the extent a penultimate futures contract or options contract does not exist to which a penultimate swap could possibly be deemed to be "economically equivalent" and therefore subject to the applicable Federal position limits)[1460] but may nonetheless be sufficiently correlated to their corresponding referenced contract. In this case, it is possible that there may be potential for excessive speculation, market manipulation, or it is possible that market participants could leave the futures markets for the swaps markets, which could introduce new costs to commercial market participants due to reduced market liquidity or disruptions to the price discovery function.[1461] Nonetheless, to the extent that swaps currently are not subject to Federal position limit levels, such potential costs would remain unchanged compared to the status quo.

Second, the relatively narrow final definition benefits market integrity, and reduces associated compliance and implementation costs, by permitting exchanges, market participants, and the Commission to focus resources on those swaps that pose the

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[1460] Or, in the case of natural gas referenced contracts, which would potentially include penultimate swaps as economically equivalent swaps, a swap with a maturity of less than one day away from the penultimate swap. *See supra* Sections II.A.4.iii.f. and II.B.3.vi. (discussing natural gas swaps).

[1461] The Commission acknowledges that liquidity could shift to penultimate swaps, which would impose costs on price discovery and market efficiency in the futures markets, in cases where there are no corresponding penultimate futures contracts or options contracts (and therefore the swap would not be deemed to be an economically equivalent swap), but the Commission believes that this concern is mitigated for two reasons. First, basis risk may exist between the penultimate swap and the referenced contract, and so the Commission believes that a market participant is less likely to hold a penultimate swap the greater the economic difference compared to the corresponding referenced contract. Second, the absence of penultimate futures contracts or options contracts may indicate lack of appropriate penultimate liquidity to hedge or offset one's penultimate swap position and therefore may militate against entering into penultimate swaps.

greatest threat for facilitating corners and squeezes – that is, those swaps with substantially identical delivery dates and identical material economic terms to futures and options on futures subject to Federal position limits. While swaps that have different material terms than their corresponding referenced contracts, including different delivery dates, may potentially be used for engaging in market manipulation, the final definition benefits market integrity by allowing exchanges and the Commission to focus on the most sensitive period of the spot month, including with respect to the Commission's and exchanges' various surveillance and enforcement functions. To the extent market participants would be able to use swaps that fall outside the scope of the final definition to effect market manipulation, such potential costs would remain unchanged from the status quo since no swaps are currently covered by existing Federal position limits. The Commission however acknowledges that its narrow economically equivalent swap definition may introduce possible burdens to market integrity – as the form of an opportunity cost – since fewer swaps are covered under the Federal position limits compared to the alternative in which the Commission adopted a broader definition.

Further, the Final Rule's delayed compliance with respect to the establishment and enforcement of exchange-set limits on swaps benefits exchanges by facilitating exchanges' ability to establish surveillance and compliance systems. As noted above, exchanges currently lack sufficient data regarding individual market participants' open swap positions since exchanges cannot view positions in OTC swaps across the various places they are trading, including competitor exchanges, which means that requiring exchanges to establish oversight over market participants' positions currently could impose substantial costs and also may be impractical to achieve.[1462]

[1462] SIFMA AMG agrees with the Commission's assessment, stating that "[s]ince the exchanges do not have visibility into OTC swaps markets, market participants and the CFTC would be responsible for implementing position limits on swaps without the benefit of the exchanges' extensive experience in monitoring and applying position limits for exchange-listed contracts." SIFMA AMG at 10.

As a result, the Commission has determined that allowing exchanges delayed compliance with respect to swaps reduces unnecessary costs. Nonetheless, the Commission's determination to permit exchanges to delay implementing Federal position limits on swaps could incentivize market participants to leave the futures markets and instead transact in economically-equivalent swaps, which could reduce liquidity in the futures and related options markets. However, the Commission emphasizes that the Commission will oversee and enforce compliance with Federal position limits for economically equivalent swaps, which should mitigate the concern related to incentivizing futures contracts and related options on futures contracts to move trading and related liquidity to the OTC swaps markets. With respect to exchange-set position limits on swaps, the Commission notes that in two years, the Commission will reevaluate the ability of exchanges to establish and implement appropriate surveillance mechanisms to implement position limits for economically equivalent swaps at the exchange level.[1463]

Additionally, while futures contracts and options thereon are subject to clearing and exchange oversight, economically equivalent swaps may be transacted bilaterally off-exchange (*i.e.*, OTC swaps). As a result, it is relatively easy to create customized OTC swaps that may be highly correlated to its corresponding futures (or options) contract, which would allow the market participant to create an exposure in the underlying commodity similar to the referenced contract's exposure. Due to the relatively narrow "economically equivalent swap" definition, the Commission believes that it may be possible for market participants to attempt to avoid Federal position limits by entering

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[1463] In response to the 2020 NPRM's proposal to permit exchanges to delay oversight and enforcement of exchanges' position limit rules on economically equivalent swaps, IATP stated that "[d]elaying compliance with position limit requirement [sic] to avoid imposing costs on market participants makes it appear that the Commission is serving as a swap dealer booster, although swap dealers are amply resourced to provide the necessary data to the exchanges and to the Commission. The Commission is bending over backward to avoid requiring swaps market participants from paying the costs of exchange trading." However, the Commission emphasizes that the Commission will still implement, oversee, and enforce Federal position limits on swaps. As a result, the proposed delayed enforcement of exchange-set position limits is designed to reduce costs imposed on *exchanges* rather than swap dealers, which will be subject to Federal position limits under the Final Rule.

into such OTC swaps.[1464] While such swaps may not be perfectly correlated to their corresponding referenced contracts, market participants may find this risk acceptable in order to avoid Federal position limits. An increase in OTC swaps at the expense of futures contracts and options on futures contracts may impose costs on market integrity due to lack of exchange oversight. If liquidity were to move from futures exchanges to the OTC swaps markets, non-dealer commercial entities may face increased transaction costs and widening spreads, as swap dealers gain market power in the OTC market relative to centralized exchange trading. The Commission is unable to quantify the costs of these potential harms. However, while the Commission acknowledges these potential costs, such costs to those contracts that already have limits (including Federal and/or exchange-set position limits) on them already may have been realized in the marketplace because swaps are not subject to Federal position limits under the status quo.

Lastly, under the Final Rule, market participants are able to determine whether a particular swap satisfies the definition of "economically equivalent swap," as long as market participants make a reasonable, good faith effort in reaching their determination and are able to provide sufficient evidence, if requested, to support a reasonable, good faith effort.[1465] The Commission anticipates that this flexibility will benefit market integrity by providing a greater level of certainty to market participants, in contrast to the alternative in which market participants would be required to first submit swaps to the Commission staff and wait for feedback or approval. On the other hand, the Commission also recognizes that not having the Commission explicitly opine on whether a swap would qualify as economically equivalent could cause market participants to avoid

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[1464] In contrast, since futures contracts and options on futures contracts are created by exchanges and submitted to the Commission for either self-certification or approval under part 40 of the Commission's regulations, a market participant would not be able to customize an exchange-traded futures contract or option on futures contract.

[1465] *See supra* Section II.A.4.g (discussing market participants' discretion in determining whether a swap is economically equivalent). Regarding the obligations of swap dealers to monitor position limits, ISDA commented that the requirements imposed by § 23.601 are burdensome and requested additional guidance regarding same. ISDA at 10. The Commission believes it is unnecessary to provide further detail with respect to § 23.601 because, as discussed above and in the preamble, the Commission will defer to a market participant's determination as long as the market participant is able to provide sufficient support to show that it made a reasonable, good faith effort in applying its discretion. Furthermore, the Commission is not adopting any amendments to § 23.601, so the baseline status quo in connection with § 23.601 is unchanged under the Final Rule. *See supra* Section II.A.4.g.

entering into such swaps.[1466] In turn, this could lead to less efficient hedging strategies if the market participant is forced to turn to the futures markets (*e.g.*, a market participant may choose to transact in the OTC swaps markets for various reasons, including liquidity, margin requirements, or simply better familiarity with ISDA and swap processes over exchange-traded futures). However, as noted below, the Commission reserves the right to declare whether a swap or class of swaps is or is not economically equivalent, and a market participant could petition, or request informally, that the Commission make such a determination, although the Commission acknowledges that there could be costs associated with this, including delayed timing and monetary costs.

Further, the Commission recognizes that requiring market participants to conduct reasonable due diligence and maintain related records also could impose new compliance costs. Additionally, the Commission recognizes that certain market participants could assert that an OTC swap is (or is not) "economically equivalent" depending upon whether such determination benefits the market participant. In such a case, market participants could theoretically subvert the intent of the Federal position limits framework, although the Commission believes that such potential costs would be mitigated due to the Commission's surveillance functions and authority to declare that a particular swap or class of swaps either does or does not qualify as economically equivalent.

(2) The Final Definition Could Increase Benefits or Costs Related to Market Liquidity and Price Discovery

First, the final economically equivalent swap definition could benefit market liquidity by being, in general, less disruptive to the swaps markets, which in turn may

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[1466] For example, NRECA believes that a standardized reference source to confirm whether a particular swap is subject to Federal position limits would benefit market participants: "Because the Commission has determined not to codify its interpretations and other guidance, or to establish a single reference source for assistance in confirming 'swap/not-a-swap' distinction, the two counterparties to a bilateral off-facility energy transaction must make the 'swap/not-a-swap' determination without the benefit of standardized rules or product definitions. Although the terms of many off-facility, bilateral energy commodity transactions are highly-customized, other such transactions may be many iterations closer to futures contract 'look-alikes,' that is, to referenced contracts. If such a transaction is (or may be) a 'swap,' such a swap would then also need to be evaluated to determine whether it was 'economically equivalent' under the Speculative Position Limits Rules." NRECA at 18; *see also* CEWG at 30-31.

reduce the potential for disruption for the price discovery function compared to a possible alternative, broader definition. For example, if the Commission were to adopt an alternative to its final "economically equivalent swap" definition that encompassed a broader range of swaps by including, for example, delivery dates that diverge by one or more calendar days – perhaps by several days or weeks – a market participant (including speculators) with a large portfolio of swaps could more easily bump up against the applicable position limits and therefore would have an incentive either to reduce its swaps activity or move its swaps activity to foreign jurisdictions. If there were many similarly situated market participants, the market for such swaps could become less liquid, which in turn could harm liquidity for bona fide hedgers as large liquidity providers could move to other markets.

Second, the final definition could benefit market liquidity by being sufficiently narrow to reduce incentives for liquidity providers to move to foreign jurisdictions, such as the European Union ("EU").[1467] Additionally, the Commission believes that proposing a definition similar to that used by the EU will benefit international comity.[1468] Further, market participants trading in both U.S. and EU markets would find the final definition to be familiar, which may help reduce compliance costs for those market participants that

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[1467] In this regard, the final definition is similar in certain ways to the EU definition for OTC contracts that are "economically equivalent" to commodity derivatives traded on an EU trading venue. The applicable European regulations define an OTC derivative to be "economically equivalent" when it has "identical contractual specifications, terms and conditions, excluding different lot size specifications, delivery dates diverging by less than one calendar day and different post trade risk management arrangements." While the Commission's final definition is similar, the Commission's final definition requires "identical *material"* terms rather than simply "identical" terms. Further, the Commission's final definition excludes different "lot size specifications or *notional amounts*" rather than referencing only "lot size" since swaps terminology usually refers to "notional amounts" rather than to "lot sizes." *See* EU Commission Delegated Regulation (EU) 2017/591, 2017 O.J. (L 87).

[1468] Both the Commission's definition and the applicable EU regulation are intended to prevent harmful netting. *See* European Securities and Markets Authority, *Draft Regulatory Technical Standards on Methodology for Calculation and the Application of Position Limits for Commodity Derivatives Traded on Trading Venues and Economically Equivalent OTC Contracts*, ESMA/2016/668 at 10 (May 2, 2016), available at https://www.esma.europa.eu/sites/default/files/library/2016-668_opinion_on_draft_rts_21.pdf ("[D]rafting the [economically equivalent OTC swap] definition in too wide a fashion carries an even higher risk of enabling circumvention of position limits by creating an ability to net off positions taken in on-venue contracts against only roughly similar OTC positions.")

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

already have systems and personnel in place to identify and monitor such swaps. As discussed by SIFMA AMG, "[m]any market participants are active in markets and products that are regulated by the CFTC and EU authorities. Having different definitions would be costly for firms, since they would have to build out different compliance functions, and inefficient for markets."[1469] As noted above, any differences between the Final Rule's "economically equivalent swap" and the EU's corresponding definition by the addition of the "material" qualifier should lead to the benefits identified in the above discussion, along with the corresponding costs.

(3) The Final Definition Could Create Costs or Benefits Related to Market Liquidity for the Natural Gas Market

SIFMA AMG commented that "financially-settled penultimate day expiry products in natural gas should be excluded from limits to the same extent as penultimate day expiry contracts for each of the other 24 core referenced futures contracts. To introduce a change from existing exchange practice (under which these financially-settled penultimate day contracts are out of scope) could introduce an otherwise avoidable disruption to trading during the closing days of the natural gas contract month, with no corresponding benefits to market oversight or integrity."[1470]

As discussed in greater detail in the preamble, the Commission recognizes that the market dynamics in natural gas are unique in several respects, including the fact that unlike with respect to other core referenced futures contracts, for natural gas, relatively liquid spot-month and penultimate cash-settled futures exist.[1471] However, in contrast to SIFMA AMG's comment, the Commission has determined that creating an exception to the proposed "economically equivalent swap" definition for natural gas benefits market

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[1469] SIFMA AMG at 6-7.

[1470] SIFMA AMG at 11. For the purpose of this comment, even though SIFMA AMG refers generally to "financially-settled penultimate" contracts in natural gas, the Commission assumes it is referring to penultimate cash-settled economically equivalent swaps since penultimate futures contracts and options on futures contracts are included under the "referenced contract" definition.

[1471] *See supra* Section II.A.4.iii.f. (discussing economically equivalent natural gas swaps).

liquidity by not unnecessarily favoring existing natural gas penultimate contracts over spot contracts. The Commission is especially sensitive to potential market manipulation in the natural gas markets since market participants – to a significantly greater extent compared to the other core referenced futures contracts that are included in the Final Rule– regularly trade in both the physically-settled core referenced futures contract and the cash-settled look-alike referenced contracts that are penultimate contracts. Accordingly, the Commission has concluded that a slightly broader definition of "economically equivalent swap" to encompass penultimate natural gas swaps uniquely benefits the natural gas markets by helping to deter and prevent manipulation of a physically-settled contract to benefit a related cash-settled contract, including penultimate positions.

(4) Alternatives to the "Economically Equivalent Swap" Definition

Several commenters provided alternative approaches to the 2020 NPRM's proposed "economically equivalent swap" definition.

First, SIFMA AMG argued that the Commission should not impose Federal position limits on swaps at all, and that the proposed Federal position limits were "unnecessary and would in fact impose cost burdens . . . that are not commensurate with any of the suggested benefits . . . ."[1472] Similarly, CHS stated that "[t]here is little doubt, from CHS's perspective, that including economically equivalent swaps as 'referenced contracts' for position limit purposes will result in a material burden for (a) commercial end–users and (b) small to mid–sized FCMs that focus on the needs of grain and energy hedgers, which are referred to as '*Commodity–Focused FCMs'*. The costs of compliance

[1472] SIFMA AMG at 6-7. Additional commenters similarly argued that subjecting swaps to position limits is unnecessary and would increase costs without commensurate benefits. *E.g.*, CHS at 5; NCFC at 5; and ISDA at 5.

on such participants will likely be large and time–consuming, and possibly entail some risk of operational error arising out of the implementation process."[1473]

However, as discussed above, the Dodd-Frank Act added CEA section 4a(a)(5), which explicitly requires that the Commission impose Federal position limits on swaps that are "economically equivalent" to the futures contracts and options on futures contracts subject to Federal position limits, and that the Commission establish limits simultaneously for "economically equivalent" swaps. Accordingly, from the perspective of this cost-benefit discussion, the question is not whether the Final Rule should encompass swaps at all, but only the extent to which swaps should be incorporated as "economically equivalent" pursuant to CEA section 4a(a)(5). Nonetheless, the Commission recognizes that subjecting economically equivalent swaps to Federal position limits could impose the compliance costs referenced above by CHS and others. However, to the extent that the Final Rule adopts a narrow "economically equivalent swap" definition, the Commission anticipates these costs should be mitigated compared to alternative definitions, while simultaneously satisfying the statutory requirement under CEA section 4a(a)(5).

Second, CME and Better Markets both suggested that the general "referenced contract" definition that applies to futures contracts and options on futures contracts should also apply to swaps, rather than the narrower "economically equivalent swap" definition. Similarly, NEFI argued that the narrower "economically equivalent swap"

[1473] CHS at 4. *See also* NCFC at 5 (similarly stating that "[t]he costs of compliance on such participants will likely be large and time-consuming, and possibly entail some risk of operational error arising out of the implementation process."). CHS further stated, "[w]ith respect to commercial end–users, absent additional Commission guidance CHS believes that the burdens will take the form of (a) determining which types of swaps will be deemed to be economically equivalent swaps, (b) making significant and costly modifications to systems to identify and track transactions for reporting purposes, (c) developing tools for swaps aggregation purposes (or manually conducting such tasks if such a tool is not readily available to be interpolated into existing systems) and (d) determining intra-day positions when addressing economically equivalent swaps, which will require real–time system reporting and real–time exception alerts, among other things . . . . In these respects, CHS asks the Commission to be mindful and more fully address the costs and benefits applicable to commercial end–users and Commodity–Focused FCMs, and to provide more clarity regarding the scope of referenced contracts. As a guide, CHS urges the Commission to maintain as narrow a definition of 'referenced contract' as possible. CHS also urges the Commission, both in the context of market participants generally and commercial end–users and Commodity–Focused FCMs particularly, to address CHS's recommendations in the following section." *Id*. at 4-5. NCFC similarly stated that "NCFC believes any Federal speculative position limits rule should not unduly burden commercial end-users who utilize derivatives markets for economically appropriate risk management activities." NCFC at 7.

definition could allow for easy avoidance of Federal position limits.[1474] The Commission discusses the possible costs and benefits of the Final Rule's narrow definition versus this proposed alternative of a broader definition throughout this cost-benefit discussion of economically equivalent swaps, and the reasons discussed by the Commission throughout this section similarly apply in response to CME's, Better Markets', and NEFI's proposed alternative to establish a broader "economically equivalent swap" definition.

Third, SIFMA AMG argued that while it opposed including swaps within the Final Rule, to the extent the Commission determines to include swaps within the Final Rule, that, in the alternative, at least cash-settled swaps should be excluded from the economically equivalent swap definition since these types of swaps "have not historically been the source of manipulative corners, squeezes, or other disruptions related to physical commodity prices, and SIFMA AMG does not believe limits on these products would be necessary to further deter and prevent this type of trading activity."[1475]

However, the Commission believes that SIFMA AMG's proposed alternative to exclude all cash-settled swaps *ex ante* would impose liquidity costs for bona fide hedgers since excluding all cash-settled swaps could incentivize liquidity to move from corresponding cash-settled referenced contracts to cash-settled OTC swaps, potentially harming the liquidity in the futures markets, including liquidity for bona fide hedgers. This could also harm price discovery if significant liquidity and trading migrates from the exchange-traded futures markets to the more opaque OTC swaps markets. For example, as noted above, if liquidity were to move from futures exchanges to the OTC swaps

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[1474] NEFI at 3.

[1475] SIFMA AMG at 7. SIFMA AMG further argued that "imposing spot month limits only on physically-settled futures contracts would avoid such confusion, and more importantly, would adequately address the products of greatest concern and would serve to reduce compliance costs and related burdens (*i.e.*, technology builds, personnel allocation, training, etc.) for the Commission and market participants by allowing the Commission to observe the impact of limits for physically-settled futures prior to evaluating whether to extend limits to a broader scope of derivatives products." SIFMA AMG at 5-6.

PIMCO and ISDA similarly argue that neither cash-settled swaps nor futures contracts should be subject to position limits. PIMCO at 3; ISDA at 5 (arguing that position limits on cash-settled referenced contracts, whether futures contracts or swaps, "impose a level of cost and complexity in implementation that does not correspond to any identified regulatory or policy benefit of such limits.") AQR similarly argued that the "opportunity or ability to use a swap to squeeze or corner an underlying physical commodity is extremely remote and thus extension of position limits to swaps would likely not be merited based on an analysis of the costs and benefits of such action." AQR at 10.

markets, non-dealer commercial entities may face increased transaction costs and widening spreads, as swap dealers gain market power in the OTC market relative to centralized exchange trading. The Commission is unable to quantify the costs of these potential harms.[1476]

Furthermore, the Commission notes that CEA section 4a(a)(3) does not merely refer to corners and squeezes, but also refers to "manipulation" generally. Accordingly, the Commission believes that the Final Rule will better benefit market integrity to the extent that cash-settled swaps would be subject to the Final Rule by helping to prevent other forms of manipulation, such as "banging" or "marking" the close.

Fourth, in contrast to the alternative posited by SIFMA AMG immediately above in which the Commission would exclude all cash-settled swaps, Better Markets believed that the Final Rule's exclusion of certain cash-settled swaps could actually impose costs on liquidity formation. Better Markets thus proposed an alternative where settlement type (*i.e.*, cash-settled versus physically-settled) was not considered to be a "material" difference and therefore cash-settled swaps could be deemed to be "economically equivalent" to core referenced futures contracts, which are all physically-settled. Better Markets argued that the 2020 NPRM's economically equivalent definition "essentially excludes" cash-settled swaps from Federal position limits because cash-settled swaps would not be able to qualify as economically equivalent to a physically-settled core referenced futures contract.[1477] As Better Markets commented, distinguishing between cash-settled and physically-settled swaps and futures contracts by deeming settlement type (*i.e.*, cash-settled vs. physically-settled settlement) to be a material term would

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[1476] However, while the Commission acknowledges these potential costs, such costs to the nine legacy agricultural contracts may already have been realized because their corresponding swaps are not subject to Federal position limits under the status quo. Nonetheless, the Commission also recognizes that certain of the 16 non-legacy core referenced futures contracts that would be subject to Federal position limits for the first time under the Final Rule may have larger, more liquid swaps markets than the nine legacy agricultural contracts, and therefore potentially larger concomitant benefits and/or costs.

[1477] Better Markets at 32.

"incentivize[] speculative liquidity formation away from more liquid, more transparent, and more restrictive futures exchanges and to the swaps markets."[1478]

However, the Commission does not believe that the treatment of cash-settled swaps under the Final Rule imposes such costs, at least to the extent assumed by Better Markets. The Commission believes Better Markets' concern is mitigated since under the Final Rule cash-settled swaps are subject to Federal position limits only if there is a corresponding (*i.e.*, "economically equivalent") cash-settled futures contract or option on a futures contract.[1479] That is, cash-settled swaps are free from Federal position limits if there are no corresponding cash-settled futures contracts or options on futures contracts. In these situations, if no corresponding futures contract or option thereon exists, then there is no liquidity formation in cash-settled futures contracts and options on futures contracts with which a cash-settled swap would be competing for liquidity in the first place.[1480]

Fifth, FIA proposed an alternative in which cash-settled economically equivalent swaps would be subject to a separate (higher) Federal spot-month position limit levels compared to their corresponding referenced contracts, and FIA argued that its proposed alternative would benefit innovation and competition between exchanges.[1481] However, the Commission believes that establishing separate (or higher) position limits for economically equivalent swaps could impose liquidity costs and burden market integrity and price discovery.

[1478] *Id*.

[1479] The Commission notes that a swap could be deemed to be "economically equivalent" to any referenced contract, including cash-settled look-alikes, and that the "economically equivalent swap" definition is not limited to core referenced futures contracts.

[1480] In contrast to Better Markets, AQR noted that any "extension of position limits to swaps risks negatively impacting commercial hedgers by reducing market liquidity, increasing transaction costs, and increasing commodity market volatility. While the Commission cannot entirely avoid those risks if compelled to impose such limits, the proposed approach to economically equivalent swaps may mitigate them in ways that allow the Commission to fully discharge its statutory obligation without unnecessarily restricting market activity." AQR at 11.

[1481] FIA at 7-8. The Commission generally addresses FIA's argument about innovation and competition in the preamble above under Section II.B.10.v.

In particular, separate position limits for cash-settled swaps would make it easier for potential manipulators to engage in market manipulation, such as "banging" or "marking" the close, by effectively permitting higher Federal position limits in cash-settled referenced contracts. For example, a market participant would be able to double its cash-settled positions by maintaining positions in both cash-settled futures and cash-settled economically equivalent swaps since under FIA's proposed alternative positions in each contract type, that is futures contracts (including options thereon) and swaps, would be subject to their own separate position limits for purposes of Federal position limits.

Furthermore, imposing position limits separately on economically equivalent swaps and futures contracts (and options thereon) as requested under FIA's proposed alternative would mean that market participants would not be able to net their economically equivalent swaps with their futures positions. In contrast, the absence of separate Federal position limits for economically equivalent swaps means that market participants are able to net economically equivalent swaps with other referenced contracts, *i.e.*, futures contracts against swaps. The Commission also recognizes that netting could permit larger speculative positions in futures markets for market participants who did not previously have bona fide hedge exemptions, but who have positions in swaps in the same commodity that could be netted against futures contracts in the same commodity. This observation might seem to be at cross-purposes with the relatively narrow "economically equivalent swap" definition. However, the Commission is concerned that separate position limits for swaps could impair liquidity in futures contracts or swaps, as the case may be. For example, a market participant (including a market maker or speculator) with a large portfolio of swaps (or futures contracts) near the applicable position limit would be assumed to have a strong preference for executing futures contracts (or swaps) transactions in order to maintain a swaps (or futures

contracts) position below the applicable position limit. If there were many similarly situated market participants, the market for such swaps (or futures contracts) could become less liquid, which could burden market efficiency and impose higher trading costs for bona fide hedgers. The absence of separate position limits for swaps should decrease the possibility of illiquid markets for referenced contracts subject to Federal position limits. Because economically equivalent swaps and the corresponding futures contracts and options on futures contracts are close substitutes for each other, the absence of separate position limits should allow greater integration between the economically equivalent swaps and corresponding futures and options markets for referenced contracts, which should benefit price discovery, and should also provide market participants with more flexibility whether hedging, providing liquidity or market making, or speculating, which should benefit market efficiency and price discovery.

Sixth, COPE alternatively requested that the Commission explicitly exclude physically-settled swaps, or at least provide specific examples of the contracts intended to be included.[1482] While the Commission provides greater clarity in the corresponding preamble discussion above,[1483] the Commission has determined that excluding all physically-settled swaps *ex ante* is inconsistent with the statutory goals in CEA section 4a(a)(3)(B), especially the requirements to deter corners and squeezes and to ensure sufficient market liquidity for bona fide hedgers enumerated in CEA section 4a(a)(3)(B)(ii) and (iii), respectively. For example, excluding physically-settled swaps could potentially incentivize liquidity to move from physically-settled core referenced futures contracts to physically-settled swaps, which could impose costs both on market liquidity for bona fide hedgers and also on market integrity by enabling potential manipulators to accumulate large directional positions in physically-settled contracts to

[1482] COPE at 4-5.
[1483] *See* Section II.A.4.iii.d(1).

effect a corner and squeeze more easily. This could additionally harm price discovery as liquidity and trading would move from the more transparent exchange-traded futures contracts and options thereon to the more opaque OTC swaps markets.

Seventh, NCFC stated that it "appreciate[s] that CFTC proposed a narrow definition of an economically equivalent swap under a Federal position limits regime. Likewise, we do not object to an inclusion of such swaps in theory since our members use them for legitimate hedging purposes. However, NCFC continues to be concerned with the operational difficulties, burdens, and costs for commercial end users and small- to mid-sized FCMs that focus on the needs of agricultural hedgers of including swaps for position limit purposes. The costs of compliance on such participants will likely be large and time-consuming, and possibly entail some risk of operational error arising out of the implementation process."[1484] As a result, NCFC suggested, as an alternative to the 2020 NPRM's approach, that the Final Rule exclude from a commercial end-user's Federal position limits those agricultural commodity swaps that are transacted by invoking the "End-User Exemption to Mandatory Clearing" rule.[1485] According to NCFC, those swap contracts already must meet the test "to hedge or mitigate commercial risk," and are "not used for a purpose that is in the nature of speculation, investing, or trading," as outlined in § 50.50 of the Commission's regulations, and therefore, by definition, these contracts should not be subject to end-user Federal speculative position limits.[1486]

The Commission understands NCFC's concern, but believes NCFC's alternative is unnecessary for two reasons. First, to the extent a swap described by NCFC would "hedge or mitigate commercial risk," the Commission believes that the costs described by NCFC are mitigated since such swap likely would qualify for an enumerated bona fide hedge under the Final Rule and therefore would not contribute to a commercial end-

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[1484] NCFC at 5.
[1485] *Id*.
[1486] *Id*.

user's net position for Federal position limits purposes.[1487] Second, the Commission believes the purported benefits related to NCFC's alternative are limited since physical commodity swaps are not required to be cleared under the Commission's existing regulations, so determining whether the end-user clearing exemption applies is not necessarily a helpful proxy in determining whether a swap is "economically equivalent" or not for purposes of CEA section 4a(a)(5).

vii. Pre-existing Positions

Final § 150.2(g) imposes Federal position limits on "pre-existing positions" [1488] – other than pre-enactment swaps and transition period swaps – during both the spot month and non-spot month.

The Commission believes that final § 150.2(g) benefits market integrity since pre-existing positions (other than pre-enactment and transition period swaps) that exceed spot-month limits could result in market or price disruptions as positions are rolled into the spot month.[1489] The Commission recognizes some costs and benefits associated with final § 150.2(g)(2) may have already been realized given that the nine legacy agricultural contracts are already subject to the Federal non-spot month position limits. Therefore, exchanges and market participants should not incur any significant new costs to comply with § 150.2(g)(2), and will likely continue to benefit from market integrity as a result of the Final Rule.

In response to the 2020 NPRM, FIA and MGEX suggested that the Commission alternatively restructure the provision to include just two categories, "pre-existing swaps" and "pre-existing futures," because the variability of exemptive relief could create

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[1487] To the extent an FCM would not be able to qualify for a bona fide hedge, the Commission believes that excepting such swaps for purely financial firms would functionally have the same effect as maintaining the risk-management exemption, which Congress, through the Dodd-Frank Act's amendments to the CEA, has directed the Commission to eliminate. *See* Section II.A.4.iii. Nonetheless, to the extent that NCFC's comment is limited to small- and medium-sized FCMs, the Commission does not believe that such FCMs generally will violate the Federal position limit levels based on the Commission's understanding of existing market dynamics and positions held by market participants under the status quo, and therefore costs should be comparatively mitigated for small- and medium-sized FCMs.

[1488] Final § 150.1 defines "pre-existing position" to mean "any position in a commodity derivative contract acquired in good faith prior to the effective date" of any applicable position limit.

[1489] The Commission is particularly concerned about protecting the spot month in physical-delivery futures from corners and squeezes.

operational challenges for market participants."[1490] Although the Commission did not adopt the terms "pre-existing swaps" and "pre-existing futures" for the Final Rule as FIA and MGEX suggested, the practical effect is that final § 150.2(g) creates two categories— (1) pre-existing futures contracts (including options thereon), which are subject to both the spot month and non-spot month Federal position limits; and (2) pre-existing swaps, which are not subject to such limits. Furthermore, to offset the operational challenges or other burdens associated with final § 150.2(g), the Commission is delaying the compliance date to January 1, 2022 in connection with the Federal position limits for the 16 non-legacy core referenced futures contracts, and further delaying the compliance date to January 1, 2023 for swaps that are subject to Federal position limits under the Final Rule.

viii. Anti-evasion

Final § 150.2(i) provides that, if used to willfully circumvent or evade speculative position limits: (1) a commodity index contract, monthly average pricing contract, outright price reporting contract, and/or a location basis contract will be considered to be a referenced contract; (2) a bona fide hedging transaction or position recognition or spread exemption will no longer apply; and (3) a swap will considered to be an economically equivalent swap even if it does not meet the economically equivalent swap definition set forth in § 150.1. This provision serves to deter and prevent a number of potential methods of evading Federal position limits, the specifics of which the Commission may not be able to anticipate. Like the Federal position limits it supports, § 150.2(i) helps to protect market integrity by preventing excessive speculation and market manipulation. However, the Commission also recognizes possible costs to market participants due to uncertainty under the Final Rule's anti-evasion provision since it may be difficult for market participants to determine, as a bright-line matter, whether their

[1490] FIA at 8-9; MGEX at 4.

positions and trading strategies represent legitimate avoidance of position limits or instead represent malfeasant evasive practices.[1491] As a result, the lack of a bright-line standard could potentially impose liquidity costs as market participants may instead choose to engage in less efficient trading strategies in order to err cautiously to avoid engaging in potentially "evasive" behavior.

As an alternative to the "willfully" standard, FIA recommended that the anti-evasion analysis be based on the presence of "deceit, deception, or other unlawful or illegitimate activity."[1492] Because a position that does not involve fraud or deceit can still involve other indicia of evasive activity, the proposed alternative would be less effective in protecting market integrity to the extent it failed to capture evasive activity. Further, the incorporation of a standard other than "willful" would create confusion to market participants by resulting in divergent standards among Commission rulemakings concerning evasion.

4. Exemptions from Federal Position Limits - Bona Fide Hedging Recognitions, Spread and Other Exemptions (Final §§ 150.1 and 150.3)

i. Background

The Final Rule provides for several exemptions that, subject to certain conditions, permit a trader to exceed the applicable Federal position limit set forth in final § 150.2. Specifically, § 150.3 generally maintains but modifies, as discussed below, the two existing Federal exemptions that include (1) bona fide hedging positions and (2) spread positions. Final § 150.3 also includes new Federal exemptions for certain conditional spot month positions in natural gas, financial distress positions, and pre-enactment and

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[1491] SIFMA AMG at 7, n.16 (noting that the anti-evasion provision makes the application of the proposed "economically equivalent swap" definition less clear because it incorporates a subjective measure of intent); *see also* FIA at 25 (questioning how a participant would distinguish a strategy that minimizes position size with an evasive strategy); Better Markets at 33 (describing the anti-evasion provision as a "useful deterrent," but noting that the willful circumvention standard would be difficult to meet and partially turns on the Commission's consideration of the legitimate business purpose analysis).

[1492] FIA at 25-26.

transition period swaps. Final § 150.1 sets forth the definitions for which positions may qualify as a "bona fide hedging transaction or position" and for "spread transaction."[1493]

ii. Bona Fide Hedging Definition; Enumerated Bona Fide Hedges; and Guidance on Spot Month Hedge Exemption Restrictions and Measuring Risk

The Commission is adopting several amendments to the bona fide hedge definition. First, the Commission is revising some of the general elements of the "bona fide hedging transaction or position" definition in final § 150.1 to conform the Commission's regulatory definition to the statutory bona fide hedge definition in CEA section 4a(c), as amended by Congress in the Dodd-Frank Act. As discussed in greater detail in the preamble, the Final Rule (1) revises the temporary substitute test, consistent with the Commission's understanding of the Dodd-Frank Act's amendments to section 4a of the CEA, to no longer recognize as bona fide hedges certain risk management positions; (2) revises the economically appropriate test to make explicit that the position must be economically appropriate to the reduction of "price risk"; and (3) eliminates the incidental test and orderly trading requirement, which the Dodd-Frank Act did not include in section 4a of the CEA. The Commission believes that these amendments to the existing general elements of the regulatory definition include non-discretionary changes that are required by Congress's amendments to section 4a of the CEA, or in the case of the incorporation of "price risk," do not represent a change from the status quo baseline. The Commission is also amending the bona fide hedge definition to conform to the CEA's statutory definition, by adding a provision for positions that qualify as pass-through swaps and pass-through swap offsets.[1494]

[1493] The Commission currently defines this term in existing §1.3 in the plural as "bona fide hedging transactions or positions" while the Final Rule defines it in the singular "bona fide hedging transaction or position." *See supra* Section I.E. (discussing use of certain terminology). This discussion sometimes refers to the "bona fide hedging transaction or position" definition as "bona fide hedges," "bona fide hedging," or "bona fide hedge positions." For the purpose of this discussion, the terms have the same meaning.

[1494] As discussed in Section II.A.—§ 150.1—Definitions of the preamble, the existing definition of "bona fide hedging transactions and positions" appears in existing § 1.3 of the Commission's regulations; the revised definition of this term, in singular form, now appears in § 150.1.

Second, the Commission is maintaining the distinction between enumerated and non-enumerated bona fide hedges but is (1) moving the location of the enumerated bona fide hedges, which will remain part of the regulatory text, from the existing definition of "bona fide hedging transactions and positions" currently found in Commission regulation § 1.3 to final Appendix A in part 150;[1495] and (2) expanding the list of enumerated hedges, which will continue to be self-effectuating for Federal position limit purposes, thereby not requiring prior Commission approval.

Third, the Commission is proposing guidance in Appendix B with respect to (i) whether an entity may measure risk on a net or gross basis for purposes of determining its bona fide hedge positions, and (ii) factors exchanges could consider when applying a restriction on an exemption against holding a position under a bona fide hedge or spread transaction exemption in excess of limits during the lesser of the last five days of trading or the time period for the spot month in a physically-delivered contract, or otherwise limit the size of such position.

The Commission expects that these modifications related to bona fide hedging will primarily benefit physical commodity commercial market participants, as well as their counterparties. CEA section 4a(c)(1) directs the Commission to exclude bona fide hedge positions from any Federal position limits framework. Further, the Commission believes that, generally, recognizing bona fide hedges supports all section 15(a) factors under this cost-benefit discussion. For example, recognizing bona fide hedges encourages participation in the futures markets by commercial market participants.[1496] Increasing participation from different types of market participants, including commercial market participants: (i) protects the legitimate commercial activity of cash-market

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[1495] For the avoidance of doubt, Appendix A will still be incorporated as part of the Commission's regulations under the Final Rule. In contrast, the 2020 NPRM had proposed to make Appendix A Acceptable Practices.

[1496] NFPEA at 6 (stating that "Congress intended the Commission to protect end-users' continued access to cost-effective commercial risk management tools, and did not intend to burden end-users with unnecessary regulatory compliance obligations").

participants,[1497] (ii) increases competitiveness, and (iii) supports the financial integrity of futures markets. Further, increased participation and competitiveness will benefit price discovery. Finally, an expanded list of enumerated bona fide hedges supports sound risk management practices by commercial market participants and their counterparties, which may result in indirect benefits to commodity end users or the public.[1498]

Recognizing an expanded list of enumerated bona fide hedges, which are self-effectuating and do not require prior approval from the Commission, will mitigate related compliance costs for those contract markets that will be newly subject to Federal position limits under the Final Rule. This is in comparison to an alternative scenario in which a narrow set of available enumerated hedges would have required market participants to obtain prior approval before availing themselves of an exemption for Federal position limit purposes.

The Commission notes that this section will discuss the substantive exemptions for Federal position limit purposes while the next section will discuss the process for the Commission or exchanges, as applicable, to grant exemptions and bona fide hedge recognitions.

a. Bona Fide Hedging Definition

(1) Elimination of Risk Management Exemptions; Addition of the Pass-through Swap Exemption

The Commission is eliminating the word "normally" from the bona fide hedge definition's temporary substitute test and, as a result, prohibiting recognition, as bona fide hedges, of risk management positions in physical commodity derivatives subject to Federal speculative position limits. This amendment conforms the regulatory bona fide

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[1497] AGA expressed its support of an expanded list of enumerated hedges by stating that, "consistent with the mandate of the CEA, any speculative position limits regime adopted by the CFTC must be established in a way that allows commercial end-users, such as natural gas utilities, to continue to enter into bona fide hedges to manage, hedge and mitigate the commercial risks of their natural gas distribution business in a non-burdensome and cost-effective manner on behalf of customers." AGA at 2.

[1498] In expressing overall support for the proposed definition of bona fide hedging transaction or position in the 2020 NPRM, CME Group noted that the Commission's recognition of a wider range of commercial hedging practices generally reflects Congress's intent not to unduly burden bona fide hedgers. CME Group at 9.

hedging definition with the Commission's interpretation that the removal of the word "normally" from the CEA's section 4a(c)(2) statutory temporary substitute test by the Dodd-Frank Act signaled Congressional intent to cease recognizing "risk management" positions as bona fide hedges for physical commodities.

Additionally, in accordance with CEA section 4a(c)(2)(B), the Commission is, however, expanding the bona fide hedging definition to also include as a bona fide hedge any position that qualifies as a pass-through swap/swap offset, discussed further below.[1499] The Commission believes that including pass-through swaps and pass-through swap offsets within the definition of a bona fide hedge will mitigate some of the potential impact resulting from the rescission of the risk management exemption,[1500] and the Commission discusses the costs and benefits related to the pass-through swap provision further below.

As discussed below, the Final Rule's pass-through provisions should help address certain of the hedging needs of persons seeking to offset the risk from swap books, allowing for sufficient liquidity in the marketplace for both bona fide hedgers and their counterparties. Accordingly, under the Final Rule, market participants with positions that do not otherwise satisfy the bona fide hedging definition or qualify for another exemption are no longer able to rely on recognition of such risk-reducing techniques as bona fide

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[1499] *See infra* Section IV.A.4.ii.a(2). The existing bona fide hedging definition in § 1.3 requires that a position must "normally" represent a substitute for transactions or positions made at a later time in a physical marketing channel (*i.e.,* the "temporary substitute test"). The Dodd-Frank Act amended the temporary substitute language that previously appeared in the statute by removing the word "normally" from the phrase normally "represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel." 7 U.S.C. 6a(c)(2)(A)(i). The Commission interprets this change as reflecting Congressional direction that a bona fide hedging position in physical commodities must *always* (and not just "normally") be in connection with the production, sale, or use of a physical cash-market commodity.

Previously, the Commission stated that, among other things, the inclusion of the word "normally" in connection with the pre-Dodd-Frank-Act version of the temporary substitute language indicated that the bona fide hedging definition should not be construed to apply only to firms using futures to reduce their exposures to risks in the cash market, and that to qualify as a bona fide hedge, a transaction in the futures market did not need to be a temporary substitute for a later transaction in the cash market. *See* Clarification of Certain Aspects of the Hedging Definition, 52 FR at 27195, 27196 (Jul. 20, 1987). In other words, that 1987 interpretation took the view that a futures position could still qualify as a bona fide hedging position even if it was not in connection with the production, sale, or use of a physical commodity. Accordingly, based on the Commission's interpretation of the revised statutory definition of bona fide hedging in CEA section 4a(c)(2), risk-management hedges would not be recognized under the Commission's bona fide hedging definition in § 150.1.

[1500] *See, e.g.*, ICE at 5-6 (contending that eliminating risk management exemptions could make it less efficient and more expensive for commercial end-users to hedge risks and that pass-through exemption is an inadequate substitution); ISDA at 6-7 (arguing that the elimination of the risk management exemptions will result in increased costs for "tailored over-the-counter financial products, . . . will cause some dealers to exit the business and will in any event lead to decreases in liquidity in the underlying futures markets, with a corresponding increase in volatility."); *see also supra* Section II.A.1.iii.a(4) (discussing elimination of the risk management exemptions).

hedges. Market participants who provide liquidity to commercial market participants and have obtained or requested a risk management exemption under the existing definition, and who do not qualify for a pass-through swap offset, may resort to other hedging strategies. These other hedging strategies may result in increased costs for these liquidity providers for those activities that are not eligible for the bona fide hedge treatment.

The Commission recognizes the possible liquidity costs as a result of eliminating risk management exemptions. Specifically, the Commission considered the risk that dealers who approach or exceed the Federal position limit may decide to pull back on providing liquidity, including to bona fide hedgers, due to the exclusion of risk management positions from the bona fide hedge definition. However, the Commission considered the risk of possible reduced liquidity against various factors and believes that the potential cost of reduced liquidity will be mitigated for several reasons.

First, the Final Rule extends the compliance date by which risk management exemption holders must reduce their positions to comply with Federal position limits under the Final Rule to January 1, 2023. This delay provides sufficient time for existing positions to roll off and/or be replaced with positions that conform with the Federal position limits adopted in this Final Rule.

Second, for the nine legacy agricultural contracts, the Final Rule generally sets Federal non-spot month position limit levels higher than existing non-spot limits, which may enable additional dealer activity described above.[1501] The remaining non-legacy 16 core referenced futures contracts will not be subject to non-spot month Federal position limits and will remain subject to existing exchange-set limits or accountability levels outside of the spot month, which does not represent a change from the status quo. The generally higher levels with respect to the nine legacy agricultural contracts, and the

[1501] *See infra* Section II.B.4. (discussing non-spot month limit levels). Final § 150.2 generally increases position limits for non-spot months for contracts that currently are subject to the Federal position limits framework other than for CBOT Oats (O), CBOT KC HRW Wheat (KW), and MGEX HRS Wheat (MWE), for which the Commission is maintaining existing levels.

exchanges' flexible accountability regimes with respect to the new 16 core referenced futures contracts, should mitigate at least some potential costs related to the prohibition on recognizing risk management positions as bona fide hedges.

Third, the Final Rule may improve market competitiveness and reduce transaction costs. As noted above, existing holders of the risk management exemption, and the levels permitted thereunder, are currently confidential, and the Commission is no longer granting new risk management exemptions to potential new liquidity providers. Accordingly, by eliminating the risk management exemption, the Final Rule benefits the public and strengthens market integrity by improving market transparency since certain dealers are no longer able to maintain the grandfathered risk management exemption while other dealers lack this ability under the status quo. While the Commission believes that the risk management exemption may allow dealers to provide additional market making activities, which benefits market liquidity and may result in lower prices for end-users, as noted above, the potential costs resulting from removing the risk management exemption may be mitigated by the Final Rule's revised position limit levels that reflect current EDS for spot month levels and current open interest and trading volume for non-spot month levels. Therefore, the Commission believes that existing risk management exemption holders should be able to continue providing liquidity to bona fide hedgers, but acknowledges that some may not to the same degree as under the exemption. However, the Commission believes that any potential harm to liquidity should be mitigated.

Further, the spot month and non-spot month levels, which generally are higher than the status quo, together with the elimination of the risk management exemptions that benefit only certain dealers, may enable new liquidity providers to enter the markets on a level playing field with the existing risk management exemption holders. With the possibility of additional liquidity providers, the framework may strengthen market

integrity by decreasing concentration risk potentially posed by too few market makers. However, the benefits to market liquidity the Commission described above may be muted since this analysis is predicated, in part, on the understanding that dealers are the predominant large traders. Data in the Commission's Supplementary COT and its underlying data indicate that risk-management exemption holders are not the only large participants in these markets—large commercial firms also hold large positions in such commodities.

Fourth, although the Commission will no longer recognize risk management positions as bona fide hedges under this Final Rule, the Commission maintains other authorities, including the authority under CEA section 4a(a)(7), to exempt risk management positions from Federal position limits.

Fifth, consistent with existing industry practice, exchanges may continue to recognize risk management positions for contracts that are not subject to Federal position limits, including for excluded commodities.

Finally, as discussed immediately below, the Commission believes the recognition of pass-through swaps and pass-through swap offsets could mitigate, to some extent, the costs to the market in general, or to specific market participants, resulting from the risk management exemption's elimination.[1502]

(2) Pass-Through Swaps and Pass-Through Swap Offsets

The revised bona fide hedging definition, consistent with the Dodd-Frank Act's changes to CEA section 4a(c)(2), permits the recognition as bona fide hedges of futures and options on futures positions that offset pass-through swaps entered into by dealers and other liquidity providers (the "pass-through swap counterparty")[1503] opposite bona fide hedging swap counterparties (the "bona fide hedge counterparty"), as long as:

[1502] NCFC concurs that "the substantial increase in the overall speculative position limits and allowances for pass-through swaps will limit any potential loss of liquidity" that may result from the elimination of the risk management exemption. NCFC at 7.

[1503] Such pass-through swap counterparties are typically swap dealers providing liquidity to bona fide hedgers.

(1) the pass-through swap counterparty receives from the bona fide hedging swap counterparty a written representation that the pass-through swap qualifies as a bona fide hedge; and (2) the pass-through swap counterparty enters into a futures or option on a futures position or a swap position to offset and reduce the price risk attendant to the pass-through swap.[1504] Accordingly, a subset of risk management exemption holders and transactions they enter into could continue to benefit from an exemption, and potential counterparties could benefit from the liquidity they provide, as long as the position being offset qualifies as a bona fide hedge for the bona fide hedge counterparty.

The Commission has determined that any resulting costs or benefits related to the proposed pass-through swap exemption are a result of Congress's amendments to CEA section 4a(c) rather than the Commission's discretionary action. On the other hand, the Commission's discretionary action to require the pass-through swap counterparty to receive and maintain a written representation from the bona fide hedging swap counterparty that the pass-through swap qualifies as a bona fide hedging position causes the swap counterparty to incur marginal recordkeeping costs.[1505] The Commission considered comments requesting the elimination of the pass-through swap provision recordkeeping requirement in § 150.3(d) based on arguments that requiring this recordkeeping was not practical.[1506] The Commission is not persuaded by those arguments as the recordkeeping requirements assist the Commission in verifying that the pass-through swap provision is only being utilized to offset risks arising from bona fide hedges. Accordingly, the Commission is finalizing the proposed pass-through swap

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[1504] *See* paragraph (2)(i) of the proposed bona fide hedging definition. Of course, if the pass-through swap qualifies as an "economically equivalent swap," then the pass-through swap counterparty does not need to rely on the pass-through swap provision since it may be able to offset its long (or short) position in the economically equivalent swap with the corresponding short (or long) position in the futures or option on futures position or on the opposite side of another economically equivalent swap.

[1505] To the extent that the pass-through swap counterparty is a swap dealer or major swap participant, it already may be subject to similar recordkeeping requirements under § 1.31 and part 23 of the Commission's regulations. As a result, such costs may already have been realized.

[1506] Cargill at 10; EEI/EPSA at 7-8; FIA at 11-12; CMC at 5; Shell at 6-7; ICE at 6-7; ISDA at 11-12.

recordkeeping requirement in § 150.3(d), subject to certain conforming changes to reflect amendments to the pass-through swap paragraph of the bona fide hedging definition.

Since not all swaps entered into by a commercial entity may qualify as a bona fide hedge, the Commission declines commenters' requests that a pass-through swap counterparty may reasonably rely solely upon the fact that the counterparty is a commercial end user and, absent an agreement between the counterparties, that the swap appears to be consistent with hedges entered into by end users in the same line of business. The Commission, however, is amending the regulatory text to provide flexibility and avoid a prescriptive requirement that would otherwise cause additional costs or burdens.

Instead, the Final Rule provides that the pass-through swap counterparty (*i.e.*, the swap dealer) may rely in good faith on a written representation made by its bona fide hedging swap counterparty, unless the pass-through swap counterparty has information that would cause a reasonable person to question the accuracy of the representation. The Commission is adding the written representation requirement to enable the Commission to verify that only market participants with bona fide hedge exemptions are able to pass-through those exemptions to their swap dealer counterparties. To avoid a prescriptive requirement that would incur additional costs to market participants, the Final Rule does not prescribe the form or manner by which the pass-through swap counterparty obtains the written representation. The Commission recognizes that such flexibility would allow for the bona fide hedging counterparty to make such representations on a relationship basis through counterparty relationship documentation (*e.g.*, through ISDA documentation) or on a transaction basis (*e.g.*, through trade confirmations or in other forms as agreed upon by the parties), based on the most cost efficient manner for the market participants.

The Final Rule's pass-through swap provision, consistent with the Dodd-Frank Act's changes to CEA section 4a(c)(2), also addresses a situation where a participant who qualifies as a bona fide hedging swap counterparty (*i.e.*, a participant with a position in a previously-entered into swap that qualified, at the time the swap was entered into, as a bona fide hedging position under the revised definition) seeks, at some later time, to offset that swap position.[1507] Such step might be taken, for example, to respond to a change in the participant's risk exposure in the underlying commodity. As a result, a participant could use futures contracts or options on futures contracts in excess of Federal position limits to offset the price risk of a previously-entered into swap, which would allow the participant to exceed Federal position limits using either new futures or options on futures or swap positions that reduce the risk of the original swap.

The Commission expects the pass-through swap provision to facilitate dynamic hedging by market participants. The Commission recognizes that a significant number of market participants use dynamic hedging to more effectively manage their portfolio risks. Therefore, this provision may increase operational efficiency. In addition, by permitting dynamic hedging, a greater number of dealers should be better able to provide liquidity to the market, as these dealers will be able to more effectively manage their risks by entering into pass-through swaps with bona fide hedgers as counterparties. Moreover, market participants are not precluded from using swaps that are not "economically equivalent swaps" for such risk management purposes since swaps that are not deemed to be "economically equivalent" to a referenced contract are not subject to the Commission's position limits framework.

(3) Limiting "Risk" to "Price" Risk; Elimination of the Incidental Test and Orderly Trading Requirement

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[1507] *See* paragraph (2)(ii) of the "bona fide hedging transaction or position" definition in § 150.1.

The bona fide hedging definition's "economically appropriate test" set out in final § 150.1 explicitly provides that only hedges that offset *price* risks can be recognized as bona fide hedging transactions or positions. The Commission does not believe that this particular change imposes any new costs or benefits, as it is consistent with both the existing bona fide hedging definition[1508] as well as the Commission's longstanding policy.[1509] Nonetheless, the Commission realizes that hedging occurs for more types of risks than price (*e.g.*, volumetric hedging) and hedging solely to protect against changes in value of non-price risks would fall outside the category of a bona fide hedge, which offsets the "price risk" of an underlying commodity cash position.

In response to commenters, the Commission clarifies in the preamble that price risk can be informed and impacted by various other types of risks.[1510] The Commission agrees with commenters who stated that market participants form independent economic assessments of how different risks (including, but not limited to, geopolitical, turmoil, weather, or counterparty) might create or impact the price risk of underlying commodities.[1511] The Commission recognizes these risks can create price risks and understands that firms may manage these potential risks to their businesses differently and in the manner most suitable for their business. By limiting the economically appropriate prong to price risk, the Commission is reiterating its historical practice (which has adequately applied to the legacy agricultural contracts for decades) to recognize hedges of price risk of an underlying commodity position as bona fide hedges while acknowledging that price risk may itself be impacted by non-price risks. Market

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[1508] The existing bona fide hedging definition in § 1.3 provides that "no transactions or positions shall be classified as bona fide hedging unless their purpose is to offset *price* risks incidental to commercial cash or spot operations." (emphasis added). Accordingly, the definition in final § 150.1 merely moves this requirement to the definition's revised "economically appropriate test" requirement.

[1509] For example, in promulgating existing § 1.3, the Commission explained that a bona fide hedging position must, among other things, "be economically appropriate to risk reduction, such risks must arise from operation of a commercial enterprise, and the price fluctuations of the futures contracts used in the transaction must be substantially related to fluctuations of the cash-market value of the assets, liabilities or services being hedged." Bona Fide Hedging Transactions or Positions, 42 FR at 14832, 14833 (Mar. 16, 1977). The Dodd-Frank Act added CEA section 4a(c)(2), which copied the "economically appropriate test" from the Commission's definition in § 1.3. *See also* 78 FR at 75702, 75703.

[1510] *See supra* Section II.A.1.iii.b (discussing economically appropriate test); Cargill at 3.

[1511] *See, e.g.,* CMC at 3.

participants may continue to manage non-price risks in a variety of ways, which may include participation in the futures markets or exposure to other financial products. In fact, market participants may decide to use futures contracts that are not subject to Federal position limits, if they determine such contracts will help them manage non-price risks faced by their businesses.

Alternatively, commenters suggested that the Commission permit market participants to use the non-enumerated hedge process to receive recognition of hedges of non-price risk on a case-by-case basis.[1512] The Commission is precluded from adopting this alternative in light of its view that price risk is required to satisfy the CEA's economically appropriate test. Further, the Commission is unaware of commercial market participants historically seeking non-enumerated bona fide hedge recognition for non-price risk in the spot month.

The Commission further implements Congress's Dodd-Frank Act amendments that did not include in the statutory bona fide hedge definition the incidental test and orderly trading requirement by eliminating those elements from to the Commission's regulatory definition. As discussed in the preamble, the Commission believes that these changes do not represent a change in policy or regulatory requirement. As a result, the Commission does not identify any costs or benefits related to these changes.

b. Enumerated Bona Fide Hedges

The Commission maintains, and incorporates in final § 150.3, a list of enumerated bona fide hedges in Appendix A to part 150 of the Commission's regulations that includes: (i) all of the existing enumerated hedges; and (ii) additional enumerated bona fide hedges. The Commission reinforces that hedging practices not otherwise listed may still be deemed, on a case-by-case basis, to comply with the proposed bona fide hedging definition (*i.e.*, non-enumerated bona fide hedges). As discussed further below, the

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[1512] MGEX at 2; FIA at 11.

enumerated bona fide hedges in Appendix A are "self-effectuating" for purposes of Federal position limit levels. This is expected to help in ensuring timely hedging and therefore reduce compliance costs associated with seeking an exemption.[1513]

(1) Treatment of Unfixed Price Transactions

As discussed in the preamble, the Commission has long recognized fixed-price commitments as the basis for a bona fide hedge.[1514] Under existing §1.3, only one enumerated hedge explicitly mentions "unfixed price," and its availability is limited to circumstances where a market participant has both an unfixed-price purchase *and* an unfixed-price sale on hand (precluding a market participant with only an unfixed-price purchase *or* an unfixed price sale from qualifying for this particular enumerated hedge).[1515] In 2012, Commission staff issued interpretive letter 12-07 ("Staff Letter 12-07"), which clarified that a commercial entity may qualify for the existing enumerated bona fide hedge for unfilled anticipated requirements even if the commercial entity has entered into long-term, unfixed-price supply or requirements contracts because, as staff explained, the unfixed-price purchase contract does not "fill" the commercial entity's anticipated requirements.[1516]

The Final Rule affirms and broadens the application of the interpretation provided in Staff Letter No. 12-07. As a result, commercial market participants with unfixed price transactions may qualify for bona fide hedge treatment under the enumerated bona fide hedges for anticipatory merchandising, anticipated unsold production, or anticipated unfilled requirements.[1517] The Commission clarifies that a commercial market participant that enters into an unfixed-price transaction will not be precluded from qualifying for one

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[1513] For example, AGA expressed support for the Commission's proposal to recognize anticipatory merchandising as an enumerated hedge because it promotes liquidity. AGA at 8. AGA stated that "[a]bsent such an enumerated hedge, there would be a piecemeal approach to permitting such hedges which could reduce liquidity, raise costs, and create undue risks for gas utilities, without any regulatory benefits toward the Commission's goal to reduce excessive speculative activities." *Id.*

[1514] *See supra* Section I.

[1515] *See, e.g.,* paragraphs (2)(i)(A) and 2(ii)(A) of existing § 1.3.

[1516] CFTC Staff Letter 12-07 at 1, issued August 16, 2012, https://www.cftc.gov/LawRegulation/CFTCStaffLetters/letters.htm, title search "12-07."

[1517] *See supra* Section II.A.1.iv (discussing treatment of unfixed price transactions).

of these anticipatory enumerated bona fide hedges as long as the commercial entity otherwise satisfies all requirements for such anticipatory bona fide hedge, including demonstrating its anticipated need in the physical marketing channel related to either its unsold production, unfilled requirements, and/or merchandising, as applicable.[1518] As such, merely entering into an unfixed-price transaction is not alone sufficient to demonstrate compliance with one of the enumerated anticipatory bona fide hedges.

The same costs and benefits described above with respect to an expanded list of enumerated bona fide hedge recognitions also apply to such recognition based on unfixed-price transactions. The Commission's treatment of unfixed price transactions under the Final Rule will benefit physical commodity commercial market participants. As discussed previously, CEA section 4a(c)(1) directs the Commission to exclude bona fide hedge positions from any Federal position limits framework. In accordance with CEA section 4a(c)(1), the Commission's treatment of unfixed price transactions entered into by commercial market participants protects the legitimate commercial activity of cash-market participants,[1519] thereby encouraging participation in the futures markets by commercial market participants. Additionally, bona hedge treatment for qualified unfixed price transactions benefits the public by allowing commercial market participants to more effectively and predictably hedge their price risks, thus controlling costs that might be passed on to the public.[1520] However, to the extent the Commission currently allows exemptions related to unfixed-price transactions, the costs and benefits already may be realized by market participants and may not represent a change from the status quo baseline.

[1518] The specific requirements associated with each enumerated bona fide hedge, including each anticipatory bona fide hedge, are described in detail further below.

[1519] *See* Cargill at 6 (stating that the Commission should recognize unfixed price transactions as they are "fundamental to price risk management and routinely used by firms to manage risk").

[1520] CEWG at 18 (discussing storage hedges, stating that "("[n]ot allowing commercial energy firms to utilize these industry-standard hedges on an enumerated basis because they are "anticipatory" in nature or viewed as a form of "merchandising" – or both – could result in storage assets being underutilized, which could increase volatility in physical and financial markets for energy commodities that ultimately could translate into higher costs for consumers").

Alternatively, several commenters requested that the Commission create a new enumerated bona fide hedge for unfixed-price transactions or amend the existing enumerated bona fide hedge for offsetting unfixed purchase and sales.[1521] The Commission does not believe that this is necessary since, as described above, commercial market participants may continue to both qualify for anticipatory bona fide hedges while also entering into unfixed-price transactions. Further, the Commission believes that neither of these alternatives is suitable because there is an inherent difficulty in evaluating the propriety of a hedge of an unfixed price obligation with a fixed-price futures contract due to the basis risk that exists until the unfixed price obligation is fixed. Given differences among markets, creating a new enumerated bona fide hedge for any unfixed price transaction could, under certain circumstances, impose costs on market integrity, including by enabling potential market manipulation and/or allowing excessive speculation by potentially affording bona fide hedging treatment for speculative transactions. To the extent that a market participant does not qualify for an enumerated bona fide hedge in connection with an unfixed-price transaction, the Commission believes that any potential harms or costs to that market participant would be mitigated because the participant could still avail itself of the process under §§ 150.3 and 150.9 for non-enumerated bona fide hedges.[1522]

(2) Elimination of the Five-Day Rule

The Final Rule eliminates the existing restriction on holding certain enumerated bona fide hedges during the last five days of trading under existing § 1.3. Instead, under

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[1521] *See, e.g.*, Ecom at 1; ACA at 2; CEWG at 19-21; Chevron at 11; CME Group at 8-9; DECA at 2; East Cotton at 2; Gerald Marshall at 2; IFUS at 5-7; IMC at 2; Jess Smith at 2; LDC at 2; Mallory Alexander at 2; McMeekin at 2; Memtex at 2; Moody Compress 1; NCC at 1; NGFA at 7; Olam at 2; Omnicotton at 2; Canale Cotton at 2; Shell at 7; Southern Cotton at 2; Suncor at 7; SW Ag at 2; Toyo at 2; Texas Cotton at 2; Walcot at 2; White Gold at 2.

[1522] One commenter maintains that reliance on the non-enumerated bona fide hedge process for management of unpriced physical purchase or sale commitments "will impose procedural hurdles, uncertainty, and additional costs on a critically important function of the supply chain in the U.S. economy." CEWG at 21. Another commenter stated that imposing a burden on commercial end users with unpriced physical purchase or sale commitments to rely on the non-enumerated hedge exemption process is contrary to the intent and language of the CEA. Cargill at 6. These concerns, however, are mitigated because, under the Final Rule, commercial market participants with unfixed price transactions may qualify for bona fide hedge treatment under the enumerated bona fide hedges for anticipatory merchandising, anticipated unsold production, or anticipated unfilled requirements.

final § 150.5(a)(2)(ii)(H), the exchanges have discretion to determine, for purposes of their own exchange-granted exemptions (for contracts subject to Federal position limits), whether to apply a restriction against holding positions in excess of limits during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract (the "Five-Day Rule"). Under final § 150.5(a)(2)(ii)(H), exchanges are able to establish their own Five-Day Rule, or otherwise limit the size of positions. The exchanges would thus have the ability and discretion, but not an obligation, to apply a five-day Rule or similar restriction to exemptions on any contracts subject to Federal position limits, regardless of whether such contracts have been subject to Federal position limits before.[1523] The Commission has determined that exchanges are well-informed with respect to their respective markets, and well-positioned to make a determination with respect to imposing the Five-Day Rule in connection with recognizing bona fide hedges for their respective commodity contracts.

In general, the Commission believes that, on the one hand, limiting a trader's ability to establish a position in this manner by requiring the Five-Day Rule could result in increased costs related to operational inefficiencies, as a trader may believe that holding a position late into the spot period is necessary for the bona fide hedge position. On the other hand, the Commission believes that price convergence may be particularly sensitive to potential market manipulation or excessive speculation during the spot period. Accordingly, the Commission believes that the determination to not impose the Five-Day Rule with respect to any of the enumerated bona fide hedges for Federal purposes, but to instead rely on exchanges' determinations with respect to exchange-granted exemptions, helps to better optimize these considerations. The Commission notes there is a potential cost to market integrity and price convergence since the Five-

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[1523] The Commission is adopting Appendix B and Appendix G of this Final Rule to provide guidance for exchanges to consider when determining whether to impose the Five-Day Rule or similar requirements on bona fide hedge exemptions and spread exemptions, respectively.

Day Rule is being eliminated as a blanket Federal requirement from some enumerated hedges while the exchanges will now have guidance from the Commission to consider when choosing whether to grant a position limits exemption subject to a five-day rule or similar restriction.[1524] Under this new framework, however, the Commission will continue to leverage its own market surveillance and oversight functions to ensure that exchanges continue to comply with their legal obligations, including with respect to Core Principles 2, 3, 4, and 5, among others.[1525] With an expanded list of contracts subject to Federal position limits, it is best to provide the exchanges additional discretion to protect their markets using tools other than a five-day rule, and to supplement that discretion with guidance highlighting the importance of the spot month to ensure price convergence and an orderly delivery process. Finally, the Commission believes a concern over oversight is also mitigated by the fact that the exchanges have an economic incentive to ensure that price convergence occurs with their respective contracts since commercial end-users would be less willing to use such contracts for hedging purposes if price convergence failed to occur in such contracts as they may generally desire to hedge cash-market prices with futures contracts.

The Commission is also adopting guidance in Appendix B to part 150 on factors for the exchanges to consider when granting an exemption subject to a restriction against holding physically delivered futures contracts into the spot month. In response to some commenters who stated that the proposed guidance was too prescriptive and would result in additional burdens,[1526] the Commission clarifies and reiterates the appendix is not intended to be used as a mandatory checklist. The Commission, however, has determined

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[1524] Better Markets at 61 (discussing elimination of the Five-Day Rule and Appendix B guidance by stating that " the CFTC proposes to abolish the rule for enumerated hedges, over-relying instead—and again—on the judgment of the exchanges to determine whether to apply the Five-Day Rule, or apply and grant fact specific waivers").

[1525] Core Principle 4, 7 U.S.C. 7b-3(f)(4)(B); 7 U.S.C. 7b-3(f)(2); 7 U.S.C. 7b-3(f)(3); 7 U.S.C.7b-3(f)(5).

[1526] Cargill at 9; CME Group at 9 (stating that the "CME Group believes the proposed guidance could be interpreted to cause unnecessary burden and costs to market participants. The guidance appears to create a formal process for firms to provide information outlined in the Appendix as part of their bona fide hedge exemption applications, but the Proposal does not seem to consider this additional burden in its cost analysis").

it is helpful to provide the exchanges with guidance highlighting the importance of the spot month to ensure price convergence and an orderly delivery process. Since price convergence and an orderly trading environment serve as a deterrent to mitigate certain types of market manipulation schemes such as corners and squeezes, the guidance is intended to include a non-exclusive list of considerations the Commission expects the exchanges to consider when determining whether to allow a position in excess of limits throughout the spot month. The Commission does not expect the guidance to impose additional burdens on the exchanges, as the exchanges currently have in place market surveillance practices or procedures to review the appropriateness of an exemption during the relevant referenced contract's spot period. The guidance is intended to supplement that existing process.

As discussed in the preamble, the guidance does not impose any additional reporting requirements on market participants, and the factors described in the guidance apply simply to the exchanges' evaluation of the specific contract market when considering whether an exemption shall be granted subject to any condition or limitation in the spot month. Finally, the Commission is making certain amendments to the guidance to ensure that the factors maintain a flexible approach, particularly where existing exchange application requirements already require market participants to provide relevant cash-market information.

c. Guidance for Measuring Risk

The Commission is issuing guidance in paragraph (a) of final Appendix B to part 150 on whether positions may be hedged on either a gross or net basis. Under the guidance, among other things, a trader may measure risk on a gross basis if that approach is consistent with the trader's historical practice and is not intended to evade applicable limits. The key cost associated with allowing gross hedging is that it may provide

opportunity for hidden speculative trading or for cherry picking of positions in a manner that subverts positions limits.[1527]

Such risk is mitigated to a certain extent by the guidance's provisos that the trader does not switch between net hedging and gross hedging in order to evade limits and that the trader must demonstrate, upon request by the Commission or an exchange, the justifications for measuring risk on a gross basis.[1528] By focusing on consistency and historical practice with respect to the manner in which a person measures risk, the guidance enables market participants to measure risk on a gross basis when dictated by the nature of the exposure, but not simply when utilizing gross hedging will yield a larger exposure than net hedging, or will otherwise subvert Federal position limit or aggregation requirements. However, the Commission also recognizes that there are myriad ways in which organizations are structured and engage in commercial hedging practices, including the use of multi-line business strategies in certain industries that are subject to Federal position limits for the first time under this Final Rule and for which net hedging could impose significant costs or be operationally unfeasible.[1529]

iii. Spread Exemptions

Under existing § 150.3, certain spread exemptions are self-effectuating. Specifically, existing § 150.3 allows for "spread or arbitrage positions" that are "between single months of a futures contract and/or, on a futures-equivalent basis, options thereon, outside of the spot month, in the same crop year; provided, however, that such spread or

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[1527] For example, using gross hedging, a market participant could potentially point to a large long cash position as justification for a bona fide hedge, even though the participant, or an entity with which the participant is required to aggregate, has an equally large short cash position that would result in the participant having no net price risk to hedge as the participant had no price risk exposure to the commodity prior to establishing such derivative position. Instead, the participant created price risk exposure to the commodity by establishing the derivative position.

[1528] The proposed guidance on gross hedging positions in the 2020 NPRM provided that an exchange document the justifications for recognizing a gross position as a non-enumerated bona fide hedge pursuant to § 150.9. Several commenters alternatively requested elimination of that requirement as imposing unnecessary burdens directly on exchanges and indirectly on market participants. *See* CEWG at 4; FIA at 14; and MGEX at 3. Because the Commission and exchanges have other tools for accessing such information, the Commission eliminated that requirement from the guidance in Appendix B of this Final Rule. Under final § 150.3(b)(2) and (e) and final § 150.9(e)(5), and (g), the Commission has access to any information related to the applicable exemption request, and therefore concludes that eliminating this requirement does not result in any related costs and benefits.

[1529] FIA stated that "the recommendation to implement specific policies and procedures governing gross and net hedging has the potential to create unnecessary, unintended and burdensome conflicts with other company policies, such as accounting policies, with little or no measurable benefit." FIA at 15. The Final Rule clarifies that the guidance does not require market participants to develop written policies or procedures setting forth when gross or net hedging is appropriate.

arbitrage positions, when combined with any other net positions in the single month, do not exceed the all-months limit set forth in § 150.2."[1530]

Final §§ 150.1 and 150.3 amend the existing spread position exemption for Federal position limits by (i) listing, in the spread transaction definition, specific types of spread exemptions that are self-effectuating for purposes of Federal limits and that may be granted by an exchange; (ii) creating a process that requires a person to apply for spread exemptions (that are not listed in the spread transaction definition) directly with the Commission pursuant to final § 150.3;[1531] and (iii) providing guidance on the types of spread positions that meet the spread transaction definition in a new Appendix G to part 150 under the Final Rule. In addition, final § 150.3 permits spread exemptions outside the same crop year and/or during the spot month.[1532]

In connection with the spread exemption provisions, the Commission is relaxing the prohibition for contracts during the same crop year and/or the spot month so that market participants may receive spread exemptions outside the same crop year and/or during the spot month. There may be benefits that result from permitting these types of spread exemptions. For example, the Commission believes that permitting spread exemptions in different crop years or during the spot month may potentially improve price discovery and provide market participants with the ability to use additional strategies involving spread positions, which may reduce hedging costs.

As in the inter-market wheat example discussed below, the spread relief, which is not limited to the same crop year, may better link prices between two markets (*e.g.*, the

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[1530] 17 CFR 150.3. CEA section 4a(a)(1) provides the Commission with authority to exempt from position limits transactions "normally known to the trade" as "spreads" or "straddles" or "arbitrage" or to fix limits for such transactions or positions different from limits fixed for other transactions or positions.

[1531] The "spread transaction" definition lists the most common types of spread positions: intra-market spread, inter-market spread, intra-commodity spread, or inter-commodity spread, including a calendar spread, quality differential spread, processing spread, product or by-product differential spread, or futures-option spread. Final § 150.3(b) also permits market participants to apply to the Commission for other spread transactions.

[1532] As discussed under final § 150.3, spread exemptions identified in the proposed "spread transaction" definition in final § 150.1 are self-effectuating, similar to the status quo, and do not represent a change to the status quo baseline. The related costs and benefits, particularly with respect to requesting exemptions with respect to spreads other than those identified in the proposed "spread transaction" definition, are discussed under the respective sections below.

price of MGEX wheat futures and the price of CBOT wheat futures). Put another way, permitting spread exemptions outside the same crop year may enable pricing in two different but related markets for substitute goods to be more highly correlated, which benefits market participants with a price exposure to the underlying protein content in wheat generally, rather than that of a particular commodity.

However, the Commission also recognizes certain potential costs to permitting spread exemptions during the spot month, particularly to extend into the last five days of trading. This feature could raise the risk of allowing participants in the market at a time in the contract where only those interested in making or taking delivery should be present. When a contract goes into expiration, open interest and trading volume naturally decrease, as traders not interested in making or taking delivery roll their positions into deferred calendar months. The presence of large spread positions, normally tied to large liquidity providers so close to the expiration of a futures contract, could lead to disruptions in the price discovery function of the contract by disrupting the futures/cash price convergence. This could lead to increased transaction costs and harm the hedging utility for end-users of the futures contract, which could lead to higher costs passed on to consumers.

However, the Commission believes that these concerns are mitigated, as spread exemptions will not be self-effectuating for purposes of exchange-set position limits. Accordingly, exchanges will continue to apply their expertise in overseeing and maintaining the integrity of their markets. For example, an exchange could: refuse to grant a spread exemption if the exchange determines that the exemption is inconsistent with the requirements of § 150.5(a) or harmful to its markets; require a market participant to reduce its positions; or implement a five-day rule for spread exemptions, as discussed above.[1533] The Commission has also provided guidance to exchanges in a new Appendix

[1533] *See supra* Section II.A.1.viii. (discussing the Five-Day Rule).

G to support exchange analysis of whether to grant a particular spread exemption and to remind exchanges of their oversight obligations when granting spread exemptions.

Generally, the Commission finds that, by allowing speculators to execute inter-market and intra-market spreads, speculators are able to hold a greater amount of open interest in underlying contract(s), and therefore, bona fide hedgers may benefit from any increase in market liquidity. Spread exemptions may also lead to better price continuity and price discovery if market participants who seek to provide liquidity (for example, through entry of resting orders for spread trades between different contracts) receive a spread exemption, and thus would not otherwise be constrained by a position limit.

For clarity, the Commission has identified the following two examples of spread positions that could benefit from the spread exemptions permitted by this Final Rule:

- Reverse crush spread in soybeans on the CBOT subject to an inter-market spread exemption. In the case where soybeans are processed into two different products, soybean meal and soybean oil, the crush spread is the difference between the combined value of the products and the value of soybeans. There are two actors in this scenario: the speculator and the soybean processor. The spread's value approximates the profit margin from actually crushing (or mashing) soybeans into meal and oil. The soybean processor may want to lock in the spread value as part of its hedging strategy, establishing a long position in soybean futures and short positions in soybean oil futures and soybean meal futures, as substitutes for the processor's expected cash-market transactions (the long position hedges the purchase of the anticipated inputs for processing and the short position hedges the sale of the anticipated soybean meal and oil products). On the other side of the processor's crush spread, a speculator takes a short position in soybean futures against long positions in soybean meal futures and soybean oil futures. The soybean processor may be able to lock in a higher crush spread because of liquidity provided by such a speculator who may need to rely upon a spread

exemption. In this example, the speculator is accepting basis risk represented by the crush spread, and the speculator is providing liquidity to the soybean processor. The crush spread positions may result in greater correlation between the futures prices of soybeans on the one hand and those of soybean oil and soybean meal on the other hand, which means that prices for all three products may move up or down together in a more correlated manner.

- Wheat spread subject to inter-market spread exemptions. There are two actors in this scenario: the speculator and the wheat farmer. In this example, a farmer growing hard wheat would like to reduce the price risk of her crop by shorting a MGEX wheat futures. There, however, may be no hedger, such as a mill, that is immediately available to trade at a desirable price for the farmer. There may be a speculator willing to offer liquidity to the hedger; however, the speculator may wish to reduce the risk of an outright long position in MGEX wheat futures through establishing a short position in CBOT wheat futures (soft wheat). Such a speculator, who otherwise would have been constrained by a position limit at MGEX and/or CBOT, may seek exemptions from MGEX and CBOT for an inter-market spread, that is, for a long position in MGEX wheat futures and a short position in CBOT wheat futures of the same maturity. As a result of the exchanges granting an inter-market spread exemption to such a speculator, who otherwise may be constrained by limits, the farmer might be able to transact at a higher price for hard wheat than might have existed absent the inter-market spread exemptions. Under this example, the speculator is accepting basis risk between hard wheat and soft wheat, reducing the risk of a position on one exchange by establishing a position on another exchange, and potentially providing liquidity to a hedger. Further, spread transactions may aid in price discovery regarding the relative protein content for each of the hard and soft wheat contracts.

iv. Conditional Spot Month Exemption Positions in Natural Gas

Final § 150.3(a)(4) provides a new Federal conditional spot month position limit exemption for cash-settled NYMEX NG referenced contracts. The conditional exemption permits traders to acquire positions up to 10,000 cash-settled NYMEX NG referenced contracts (the Federal spot month limit in final § 150.2 for cash-settled NYMEX NG is 2,000 cash-settled NYMEX NG referenced contracts per exchange and another 2,000 cash-settled NYMEX NG referenced contracts in the OTC swaps market) per exchange that lists a cash-settled NYMEX NG referenced contract, along with an additional position in cash-settled economically equivalent NYMEX NG OTC swaps that has a notional amount of up to 10,000 equivalent-sized contracts, as long as such person does not also hold positions in the physically-settled NYMEX NG referenced contract.[1534]

NYMEX, IFUS, and Nodal currently have rules in place establishing a conditional spot month limit exemption of up to 5,000 equivalent-sized cash-settled natural gas contracts per exchange, provided that the market participant does not hold any physically-settled natural gas contracts. Finalizing the conditional limit exemption for NYMEX NG enables the NYMEX NG referenced contract market to continue to operate as it has under the existing exchange-set conditional limit exemption framework, which the Commission notes has functioned well based on its observation over the past decade. Removing the conditional limit exemption will result in reduced liquidity, including for commercial hedgers seeking to offset price risks but not necessarily looking to make or take delivery, due to the significantly lower positions a market participant would be able to hold in the cash-settled NYMEX NG referenced contracts.

Several commenters suggested removing the NYMEX NG conditional limit exemption's requirement to divest all holdings in the physically-settled NYMEX NG

[1534] The NYMEX NG contract is the only natural gas contract included as a core referenced futures contract under the Final Rule.

referenced contract.[1535] The Commission believes that this could result in significant costs to the market by encouraging manipulation of the physically-settled NYMEX NG referenced contract to benefit a large position in the cash-settled NYMEX NG referenced contract available through the conditional limit exemption. Specifically, without this divestiture requirement, a trader could hold up to 40,000 cash-settled NYMEX NG referenced contracts and 2,000 physically-settled NYMEX NG referenced contracts. At these levels, it may not require much movement in the physically-settled markets to disproportionately benefit the cash-settled holdings. As a result, the requirement to exit the physically-settled contract is critical for reducing a market participant's incentive to manipulate the cash settlement price by, for example, banging-the-close or distorting physical delivery prices in the physically-settled contract to benefit leveraged cash-settled positions.

CME commented that the conditional limit exemption for NYMEX NG could "incentivize the manipulation of a cash commodity price in order to benefit a position in a cash-settled contract."[1536] The Commission notes that the conditional limit exemption does provide for a substantial increase in a trader's cash-settled position, but the core requirement that a trader must divest out of the physically-settled NYMEX NG referenced contract during the spot month period is intended to address and reduce the incentive for a trader to manipulate the physically-settled NYMEX NG core referenced futures contract to benefit a position in the cash-settled NYMEX NG referenced contracts. Furthermore, based on its experience in monitoring the NYMEX NG market since the conditional limit exemption was adopted, the Commission has not observed any market manipulations attributable to a trader utilizing the conditional limit exemption. That said, the Commission is aware of instances where traders violated the

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[1535] ISDA at 8; SIFMA AMG at 10-11; FIA at 7-8; NGSA at 12-14; Citadel at 7; CCI at 4; EEI/EPSA at 4.
[1536] CME Group at 6.

conditional exemption by holding or trading in the physically-settled NYMEX NG core referenced futures contracts. The exchanges also detected and took corrective action against those traders. The Commission will continue to closely monitor natural gas trader positions across exchanges and work with the exchanges to ensure the CME Group's concerns continue to be addressed to protect the market participants and the public and defend the financial integrity and price discovery function of the NYMEX NG core referenced futures contract.[1537]

Further, the Commission has heeded natural gas traders' concerns about disrupting market practices and harming liquidity in the cash-settled contract, which could increase the cost of hedging and possibly prevent convergence between the physical delivery futures and cash markets.[1538] While a trader with a position in the physically-settled NYMEX NG referenced contract may incur costs associated with liquidating that position in order to meet the conditions of the Federal exemption, such costs are incurred outside of the Final Rule, as the trader would have to do so as a condition of the exchange-level exemption under current exchange rules.[1539]

v. Financial Distress Exemption

Final § 150.3(a)(3) provides an exemption for certain financial distress circumstances, including the default of a customer, affiliate, or acquisition target of the requesting entity that may require the requesting entity to take on, in short order, the positions of another entity. In codifying the Commission's historical practice, the Final Rule accommodates transfers of positions from financially distressed firms to financially secure firms. The disorderly liquidation of a position threatens price impacts that may harm the efficiency and price discovery function of markets, and § 150.3(a)(3) makes it less likely that positions are prematurely or needlessly liquidated. The Commission has

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[1537] *See* IFUS Rule 6.20(c) and NYMEX Rule 559.F. *See, e.g.*, Nodal Rulebook Appendix C (equivalent rule of Nodal).
[1538] *See* 81 FR at 96862, 96863.
[1539] *See* IFUS Rule 6.20(c) and NYMEX Rule 559.F. *See, e.g.*, Nodal Rulebook Appendix C (equivalent rules of Nodal).

determined that costs related to filing and recordkeeping are negligible. The Commission cannot accurately estimate how often this exemption may be invoked because emergency or distressed market situations are unpredictable and dependent on a variety of firm and market-specific factors as well as general macroeconomic indicators.[1540] The Commission, nevertheless, believes that emergency or distressed market situations that might trigger the need for this exemption are infrequent, and that codifying this historical practice adds transparency to the Commission's oversight responsibilities.

vi. Pre-enactment and Transition Period Swaps Exemption

Final § 150.3(a)(5) provides an exemption from position limits for positions acquired in good faith in any "pre-enactment swap," or in any "transition period swap," in either case as defined in final § 150.1. A person relying on this exemption may net such positions with post-effective date commodity derivative contracts for the purpose of complying with any non-spot month speculative positions limits, but may not net against spot month positions. This exemption is self-effectuating, and the Commission believes that § 150.3(a)(5) benefits both individual market participants by lessening the impact of the Federal position limits in final § 150.2, and market liquidity in general as liquidity providers initially will not be forced to reduce or exit their positions.

Final § 150.3(a)(5) benefits price discovery and convergence by prohibiting large traders seeking to roll their positions into the spot month from netting down positions in the spot-month against their pre-enactment swap or transition period swap. The Commission acknowledges that, on its face, including a "good-faith" requirement in final § 150.3(a)(5) could hypothetically diminish market integrity since determining whether a trader has acted in "good faith" is inherently subjective and could result in disparate treatment among traders, where certain traders may assert a more aggressive position in order to seek a competitive advantage over others. The Commission believes the risk of

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[1540] *See* 81 FR at 96862, 96863.

any such unscrupulous trader or exchange is mitigated since exchanges are still subject to Commission oversight and to DCM Core Principles 4 ("prevention of market disruption") and 12 ("protection of markets and market participants"), among others. The Commission has determined that market participants who voluntarily employ this exemption also incur negligible recordkeeping costs.

5. Process for the Commission or Exchanges to Grant Exemptions and Bona Fide Hedge Recognitions for Purposes of Federal Position Limits (Final §§ 150.3 and 150.9) and Related Changes to Part 19 of the Commission's Regulations

Existing §§ 1.47 and 1.48 set forth the process for market participants to apply to the Commission for recognition of certain bona fide hedges for purposes of Federal position limits, and existing § 150.3 set forth the types of spread exemptions a person can rely on for purposes of Federal position limits. Under existing Commission practices, spread exemptions and certain enumerated bona fide hedges are generally self-effectuating and do not require market participants to apply to the Commission for purposes of Federal position limits. Market participants are currently, however, required to file Form 204 monthly reports[1541] to justify certain position limit overages.

Further, for those bona fide hedges for which market participants are required to apply to the Commission, existing regulations and market practice require market participants to apply both to the Commission for purposes of Federal position limits and also to the relevant exchanges for purposes of exchange-set limits. The Commission has determined that this dual application process creates inefficiencies for market participants.

Final §§ 150.3 and 150.9, taken together, make several changes to the process of acquiring bona fide hedge recognitions and spread exemptions for Federal position limits

[1541] In the case of cotton, market participants currently file the relevant portions of Form 304.

purposes. Final §§ 150.3 and 150.9 maintain certain elements of the status quo while also adopting certain changes to facilitate the exemption process.[1542]

First, with respect to the proposed enumerated bona fide hedges, final § 150.3 maintains the status quo by providing that those enumerated bona fide hedges that currently are self-effectuating for the nine legacy agricultural contracts will continue to remain self-effectuating for the nine legacy agricultural contracts for purposes of Federal position limits.[1543] Similarly, the enumerated bona fide hedges for the additional 16 contracts that are newly subject to Federal position limits (*i.e.*, those contracts other than the nine legacy agricultural contracts) also are self-effectuating for purposes of Federal position limits.

Second, for recognition of any non-enumerated bona fide hedge in connection with any referenced contract, market participants are required to apply either directly to the Commission under final § 150.3 or through an exchange that adheres to certain requirements under final § 150.9. The Commission notes that existing regulations require market participants to apply to the Commission for recognition of non-enumerated bona fide hedges, and so the Final Rule does not represent a change to the status quo in this respect for the nine legacy agricultural contracts.

Third, final § 150.3 maintains the status quo by providing that the most common spread exemptions for the nine legacy agricultural contracts remain self-effectuating. Similarly, these common spread exemptions also are self-effectuating for the additional 16 contracts that are newly subject to Federal position limits. These common spread exemptions are listed in the "spread transaction" definition under final § 150.1.[1544]

[1542] In this section the Commission discusses the costs and benefits related to the *application* process for these exemptions and bona fide hedge recognitions. For a discussion of the costs and benefits related to the scope of the exemptions and bona fide hedge recognitions, *see supra* Section IV.A.4.

[1543] Final § 150.3(a)(1)(i). Under the status quo, market participants must apply to the Commission for recognition of certain enumerated anticipatory bona fide hedges. The Final Rule also makes these enumerated anticipatory bona fide hedges self-effectuating for the nine legacy agricultural contracts.

[1544] Final § 150.1 defines "spread transaction" to include an intra-market spread, inter-market spread, intra-commodity spread, or inter-commodity spread, including a calendar spread, quality differential spread, processing spread, product or by-product differential spread, or futures-option spread.

Fourth, for any spread exemption not listed in the "spread transaction" definition, market participants are required to apply directly to the Commission under final §150.3. There is no exception for the nine legacy agricultural products, nor are market participants permitted to apply through an exchange under final § 150.9 for these types of spread exemptions.[1545]

The Commission anticipates that most – if not all – market participants will utilize the exchange-centric process set forth in final § 150.9 with respect to applying for recognition of non-enumerated bona fide hedges, rather than applying directly to the Commission under § 150.3. Market participants are likely already familiar with the processes set forth in § 150.9, which is intended to leverage the processes currently in place at the exchanges for addressing requests for bona fide hedge recognitions from exchange-set limits. In the sections below, the Commission will discuss the costs and benefits related to both processes.

i. Process for Requesting Exemptions and Bona Fide Hedge Recognitions Directly from the Commission (Final § 150.3)

Under existing §§ 1.47 and 1.48, and existing § 150.3, the processes for obtaining a recognition of a bona fide hedge or for relying on a spread exemption, are similar in some respects and different in other respects than the approach adopted in final § 150.3. Existing §§ 1.47 and 1.48 require market participants seeking recognition of non-enumerated bona fide hedges and enumerated anticipatory bona fide hedges, respectively, for purposes of Federal position limits to apply directly to the Commission for prior approval.

In contrast, existing non-anticipatory enumerated bona fide hedges and spread exemptions are self-effectuating, which means that market participants are not required to submit any information to the Commission for prior approval, although such market

[1545] As discussed below, the Final Rule also eliminates the Form 204 and the equivalent portions of the Form 304.

participants must subsequently file Form 204 or Form 304 each month in order to describe their cash-market positions and justify their bona fide hedge position. There currently is no codified Federal process related to financial distress exemptions or natural gas conditional spot month exemptions.

Final § 150.3 provides a process for market participants to apply directly to the Commission for recognition of non-enumerated bona fide hedges or spread exemptions not included in the "spread transaction" definition in final § 150.1, which in each case would not be self-effectuating under the Final Rule. Under final § 150.3, any person seeking Commission recognition of these types of bona fide hedges or spread exemptions (as opposed to applying for recognition of non-enumerated bona fide hedges using the exchange-centric process under proposed § 150.9 described below) are required to submit a request directly to the Commission and to provide information similar to what is currently required under existing §§ 1.47 and 1.48.[1546]

a. Existing Bona Fide Hedges that Currently Require Prior Submission to the Commission under Existing §§ 1.47 and 1.48 for the Nine Legacy Agricultural Contracts

Under the Final Rule, the Commission maintains the distinction between enumerated bona fide hedges and non-enumerated bona fide hedges in final § 150.3: (1) enumerated bona fide hedges continue to be self-effectuating; (2) enumerated anticipatory bona fide hedges are now self-effectuating, so market participants no longer need to apply to the Commission for recognition; and (3) non-enumerated bona fide hedges still require market participants to apply for recognition. Market participants that choose to apply directly to the Commission for a bona fide hedge recognition (*i.e.*, for

[1546] For bona fide hedges and spread exemptions, this information includes: (i) a description of the position in the commodity derivative contract (including the name of the underlying commodity and the derivative position size) or of the spread position for which the application is submitted; (ii) an explanation of the hedging strategy, including a statement that the position complies with the applicable requirements for, and the definition of, a bona fide hedging transaction or position, and information to demonstrate why the position satisfies such requirements and definition; (iii) a statement concerning the maximum size of all gross positions in commodity derivative contracts for which the application is submitted; (iv) for bona fide hedges, a description of the applicant's activity in the cash markets and swaps markets for the commodity underlying the position for which the application is submitted, including information regarding the offsetting cash positions; and (v) any other information that may help the Commission determine whether the position meets the applicable requirements for a bona fide hedge position or spread transaction.

non-enumerated bona fide hedges) are subject to an application process that generally is similar to what the Commission currently administers for the non-enumerated bona fide hedges and the enumerated anticipatory bona fide hedges.[1547]

With respect to enumerated anticipatory bona fide hedges for the nine legacy agricultural contracts, for which market participants currently are required to apply to the Commission for recognition for Federal position limit purposes, the Commission anticipates that the Final Rule will benefit market participants by making such hedges self-effectuating.[1548] As a result, market participants will no longer be required to spend time and resources applying to the Commission.

Further, for these enumerated anticipatory hedges, existing § 1.48 requires market participants to submit either an initial or supplemental application to the Commission 10 days prior to entering into the bona fide hedge that would cause the hedger to exceed Federal position limits.[1549] Under existing § 1.48, a market participant could proceed with its proposed bona fide hedge if the Commission does not notify a market participant otherwise within the specific 10-day period. Under the Final Rule, because bona fide hedgers can implement enumerated anticipatory bona fide hedges without filing an application with the Commission for approval and waiting the requisite 10 days, they may be able to implement their hedging strategy more efficiently with reduced cost and risk. The Commission acknowledges that making such bona fide hedges more efficient to obtain could increase the possibility of excess speculation since anticipatory

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[1547] As noted above, under the existing framework, market participants are not required to apply for any type of bona fide hedge recognition or spread exemption from the Commission for any of the additional 16 contracts that are newly subject to Federal position limits (*i.e.*, those contracts other than the nine legacy agricultural contracts); rather, under the existing framework, such market participants must apply to the exchanges for bona fide hedge recognitions or exemptions for purposes of exchange-set position limits. Accordingly, to the extent that market participants do not need to apply to the Commission in connection with any of the additional 16 contracts, the Final Rule does not impose additional costs or benefits compared to the status quo.

[1548] As noted above, since market participants do not need to apply to the Commission for bona fide hedge recognition for any of the additional 16 contracts that are newly subject to Federal position limits, the Commission's proposal does not result in any additional costs or benefits to the extent such bona fide hedge recognitions are self-effectuating.

[1549] Under the Commission's existing regulations, non-anticipatory enumerated bona fide hedges are self-effectuating, and market participants do not have to file any applications for recognition under existing Commission regulations. However, existing Commission regulations require bona fide hedgers to file with the Commission monthly Form 204 (or Form 304 in connection with ICE Cotton No. 2 (CT)) reports discussing their underlying cash positions in order to substantiate their bona fide hedge positions.

exemptions are theoretically more difficult to substantiate compared to the other existing enumerated bona fide hedges.

However, the Commission has gained significant experience over the years with bona fide hedging practices in general, and with enumerated anticipatory bona fide hedging practices in particular, and the Commission has determined that making such hedges self-effectuating should not increase the risk of excessive speculation or market manipulation compared to the status quo.

For non-enumerated bona fide hedges, existing § 1.47 requires market participants to submit (i) initial applications to the Commission 30 days prior to the date the market participant would exceed the applicable position limits and (ii) supplemental applications (*i.e.*, applications for a market participant that desires to exceed the bona fide hedge amount provided in the person's previous Commission filing) 10 days prior for Commission approval, and market participants can proceed with their proposed bona fide hedges if the Commission does not intervene within the specific time (*e.g.*, either 10 days or 30 days).

Final § 150.3 similarly requires market participants that elect to apply directly to the Commission (as opposed to applying through an exchange pursuant to final § 150.9) for a recognition of a non-enumerated bona fide hedge for any of the 25 core referenced futures contracts to apply to the Commission prior to exceeding Federal position limits. Final § 150.3 does not, however, prescribe a certain time period by which a bona fide hedger must apply or by which the Commission must respond. The Commission anticipates that the Final Rule benefits bona fide hedgers by enabling them, in many cases, to generally implement their hedging strategies sooner than the existing 30-day or 10-day waiting period, as applicants will have access to an expanded list of enumerated hedges (which don't require prior Commission approval), a new streamlined process for applying through exchanges for non-enumerated hedges, increased position limits, and,

as discussed here, a more flexible approach for applying directly to the Commission for a non-enumerated hedge. Considering these factors, the Commission believes that, ultimately, hedging-related costs would likely decrease. However, the Commission believes that there could also be circumstances in which the overall process for applying directly to the Commission could take longer than the existing timelines under § 1.47, which could increase hedging-related costs if a bona fide hedger is compelled to wait longer, compared to existing Commission practices, before executing its hedging strategy.

On the other hand, the Commission also recognizes that there could be potential costs to bona fide hedgers if, under the Final Rule, they are forced either to enter into less effective bona fide hedges, or to wait to implement their hedging strategy, as a result of the potential uncertainty that could result from § 150.3 not requiring the Commission to respond within a certain amount of time. However, the Commission believes this concern is mitigated since market participants will likely also have the option to apply for a non-enumerated bona fide hedge under final § 150.9. As explained further below, final § 150.9(e)(3) is a streamlined process whereby a market participant in receipt of a notice of approval from the relevant exchange may elect, at its own risk, to exceed Federal position limits during the Commission's review period, which is limited to 10 (or 2) days under § 150.9.[1550]

This concern is also mitigated to the extent market participants utilize the § 150.3 process that permits a market participant that demonstrates a "sudden or unforeseen" increase in its bona fide hedging needs to enter into a bona fide hedge without first obtaining the Commission's prior approval, as long as the market participant submits a retroactive application to the Commission within five business days of exceeding the applicable position limit. The Commission believes this "five-business day retroactive

[1550] *See supra* Section II.G.7. (discussing when a person may exceed Federal position limits).

exemption" benefits bona fide hedgers compared to existing §§ 1.47 and 1.48, which require Commission prior approval, since hedgers that qualify to exercise the five-business day retroactive exemption are also likely facing more acute hedging needs – with potentially commensurate costs if required to wait. This provision also leverages, for Federal position limit purposes, existing exchange practices for granting retroactive exemptions from exchange-set limits.

On the other hand, the proposed five-business day retroactive exemption could harm market liquidity and bona fide hedgers if the applicable exchange or the Commission were to not approve the retroactive request, and the Commission subsequently required liquidation of the position in question. As a result, such possibility could cause market participants to either enter into smaller bona fide hedge positions than they otherwise would, or cause the bona fide hedger to delay entering into its hedge, in either case potentially causing bona fide hedgers to incur increased hedging costs.

However, the Commission believes this concern is partially mitigated since proposed § 150.3 requires the purported bona fide hedger to exit its position in a "commercially reasonable time," which the Commission believes should partially mitigate any costs incurred by the market participant compared to either an alternative that would require the bona fide hedger to exit its position immediately, or the status quo where the market participant either is unable to enter into a hedge at all without Commission prior approval.

b. Spread Exemptions and Non-enumerated Bona Fide Hedges

Final § 150.3 imposes a new requirement for Federal position limit purposes for market participants to (1) apply either directly to the Commission pursuant to § 150.3 or indirectly through an exchange pursuant to final § 150.9 for any non-enumerated bona fide hedge; and (2) to apply directly to the Commission pursuant to § 150.3 for any spread exemptions not identified in the proposed "spread transaction" definition (the

Commission notes that a market participant may not apply indirectly through an exchange for spread exemptions for Federal position limit purposes).[1551] As noted above, common spread exemptions (*i.e.*, those identified in the definition of "spread transaction" in final § 150.1) remain self-effectuating for the nine legacy agricultural products, and also are self-effectuating for the 16 additional core referenced futures contracts.[1552]

The baseline is the status quo under existing § 150.3(a)(3), which provides that certain spread exemptions are self-effectuating for purposes of Federal position limits. As noted above, § 150.3 is also the baseline for non-enumerated bona fide hedges. The final rule maintains the status quo with respect to spread exemptions that meet the "spread transaction definition" for the nine legacy agricultural contracts as such spread exemptions will continue to be self-effectuating. The final rule also maintains the status quo for any non-enumerated bona fide hedge in one of the nine legacy agricultural contracts by requiring an applicant to receive prior approval, and similarly requiring prior approval for such non-enumerated bona fide hedges for the additional 16 contracts that are newly subject to Federal position limits.[1553]

The Commission concludes that there is a change to the status quo baseline with respect to the 16 non-legacy core referenced futures contracts to the extent that they will be subject to Federal position limits for the first time under the Final Rule. However, since the most common spread exemptions will be "self-effectuating" for Federal purposes, market participants will not need to do anything new, compared to the status quo, under the Final Rule in connection with self-effectuating spread exemptions. Accordingly, as a practical matter, the Commission does not believe that the Final Rule will impose any new costs or benefits with respect to the 16 non-legacy core referenced

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[1551] As discussed below, for spread exemptions not identified in the proposed "spread transaction" definition in § 150.3, market participants are required to apply directly to the Commission under § 150.3 and are not able to apply under § 150.9.

[1552] Existing § 150.3(a)(2) does not specify a formal process for granting either spread exemptions or non-anticipatory enumerated bona fide hedges that are consistent with CEA section 4a(a)(1), so, in practice, spread exemptions and non-anticipatory enumerated bona fide hedges have been self-effectuating.

[1553] The Commission discusses the costs and benefits related to the process for non-enumerated bona fide hedge recognitions with respect to the nine legacy agricultural products in the above section.

futures products related to the Final Rule's treatment of these self-effectuating spread exemptions since market participants will not need to do anything differently compared to the status quo (*i.e.*, market participants will still need to obtain exchange approval of any spread exemption for purposes of exchange-set position limits, but will not be required to do anything for Federal purposes in connection with self-effectuating spread exemptions).

Alternatively, several commenters advocated for the Commission to expand the proposed § 150.9 process to also allow exchanges to grant "non-enumerated" spread exemptions for spread positions that do not meet the "spread transaction" definition.[1554] As more fully explained in the preamble, the Commission determined not to expand § 150.9 for two primary reasons.[1555] First, most of the more common spread exemptions used by market participants fall within the scope of the Final Rule's expanded "spread transaction" definition and are self-effectuating for purposes of Federal position limits. Spread exemption requests that fall outside of the "spread transaction" definition are likely to be novel exemption requests that require Commission review.

Second, bona fide hedge recognitions and spread transactions are subject to different legal standards under CEA section 4a(a). Because CEA section 4a(a)(c)(2) provides clear criteria to the Commission for determining what constitutes a bona fide hedging transaction or position, the Commission has defined in detail the term "bona fide hedging transaction or position" in § 150.1. As a result, the Commission is permitting exchanges to evaluate applications for non-enumerated bona fide hedges for purposes of exchange-set limits in accordance with the same clear criteria used by the Commission. In contrast, CEA section 4(a)(a)(1) does not include clear criteria to the Commission for the granting of spread exemptions and requires the Commission to use its judgment to

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[1554] *See* MFA/AIMA at 10; FIA at 21; Citadel at 8-9; ISDA at 9; ICE at 7-8.
[1555] *See supra* Sections II.G.4., II.G.5.

conduct a fact-specific analysis of novel spread exemption requests. Because exchanges would lack clear standards for assessing whether a particular spread position satisfies the requirements of the CEA, the Commission currently is uncomfortable with leveraging an exchange's analysis and determination with respect to novel spread exemption requests and believes that such an alternative could impose costs on risk management practices due to possible inconsistent treatment of such exemption requests across exchanges as well as potential uncertainty due to lack of a clear statutory standard.

To the extent market participants are required to obtain prior approval for a non-enumerated bona fide hedge or spread exemption for any of the additional 16 contracts that are newly subject to Federal position limits, the Commission recognizes that § 150.3 imposes costs on market participants who are now required to spend time and resources submitting applications to the Commission or an exchange, or both, as applicable, for prior approval of exemptions for Federal position limit purposes.[1556] Further, compared to the status quo in which the proposed new 16 contracts are not subject to Federal position limits, the process in § 150.3 could increase uncertainty since market participants are required to seek prior approval and wait for an undetermined amount of time for a Commission response. As a result, such uncertainty could cause market participants to either enter into smaller spread or bona fide hedging positions or do so at a later time. In either case, this could cause market participants to incur additional costs and/or implement less efficient hedging strategies.

However, the Commission believes that final § 150.3's framework is familiar to market participants that currently apply to the Commission for bona fide exemptions for the nine legacy agricultural products, which should serve to reduce costs for some market participants associated with obtaining recognition of a bona fide hedge or spread

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[1556] The Commission's Paperwork Reduction Act analysis identifies some of these information collection burdens in greater specificity. *See infra* Section IV.B.3.ii.c. (discussing in greater detail the cost and benefits related to spread exemptions).

exemption from the Commission for Federal position limits for those market participants.[1557]

The Commission believes that this analysis also applies to the nine legacy agricultural contracts for spread exemptions that are not listed in the proposed "spread transaction" definition and therefore also requires market participants to apply to the Commission for these types of spread exemptions for the first time for the nine legacy agricultural products. However, because the Commission has determined that most spread transactions are self-effectuating (especially for the nine legacy agricultural contracts based on the Commission's experience), the Commission believes that § 150.3 imposes only small costs with respect to spread exemptions for both the nine legacy agricultural contracts as well as the additional 16 contracts that are newly subject to Federal position limits.[1558]

While the Commission has years of experience granting and monitoring spread exemptions and enumerated and non-enumerated bona fide hedges for the nine legacy agricultural contracts, as well as overseeing exchange processes for administering exemptions from exchange-set limits on such commodities, the Commission does not have the same level of experience or comfort administering bona fide hedge recognitions and spread exemptions for the additional 16 contracts that are subject to the Federal position limits and the new exemption processes for the first time. Accordingly, the Commission recognizes that permitting enumerated bona fide hedges and spread

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[1557] The Commission anticipates that the application process in § 150.3(b) could slightly reduce compliance-related costs, compared to the status quo application process to the Commission under existing §§ 1.47 and 1.48, because § 150.3 provides a single, standardized process for all bona fide hedge and spread exemption requests that is slightly less complex – and more clearly laid out in the proposed regulations – than the Commission's existing application processes. Nonetheless, since the Commission anticipates that most market participants would apply directly to exchanges for bona fide hedges when provided the option under § 150.9, the Commission believes that most market participants would incur the costs and benefits discussed thereunder.

[1558] ICE requested that market participants be able to apply for spread exemptions on a late or retroactive basis the same way they would be permitted to apply for bona fide hedge exemptions within five days of exceeding Federal position limits under proposed §§ 150.3 and 150.9. ICE at 8. The Commission has determined not to permit late retroactive applications for spread exemptions under § 150.3(a) because the Commission believes that the Final Rule provides sufficient flexibility to allow market participants to identify their exemption needs and submit timely applications. *See supra* Section II.C.4.iii. The Commission further believes that allowing retroactive spread exemptions (and other types of retroactive exemptions) could potentially be harmful to the market, as these types of strategies may involve non-risk-reducing or speculative activity that should be evaluated prior to a person exceeding Federal position limits. *Id.*

exemptions identified in the "spread transaction" definition for these additional 16 contracts might not provide the purported benefits, or could result in increased costs, compared to the nine legacy agricultural products.

The Commission also believes that § 150.3 benefits market participants by providing them the option to choose the process for applying for a non-enumerated bona fide hedge (*i.e.*, either directly with the Commission or, alternatively, through the exchange-centric process discussed under § 150.9 below) for the additional 16 contracts that are newly subject to Federal position limits that are more efficient given the market participants' unique facts, circumstances, and experience.[1559] If a market participant chooses to apply through an exchange for Federal position limits pursuant to final § 150.9, the market participant receives the added benefit of not being required to also submit another application directly to the Commission. The Commission anticipates that most market participants would apply directly to exchanges for non-enumerated bona fide hedges, pursuant to the streamlined process § 150.9, as explained below, in which case the Commission believes that most market participants would incur the costs and benefits discussed thereunder. The Commission also believes that this analysis applies with respect to non-enumerated bona fide hedges for the nine legacy agricultural contracts.

c. Exemption-Related Recordkeeping

Final § 150.3(d) requires persons who avail themselves of any of the foregoing exemptions to maintain complete books and records concerning all details of each of their exemptions and any related position, and to make such records available to the Commission upon request under § 150.3(e).

[1559] As noted above, market participants seeking spread exemptions not listed in the proposed "spread transaction" definition in § 150.1 are required to apply directly with the Commission under § 150.3 and are not permitted to apply under § 150.9. The Commission recognizes that these types of spread exemptions are difficult to analyze compared to either the spread exemptions identified in § 150.1 or bona fide hedges in general. Accordingly, the Commission has determined to require market participants to apply directly to the Commission. Further, compared to the spread exemptions identified in final § 150.1, the Commission anticipates relatively few requests, and so does not believe the application requirement will impose a large aggregate burden across market participants.

Several commenters recommended that the Commission delete the pass-through swap recordkeeping requirements in proposed § 150.3(d)(2) based on concerns it would place all compliance burdens on the pass-through swap counterparty offering the swap rather than the bona fide hedging counterparty.[1560] Commenters further expressed concerns the proposed provision would be burdensome to the extent it would require the pass-through swap counterparty to maintain records of each representation made by the bona fide hedging counterparty on a trade-by-trade basis.[1561]

The Commission intended § 150.3(d)(2) to be an extension of market participants' existing obligations to maintain regulatory records under part 45 and § 1.31. As discussed above, the revised "bona fide hedging transaction or position" definition in final § 150.1 requires that a pass-through swap counterparty receive a written representation from its bona fide hedging swap counterparty in order for the pass-through swap to qualify as a bona fide hedge.[1562] In light of that, final § 150.3(d)(2) requires a person relying on the pass-through swap provision to maintain any records created for purposes of demonstrating a good faith reliance on that provision in accordance with § 150.1.

These recordkeeping requirements benefit market integrity by providing the Commission with the necessary information to monitor the use of exemptions from speculative position limits and help to ensure that any person who claims any exemption permitted by § 150.3 can demonstrate compliance with the applicable requirements. The Commission does not expect these requirements to impose significant new costs on market participants, as these requirements are in line with existing Commission and exchange-level recordkeeping obligations.

d. Exemption Renewals

[1560] Cargill at 6; Shell at 6.

[1561] *Id.*

[1562] *See supra* at Section II.A.1.x.

Consistent with existing §§ 1.47 and 1.48, with respect to any Commission-recognized bona fide hedge or Commission-granted spread exemption pursuant to final § 150.3, the Commission does not require a market participant to reapply annually to the Commission.[1563] The Commission believes that this reduces burdens on market participants but also recognizes that not requiring market participants to annually reapply to the Commission ostensibly could harm market integrity since the Commission will not directly receive updated information with respect to particular bona fide hedgers or exemption holders prior to the trader exceeding the applicable Federal position limits.

However, the Commission believes that any potential harm is mitigated since the Commission, unlike exchanges, has access to aggregate market data, including positions held by individual market participants. Further, § 150.3 requires a market participant to submit a new application if any material information changes, or upon the Commission's request. In addition, the Commission will receive information about any annual renewals of such requests made to an exchange (for purposes of exchange-set limits) through the monthly exchange reports required under § 150.5(a)(4). On the other hand, market participants benefit by not being required to annually submit new applications, which the Commission believes reduces compliance costs.

e. Exemptions for Financial Distress and Conditional Natural Gas Positions

Final § 150.3 codifies the Commission's existing informal practice with respect to exemptions for financial distress and existing industry practice with respect to the conditional spot month limit exemption positions in natural gas. The same costs and benefits described above with respect to applications for bona fide hedge recognitions and spread exemptions also apply to these exemptions. However, to the extent the Commission currently allows exemptions related to financial distress, the Commission

[1563] As discussed below, with respect to exchange-set limits under § 150.5 or the exchange process for Federal position limits under § 150.9, market participants are required to annually reapply to exchanges.

has determined that the costs and benefits with respect to the related application process already may be recognized by market participants.

ii. Process for Market Participants to Apply to an Exchange for Non-enumerated Bona Fide Hedge Recognitions for Purposes of Federal Position Limits (Final § 150.9) and Related Changes to Part 19 of the Commission's Regulations

Final § 150.9 provides a framework whereby a market participant could avoid the existing dual application process described above and, instead, file one application with an exchange to receive a non-enumerated bona fide hedging recognition, which as discussed previously is not self-effectuating for purposes of Federal position limits. Under this process, a person is allowed to exceed the Federal position limit levels following an exchange's review and approval of an application for a bona fide hedge recognition, provided that the Commission during its review does not notify the exchange otherwise within a certain period of time thereafter. Market participants who do not elect to use the process in final § 150.9 for purposes of Federal position limits are required to request relief both directly from the Commission under § 150.3, as discussed above, and also apply to the relevant exchange, consistent with existing practices.[1564]

a. Final § 150.9 — Establishment of General Exchange Process

Pursuant to final § 150.9, exchanges that elect to process these applications are required to file new rules or rule amendments with the Commission under § 40.5 of the Commission's regulations and obtain from applicants all information to enable the exchange and the Commission to determine that the facts and circumstances support a non-enumerated bona fide hedge recognition. Also, final § 150.9(e)(1) requires exchanges to provide real-time notification to the Commission of each initial determination to recognize a non-enumerated bona fide hedging transaction or position.

[1564] As noted above, the Commission anticipates that most, if not all, market participants will use § 150.9, rather than § 150.3, where permitted.

The Commission believes that exchanges' existing practices generally are consistent with the requirements of § 150.9, and, therefore, exchanges will only incur marginal costs, if any, to modify their existing practices to comply. Similarly, the Commission anticipates that establishing uniform, standardized exemption processes across exchanges benefits market participants by reducing compliance costs. On the other hand, the Commission recognizes that exchanges that wish to participate in the processing of applications with the Commission under § 150.9 are required to expend resources to establish a process consistent with the Final Rule. However, to the extent exchanges have similar procedures, such benefits and costs may already have been realized by market participants and exchanges.

The Commission believes that there are significant benefits to the § 150.9 process that will be largely realized by market participants. The Commission has determined that the use of a single application to process both exchange and Federal position limits exemptions benefits market participants and exchanges by simplifying and streamlining the process. For applicants seeking recognition of a non-enumerated bona fide hedge, § 150.9 should reduce duplicative efforts, because applicants are saved the expense of applying in parallel to both an exchange and the Commission for relief from exchange-set position limits and Federal position limits, respectively. Because many exchanges already possess similar application processes with which market participants are likely accustomed, compliance costs should be decreased in the form of reduced application-production time by market participants and reduced response time by exchanges.[1565]

As discussed above, in connection with the recognition of bona fide hedges for Federal position limit purposes, current practices set forth in existing §§ 1.47 and 1.48 require market participants to differentiate between (i) enumerated non-anticipatory bona

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[1565] The Commission has previously estimated the combined annual burden hours for submitting applications under both §§ 1.47 and 1.48 to be 42 hours. *See infra* Section IV.B. (Paperwork Reduction Act) and 85 FR 11596, 11700 (Feb. 27, 2020).

fide hedges that are self-effectuating, and (ii) enumerated anticipatory bona fide hedges and non-enumerated bona fide hedges for which market participants must apply to the Commission for prior approval. Under the Final Rule, the Commission's application processes no longer distinguish among different types of enumerated bona fide hedges (*e.g.*, anticipatory versus non-anticipatory enumerated bona fide hedges), and therefore, do not require exchanges to have separate processes for enumerated anticipatory positions under § 150.9. The Final Rule also eliminates the requirement for bona fide hedgers to file Form 204 or the relevant portions of Form 304, as applicable, with respect to any bona fide hedge, whether enumerated or non-enumerated.[1566] The Commission expects this to benefit market participants by providing a more efficient and less complex process that is consistent with existing practices at the exchange-level.[1567]

On the other hand, the Commission recognizes that § 150.9 imposes new costs related to non-enumerated bona fide hedges for the additional 16 contracts that are newly subject to Federal position limits. Under final § 150.9(c), market participants are now required to submit applications, including information to demonstrate why a particular position qualifies as bona fide hedge, as defined in § 150.1 and CEA section 4a(c)(2), to receive prior approval for Federal position limits purposes.[1568] However, since the Commission understands that exchanges already require market participants to submit applications and receive prior approval under exchange-set limits for all types of bona fide hedges, the Commission does not believe § 150.9 imposes any additional incremental costs on market participants beyond those already incurred under exchanges'

[1566] *See supra* Section II.H.2. (discussing changes to part 19 eliminating Form 204 and portions of Form 304).

[1567] *See infra* Section IV.A.5.iii. for discussion related to changes to part 19 regarding the provision of information by market participants, noting that the elimination of Form 204 by the Final Rule reduces the burden hours estimates by 300 annual aggregate burden hours.

[1568] One commenter requested that the Commission provide additional factors that exchanges should consider when granting non-enumerated bona fide hedge recognitions. ISDA at 9. As discussed more fully in the preamble, the Commission believes that the final regulations strike a reasonable tradeoff by providing sufficient guidance to the exchanges for their review and determination in the context of exchange limits, while preserving the exchanges' discretionary authority to determine what types of additional information, if any, to collect. *See supra* Section II.G.5. (discussing final § 150.9(c)).

existing processes.[1569] Accordingly, the Commission believes that any costs already may have been realized by market participants.

Further, the Commission believes that employing a concurrent process with exchanges that are self-regulatory organizations responsible for overseeing non-enumerated bona fide hedges executed on their platforms and that are not self-effectuating for Federal position limits purposes benefits market integrity by ensuring that market participants are appropriately relying on such bona fide hedges and not entering into such positions in order to attempt to manipulate the market or evade position limits. However, to the extent that exchange oversight, consistent with Commission standards and DCM core principles, already exists, such benefits may already be realized.

b. Final §150.9 – Exchange Expertise, Market Integrity, and Commission Oversight

For non-enumerated bona fide hedge recognitions that require the Commission's prior approval, the Final Rule provides a framework that utilizes existing exchange resources and expertise so that fair access and liquidity are promoted at the same time market manipulations, squeezes, corners, and other conduct that would disrupt markets are deterred and prevented.[1570] Final § 150.9 builds on existing exchange processes, which the Commission believes strengthens the ability of the Commission and exchanges to monitor markets and trading strategies while reducing burdens on both the exchanges, which administer the process, and market participants, who utilize the process. For example, exchanges are familiar with their market participants' commercial needs,

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[1569] Under the 2020 NPRM, proposed § 150.9(c)(1)(ii) would have required exchanges to request a "factual and legal" analysis from applicants for non-enumerated bona fide hedge recognitions. 85 FR 11638. Two commenters expressed concern that the proposed requirement could be interpreted as requiring applications to engage legal counsel to complete their applications, which would result in additional costs to market participants. *See* CME Group at 10 and CMC at 11. The Commission did not intend for exchanges to require that applicants engage legal counsel to complete their applications for non-enumerated bona fide hedge recognitions. Final § 150.9(c)(1)(ii), instead of requiring a "factual and legal analysis," requires an applicant to provide "an explanation of the hedging strategy," including a statement that the position complies with the applicable requirements of the bona fide hedge definition, and information to demonstrate why the position satisfies the applicable requirements. *See supra* Section II.G.5. (discussing final § 150.9(c)).

[1570] *See* CME Group at 7 (stating that the § 150.9 "streamlined process would wisely leverage exchanges' long history of reviewing hedging approaches and applying those approaches to specific facts and circumstances, and would thereby advance the statutory goal of allowing commercial parties to "hedge their legitimate anticipated business needs" without imposing any undue burden in doing so).

practices, and trading strategies, and already evaluate hedging strategies in connection with setting and enforcing exchange-set position limits.[1571] Accordingly, exchanges should be able to readily identify bona fide hedges.

For these reasons, the Commission has determined that allowing market participants to apply through an exchange under § 150.9, rather than directly to the Commission as required under existing § 1.47, is likely to be more efficient than if the Commission itself initially had to review and approve all applications. The Commission considers the increased efficiency in processing applications under § 150.9 as a benefit to bona fide hedgers and liquidity providers. By having the availability of the exchange's analysis and view of the markets, the Commission is better informed in its review of the market participant and its application, which in turn may further benefit market participants in the form of administrative efficiency and regulatory consistency. However, the Commission recognizes additional costs for exchanges required to create and submit real-time notices under final § 150.9(e). In particular, commenters voiced concerns that the Commission's review of each non-enumerated bona fide hedge application could impose significant burdens on exchanges, market participants, and the Commission.[1572] To the extent exchanges already provide similar notice to the Commission or to market participants, or otherwise are required to notify the Commission under certain circumstances, such benefits and costs already may have been realized. In addition, the Commission expects that, due to the expanded list of enumerated hedges and other exemptions available to market participants as well as the higher Federal limits in the Final Rule, there will be a manageable amount of non-enumerated bona fide hedges that exchanges and the Commission will review through the

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[1571] For a discussion on the history of exemptions, *see* 78 FR at 75703–75706.

[1572] IFUS at 52 (stating that the "exemption-by-exemption review of exchange decisions is a novel and significant departure from the longstanding process for the implementation of the position limits regime, imposes substantial burdens on the Commission and the exchanges, and decreases regulatory certainty for market participants regarding the status of an exemption"). *See also* ICE at 9 (questioning "whether it is necessary for the Commission to routinely review each non-enumerated determination by the exchange" and asserting that the § 150.9 10-day review process "imposes unnecessary burdens and delays on market participants").

new streamlined process. The Commission also reiterates that § 150.9 is an optional process that exchanges and market participants may elect to use in lieu of utilizing the traditional process of requesting non-enumerated bona fide hedges directly from the Commission under § 150.3.

On the other hand, to the extent exchanges become more involved with respect to review and oversight of market participants' bona fide hedges and spread exemptions, exchanges could incur additional costs. However, as noted, the Commission believes most of the costs have been realized by exchanges under current market practice.

At the same time, the Commission also recognizes that this aspect of the Final Rule could hypothetically harm market integrity. Absent other provisions, since exchanges profit from increased activity, an exchange could hypothetically seek a competitive advantage by offering excessively permissive exemptions, which could allow certain market participants to utilize non-enumerated bona fide hedge recognitions to engage in excessive speculation or to manipulate market prices. If an exchange engaged in such activity, other market participants would likely face greater costs through increased transaction fees, including forgoing trading opportunities resulting from market prices moving against market participants and/or preventing the market participant from executing at its desired prices, which may also further lead to inefficient hedging.

However, the Commission believes that these hypothetical costs are unfounded since under final § 150.9 the Commission reviews the applications submitted by market participants for bona fide hedge recognitions and spread exemptions for Federal position limits. The Commission emphasizes that § 150.9 is not providing exchanges with an ability to recognize a bona fide hedge or grant an exemption for Federal position limit purposes in lieu of a Commission review.[1573] Rather, § 150.9(e) and (f) require an

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[1573] *See supra* Section II.G. (discussing Commission determination of non-enumerated bona fide hedge applications submitted under § 150.9).

exchange to provide the Commission with notice of the disposition of any application for purposes of exchange limits concurrently with the notice the exchange provides to the applicant, and the Commission will have 10 business days to make its determination for Federal position limits purposes (although, in connection with "sudden or unforeseen increases" in bona fide hedging needs, as discussed in connection with final § 150.3, § 150.9 requires the Commission to make its determination within two business days). Each non-enumerated bona fide hedge approved by an exchange for purposes of its own limits is separately and independently reviewed by the Commission for purposes of Federal position limits. Finally, under DCM Core Principle 5 and SEF Core Principle 6, exchanges are accountable for administering position limits in a manner that reduces the potential threat of market manipulation or congestion. The Commission believes that these requirements, working in concert, provide sufficient protection against any potential harm to market integrity.

On the other hand, the Commission also recognizes that there could be potential costs to bona fide hedgers if, under the Final Rule, they wait up to 10 business days for the Commission to complete its review after the exchange's initial review – especially compared to the status quo for the 16 commodities that are subject to Federal position limits for the first time under the Final Rule and currently are not required to receive the Commission's prior approval. As a result, the Commission recognizes that a market participant could incur costs by waiting during the 10 business day period, or be required to enter into a less efficient hedge, which would harm liquidity.[1574] However, the Commission believes this concern is mitigated since, under final § 150.9(e)(3), a market participant in receipt of a notice of approval from the relevant exchange may elect, at its

[1574] *See* ICE at 9 (requesting that the Commission permit a "market participant to engage in hedging up to the requested exemption limit while waiting for approval").

own risk, to exceed Federal position limits during the Commission's 10-day review period.[1575]

Further, final § 150.9(c)(2)(i), similar to final § 150.3, permits a market participant that demonstrates a "sudden or unforeseen" increase in its bona fide hedging needs to enter into a bona fide hedge without first obtaining the Commission's prior approval, as long as the market participant submits a retroactive application to the Commission within five business days of exceeding the applicable position limit.[1576] In turn, the Commission only has two business days (as opposed to the default 10 business days) to complete its review for Federal purposes. The Commission believes this retroactive application exemption benefits bona fide hedgers compared to existing § 1.47, which requires Commission prior approval, since hedgers that qualify to exercise the retroactive exemption are also likely facing more acute hedging needs – with potentially commensurate costs if required to wait. Absent the retroactive application exemption, market participants would be penalized and prevented from assuming appropriate hedges even though their hedging need arises from circumstances beyond their control. This provision also leverages, for Federal position limit purposes, existing exchange practices for granting retroactive exemptions from exchange-set limits.

On the other hand, the retroactive application exemption could harm market liquidity and bona fide hedgers since the Commission is able to require a market participant to exit its position if the exchange or the Commission does not approve of the retroactive request. Such uncertainty could cause market participants to either enter into smaller bona fide hedge positions than it otherwise would, or could cause the bona fide hedger to delay entering into its hedge, in either case potentially causing bona fide hedgers to incur increased hedging costs. However, the Commission believes this

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[1575] *See supra* Sections II.G.7. (discussing when a person may exceed Federal position limits).
[1576] *Id*.

concern is partially mitigated since § 150.9 requires the purported bona fide hedger to exit its position in a "commercially reasonable time," which the Commission believes should partially mitigate any costs incurred by the market participant compared to either an alternative that would require the bona fide hedger to exit its position immediately, or the status quo where the market participant is unable to enter into a hedge at all without Commission approval.

As discussed in the preamble, the Commission received and considered two comments recommending a broader retroactive application exemption: (1) CME recommended that the Commission allow retroactive applications regardless of the circumstances and impose a position limits violation on an applicant in the event the exchange denies its application; and (2) ICE recommended that the Commission permit retroactive exemptions for other types of exemptions, as well as for position limit overages that occur as a result of operational or incidental issues where the applicant did not intend to evade position limits.[1577] An expansion of this exception beyond bona fide hedge needs that arise due to sudden or unforeseen circumstances could disincentivize market participants from properly monitoring their hedging activities and filing applications in a timely manner. Because the Final Rule provides broad flexibility to market participants in the form of various exemptions, among other enhancements to the Federal position limits framework for bona fide hedges and other exemptions, the Commission determined not to expand the retroactive application provision in § 150.9(c)(2)(ii).[1578]

While existing § 1.47 does not require market participants to annually reapply for certain bona fide hedges, final § 150.9(c)(3) requires market participants to reapply at least annually with exchanges to maintain previously-approved non-enumerated bona

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[1577] *See supra* Section II.G.5.iii.b. (citing CME Group at 9-10 and ICE at 10).
[1578] *See supra* Section II.G.5.ii. (discussing final § 150.9(c)(2)(i)).

fide hedge recognition for purposes of Federal position limits. Several commenters requested the Commission to clarify that an applicant is subject to the Commission's 10/2-day review process in § 150.9(e) only for initial applications for non-enumerated bona fide hedges, and is not subject to such review for annual renewal applications unless the facts and circumstances materially change from those presented in the initial application. As discussed in the preamble, market participants are only subject to the Commission's 10/2-day review process for their initial applications for non-enumerated bona fide hedges unless there are material changes to their initial application.

The Commission recognizes that requiring market participants to reapply annually could impose additional costs on those that are not currently required to do so. However, the Commission believes that this is consistent with industry practice with respect to exchange-set limits and that market participants are familiar with exchanges' exemption processes, which should reduce related costs.[1579] Further, the Commission believes that market integrity is strengthened by ensuring that exchanges receive updated trader information that may be relevant to the exchange's oversight.[1580] However, to the extent any of these benefits and costs reflects current market practice, they already may have been realized by exchanges and market participants.

The Commission anticipates additional costs for exchanges required to create and submit certain notifications and monthly reports. Final § 150.9(e)(1) requires exchanges to provide real-time notification to the Commission of each initial determination to recognize a bona fide hedging transaction or position.[1581] Final § 150.5(a)(4) requires

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[1579] *See infra* Section IV.A.6. (discussing final § 150.5).

[1580] In contrast, the Commission, unlike exchanges, has access to aggregate market data, including positions held by individual market participants, and so the Commission has determined that requiring market participants to apply annually under final § 150.3, absent any changes to their application, does not benefit market integrity to the same extent.

[1581] In addition to submitting a copy of any exchange-approved non-enumerated bona fide hedge application to the Commission under § 150.9(e), an exchange may, on a voluntary basis, send the Commission an advance courtesy copy of the non-enumerated bona fide hedge application when the exchange first receives it from the applicant. For purposes of the cost-benefit considerations, we expect this to be a *de minimis* burden on an exchange that elects to provide the courtesy copy to the Commission. In addition, we expect that providing the courtesy copy could facilitate a more rapid Commission evaluation of applications submitted under § 150.9, help facilitate additional regulatory certainty for market participants, and aid the Commission in its review of applications processed under § 150.9.

exchanges to provide monthly reports with necessary information in the form and manner required by the Commission. The exchange-to-Commission monthly report for contracts subject to Federal speculative position limits in final § 150.5(a)(4) further details the exchange's disposition of a market participant's application for recognition of a bona fide hedge position or spread exemption as well as the related position(s) in the underlying cash markets and swaps markets.[1582] The Commission believes that such reports provide greater transparency by facilitating the tracking of these positions by the Commission and further assist the Commission in ensuring that a market participant's activities conform to the exchange's rules and to the CEA. The combination of the "real-time" exchange notification and exchanges' provision of monthly reports to the Commission under final §§ 150.9(e)(1) and 150.5(a)(4), respectively, provides the Commission with enhanced surveillance tools on both a "real-time" and a monthly basis to ensure compliance with the requirements of the Final Rule. However, to the extent exchanges already provide similar notice to the Commission, or otherwise are required to notify the Commission under certain circumstances, such benefits and costs already may have been realized.

c. Final § 150.9(d) – Recordkeeping

Final § 150.9(d) requires exchanges to maintain complete books and records of all activities relating to the processing and disposition of any applications, including applicants' submission materials,[1583] and determination documents.[1584] The Commission believes that this benefits market integrity and Commission oversight by ensuring that pertinent records are readily accessible, as needed by the Commission. However, the

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[1582] In response to concerns from ICE that proposed § 150.5(a)(4) may be overly burdensome and redundant, the Commission clarified that the monthly report is required to capture only positions that are subject to Federal position limits (as opposed to other exchange-set non-enumerated exemptions), exchanges have discretion as to the best timing for submitting their reports so long as they are submitted on a monthly basis, and exchanges need not include factual and legal analysis in the monthly report. *See supra* Section II.D.3.iv. (discussing § 150.5(a)(4)).

[1583] One commenter requested that § 150.9 allow exchanges to maintain records of applicants' positions on an aggregate basis, as opposed to requiring an exchange to match applicants' bona fide hedge positions to their underlying cash positions on a one-to-one basis. NGSA at 9. In the preamble, the Commission noted that final § 150.9(d) does not prescribe the manner in which exchanges record application materials and information—it simply requires exchanges to keep a record of application materials and information collected. *See supra* Section II.G.6.iii.

[1584] Moreover, consistent with existing § 1.31, the Commission expects that these records will be readily accessible until the termination, maturity, or expiration date of the bona fide hedge recognition or exempt spread position and during the first two years of the subsequent five-year retention period.

Commission acknowledges that such requirements impose costs on exchanges. Nonetheless, to the extent that exchanges are already required to maintain similar records, such costs and benefits already may be realized.[1585]

d. Final § 150.9(f) – Commission Revocation of Previously Approved Applications

The Commission acknowledges that there may be costs to market participants if the Commission revokes a previously-approved non-enumerated hedge recognition for Federal purposes under final § 150.9(f). Specifically, market participants could incur costs to unwind trades or reduce positions if the Commission required the market participant to do so under final § 150.9(f)(2).

However, the potential cost to market participants is mitigated under final § 150.9(f) since the Commission provides a commercially reasonable time for a person to come back into compliance with the Federal position limits, which the Commission believes should mitigate transaction costs to exit the position and allow a market participant the opportunity to potentially execute other hedging strategies.

e. Final § 150.9 – Commodity Indexes and Risk Management Exemptions

Final § 150.9(b) prohibits exchanges from recognizing as a bona fide hedge any positions that include commodity index contracts and one or more referenced contracts, including exemptions known as risk management exemptions. The Commission recognizes that this prohibition could alter trading strategies that currently use commodity index contracts as part of an entity's risk management program. Although there likely is a cost to change risk management strategies for entities that currently rely on a bona fide hedge recognition for positions in commodity index contracts, as discussed above, the Commission believes that such financial products are not substitutes for

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[1585] The Commission believes that exchanges that process applications for recognition of bona fide hedging transactions or positions and/or spread exemptions currently maintain records of such applications as required pursuant to other existing Commission regulations, including existing § 1.31. The Commission, however, also believes that final § 150.9(d) may impose additional recordkeeping obligations on such exchanges. The Commission estimates that each exchange electing to administer the processes will likely spend five (5) hours annually to comply with the recordkeeping requirement of final § 150.9(d) and thus will incur minimal costs compared to the status quo. *See generally* Section IV.B. (discussing the Commission's PRA determinations).

positions in a physical market and therefore do not satisfy the statutory requirement for a bona fide hedge under section 4a(c)(2) of the Act.[1586] In addition, the Commission further posits that this cost may be reduced or mitigated by the proposed increase in Federal position limit levels set forth in final § 150.2, or by the implementation of the pass-through swap provision of the bona fide hedge definition in final § 150.1.[1587]

iii. Related Changes to Part 19 of the Commission's Regulations Regarding the Provision of Information by Market Participants

Under existing regulations, the Commission relies on Form 204[1588] and Form 304,[1589] known collectively as the "series '04" reports, to monitor for compliance with Federal position limits. Prior to the amendments to part 19 in the Final Rule, market participants that held bona fide hedging positions in excess of Federal position limits for the nine legacy agricultural contracts had to justify such overages by filing the applicable report (Form 304 for cotton and Form 204 for the other eight legacy commodities) each month.[1590] The Commission has used these reports to determine whether a trader had sufficient cash positions to justify purported bona fide hedges positions using futures and options on futures positions above the applicable Federal position limits.

As discussed above, with respect to bona fide hedging positions, the Commission is adopting a streamlined approach, under final §§ 150.5 and 150.9, to cash-market reporting that reduces duplication between the Commission and the exchanges. Generally, the Commission is adopting amendments to part 19 and related provisions in part 15 that: (i) eliminate Form 204; and (ii) amend the Form 304, in each case to

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[1586] *See supra* Section III.C.4. (discussing commodity indices); s*ee supra* Section IV.A.4.ii.a(1) (discussing elimination of the risk management exemption).

[1587] *See supra* Section IV.A.4.b.i(1) (discussing the pass-through swap exemption).

[1588] *CFTC Form 204: Statement of Cash Positions in Grains, Soybeans, Soybean Oil, and Soybean Meal*, available at https://www.cftc.gov/sites/default/files/idc/groups/public/@forms/documents/file/cftcform204.pdf (existing Form 204).

[1589] *CFTC Form 304: Statement of Cash Positions in Cotton*, U.S. Commodity Futures Trading Commission website, available at http://www.cftc.gov/ucm/groups/public/@forms/documents/file/cftcform304.pdf (existing Form 204). Parts I and II of Form 304 address fixed-price cash positions used to justify cotton positions in excess of Federal position limits. As described below, Part III of Form 304 addresses unfixed price cotton "on-call" information, which is not used to justify cotton positions in excess of limits, but rather to allow the Commission to prepare its weekly cotton on-call report.

[1590] 17 CFR 19.01.

remove any cash-market reporting requirements. Under the Final Rule, the Commission instead relies on cash-market reporting submitted directly to the exchanges, pursuant to final §§ 150.5 and 150.9,[1591] or requests cash-market information through a special call.[1592]

The cash-market and swap-market reporting elements of §§ 150.5 and 150.9 discussed above are largely consistent with current market practices with respect to exchange-set limits and thus should not result in any new costs.[1593] The Final Rule's elimination of Form 204 and the cash-market reporting segments of the Form 304 eliminate the reporting burden and associated costs.[1594] Market participants should realize significant benefits by being able to submit cash-market reporting to one entity – the exchanges – instead of having to comply with duplicative reporting requirements between the Commission and applicable exchange, or implement new Commission processes for reporting cash-market data for market participants who will be newly subject to position limits.[1595] Further, market participants are generally already familiar with exchange processes for reporting and recognizing bona fide hedging exemptions, which is an added benefit, especially for market participants that are newly subject to Federal position limits.

Further, these changes do not impact the Commission's existing provisions for gathering information through special calls relating to positions exceeding limits and/or to reportable positions. Accordingly, as discussed above, the Commission requires that

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[1591] *See supra* Section II.G.ii.3. (discussing final § 150.9). As discussed above, leveraging existing exchange application processes should avoid duplicative Commission and exchange procedures and increase the speed by which position limit exemption applications are addressed. For purposes of Federal position limits, the cash-market reporting regime discussed in this section of the release only pertains to bona fide hedges, not to spread exemptions, because the Commission has not traditionally relied on cash-market information when reviewing requests for spread exemptions.

[1592] *See* final § 19.00(b).

[1593] *See*, *e.g.*, CME Rule 559 and ICE Rule 6.29.

[1594] Based on revised estimates of the current collections of information under existing part 19, the Commission estimates that the Final Rule reduces the collections of information in part 19 by 600 reports and by 300 annual aggregate burden hours since the Final Rule eliminates Form 204. *See infra* Section IV.B. (Paperwork Reduction Act) and 85 FR 11596, 11700 (Feb. 27, 2020).

[1595] The Commission has noted that certain commodity markets are subject to Federal position limits for the first time. In addition, the existing Form 204 would be inadequate for reporting of cash-market positions relating to certain energy contracts that are subject to Federal position limits for the first time under the Final Rule.

all persons exceeding the Federal position limits set forth in final § 150.2, as well as all persons holding or controlling reportable positions pursuant to existing § 15.00(p)(1), must file any pertinent information as instructed in a special call.[1596] The Commission acknowledges that, on its face, not obtaining the cash-market position information in the form of a series '04 report could hypothetically result in some increase in speculation; however, as set out above, this risk is mitigated by the Commission's special call authority and by the requirements that the exchanges receive this information under §§ 150.5 and 150.9, as applicable. The Commission in turn would be able to receive this information from the applicable exchange. Final § 19.00(a)(3) is similar to existing § 19.00(a)(3), but requires any such person to file the information as instructed in the special call, rather than to file a series '04 report.[1597] The Commission believes that relying on its special call authority is less burdensome for market participants than the existing Forms 204 and 304 reporting costs, as special calls are discretionary requests for information whereas the series '04 reporting requirements are a monthly, recurring reporting burden for market participants. While collecting this data monthly would permit the Commission to analyze the bona fide hedges in a time series, which may be helpful in understanding trends in hedging techniques, the Commission will have access to this same data from the exchanges and could do the same analysis if required.

The Commission received one comment addressing the purported burdens that would accompany elimination of the cash-market reporting forms. Better Markets, for example, argued that eliminating these series '04 forms would impose additional reporting burdens on market participants by requiring participants to report cash-market information to multiple exchanges, and suggested that the Commission should instead "ensure that all cash positions reporting is automated" and "amenable to aggregation" in

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[1596] *See* final § 19.00(b).
[1597] 17 CFR 19.00(a)(3).

order to provide such information to the exchanges.[1598] The Commission disagrees with Better Markets' concerns about increased reporting burdens and criticism of the existing reporting infrastructure for the reasons discussed above.[1599] However, as noted above, eliminating the '04 forms will reduce burdens on market participants.[1600]

Separately, ACSA argued for the elimination of Form 304 in its entirety.[1601] ACSA asserted that Part III of Form 304, which is used to prepare the Commission's cotton on-call report, causes competitive harm to the U.S. cotton industry because the report divulges one market participant's proprietary information to another market participant and, according to ACSA, foreign mills believe that the report imposes risks and costs and are therefore more likely to purchase cotton from outside of the United States in order to avoid completing Part III of Form 304.[1602]

As discussed in detail above at Section II.H.5.iv, the Commission believes that the cotton on-call report contributes to efficient price discovery,[1603] and that continued publication of the cotton on-call report will not change the existing dynamics of the cotton market.

6. Exchange-Set Position Limits (Final § 150.5)

i. Introduction

Existing § 150.5 addresses exchange-set position limits on contracts not subject to Federal position limits under existing § 150.2, and sets forth different standards for DCMs to apply in setting limit levels depending on whether the DCM is establishing

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[1598] Better Markets at 59-60.

[1599] *See supra* Section H.2.iii.-iv. (discussing Better Markets' comments and the Commission's responses thereto).

[1600] *Id.*

[1601] ACSA at 9-11.

[1602] *See id.; see also* NCTO at 1-2 (arguing against publication of the cotton-on-call report and that textile mills are particularly harmed when speculators trade against the cash-market positions disclosed in the cotton on-call report because textile mills purchase the majority of their cotton on call).

[1603] *See, e.g.*, Glencore at 2. One commenter stated that it is difficult to see the benefit in limiting transparency in the cotton market and that cotton on-call report is useful and necessary because it allows market participants to identify market composition. Dunavant at 1. Similarly, another commenter stated that discontinuation of the cotton on-call report would widen the informational divide between large and small market participants while providing no benefits to the public or price discovery. Gerald Marshall at 3.

limit levels: (1) on an initial or subsequent basis; (2) for cash-settled or physically-settled contracts; and (3) during or outside the spot month.

In contrast, for physical commodity derivatives, final § 150.5(a) and (b): (1) expands existing § 150.5's framework to also cover contracts subject to Federal position limits under final § 150.2; (2) simplifies the existing standards that DCMs apply when establishing exchange-set position limits; and (3) provides non-exclusive acceptable practices for compliance with those standards.[1604] Additionally, final § 150.5(d) requires DCMs to adopt aggregation rules that conform to existing § 150.4.[1605]

As a general matter, one factor (in addition to more specific factors discussed throughout this Final Rule's cost-benefit considerations) affecting the costs and benefits of the Federal position limits established by this Final Rule is the fact that exchanges, for many years, have had in place spot month position limits for all of the core referenced contracts and non-spot month limits for all of the nine legacy agricultural contracts.[1606] Under final § 150.5(a) and (b), exchanges will be required to adopt exchange-set position limits both (i) for contracts subject to Federal position limits and (ii) during the spot month for physical commodity contracts not subject to Federal position limits. Exchanges also will be required to adopt position limits or position accountability outside the spot month for those physical commodity contracts not subject to non-spot month Federal position limits, although the specifics may change with evolving market conditions and regulatory requirements.[1607] Exchange-set position limits, broadly speaking, have much the same effect as Federal position limits since both restrict the size

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[1604] *See* 17 CFR 150.2. Existing § 150.5 addresses only contracts *not* subject to Federal position limits under existing § 150.2 (aside from certain major foreign currency contracts). To avoid confusion created by the parallel Federal and exchange-set position limit frameworks, the Commission clarifies that final § 150.5 deals solely with exchange-set position limits and exemptions therefrom, whereas final § 150.9 deals solely with the process for purposes of Federal position limits.

[1605] *See* 17 CFR 150.4.

[1606] *See* Section II.D, *supra*, CME Group, Position Limits, https://www.cmegroup.com/market-regulation/position-limits.html; IFUS, Market Resources, Position Limits & Reporting, https://www.theice.com/futures-us/market-resources; CEA section 5(d)(5)(A) (requiring position limits or accountability); existing § 150.5; final § 150.5(a). This is generally true with the exception of ICE Sugar No. 16, which is only subject to exchange-set single month and all-months-combined position limits. However, the single month position limit effectively acts as the spot month position limits for this contract.

[1607] *See supra* Section II.D; *see also* CEA section 5(d)(5); final § 150.5(a).

of speculative positions market participants may hold.[1608] Moreover, there is significant interaction between Federal position limits and exchange-set position limits. In particular, CEA section 5(d)(5)(B) provides that, for contracts where the Commission has established a position limit, exchange-set position limits must be set at a level no higher than the Federal limit.[1609] In addition, where both the Commission and an exchange have position limits in place for a contract, final § 150.5(a)(2) puts constraints on exemptions from the exchange-set limit that are tied to the Commission's position limits in ways described in detail in Section II.D.3, above. As a result, the costs and benefits considered by the Commission, to a considerable extent, are jointly attributable to Federal and exchange-set position limits. The Commission does not have information that would permit a quantitative evaluation of the extent to which this is true. Qualitatively, where position limits overlap, a greater attribution of costs and benefits to the Federal limits appears appropriate to the extent that Federal limits trigger exchange-set limits pursuant to CEA section 5(d)(5)(B). However, this is less true if an exchange elects to impose position limits that are more stringent than the Federal limits for particular contracts.[1610]

Despite the overlap in the effects of Federal and exchange-set position limits, there are a number of distinctive features of Federal position limits. Most importantly, as noted above, for contracts where Federal position limits are established, they establish a ceiling on positions that can be held, both as a matter of law under CEA section 5(d)(5)(B) and as a matter of practicality since market participants must comply with Federal limits no matter what the level of exchange-set limits. In addition, while exchanges can share information to some extent, the Commission regulates trading on all

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[1608] *See* ICE Futures U.S. at 3 ("There is no apparent benefit provided by adding a Federal position limit and guidance" to ICE's procedures for position limits and exemptions to such limits.)

[1609] *See also* final § 150.5(a)(1).

[1610] For example, exchanges sometimes reduce position limit levels in response to particular market conditions. *See, e.g.*, ICE Futures U.S. at 3, n.3 (describing a reduction in spot month position limit for cocoa in March of 2020 in response to potential impact of disruptions to normal business conditions on ability of market participants to submit cocoa for grading). In addition, an exchange could routinely set a lower position limit based on its judgment of what is necessary to prevent manipulation or other problems or based on the preferences of important participants in its market.

exchanges and therefore is generally in a position to better monitor and enforce compliance with position limits across more than one exchange, for example in connection with positions in a core referenced futures contract in one exchange and a linked cash-settled look-alike referenced contract on another exchange.

There are other differences as well. Even where the Commission and an exchange set the same numerical position limit for a contract, final § 150.5(a)(2) allows for the possibility that there may be some differences in the exemptions allowed.[1611] And Federal position limits established pursuant to paragraph CEA section 4a(a)(2) are subject to a statutory requirement to achieve, to the maximum extent practicable, the multiple policy objectives set forth in subparagraph 4a(a)(3)(B) of the CEA. By contrast, exchanges have a narrower statutory mandate to adopt position limits or position accountability to "reduce the potential threat of market manipulation or congestion."[1612] Finally, Federal position limits create compliance costs beyond those attributable to exchange-set position limits since market participants will need to establish systems to ensure compliance with Federal requirements. However, some compliance costs, for example keeping track of position levels, may be common to both forms of position limits.[1613]

Exchange-set position limits for contracts and commodities not subject to Federal position limits also affect the costs and benefits of Federal position limits, and, in particular, of the Commission's finding that position limits are necessary only for the 25 CRFCs and contracts linked to them.[1614] The Commission also has concluded that the

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[1611] *See supra* Section II.D.

[1612] CEA section 5(d)(5)(A), 7 U.S.C. 7(d)(5)(A). However, the statutory policy objectives for Federal position limits may indirectly affect exchange-set limits where Federal limits set a ceiling for exchange-set limits pursuant to CEA section 5(d)(5)(B), 7 U.S.C. 7(d)(5)(B).

[1613] *See supra* Section III.B.2.c.ii; *see also* COPE at 3 (rule does not require market participants to create recordkeeping system to track data solely for purpose of filing forms with the Commission although some additions to existing tracking effort will be required).

[1614] For information on exchange-set position limits and position accountability for contracts and commodities not subject to Federal position limits, *see*, *e.g.*, CME Group, Position Limits, https://www.cmegroup.com/market-regulation/position-limits.html; IFUS, Market Resources, Position Limits & Reporting, https://www.theice.com/futures-us/market-resources; CEA section 5(d)(5)(A) (requiring position limits or accountability); existing § 150.5; final § 150.5(b).

existence of exchange-set limits and position accountability (discussed further below) mitigates the effects of not establishing Federal position limits for other commodity derivatives contracts.[1615]

ii. Physical Commodity Derivative Contracts Subject to Federal Position Limits Under the Final Rule (Final § 150.5(a))

a. Exchange-Set Position Limits and Related Exemption Process

For contracts subject to Federal position limits under the Final Rule, final § 150.5(a)(1) requires DCMs to establish exchange-set limits no higher than the level set by the Commission. This is not a new requirement, and merely restates the applicable requirement in DCM Core Principle 5.[1616]

Final § 150.5(a)(2) authorizes DCMs to grant exemptions from such limits and is generally consistent with current industry practice. The Commission has determined that codifying such practice establishes important, minimum standards needed for DCMs to administer – and the Commission to oversee – an effective and efficient program for granting exemptions to exchange-set limits in a manner that does not undermine the Federal position limits framework.[1617]

In particular, § 150.5(a)(2) protects market integrity and prevents exchange-granted exemptions from undermining the Federal position limits framework by requiring DCMs to either conform their exemptions to the type the Commission would grant under final §§ 150.3 or 150.9, or to cap the exemption at the applicable Federal position limit level and to assess whether an exemption request would result in a position that is "not in

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[1615] *See infra* Section IV.A.6.

[1616] *See* Commission regulation § 38.300 (restating DCMs' statutory obligations under the CEA 5(d)(5), 7 U.S.C. 7(d)(5)). Accordingly, the Commission will not discuss any costs or benefits related to this proposed change since it merely reflects an existing regulatory and statutory obligation.

[1617] This standard is substantively consistent with current market practice. *See, e.g.*, CME Rule 559 (providing that CME will consider, among other things, the "applicant's business needs and financial status, as well as whether the positions can be established and liquidated in an orderly manner . . .") and ICE Rule 6.29 (requiring a statement that the applicant's "positions will be initiated and liquidated in an orderly manner . . ."). This standard is also substantively similar to existing § 150.5's standard and is not intended to be materially different. *See* existing § 150.5(d)(1) (an exemption may be limited if it would not be "in accord with sound commercial practices or exceed an amount which may be established and liquidated in orderly fashion.") 17 CFR 150.5(d)(1).

accord with sound commercial practices" or would "exceed an amount that may be established or liquidated in an orderly fashion in that market."

Absent other factors, this element of the Final Rule could potentially increase compliance costs for traders since each DCM could establish different exemption-related rules and practices. However, to the extent that rules and procedures currently differ across exchanges, any compliance-related costs and benefits for traders may already be realized. Similarly, absent other provisions, a DCM could hypothetically seek a competitive advantage by offering excessively permissive exemptions, which could allow certain market participants to utilize exemptions in establishing sufficiently large positions to engage in excessive speculation and to manipulate market prices. However, final § 150.5(a)(2) mitigates these risks by requiring that exemptions that do not conform to the types the Commission may grant under final § 150.3 cannot exceed final § 150.2's applicable Federal position limit unless the Commission has first approved such exemption. Moreover, before a DCM could permit a new exemption category, final § 150.5(e) requires a DCM to submit rules to the Commission allowing for such exemptions, allowing the Commission to ensure that the proposed exemption type would be consistent with applicable requirements, including with the requirement that any resulting positions would be "in accord with sound commercial practices" and may be "established and liquidated in an orderly fashion."

Final § 150.5(a)(2) additionally requires traders to re-apply to the exchange at least annually for the exchange-level exemption. The Commission recognizes that requiring traders to re-apply annually could impose additional costs on traders that are not currently required to do so. However, the Commission believes this is industry practice among existing market participants, who are likely already familiar with DCMs'

exemption processes.[1618] This familiarity should reduce related costs, and the Final Rule should strengthen market integrity by ensuring that DCMs receive updated information related to a particular exemption.

The Commission received various comments pertaining to § 150.5(a)(2). CMC requested that the Commission clarify that each exchange has discretion to determine what information is required of applicants when applying for a spread exemption from exchange-set limits.[1619] As noted in the 2020 NRPM, exchanges have discretion to determine what information is required of applicants applying for a spread exemption, or any other exemption from exchange-set limits, except for instances where the exchange is processing a non-enumerated bona fide hedge applications in accordance with the applications requirements of § 150.9.[1620] This flexibility permits exchanges to further mitigate costs and/or burdens associated with the exemption process by adopting protocols that leverage existing processes with which their participants are already familiar.

CMC also requested that the Commission clarify that an exchange is not responsible for monitoring the use of spread positions for purposes of Federal position limits.[1621] Exchanges are required to administer and monitor their position limits and any exemptions therefrom in accordance with DCM Core Principle 5 and SEF Core Principle 6, as applicable.[1622] For an inter-market spread exemption where part of the spread position is executed on another exchange or over the counter, exchanges are encouraged to request information from the spread exemption applicant about the entire composition of the spread position.[1623] Even though an exchange is not responsible for monitoring a

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[1618] As noted above, the Commission believes this requirement is consistent with current market practice. *See, e.g.*, CME Rule 559 and ICE Rule 6.29. While ICE Rule 6.29 merely requires a trader to "submit to [ICE Exchange] a written request" without specifying how often a trader must reapply, the Commission understands from informal discussions between Commission staff and ICE that traders must generally submit annual updates.

[1619] CMC at 7.

[1620] 85 FR 11644 (explaining that exchanges have flexibility to establish the application process as they see fit).

[1621] CMC at 7.

[1622] *See supra* Section II.D.3.ii.c.

[1623] *See id.*

trader's position on other exchanges, it is beneficial to the exchange to obtain this information so it is best informed about whether to grant the exemption. The Commission notes while an exchange may incur costs through requesting information from (or providing information to) another exchange, these costs already may have been realized by exchanges to the extent they reflect existing market practice. Similarly, such information sharing benefits market integrity, but such benefits likewise already may have been realized.

Final § 150.5(a)(4) requires a DCM to provide the Commission with certain monthly reports regarding the disposition of any exemption application, including the recognition of any position as a bona fide hedge, the exemption of any spread transaction or other position, the revocation or modification or previously granted recognitions or exemptions, or the rejection of any application, as well as certain related information similar to the information that applicants must provide the Commission under final § 150.3 or an exchange under final § 150.9, including underlying cash-market and swap-market information related to bona fide hedge positions. The Commission generally recognizes that this monthly reporting requirement could impose additional costs on exchanges, although the Commission also has determined that this requirement would assist with the Commission's oversight functions and therefore benefit market integrity. The Commission discusses this proposed requirement in greater detail in its discussion of final § 150.9.[1624]

Further, while existing § 150.5(d) does not explicitly address whether traders should request an exemption prior to taking on its position, final § 150.5(a)(2), in contrast, explicitly authorizes (but does not require) DCMs to permit traders to file a retroactive exemption request due to "demonstrated sudden or unforeseen increases in its bona fide hedging needs," but only within five business days after the trade and as long

[1624] *See supra* Section IV.A.5.b.ii. (discussing monthly exchange-to-Commission report in final § 150.5(a)).

as the trader provides a supporting explanation.[1625] As noted above, these provisions are largely consistent with existing market practice, and to this extent, the benefits and costs already may have been realized by DCMs and market participants.

b. Pre-existing Positions

Final § 150.5(a)(3) requires DCMs to impose exchange-set position limits on "pre-existing positions," other than pre-enactment swaps and transition period swaps.[1626] The Commission believes that this approach benefits market integrity since pre-existing positions that exceed spot-month limits could result in market or price disruptions as positions are rolled into the spot month.[1627]

The Commission is alleviating the burden associated with final 150.5(a)(3) by delaying the compliance date to allow exchanges sufficient time to implement the Final Rule.

iii. Physical Commodity Derivative Contracts Not Subject to Federal Position Limits Under the Final Rule (Final § 150.5(b))

a. Spot Month Limits and Related Acceptable Practices

For cash-settled contracts during the spot month, existing § 150.5 sets forth the following qualitative standard: exchange-set limits should be "no greater than necessary to minimize the potential for market manipulation or distortion of the contract's or underling commodity's price." However, for physically-settled contracts, existing § 150.5 provides a one-size-fits-all parameter that exchange limits must be no greater than 25% of EDS.

In contrast, the standard for setting spot month limit levels for physical commodity derivative contracts not subject to Federal position limits set forth in final

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[1625] Certain exchanges currently allow for the submission of exemption requests up to five business days after the trader established the position that exceeded a limit in certain circumstances. *See, e.g.*, CME Rule 559 and ICE's "Guidance on Position Limits" (Mar. 2018).

[1626] Final § 150.1 defines "pre-existing position" to mean "any position in a commodity derivative contract acquired in good faith prior to the effective date" of any applicable position limit.

[1627] The Commission is particularly concerned about protecting the spot month in physical-delivery futures from corners and squeezes.

§ 150.5(b)(1) does not distinguish between cash-settled and physically-settled contracts, and instead requires DCMs to apply the existing § 150.5 qualitative standard to both.[1628] The Commission also provides a related, non-exclusive acceptable practice that deems exchange-set position limits for both cash-settled and physically-settled contracts subject to § 150.5(b) to be in compliance if the limits are no higher than 25% of the spot-month EDS.

Applying the existing § 150.5 qualitative standard and non-exclusive acceptable practice in final 150.5(b)(1), rather than a one-size-fits-all regulation, to both cash-settled and physically-settled contracts during the spot month is expected to enhance market integrity by permitting a DCM to establish a more tailored, product-specific approach by applying other parameters that may take into account the unique liquidity and other characteristics of the particular market and contract, which is not possible under the one-size-fits-all 25% of EDS parameter set forth in existing § 150.5. While the Commission recognizes that the existing 25% of EDS parameter has generally worked well, the Commission also recognizes that there may be circumstances where other parameters may be preferable and just as effective, if not more, including, for example, if the contract is cash-settled or does not have a reasonably accurate measurable deliverable supply, or if the DCM can demonstrate that a different parameter would better promote market integrity or efficiency for a particular contract or market.

On the other hand, the Commission recognizes that final § 150.5(b)(1) could adversely affect market integrity by theoretically allowing DCMs to establish excessively high position limits in order to gain a competitive advantage, which also could harm the

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[1628] Final § 150.5(b)(1) requires DCMs to establish position limits for spot-month contracts at a level that is "necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index." Existing § 150.5 also distinguishes between "levels at designation" and "adjustments to levels," although each category similarly incorporates the qualitative standard for cash-settled contracts and the 25% metric for physically-settled contracts. Final § 150.5(b) eliminates this distinction. The Commission intends the final § 150.5(b)(1) standard to be substantively the same as the existing § 150.5 standard for cash-settled contracts, except that under final § 150.5(b)(1), the standard applies to physically-settled contracts.

integrity of other markets that offer similar products.[1629] However, the Commission believes these potential risks are mitigated since (i) final § 150.5(e) requires DCMs to submit proposed position limits to the Commission, which will review those rules for compliance with § 150.5(b), including to ensure that the proposed limits are "in accord with sound commercial practices" and that they may be "established and liquidated in an orderly fashion"; and (ii) final § 150.5(b)(3) requires DCMs to adopt position limits for any new contract at a "comparable" level to existing contracts that are substantially similar (*i.e.*, "look-alike contracts") on other exchanges unless the exchange listing the new contracts demonstrates to the satisfaction of Commission staff, in their product filing with the Commission, how its levels comply with the requirements of § 150.5(b)(1) and (2). Moreover, this latter requirement also may reduce the amount of time and effort needed for the DCM and Commission staff to assess proposed limits for any new contract that competes with another DCM's existing contract.

b. Non-Spot Month Limits/Accountability Levels and Related Acceptable Practices

Existing § 150.5 provides one-size-fits-all levels for non-spot month contracts and allows for position accountability after a contract's initial listing only for those contracts that satisfy certain trading thresholds.[1630] In contrast, for contracts outside the spot-month, final § 150.5(b)(2) requires DCMs to establish either position limits or position accountability levels that satisfy the same proposed qualitative standard discussed above for spot-month contracts.[1631] For DCMs that establish position limits, final Appendix F to part 150 sets forth related acceptable practices that provide non-exclusive parameters that are generally consistent with existing § 150.5's parameters for non-spot month

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[1629] Since the existing § 150.5 framework already applies the proposed qualitative standard to cash-settled spot-month contracts, any new risks resulting from the proposed standard would occur only with respect to physically-settled contracts, which are currently subject to the one-size-fits-all 25% EDS parameter under the existing framework.

[1630] As noted above, in establishing the specific metric, existing § 150.5 distinguishes between "levels at designation" and "adjustments to [subsequent] levels." Final § 150.5(b)(2) eliminates this distinction and applies the qualitative standard for all non-spot month position limit and accountability levels.

[1631] DCM Core Principle 5 requires DCMs to establish either position limits or accountability for speculators. *See* Commission regulation § 38.300 (restating DCMs' statutory obligations under the CEA 5(d)(5)). Accordingly, inasmuch as final § 150.5(b)(2) requires DCMs to establish position limits or accountability, the Final Rule does not represent a change to the status quo baseline requirements.

contracts.[1632] For DCMs that establish position accountability, § 150.1's definition of "position accountability" provides that a trader must reduce its position upon a DCM's request, which is generally consistent with existing § 150.5's framework, but does not distinguish between trading volume or contract type, like existing § 150.5. While DCMs are provided the ability to decide whether to use limit levels or accountability levels for any such contract, under either approach, the DCM has to set a level that is "necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index."

One commenter alternatively recommended that § 150.5(b)(2) should require exchanges to set position limits *and* position accountability levels outside of the spot month at levels that reduce the potential threat of market manipulation or price distortion and the potential for sudden or unreasonable fluctuations or unwarranted changes.[1633] For the reasons more fully discussed below, the Commission believes that outside the spot-month, either exchange-set position limits or exchange-set accountability levels are sufficient for exchanges to reduce these potential threats.

Proposed § 150.5(b)(2) benefits market efficiency by authorizing DCMs to determine whether position limits or accountability is best-suited outside of the spot month based on the DCM's knowledge of its markets. For example, position accountability could improve liquidity compared to position limits since liquidity providers may be more willing or able to participate in markets that do not have hard

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[1632] Specifically, the acceptable practices in final Appendix F to part 150 provides that DCMs are deemed to comply with final § 150.5(b)(2)(i) qualitative standard if they establish non-spot limit levels no greater than any one of the following: (1) based on the average of historical positions sizes held by speculative traders in the contract as a percentage of open interest in that contract; (2) the spot month limit level for that contract; (3) 5,000 contracts (scaled up proportionally to the ratio of the notional quantity per contract to the typical cash-market transaction if the notional quantity per contract is smaller than the typical cash-market transaction, or scaled down proportionally if the notional quantity per contract is larger than the typical cash-market transaction); or (4) 10% of open interest in that contract for the most recent calendar year up to 50,000 contracts, with a marginal increase of 2.5% of open interest thereafter. These parameters have largely appeared in existing § 150.5 for many years in connection with non-spot month limits, either for levels at designation, or for subsequent levels, with certain revisions. For example, while existing § 150.5(b)(3) has provided a limit of 5,000 contracts for energy products, existing § 150.5(b)(2) provides a limit of 1,000 contracts for physical commodities other than energy products. The acceptable practice parameters in final Appendix F create a uniform standard of 5,000 contracts for all physical commodities. The Commission expects that the 5,000 contract acceptable practice, for example, is a useful rule of thumb for exchanges because it allows them to establish limits and demonstrate compliance with Commission regulations in a relatively efficient manner, particularly for new contracts that have yet to establish open interest. The spot month limit level under item (2) above is a new parameter for non-spot month contracts.

[1633] Better Markets at 47-48.

limits. As discussed above, DCMs are well-positioned to understand their respective markets, and best practices in one market may differ in another market, including due to different market participants or liquidity characteristics of the underlying commodities. For DCMs that choose to establish position limits, the Commission believes that applying the final § 150.5 qualitative standard to contracts outside the spot-month benefits market integrity by permitting a DCM to establish a more tailored, product-specific approach by applying other tools that may take into account the unique liquidity and other characteristics of the particular market and contract, which is not possible under the existing § 150.5 specific parameters for non-spot month contracts. While the Commission recognizes that the existing parameters may have been well-suited to market dynamics when initially promulgated, the Commission also recognizes that open interest may have changed for certain contracts subject to final § 150.5(b), and open interest will likely continue to change in the future (*e.g.*, as new contracts may be introduced and as supply and/or demand may change for underlying commodities). In cases where open interest has not increased, the exchange may not need to change existing limit levels. But, for contracts where open interest has increased, the exchange is able to raise its limits to facilitate liquidity consistent with an orderly market. However, the Commission reiterates that the specific parameters in the acceptable practices set forth in final Appendix F to part 150 are merely non-exclusive examples, and an exchange is be able to establish higher (or lower) limits, provided the exchange submits its proposed limits to the Commission under final § 150.5(e) and explains how its proposed limits satisfy the qualitative standard and are otherwise consistent with all applicable requirements.

The Commission, however, recognizes that final § 150.5(b)(2) could adversely affect market integrity by potentially allowing DCMs to establish position accountability levels rather than position limits, regardless of whether the contract exceeds the volume-based thresholds provided in existing § 150.5. However, final § 150.5(e) requires DCMs

to submit any proposed position accountability rules to the Commission for review, and the Commission will determine on a case-by-case basis whether such rules satisfy regulatory requirements, including the proposed qualitative standard. Similarly, in order to gain a competitive advantage, DCMs could theoretically set excessively high accountability (or position limit) levels, which also could potentially adversely affect markets with similar products. However, the Commission believes these risks are mitigated since (i) final § 150.5(e) requires DCMs to submit proposed position accountability (or limits) to the Commission, which will review those rules for compliance with § 150.5(b), including to ensure that the exchange's proposed accountability levels (or limits) are "necessary and appropriate to reduce the potential threat of market manipulation or price distortion" of the contract or underlying commodity; and (ii) final § 150.5(b)(3) requires DCMs to adopt position limits for any new contract at a "comparable" level to existing contracts that are substantially similar on other exchanges unless the exchange listing the new contracts demonstrates to the satisfaction of Commission staff, in their product filing with the Commission, how its levels comply with the requirements of § 150.5(b)(1) and (2).

c. Exchange-Set Limits on Economically Equivalent Swaps

As discussed above, swaps that qualify as "economically equivalent swaps" are subject to the Federal position limits framework. However, the Commission has determined to permit exchanges to delay enforcing their respective exchange-set position limits on economically equivalent swaps at this time. Specifically, with respect to exchange-set position limits on swaps, the Commission notes that in two years (which generally coincides with the compliance date for economically equivalent swaps), the Commission will reevaluate the ability of exchanges to establish and implement appropriate surveillance mechanisms to implement DCM Core Principle 5 and SEF Core Principle 6. However, after the swap compliance period (January 1, 2023), the

Commission underscores that it will enforce Federal position limits in connection with OTC swaps.

Nonetheless, the Commission's determination to permit exchanges to delay implementing exchange-set position limits on swaps could incentivize market participants to leave the futures markets and instead transact in economically equivalent swaps, which could reduce liquidity in the futures and related options markets, which could also increase transaction and hedging costs. Delaying position limits on swaps therefore could harm market participants, especially end-users that do not transact in swaps, if many participants were to shift trading from the futures to the swaps markets. In turn, end-users could pass on some of these increased costs to the public at large.[1634] However, the Commission believes that these concerns are mitigated to the extent the Commission still oversees and enforces Federal position limits even if the exchanges are not be required to do so.

iv. Position Aggregation

Final § 150.5(d) requires all DCMs that list physical commodity derivative contracts to apply aggregation rules that conform to existing § 150.4, regardless of whether the contract is subject to Federal position limits under § 150.2.[1635] The Commission believes final § 150.5(d) benefits market integrity in several ways. First, a harmonized approach to aggregation across exchanges that list physical commodity derivative contracts prevents confusion that could result from divergent standards between Federal position limits under § 150.2 and exchange-set limits under § 150.5(b).

[1634] On the other hand, the Commission has not seen any shifting of liquidity to the swaps markets – or general attempts at market manipulation or evasion of Federal position limits – with respect to the nine legacy core referenced futures contracts, even though swaps currently are not subject to Federal or exchange position limits.

[1635] The Commission adopted final aggregation rules in 2016 under existing §150.4, which applies to contracts subject to Federal position limits under § 150.2. *See* Final Aggregation Rulemaking, 81 FR at 91454. Under the Final Aggregation Rulemaking, unless an exemption applies, a person's positions must be aggregated with positions for which the person controls trading or for which the person holds a 10% or greater ownership interest. The Division of Market Oversight has issued time-limited no-action relief from some of the aggregation requirements contained in that rulemaking. *See* CFTC Letter No. 19-19 (July 31, 2019), available at https://www.cftc.gov/csl/19-19/download. Commission regulation § 150.4(b) sets forth several permissible exemptions from aggregation. The Commission, outside the Final Rule, will separately consider comments related to the Final Aggregation Rulemaking and codification of NAL 19-19.

As a result, final §150.5(d) provides uniformity, consistency, and reduced administrative burdens for traders who are active on multiple trading venues and/or trade similar physical contracts, regardless of whether the contracts are subject to § 150.2's Federal position limits. Second, a harmonized aggregation policy eliminates the potential for DCMs to use excessively permissive aggregation policies as a competitive advantage, which would impair the effectiveness of the Commission's aggregation policy and position limits framework. Third, since, for contracts subject to Federal position limits, final § 150.5(a) requires DCMs to set position limits at a level not higher than that set by the Commission under final § 150.2, differing aggregation standards could effectively lead to an exchange-set limit that is higher than that set by the Commission. Accordingly, harmonizing aggregation standards reinforces the efficacy and intended purpose of final §§ 150.2 and 150.5 and existing § 150.4 by eliminating DCMs' ability to circumvent the applicable Federal aggregation and position limits rules.

To the extent a DCM currently is not applying the Federal aggregation rules in existing § 150.4, or similar exchange-based rules, final § 150.5(d) could impose costs with respect to market participants trading referenced contracts for the 16 new commodities that are subject to Federal position limits for the first time. Market participants are required to update their trading and compliance systems to ensure they comply with the new aggregation rules.

7. Section 15(a) Factors[1636]

i. Protection of Market Participants and the Public

A chief purpose of speculative position limits is to preserve the integrity of derivatives markets for the benefit of commercial interests, producers, and other end-users that use these markets to hedge risk and of consumers that consume the underlying

[1636] The discussion here covers the Final Rule amendments that the Commission has identified as being relevant to the areas set out in section 15(a) of the CEA: (i) Protection of market participants and the public; (ii) efficiency, competitiveness, and financial integrity of futures markets; (iii) price discovery; (iv) sound risk management practices; and (v) other public interest considerations. For amendments that are not specifically addressed, the Commission has not identified any effects.

commodities. As discussed above, the Commission believes that the final position limits regime operates to deter excessive speculation and manipulation, such as corners and squeezes, which might impair the contract's price discovery function and liquidity for bona fide hedgers – and ultimately, protects the integrity and utility of the commodity markets for the benefit of both producers and consumers.

The Commission is including 25 core referenced futures contracts, as well as any referenced contracts directly or indirectly linked thereto, within the final Federal position limits framework. In selecting the 25 core referenced futures contracts, the Commission analyzed (1) the importance of these contracts to the operation of the underlying cash commodity market, including that they require physical delivery; and (2) the importance of the underlying commodity to the economy as a whole. As discussed above, the Commission is of the view that evidence demonstrating one or both of these factors is sufficient to establish that position limits are necessary because each factor relates to the statutory objective identified in CEA section 4a(a)(1).[1637]

Of particular importance in the Commission's position limit regime are the limits on the spot month, because the Commission believes that deterring and preventing manipulative behaviors, such as corners and squeezes, is more urgent during this period. The spot month position limits are designed, among other things, to deter and prevent corners and squeezes, as spot months are more susceptible to such activities than non-spot months, as well as promote a more orderly liquidation process at expiration.[1638] By restricting derivatives positions to a proportion of the deliverable supply of the commodity, the spot month position limits reduce the possibility that a market participant can use derivatives to affect the price of the cash commodity (and vice versa).[1639] Limiting a speculative position based on a percentage of deliverable supply also restricts

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[1637] *See supra* Section III.C. (discussing the necessity findings as to the 25 core referenced futures contacts).
[1638] *See supra* Sections II.A.19 and II.B.3.iii.
[1639] *See supra* Section II.B.3.iii.

a speculative trader's ability to establish a leveraged position in cash-settled derivative contracts, diminishing that trader's incentive to manipulate the cash settlement price. As the Commission has determined in the preamble, excessive speculation or manipulation during the spot month may cause sudden or unreasonable fluctuations or unwarranted changes in the price of the commodities underlying these contracts.[1640] In this way, the Commission believes that the limits in the Final Rule benefit market participants that seek to hedge the spot price of a commodity at expiration, and benefit consumers who are able to purchase underlying commodities for which prices are determined by fundamentals of supply and demand, rather than influenced by excessive speculation, manipulation, or other undue and unnecessary burdens on interstate commerce.

The Commission believes that the Final Rule's Commission and exchange-centric processes for granting exemptions from Federal position limits, including non-enumerated bona fide hedging recognitions, help ensure the hedging utility of the derivatives markets for commercial end-users.

First, the Final Rule allows exchanges to leverage existing processes and their knowledge of their own markets, including participant positions and activities, along with their knowledge of the underlying commodity cash market, which should allow for more timely review of exemption applications than if the Commission were to conduct such initial application reviews. This benefits the public by allowing producers and end-users of a commodity to more efficiently and predictably hedge their price risks, thus controlling costs that might be passed on to the public.

Second, exchanges may be better-suited than the Commission to leverage their knowledge of their own markets, including participant positions and activities, along with their knowledge of the underlying commodity cash market, in order to recognize whether an applicant qualifies for an exemption and what the level for that exemption should be.

[1640] *See supra* Section III.C. (discussing the necessity finding).

This benefits market participants and the public by helping assure that exemption levels are set in a manner that meets the risk management needs of the applicant without negatively impacting the derivative and cash market for that commodity.

Third, allowing for self-effectuating spread exemptions for purposes of Federal position limits could improve liquidity in all months for a listed contract or across commodities, benefitting hedgers by providing tighter bid-ask spreads for out-right trades. Furthermore, traders using spreads can arbitrage price discrepancies between calendar months within the same commodity contract or price discrepancies between commodities, helping ensure that futures prices more accurately reflect the underlying market fundamentals for a commodity.

Lastly, the Commission will review each application for bona fide hedge recognitions (other than those bona fide hedges that would be self-effectuating under the Final Rule), but the Final Rule allows the Commission to also leverage the exchange's knowledge and experience of its own markets and market participants discussed above for market participants that applies to the Commission by first submitting the application for a non-enumerated bona fide hedge exemption to the exchange for purposed of exchange-set limits under final § 150.9. Similarly, the Commission will review each application for a spread exemption that is not covered by the spread transaction definition and therefore is not self-effectuating for purposes of Federal position limits.

The Commission also understands that there are costs to market participants and the public to setting position limit levels that are too high or too low. If the levels are set too high, there's greater risk of excessive speculation, which may harm market participants and the public. Further, to the extent that the limits are set at such a level that even without these proposed exemptions, the probability of nearing or breaching such levels may be negligible for most market participants, benefits associated with such exemptions may be reduced.

Conversely, if the limits are set too low, transaction costs for market participants who are near or above the limit will rise as they transact in other instruments with higher transaction costs to obtain their desired level of speculative positions. Additionally, limits that are too low could incentivize speculators to leave the market and be unavailable to provide liquidity for hedgers, resulting in "choppy" prices. It is also possible for limits that are set too low to harm market efficiency because the views of some speculators might not be reflected fully in the price formation process.

In setting the final Federal position limit levels, the Commission considered these factors in order to implement to the maximum extent practicable, as it finds necessary in its discretion, to apply the position limits framework articulated in CEA section 4a(a) to set Federal position limits to protect market integrity and price discovery, thereby benefiting market participants and the public.

ii. Efficiency, Competitiveness, and Financial Integrity of Futures Markets

Position limits help to prevent market manipulation or excessive speculation that may unduly influence prices at the expense of the efficiency and integrity of markets. The Final Rule's expansion of the Federal position limits regime to 25 core referenced futures contracts (*e.g.*, the existing nine legacy agricultural contracts and the 16 new contracts) enhances the buffer against excessive speculation historically afforded exclusively to the nine legacy agricultural contracts, improving the financial integrity of those markets. Moreover, the limits in final § 150.2 may promote market competitiveness by preventing a trader from gaining too much market power in the respective markets.

Also, in the absence of position limits, market participants may be deterred from participating in a particular market if the market participants perceive that there is a participant with an unusually large speculative position exerting what they believe is

unreasonable market power. A lack of participation may harm liquidity, and consequently, may harm market efficiency.

On the other hand, traders who find position limits overly constraining may seek to trade in substitute instruments in order to meet their demand for speculative instruments. The substitute instruments could be futures contracts or swaps that are similar to or highly correlated with their corresponding core referenced futures contracts (but not otherwise deemed to be referenced contracts). They could also be trade options or other forward contracts. These traders may also decide to not trade beyond the Federal speculative position limit.

Trading in substitute instruments may be less effective than trading in referenced contracts. For example, the trading of futures contracts has strong safeguards since futures contracts are by definition exchange-traded, which includes (1) the posting of initial and variation margin and (2) credit reviews and guarantees by futures commission merchants. These safeguards protect the integrity of futures markets but are generally not required for forward transactions, which are generally not traded on exchanges or centrally cleared. Forward contract nonperformance may result in dislocations in the physical marketing channel, which may lead to higher prices for consumers and end users and otherwise impose burdens on commerce. Further, with the use of substitute instruments, futures prices might not fully reflect all the speculative demand to hold the futures contract, because substitute instruments may not fully influence prices the same way that trading directly in the futures contract does. Thus, market efficiency and price discovery might be harmed, too.

The Commission believes that focusing on the 25 core referenced futures contracts (included any referenced contracts linked thereto), which generally have high levels of open interest and trading volume and/or have been subject to existing Federal position limits for many years, should, in general, be less disruptive for the respective

derivatives markets, which in turn may reduce the potential for disruption for the price discovery function of the underlying commodity markets as compared to including less liquid contracts (only to the extent that the Commission is able to make the requisite necessity finding for such contracts).

Finally, the Commission believes that eliminating certain risk management positions as bona fide hedges, coupled with the increased non-spot month limit levels for most of the nine legacy agricultural contracts, will foster competition among swap dealers by subjecting all market participants, including all swap dealers, to the same non-spot month limit rather than limited staff-granted risk management exemptions. Accommodating risk management activity by additional entities with higher position limit levels may also help lessen the concentration risk potentially posed by a few commodity index traders holding exemptions that are not available to competing market participants.

iii. Price Discovery

As discussed above, market manipulation may result in artificial or distorted prices.[1641] Similarly, excessive speculation may result in "sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity."[1642] Position limits may help to prevent the price discovery function of the underlying commodity markets from being disrupted.[1643] Also, in the absence of position limits, market participants might elect to trade less as a result of a perception that the market pricing does not reflect market forces, as a consequence of what they perceive is the exercise of too much market power by a concentration of several or one larger speculator. This reduced trading may result in a reduction in liquidity, which may have a negative impact on price discovery.

[1641] *See supra* Section II.A.16. (discussing the referenced contract definition).
[1642] *See supra* Section III.A. (discussing the necessity finding).
[1643] *Id*.

On the other hand, imposing position limits raises the concerns that liquidity and price discovery may be diminished, because certain market segments, *i.e.*, speculative traders, are restricted. For certain commodities, the Final Rule sets the levels of position limits at increased levels, to avoid harming liquidity that may be provided by speculators that would establish large positions, while restricting speculators from establishing extraordinarily large positions. The Commission further believes that the bona fide hedging recognition and exemption processes will foster liquidity and potentially improve price discovery by making it more efficient for market participants to apply for bona fide hedging recognitions and spread exemptions.

In addition, position limits may serve as a prophylactic measure that reduces market volatility due to a participant otherwise engaging in large quantity trades in a short time interval that induce price impacts that interfere with price discovery. In particular, spot month position limits make it more difficult to mark the close of a futures contract to possibly benefit other contracts that settle on the closing futures price. Marking the close harms markets by spoiling convergence between futures prices and spot prices at expiration and by damaging price discovery.

iv. Sound Risk Management Practices

The Final Rule promotes sound risk management practices by providing exemptions for bona fide hedgers to hedge their corresponding risk. In addition, the Commission crafted the Final Rule to ensure sufficient market liquidity for bona fide hedgers to the maximum extent practicable, *e.g.*, by: (1) creating a bona fide hedging definition that is broad enough to accommodate common commercial hedging practices, including anticipatory hedging, for a variety of commodity types; (2) maintaining the status quo with respect to existing bona fide hedge recognitions and spread exemptions that will remain self-effectuating and make additional bona fide hedges and spreads self-effectuating (*i.e.*, certain anticipatory hedging); (3) providing additional ability for a

streamlined process where market participants can make a single submission to an exchange in which the exchange and Commission will each review applications for non-enumerated bona fide hedge recognitions for purposes of Federal and exchange-set limits that are in line with commercial hedging practices; and (4) allowing for a conditional spot month limit exemption in natural gas.

To the extent that monitoring for position limits requires market participants to create internal risk limits and evaluate position size in relation to the market, position limits may also provide an incentive for market participants to engage in sound risk management practices. Further, sound risk management practices will be promoted by the Final Rule to allow for market participants to measure risk in the manner most suitable for their business (*i.e.*, net versus gross hedging practices), rather than having to conform their hedging programs to a one-size-fits-all standard that may not be suitable for their risk management needs. Finally, generally increasing non-spot month limit levels for the nine legacy agricultural contracts to levels that reflect observed levels of trading activity, based on recent data reviewed by the Commission, should allow swap dealers, liquidity providers, market makers, and others who have risk management needs, but who are not hedging a physical commercial, to soundly manage their risks.

v. Other Public Interest

The Commission has not identified any additional public interest considerations related to the costs and benefits of this Final Rule.

B. Paperwork Reduction Act

1. Overview

Certain provisions of the Final Rule amend or impose new "collection of information" requirements as that term is defined under the Paperwork Reduction Act ("PRA").[1644] An agency may not conduct or sponsor, and a person is not required to

[1644] 44 U.S.C. 3501 *et seq*.

respond to, a collection of information unless it displays a valid control number from the Office of Management and Budget ("OMB"). The Final Rule modifies the following existing collections of information previously approved by OMB and for which the Commodity Futures Trading Commission ("Commission") has received control numbers: (i) OMB control number 3038-0009 (Large Trader Reports), which generally covers Commission regulations in parts 15 through 21; (ii) OMB control number 3038-0013 (Aggregation of Positions), which covers Commission regulations in part 150;[1645] and (iii) OMB control number 3038-0093 (Provisions Common to Registered Entities), which covers Commission regulations in part 40.

The Commission requested that OMB approve and revise OMB control numbers 3038-0009, 3038-0013, and 3038-0093 in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11.

2. Commission Reorganization of OMB Control Numbers 3038-0009 and 3038-0013

The Commission requested two non-substantive changes so that all collections of information related solely to the Commission's position limit requirements are consolidated under one OMB control number.[1646] First, the Commission is transferring collections of information under part 19 (Reports by Persons Holding Bona Fide Hedge Positions and By Merchants and Dealers in Cotton) related to position limit requirements from OMB control number 3038-0009 to OMB control number 3038-0013. Second, the modified OMB control number 3038-0013 is renamed as "Position Limits." This renaming change is non-substantive and allows for all collections of information related

[1645] Currently, OMB control number 3038-0013 is titled "Aggregation of Positions." The Commission is renaming the OMB control number "Position Limits" to better reflect the nature of the information collections covered by that OMB control number.

[1646] The Commission notes that certain collections of information under OMB control number 3038-0093 relate to several Commission regulations in addition to the Commission's final position limits framework. As a result, the collections of information discussed herein under this OMB control number 3038-0093 are not being consolidated under OMB control number 3038-0013.

to the Federal position limits requirements, including exemptions from speculative position limits and related large trader reporting, to be housed in one collection.

A single collection makes it easier for market participants to know where to find the relevant position limits PRA burdens. The remaining collections of information under OMB control number 3038–0009 cover reports by various entities under parts 15, 17, and 21[1647] of the Commission's regulations, while OMB control number 3038–0013 holds collections of information arising from parts 19 and 150.

As discussed in Section 3 below, this non-substantive reorganization results in: (i) a decreased burden estimate under control number 3038-0009 due to the transfer of the collection of information arising from obligations in part 19; and (ii) a corresponding increase of the amended part 19 burdens under control number 3038-0013. However, as discussed further below, the collection of information and burden hours arising from revised part 19 that is transferred to OMB control number 3038-0013 is less than the existing burden estimate under OMB control number 3038-0009 since the Final Rule amends existing part 19 by eliminating existing Form 204 and certain parts of Form 304 and the reporting burdens related thereto. As a result, market participants will see a net reduction of collections of information and burden hours under revised part 19.

3. Collections of Information

The Final Rule amends existing regulations, and creates new regulations, concerning speculative position limits. Among other amendments, the Final Rule includes: (1) new and amended Federal spot-month limits for the 25 core referenced futures contracts; (2) amended Federal non-spot limits for the nine legacy agricultural contracts subject to existing Federal position limits; (3) amended rules governing exchange-set limit levels and grants of exemptions therefrom; (4) an amended process for

[1647] As noted above, OMB control number 3038-0009 generally covers Commission regulations in parts 15 through 21. However, it does not cover §§ 16.02, 17.01, 18.04, or 18.05, which are under OMB control number 3038-0103. 78 FR at 69200 (transferring §§ 16.02, 17.01, 18.04, and 18.05 to OMB Control Number 3038-0103).

requesting certain spread exemptions and non-enumerated bona fide hedge recognitions for purposes of Federal position limits directly from the Commission; (5) a new streamlined process for recognizing non-enumerated bona fide hedge positions from Federal limit requirements; and (6) amendments to part 19 and related provisions that eliminate certain reporting obligations that require traders to submit a Form 204 and Parts I and II of Form 304.

Specifically, the Final Rule amends parts 15, 17, 19, 40, and 150 of the Commission's regulations to implement the revised Federal position limits framework. The Final Rule also transfers an amended version of the "bona fide hedging transactions or positions" definition from existing § 1.3 to final § 150.1, and removes §§ 1.47, 1.48, and 140.97. The Final Rule revises existing collections of information covered by OMB control number 3038-0009 by amending part 19,[1648] along with conforming changes to part 15, in order to narrow the scope of who is required to report under part 19.[1649]

Furthermore, the Final Rule's amendments to part 150 revise existing collections of information covered by OMB control number 3038-0013, including new reporting and recordkeeping requirements related to the application and request for relief from Federal position limit requirements submitted to exchanges. Finally, the Final Rule amends part 40 to incorporate a new reporting obligation into the definition of "terms and conditions" in § 40.1(j) and results in a revised existing collection of information covered by OMB control number 3038-0093.

i. OMB Control Number 3038-0009 – Large Trader Reports; Part 19 – Reports by Persons Holding Bona Fide Hedge Positions and by Merchants and Dealers in Cotton

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[1648] *See supra* Section IV.B.2 (discussing the transfer of information collection under part 19 from OMB control number 3038-0009 to 3038-0013).

[1649] As noted above, the Commission accomplishes this by eliminating existing Form 204 and Parts I and II of Form 304. Additionally, changes to part 17, covered by OMB control number 3038-0009, make conforming amendments to remove certain duplicative provisions and associated information collections related to aggregation of positions, which are in existing § 150.4. These conforming changes do not impact the burden estimates of OMB control number 3038-0009.

Under OMB control number 3038-0009, the Commission currently estimates that the collections of information related to existing part 19, including Form 204 and Form 304, collectively known as the "series '04" reports, have a combined annual burden hours of 1,553 hours. Under existing part 19, market participants that hold *bona fide* hedging positions in excess of position limits for the nine legacy agricultural contracts subject to existing Federal position limits must file a monthly report on Form 204 (or Parts I and II of Form 304 for cotton). These reports show a snapshot of traders' cash positions on one given day each month, and are used by the Commission to determine whether a trader has sufficient cash positions to justify futures and options on futures positions above the applicable Federal position limits in existing § 150.2.

The Final Rule amends part 19 to remove these reporting obligations associated with Form 204 and Parts I and II of Form 304. As discussed under final § 150.9 below, the Commission has determined to eliminate these forms because the Commission will still receive adequate information to carry out its market and financial surveillance programs since its amendments to §§ 150.5 and 150.9 enable the Commission to obtain the necessary information from the exchanges. To effect these changes to traders' reporting obligations, the Commission is eliminating (i) existing § 19.00(a)(1), which requires the applicable persons to file a Form 204; and (ii) existing § 19.01, which among other things, sets forth the cash-market information required to be submitted on Forms 204 and 304.[1650] The Commission is maintaining Part III of Form 304, which requests information on unfixed-price "on call" purchases and sales of cotton and which the Commission utilizes to prepare its weekly cotton on-call report.[1651] The Commission is also maintaining its existing special call authority under part 19.

[1650] As noted above, the amendments to part 19 affect certain provisions of part 15 and § 17.00. Based on the elimination of Form 204 and Parts I and II of Form 304, as discussed above, the Commission is adopting conforming technical changes to remove related reporting provisions from (i) the "reportable position" definition in § 15.00(p); (ii) the list of "persons required to report" in § 15.01; and (iii) the list of reporting forms in § 15.02. These conforming amendments to part 15 do not impact the existing burden estimates.

[1651] The Commission is adopting a conforming technical change to Part III of Form 304 to require traders to identify themselves on the Form 304 using their Public Trader Identification Number, in lieu of the CFTC Code Number required on previous versions of the

The supporting statement for the current active information collection request for part 19 under OMB control number 3038-0009[1652] states that in 2014: (i) 135 reportable traders filed the series '04 reports (*i.e.*, Form 204 and Form 304 in the aggregate), (ii) totaling 3,105 series '04 reports, for a total of (iii) 1,553 burden hours.[1653] However, based on more current and recent 2019 submission data, the Commission has revised its existing estimates slightly higher for the series '04 reports under part 19:

F. *Form 204*: 50 monthly reports, for an annual total of 600 reports (50 monthly reports x 12 months = 600 total annual reports) and 300 annual burden hours (600 annual Form 204s submitted x 0.5 hours per report = 300 aggregate annual burden hours for all Form 204s).

G. *Form 304*: 55 weekly reports, for an annual total of 2,860 reports (55 weekly reports x 52 weeks = 2,860 total annual reports) and 1,430 annual burden hours (2,860 annual Form 304s submitted x 0.5 hours per report = 1,430 aggregate annual burden hours for all Form 304s).

Accordingly, based on the above revised estimates, the Commission is revising its estimate of the current collections of information under existing part 19 to reflect that approximately 105 reportable traders[1654] file a total of 3,460 responses annually[1655] resulting in an aggregate annual burden of 1,730 hours.[1656,1657] The Final Rule reduces the current OMB control number 3038-0009 by these revised burden estimates under part 19 as they will be transferred to OMB control number 3038-0013.

With respect to the overall collections of information transferred to OMB control number 3038-0013 based on the Commission's revised part 19 estimate, the Commission estimates that the Final Rule reduces the collections of information in part 19 by

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Form 304. However, the Commission has determined that this does not result in any change to its existing PRA estimates with respect to the collections of information related to Part III of Form 304.

[1652] *See* ICR Reference No: 201906-3038-008.

[1653] 3,105 Series '04 submissions x 0.5 hours per submission = 1,553 aggregate burden hours for all submissions. The Commission notes that it has estimated that it takes approximately 20 minutes to complete a Form 204 or 304. However, in order to err conservatively, the Commission now uses a figure of 30 minutes.

[1654] 55 Form 304 reports + 50 Form 204 reports = 105 reportable traders.

[1655] 2,860 Form 304s + 600 Form 204s = 3,460 total annual series '04 reports.

[1656] 3,460 series '04 reports x 0.5 hours per report = 1,730 annual aggregate burden hours.

[1657] These revised estimates result in an increased estimate under existing part 19 of 355 series '04 reports submitted by traders (3,460 estimated series '04 reports – 3,105 submissions from the Commission's previous estimate = an increase of 355 response difference); an increase of 177 aggregate burden hours across all respondents (1,730 aggregate burden hours – 1,553 aggregate burden hours from the Commission's previous estimate = an increase of 177 aggregate burden hours); and a decrease of 30 respondent traders (105 respondents – 135 respondents from the Commission's previous estimate = a decrease of 30 respondents).

600 reports[1658] and by 300 annual aggregate burden hours since the Final Rule eliminates Form 204, as discussed above.[1659] The Commission does not expect a change in the number of reportable traders that are required to file Part III of Form 304.[1660] Thus, the Commission continues to expect approximately 55 weekly Form 304 reports, for an annual total of 2,860 reports[1661] for an aggregate total of 1,430 burden hours, which information collection burdens will be transferred to OMB control number 3038-0013.[1662]

In addition, the Commission is maintaining its authority to issue special calls for information to any person claiming an exemption from speculative Federal position limits. While the position limits framework expands to traders in the 25 core referenced futures contacts (an increase from the existing nine legacy agricultural products), the position limit levels themselves are also generally higher. The higher position limit levels result in a smaller universe of traders who may exceed the position limits and thus be subject to a special call for information on their large position(s). Taking into account the higher limits and smaller universe of traders who will likely exceed the position limits, the Commission estimates that it is likely to issue a special call for information to four reportable traders. The Commission estimates that it will take approximately five hours to respond to a special call. The Commission therefore estimates that industry will incur a total of 20 aggregate annual burden hours.[1663]

ii. OMB Control Number 3038-0013 – Aggregation of Positions (Renaming "Position Limits")

a. Introduction; Bona Fide Hedge Recognition and Exemption Process

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[1658] 50 monthly Form 204 reports x 12 months = 600 total annual reports.

[1659] 600 Form 204 reports x 0.5 burden hours per report = 300 aggregate annual burden hours.

[1660] Since the Final Rule eliminates Parts I and II of Form 304, amended Form 304 only refers to existing Part III of that form.

[1661] 55 weekly Form 304 reports x 52 weeks = 2,860 total annual Form 304 reports.

[1662] 2,860 Form 304 reports x 0.5 burden hours per report = 1,430 aggregate annual burden hours.

[1663] Four possible reportable traders x 5 hours each = 20 aggregate annual burden hours.

The Final Rule amends the existing process for market participants to apply to obtain an exemption or recognition of a bona fide hedge position. Currently, the "bona fide hedging transaction or position" definition appears in existing § 1.3. Under existing §§ 1.47 and 1.48, a market participant must apply directly to the Commission to obtain a bona fide hedge recognition in accordance with § 1.3 for Federal position limit purposes.

Final §§ 150.3 and 150.9 establish an amended process for obtaining a bona fide hedge exemption or recognition, which includes: (i) a new bona fide hedging definition in § 150.1, (ii) a new process administered by the exchanges in final § 150.9 for recognizing non-enumerated bona fide hedging positions for Federal limit requirements, and (iii) an amended process to apply directly to the Commission for certain spread exemptions or for recognition of non-enumerated bona fide hedging positions in final § 150.3. Final § 150.3 also includes new exemption types not explicitly listed in existing § 150.3.

The Commission has previously estimated the combined annual burden hours for submitting applications under both §§ 1.47 and 1.48 to be 42 hours.[1664] The Final Rule largely maintains the existing process where market participants may apply directly to the Commission, although the Commission expects market participants to predominantly rely on the streamlined process to obtain recognition of their non-enumerated bona fide hedging positions for purposes of Federal position limit requirements. Enumerated bona fide hedge positions remain self-effectuating, which means that market participants do not need to apply to the Commission for purposes of Federal position limits, although market participants still need to apply to an exchange for recognition of bona fide hedge positions for purposes of exchange-set position limits. The Commission expects market participants to rely on the streamlined exchange process because all the contracts that are

[1664] The supporting statement for a previous information collection request, ICR Reference No: 201808-3038-003, for OMB control number 3038-0013, estimated that seven respondents would file the §§ 1.47 and 1.48 submissions, and that each respondent would file two submissions for a total of 14 annual submissions, requiring 3 hours per response, for a total of 42 burden hours for all respondents.

now subject to Federal position limits are already subject to exchange-set limits. Thus, most market participants are likely to already be familiar with an exchange-administered process, as adopted under § 150.9. Familiarity with an exchange-administered process will result in operational efficiencies, such as completing one application for non-enumerated bona fide hedge requests for both Federal and exchange-set limits and thus a reduced burden on market participants.

As previously discussed, the Final Rule moves the "bona fide hedge transaction or position" definition to final § 150.1. The Final Rule maintains the distinction between enumerated and non-enumerated bona fide hedges, and market participants are required to apply for recognition of non-enumerated bona fide hedge positions either directly from the Commission pursuant to § 150.3 or through an exchange-centric process under § 150.9.[1665] The Commission does not believe that this amendment has any PRA impacts since it is maintaining the status quo in which enumerated bona fide hedges are self-effectuating while requiring traders to apply to the Commission or an exchange for recognition of non-enumerated bona fide hedge positions.

b. § 150.2 Speculative Limits

Under final § 150.2(f), upon request from the Commission, DCMs listing a core referenced futures contract are required to supply to the Commission deliverable supply estimates for each core referenced futures contract listed at that DCM. DCMs are only required to submit estimates if requested to do so by the Commission on an as-needed basis. When submitting estimates, DCMs are required to provide a description of the methodology used to derive the estimate, as well as any statistical data supporting the estimate. Appendix C to part 38 sets forth guidance regarding estimating deliverable supply.

[1665] Currently, in order to determine whether a futures or an option on futures as a bona fide hedge, either (1) the position in question must qualify as an enumerated bona fide hedge, as defined in existing § 1.3, or (2) the trader must file a statement with the Commission, pursuant to existing § 1.47 (for non-enumerated bona fide hedges) and/or existing § 1.48 (for enumerated anticipatory bona fide hedges). The Commission does not expect this change to have any PRA impacts.

Submitting deliverable supply estimates upon demand from the Commission for contracts subject to Federal position limits is a new reporting obligation for DCMs. The Commission estimates that six DCMs will be required to submit initial deliverable supply estimates. The Commission estimates that it will request each DCM that lists a core referenced futures contract to file one initial report for each core reference futures contract it lists on its market. Such requests from the Commission will result in one initial submission for each of the 25 core referenced futures contracts. The Commission further estimates that it will take 20 hours to complete and file each report for a total annual burden of 500 hours for all respondents.[1666] Accordingly, the changes to § 150.2(f) result in an initial, one-time increase to the current burden estimates of OMB control number 3038-0013 of 25 submissions across six respondent DCMs for the initial number of submissions for the 25 core referenced futures contracts and an initial, one-time burden of 500 hours.

c. § 150.3 Exemptions from Federal Position Limit Requirements

Market participants may currently apply directly to the Commission for recognition of certain bona fide hedges under the process set forth in existing §§ 1.47 and 1.48. There is no existing process that is codified under the Commission's regulations for spread exemptions or other exemptions included under final § 150.3.

Final § 150.3(a) specifies the circumstances in which a trader could exceed Federal position limits.[1667] With respect to non-enumerated bona fide hedge recognitions and spread exemptions not identified in the proposed "spread transaction" definition in § 150.1, final § 150.3(b) provides a process for market participants to request such non-enumerated bona fide hedge recognitions or spread exemptions directly from the

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[1666] 20 initial hours x 25 core referenced futures contracts = 500 one-time, aggregate burden hours. While there is an initial annual submission, the Commission does not expect to require the exchanges to resubmit the supply estimates on an annual basis.

[1667] Final § 150.3(b) includes (1) recognitions of bona fide hedges under § 150.3(b); (2) spread exemptions under § 150.3(b); (3) financial distress positions a person could request from the Commission under § 140.99(a)(1); and (4) exemptions for certain natural gas positions held during the spot month. Final § 150.3(b) also exempts pre-enactment and transition period swaps. The enumerated bona fide hedge recognitions and spread exemptions identified in the proposed "spread transaction" definition in § 150.1 are self-effectuating.

Commission (as previously noted, both enumerated bona fide hedges and spread exemptions identified in the proposed "spread transaction" definition are self-effectuating and do not require a market participant to submit an exemption request to the Commission). Final § 150.3(b), (d), and (e) sets forth exemption-related reporting and recordkeeping requirements that impact the current burden estimates in OMB control number 3038-0013.[1668] The collection of information under final § 150.3(b), (d) and (e) is necessary for the Commission to determine whether to recognize a trader's position qualifies for one of the exemptions from Federal position limit requirements listed in § 150.3(a).

Final § 150.3(b) establishes application filing requirements and recordkeeping and reporting requirements that are similar to existing requirements for bona fide hedge recognitions under existing §§ 1.47 and 1.48. Although these requirements in final § 150.3 are new for market participants seeking spread exemptions (which are currently self-effectuating), the filing, recordkeeping, and reporting requirements in § 150.3(b) are otherwise familiar to market participants that have requested certain bona fide hedging recognitions from the Commission under existing regulations.

The Commission estimates that very few or no traders will request recognition of a non-enumerated bona fide hedge, and any traders that do would likely prefer the streamlined process in final § 150.9 (discussed further below) rather than applying directly to the Commission under final § 150.3(b). Similarly, the Commission estimates that very few or no traders will submit a request for a spread exemption since the Commission has determined that the most common spread exemptions are included in the "spread transaction" definition and therefore are self-effectuating and do not need Commission approval for purposes of Federal position limits. The Commission expects

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[1668] Final § 150.3(f) clarifies the implications on entities required to aggregate accounts under § 150.4, and § 150.3(g) provides for delegation of certain authorities to the Director of the Division of Market Oversight. The changes to §§ 150.3(f) and 150.3(g) do not impact the current estimates for these OMB control numbers. Also, the Final Rule reminds persons of the relief provisions in § 140.99, covered by OMB control number 3038-0049, which does not impact the burden estimates.

that traders are likely to rely on the § 150.3(b) process when dealing with a spread transaction or non-enumerated bona fide hedge position that poses a novel or complex question under the Commission's rules. Particularly when the exchanges have not recognized a particular hedging strategy as a non-enumerated bona fide hedge previously, the Commission expects market participants to seek more regulatory clarity under § 150.3(b). In the event a trader submits such request under § 150.3, the Commission estimates that traders would file one request per year for a total of one annual request for all respondents. The Commission further estimates that in such situation, it would take 20 hours to complete and file each report, for a total of 20 aggregate annual burden hours for all traders.

Final § 150.3(d) establishes recordkeeping requirements for persons who claim any exemptions or relief under § 150.3. Section 150.3(d) should help to ensure that if any person claims any exemption permitted under § 150.3 such exemption holder can demonstrate compliance with the applicable requirements as follows:

First, under § 150.3(d)(1), any person claiming an exemption is required to keep and maintain complete books and records concerning certain details.[1669] Section 150.3(d)(1) establishes recordkeeping requirements for any person relying on an exemption permitted under final § 150.3(a). Under § 150.3(d), the Commission estimates that 425 traders will create five records each, per year, for a total of 2,125 annual records for respondents. The Commission further estimates that it will take one hour to comply with the recordkeeping requirement of § 150.3(d)(1) for a total of five aggregate annual burden hours for each trader.

Second, under § 150.3(d)(2), a pass-through swap counterparty, as defined by § 150.1, that relies on a written representation received from a bona fide hedging swap

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[1669] The requirement includes all details of related cash, forward, futures, options on futures, and swap positions and transactions (including anticipated requirements, production, merchandising activities, royalties, contracts for services, cash commodity products and by-products, cross-commodity hedges, and records of bona fide hedging swap counterparties).

counterparty that the swap qualifies in good faith as a "bona fide hedging position or transaction," as defined under § 150.1, is required to: (i) maintain the relevant books and records of any such written representation for at least two years following the expiration of the swap; and (ii) furnish any books and records of such written representation to the Commission upon request. Section 150.3(d)(2) creates a new recordkeeping obligation for certain persons relying on the pass-through swap representations, and the Commission estimates that 425 traders will be requested to maintain the required records. The Commission estimates that each trader will maintain at least five records per year for a total of 2,125 aggregate annual records for all respondents. The Commission further estimates that it will take one hour to comply with the recordkeeping requirement of § 150.3(d) for a total of five annual burden hours for each trader and 2,125 aggregate annual burden hours for all traders.

The Commission is moving existing § 150.3(b), which currently allows the Commission or certain Commission staff to make special calls to demand certain information regarding persons claiming exemptions, to final § 150.3(e), with some modifications to include swaps.[1670] Together with the recordkeeping provision of § 150.3(d), § 150.3(e) should enable the Commission to monitor the use of exemptions from speculative position limits and help to ensure that any person who claims any exemption permitted by § 150.3 can demonstrate compliance with the applicable requirements. The Commission's existing collection under existing § 150.3 estimated that the Commission issues two special calls per year for information related to exemptions, and that each response to a special call for information takes 3 burden hours to complete. This includes two burden hours to fulfill reporting requirements and one burden hour related to recordkeeping for an aggregate total for all respondents of six

[1670] Final § 150.3(e) refers to commodity derivative contracts, whereas existing § 150.3(b) refers to futures and options on futures. The change results in the inclusion of swaps.

annual burden hours, broken down into four aggregate annual burden hours for reporting and two aggregate annual burden hours for recordkeeping.[1671]

The Commission estimates that § 150.3(e) imposes information collection burdens related to special calls by the Commission on approximately 18 additional respondents, for an estimated 20 special calls per year.[1672] The Commission estimates that these 20 market participants will provide one submission per year to respond to the special call for a total of 20 annual submissions for all respondents. The Commission estimates it will take a market participant approximately 10 hours to complete a response to a special call. Therefore, the Commission estimates responses to special calls for information will take an aggregate total of 200 burden hours for all traders.[1673] The Commission notes that it is also maintaining its special call authority for reporting requirements under part 19 discussed above.

d. § 150.5 Exchange-Set Limits and Exemptions

Amendments to § 150.5 refine the process, and establish non-exclusive methodologies, by which exchanges may set exchange-level limits and grant exemptions therefrom, including separate methodologies for setting limit levels for contracts subject to Federal position limits (§ 150.5(a)) and physical commodity derivatives not subject to Federal position limits (§ 150.5(b)).[1674] In compliance with part 40 of the Commission's regulations, exchanges currently have policies and procedures in place to address exemptions from exchange-set limits through their rulebooks. The Commission expects that the exchanges will accordingly update their rulebooks, both to conform to new

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[1671] The special call authority under part 19 and the special call authority discussed under § 150.3 are similar in nature; however, part 19 applies to special calls regarding bona fide hedge recognitions and related underlying cash-market positions while the special calls under § 150.3 applies to the other exemptions under § 150.3.

[1672] 2 respondents subject to special calls under existing § 150.3 + 18 additional respondents under final § 150.3 = 20 total respondents. The Commission estimates, at least during the initial implementation period, that it is likely to issue more special calls for information to monitor compliance with position limits, particularly in the commodity markets that will now be subject to Federal position limits for the first time.

[1673] 20 special calls x 10 burden hours per call = 200 total burden hours.

[1674] Final § 150.5 addresses exchange-set position limits and exemptions therefrom, whereas final § 150.9 addresses Federal position limits and a streamlined process for purposes of Federal position limits where an applicant may apply through an exchange to the Commission for recognition of an non-enumerated bona fide hedge for purposes of Federal position limits.

requirements and to incorporate the additional contracts that are subject to Federal position limits for the first time into their process for setting exchange-level limits and exemptions therefrom.

The collections of information related to amended rulebooks under part 40 are covered by OMB control number 3038-0093. Separately, the collections of information related to applications for exemptions from exchange-set limits are covered by OMB control number 3038-0013.

Under final § 150.5(a)(1), for any contract subject to a Federal position limit, DCMs and, ultimately, SEFs, will be required to establish exchange-set position limits for such contracts. Under final § 150.5(a)(2), exchanges that wish to grant exemptions from exchange-set limits on commodity derivative contracts subject to Federal position limits must require traders to file an application that shows a request for a bona fide hedge recognition or exemption conforms to a type that may be granted under final § 150.3(a)(1)-(4). Exchanges must require that such exchange-set limit exemption applications be filed in advance of the date such position would be in excess of the limits, but exchanges have the discretion to adopt rules allowing traders to file bona fide hedging applications within five business days after a trader took on such position due to sudden or unforeseen increases in the trader's bona fide hedging needs. Final § 150.5(a)(2) also provides that exchanges must require that the trader reapply for the exemption at least annually. Final § 150.5(a)(4) requires each exchange to provide a monthly report showing the disposition of any exemption application, including the recognition of any position as a bona fide hedge, the exemption of any spread transaction, the renewal, revocation, or modification of a previously granted recognition or exemption, or the rejection of any application.[1675]

[1675] Additionally, each report should include the following details: (A) The date of disposition; (B) The effective date of the disposition; (C) The expiration date of any recognition or exemption; (D) Any unique identifier(s) the designated contract market or swap execution facility may assign to track the application, or the specific type of recognition or exemption; (E) If the application is

These collections of information related to exemptions from exchange-set limits are necessary to ensure that such exchange-set limits comply with Commission regulations, including that exchange limits are no higher than the applicable Federal level; to establish minimum standards needed for exchanges to administer the exchange's position limits framework; and to enable the Commission to oversee an exchange's exemptions process to ensure it does not undermine the Federal position limits framework. In addition, the Commission will use the information to confirm that exemptions are granted and renewed in accordance with the types of exemptions that may be granted under final § 150.3(a)(1)-(4).

The Commission estimates under final § 150.5(a) that 425 traders will submit applications to claim spread exemptions and bona fide hedge recognitions from exchange-set position limits on commodity derivatives contracts subject to Federal position limits set forth in § 150.2. The Commission estimates that each trader on average will submit five applications to an exchange each year for a total of 2,125 applications for all respondents. The Commission further estimates that it will take two hours to complete and file each application for a total of 10 annual burden hours for each trader and 4,250 aggregate burden hours for all traders.[1676]

The Commission estimates under final § 150.5(a)(4) that six exchanges will provide monthly reports for an annual total of 72 monthly reports for all exchanges.[1677]

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for an enumerated bona fide hedging transaction or position, the name of the enumerated bona fide hedging transaction or position listed in Appendix A to this part; (F) If the application is for a spread transaction listed in the spread transaction definition in § 150.1, the name of the spread transaction as it is listed in § 150.1; (G) The identity of the applicant; (H) The listed commodity derivative contract or position(s) to which the application pertains; (I) The underlying cash commodity; (J) The maximum size of the commodity derivative position that is recognized by the designated contract market or swap execution facility as a bona fide hedging transaction or position, specified by contract month and by the type of limit as spot month, single month, or all-months-combined, as applicable; (K) Any size limitations or conditions established for a spread exemption or other exemption; and (L) For a bona fide hedging transaction or position, a concise summary of the applicant's activity in the cash markets and swaps markets for the commodity underlying the commodity derivative position for which the application was submitted.

[1676] To increase efficiency and reduce duplicative efforts, the Final Rule permits an exchange to have a single process in place that allows market participants to request non-enumerated bona fide hedge recognitions from both Federal and exchange-set position limits at the same time. The Commission believes that under a single process, the estimated burdens under final § 150.5(a) discussed in this section for exemptions from exchange-set limits includes the burdens under the Federal limit exemption process for non-enumerated bona fide hedges under final § 150.9 discussed below.

[1677] 6 exchanges x 12 months = 72 total monthly reports per year.

The Commission further estimates that it will take five hours to complete and file each monthly report for a total of 60 annual burden hours for each exchange and 360 annual burden hours for all exchanges.[1678]

Final § 150.5(b) requires exchanges, for physical commodity derivatives that are not subject to Federal position limits, to set limits during the spot month and to set either limits or accountability outside of the spot month. Under § 150.5(b)(3), where multiple exchanges list contracts that are substantially the same, including physically-settled contracts that have the same underlying commodity and delivery location, or cash-settled contracts that are directly or indirectly linked to a physically-settled contract, the exchange must either adopt "comparable" limits for such contracts, or demonstrate to the Commission how the non-comparable levels comply with the standards set forth in § 150.5(b)(1) and (2). Such a determination also must address how the levels are necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index. Final § 150.5(b)(3) is intended to help ensure that position limits established on one exchange do not jeopardize market integrity or otherwise harm other markets. This provision may also improve the efficiency with which exchanges adopt limits on newly-listed contracts that compete with an existing contract listed on another exchange and help reduce the amount of time and effort needed for Commission staff to assess the new limit levels. Further, § 150.5(b)(3) is consistent with the Commission's determination to generally apply equivalent Federal position limits to linked contracts, including linked contracts listed on multiple exchanges.

The Commission estimates that under § 150.5(b)(3), six exchanges will make submissions to demonstrate to the Commission how the non-comparable levels comply

[1678] 5 hours per monthly report x 12 months = 60 hours per year for each exchange. 60 annual hours x 6 exchanges = 360 aggregate annual hours for all exchanges.

with the standards set forth in § 150.5(b)(1) and (2). The Commission estimates that each exchange on average will make three submissions each year for a total of 18 submissions for all exchanges. The Commission further estimates that it will take 10 hours to complete and file each submission for a total of 18 annual burden hours for each exchange and 180 burden hours for all exchanges.[1679]

Final § 150.5(b)(4) permits exchanges to grant exemptions from any exchange limit established for physical commodity contracts not subject to Federal position limits. To grant such exemptions, exchanges must require traders to file an application to show whether the requested exemption from exchange-set limits is in accord with sound commercial practices in the relevant commodity derivative market and/or that may be established and liquidated in an orderly fashion in that market. This collection of information is necessary to confirm that any exemptions granted from exchange limits on physical commodity contracts not subject to Federal position limits do not pose a threat of market manipulation or congestion, and maintains orderly execution of transactions. The Commission estimates that 200 traders will submit one application each year and that each application will take approximately two hours to complete, for an aggregate total of 400 burden hours per year for all traders.

Final § 150.5(e) reflects that, consistent with the definition of "rule" in existing § 40.1, any exchange action establishing or modifying position limits or exemptions therefrom, or position accountability, in any case pursuant to § 150.5(a), (b), or (c), including related guidance in Appendices F or G, to part 150, qualifies as a "rule" and must be submitted to the Commission pursuant to part 40 of the Commission's regulations. Final § 150.5(e) further provides that exchanges are required to review regularly any position limit levels established under § 150.5 to ensure the level continues to comply with the requirements of those sections. The Commission estimates under §

[1679] 18 estimated annual submissions x 10 burden hours per submission = 180 aggregate annual burden hours.

150.5(e) that six exchanges will submit revised rulebooks to satisfy their compliance obligations under part 40. The Commission estimates that each exchange on average will make one initial revision of its rulebook to reflect the new position limit framework for a total of six applications for all exchanges. The Commission further estimates that it will take 30 hours to revise a rulebook for a total of 30 annual burden hours for each exchange and 180 burden hours for all exchanges.[1680]

This collection of information is necessary to ensure that the exchanges' rulebooks reflect the most up-to-date rules and requirements in compliance with the position limits framework. The information is used to confirm that exchanges are complying with their requirements to regularly review any position limit levels established under § 150.5.

e. § 150.9 Exchange Process for Bona Fide Hedge Recognitions from Federal Position Limits

Final § 150.9 establishes a new streamlined process in which a trader could apply through an exchange to request a non-enumerated bona fide hedging recognition for purposes of Federal position limits. As part of the process, final § 150.9 creates certain recordkeeping and reporting obligations on the market participant and the exchange, including: (i) an application to request non-enumerated bona fide hedge recognitions, which the trader submits to the exchange and which the exchange subsequently provides to the Commission if the exchange approves the application for purposes of exchange-set limits; (ii) a notification to the Commission and the applicant of the exchange's determination for purposes of exchange limits regarding the trader's request for recognition of a bona fide hedge or spread exemption; (iii) and a requirement to maintain full, complete and systematic records for Commission review of the exchange's decisions. The Commission believes that the exchanges that will elect to process

[1680] 6 initial applications x 30 burden hours = 180 initial aggregate burden hours.

applications for non-enumerated bona fide hedging exemptions under § 150.9(a) already have similar processes for the review and disposition of such exemption applications in place through their rulebooks for purposes of exchange-set position limits.

Accordingly, the estimated burden on an exchange to comply with final § 150.9 will be less burdensome because the exchanges may leverage their existing policies and procedures to comply with the Final Rule. The Commission estimates that six exchanges will elect to process applications for non-enumerated bona fide hedge recognitions that satisfy the Federal position limit requirements under final § 150.9, and will be required to file amended rulebooks pursuant to part 40 of the Commission's regulations. The Commission bases its estimate on the number of exchanges that have submitted similar rules to the Commission in the past.

Final § 150.9(c) requires a trader to submit an application with certain information to enable the exchange to determine whether it should recognize a position as a bona fide hedge for purposes of exchange-set position limits. Each applicant will need to reapply to the exchange for its non-enumerated bona fide hedge recognition at least on an annual basis by updating its original application. The Commission expects that traders will benefit from the streamlined framework established under final § 150.9 because traders may submit one application to obtain a non-enumerated bona fide hedge recognition for purposes of both exchange-set and Federal position limits, as opposed to submitting separate applications to the Commission for Federal position limit purposes and separate applications to an exchange for exchange limit purposes.[1681]

Accordingly, the estimated burden for traders requesting non-enumerated bona fide hedge recognitions from exchange-set limits under § 150.5(a) will subsume the

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[1681] The Commission believes the collections of information set forth above are necessary for the exchange to process requests for recognition of non-enumerated bona fide hedges for purposes of exchange-set position limits, and separately, if applicable, for the Commission to make its determination for purposes of Federal position limits. The information is used by the exchange to determine, and the Commission to review and determine, whether the facts and circumstances demonstrate it is appropriate to recognize a position as a non-enumerated bona fide hedging transaction or position.

burden estimates in connection with final § 150.9 for requesting non-enumerated bona fide hedge recognition's from Federal position limits since the Commission believes exchanges will combine the two processes (*i.e.*, any trader who applies through an exchange under final § 150.9 for a non-enumerated bona fide hedge for Federal position limits purposes also will be deemed to be applying at the same time under final § 150.5(a) for exchange position limits purposes and thus it would not be appropriate to distinguish between the two for PRA purposes). Accordingly, the Commission anticipates that six exchanges each will receive only one application for a non-enumerated bona fide hedge recognition under final § 150.9 for a total of six aggregate annual applications for all exchanges; however, as noted above, this amount is included in the Commission's estimate in connection with final § 150.5(a).[1682] Specifically, as discussed above in connection with final § 150.5(a), the Commission estimates under final §§ 150.5(a) and 150.9(a) that 425 traders will submit applications to claim exemptions and/or bona fide hedge recognitions for contracts subject to Federal position limits as set forth in § 150.2.[1683]

Final § 150.9(d) requires exchanges to keep full, complete, and systematic records, including all pertinent data and memoranda, of all activities relating to the processing of such applications and the disposition thereof. In addition, as provided for in final § 150.9(g) and existing § 1.31, the Commission may, in its discretion, at any time,

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[1682] As discussed above, the process and estimated burdens under final § 150.9 do not apply to § 150.5(b) because final § 150.5(b) applies to those physical commodity contracts that are not subject to Federal position limits (as opposed to final § 150.5(a), which applies to those contracts subject to Federal position limits). As a result, a trader that would use the process established under § 150.5(b) for exchange-set limits will not need to apply under final § 150.9 since the traders would not need a bona fide hedge recognition or an exemption from Federal position limits.

[1683] As discussed in connection with final § 150.5(a) above, the Commission estimates that each trader on average will make five applications each year for a total of 2,125 applications across all exchanges. The Commission further estimates that, for final §§ 150.5(a) and 150.9(a), taken together, it will take two hours to complete and file each application for a total of 10 annual burden hours for each trader and 4,250 aggregate annual burden hours for all traders (2,125 total annual applications x two burden hours per application = 4,250 aggregate annual burden hours). The Commission anticipates that compared to final § 150.5(a), fewer traders will apply under final § 150.9 since final §150.9 applies only to non-enumerated bona fide hedge recognitions for Federal purposes. In comparison, while final § 150.5 encompasses these same applications for non-enumerated bona fide hedge recognitions (but for the purpose of exchange-set limits), final § 150.5(a) also includes enumerated bona fide hedge applications along with spread exemption requests. The Commission's estimate of 4,250 aggregate annual burden hours encompasses all such requests from all traders. However, for the sake of clarity, the Commission anticipates that six exchanges each will receive one application per year for a non-enumerated bona fide hedge under final § 150.9 (for a total of six applications across all exchanges); as noted, this burden is included in the Commission's estimate of 425 respondents in connection with its estimate under final § 150.5(a).

review the exchange's records retained pursuant to final § 150.9(d) or request additional information pursuant to § 150.9(e)(5). The recordkeeping requirement is necessary for the Commission to review the exchanges' processes, retention of records, and compliance with requirements established and implemented under this section.

Final § 150.9(d) creates a new recordkeeping obligation consistent with the standards in existing § 1.31.[1684] The Commission estimates that six exchanges will each create one record in connection with final § 150.9 each year for a total of six annual records for all respondents. The Commission further estimates that it will take five hours to comply with the recordkeeping requirement of § 150.9(d) for a total of five annual burden hours for each exchange and 30 aggregate annual burden hours across all exchanges.

Final § 150.9(d) allows the Commission to inspect such books and records.[1685] In the event the Commission exercises its authority to inspect such books and records, it estimates that the Commission will conduct an inspection of two exchanges per year and each exchange will incur four hours to make its books and records available to the Commission for review for a total of eight aggregate annual burden hours for the two estimated respondent exchanges.[1686]

Under final § 150.9(e), an exchange needs to provide an applicant and the Commission with notice of any approved application of an exchange's determination to recognize bona fide hedges with respect to its own position limits for purposes of exceeding the Federal position limits. The notification requirement is necessary to

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[1684] Consistent with existing § 1.31, the Commission expects that these records will be readily available during the first two years of the required five-year recordkeeping period for paper records, and readily accessible for the entire five-year recordkeeping period for electronic records. In addition, the Commission expects that records required to be maintained by an exchange pursuant to this section will be readily accessible during the pendency of any application, and for two years following any disposition that did not recognize a derivative position as a bona fide hedge.

[1685] Final § 150.9(d)(1) requires the exchange to keep full, complete, and systematic records, which include all pertinent data and memoranda, of all activities relating to the processing of such applications and the disposition thereof. This requirement working in concert with § 1.31 allows the Commission to inspect any such records. Separately, under § 150.9(e)(5), if the Commission determines additional information is required to conduct its review, then it would notify the exchange and the relevant market participant of any issues identified and provide them with an opportunity to provide supplemental information.

[1686] 2 exchanges per year subject to a Commission inspection x 4 hours per inspection request = 8 aggregate annual burden hours for all exchanges.

inform the Commission of the details of the type of bona fide hedge recognitions being granted. The information is used to keep the Commission informed as to the manner in which an exchange administers its application procedures, and the exchange's rationale for permitting large positions.

The Commission estimates that under final § 150.9(e), six exchanges will submit notifications of approved application of an exchange's determination to recognize non-enumerated bona fide hedges for purposes of exceeding the Federal position limits. The Commission estimates that each exchange on average will make two notifications: one notification each to the applicant trader and to the Commission each year for a total of 12 notices for all exchanges. The Commission further estimates that it will take 0.5 hours to complete and file each notification for a total of one annual burden hour for each exchange and six burden hours for all exchanges.[1687]

In addition to submitting a copy of any exchange-approved non-enumerated bona fide hedge application to the Commission under § 150.9(e), the preamble clarifies that an exchange may, on a voluntary basis, send the Commission an advance courtesy copy of the non-enumerated bona fide hedge application when the exchange first receives it from the applicant. Although this advance courtesy copy would be a voluntary submission, it is still considered a new information collection under the PRA. However, the Commission believes there is no corresponding burden for this filing because the Commission considers this practice to be in the ordinary course of business as it is usual and customary for exchanges to provide the Commission with advance copies of various filings under other Commission regulations.[1688] In the event that this practice is not considered usual and customary, the Commission estimates that the burden of such filing will be *de minimis* and take less than five minutes for an exchange to send an application

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[1687] Twelve notices for all exchanges x 0.5 hours per notice = six total burden hours across all exchanges.

[1688] For example, exchanges have frequently submitted advance courtesy copies of new rule filings and product filings to the Commission under the part 40 regulations.

to the Commission, if the exchange elects to do so (less than 30 total minutes in the aggregate across all exchanges: 6 exchanges x 1 advance copy x less than 5 minutes = less than 30 minutes).

iii. OMB Control Number 3038-0093 – Provisions Common to Registered Entities

a. § 150.9(a)

Under final § 150.9(a), exchanges that would like for their market participants to be able to exceed Federal position limits based on a non-enumerated bona fide hedge recognition granted by the exchange with respect to its own limits must maintain rules that establish processes consistent with the provisions of final § 150.9 and must seek approval of such rules from the Commission pursuant to § 40.5 of the Commission's regulations. The collection of information is necessary to capture the new non-enumerated bona fide hedge process in the exchanges' rulebook, which is subject to Commission approval. The information is used to assess the process put in place by each exchange submitting amended rulebooks.

The Commission has previously estimated the combined annual burden hours for both §§ 40.5 and 40.6 to be 7,000 hours.[1689] Upon implementation of final § 150.9, the Commission estimates that six exchanges will each make one initial § 40.5 rule filing per year for a total of six one-time initial submissions for all exchanges. The Commission further estimates that the exchanges will employ a combination of in-house and outside legal and compliance counsel to update existing rulebooks and it will take 25 hours to complete and file each rule for a total 25 one-time burden hours for each exchange and 150 one-time burden hours for all exchanges.

C. Regulatory Flexibility Act

[1689] The supporting statement for the current active information collection request, ICR Reference No: 201503-3038-002, for OMB control number 3038-0013, estimated that seven respondents would file the §§ 1.47 and 1.48 reports, and that each respondent would file two reports for a total of 14 annual responses, requiring three hour per response, for a total of 42 burden hours for all respondents.

The Regulatory Flexibility Act ("RFA") requires that agencies consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.[1690] 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).[1691] The requirements related to the Final Rule fall mainly on registered entities, exchanges, FCMs, swap dealers, clearing members, foreign brokers, and large traders. The Commission has previously determined that registered DCMs, FCMs, swap dealers, major swap participants, eligible contract participants, SEFs, clearing members, foreign brokers and large traders are not small entities for purposes of the RFA.[1692]

Further, while the requirements under this rulemaking may impact nonfinancial end users, the Commission notes that position limits levels apply only to large traders. Accordingly, the Chairman, on behalf of the Commission, hereby certifies, on behalf of the Commission, pursuant to 5 U.S.C. 605(b), that the actions taken herein will not have a significant economic impact on a substantial number of small entities.

The Chairman made the same certification in the 2013 Proposal,[1693] the 2016 Supplemental Proposal,[1694] the 2016 Reproposal,[1695] and the 2020 NPRM.[1696]

D. Antitrust Considerations

[1690] 44 U.S.C. 601 et seq.

[1684] 5 U.S.C. 601(2), 603-05.

[1692] *See* Policy Statement and Establishment of Definitions of ''Small Entities'' for Purposes of the Regulatory Flexibility Act, 47 FR 18618–19, (Apr. 30, 1982) (DCMs, FCMs, and large traders) (''RFA Small Entities Definitions''); Opting Out of Segregation, 66 FR 20740–20743, (Apr. 25, 2001) (eligible contract participants); Position Limits for Futures and Swaps; Final Rule and Interim Final Rule, 76 FR 71626, 71680, (Nov. 18, 2011) (clearing members); Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476, 33548, (Jun. 4, 2013) (SEFs); A New Regulatory Framework for Clearing Organizations, 66 FR 45604, 45609, (Aug. 29, 2001) (DCOs); Registration of Swap Dealers and Major Swap Participants, 77 FR 2613, Jan. 19, 2012, (swap dealers and major swap participants);and Special Calls, 72 FR 50209, (Aug. 31, 2007) (foreign brokers).

[1693] *See* 2013 Proposal, 78 FR at 75784.

[1694] *See* 2016 Supplemental Proposal, 81 FR at 38499.

[1695] *See* 2016 Reproposal, 81 FR at 96894.

[1696] *See* 2020 NPRM, 85 FR at 11708.

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA, in issuing any order or adopting any Commission rule or regulation.[1697] The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. In the Proposal, the Commission requested comments on whether: (1) the proposed rules could be anticompetitive; (2) there are other less anticompetitive means of deterring and preventing price manipulation or any other disruptions to market integrity; and (3) requiring DCOs to impose initial margin surcharges in lieu of imposing position limits is feasible.

The Commission does not anticipate that the position limits regime that it is adopting today will result in anticompetitive behavior. To the contrary, the Commission believes that the relatively high position limit levels (coupled with the numerous exemptions from position limits adopted as part of this rulemaking) do not establish any barriers to entry or competitive restraints. As noted above, the Commission encouraged comments from the public on any aspect of the rulemaking that may have the potential to be inconsistent with the antitrust laws or be anticompetitive in nature. The Commission received two (2) comments asserting that the proposed rule may be anticompetitive.

ICE commented that it has concerns regarding the potential anticompetitive aspects of the Commission's approach to aggregation of contracts across all exchanges rather than on a per exchange basis.[1698] In particular, ICE asserted that the aggregation of referenced contracts across all exchanges by the Commission fails to comply with the requirements of Section 15(b) of the CEA that requires the Commission take into consideration the public interest to be protected by the antitrust laws and endeavor to take

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[1697] 7 U.S.C. 19(b).

[1698] ICE at 12.

the least anticompetitive means of achieving the purposes of the CEA.[1699] ICE noted that an aggregated Federal position limit, across all exchanges, may make it very difficult for an exchange to launch a new contract or that would be aggregated with an existing contract for position limit purposes. In addition, ICE also indicated that launching a new exchange may even be more difficult given the aggregate approach to position limits across exchanges. The underlying basis for ICE's assertion is that aggregation may potentially reduce the ability of a new exchange or new contract to attract enough liquidity to become sustainable. ICE argued that a more flexible approach to aggregation of positions that allows each exchange to develop its own liquidity (and establish its own limits), even for similar or look-alike contracts, would better advance the goals of developing robust and liquid markets while providing adequate means to protect against excessive speculation.

Similarly, FIA commented that the Commission's aggregation of position limits across exchanges in connection with financially-settled reference contracts "will reduce innovation and competition between exchanges because any new proposed financially-settled referenced futures contracts will have to share the same liquidity pool with existing financially-settled referenced futures contracts, including economically-equivalent swaps."[1700] Instead, FIA argued that position limits should be established per designated contract spot month limits for financially-settled referenced contracts and a separate spot month limit should be established for economically-equivalent swaps in order to enhance competition, innovation and liquidity for bona fide hedgers.

As an initial legal matter, the Commission interprets CEA section 4a(a)(6) to generally require aggregated Federal position limits across exchanges. CEA section 4a(a)(6) requires the Commission to "establish limits . . . on the aggregate number or

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[1699] ICE believes that this is particularly true for cash-settled contracts and for other contracts outside of the delivery month.
[1700] FIA at p. 8.

amount of positions . . . across – (A) contracts listed by designated contract markets . . . ." Accordingly, even if the Commission were to grant ICE's claim *in arguendo* of possible anti-competitive affects, the requirement in CEA section 4a(a)(6) that Federal position limits should apply in the aggregate across exchanges is dispositive for the Commission's approach under the Final Rule.[1701]

As stated above in Section II.B.10 of the preamble, the Commission disagrees with comments by ICE and FIA asserting that generally the aggregation of cash-settled positions across exchanges would impair competition and provide a barrier to financial innovation. Both commenters essentially advocate for a disaggregated Federal position limit that applies on a per-exchange basis based on the notion that this will promote and attract greater liquidity to the markets regardless of the potential for manipulation and/or market disruption. In contrast to these commenters' concerns, the Commission submits that in general an aggregate position limit framework across exchanges should promote, not prohibit, competition and therefore enhance liquidity formation.[1702] The ability to apply the Federal position limits framework on a disaggregated basis would also significantly increase position limits so that the potential risk of excessive speculation and manipulation would become a much greater concern to the Commission based on the ability of market participants to hold larger positions in the aggregate across exchanges. Therefore, under the approach supported by ICE and FIA, the Commission would be required to re-adjust Federal position limits to a much lower level, potentially impacting liquidity and future financial innovation. The Commission also asserts that the application of the Federal position limit levels across exchanges promotes innovation and competition in the marketplace because the full aggregate position limit level is available

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[1701] As discussed in the preamble to this release, however, the Commission is making an exception under its exemptive authority for position limits in CEA section 4a(a)(7) for the NYMEX NG referenced contracts, which will be subject to a per-exchange position limit level, based on the unique liquidity characteristics of the natural gas markets.

[1702] The Commission believes that permitting Federal position limits to apply on a disaggregated, per-exchange basis also has the potential to further divide liquidity among several liquidity pools, which could make accessing liquidity for bona fide hedgers more difficult and reduce price discovery.

for market participants regardless of the particular trading venue/exchange, which, by definition, promotes greater competition and significant price discovery.

As noted in the 2020 NPRM and the preamble of this adopting release,[1703] the Commission is aware that exchanges may also have conflicting and competing interests in connection with the adoption of exchange position limits and accountability levels. Additionally, the final rules with respect to exchange-set position limits require any new commodity derivative contract to establish limits at a "comparable" level to existing contracts that are substantially similar (*i.e.*, "look-alike contracts") on other exchanges unless the exchange listing the new contract demonstrates to the satisfaction of Commission staff, in its product filing with the Commission, how its levels comply with the requirements of § 150.5(b)(1) and (2). This requirement could potentially provide competitive advantages to the "first mover" exchange since such exchange could effectively establish the position limit for all other exchanges that seek to list and trade substantially similar contracts.

Although the Commission acknowledges these competitive concerns, the Commission believes that these concerns are mitigated because (i) an exchange is required to submit any proposed position limits to the Commission under part 40 of the Commission's regulations and (ii) an exchange is required pursuant to § 150.5(b) to set limits that are necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index. In addition, for those commodity derivative contracts that are subject to a Federal speculative position limit under § 150.2, the limit set by the exchange can be no higher than Federal speculative position limit specified in § 150.2. The Commission believes that exchanges have significant incentives to maintain well-functioning markets to remain

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[1703] *See* 85 FR 11596, 11677 at fn. 576; *see also* Section II.G. (discussing the § 150.9 process and the role of the exchanges) and Section II.B.2 (discussing the role of exchanges in connection with non-spot month limits under § 150.2).

competitive with other exchanges. Market participants may choose exchanges that are less susceptible to sudden or unreasonable fluctuations or unwarranted changes caused by excessive speculation or corners, squeezes, and manipulation, which could, among other things, harm the price discovery function of the commodity derivative contracts and negatively impact the delivery of the underlying commodity, bona fide hedging strategies, and market participants' general risk management.[1704] Furthermore, several academic studies, including one concerning futures exchanges and another concerning demutualized stock exchanges, support the conclusion that exchanges are able to both satisfy shareholder interests and meet their self-regulatory organization responsibilities.[1705]

The Commission has determined that the position limit rules adopted today serve the regulatory purpose of the CEA "to deter and prevent price manipulation or any other disruptions to market integrity."[1706] In addition, the Commission notes that the adopted position limit rules implement additional purposes and policies set forth in section 4a(a) of the CEA.[1707] The Commission has considered the rulemaking and related comments to determine whether it is anticompetitive, and continues to believe that the position limits rulemaking will not result in any unreasonable restraint of trade or impose any material anticompetitive burden on trading in the markets.

Final Regulatory Text and Related Appendices

List of Subjects

17 CFR Part 1

[1704] Kane, Stephen, *Exploring price impact liquidity for December 2016 NYMEX energy contracts*, n.33, available at https://www.cftc.gov/sites/default/files/idc/groups/public/@economicanalysis/documents/file/oce_priceimpact.pdf.

[1705] *See* David Reiffen and Michel A. Robe, *Demutualization and Customer Protection at Self-Regulatory Financial Exchanges*, Journal of Futures Markets, Vol. 31, 126-164, Feb. 2011 (in many circumstances, an exchange that maximizes shareholder (rather than member) income has a greater incentive to aggressively enforce regulations that protect participants from dishonest agents); and Kobana Abukari and Isaac Otchere, *Has Stock Exchange Demutualization Improved Market Quality? International Evidence*, Review of Quantitative Finance and Accounting, Dec 09, 2019, https://doi.org/10.1007/s11156-019-00863-y (demutualized exchanges have realized significant reductions in transaction costs in the post-demutualization period).

[1706] Section 3(b) of the CEA, 7 U.S.C. 5(b).

[1707] 7 U.S.C. 7a(a) (burdens on interstate commerce; trading or position limits).

Agricultural commodity, Agriculture, Brokers, Committees, Commodity futures, Conflicts of interest, Consumer protection, Definitions, Designated contract markets, Directors, Major swap participants, Minimum financial requirements for intermediaries, Reporting and recordkeeping requirements, Swap dealers, Swaps.

17 CFR Part 15

Brokers, Commodity futures, Reporting and recordkeeping requirements, Swaps.

17 CFR Part 17

Brokers, Commodity futures, Reporting and recordkeeping requirements, Swaps.

17 CFR Part 19

Commodity futures, Cottons, Grains, Reporting and recordkeeping requirements, Swaps.

17 CFR Part 40

Commodity futures, Procedural rules, Reporting and recordkeeping requirements.

17 CFR Part 140

Authority delegations (Government agencies), Conflict of interests, Organizations and functions (Government agencies).

17 CFR Part 150

Bona fide hedging, Commodity futures, Cotton, Grains, Position limits, Referenced Contracts, Swaps.

17 CFR Part 151

Bona fide hedging, Commodity futures, Cotton, Grains, Position limits, Referenced Contracts, Swaps.

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 17 CFR chapter I as follows:

PART 1 – GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

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

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a-1, 7a-2, 7b, 7b-3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24 (2012).

§ 1.3 [Amended]

2. In § 1.3, remove the definition of the term "bona fide hedging transactions and positions for excluded commodities".

PART 15 – REPORTS – GENERAL PROVISIONS

3. The authority citation for part 15 continues to read as follows:

Authority: 7 U.S.C. 2, 5, 6a, 6c, 6f, 6g, 6i, 6k, 6m, 6n, 7, 7a, 9, 12a, 19, and 21, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

4. In § 15.00, revise paragraph (p)(1) to read as follows:

§ 15.00 Definitions of terms used in parts 15 to 19, and 21 of this chapter.

* * * * *

(p) * * *

(1) For reports specified in parts 17 and 18 and in § 19.00(a) and (b) of this chapter, any open contract position that at the close of the market on any business day equals or exceeds the quantity specified in § 15.03 in either:

(i) Any one futures of any commodity on any one reporting market, excluding futures contracts against which notices of delivery have been stopped by a trader or issued by the clearing organization of the reporting market; or

(ii) Long or short put or call options that exercise into the same futures contract of any commodity, or other long or short put or call commodity options that have identical expirations and exercise into the same commodity, on any one reporting market.

* * * * *

5. In § 15.01, revise paragraph (d) to read as follows:

§ 15.01 Persons required to report.

* * * * *

(d) Persons, as specified in part 19 of this chapter, who:

(1) Are merchants or dealers of cotton holding or controlling positions for future delivery in cotton that equal or exceed the amount set forth in § 15.03; or

(2) Are persons who have received a special call from the Commission or its designee under § 19.00(b) of this chapter.

* * * * *

6. Revise § 15.02 to read as follows:

§ 15.02 Reporting forms.

Forms on which to report may be obtained from any office of the Commission or via *https://www.cftc.gov*. Listed below are the forms to be used for the filing of reports. To determine who shall file these forms, refer to the Commission rule listed in the column opposite the form number.

Form No.	Title	Rule
40	Statement of Reporting Trader	18.04
71	Identification of Omnibus Accounts and Sub-accounts	17.01
101	Positions of Special Accounts	17.00
102	Identification of Special Accounts, Volume Threshold Accounts, and Consolidated Accounts	17.01
304	Statement of Cash Positions for Unfixed-Price Cotton "On Call"	19.00

(Approved by the Office of Management and Budget under control numbers 3038-0007, 3038-0009, 3038-0013, and 3038-0103.)

PART 17 – REPORTS BY REPORTING MARKETS, FUTURES COMMISSION MERCHANTS, CLEARING MEMBERS, AND FOREIGN BROKERS

7. The authority citation for part 17 continues to read as follows:

Authority: 7 U.S.C. 2, 6a, 6c, 6d, 6f, 6g, 6i, 6t, 7, 7a, and 12a.

8. In § 17.00, revise paragraph (b) introductory text to read as follows:

§ 17.00 Information to be furnished by futures commission merchants, clearing members and foreign brokers.

* * * * *

(b) *Interest in or control of several accounts.* Except as otherwise instructed by the Commission or its designee and as specifically provided in § 150.4 of this chapter, if any person holds or has a financial interest in or controls more than one account, all such accounts shall be considered by the futures commission merchant, clearing member, or foreign broker as a single account for the purpose of determining special account status and for reporting purposes.

* * * * *

9. In § 17.03, add paragraph (i) to read as follows:

§ 17.03 Delegation of authority to the Director of the Office of Data and Technology or the Director of the Division of Market Oversight.

* * * * *

(i) Pursuant to § 17.00(b), and as specifically provided in § 150.4 of this chapter, the authority shall be designated to the Director of the Office of Data and Technology to instruct a futures commission merchant, clearing member, or foreign broker to consider otherwise than as a single account for the purpose of determining special account status and for reporting purposes all accounts one person holds or controls, or in which the person has a financial interest.

10. Revise part 19 to read as follows:

PART 19 – REPORTS BY PERSONS HOLDING REPORTABLE POSITIONS IN EXCESS OF POSITION LIMITS, AND BY MERCHANTS AND DEALERS IN COTTON

Sec.
19.00 Who shall furnish information.
19.01 [Reserved]
19.02 Reports pertaining to cotton on call purchases and sales.
19.03 Delegation of authority to the Director of the Division of Enforcement.
19.04 – 19.10 [Reserved]
Appendix A to Part 19 – Form 304

Authority: 7 U.S.C. 6g, 6c(b), 6i, and 12a(5).

§ 19.00 Who shall furnish information.

(a) *Persons filing cotton-on-call reports.* Merchants and dealers of cotton holding or controlling positions for future delivery in cotton that are reportable pursuant to § 15.00(p)(1)(i) of this chapter shall file CFTC Form 304.

(b) *Persons responding to a special call.* All persons: exceeding speculative position limits under § 150.2 of this chapter; or holding or controlling positions for future delivery that are reportable pursuant to § 15.00(p)(1) of this chapter and who have received a special call from the Commission or its designee shall file any pertinent information as instructed in the special call. Filings in response to a special call shall be made within one business day of receipt of the special call unless otherwise specified in the call. Such filing shall be transmitted using the format, coding structure, and electronic data submission procedures approved in writing by the Commission.

§ 19.01 [Reserved]

§ 19.02 Reports pertaining to cotton on call purchases and sales.

(a) *Information required.* Persons required to file CFTC Form 304 reports under § 19.00(a) shall file CFTC Form 304 reports showing the quantity of call cotton bought or sold on which the price has not been fixed, together with the respective futures on which the purchase or sale is based. As used herein, call cotton refers to spot cotton bought or sold, or contracted for purchase or sale at a price to be fixed later based upon a specified future.

(b) *Time and place of filing reports.* Each CFTC Form 304 report shall be made weekly, dated as of the close of business on Friday, and filed not later than 9 a.m. Eastern Time on the third business day following that Friday using the format, coding structure, and electronic data transmission procedures approved in writing by the Commission.

§ 19.03 Delegation of authority to the Director of the Division of Enforcement.

(a) The Commission hereby delegates, until it orders otherwise, the authority in § 19.00(b) to issue special calls to the Director of the Division of Enforcement, or such other employee or employees as the Director may designate from time to time.

(b) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Enforcement, or such other employee or employees as the Director may designate from time to time, the authority in § 19.00(b) to provide instructions or to determine the format, coding structure, and electronic data transmission procedures for submitting data records and any other information required under this part.

(c) The Director of the Division of Enforcement may submit to the Commission for its consideration any matter which has been delegated in this section.

(d) Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

§§ 19.04 – 19.10 [Reserved]

Appendix A to Part 19 – Form 304

CFTC FORM 304

Statement of Cash Positions for Unfixed-Price

Cotton "On Call"

NOTICE: Failure to file a report required by the Commodity Exchange Act ("CEA" or the "Act")[1] and the regulations thereunder,[2] or the filing of a report with the Commodity Futures Trading Commission ("CFTC" or "Commission") that includes a false, misleading, or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both.

PRIVACY ACT NOTICE

The Commission's authority for soliciting this information is granted in sections 4i and 8 of the CEA and related regulations (*see, e.g.*, 17 CFR 19.02). The information solicited from entities and individuals engaged in activities covered by the CEA is required to be provided to the CFTC, and failure to comply may result in the imposition of criminal or administrative sanctions (*see, e.g.*, 7 U.S.C. 9 and 13a-1, and/or 18 U.S.C. 1001). The information requested is used by the Commission to prepare its cotton on-call report. The requested information may be used by the Commission in the conduct of investigations and litigation and, in limited circumstances, may be made public in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies and to contract markets to meet responsibilities assigned to them by law. The information will be maintained in, and any additional disclosures will be made in accordance with, the CFTC System of Records Notices, available on *www.cftc.gov*.

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

[2] Unless otherwise noted, the rules and regulations referenced in this notice are found in chapter I of title 17 of the Code of Federal Regulations; 17 CFR chapter I.

BACKGROUND & INSTRUCTIONS

Applicable Regulations:

- 17 CFR 19.00(a) specifies who shall file Form 304.
- 17 CFR 19.02(a) specifies the information required on Form 304.
- 17 CFR 19.02(b) specifies the frequency (weekly), the report date (close of business on Friday), and the time (9 a.m. Eastern Time on the third business day following that Friday) and manner, for filing the Form 304.

Please follow the instructions below to generate and submit the required filing. Relevant regulations are cited in parentheses () for reference. Unless the context requires otherwise, the terms used herein shall have the same meaning as ascribed in parts 15 to 21 of the Commission's regulations.

Complete Form 304 as follows:

The trader identification fields should be completed by all filers. This Form 304 requires traders to identify themselves using their Public Trader Identification Number, in lieu of the CFTC Code Number required on previous versions of the Form 304. This number is provided to traders who have previously filed Forms 40 or 102 with the Commission. Traders may contact the Commission to obtain this number if it is unknown. If a trader has a National Futures Association Identification Number ("NFA ID") and/or a Legal Entity Identifier ("LEI"), the trader should also identify itself using those numbers. Form 304 requires traders to identify the name of the reporting trader or firm and the contact information (including full name, address, phone number, and email address) for a natural person the Commission may contact regarding the submitted Form 304.

Merchants and dealers of cotton shall report on Form 304. Report in hundreds of 500-lb. bales unfixed-price cotton "on-call" pursuant to § 19.02(a) of the Commission's regulations. Include under "Call Purchases" stocks on hand for which price has not yet been fixed. For each

listed stock, report the delivery month, delivery year, quantity of call purchases, and quantity of call sales.

The signature/authorization page shall be completed by all filers. This page shall include the name and position of the natural person filing Form 304 as well as the name of the reporting trader represented by that person. The trader certifying this Form 304 on the signature/authorization page should note that filing a report that includes a false, misleading, or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 U.S.C. 1001) and (b) result in punishment by fine or imprisonment, or both.

Submitting Form 304: Once completed, please submit this form to the Commission pursuant to the instructions on *www.cftc.gov* or as otherwise directed by Commission staff. If submission attempts fail, the reporting trader shall contact the Commission at *techsupport@cftc.gov* for further technical support.

Please be advised that pursuant to 5 CFR 1320.5(b)(2)(i), you are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Public Trader ID No. [provided by CFTC]	OMB No. 3038-

MMODITY FUTURES TRADING COMMISSION

FORM 304

TEMENT OF CASH POSITIONS FOR UNFIXED-PRICE

COTTON "ON-CALL"

Identifying Information			
Identification Codes:			
NFA ID	Legal Entity Identifier (LEI)		
Name of Reporting Trader or Firm:			
Name of Person to Contact Regarding This Form:			
First Name	Middle Name	Last Name	
Contact Information:			
Address	Phone Number	Email Address	

E: Failure to file a report required by the Commodity Exchange Act ("CEA" or the "Act") and the regulations thereunder, or the
vith the Commodity Futures Trading Commission ("CFTC" or "Commission") that includes a false, misleading or fraudulent sta
naterial facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a viol
6(c)(2) of the Act (7 U.S.C. 9), section 9(a)(3) of the Act (7 U.S.C. 13(a)(3)), and/or section 1001 of Title 18, Crimes and Crim
.C. 1001) and (b) result in punishment by fine or imprisonment, or both. Please be advised that pursuant to 5 CFR 1320.5(b)(2)
d to respond to this collection of information unless it displays a currently valid OMB control number.

d-price Cotton "on-call" pursuant to § 19.02(a); include under "Call Purchases" stocks on hand for which price has not yet been

in hundreds of bales (500-lb. bales).

Delivery Month	Delivery Year	Call Purchases	Call Sal

		('00 bales)	('00 bal

CFTC Form 304 (XX-XX)

Previous Editions Obsolete

Please sign/authenticate the Form 304 prior to submitting.

Signature/ Electronic Authentication:

- ☐ By checking this box and submitting this form (or by clicking "submit," "send," or any other analogous transmission command if transmitting electronically), I certify that I am duly authorized by the reporting trader identified below to provide the information and representations submitted on this Form 304, and that to the best of my knowledge the information and representations made herein are true and correct.

Reporting Trader Authorized Representative (Name and Position):

_____ (Name)

_____ (Position)

Submitted on behalf of:

_____ (Reporting Trader Name)

Date of Submission: _____

CFTC Form 304 (XX-XX)

Previous Editions Obsolete

Form 304, Example – July 2020 Call purchases of 200 bales and sales of 1,800 bales; October Call purchases of 6,600 bales and sales of 8,000 bales.

Unfixed-price Cotton "on-call" pursuant to § 19.02(a); include under "Call Purchases" stocks on hand for which price has not yet been fixed. Report in hundreds of bales (500-lb. bales).			
Delivery Month	Delivery Year	Call Purchases ('00 bales)	Call Sales ('00 bales)
July	2020	2	18
October	2020	66	80

PART 40 – PROVISIONS COMMON TO REGISTERED ENTITIES

11. The authority citation for part 40 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 7, 7a, 8 and 12, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Pub. L. 111-203, 124 Stat. 1376 (2010).

12. In § 40.1, revise paragraphs (j)(1)(vii) and (j)(2)(vii) to read as follows:

§ 40.1 Definitions.

* * * * *

(j) * * *

(1) * * *

(vii) Speculative position limits, position accountability standards, and position reporting requirements, including an indication as to whether the contract meets the definition of a referenced contract as defined in § 150.1 of this chapter, and, if so, the name of either the core referenced futures contract or other referenced contract upon which the new referenced contract submitted under this part 40 is based.

* * * * *

(2) * * *

(vii) Speculative position limits, position accountability standards, and position reporting requirements, including an indication as to whether the contract meets the definition of economically equivalent swap as defined in § 150.1 of this chapter, and, if so, the name of either the core referenced futures contract or referenced contract, as applicable, to which the swap submitted under this part 40 is economically equivalent.

* * * * *

PART 140 – ORGANIZATION, FUNCTIONS, AND PROCEDURES OF THE COMMISSION

13. The authority citation for part 140 continues to read as follows:

Authority: 7 U.S.C. 2(a) (12), 12a, 13(c), 13(d), 13(e), and 16(b).

§ 140.97 [Removed and Reserved]

14. Remove and reserve § 140.97.

PART 150 – LIMITS ON POSITIONS

15. The authority citation for part 150 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6c, 6f, 6g, 6t, 12a, and 19, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

16. Revise § 150.1 to read as follows:

§ 150.1 Definitions.

As used in this part—

Bona fide hedging transaction or position means a transaction or position in commodity derivative contracts in a physical commodity, where:

(1) Such transaction or position:

(i) Represents a substitute for transactions made or to be made, or positions taken or to be taken, at a later time in a physical marketing channel;

(ii) Is economically appropriate to the reduction of price risks in the conduct and management of a commercial enterprise; and

(iii) Arises from the potential change in the value of—

(A) Assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;

(B) Liabilities which a person owes or anticipates incurring; or

(C) Services that a person provides or purchases, or anticipates providing or purchasing; or

(2) Such transaction or position qualifies as a:

(i) *Pass-through swap and pass-through swap offset pair.* Paired positions of a pass-through swap and a pass-through swap offset, where:

(A) The pass-through swap is a swap position entered into by one person for which the swap would qualify as a bona fide hedging transaction or position pursuant to paragraph (1) of this definition (the bona fide hedging swap counterparty) that is opposite another person (the pass-through swap counterparty);

(B) The pass-through swap offset:

(*1*) Is a futures contract position, option on a futures contract position, or swap position entered into by the pass-through swap counterparty; and

(*2*) Reduces the pass-through swap counterparty's price risks attendant to the pass-through swap; and

(C) With respect to the pass-through swap offset, the pass-through swap counterparty receives from the bona fide hedging swap counterparty a written representation that the pass-through swap qualifies as a bona fide hedging transaction or position pursuant to paragraph (1) of this definition, and the pass-through swap counterparty may rely in good faith on such written representation, unless the pass-

through swap counterparty has information that would cause a reasonable person to question the accuracy of the representation; or

(ii) *Offset of a bona fide hedger's qualifying swap position.* A futures contract position, option on a futures contract position, or swap position entered into by a bona fide hedging swap counterparty that reduces price risks attendant to a previously-entered-into swap position that qualified as a bona fide hedging transaction or position at the time it was entered into for that counterparty pursuant to paragraph (1) of this definition.

Commodity derivative contract means any futures contract, option on a futures contract, or swap in a commodity (other than a security futures product as defined in section 1a(45) of the Act).

Core referenced futures contract means a futures contract that is listed in § 150.2(d).

Economically equivalent swap means, with respect to a particular referenced contract, any swap that has identical material contractual specifications, terms, and conditions to such referenced contract.

(1) Other than as provided in paragraph (2) of this definition, for the purpose of determining whether a swap is an economically equivalent swap with respect to a particular referenced contract, the swap shall not be deemed to lack identical material contractual specifications, terms, and conditions due to different lot size specifications or notional amounts, delivery dates diverging by less than one calendar day, or different post-trade risk management arrangements.

(2) With respect to any natural gas referenced contract, for the purpose of determining whether a swap is an economically equivalent swap to such referenced contract, the swap shall not be deemed to lack identical material contractual specifications, terms, and conditions due to different lot size specifications or notional

amounts, delivery dates diverging by less than two calendar days, or different post-trade risk management arrangements.

(3) With respect to any referenced contract or class of referenced contracts, the Commission may make a determination that any swap or class of swaps satisfies, or does not satisfy, this economically equivalent swap definition.

Eligible affiliate means an entity with respect to which another person:

(1) Directly or indirectly holds either:

(i) A majority of the equity securities of such entity, or

(ii) The right to receive upon dissolution of, or the contribution of, a majority of the capital of such entity;

(2) Reports its financial statements on a consolidated basis under Generally Accepted Accounting Principles or International Financial Reporting Standards, and such consolidated financial statements include the financial results of such entity; and

(3) Is required to aggregate the positions of such entity under § 150.4 and does not claim an exemption from aggregation for such entity.

Eligible entity 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, limited member or shareholder in a commodity pool the operator of which is exempt from registration under § 4.13 of this chapter; a commodity trading advisor; a bank or trust company; a savings association; an insurance company; or the separately organized affiliates of any of the above entities:

(1) Which authorizes an independent account controller independently to control all trading decisions with respect to the eligible entity's client positions and accounts that the independent account controller holds directly or indirectly, or on the eligible entity's behalf, but without the eligible entity's day-to-day direction; and

(2) Which maintains:

(i) Only such minimum control over the independent account controller as is consistent with its fiduciary responsibilities to the managed positions and accounts, and necessary to fulfill its duty to supervise diligently the trading done on its behalf; or

(ii) If a limited partner, limited member or shareholder of a commodity pool the operator of which is exempt from registration under § 4.13 of this chapter, only such limited control as is consistent with its status.

Entity means a "person" as defined in section 1a of the Act.

Excluded commodity means an "excluded commodity" as defined in section 1a of the Act.

Futures-equivalent means:

(1)(i) An option contract, whether an option on a futures contract or an option that is a swap, which has been:

(A) adjusted by an economically reasonable and analytically supported exposure to price changes of the underlying referenced contract that has been computed for that option contract as of the previous day's close or the current day's close or computed contemporaneously during the trading day, and

(B) Converted to an economically equivalent amount of an open position in the underlying referenced contract.

(ii) An entity is allowed one business day to liquidate an amount of the position that is in excess of speculative position limits without being considered in violation of the speculative position limits if such excess position results from:

(A) A position that exceeds speculative position limits as a result of an option contract assignment; or

(B) A position that includes an option contract that exceeds speculative position limits when the applicable option contract is adjusted by an economically reasonable and

analytically supported exposure to price changes of the underlying referenced contract as of that business day's close of trading, as long as the applicable option contract does not exceed such speculative position limits when evaluated using the previous business day's exposure to the underlying referenced contract. This paragraph (B) shall not apply if such day would be the last trading day of the spot month for the corresponding core referenced futures contract.

(2) A futures contract which has been converted to an economically equivalent amount of an open position in a core referenced futures contract; and

(3) A swap which has been converted to an economically equivalent amount of an open position in a core referenced futures contract.

Independent account controller means a person:

(1) Who specifically is authorized by an eligible entity, as defined in this section, independently to control trading decisions on behalf of, but without the day-to-day direction of, the eligible entity;

(2) Over whose trading the eligible entity maintains only such minimum control as is consistent with its fiduciary responsibilities for managed positions and accounts to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations which may be incumbent upon the eligible entity to fulfill;

(3) Who trades independently of the eligible entity and of any other independent account controller trading for the eligible entity;

(4) Who has no knowledge of trading decisions by any other independent account controller; and

(5) Who is:

(i) Registered as a futures commission merchant, an introducing broker, a commodity trading advisor, or an associated person of any such registrant, or

(ii) A general partner, managing member or manager of a commodity pool the operator of which is excluded from registration under § 4.5(a)(4) of this chapter or § 4.13 of this chapter, *provided that* such general partner, managing member or manager complies with the requirements of § 150.4(c).

Long position means, on a futures-equivalent basis, a long call option, a short put option, a long underlying futures contract, or a swap position that is equivalent to a long futures contract.

Physical commodity means any agricultural commodity as that term is defined in § 1.3 of this chapter or any exempt commodity as that term is defined in section 1a of the Act.

Position accountability means any bylaw, rule, regulation, or resolution that:

(1) Is submitted to the Commission pursuant to part 40 of this chapter in lieu of, or along with, a speculative position limit, and

(2) Requires an entity whose position exceeds the accountability level to consent to:

(i) Provide information about its position to the designated contract market or swap execution facility; and

(ii) Halt increasing further its position or reduce its position in an orderly manner, in each case as requested by the designated contract market or swap execution facility.

Pre-enactment swap means any swap entered into prior to enactment of the Dodd-Frank Act of 2010 (July 21, 2010), the terms of which have not expired as of the date of enactment of that Act.

Pre-existing position means any position in a commodity derivative contract acquired in good faith prior to the effective date of any bylaw, rule, regulation, or resolution that specifies a speculative position limit level or a subsequent change to that level.

Referenced contract means:

(1) A core referenced futures contract listed in § 150.2(d) or, on a futures-equivalent basis with respect to a particular core referenced futures contract, a futures contract or an option on a futures contract, including a spread, that is either:

(i) Directly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to, the price of that particular core referenced futures contract; or

(ii) Directly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to, the price of the same commodity underlying that particular core referenced futures contract for delivery at the same location or locations as specified in that particular core referenced futures contract; or

(2) On a futures-equivalent basis, an economically equivalent swap.

(3) The definition of referenced contract does not include a location basis contract, a commodity index contract, any guarantee of a swap, a trade option that meets the requirements of § 32.3 of this chapter, any outright price reporting agency index contract, or any monthly average pricing contract.

Short position means, on a futures-equivalent basis, a short call option, a long put option, a short underlying futures contract, or a swap position that is equivalent to a short futures contract.

Speculative position limit means the maximum position, either net long or net short, in a commodity derivative contract that may be held or controlled by one person absent an exemption, whether such limits are adopted for:

(1) Combined positions in all commodity derivative contracts in a particular commodity, including the spot month futures contract and all single month futures contracts (the spot month and all single month futures contracts, cumulatively, "all-months-combined");

(2) Positions in a single month of commodity derivative contracts in a particular commodity other than the spot month futures contract ("single month"); or

(3) Positions in the spot month of commodity derivative contacts in a particular commodity. Such a limit may be established under Federal regulations or rules of a designated contract market or swap execution facility. For referenced contracts other than core referenced futures contracts, single month means the same period as that of the relevant core referenced futures contract.

Spot month means:

(1) For physical-delivery core referenced futures contracts, the period of time beginning at the earlier of:

(i) The close of business on the trading day preceding the first day on which delivery notices can be issued by the clearing organization of a contract market or

(ii) The close of business on the trading day preceding the third-to-last trading day and ending when the contract expires, except as follows:

(A) For the *ICE Futures U.S. Sugar No. 11* (SB) core referenced futures contract, the spot month means the period of time beginning at the opening of trading on the second business day following the expiration of the regular option contract traded on the expiring futures contract and ending when the contract expires;

(B) For the *ICE Futures U.S. Sugar No. 16* (SF) core referenced futures contract, the spot month means the period of time beginning on the third-to-last trading day of the contract month and ending when the contract expires; and

(C) For the *Chicago Mercantile Exchange Live Cattle* (LC) core referenced futures contract, the spot month means the period of time beginning at the close of trading on the first business day following the first Friday of the contract month and ending when the contract expires; and

(2) For referenced contracts other than core referenced futures contracts, the spot month means the same period as that of the relevant core referenced futures contract.

Spread transaction means an intra-market spread, inter-market spread, intra-commodity spread, or inter-commodity spread, including a calendar spread, quality differential spread, processing spread, product or by-product differential spread, or futures-option spread.

Swap means "swap" as that term is defined in section 1a of the Act and as further defined in § 1.3 of this chapter.

Swap dealer means "swap dealer" as that term is defined in section 1a of the Act and as further defined in § 1.3 of this chapter.

Transition period swap means a swap entered into during the period commencing on the day of the enactment of the Dodd-Frank Act of 2010 (July 21, 2010), and ending 60 days after the publication in the *Federal Register* of final amendments to this part implementing section 737 of the Dodd-Frank Act of 2010, the terms of which have not expired as of 60 days after the publication date.

17. Revise § 150.2 to read as follows:

§ 150.2 Federal speculative position limits.

(a) *Spot month speculative position limits.* For physical-delivery referenced contracts and, separately, for cash-settled referenced contracts, no person may hold or control positions in the spot month, net long or net short, in excess of the levels specified by the Commission.

(b) *Single month and all-months-combined speculative position limits.* For any referenced contract, no person may hold or control positions in a single month or in all-months-combined (including the spot month), net long or net short, in excess of the levels specified by the Commission.

(c) *Relevant contract month.* For purposes of this part, for referenced contracts other than core referenced futures contracts, the spot month and any single month shall be the same as those of the relevant core referenced futures contract.

(d) *Core referenced futures contracts.* Federal speculative position limits apply to referenced contracts based on the following core referenced futures contracts:

Core Referenced Futures Contracts

Commodity Type	***Designated Contract Market***	***Core Referenced Futures Contract[1]***
Legacy Agricultural		
	Chicago Board of Trade	
		Corn (C)
		Oats (O)
		Soybeans (S)
		Soybean Meal (SM)
		Soybean Oil (SO)
		Wheat (W)
		Hard Winter Wheat (KW)
	ICE Futures U.S.	
		Cotton No. 2 (CT)
	Minneapolis Grain Exchange	
		Hard Red Spring Wheat (MWE)
Other Agricultural		
	Chicago Board of Trade	
		Rough Rice (RR)
	Chicago Mercantile Exchange	
		Live Cattle (LC)
	ICE Futures U.S.	
		Cocoa (CC)
		Coffee C (KC)
		FCOJ-A (OJ)

Commodity Type	*Designated Contract Market*	*Core Referenced Futures Contract*[1]
		U.S. Sugar No. 11 (SB)
		U.S. Sugar No. 16 (SF)
Energy		
	New York Mercantile Exchange	
		Light Sweet Crude Oil (CL)
		NY Harbor ULSD (HO)
		RBOB Gasoline (RB)
		Henry Hub Natural Gas (NG)
Metals		
	Commodity Exchange, Inc.	
		Gold (GC)
		Silver (SI)
		Copper (HG)
	New York Mercantile Exchange	
		Palladium (PA)
		Platinum (PL)

[1] The core referenced futures contract includes any successor contracts.

(e) *Establishment of speculative position limit levels.* The levels of Federal speculative position limits are fixed by the Commission at the levels listed in appendix E to this part.

(f) *Designated contract market estimates of deliverable supply.* Each designated contract market listing a core referenced futures contract shall supply to the Commission an estimated spot month deliverable supply upon request by the Commission, and may supply such estimates to the Commission at any other time. Each estimate shall be accompanied by a description of the methodology used to derive the estimate and any statistical data supporting the estimate, and shall be submitted using the format and

procedures approved in writing by the Commission. A designated contract market should use the guidance regarding deliverable supply in appendix C to part 38 of this chapter.

(g) *Pre-existing positions*—(1) *Pre-existing positions in a spot month.* A spot month speculative position limit established under this section shall apply to pre-existing positions, other than pre-enactment swaps and transition period swaps.

(2) *Pre-existing positions in a non-spot month.* A single month or all-months-combined speculative position limit established under this section shall apply to pre-existing positions, other than pre-enactment swaps and transition period swaps.

(h) *Positions on foreign boards of trade.* The speculative position limits established under this section shall apply to a person's combined positions in referenced contracts, including positions executed on, or pursuant to the rules of, a foreign board of trade, pursuant to section 4a(a)(6) of the Act, *provided that*:

(1) Such referenced contracts settle against any price (including the daily or final settlement price) of one or more contracts listed for trading on a designated contract market or swap execution facility that is a trading facility; and

(2) The foreign board of trade makes available such referenced contracts to its members or other participants located in the United States through direct access to its electronic trading and order matching system.

(i) *Anti-evasion provision.* For the purposes of applying the speculative position limits in this section, if used to willfully circumvent or evade speculative position limits:

(1) A commodity index contract, monthly average pricing contract, outright price reporting agency index contract, and/or a location basis contract shall be considered to be a referenced contract;

(2) A bona fide hedging transaction or position recognition or spread exemption shall no longer apply; and

(3) A swap shall be considered to be an economically equivalent swap.

(j) *Delegation of authority to the Director of the Division of Market Oversight.* (1) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, the authority in paragraph (f) of this section to request estimated spot month deliverable supply from a designated contract market and to provide the format and procedures for submitting such estimates.

(2) The Director of the Division of Market Oversight may submit to the Commission for its consideration any matter which has been delegated in this section.

(3) Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

(k) *Eligible affiliates and aggregation.* For purposes of this part, if an eligible affiliate meets the conditions for any exemption from aggregation under § 150.4, the eligible affiliate may choose to utilize that exemption, or it may opt to be aggregated with its affiliated entities.

18. Revise § 150.3 to read as follows:

§ 150.3 Exemptions.

(a) *Positions which may exceed limits.* A person may exceed the speculative position limits set forth in § 150.2 to the extent that all applicable requirements in this part are met, *provided that* such person's transactions or positions each satisfy one of the following:

(1) *Bona fide hedging transactions or positions.* Positions that comply with the bona fide hedging transaction or position definition in § 150.1, and are:

(i) Enumerated in appendix A to this part; or

(ii) Approved as non-enumerated bona fide hedging transactions or positions in accordance with paragraph (b)(4) of this section or § 150.9.

(2) *Spread transactions.* Transactions that:

(i) Meet the spread transaction definition in § 150.1; or

(ii) Do not meet the spread transaction definition in § 150.1, but have been approved by the Commission pursuant to paragraph (b)(4) of this section.

(3) *Financial distress positions.* Positions of a person, or a related person or persons, under financial distress circumstances, when exempted by the Commission from any of the requirements of this part in response to a specific request made pursuant to § 140.99(a)(1) of this chapter, where financial distress circumstances include, but are not limited to, situations involving the potential default or bankruptcy of a customer of the requesting person or persons, an affiliate of the requesting person or persons, or a potential acquisition target of the requesting person or persons.

(4) *Conditional spot month limit exemption positions in natural gas.* Spot month positions in natural gas cash-settled referenced contracts that exceed the spot month speculative position limit set forth in § 150.2, *provided that:*

(i) Such positions do not exceed the futures-equivalent of 10,000 NYMEX Henry Hub Natural Gas core referenced futures contracts per designated contract market that lists a cash-settled referenced contract in natural gas;

(ii) Such positions do not exceed the futures-equivalent of 10,000 NYMEX Henry Hub Natural Gas core referenced futures contracts in economically equivalent swaps in natural gas; and

(iii) The person holding or controlling such positions does not hold or control positions in spot month physical-delivery referenced contracts in natural gas.

(5) *Pre-enactment and transition period swaps exemption*. The speculative position limits set forth in § 150.2 shall not apply to positions acquired in good faith in any pre-enactment swap or any transition period swap, *provided however* that a person may net such positions with post-effective date commodity derivative contracts for the purpose of complying with any non-spot month speculative position limit.

(b) *Application for relief.* Any person with a position in a referenced contract seeking recognition of such position as a bona fide hedging transaction or position in accordance with paragraph (a)(1)(ii) of this section, or seeking an exemption for a spread position in accordance with paragraphs (a)(2)(ii) of this section, in each case for purposes of Federal speculative position limits set forth in § 150.2, may apply to the Commission in accordance with this section.

(1) *Required information.* The application shall include the following information:

(i) With respect to an application for recognition of a bona fide hedging transaction or position:

(A) A description of the position in the commodity derivative contract for which the application is submitted, including but not necessarily limited to, the name of the underlying commodity and the derivative position size;

(B) An explanation of the hedging strategy, including a statement that the position complies with the requirements of section 4a(c)(2) of the Act and the definition of bona fide hedging transaction or position in § 150.1, and information to demonstrate why the position satisfies such requirements and definition;

(C) A statement concerning the maximum size of all gross positions in commodity derivative contracts for which the application is submitted;

(D) A description of the applicant's activity in the cash markets and swaps markets for the commodity underlying the position for which the application is submitted, including, but not necessarily limited to, information regarding the offsetting cash positions; and

(E) Any other information that may help the Commission determine whether the position satisfies the requirements of section 4a(c)(2) of the Act and the definition of bona fide hedging transaction or position in § 150.1.

(ii) With respect to an application for a spread exemption:

(A) A description of the spread position for which the application is submitted;

(B) A statement concerning the maximum size of all gross positions in commodity derivative contracts for which the application is submitted; and

(C) Any other information that may help the Commission determine whether the position is consistent with section 4a(a)(3)(B) of the Act.

(2) *Additional information.* If the Commission determines that it requires additional information in order to determine whether to recognize a position as a bona fide hedging transaction or position or to grant a spread exemption, the Commission shall:

(i) Notify the applicant of any supplemental information required; and

(ii) Provide the applicant with ten business days in which to provide the Commission with any supplemental information.

(3) *Timing of application.* (i) Except as provided in paragraph (b)(3)(ii) of this section, a person seeking relief in accordance with this section must apply to the Commission and receive a notice of approval of such application prior to the date that the position for which the application was submitted would be in excess of the applicable Federal speculative position limit set forth in § 150.2;

(ii) Due to demonstrated sudden or unforeseen increases in its bona fide hedging needs, a person may apply for recognition of a bona fide hedging transaction or position within five business days after the person established the position that exceeded the applicable Federal speculative position limit.

(A) Any application filed pursuant to paragraph (b)(3)(ii) of this section must include an explanation of the circumstances warranting the sudden or unforeseen increases in bona fide hedging needs.

(B) If an application filed pursuant to paragraph (b)(3)(ii) of this section is denied, the person must bring its position within the Federal speculative position limits within a commercially reasonable time, as determined by the Commission in consultation with the applicant and the applicable designated contract market or swap execution facility.

(C) If an application filed pursuant to paragraph (b)(3)(ii) of this section is denied, the Commission will not pursue an enforcement action for a position limits violation for the person holding the position during the period of the Commission's review nor once the Commission has issued its determination so long as the application was submitted in good faith and the person brings its position within the Federal speculative position limits within a commercially reasonable time in accordance with paragraph (b)(3)(ii)(B) of this section.

(4) *Commission determination.* After a review of any application submitted under paragraph (b) of this section and any supplemental information provided by the applicant, the Commission will determine, with respect to the transaction or position for which the application is submitted, whether to recognize all or a specified portion of such transaction or position as a bona fide hedging transaction or position or whether to exempt all or a specified portion of such spread transaction, as applicable. The Commission shall notify the applicant of its determination, and an applicant may exceed Federal speculative position limits set forth in § 150.2, or in the case of applications filed pursuant to paragraph (b)(3)(ii) of this section, the applicant may rely upon the Commission's determination, upon receiving a notice of approval.

(5) *Renewal of application.* With respect to any application approved by the Commission pursuant to this section, a person shall renew such application if there are any material changes to the information provided in the original application pursuant to paragraph (b)(1) of this section or upon request by the Commission.

(6) *Commission revocation or modification.* If the Commission determines, at any time, that a recognized bona fide hedging transaction or position is no longer consistent with section 4a(c)(2) of the Act or the definition of bona fide hedging transaction or position in § 150.1, or that a spread exemption is no longer consistent with section 4a(a)(3)(B) of the Act, the Commission shall:

(i) Notify the person holding such position;

(ii) Provide an opportunity for the applicant to respond to such notification; and

(iii) Issue a determination to revoke or modify the bona fide hedge recognition or spread exemption for purposes of Federal speculative position limits and, as applicable, require the person to reduce the derivative~~s~~ position within a commercially reasonable time, as determined by the Commission in consultation with the applicant and the applicable designated contract market or swap execution facility, or otherwise come into compliance. This notification shall briefly specify the nature of the issues raised and the specific provisions of the Act or the Commission's regulations with which the position or application is, or appears to be, inconsistent.

(c) *Previously-granted risk management exemptions.* To the extent that exemptions previously granted under § 1.47 of this chapter or by a designated contract market or a swap execution facility are for the risk management of positions in financial instruments, including but not limited to index funds, such exemptions shall no longer apply as of January 1, 2023.

(d) *Recordkeeping.* (1) Persons who avail themselves of exemptions under this section shall keep and maintain complete books and records concerning all details of each of their exemptions, including relevant information about related cash, forward, futures contracts, option on futures contracts, and swap positions and transactions (including anticipated requirements, production, merchandising activities, royalties, contracts for services, cash commodity products and by-products, cross-commodity hedges, and

records of bona fide hedging swap counterparties) as applicable, and shall make such books and records available to the Commission upon request under paragraph (e) of this section.

(2) Any person that relies on a written representation received from another person that a swap qualifies as a pass-through swap under paragraph (2) of the definition of bona fide hedging transaction or position in § 150.1 shall keep and make available to the Commission upon request the relevant books and records of such written representation, including any books and records that the person intends to use to demonstrate that the pass-through swap is a bona fide hedging transaction or position, for a period of at least two years following the expiration of the swap.

(3) All books and records required to be kept pursuant to this section shall be kept in accordance with the requirements of § 1.31 of this chapter.

(e) *Call for information.* Upon call by the Commission, the Director of the Division of Enforcement, or the Director's delegate, any person claiming an exemption from speculative position limits under this section shall provide to the Commission such information as specified in the call relating to: the positions owned or controlled by that person; trading done pursuant to the claimed exemption; the commodity derivative contracts or cash-market positions which support the claimed exemption; and the relevant business relationships supporting a claimed exemption.

(f) *Aggregation of accounts.* Entities required to aggregate accounts or positions under § 150.4 shall be considered the same person for the purpose of determining whether they are eligible for an exemption under paragraphs (a)(1) through (4) of this section with respect to such aggregated account or position.

(g) *Delegation of authority to the Director of the Division of Market Oversight.* (1) The Commission hereby delegates, until it orders otherwise, to the Director of the

Division of Market Oversight, or such other employee or employees as the Director may designate from time to time:

(i) The authority in paragraph (a)(3) of this section to provide exemptions in circumstances of financial distress;

(ii) The authority in paragraph (b)(2) of this section to request additional information with respect to a request for a bona fide hedging transaction or position recognition or spread exemption;

(iii) The authority in paragraph (b)(3)(ii)(B) of this section to, if applicable, determine a commercially reasonable amount of time required for a person to bring its position within the Federal speculative position limits;

(iv) The authority in paragraph (b)(4) of this section to determine whether to recognize a position as a bona fide hedging transaction or position or to grant a spread exemption; and

(v) The authority in paragraph (b)(2) or (5) of this section to request that a person submit updated materials or renew their request with the Commission.

(2) The Director of the Division of Market Oversight may submit to the Commission for its consideration any matter which has been delegated in this section.

(3) Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

19. Revise § 150.5 to read as follows:

§ 150.5 Exchange-set speculative position limits and exemptions therefrom.

(a) *Requirements for exchange-set limits on commodity derivative contracts subject to Federal speculative position limits set forth in § 150.2*—(1) *Exchange-set limits.* For any commodity derivative contract that is subject to a Federal speculative position limit under § 150.2, a designated contract market or swap execution facility that

is a trading facility shall set a speculative position limit no higher than the level specified in § 150.2.

(2) *Exemptions to exchange-set limits.* A designated contract market or swap execution facility that is a trading facility may grant exemptions from any speculative position limits it sets under paragraph (a)(1) of this section in accordance with the following:

(i) *Exemption levels.* An exemption that conforms to an exemption the Commission identified in:

(A) Sections 150.3(a)(1)(i), (a)(2)(i), (a)(4) and (a)(5) may be granted at a level that exceeds the level of the applicable Federal limit in § 150.2;

(B) Sections 150.3(a)(1)(ii) and (a)(2)(ii) may be granted at a level that exceeds the level of the applicable Federal limit in § 150.2, *provided* the exemption is first approved in accordance with § 150.3(b) or 150.9, as applicable;

(C) Section 150.3(a)(3) may be granted at a level that exceeds the level of the applicable Federal limit in § 150.2, *provided that*, a division of the Commission has first approved such exemption pursuant to a request submitted under § 140.99(a)(1) of this chapter; and

(D) An exemption of the type that does not conform to any of the exemptions identified in § 150.3(a) must be granted at a level that does not exceed the applicable Federal limit in § 150.2 and that complies with paragraph (a)(2)(ii)(G) of this section, unless the Commission has first approved such exemption pursuant to § 150.3(b) or pursuant to a request submitted under § 140.99(a)(1).

(ii) *Application for exemption from exchange-set limits.* With respect to a designated contract market or swap execution facility that is a trading facility that elects to grant exemptions under paragraph (a)(2)(i) of this section:

(A) Except as provided in paragraph (a)(2)(ii)(B) of this section, the designated contract market or swap execution facility shall require an entity to file an application requesting such exemption in advance of the date that such position would be in excess of the limits then in effect. Such application shall include any information needed to enable the designated contract market or swap execution facility and the Commission to determine whether the facts and circumstances demonstrate that the designated contract market or swap execution facility may grant an exemption. Any application for a bona fide hedging transaction or position shall include a description of the applicant's activity in the cash markets and swaps markets for the commodity underlying the position for which the application is submitted, including, but not limited to, information regarding the offsetting cash positions.

(B) The designated contract market or swap execution facility may adopt rules that allow a person, due to demonstrated sudden or unforeseen increases in its bona fide hedging needs, to file an application to request a recognition of a bona fide hedging transaction or position within five business days after the person established the position that exceeded the applicable exchange-set speculative position limit.

(C) The designated contract market or swap execution facility must require that any application filed pursuant to paragraph (a)(2)(ii)(B) of this section include an explanation of the circumstances warranting the sudden or unforeseen increases in bona fide hedging needs.

(D) If an application filed pursuant to paragraph (a)(2)(ii)(B) of this section is denied, the applicant must bring its position within the designated contract market or swap execution facility's speculative position limits within a commercially reasonable time as determined by the designated contract market or swap execution facility.

(E) The Commission will not pursue an enforcement action for a position limits violation for the person holding the position during the period of the designated contract

market or swap execution facility's review nor once the designated contract market or swap execution facility has issued its determination, so long as the application was submitted in good faith and the applicant brings its position within the designated contract market or swap execution facility's speculative position limits within a commercially reasonable time as determined by the designated contract market or swap execution facility.

(F) The designated contract market or swap execution facility shall require, for any such exemption granted, that the entity re-apply for the exemption at least annually;

(G) The designated contract market or swap execution facility:

(*1*) May, in accordance with the designated contract market or swap execution facility's rules, deny any such application, or limit, condition, or revoke any such exemption, at any time after providing notice to the applicant, and

(*2*) Shall consider whether the requested exemption would result in positions that would not be in accord with sound commercial practices in the relevant commodity derivative market and/or that would exceed an amount that may be established and liquidated in an orderly fashion in that market; and

(H) Notwithstanding paragraph (a)(2)(ii)(G) of this section, the designated contract market or swap execution facility may grant exemptions, subject to terms, conditions, or limitations, that require a person to exit any referenced contract positions in excess of position limits during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract, or to otherwise limit the size of such position during that time period. Designated contract markets and swap execution facilities may refer to paragraph (b) of appendix B or appendix G to part 150, for guidance regarding the foregoing, as applicable.

(3) *Exchange-set limits on pre-existing positions*—(i) *Pre-existing positions in a spot month.* A designated contract market or swap execution facility that is a trading

facility shall require compliance with spot month exchange-set speculative position limits for pre-existing positions in commodity derivative contracts other than pre-enactment swaps and transition period swaps.

(ii) *Pre-existing positions in a non-spot month.* A single month or all-months-combined speculative position limit established under paragraph (a)(1) of this section shall apply to any pre-existing positions in commodity derivative contracts, other than pre-enactment swaps and transition period swaps.

(4) *Monthly reports detailing the disposition of each exemption application*. (i) For commodity derivative contracts subject to Federal speculative position limits, the designated contract market or swap execution facility shall submit to the Commission a report each month showing the disposition of any exemption application, including the recognition of any position as a bona fide hedging transaction or position, the exemption of any spread transaction or other position, the renewal, revocation, or modification of a previously granted recognition or exemption, and the rejection of any application, as well as the following details for each application:

(A) The date of disposition;

(B) The effective date of the disposition;

(C) The expiration date of any recognition or exemption;

(D) Any unique identifier(s) the designated contract market or swap execution facility may assign to track the application, or the specific type of recognition or exemption;

(E) If the application is for an enumerated bona fide hedging transaction or position, the name of the enumerated bona fide hedging transaction or position listed in appendix A to this part;

(F) If the application is for a spread transaction listed in the spread transaction definition in § 150.1, the name of the spread transaction as it is listed in § 150.1;

(G) The identity of the applicant;

(H) The listed commodity derivative contract or position(s) to which the application pertains;

(I) The underlying cash commodity;

(J) The maximum size of the commodity derivative position that is recognized by the designated contract market or swap execution facility as a bona fide hedging transaction or position, specified by contract month and by the type of limit as spot month, single month, or all-months-combined, as applicable;

(K) Any size limitations or conditions established for a spread exemption or other exemption; and

(L) For a bona fide hedging transaction or position, a concise summary of the applicant's activity in the cash markets and swaps markets for the commodity underlying the commodity derivative position for which the application was submitted.

(ii) The designated contract market or swap execution facility shall submit to the Commission the information required by paragraph (a)(4)(i) of this section:

(A) As specified by the Commission on the Forms and Submissions page at *www.cftc.gov*; and

(B) Using the format, coding structure, and electronic data transmission procedures approved in writing by the Commission.

(b) *Requirements for exchange-set limits on commodity derivative contracts in a physical commodity that are not subject to the limits set forth in § 150.2*—(1) *Exchange-set spot-month limits*. For any physical commodity derivative contract that is not subject to a Federal speculative position limit under § 150.2, a designated contract market or swap execution facility that is a trading facility shall set a speculative position limit as follows:

(i) *Spot month speculative position limit levels.* For any commodity derivative contract subject to paragraph (b) of this section, a designated contract market or swap execution facility that is a trading facility shall establish speculative position limits for the spot month no greater than 25 percent of the estimated spot month deliverable supply, calculated separately for each month to be listed.

(ii) *Additional sources for compliance.* Alternatively, a designated contract market or swap execution facility that is a trading facility may submit rules to the Commission establishing spot month speculative position limits other than as provided in paragraph (b)(1)(i) of this section, provided that each limit is set at a level that is necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index.

(2) *Exchange-set limits or accountability outside of the spot month*—(i) *Non-spot month speculative position limit or accountability levels.* For any commodity derivative contract subject to paragraph (b) of this section, a designated contract market or swap execution facility that is a trading facility shall adopt either speculative position limits or position accountability outside of the spot month at a level that is necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index.

(ii) *Additional sources for compliance.* A designated contract market or swap execution facility that is a trading facility may refer to the non-exclusive acceptable practices in paragraph (b) of appendix F of this part to demonstrate to the Commission compliance with the requirements of paragraph (b)(2)(i) of this section.

(3) *Look-alike contracts.* For any newly listed commodity derivative contract subject to paragraph (b) of this section that is substantially the same as an existing contract listed on a designated contract market or swap execution facility that is a trading facility, the designated contract market or swap execution facility that is a trading facility

listing such newly listed contract shall adopt spot month, individual month, and all-months-combined speculative position limits comparable to those of the existing contract. Alternatively, if such designated contract market or swap execution facility seeks to adopt speculative position limits that are not comparable to those of the existing contract, such designated contract market or swap execution facility shall demonstrate to the Commission how the levels comply with paragraphs (b)(1) and/or (b)(2) of this section.

(4) *Exemptions to exchange-set limits.* A designated contract market or swap execution facility that is a trading facility may grant exemptions from any speculative position limits it sets under paragraph (b)(1) or (2) of this section in accordance with the following:

(i) An entity seeking an exemption shall be required to apply to the designated contract market or swap execution facility for any such exemption from its speculative position limit rules; and

(ii) A designated contract market or swap execution facility that is a trading facility may deny any such application, or limit, condition, or revoke any such exemption, at any time after providing notice to the applicant. Such designated contract market or swap execution facility shall consider whether the requested exemption would result in positions that would not be in accord with sound commercial practices in the relevant commodity derivative market and/or would exceed an amount that may be established and liquidated in an orderly fashion in that market.

(c) *Requirements for security futures products.* For security futures products, speculative position limits and position accountability requirements are specified in § 41.25 of this chapter.

(d) *Rules on aggregation.* For commodity derivative contracts in a physical commodity, a designated contract market or swap execution facility that is a trading facility shall have aggregation rules that conform to § 150.4.

(e) *Requirements for submissions to the Commission.* In order for a designated contract market or swap execution facility that is a trading facility to adopt speculative position limits and/or position accountability pursuant to paragraph (a) or (b) of this section and/or to elect to offer exemptions from any such levels pursuant to such paragraphs, the designated contract market or swap execution facility shall submit to the Commission pursuant to part 40 of this chapter rules establishing such levels and/or exemptions. To the extent that a designated contract market or swap execution facility adopts speculative position limit levels, such part 40 submission shall also include the methodology by which such levels are calculated. The designated contract market or swap execution facility shall review such speculative position limit levels regularly for compliance with this section and update such speculative position limit levels as needed.

(f) *Delegation of authority to the Director of the Division of Market Oversight*—(1) *Commission delegations*. The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight, or such other employee or employees as the Director may designate from time to time, the authority in paragraph (a)(4)(ii) of this section to provide instructions regarding the submission to the Commission of information required to be reported, pursuant to paragraph (a)(4)(i) of this section, by a designated contract market or swap execution facility, to specify the manner for submitting such information on the Forms and Submissions page at *www.cftc.gov*, and to determine the format, coding structure, and electronic data transmission procedures for submitting such information.

(2) *Commission consideration of delegated matter*. The Director of the Division of Market Oversight may submit to the Commission for its consideration any matter which has been delegated in this section.

(3) *Commission authority*. Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

20. Revise § 150.6 to read as follows:

§ 150.6 Scope.

This part shall only be construed as having an effect on speculative position limits set by the Commission or by a designated contract market or swap execution facility, including any associated recordkeeping and reporting regulations in this chapter. Nothing in this part shall be construed to relieve any designated contract market, swap execution facility, or its governing board from responsibility under section 5(d)(4) of the Act to prevent manipulation and corners. Further, nothing in this part shall be construed to affect any other provisions of the Act or Commission regulations, including, but not limited to, those relating to actual or attempted manipulation, corners, squeezes, fraudulent or deceptive conduct, or to prohibited transactions.

§ 150.7 [Reserved]

21. Add reserved § 150.7.

22. Add § 150.8 to read as follows:

§ 150.8 Severability.

If any provision of this part, or the application thereof to any person or circumstances, is held invalid, such invalidity shall not affect the validity of other provisions or the application of such provision to other persons or circumstances that can be given effect without the invalid provision or application.

23. Add § 150.9 to read as follows:

§ 150.9 Process for recognizing non-enumerated bona fide hedging transactions or positions with respect to Federal speculative position limits.

For purposes of Federal speculative position limits, a person with a position in a referenced contract seeking recognition of such position as a non-enumerated bona fide hedging transaction or position, in accordance with § 150.3(a)(1)(ii), shall apply to the Commission, pursuant to § 150.3(b), or apply to a designated contract market or swap

execution facility in accordance with this section. If such person submits an application to a designated contract market or swap execution facility in accordance with this section, and the designated contract market or swap execution facility, with respect to its own speculative position limits established pursuant to § 150.5(a), recognizes the person's position as a non-enumerated bona fide hedging transaction or position, then the person may also exceed the applicable Federal speculative position limit for such position in accordance with paragraph (e) of this section. The designated contract market or swap execution facility may approve such applications only if the designated contract market or swap execution facility complies with the conditions set forth in paragraphs (a) through (e) of this section.

(a) *Approval of rules.* The designated contract market or swap execution facility must maintain rules that establish application processes and conditions for recognizing bona fide hedging transactions or positions consistent with the requirements of this section, and must seek approval of such rules from the Commission pursuant to § 40.5 of this chapter.

(b) *Prerequisites for a designated contract market or swap execution facility to recognize a bona fide hedging transaction or position in accordance with this section.* (1) The designated contract market or swap execution facility lists the applicable referenced contract for trading;

(2) The position meets the definition of bona fide hedging transaction or position in section 4a(c)(2) of the Act and the definition of bona fide hedging transaction or position in § 150.1; and

(3) The designated contract market or swap execution facility does not recognize as a bona fide hedging transaction or position any position involving a commodity index contract and one or more referenced contracts, including exemptions known as risk management exemptions.

(c) *Application process*. The designated contract market or swap execution facility's application process meets the following conditions:

(1) *Required application information*. The designated contract market or swap execution facility requires the applicant to provide, and can obtain from the applicant, all information needed to enable the designated contract market or swap execution facility and the Commission to determine whether the facts and circumstances demonstrate that the designated contract market or swap execution facility may recognize a position as a bona fide hedging transaction or position, including the following:

(i) A description of the position in the commodity derivative contract for which the application is submitted, including but not limited to, the name of the underlying commodity and the derivative position size;

(ii) An explanation of the hedging strategy, including a statement that the position complies with the requirements of section 4a(c)(2) of the Act and the definition of bona fide hedging transaction or position in § 150.1, and information to demonstrate why the position satisfies such requirements and definition;

(iii) A statement concerning the maximum size of all gross positions in commodity derivative contracts for which the application is submitted;

(iv) A description of the applicant's activity in the cash markets and the swaps markets for the commodity underlying the position for which the application is submitted, including, but not limited to, information regarding the offsetting cash positions; and

(v) Any other information the designated contract market or swap execution facility requires, in its discretion, to determine that the position complies with paragraph (b)(2) of this section, as applicable.

(2) *Timing of application*. (i) Except as provided in paragraph (c)(2)(ii) of this section, the designated contract market or swap execution facility requires the applicant

to submit an application and receive a notice of approval of such application from the designated contract market or swap execution facility prior to the date that the position for which such application was submitted would be in excess of the applicable Federal speculative position limits.

(ii) A designated contract market or swap execution facility may adopt rules that allow a person, due to demonstrated sudden or unforeseen increases in its bona fide hedging needs, to file an application with the designated contract market or swap execution facility to request a recognition of a bona fide hedging transaction or position within five business days after the person established the position that exceeded the applicable Federal speculative position limit.

(A) The designated contract market or swap execution facility must require that any application filed pursuant to paragraph (c)(2)(ii) of this section include an explanation of the circumstances warranting the sudden or unforeseen increases in bona fide hedging needs.

(B) If an application filed pursuant to paragraph (c)(2)(ii) of this section is denied by the designated contract market, swap execution facility, or Commission, the applicant must bring its position within the applicable Federal speculative position limits within a commercially reasonable time as determined by the Commission in consultation with the applicant and the applicable designated contract market or swap execution facility.

(C) The Commission will not pursue an enforcement action for a position limits violation for the person holding the position during the period of the designated contract market, swap execution facility, or Commission's review nor once a determination has been issued, so long as the application was submitted in good faith and the person complies with paragraph (c)(2)(ii)(B) of this section.

(3) *Renewal of applications*. The designated contract market or swap execution facility requires each applicant to reapply with the designated contract market or swap

execution facility to maintain such recognition at least on an annual basis by updating the initial application, and to receive a notice of extension of the original approval from the designated contract market or swap execution facility to continue relying on such recognition for purposes of Federal speculative position limits. If the facts and circumstances underlying a renewal application are materially different than the initial application, the designated contract market or swap execution facility is required to treat such application as a new request submitted through the § 150.9 process and subject to the Commission's 10/2-day review process in paragraph (e) of this section.

(4) *Exchange revocation authority*. The designated contract market or swap execution facility retains its authority to limit, condition, or revoke, at any time after providing notice to the applicant, any bona fide hedging transaction or position recognition for purposes of the designated contract market or swap execution facility's speculative position limits established under § 150.5(a), for any reason as determined in the discretion of the designated contract market or swap execution facility, including if the designated contract market or swap execution facility determines that the position no longer meets the conditions set forth in paragraph (b) of this section, as applicable.

(d) *Recordkeeping*. (1) The designated contract market or swap execution facility keeps full, complete, and systematic records, which include all pertinent data and memoranda, of all activities relating to the processing of such applications and the disposition thereof. Such records include:

(i) Records of the designated contract market's or swap execution facility's recognition of any derivative position as a bona fide hedging transaction or position, revocation or modification of any such recognition, or the rejection of an application;

(ii) All information and documents submitted by an applicant in connection with its application, including documentation and information that is submitted after the

disposition of the application, and any withdrawal, supplementation, or update of any application;

(iii) Records of oral and written communications between the designated contract market or swap execution facility and the applicant in connection with such application; and

(iv) All information and documents in connection with the designated contract market or swap execution facility's analysis of, and action(s) taken with respect to, such application.

(2) All books and records required to be kept pursuant to this section shall be kept in accordance with the requirements of § 1.31 of this chapter.

(e) *Process for a person to exceed Federal speculative position limits on a referenced contract*—(1) *Notification to the Commission*. The designated contract market or swap execution facility must submit to the Commission a notification of each initial determination to recognize a bona fide hedging transaction or position in accordance with this section, concurrently with the notice of such determination the designated contract market or swap execution facility provides to the applicant.

(2) *Notification requirements*. The notification in paragraph (e)(1) of this section shall include, at a minimum, the following information:

(i) Name of the applicant;

(ii) Brief description of the bona fide hedging transaction or position being recognized;

(iii) Name of the contract(s) relevant to the recognition;

(iv) The maximum size of the position that may exceed Federal speculative position limits;

(v) The effective date and expiration date of the recognition;

(vi) An indication regarding whether the position may be maintained during the last five days of trading during the spot month, or the time period for the spot month; and

(vii) A copy of the application and any supporting materials.

(3) *Exceeding Federal speculative position limits on referenced contracts*. A person may exceed Federal speculative position limits on a referenced contract after the designated contract market or swap execution facility issues the notification required pursuant to paragraph (e)(1) of this section, unless the Commission notifies the designated contract market or swap execution facility and the applicant otherwise, pursuant to paragraph (e)(5) or (6) of this section, before the ten business day period expires.

(4) *Exceeding Federal speculative position limits on referenced contracts due to sudden or unforeseen circumstances.* If a person files an application for a recognition of a bona fide hedging transaction or position in accordance with paragraph (c)(2)(ii) of this section, then such person may rely on the designated contract market or swap execution facility's determination to grant such recognition for purposes of Federal speculative position limits two business days after the designated contract market or swap execution facility issues the notification required pursuant to paragraph (e)(1) of this section, unless the Commission notifies the designated contract market or swap execution facility and the applicant otherwise, pursuant to paragraph (e)(5) or (6) of this section, before the two business day period expires.

(5) *Commission stay of pending applications and requests for additional information.* The Commission may stay an application that requires additional time to analyze, and/or may request additional information to determine whether the position for which the application is submitted meets the conditions set forth in paragraph (b) of this section. The Commission shall notify the applicable designated contract market or swap execution facility and the applicant of a Commission determination to stay the application

and/or request any supplemental information, and shall provide an opportunity for the applicant to respond. The Commission will have an additional 45 days from the date of the stay notification to conduct the review and issue a determination with respect to the application. If the Commission stays an application and the applicant has not yet exceeded Federal speculative position limits, then the applicant may not exceed Federal speculative position limits unless the Commission approves the application. If the Commission stays an application and the applicant has already exceeded Federal speculative position limits, then the applicant may continue to maintain the position unless the Commission notifies the designated contract market or swap execution facility and the applicant otherwise, pursuant to paragraph (e)(6) of this section.

(6) *Commission determination for pending applications.* If, during the Commission's ten or two business day review period in paragraphs (e)(3) and (4) of this section, the Commission determines that a position for which the application is submitted does not meet the conditions set forth in paragraph (b) of this section, the Commission shall:

(i) Notify the designated contract market or swap execution facility and the applicant within ten or two business days, as applicable, after the designated contract market or swap execution facility issues the notification required pursuant to paragraph (e)(1) of this section;

(ii) Provide an opportunity for the applicant to respond to such notification;

(iii) Issue a determination to deny the application, or limit or condition the application approval for purposes of Federal speculative position limits and, as applicable, require the person to reduce the derivatives position within a commercially reasonable time, as determined by the Commission in consultation with the applicant and the applicable designated contract market or swap execution facility, or otherwise come into compliance; and

(iv) The Commission will not pursue an enforcement action for a position limits violation for the person holding the position during the period of the Commission's review nor once the Commission has issued its determination, so long as the application was submitted in good faith and the person complies with any requirement to reduce the position pursuant to paragraph (e)(6)(iii) of this section, as applicable.

(f) *Commission revocation of applications previously approved.* (1) If a designated contract market or a swap execution facility limits, conditions, or revokes any recognition of a bona fide hedging transaction or position for purposes of the respective designated contract market's or swap execution facility's speculative position limits established under § 150.5(a), then such recognition will also be deemed limited, conditioned, or revoked for purposes of Federal speculative position limits.

(2) If the Commission determines, at any time, that a position that has been recognized as a bona fide hedging transaction or position for purposes of Federal speculative position limits is no longer consistent with section 4a(c)(2) of the Act or the definition of bona fide hedging transaction or position in § 150.1, the following applies:

(i) The Commission shall notify the person holding the position and the relevant designated contract market or swap execution facility. After providing such person and such designated contract market or swap execution facility an opportunity to respond, the Commission may, in its discretion, limit, condition, or revoke its determination for purposes of Federal speculative position limits and require the person to reduce the derivatives position within a commercially reasonable time as determined by the Commission in consultation with such person and such designated contract market or swap execution facility, or otherwise come into compliance;

(ii) The Commission shall include in its notification a brief explanation of the nature of the issues raised and the specific provisions of the Act or the Commission's regulations with which the position or application is, or appears to be, inconsistent; and

(iii) The Commission will not pursue an enforcement action for a position limits violation for the person holding the position during the period of the Commission's review, nor once the Commission has issued its determination, provided the person submitted the application in good faith and reduces the position within a commercially reasonable time, as determined by the Commission in consultation with such person and the relevant designated contract market or swap execution facility, or otherwise comes into compliance.

(g) *Delegation of authority to the Director of the Division of Market Oversight*—(1) *Commission delegations*. The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight, or such other employee or employees as the Director may designate from time to time, the authority to request additional information, pursuant to paragraph (e)(5) of this section, from the applicable designated contract market or swap execution facility and applicant.

(2) *Commission consideration of delegated matter*. The Director of the Division of Market Oversight may submit to the Commission for its consideration any matter which has been delegated in this section.

(3) *Commission authority*. Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

24. Add appendices A through G to read as follows:

Appendix A to Part 150 – List of Enumerated Bona Fide Hedges

Pursuant to § 150.3(a)(1)(i), positions that comply with the bona fide hedging transaction or position definition in § 150.1 and that are enumerated in this appendix A may exceed Federal speculative position limits to the extent that all applicable requirements in this part are met. A person holding such positions enumerated in this appendix A may exceed Federal speculative position limits for such positions without requesting prior approval under § 150.3 or § 150.9. A person holding such positions that

are not enumerated in this appendix A must request and obtain approval pursuant to § 150.3 or § 150.9 prior to exceeding the applicable Federal speculative position limits—unless such positions qualify for the retroactive approval process, and the person seeks retroactive approval in accordance with § 150.3 or § 150.9.

The enumerated bona fide hedges do not state the exclusive means for establishing compliance with the bona fide hedging transaction or position definition in § 150.1 or with the requirements of § 150.3(a)(1).

(a) *Enumerated hedges*—(1) *Hedges of inventory and cash commodity fixed-price purchase contracts.* Short positions in commodity derivative contracts that do not exceed in quantity the sum of the person's ownership of inventory and fixed-price purchase contracts in the commodity derivative contracts' underlying cash commodity.

(2) *Hedges of cash commodity fixed-price sales contracts.* Long positions in commodity derivative contracts that do not exceed in quantity the sum of the person's fixed-price sales contracts in the commodity derivative contracts' underlying cash commodity and the quantity equivalent of fixed-price sales contracts of the cash products and by-products of such commodity.

(3) *Hedges of offsetting unfixed-price cash commodity sales and purchases.* Both short and long positions in commodity derivative contracts that do not exceed in quantity the amount of the commodity derivative contracts' underlying cash commodity that has been both bought and sold by the same person at unfixed prices:

(i) Basis different delivery months in the same commodity derivative contract; or

(ii) Basis different commodity derivative contracts in the same commodity, regardless of whether the commodity derivative contracts are in the same calendar month.

(4) *Hedges of unsold anticipated production.* Short positions in commodity derivative contracts that do not exceed in quantity the person's unsold anticipated production of the commodity derivative contracts' underlying cash commodity.

(5) *Hedges of unfilled anticipated requirements.* Long positions in commodity derivative contracts that do not exceed in quantity the person's unfilled anticipated requirements for the commodity derivative contracts' underlying cash commodity, for processing, manufacturing, or use by that person, or for resale by a utility as it pertains to the utility's obligations to meet the unfilled anticipated demand of its customers for the customer's use.

(6) *Hedges of anticipated merchandising*. Long or short positions in commodity derivative contracts that offset the anticipated change in value of the underlying commodity that a person anticipates purchasing or selling, *provided that*:

(i) The positions in the commodity derivative contracts do not exceed in quantity twelve months' of current or anticipated purchase or sale requirements of the same cash commodity that is anticipated to be purchased or sold; and

(ii) The person is a merchant handling the underlying commodity that is subject to the anticipatory merchandising hedge, and that such merchant is entering into the position solely for purposes related to its merchandising business and has a demonstrated history of buying and selling the underlying commodity for its merchandising business.

(7) *Hedges by agents.* Long or short positions in commodity derivative contracts by an agent who does not own or has not contracted to sell or purchase the commodity derivative contracts' underlying cash commodity at a fixed price, *provided that* the agent is responsible for merchandising the cash positions that are being offset in commodity derivative contracts and the agent has a contractual arrangement with the person who owns the commodity or holds the cash-market commitment being offset.

(8) *Hedges of anticipated mineral royalties.* Short positions in a person's commodity derivative contracts offset by the anticipated change in value of mineral royalty rights that are owned by that person, *provided that* the royalty rights arise out of the production of the commodity underlying the commodity derivative contracts.

(9) *Hedges of anticipated services.* Short or long positions in a person's commodity derivative contracts offset by the anticipated change in value of receipts or payments due or expected to be due under an executed contract for services held by that person, *provided that* the contract for services arises out of the production, manufacturing, processing, use, or transportation of the commodity underlying the commodity derivative contracts.

(10) *Offsets of commodity trade options.* Long or short positions in commodity derivative contracts that do not exceed in quantity, on a futures-equivalent basis, a position in a commodity trade option that meets the requirements of § 32.3 of this chapter. Such commodity trade option transaction, if it meets the requirements of § 32.3 of this chapter, may be deemed, for purposes of complying with this paragraph (a)(10) of this appendix A, as either a cash commodity purchase or sales contract as set forth in paragraph (a)(1) or (2) of this appendix A, as applicable.

(11) *Cross-commodity hedges.* Positions in commodity derivative contracts described in paragraph (2) of the bona fide hedging transaction or position definition in § 150.1 or in paragraphs (a)(1) through (10) of this appendix A may also be used to offset the risks arising from a commodity other than the cash commodity underlying the commodity derivative contracts, *provided that* the fluctuations in value of the cash commodity underlying the commodity derivative contracts, shall be substantially related to the fluctuations in value of the actual or anticipated cash commodity position or a pass-through swap.

(b) [Reserved]

Appendix B to Part 150 – Guidance on Gross Hedging Positions and Positions Held During the Spot Period

(a) *Guidance on gross hedging positions.* (1) A person's gross hedging positions may be deemed in compliance with the bona fide hedging transaction or position

definition in § 150.1, whether enumerated or non-enumerated, *provided that* all applicable regulatory requirements are met, including that the position is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise and otherwise satisfies the bona fide hedging definition in § 150.1, and *provided further that*:

(i) The manner in which the person measures risk is consistent and follows historical practice for that person;

(ii) The person is not measuring risk on a gross basis to evade the speculative position limits in § 150.2 or the aggregation rules in § 150.4; and

(iii) The person is able to demonstrate compliance with paragraphs (a)(1)(i) and (ii) of this appendix, including by providing justifications for measuring risk on a gross basis, upon the request of the Commission and/or of a designated contract market, including by providing information regarding the entities with which the person aggregates positions.

(b) *Guidance regarding positions held during the spot period.* The regulations governing exchange-set speculative position limits and exemptions therefrom under § 150.5(a)(2)(ii)(D) provide that designated contract markets and swap execution facilities ("exchanges") may impose restrictions on bona fide hedging transaction or position exemptions to require the person to exit any such positions in excess of limits during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract, or otherwise limit the size of such position. This guidance is intended to provide factors the Commission believes exchanges should consider when determining whether to impose a five-day rule or similar restriction but is not intended to be used as a mandatory checklist. The exchanges may consider whether:

(1) The position complies with the bona fide hedging transaction or position definition in § 150.1, whether enumerated or non-enumerated;

(2) There is an economically appropriate need to maintain such position in excess of Federal speculative position limits during the spot period for such contract, and such need relates to the purchase or sale of a cash commodity; and

(3) The person wishing to exceed Federal position limits during the spot period:

(i) Intends to make or take delivery during that time period;

(ii) Has the ability to take delivery for any long position at levels that are economically appropriate (*i.e.*, the delivery comports with the person's demonstrated need for the commodity and the contract is the most economical source for that commodity);

(iii) Has the ability to deliver against any short position (*i.e.*, has inventory on hand in a deliverable location and in a condition in which the commodity can be used upon delivery and that delivery against futures contracts is economically appropriate, as it is the best sales option for that inventory).

Appendix C to Part 150 – Guidance Regarding the Definition of Referenced Contract

This appendix C provides guidance regarding the "referenced contract" definition in § 150.1, which provides in paragraph (3) of the definition of referenced contract that the term referenced contract does not include a location basis contract, a commodity index contract, a swap guarantee, a trade option that meets the requirements of § 32.3 of this chapter, a monthly average pricing contract, or an outright price reporting agency index contract. The term "referenced contract" is used throughout part 150 of the Commission's regulations to refer to contracts that are subject to Federal position limits. A position in a contract that is not a referenced contract is not subject to Federal position limits, and, as a consequence, cannot be netted with positions in referenced contracts for purposes of Federal position limits. This guidance is intended to clarify the types of

contracts that would qualify as a location basis contract, commodity index contract, monthly average pricing contract, or outright price reporting agency index contract.

Compliance with this guidance does not diminish or replace, in any event, the obligations and requirements of any person to comply with the regulations provided under this part, or any other part of the Commission's regulations. The guidance is for illustrative purposes only and does not state the exclusive means for a contract to qualify, or not qualify, as a referenced contract as defined in § 150.1, or to comply with any other provision in this part.

(a) *Guidance.* (1) As provided in paragraph (3) of the "referenced contract" definition in § 150.1, the following types of contracts are not deemed referenced contracts, meaning such contracts are not subject to Federal position limits and cannot be netted with positions in referenced contracts for purposes of Federal position limits: location basis contracts; commodity index contracts; swap guarantees; trade options that meet the requirements of § 32.3 of this chapter; monthly average pricing contracts; and outright price reporting agency index contracts.

(2) *Location basis contract.* For purposes of the referenced contract definition in § 150.1, a location basis contract means a commodity derivative contract that is cash-settled based on the difference in:

(i) The price, directly or indirectly, of:

(A) A particular core referenced futures contract; or

(B) A commodity deliverable on a particular core referenced futures contract, whether at par, a fixed discount to par, or a premium to par; and

(ii) The price, at a different delivery location or pricing point than that of the same particular core referenced futures contract, directly or indirectly, of:

(A) A commodity deliverable on the same particular core referenced futures contract, whether at par, a fixed discount to par, or a premium to par; or

(B) A commodity that is listed in appendix D to this part as substantially the same as a commodity underlying the same core referenced futures contract.

(3) *Commodity index contract.* For purposes of the referenced contract definition in § 150.1, a commodity index contract means an agreement, contract, or transaction that is based on an index comprised of prices of commodities that are not the same or substantially the same, and that is not a location basis contract, a calendar spread contract, or an intercommodity spread contract as such terms are defined in this guidance, where:

(i) A calendar spread contract means a cash-settled agreement, contract, or transaction that represents the difference between the settlement price in one or a series of contract months of an agreement, contract, or transaction and the settlement price of another contract month or another series of contract months' settlement prices for the same agreement, contract, or transaction; and

(ii) An intercommodity spread contract means a cash-settled agreement, contract, or transaction that represents the difference between the settlement price of a referenced contract and the settlement price of another contract, agreement, or transaction that is based on a different commodity.

(4) *Monthly average pricing contract* means a contract that satisfies one of the following:

(i) The contract's price is calculated based on the equally-weighted arithmetic average of the daily prices of the underlying referenced contract for the entire corresponding calendar month or trade month, as applicable; or

(ii) In determining the price of such contract, the component daily prices, in the aggregate, during the spot month of the underlying referenced contract comprise no more than 40 percent of such contract's weighting.

(5) *Outright price reporting agency index contract* means any outright commodity derivative contract whose settlement price is based solely on an index published by a price reporting agency that surveys cash-market transaction prices, p*rovided, however*, that this term does not include any commodity derivative contract that settles at a basis, or differential, between a referenced contract and a price reporting agency index.

(b) [Reserved]

Appendix D to Part 150 – Commodities Listed as Substantially the Same for Purposes of the Term "Location Basis Contract" as Used in the Referenced Contract Definition

The following table lists each relevant core referenced futures contract and associated commodities that are treated as substantially the same as a commodity underlying a core referenced futures contract for purposes of the term "location basis contract" as such term is used in the referenced contract definition under § 150.1, and as such term is discussed in appendix C to this part.

LOCATION BASIS CONTRACT LIST OF SUBSTANTIALLY THE SAME COMMODITIES

Core Referenced Futures Contract	Commodities Considered Substantially the Same (regardless of location)	Source(s) for Specification of Quality
NYMEX Light Sweet Crude Oil futures contract (CL)	1. Light Louisiana Sweet (LLS) Crude Oil	1a) NYMEX Argus LLS vs. WTI (Argus) Trade Month futures contract (E5)
		1b) NYMEX LLS (Argus) vs. WTI Financial futures contract (WJ)
		1c) ICE Futures Europe Crude Diff—Argus LLS vs WTI 1st Line Swap futures contract (ARK)
		1d) ICE Futures Europe Crude Diff—Argus LLS vs WTI Trade Month Swap futures contract (ARL)
NYMEX New York Harbor ULSD Heating Oil	1. Chicago ULSD	1a) NYMEX Chicago ULSD (Platts) vs. NY Harbor ULSD Heating Oil futures contract (5C)

Core Referenced Futures Contract	Commodities Considered Substantially the Same (regardless of location)	Source(s) for Specification of Quality
futures contract (HO)		
	2. Gulf Coast ULSD	2a) NYMEX Group Three ULSD (Platts) vs. NY Harbor ULSD Heating Oil futures contract (A6)
		2b) NYMEX Gulf Coast ULSD (Argus) Up-Down futures contract (US)
		2c) NYMEX Gulf Coast ULSD (Platts) Up-Down Spread futures contract (LT)
		2d) ICE Futures Europe Diesel Diff- Gulf Coast vs Heating Oil 1st Line Swap futures contract (GOH)
		2e) CME Clearing Europe Gulf Coast ULSD(Platts) vs. New York Heating Oil (NYMEX) Spread Calendar swap (ELT)
		2f) CME Clearing Europe New York Heating Oil (NYMEX) vs. European Gasoil (IC) Spread Calendar swap (EHA)
	3. California Air Resources Board Spec ULSD (CARB no. 2 oil)	3a) NYMEX Los Angeles CARB Diesel (OPIS) vs. NY Harbor ULSD Heating Oil futures contract (KL)
	4. Gas Oil Deliverable in Antwerp, Rotterdam, or Amsterdam Area	4a) ICE Futures Europe Gasoil futures contract (G)
		4b) ICE Futures Europe Heating Oil Arb—Heating Oil 1st Line vs Gasoil 1st Line Swap futures contract (HOT)
		4c) ICE Futures Europe Heating Oil Arb—Heating Oil 1st Line vs Low Sulphur Gasoil 1st Line Swap futures contract (ULL)
		4d) NYMEX NY Harbor ULSD Heating Oil vs. Gasoil futures contract (HA)
NYMEX RBOB Gasoline futures contract (RB)	1. Chicago Unleaded 87 gasoline	1a) NYMEX Chicago Unleaded Gasoline (Platts) vs. RBOB Gasoline futures contract (3C)
		1b) NYMEX Group Three Unleaded Gasoline (Platts) vs.

Core Referenced Futures Contract	Commodities Considered Substantially the Same (regardless of location)	Source(s) for Specification of Quality
		RBOB Gasoline futures contract (A8)
	2. Gulf Coast Conventional Blendstock for Oxygenated Blending (CBOB) 87	2a) NYMEX Gulf Coast CBOB Gasoline A1 (Platts) vs. RBOB Gasoline futures contract (CBA)
		2b) NYMEX Gulf Coast Unl 87 (Argus) Up-Down futures contract (UZ)
	3. Gulf Coast CBOB 87 (Summer Assessment)	3a) NYMEX Gulf Coast CBOB Gasoline A2 (Platts) vs. RBOB Gasoline futures contract (CRB)
	4. Gulf Coast Unleaded 87 (Summer Assessment)	4a) NYMEX Gulf Coast 87 Gasoline M2 (Platts) vs. RBOB Gasoline futures contract (RVG)
	5. Gulf Coast Unleaded 87	5a) NYMEX Gulf Coast Unl 87 Gasoline M1 (Platts) vs. RBOB Gasoline futures contract (RV)
		5b) CME Clearing Europe Gulf Coast Unleaded 87 Gasoline M1 (Platts) vs. New York RBOB Gasoline (NYMEX) Spread Calendar swap (ERV)
	6. Los Angeles California Reformulated Blendstock for Oxygenate Blending (CARBOB) Regular	6a) NYMEX Los Angeles CARBOB Gasoline (OPIS) vs. RBOB Gasoline futures contract (JL)
	7. Los Angeles California Reformulated Blendstock for Oxygenate Blending (CARBOB) Premium	7a) NYMEX Los Angeles CARBOB Gasoline (OPIS) vs. RBOB Gasoline futures contract (JL)
	8. Euro-BOB OXY NWE Barges	8a) NYMEX RBOB Gasoline vs. Euro-bob Oxy NWE Barges (Argus) (1000mt) futures contract (EXR)
		8b) CME Clearing Europe New York RBOB Gasoline (NYMEX) vs. European Gasoline Euro-bob Oxy Barges NWE (Argus) (1000mt) Spread Calendar swap (EEXR)
	9. Euro-BOB OXY FOB Rotterdam	9a) ICE Futures Europe Gasoline Diff—RBOB Gasoline 1st Line vs. Argus Euro-BOB OXY FOB Rotterdam Barge Swap futures contract (ROE)

Appendix E to Part 150 – Speculative Position Limit Levels

Contract	Spot Month	Single Month and All-Months-Combined
Legacy Agricultural		
Chicago Board of Trade Corn (C)	1,200	57,800
Chicago Board of Trade Oats (O)	600	2,000
Chicago Board of Trade Soybeans (S)	1,200	27,300
Chicago Board of Trade Soybean Meal (SM)	1,500	16,900
Chicago Board of Trade Soybean Oil (SO)	1,100	17,400
Chicago Board of Trade Wheat (W)	1,200	19,300
Chicago Board of Trade KC HRW Wheat (KW)	1,200	12,000
Minneapolis Grain Exchange Hard Red Spring Wheat (MWE)	1,200	12,000
ICE Futures U.S. Cotton No. 2 (CT)	900	5,950 (single month) 11,900 (all-months-combined)
Other Agricultural		
Chicago Board of Trade Rough Rice (RR)	800	Not Applicable
Chicago Mercantile Exchange Live Cattle (LC)	600/300/200[1]	Not Applicable
ICE Futures U.S. Cocoa (CC)	4,900	Not Applicable
ICE Futures U.S. Coffee C (KC)	1,700	Not Applicable
ICE Futures U.S. FCOJ-A (OJ)	2,200	Not Applicable
ICE Futures U.S. Sugar No. 11 (SB)	25,800	Not Applicable
ICE Futures U.S. Sugar No. 16 (SF)	6,400	Not Applicable
Energy		

[1] Step-down spot month limits apply to positions net long or net short as follows: 600 contracts at the close of trading on the first business day following the first Friday of the contract month; 300 contracts at the close of trading on the business day prior to the last five trading days of the contract month; and 200 contracts at the close of trading on the business day prior to the last two trading days of the contract month.

Contract	Spot Month	Single Month and All-Months-Combined
New York Mercantile Exchange Henry Hub Natural Gas (NG)	2,000[2]	Not Applicable
New York Mercantile Exchange Light Sweet Crude Oil (CL)	6,000/5,000/4,000[3]	Not Applicable
New York Mercantile Exchange NY Harbor ULSD (HO)	2,000	Not Applicable
New York Mercantile Exchange RBOB Gasoline (RB)	2,000	Not Applicable
Metal		
Commodity Exchange, Inc. Copper (HG)	1,000	Not Applicable
Commodity Exchange, Inc. Gold (GC)	6,000	Not Applicable
Commodity Exchange, Inc. Silver (SI)	3,000	Not Applicable
New York Mercantile Exchange Palladium (PA)	50	Not Applicable
New York Mercantile Exchange Platinum (PL)	500	Not Applicable

[2] For persons that are not availing themselves of the § 150.3(a)(4) conditional spot month limit exemption in natural gas, the 2,000 contract spot month speculative position limit level applies to: (1) the physically-settled NYMEX Henry Hub Natural Gas (NG) core referenced futures contract and any other physically-settled contract that qualifies as a referenced contract to NYMEX Henry Hub Natural Gas (NG) under the definition of "referenced contract" under § 150.1, in the aggregate across all exchanges listing a physically-settled NYMEX Henry Hub Natural Gas (NG) referenced contract and the OTC swaps market, net long or net short; and (2) the cash-settled NYMEX Henry Hub Natural Gas (NG) referenced contracts, net long or net short, on a per-exchange basis for each exchange that lists one or more cash-settled NYMEX Henry Hub Natural Gas (NG) referenced contract(s) rather than aggregated across such exchanges. Further, an additional 2,000 contract limit, net long or net short, applies across all cash-settled economically equivalent NYMEX Henry Hub Natural Gas (NG) OTC swaps.

[3] Step-down spot month limits apply to positions net long or net short as follows: 6,000 contracts at the close of trading three business days prior to the last trading day of the contract; 5,000 contracts at the close of trading two business days prior to the last trading day of the contract; and 4,000 contracts at the close of trading one business day prior to the last trading day of the contract.

Appendix F to Part 150 – Guidance on, and Acceptable Practices in, Compliance with the Requirements for Exchange-set Limits and Position Accountability on Commodity Derivative Contracts

The following are guidance and acceptable practices for compliance with § 150.5. Compliance with the acceptable practices and guidance does not diminish or replace, in any event, the obligations and requirements of the person to comply with the other regulations provided under this part. The acceptable practices and guidance are for illustrative purposes only and do not state the exclusive means for establishing compliance with § 150.5.

(a) *Acceptable practices for compliance with § 150.5(b)(2)(i) regarding exchange-set limits or accountability outside of the spot month.* A designated contract market or swap execution facility that is a trading facility may satisfy § 150.5(b)(2)(i) by complying with either of the following acceptable practices:

(1) *Non-spot month speculative position limits.* For any commodity derivative contract subject to § 150.5(b), a designated contract market or swap execution facility that is a trading facility sets individual single month or all-months-combined levels no greater than any one of the following:

(i) The average of historical position sizes held by speculative traders in the contract as a percentage of the average combined futures and delta-adjusted option month-end open interest for that contract for the most recent calendar year;

(ii) The level of the spot month limit for the contract;

(iii) 5,000 contracts (scaled-down proportionally to the notional quantity per contract relative to the typical cash-market transaction if the notional quantity per contract is larger than the typical cash-market transaction, and scaled up proportionally to

the notional quantity per contract relative to the typical cash-market transaction if the notional quantity per contract is smaller than the typical cash-market transaction); or

(iv) 10 percent of the average combined futures and delta-adjusted option month-end open interest in the contract for the most recent calendar year up to 50,000 contracts, with a marginal increase of 2.5 percent of open interest thereafter.

(2) *Non-spot month position accountability.* For any commodity derivative contract subject to § 150.5(b), a designated contract market or swap execution facility that is a trading facility adopts position accountability, as defined in § 150.1.

(b) [Reserved]

Appendix G to Part 150—Guidance on Spread Transaction Exemptions Granted for Contracts that are Subject to Federal Speculative Position Limits

Positions that comply with § 150.3(a)(2)(i) or (ii) may exceed Federal speculative position limits, provided that the entity separately requests a spread transaction exemption from the relevant exchange's position limits established pursuant to proposed § 150.5(a). The following provides guidance to exchanges and market participants on the use of spread transaction exemptions granted pursuant to § 150.5(a). Exchanges and market participants may also consider this guidance for purposes of spread transaction exemptions granted pursuant to § 150.5(b). The following guidance includes recommendations for exchanges and market participants to consider when granting or relying on spread transaction exemptions for positions that include referenced contracts that are subject to Federal speculative position limits.

(a) *General guidance on spread transaction exemptions for referenced contracts.* (1) When granting spread transaction exemptions pursuant to § 150.5(a), an exchange should:

(i) Collect sufficient information from the market participant to be able to:

(A) Understand the spread strategy, consistent with § 150.5(a)(2)(ii)(A); and

(B) Verify that there is a material economic relationship between the legs of the spread transaction, consistent with the requirement in § 150.5(a)(2)(ii)(G) to grant exemptions in accordance with sound commercial practices;

(ii) Consider whether granting the spread transaction exemption would, to the maximum extent practicable:

(A) Ensure sufficient market liquidity for bona fide hedgers; and

(B) Not unduly reduce the effectiveness of Federal speculative position limits to:

(*1*) Diminish, eliminate, or prevent excessive speculation;

(*2*) Deter and prevent market manipulations, squeezes, and corners; and

(*3*) Ensure that the price discovery function of the underlying market is not disrupted;

(iii) Consider implementing safeguards to ensure that when granting spread transaction exemptions, especially during the spot period, the exchange is able to comply with all statutory and regulatory obligations, including the requirements of:

(A) DCM Core Principle 2 and SEF Core Principle 2, as applicable, to, among other things, prohibit abusive trading practices on its markets by members and market participants, and prohibit any other manipulative or disruptive trading practices prohibited by the Act or Commission regulations;

(B) DCM Core Principle 4 and SEF Core Principle 4, as applicable, to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures;

(C) DCM Core Principle 5 and SEF Core Principle 6, as applicable, to implement exchange-set position limits in a manner that reduces the potential threat of market manipulation or congestion; and

(D) DCM Core Principle 12, as applicable, to protect markets and market participants from abusive practices committed by any party, including abusive practices

committed by a party acting as an agent for a participant; and to promote fair and equitable trading on the contract market;

(iv) Ensure that any spread exemption transaction does not impede convergence or facilitate the formation of artificial prices; and

(v) Provide a cap or limit on the maximum size of all gross positions permitted under the spread transaction exemption.

(2) The Commission reminds market participants that when utilizing a spread transaction exemption, compliance with Federal speculative position limits or an exemption thereto does not confer any type of safe harbor or good faith defense to a claim that the participant has engaged in an attempted or perfected manipulation or willfully circumvented or evaded speculative position limits, consistent with the Commission's anti-evasion provision in § 150.2(i).

(b) *Guidance on transactions permitted under the spread transaction definition.* (1) The Commission understands that market participants are generally familiar with the meaning of intra-market spreads, inter-market spreads, intra-commodity spreads, and inter-commodity spreads, as those terms are used in the spread transaction definition in § 150.1. However, for the avoidance of confusion, the Commission provides the following descriptions of such spread strategies to assist exchanges in their analysis of whether a spread position complies with the spread transaction definition. The Commission generally understands that the following spread strategies are typically defined as follows:

(i) *Intra-market spread* means a long (short) position in one or more commodity derivative contracts in a particular commodity, or its products or by-products, and a short (long) position in one or more commodity derivative contracts in the same, or similar, commodity, or its products or by-products, on the same designated contract market or swap execution facility.

(ii*) Inter-market spread* means a long (short) position in one or more commodity derivative contracts in a particular commodity, or its products or by-products, at a particular designated contract market or swap execution facility and a short (long) position in one or more commodity derivative contracts in that same, or similar, commodity, or its products or by-products, away from that particular designated contract market or swap execution facility.

(iii) *Intra-commodity spread* means a long (short) position in one or more commodity derivatives contracts in a particular commodity, or its product or by-products, and a short (long) position in one or more commodity derivative contracts in the same, or similar, commodity, or its products or by-products.

(iv) *Inter-commodity spread* means a long (short) position in one or more commodity derivatives contracts in a particular commodity, or its product or by-products, and a short (long) position in one or more commodity derivative contracts in a different commodity or its products or by-products.

(2) The following is a non-exhaustive list of spread strategies that comply with the spread transaction definition in § 150.1:

(i) An inter-market spread transaction in which the legs of the transaction are futures contracts in the same, or similar commodity, or its products or its by-products, and same calendar month or expiration;

(ii) A spread transaction in which one leg is a referenced contract, as defined in § 150.1, and the other leg is a commodity derivative contract, as defined in § 150.1, that is not a referenced contract (including over-the-counter commodity derivative contracts);

(iii) A spread transaction between a physically-settled contract and a cash-settled contract;

(iv) A spread transaction between two cash-settled contracts; and

(v) Spread transactions that are "legged in," that is, carried out in two steps, or alternatively are "combination trades," that is, all components of the spread are executed simultaneously or contemporaneously.

(3) A spread transaction exemption cannot be used to exceed the conditional spot month limit exemption, in § 150.3(a)(4), for positions in natural gas.

(4) The spread transaction definition does not include a single cash-settled agreement, contract or transaction that, by its terms and conditions:

(i) Simply represents the difference (or basis) between the settlement price of a referenced contract and the settlement price of another contract, agreement, or transaction (whether or not a referenced contract), and

(ii) Does not comprise separate long and short positions.

(5) The spread transaction definition does not include a spread position involving a commodity index contract and one or more referenced contracts.

(c) *Guidance on cash-and-carry exemptions.* The spread transaction definition in § 150.1 would permit transactions commonly known as "cash-and-carry" trades whereby a market participant enters a long futures position in the spot month and an equivalent short futures position in the following month, in order to guarantee a return that, at minimum, covers the costs of its carrying charges, *such as* the cost of financing, insuring, and storing the physical inventory until the next expiration (including insurance, storage fees, and financing costs, as well as other costs such as aging discounts that are specific to individual commodities). With this exemption, the market participant is able to take physical delivery of the product in the nearby month and may redeliver the same product in a deferred month. When determining whether to grant, and when monitoring, cash-and-carry spread transaction exemptions, the exchange should consider:

(1) Implementing safeguards to require a market participant relying on such an exemption to reduce its position below the speculative Federal position limit within a timely manner once market prices no longer permit entry into a full carry transaction;

(2) Implementing safeguards that require market participants to liquidate all long positions in the nearby contract month before the price of the nearby contract month rises to a premium to the second (2nd) contract month; and

(3) Requiring market participants that seek to rely on such exemption to:

(i) Provide information about their expected cost of carrying the physical commodity, and the quantity of stocks currently owned in exchange-licensed warehouses or tank facilities; and

(ii) Agree that before the price of the nearby contract month rises to a premium to the second (2nd) contract month, the market participant will liquidate all long positions in the nearby contract month.

PART 151 [REMOVED AND RESERVED]

27. Under the authority of section 8a(5) of the Commodity Exchange Act, 7 U.S.C. 12a(5), remove and reserve part 151.

Issued in Washington, DC, on November 12, 2020, by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Position Limits for Derivatives – Commission Voting Summary, Chairman's Statement, and Commissioners' Statements

Appendix 1 – Commission Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz and Stump voted in the affirmative. Commissioners Behnam and Berkovitz voted in the negative.

Appendix 2 – Statement of Support of Chairman Heath P. Tarbert

I am very proud to bring to a final vote the Commission's rule on speculative position limits. Like my fellow Commissioners and so many who have held these seats before us, I promised during my confirmation hearing that I would work to finalize this rule. So to the Senate Committee on Agriculture, Nutrition, and Forestry, to the market participants who rely on futures markets, and to the American people, I am pleased to say—promise made, promise kept.

Today, we are removing a cloud that has hung over both the CFTC and the derivatives markets for a decade. Market participants, particularly Americans who need these markets to hedge the risks inherent in their businesses, will finally have regulatory certainty.

Long Journey of Position Limits

Ralph Waldo Emerson is quoted as saying "Life is a journey, not a destination." Lucky for him, his journey did not involve position limits. This rule has been one of the most difficult undertakings in CFTC history.

The Commission has issued five position limits proposals over the past 10 years. The first was adopted in 2011, but vacated by the U.S. District Court for the District of Columbia before it took effect. One proposal issued in 2013, and two more in 2016, were never finalized. All told, those four proposals received thousands of comments from the public—the vast majority of which objected to the proposals for good reason. Much ink was spilled, and many trees were felled over those proposals.

Finally, the Commission issued its fifth position limits proposal in January of this year. Today we will finalize that rule. But it is important to note we are not completely

rejecting prior attempts. Instead, we build on the good from previous proposals while recognizing and fixing their shortcomings.

Any position limits rule involves a balancing act. To paraphrase a famous saying – *You can please some of the people all the time, and all the people some of the time, but*—as is certainly the case with position limits—*you can't please all the people all the time*.

That is especially true given the three things the Commission is tasked with balancing for position limits:

1. whether position limits on a particular contract are more helpful than harmful;
2. which positions should be subject to the limits and which should not; and
3. at what levels position limits should be set to allow for liquid markets but not excessive speculation.

Recognizing Dead Ends

Prior position limits proposals ultimately failed because they were unable to strike the correct balance on these three points.

First, prior proposals were based on a plausible, but ultimately unsupportable, interpretation—"the mandate." The mandate would mean there is no balancing test; instead, all futures would be subject to Federal limits. Given the wide range of futures in our markets, this approach would require the CFTC to evaluate thousands of contracts. It also would necessitate limits on everything—regardless of the benefits those limits would bring or the burdens they would impose.

Second, prior proposals failed to recognize all the ways that participants use futures markets to hedge price risks. Agricultural, energy, and metal futures markets are a vital to American businesses, which is why Congress explicitly excluded bona fide hedging positions from position limits. Reading the term bona fide hedging too broadly risks inviting the wolf of speculative activity into the market wearing sheep's clothing.

Reading it too narrowly creates the possibility of locking out the businesses that need these markets to manage their risks. And taking away that ability to manage risk jeopardizes economic growth.

As a result, the Commission's prior proposals were too restrictive on what constitutes bona fide hedging. They threw up too many roadblocks for businesses to access futures markets. Ultimately, an overly rigid interpretation of bona fide hedging stood in the way of finalizing a position limits rule.

Finally, prior proposals set limits that were both too low and too rigid. Those limits did not balance the need for liquidity and price discovery against the risks of excessive speculation, which is the real mandate of Congress. The proposed limits were frozen in time, not budging from limits last updated as far back as 1999.

Getting Back on the Right Path

Recognizing the missteps of the past yields a path to success. Unlike prior position limits proposals that garnered a library of negative comment letters, this proposal is overwhelmingly supported by businesses and trade groups across many facets of our real economy.

There are several differences that will let today's rule succeed where others failed.

First, the rule recognizes the limits of limits. Position limits are *one* method to combat corners and squeezes, but that does not mean they are the singular tool that should always be deployed. Position limits are like a medicine that can help cure a disease, but also carries potential side effects. That is why Congress told us to use them only when "necessary." The necessity finding is like a doctor's prescription—someone needs to evaluate the risks of the disease against the side effects.

In addition, the rule takes into account market participants' needs. As I have always said, position limits is the rare case where the exception is as important as the rule. Today's rule lays out a robust set of enumerated bona fide hedge exemptions to

ensure that participants in the physical commodity markets can access the futures markets. Building on the proposal, we have added clarity around unfixed price transactions and storage.

The rule also acknowledges the different ways people access the markets. We have streamlined the process for pass-through swap exemptions, making it easier for dealers to provide liquidity to commercial users in the swaps market. And the rule clarifies that someone can take a position during the Commission's 10-day review period of an exchange-granted, non-enumerated exemption. In short, we have built a robust set of enumerated exemptions and a workable non-enumerated exemption process.

The rule also strikes a balance with respect to the limits themselves. The January proposal included significant increases to spot and non-spot limits for the legacy agricultural products. Many commenters were concerned about these increases, particularly for non-spot limits.

The level of the non-spot limits in the final rule are a function of the significant growth in the market and the long delay in making adjustments. Open interest in many of the legacy grains contracts has doubled or tripled since we last updated position limits, reflecting the usefulness of these contracts as a benchmark for cash market transactions and faith in CFTC-regulated markets. The non-spot limits we are adopting are the same percentage of today's open interest as the 2011 limits were compared to open interest back then. Our markets have grown tremendously, and we cannot expect them to be subject to the same limits they were 10 years ago.

It is important to remember that Federal position limits are a ceiling, not a floor. Exchanges have their own limits, which can be no higher than what we specify. And exchanges can calibrate those limits quickly to account for issues with deliverable supply or other cash market issues. As we have seen play out over the past decade, the CFTC has a difficult time adjusting position limits. Therefore, exchange-set limits are a way to

fine tune position limits on a particular market within the outer bounds of the Federal limits. Similar to the process for granting non-enumerated exemptions, we are leveraging the knowledge of the exchanges as well as their ability to act more nimbly to respond to market needs.

Arriving at the Destination

Some of my colleagues may see these features of the final rule as a flaw. While there are significant departures from prior proposals, after four *failed* attempts, that departure is exactly what we need. The flexibility in the necessity finding, the exemption process, and the adjusted limits are what make this rule workable. Otherwise, we are just repeating past mistakes and hoping for a different result—the very definition of insanity.

So let me conclude by saying that we have come a long way. Today we have reached the end of an arduous journey. We have learned from our mistakes and adjusted our approach. We have balanced the interests of all the participants in these markets—some of which are in diametric opposition to one another. Most importantly, we have crafted a workable and flexible system. The rule sets hard limits, but leverages the flexibility of exchanges to adjust for a particular market. The rule recognizes the variety of ways that businesses use these markets to hedge their risks, while recognizing how vital it is to have a method to address the unknown unknowns. And the rule acknowledges that position limits are not always necessary and sets out a solid methodology for determining when they are.

I again want to thank the CFTC staff and my fellow Commissioners for their tireless commitment to finishing this journey. I look forward to voting in favor of this final rule.

Appendix 3 – Supporting Statement of Commissioner Brian Quintenz

I am pleased to support the agency's revitalized approach to position limits. The rulemaking finalized today follows four proposals since the passage of the Dodd-Frank

Act[1712]and is, by far, the strongest of them all. I commend Chairman Tarbert for his leadership in completing this rulemaking. I am very pleased that today's final rule echoes the key policy points I outlined in my remarks before the 2018 Commodity Markets Council State of the Industry Conference.[1713] The new position limits regime will provide commercial market participants with sufficient flexibility to hedge their risks efficiently and will promote liquidity and price discovery.

Today's rule promotes flexibility, certainty, and market integrity for end-users – farmers, ranchers, energy producers, transporters, processors, manufacturers, merchandisers, and all who use physically-settled derivatives to risk manage their exposure to physical goods. The rule includes an expansive list of enumerated and self-effectuating bona fide hedge exemptions and spread exemptions, and a streamlined, exchange-centered process to adjudicate non-enumerated bona fide hedge exemption requests. I am pleased that the rule seriously considered the usability of hedging exemptions, and I thank Commissioner Stump for her leadership on that point.

In contrast to the Commission's failed proposed rulemakings in 2011, 2013, and 2016, this rule is the most true to the CEA in many significant respects. It requires, as has long been the Commission's practice, a necessity finding before imposing limits. It includes economically equivalent swaps. And, perhaps most importantly, it balances the interests among promoting liquidity, deterring manipulation, and ensuring the price discovery function of the underlying market is not disrupted.[1714] The confluence of these factors occurs most acutely in the spot month for physically-settled contracts. In the spot month, price convergence is exceptionally vulnerable to potential manipulation or

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[1712] 76 FR 4752 (Jan. 26, 2011); 78 FR 75680 (Dec. 12, 2013); 81 FR 38458 (June 13, 2016) ("supplemental proposal"); and 81 FR 96704 (Dec. 30, 2016). The Commodity Exchange Act (CEA) addresses position limits in Section (Sec.) 4a (7 U.S.C. 6a).

[1713] Remarks of Commissioner Brian Quintenz before the CMC State of the Industry 2018 Conference, https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz5.

[1714] Sec. 4a(a)(3).

disruption due to outsized positions. By establishing position limits for non-legacy contracts only in the spot month, the rule elegantly balances the countervailing policy interests enumerated in the statute.

Responding to the Public's Concerns

Through staff's serious consideration of over 70 public comments, the final rule significantly improves on what appears in the proposal. Examples of modifications based on public comment include considerations of gross hedging, price risk, the pass-through swap exemption, spot month limits for natural gas and cotton, a special non-spot single-month limit for cotton, spread exemptions, and the Commission's review of exchange-granted non-enumerated hedge exemptions.

With regard to enumerated bona fide hedges, the final rule took into account several suggestions from commenters. The proposed enumerated hedges were already a significant improvement upon previously proposed hedge exemptions (for example, eliminating a mandatory "five-day rule"[1715] and no longer conditioning cross-commodity hedging on a needlessly rigid quantitative test). Now, under the final rule, the enumerated hedges will be even more practical. For example, the final rule makes clear that a hedger with only an unfixed-price cash commodity sale or purchase, but not an offsetting pair, may rely on one of the three anticipatory hedges, provided that the other elements of such hedge are also met, even though the hedger is ineligible to elect the hedge for a pair of unfixed-price sale and purchase transactions.[1716] The final rule also makes clear that the new anticipatory merchandising hedge can be used both by integrated energy firms and by firms that limit their business to merchandising. Furthermore, the final rule permits the anticipatory merchandising hedge to now be used in connection with storage hedges.

[1715] Previous versions of enumerated hedges had required a hedger to eliminate positions in excess of position limits during the last five days of the spot month.

[1716] Preamble discussion of Exemptions from Federal Position Limits. The hedge for a pair of offsetting unfixed-price transactions is described in Appendix B, paragraph (a)(3), and the anticipatory hedges are described in Appendix B, paragraphs (a)(4) – (6).

I support the final rule's determination to delay by two years two important elements that will require significant changes in the marketplace: the imposition of position limits on swaps economically equivalent to the referenced futures contracts and the required unwinding of previously elected risk management exemptions.[1717] It is prudent to allow for additional time for financial entities to adjust to these significant new policies.

Necessity Finding

Today's rule correctly premises new limits on a finding that they are necessary to diminish, eliminate, or prevent the burden on interstate commerce from extraordinary price movements caused by excessive speculation ("necessity finding") in specific contracts, as Congress has long required in the CEA and its legislative precursors since 1936.[1718] I am pleased that the rule complies with the District Court's ruling in the ISDA-position limits litigation: that the Commission must decide whether Section 4a of the CEA mandates the CFTC set new limits or only permits the CFTC to set such limits pursuant to a necessity finding.[1719] As the District Court noted, "the Dodd-Frank amendments do not constitute a clear and unambiguous mandate to set position limits."[1720] I agree with the rule's determination that, when read together, paragraphs (1) and (2) of Section 4a demand a necessity finding.

Section 4a(a)(2)(A) states that the Commission shall establish limits "in accordance with the standards set forth in paragraph (1) of this subsection."[1721] Paragraph (1) establishes the Commission's authority to, "proclaim and fix such limits on the

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[1717] Whereas the general compliance date for the final rule is January 1, 2022, the compliance date for these two items is January 1, 2023.

[1718] Sec. 4a(1).

[1719] *ISDA et al. v CFTC*, 887 F. Supp. 2d 259, 278 and 283-84 (D.D.C. Sept. 28, 2012).

[1720] *Id*. at 280.

[1721] Sec. 4a(a)(2)(A) ("In accordance with the standards set forth in paragraph (1) of this subsection and consistent with the good faith exception cited in subsection (b)(2), with respect to physical commodities other than excluded commodities as defined by the Commission, the Commission shall by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a designated contract market.")

amounts of trading… as the Commission finds are necessary to diminish, eliminate or prevent [the] burden" on interstate commerce caused by unreasonable or unwarranted price moves associated with excessive speculation. This language dates back almost verbatim to legislation passed in 1936, in which Congress directed the CFTC's precursor to make a necessity finding before imposing position limits. The Congressional report accompanying the CEA from the 74th Congress includes the following directive, "[Section 4a of the CEA] gives the Commodity Exchange Commission the power, after due notice and opportunity for hearing and a finding of a burden on interstate commerce caused by such speculation, to fix and proclaim limits on futures trading ..."[1722] In its ISDA opinion, the District Court noted the following: "This text clearly indicated that Congress intended for the CFTC to make a 'finding of a burden on interstate commerce caused by such speculation' prior to enacting position limits."[1723]

I support the rule's view that the most natural reading of Section 4a(a)(2)(A)'s reference to paragraph (1)'s "standards" is that it logically includes the "necessity" standard. Paragraph (1)'s requirement to make a necessity finding, along with the aggregation requirement, provide substantive guidance to the Commission about when and how position limits should be implemented.

If Congress intended to mandate that the Commission impose position limits on all physical commodity derivatives, there is little reason it would have referred to paragraph (1) and the Commission's long established practice of necessity findings. Instead, Congress intended to focus the Commission's attention on whether position limits should be considered for a broader set of contracts than the legacy agricultural contracts, but did not mandate those limits be imposed.

Setting New Limits "As Appropriate"

[1722] H.R. Rep. 74-421, at 5 (1935).

[1723] 887 F. Supp. 2d 259, 269 (fn 4).

The rule determines that position limits are necessary to diminish, eliminate, or prevent the burden on interstate commerce posed by unreasonable or unwarranted prices moves that are attributable to excessive speculation in 25 referenced commodity markets that each play a crucial role in the U.S. economy. Conversely, the rule also finds that the contracts on which the referenced limits are placed are the only contracts which met the necessity finding. The rule explicitly states that no other contracts met this test.

I am aware that there is significant skepticism in the marketplace and among academics as to whether position limits are an appropriate tool to guard against extraordinary price movements caused by extraordinarily large position size. Some argue there is no evidence that excessive speculation currently exists in U.S. derivatives markets.[1724] Others believe that large and sudden price fluctuations are not caused by hyper-speculation, but rather by market participants' interpretations of basic supply and demand fundamentals.[1725] In contrast, still others believe that outsized speculative positions, however defined, may aggravate price volatility, leading to price run-ups or declines that are not fully supported by market fundamentals.[1726]

In my opinion, one thing is predominately clear: position limits should not be viewed as a means to counteract long-term directional price moves. The CFTC is not a price setting agency and we should not impede the market from reflecting long term

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[1724] Testimony of Erik Haas (Director, Market Regulation, ICE Futures U.S.) before the CFTC at 70 (Feb. 26, 2015) ("We point out the makeup of these markets, primarily to show that any regulations aimed at excessive speculation is a solution to a nonexistent problem in these contracts."), *available at*: https://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/emactranscript022615.pdf.

[1725] BAHATTIN BÜYÜKŞAHIN & JEFFREY HARRIS, CFTC, THE ROLE OF SPECULATORS IN THE CRUDE OIL FUTURES MARKET 1, 16-19 (2009) ("Our results suggest that price changes leads the net position and net position changes of speculators and commodity swap dealers, with little or no feedback in the reverse direction. This uni-directional causality suggests that traditional speculators as well as commodity swap dealers are generally trend followers."), *available at* http://www.cftc.gov/idc/groups/public/@swaps/documents/file/plstudy_19_cftc.pdf; Testimony of Philip K. Verleger, Jr. before the CFTC, Aug. 5, 2009 ("The increase in crude prices between 2007 and 2008 was caused by the incompatibility of environmental regulations with the then-current global crude supply. Speculation had nothing to do with the price rise."), *available at:* https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/hearing080509_verleger.pdf.

[1726] For a discussion of studies discussing supply and demand fundamentals and the role of speculation, *see* 81 FR 96704, 96727 (Dec. 30, 2016). *See, e.g.,* Hamilton, Causes and Consequences of the Oil Shock of 2007–2008, Brookings Paper on Economic Activity (2009); Chevallier, Price Relationships in Crude oil Futures: New Evidence from CFTC Disaggregated Data, Environmental Economics and Policy Studies (2012).

supply and demand fundamentals. A case in point is palladium, the physically-settled contract which has seen the largest sustained price increase recently,[1727] and which has also seen its exchange-set position limit decline four times since 2014 to what is now the smallest limit of any contract in the referenced contract set.[1728] Nevertheless, between the start of 2018 and the end of 2019, palladium futures prices rose 76%.[1729] Taking these conflicting views and facts into account, it is clear the Commission correctly stated in its 2013 proposal, "there is a demonstrable lack of consensus in the [academic] studies" as to the effectiveness of position limits.[1730]

With that healthy dose of skepticism, and in strict accordance with the balance of factors which Dodd Frank added to the CEA for the Commission to consider, I think the rule appropriately focuses on the time period and contract type where position limits can have the most positive, and the least negative, impact - the spot month of physically settled contracts - while also calibrating those limits to function as just one of many tools in the Commission's regulatory toolbox that can be used to promote credible, well-functioning derivatives and cash commodity markets.

Because of the significance of these 25 core referenced futures contracts to the underlying cash markets, the level of liquidity in the contracts, as well as the importance of these cash markets to the national economy, I think it is appropriate for the Commission to protect the physical delivery process and promote convergence in these critical commodity markets. Further, the limits issued today are higher than in the past,

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[1727] *Platinum, gold slide as dollar soars; palladium eases off record*, Reuters (Sept. 30, 2019), *available at:* https://www.reuters.com/article/global-precious/precious-platinum-gold-slide-as-dollar-soars-palladium-eases-off-record- idUSL3N26L3UV.

[1728] Between 2014 and 2017, the CME Group lowered the spot month position limit in the contract four times, from 650, to 500, to 400, to 100, to the current limit of 50 (NYMEX regulation 40.6(a) certifications, filed with the CFTC, 14-463 (Oct. 31, 2014), 15-145 (Apr. 14, 2015), 15-377 (Aug. 27, 2015), and 17-227 (June 6, 2017)), *available at*: https://sirt.cftc.gov/sirt/sirt.aspx?Topic=ProductTermsandConditions.

[1729] Palladium futures were at $1,087.35 on Jan. 2, 2018 and at $1,909.30 on Dec. 31, 2019. Historical prices *available at*: https://futures.tradingcharts.com/historical/PA_/2009/0/continuous.html.

[1730] 78 FR 75694 (Dec. 12, 2013).

notably because the rule utilizes current estimates of deliverable supply - numbers which haven't been updated since 1999.[1731]

Taking End-Users Into Account

Perhaps more than any other area of the CFTC's regulations, position limits directly affect the participants in America's real economy: farmers, ranchers, energy producers, manufacturers, merchandisers, transporters, and other commercial end-users that use the derivatives market as a risk management tool to support their businesses. I am pleased that today's rule takes into account many of the serious concerns that end-users voiced in response to this rulemaking's proposal, and in response to the CFTC's previous four unsuccessful position limits proposals.

Importantly, and in response to many comments, this rule, for the first time, expands the possibility for enterprise-wide hedging,[1732] (including additional clarification provided in the proposal in response to comments), establishes an enumerated anticipated merchandising exemption,[1733] eliminates the "five-day rule" for enumerated hedges,[1734] and no longer requires the filing of certain cash market information with the Commission that the CFTC can obtain from exchanges.[1735] Regarding enterprise-wide hedging – otherwise known as "gross hedging" – the rule will provide an energy company, for example, with increased flexibility to hedge different units of its business separately if those units face different economic realities. The final rule eliminates the requirement that exchanges document their justifications when allowing gross hedging; clarifies that market participants are not required to develop written policies or procedures that set

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[1731] 64 FR 24038 (May 5, 1999).

[1732] Appendix B, paragraph (a).

[1733] Appendix A, paragraph (a)(6).

[1734] Preamble discussion of Exemptions from Federal Position Limits.

[1735] Elimination of CFTC Form 204.

forth when gross versus net hedging is appropriate; and clarifies that gross hedging is permissible for both enumerated and non-enumerated hedges.[1736]

With respect to cross-commodity hedging, today's rule completely rejects the arbitrary, unworkable, ill-informed, and frankly, ludicrous "quantitative test" from the 2013 proposal.[1737] That test would have required a correlation of at least 0.80 or greater in the spot markets prices of the two commodities for a time period of at least 36 months in order to qualify as a cross-hedge.[1738] Under this test, longstanding hedging practices in the electric power generation and transmission markets would have been prohibited. Today's rule not only shuns this Government-Knows-Best approach, it also establishes new flexibility for the cross-commodity hedging exemption, allowing it to be used in conjunction with other enumerated hedges, such as hedges of anticipated merchandising transactions.[1739] For example, an energy marketer anticipating buying and selling jet fuel to supply airports will be eligible for a hedge exemption in connection with trading heating oil futures, a commonly-used cross-commodity hedge for jet fuel.

Bona Fide Hedges and Coordination with Exchanges

For those market participants who employ non-enumerated bona fide hedging practices in the marketplace, the final rule creates a streamlined, exchange-focused process to approve those requests for purposes of both exchange-set and Federal limits. I am pleased that commenters were generally supportive of the proposed process. As the marketplaces for the core referenced futures contracts addressed by the proposal, the DCMs have significant experience in, and responsibility towards, a workable position limits regime. CEA core principles require DCMs and swap execution facilities to set position limits, or position accountability levels, for the contracts that they list in order to

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[1736] Preamble discussion, Execution Summary, section 6. Legal Standards for Exemptions from Position Limits.

[1737] 78 FR 75717 (Dec. 12, 2013).

[1738] *Id*.

[1739] Appendix A, paragraph (a)(11).

reduce the threat of market manipulation.[1740] DCMs have long administered position limits in futures contracts for which the CFTC has not set limits, including in certain agricultural, energy, and metals markets. In addition, the exchanges have been strong enforcers of their own rules: during 2018 and 2019, CME Group and ICE Futures US concluded 32 enforcement matters regarding position limits.

As part of their stewardship of their own position limits regimes, DCMs have long granted bona fide hedging exemptions in those markets where there are no Federal limits. Today's final rule provides what I believe is a workable framework to utilize exchanges' long standing expertise in granting exemptions that are not enumerated by CFTC rules.[1741] This rule also recognizes that the CEA does not provide the Commission with free rein to delegate all of the authorities granted to it under the statute.[1742] The Commission itself, through a majority vote of the five Commissioners, retains the ability to reject an exchange-granted non-enumerated hedge request within 10 days of the exchange's approval.[1743] The Commission has successfully and responsibly used a similar process for both new contract listings as well as exchange rule filings, and I am pleased to see the final rule expand that approach to non-enumerated hedge exemption requests that will limit the uncertainty for bone fide commercial market participants.

Limits on Swaps

The CEA requires the Commission to consider limits not only on exchange-traded futures and options, but also on "economically equivalent" swaps.[1744] Today's final rule provides the market with far greater certainty on the universe of such swaps than the

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[1740] DCM Core Principle 5 (sec. 5 of the CEA, 7 U.S.C. 7) (implemented by CFTC regulation 38.300) and SEF Core Principle 6 (sec. 5h of the CEA, 7 U.S.C. 7b-3) (implemented by CFTC regulation 37.600).

[1741] Regulation 150.9.

[1742] Preamble discussion of regulation 150.9, including references to cases pointing out the extent to which an agency can delegate to persons outside of the agency.

[1743] Regulation 150.9(e)(6).

[1744] Sec. 4a(5).

previous proposed rulemakings. Prior proposals failed to sufficiently explain what constituted an "economically equivalent swap," thereby ensuring that compliance with position limits was essentially unworkable, given real-time aggregation requirements and ambiguity over in-scope contracts. In stark contrast, today's rule narrows the scope of "economically equivalent" swaps to those with material contractual specifications, terms, and conditions that are identical to exchange-traded contracts.[1745] For example, in order for a swap to be considered "economically equivalent" to a physically-settled core referenced futures contract, that swap would also have to be physically-settled, because settlement type is considered a material contractual term. I believe the narrowly-tailored definition included in today's rule will provide market participants with clarity over those contracts subject to position limits. I think it is prudent that the final rule took commenters' concerns about updating compliance systems into account by delaying for an additional year, beyond the general compliance date of January 1, 2022, that is until January 1, 2023, the imposition of position limits on economically equivalent swaps.

Conclusion

During my confirmation hearing in front of the Senate Committee on Agriculture, Forestry and Nutrition on July 27, 2017, I was asked to directly commit to finalizing a position limits rule. My response was brief, but unquestionable: "Yes, I commit to support finalizing a position limits rule." Making such a commitment to a committee of the U.S. Congress in sworn testimony is something I take very seriously, second only to taking my oath to defend the Constitution of the United States. With today's vote, I am very pleased to have made good on that commitment three years in the making and am even more proud of the product with which I was able to fulfill it.

[1745] Regulation 150.1.

Appendix 4 – Dissenting Statement of Commissioner Rostin Behnam

Introduction

The last time we gathered as a Commission to discuss position limits I used some of my time to speak a bit about the award winning movie, *Ford v Ferrari*.[1746] At that point, we were nearing the airing of the 92nd Academy Awards and this action-packed drama had earned four nominations—not to mention the distinction of being one of the few films I actually saw in a theater. For those of you who have not found it in one of your quarantine movie queues, *Ford v Ferrari* tells the true story of American car designer Carroll Shelby and British-born driver Ken Miles who built a race car for Ford Motor Company—the GT40—and competed with Enzo Ferrari's dominating, iconic red racing cars at the 1966 24 Hours of Le Mans.[1747] I used the film and racing metaphors throughout my speaking and written statements to highlight serious concerns that the proposed amendments to the CFTC rules addressing position limits (the "Proposal") signified yet one more instance where the Commission seemed to be comfortable with deferring core, congressionally mandated duties to others and calling it a victory.[1748]

We are here today to finalize the Proposal.[1749] In just short of nine months, we have come to terms with life during a global pandemic complete with economic turmoil and pockets of historic market volatility. Amid the mere 60-day open comment period following the Proposal's publication in the Federal Register (graciously extended by 16 days to May 15th in light of the pandemic[1750]), on April 20th, the price of the West Texas Intermediate crude oil futures contract ("WTI contract"), a key benchmark in the energy

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[1746] Statement of Dissent by Commissioner Rostin Behnam Regarding Position Limits for Derivatives; Proposed Rule, https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement013020 (the "Dissent").

[1747] Ford v Ferrari, FOX MOVIES, https://www.foxmovies.com/movies/ford-v-ferrari (Last visited Oct. 13, 2020).

[1748] Dissent.

[1749] *See* Position Limits for Derivatives, 85 FR 11596 (Feb. 27, 2020).

[1750] *See* Press Release Number 8146-20, CFTC, CFTC Extends Certain Comment Periods in Response to COVID-19 (Apr. 10, 2020), https://www.cftc.gov/PressRoom/PressReleases/8146-20; Extension of Currently Open Comment Periods for Rulemakings in Response to the COVID-19 Pandemic, 85 FR 22690, 22691 (Apr. 23, 2020).

and financial markets, experienced an unprecedented collapse one day prior to the last day of trading and expiration for May delivery.[1751] Defying market mechanics, the price of the contract fell from $17.73 per barrel at market open, to a closing settlement price of negative $37.63—with the price dropping approximately $40 in the last 20 minutes of trading.[1752] And, while we are still in recovery, with great fanfare after almost 10 years, the Commission is going to establish the position limits regime required under the Dodd-Frank Act. I am reminded again of Ken who, at the 1966 24 Hours of Le Mans, went against his gut, giving way and leaving behind a milestone in car racing that to this day remains elusive.

If you have not seen the movie, this is a spoiler alert: Ken did not win Le Mans in '66. While he was one and a half laps ahead of two other GT40s, he was given orders to slow down so that the three Fords in the lead would cross the finish line in a dead heat formation. Ken lost his well-deserved win because the 24 Hours of Le Mans awards the victory to the car that covers the greatest distance in 24 hours. In the event of a tie, the rules provided that the car that had started farther down the grid had traveled the greater distance. Ken's GT 40 had started in the grid roughly 60 feet ahead of the GT40 driven by Bruce McLaren and Chris Amon, who were the declared winners.[1753]

In the film, Ken seems to accept his loss with quiet dignity. However, in reality he was fully aware that in many respects, he had been robbed. From what I've read, Ken likely articulated his feelings a bit more colorfully.[1754]

[1751] *See* Statement of Commissioner Dan M. Berkovitz on Recent Trading in the WTI Futures Contract before the Energy and Environmental Markets Advisory Committee Meeting (May 7, 2020), https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement050720.

[1752] *See* Bloomberg News, *The 20 Minutes that Broke the U.S. Oil Market,* BLOOMBERG (Apr. 25, 2020), https://www.bloomberg.com/news/articles/2020-04-25/the-20-minutes-that-broke-the-u-s-oil-market?sref=DzeLiNol.

[1753] Press Release, Ford Division News Bureau, For Immediate Release at 8 (July 5, 1966), made available in PDF at Wikipedia, the Free Encyclopedia, 1966 24 Hours of Le Mans, at https://en.wikipedia.org/wiki/1966_24_Hours_of_Le_Mans.

[1754] Matthew Phelan, *What's Fact and What's Fiction in Ford v. Ferrari*, SLATE (Nov. 18, 2019), https://slate.com/culture/2019/11/ford-v-ferrari-fact-vs-fiction-le-mans-ken-miles.html.

The point is that bringing something across the finish line doesn't always equate to a success. As detailed in my questions today, I believe that by going against our Congressional mandate and clear statutory intent by overly deferring to the exchanges, we have relinquished a claim to victory in this final position limits rule which in many ways has itself felt like the CFTC's version of the 24 hours of Le Mans. Therefore, I will go with my gut and not be part of the formation in supporting this final rule.

A Long Road, But a Fast Finish

It has been nine years since the Commission first set out to establish the position limits regime required by amendments to section 4a of the Commodity Exchange Act (the "Act" or "CEA")[1755] under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[1756] While today's final rule purports to respect Congressional intent and the purpose and language of CEA section 4a, in reality, it pushes the bounds of reasonable interpretation by overly deferring to the exchanges[1757] and allowing them to take the lead in administering a position limits regime.

In passing the Dodd-Frank Act, Congress understood that for the derivatives markets in physical commodities to perform optimally, there needed to be limits on the amount of control exerted by a single person (or persons acting in agreement). In fact, Congress has understood this need since at least 1936, when it first authorized the Commission's predecessor to impose limits on speculative positions in order to prevent the harms caused by excessive speculation. In tasking the Commission with establishing limits and the framework around their operation, Congress was aware of our relationship with the exchanges, but nevertheless opted for our experience and our expertise to meet the policy objectives of the Act.

[1755] *See* Position Limits for Derivatives, 76 FR 4752 (proposed Jan. 26, 2011) (the "2011 Proposal").

[1756] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 sec. 737, 124 Stat. 1376, 1722-25 (2010) (the "Dodd-Frank Act").

[1757] Unless otherwise indicated, the use of the term "exchanges" throughout this statement refers to designated contract markets ("DCMs") and swap execution facilities ("SEFs").

Last January, as the Commission voted on the Proposal that is being finalized today, I warned that we seemed to be pushing to go faster and just get to the finish line, making real-time adjustments without regard to even trying for that "perfect lap."[1758] Just nine months later, nothing has changed. If anything, we seem to be further prioritizing just crossing the finish line over achieving a rule that actually follows Congressional intent and its first order priority: protecting market participants from excessive speculation.

Letting the Exchanges Make the Call

As I argued in regard to the proposal, my principal disagreement is with the Commission's determination to in effect disregard the tenets supporting the statutorily created parallel Federal and exchange-set position limit regime, and take a back seat when it comes to administration and oversight.[1759] Like Ken Miles, the Commission is relinquishing a rightful lead in an act of deference. In doing so, the Commission claims victory for recognizing that the exchanges are better positioned in terms of resources, information, knowledge, and agility, and therefore ought to take the wheel. While this may seem like the logical move, it ignores that even if we operate as a team, our incentives and interests are not fully aligned. Based on consideration of the Commission's mission, and Congressional intent as evinced in the Dodd-Frank Act amendments to CEA section 4a and elsewhere in the Act, I continue to believe that (1) the Commission is required to establish position limits based on its reasoned and expert judgment within the parameters of the Act; (2) the Commission has not provided a rational basis for its determination *not* to establish Federal limits outside of the spot month for referenced contracts based on commodities other than the nine legacy agricultural commodities; and (3) the Commission's seemingly unlimited flexibility in

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[1758] Dissent.

[1759] *Id.*

deciding to (a) significantly broaden the bona fide hedging definition, (b) codify an expanded list of self-effectuating enumerated bona fide hedges, and (c) provide for exchange recognition of non-enumerated bona fide hedge exemptions with respect to Federal limits, is both inexplicably complicated to parse and inconsistent with Congressional intent.

Not only does the final version of the rule fail to address these deficiencies in the proposal, it actually goes and makes many of these issues worse.

Ignoring a Mandate

Like the proposal, this final rule goes to great lengths to reconcile whether CEA section 4a(a)(2)(A) requires the Commission to make an antecedent necessity finding before establishing any position limit,[1760] with the implication that if a necessity finding is required, then the Commission could rationalize imposing no limits at all. Looking back at the record, what is necessary is that the Commission complies with the mandate in the Dodd-Frank Act.[1761] In the 2011 Proposal, the Commission provided a review of CEA section 4a(a)—interpreting the various provisions, giving effect to each paragraph, acknowledging the Commission's own informational and experiential limitations regarding the swaps markets at that time, and focusing on the Commission's primary mission of fostering fair, open and efficient functioning of the commodity derivatives markets.[1762] Of note, "Critical to fulfilling this statutory mandate," the Commission pronounced, "is protecting market users and the public from undue burdens that may result from 'excessive speculation.'"[1763] Federal position limits, as predetermined by Congress, are most certainly the only means towards addressing the burdens of excessive

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[1760] *See* Final Rule at III.

[1761] The Commission's analysis in support of its denial of a mandate misconstrues form over substance and assumes the answer it is looking for. The Commission seems to suggest that it is free to ignore a Congressional mandate if it determines that Congress is wrong about the underlying policy. *See* Final Rule at III.A.

[1762] 76 FR at 4752-4754.

[1763] *Id.* at 4753.

speculation when such limits must address a "proliferation of economically equivalent instruments trading in multiple trading venues."[1764] Exchange-set position limits or accountability levels simply cannot meet the mandate.

In exercising its authority, the Commission may evaluate whether exchange-set position limits, accountability provisions, or other tools for contracts listed on such exchanges are currently in place to protect against manipulation, congestion, and price distortions.[1765] Such an evaluation—while permissible—is just one factor for consideration. The existence of exchange-set limits or accountability levels, on their own, can neither predetermine deference nor be justified absent substantial consideration. As I argued in my dissenting statement regarding the Proposal, the authority and jurisdiction of individual exchanges are necessarily different than that of the Commission. They do not always have congruent interests to the Commission in monitoring instruments that do not trade on or subject to the rules of their particular platform or the market participants that trade them. They do not have the attendant authority to determine key issues such as whether a swap performs or affects a significant price discovery function, or what instruments fit into the universe of economically equivalent swaps. They are not permitted to define bona fide hedging transactions or grant exemptions for purposes of Federal position limits. It is therefore clear that CEA section 4a, as amended by the Dodd-Frank Act "warrants extension of Commission-set position limits beyond agricultural products to metals and energy commodities."[1766]

"If it ain't broke, don't fix it"

In spite of all of this—the foregoing mandate; the clear Congressional intent in CEA section 4a(a)(3)(A); and the Commission's real experience and expertise (including

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[1764] *Id.* at 4754-4755.

[1765] *See* 76 FR at 4755.

[1766] *Id.*

its unique data repository)—the Commission's final rule only maintains Federal non-spot month limits for the nine legacy agricultural contracts (with questionably appropriate modifications), "because the Commission has observed no reason to eliminate them."[1767] Essentially, the Commission concludes: "if it ain't broke, don't fix it." In keeping with this relatively riskless course of action, the Commission similarly concludes that Federal non-spot month limits are not necessary for the remaining 16 proposed core referenced futures contracts identified in the Final Rule.

In so doing, the Commission ignores Congressional intent. The Commission never considers that Congress directed the Commission to establish limits—not accountability levels. The Commission's observation that exchange-set accountability levels have "functioned as-intended" until this point in time ignores the wider purpose and function of aggregate position limits established by the Commission, and is shortsighted given the ever expanding universe of economically equivalent instruments trading across multiple trading venues. As I pointed out in my dissenting statement regarding the Proposal, it seems odd to conclude that Congress envisioned that its painstaking amendments to CEA section 4a were a directive for the Commission to check the box that the current system is working perfectly.

Hedging on Bona Fide Hedging

Today's Final Rule provides for significantly broader bona fide hedging opportunities that will be largely self-effectuating, and the Commission defers to the exchanges in recognizing non-enumerated bona fide hedging. While I support enhancing the cooperation between the Commission and the exchanges, the Commission here is cooperating by dropping back. The Commission's decision to essentially give up primary authority to recognize non-enumerated bona fide hedges seems both careless and inconsistent with Congressional intent.

[1767] Final Rule at II.B.2.i.

I raised these concerns last January when we voted on the Position Limits Proposal. Unfortunately, rather than retaking the lead, the Commission further cedes authority to the exchanges. The Proposal provided the Commission with the authority to reject an exchange's grant of non-enumerated bona fide hedge recognition, and provided a window of ten business days (or two in the case of sudden or unforeseen circumstances) for the Commission to make this determination. I pointed out in my dissent that this did not give the Commission nearly enough time or guidance to properly make a determination. In today's Final Rule, the Commission actually further reduces its ability to make an independent determination. Now, market participants will be able to establish positions based upon an exchange's non-enumerated bona fide hedge recognition during the Commission's 10-day review period, and the Commission cannot determine that the person holding the position has committed a position limits violation during the Commission's ongoing review or upon issuing its determination. This reduces the Commission's review to an ineffectual afterthought.

Trust the Process

A clear theme in my statements regarding our many rules over the last few years is this: process matters. Sharing our viewpoints with the public matters. Following the Administrative Procedure Act,[1768] and giving the public an opportunity for meaningful comment on our proposals, matters. We are at our best when we involve all five Commissioners and our many stakeholders in the process.

I want to thank the Chairman for consistently providing the Commissioners with drafts of proposed and final rules 30 days in advance of an open meeting. I believe there have only been two major exceptions over the course of our many laps in the last year: the position limits proposal, and the position limits final rule. In the case of the final rule, we did not receive a full draft until last Friday – six days before the open meeting. This

[1768] 5 U.S.C. 553(b).

simply is not enough time for the Commission to engage in a fulsome discussion of the merits of the rule, and makes the final rule more or less a fait accompli. Perhaps most perplexing is that we did not receive a draft of the cost benefit considerations until two weeks ago. This is literally a rule where a prior iteration resulted in a court challenge – one that the Commission lost.[1769] If ever a rule required more consideration by the Commission itself, this would seem to be it. Instead, the Commissioners actually had less time to review and consider the rule than we normally do.

When we focus on just getting to the finish line, and do not take the time for meaningful consideration and dialogue, we risk failing to take into account everything that we should in our rulemakings. Subsequent to the issuance of the Position Limits Proposal, there was a major market event resulting from the ongoing pandemic that may have important implications for our position limits regime. As the NYMEX Light Sweet Crude Oil (CL) contract, also known as the WTI contract, neared expiration in April 2020, the contract experienced extreme volatility, with the market trading below zero for the first time. The Commission received at least eight comments that addressed this event; a number of commenters noted that the extreme volatility was driven by speculators. The speculators, unable to physically deliver upon expiration for various reasons, had no choice but to exit the contract at whatever price was available. Commission staff continues to review and analyze this event, and the rule today recognizes that the analysis may impact the rule itself. Today's preamble states: "The Commission will continue to analyze the events of April 20 to evaluate whether any changes to the position limits regulations may be warranted in light of the circumstances surrounding the volatility in the WTI contract."[1770] This begs the question – if the

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[1769] *Int'l Swaps & Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n*, 887 F. Supp. 2d 259 (D.D.C. 2012).

[1770] Final Rule at I.G.

Commission is currently in the midst of this analysis, why not wait to finalize position limits until the analysis is complete?

Conclusion

Before concluding, I want to acknowledge and thank the Commission staff who worked on the Proposal, today's final rule, and every related study, matter, and undertaking to support it for the better part of 10 years. You were the design team, the engineers, the production team and the pit crew. You kept us on course at a pace set by our Chairman, and you have performed at the top of your field.

Back in '66, by holding back, Ken Miles lost the win at Le Mans, which denied him the "Triple Crown" of endurance racing: the 24 Hours of Daytona, the 12 Hours of Sebring, and the 24 Hours of Le Mans. No driver has won all three races in the same year, [1771] and Ken missed out because he was part of a team and Ford had been good to him. [1772] He committed and moved forward without the victory that should have been his because he was the best driver that day. I am committed to vote and move forward, even if it means giving up the triple crown of the day. But I will not go against my gut.

[1771] Martin Raffauf, *Porsche and the Triple Crown of endurance racing*, PORSCHE ROAD & RACE (Dec. 7, 2018), https://www.porscheroadandrace.com/porsche-and-the-triple-crown-of-endurance-racing/.

[1772] Phelan, *supra* note 9.

Appendix 5 – Statement of Commissioner Dawn D. Stump

Overview

With all that has transpired in our country and in our lives this year, it feels like ages ago that we gathered together in person to consider proposing amendments to update the Commission's rules regarding position limits back at the end of January. At the time, I said that there were three guideposts by which I would evaluate that proposal: First, is it reasonable in design? Second, is it balanced in approach? And third, is it workable in practice for both market participants and for the Commission?

Since I believed the answer to each of these questions was yes, I supported issuing the proposal. And by and large, my belief has been confirmed by the comments we received from those who trade in this country's derivatives markets. In the months since January, we have heard from all corners of the marketplace – agricultural interests, energy interests, managed fund advisors, and dealers that provide liquidity, to name a few – that have voiced support for the fundamental architecture of the position limits framework that we proposed. Their support stands in stark contrast to the serious concerns they had expressed about the several previous position limit proposals put forward by the Commission during the past decade.

Of course, each interest had its issues with one aspect or another in the proposal. That is to be expected, given the varied and sometimes divergent objectives for our position limit rules set out in the Commodity Exchange Act ("CEA").[1773] Congress has tasked us with adopting position limits that: 1) on the one hand, diminish, eliminate or prevent excessive speculation in derivatives and deter and prevent market manipulation, squeezes, and corners; while on the other hand, and simultaneously 2) ensuring sufficient

[1773] CEA Section 4a(a), 7 U.S.C. 6a(a).

market liquidity for bona fide hedgers and ensuring that the price discovery function of the underlying market is not disrupted and does not shift to foreign competitors.

Reasonable minds will always differ as to exactly where to draw the line among these statutory objectives. But while we must always strive for perfection, we cannot permit that aspiration to paralyze us from acting to improve our rule sets. The final position limit rules before us smooth some of the rough edges in the proposal, and they address the areas in which I expressed some misgivings at the time. They incorporate valuable input we have received from the exchanges that operate the markets and the businesses that trade in those markets.

And above all, the final rulemaking is reasonable in design, balanced in approach, and workable in practice. For these reasons, I am pleased to support it.

Bona Fide Hedging and Spread Transactions: Policy and Process

In commenting on the proposal in January, I noted two areas that I felt could be improved: 1) the list of enumerated bona fide hedging transactions and positions; and 2) the process for reviewing hedging transactions outside of that list. I want to briefly address each of these concerns, in turn.

Enumerated Bona Fide Hedges

The CEA prohibits the Commission from adopting position limit rules that apply to bona fide hedging transactions or positions, as such terms are defined by the Commission. It gives the Commission the authority to define the term "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 . . ."[1774] Congress thereby recognized the critical function of our derivatives markets in enabling those whom we all depend upon to deliver goods and

[1774] CEA Section 4a(c)(1), 7 U.S.C. 6a(c)(1).

services to hedge their risks – both risks they currently bear as well as those they reasonably anticipate.[1775]

The Commission's proposal recognized this as well, as it expanded the list of "enumerated" bona fide hedging transactions that are identified in our current rules. Positions taken as a result of these enumerated hedging transactions constitute bona fide hedging, and therefore are not subject to Federal speculative position limits. This expansion of the list of enumerated bona fide hedges is entirely appropriate (indeed, it is long overdue). Hedging practices at companies that produce, process, trade, and use agricultural, energy, and metals commodities have become far more sophisticated, complex, and global over time, and the Commission's list of enumerated hedging practices to which its position limit rules do not apply has failed to keep pace with these realities.

And given Congress' recognition of the appropriateness of hedging legitimate anticipated business needs,[1776] the proposal also added, at my request, anticipatory merchandising as an enumerated bona fide hedge. There is no policy basis for distinguishing hedging risks of anticipated merchandising from hedging risks of other activities in the physical supply chain.

Yet, I was concerned in January that our proposed list of enumerated bona fide hedges still might not be as robust as it should be. We needed input on this question from market participants – especially those in the energy and metals sectors where we are

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[1775] The CEA provides that a bona fide hedging transaction or position is one that, among other things, "is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise." CEA Section 4a(c)(2)(A)(ii), 7 U.S.C. 6a(c)(2)(A)(ii). The Commission's policy in administering Federal position limits in the agricultural sector over the years has been to limit this economically appropriate test to the hedging of price risk. However, as set forth in the final rulemaking release, the Commission acknowledges, consistent with that historical policy, that price risk can be impacted by various non-price risks.

[1776] CEA Section 4a(c)(1), 7 U.S.C. 6a(c)(1). *See also* CEA Section 4a(c)(2)(A)(iii)(I), 7 U.S.C. 6a(c)(2)(A)(iii)(I) (bona fide hedging transaction or position is a transaction or position that, among other things, "arises from the potential change in the value of . . . assets that a person owns, produces, manufactures, processes, or merchandises or *anticipates* owning, producing, manufacturing, processing, or merchandising . . ." (emphasis added)).

applying Federal position limits for the first time. And that input was nearly unanimous in recommending that hedging the risk of unfixed-price forward transactions be added to the list of enumerated bona fide hedges.

Hedges of offsetting unfixed-price cash commodity sales and purchases have historically been recognized as an enumerated bona fide hedge under our rules, and that was carried over in the proposal, too. These are hedges of risk incurred where a market participant has both bought and sold the underlying cash commodity at unfixed prices. We received many comments, though, urging us to include as an enumerated bona fide hedge those situations in which the purchase or sale, but not both, is an unfixed-price forward transaction. Some commenters asked that the historical enumerated hedge for offsetting unfixed-price cash commodity sales and purchases be expanded to cover unfixed-price cash commodity sales or purchases; others asked the Commission to create a new, stand-alone enumerated bona fide hedge category for these unfixed-price transactions. The final rulemaking concludes that neither step is necessary because, as suggested by still other commenters, commercial market participants may qualify for one of the enumerated anticipatory bona fide hedges that will be available, to the extent of their demonstrated anticipated need.[1777]

Spread Transactions

Although the treatment of spread transactions for purposes of Federal position limits is distinct from the treatment of bona fide hedging transactions, I would like to take a short detour to note an important similarity between the two. That is, we also received numerous comments suggesting that the proposed definition of a spread transaction, which would be exempt from Federal position limits, was too narrow.

[1777] These enumerated anticipatory bona fide hedges include: 1) the existing enumerated bona fide hedge for unsold anticipated production; 2) the existing enumerated bona fide hedge for anticipated requirements; and 3) the new enumerated bona fide hedge established in this rulemaking for anticipated merchandising.

At the suggestion of commenters, the final rulemaking adds the well-established categories of intra-market, inter-market, and intra-commodity spreads to the list of defined spreads that fall outside the Federal position limits regime. The release notes that as a result, the spread transaction definition captures most, if not all, spread exemptions currently granted by exchanges and used by market participants. The rulemaking appropriately recognizes that these spread positions simply do not raise the type of concerns that position limits are intended to address.

The Non-Enumerated Bona Fide Hedge Recognition Process

Getting the list of enumerated bona fide hedges right is important because they are "self-effectuating" for purposes of Federal position limits. In other words, a trader need not count positions that result from enumerated bona fide hedging transactions towards the Federal position limits, and does not need to apply to the Commission for approval (although the trader still must receive approval from the relevant exchange to exceed exchange-set limits).

Other hedging practices, generally referred to as "non-enumerated" hedges, can still be recognized as bona fide hedging, but only after a review process. A trader can either ask the exchange and the Commission to separately review and approve the proposed non-enumerated hedging activity for purposes of exchange and Federal limits, respectively, or it can follow what the rulemaking calls a "streamlined" process. Under that process, if an exchange recognizes a non-enumerated transaction as a bona fide hedge for purposes of the exchange's position limits, the Commission would then review the exchange's bona fide hedge recognition for application to Federal limits as well. The Commission must notify the exchange and market participant of any denial within 10 business days, or 2 business days in the case of an application based on a sudden or unforeseen increase in the trader's bona fide hedging needs (although that timeline can be extended if the Commission issues a stay or requests additional information).

In January, I expressed reservations about whether this 10/2-day process would be workable in practice for either market participants or the Commission because it appeared to be both too long and too short: 1) too long to be workable for market participants that may need to take a hedge position quickly; and 2) too short for the Commission to meaningfully review the relevant circumstances related to the exchange's recognition of the hedge as bona fide. But while some commenters took the "too long" view and others took the "too short" view, the majority of commenters were generally supportive of this process.

The final rulemaking adopts the 10/2-day process, with an adjustment recommended by several commenters as well as participants in a meeting of the Commission's Energy and Environmental Markets Advisory Committee ("EEMAC")[1778] that discussed the position limits proposal. That is, the final rulemaking now provides that a trader can exceed Federal limits based on the exchange's approval of the non-enumerated hedge while the Commission is conducting its assessment. This is not a delegation of authority to the exchange, since the Commission will still make the final determination whether positions resulting from the non-enumerated hedging transaction should count towards Federal position limits. Thus, a trader that exceeds Federal limits in reliance on the initial exchange determination runs the risk that the Commission will later deny the requested non-enumerated hedge. In that event, the trader will have to reduce the position to come into compliance with limits within a commercially reasonable period of time.

Is it a perfect process? It is not. My preference would have been that recognition of non-enumerated hedges be the responsibility of the exchanges, which are most familiar

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[1778] *See, e.g.,* Transcript of CFTC Energy and Environmental Markets Advisory Committee Meeting at 103:14-17, Comment by Thomas LaSala, CME Group (May 7, 2020) ("the Commission should permit a participant to exceed Federal position limits during the 10-day/2-day Commission review period of an exchange-granted exemption"), *available at* https://www.cftc.gov/sites/default/files/2020/06/1591218221/eemactranscript050720.pdf.

with both their own markets and the hedging practices of participants in those markets. The Commission, in turn, has the tools it needs to monitor this process through its routine, ongoing review of the exchanges. But those who participate in the markets have generally expressed the view that this is a reasonable, balanced, and workable process. And so, I support it.

Response to Commenter Objections

Before concluding, I would like to briefly respond to a couple of points raised by commenters that were critical of the proposed position limit rules. Some commenters argued that: 1) the amendments to the CEA's position limit provisions that were enacted as part of the Dodd-Frank Act[1779] constitute a mandate for the Commission to establish Federal position limits without having to make an antecedent finding that such limits are necessary to achieve the CEA's objectives; and 2) the rules we are adopting improperly abdicate Commission responsibilities with respect to Federal position limits to the exchanges.

The Commission's Mandate to Impose Position Limits it Finds are Necessary

As I read the statute, the CEA's position limit provisions, as amended by the Dodd-Frank Act, mandate the Commission to impose position limits that it finds are necessary. The basis for my view is set out in detail in my Statement in support of the proposal last January, which included an explanatory graphic. Both of these documents are available on the Commission's website for those who are interested,[1780] and so I will not repeat that analysis here. Suffice it to say, though, that I have not seen anything in the comment letters we received that changes my view.

[1779] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203 (2010) ("Dodd-Frank Act").

[1780] *See* Statement of Commissioner Dawn D. Stump Regarding Proposed Rule: Position Limits for Derivatives (January 30, 2020), and Commodity Exchange Act § 4a(a): Finding Position Limits Necessary is a Prerequisite to the Mandate for Establishing Such (January 30, 2020), *available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement013020.

The Role of the Exchanges

I fundamentally disagree with the suggestion that the amended position limit rules that we are adopting in any way reflect an inappropriate reliance by the Commission on the exchanges. My disagreement is rooted in several considerations.

First, the CEA itself states without limitation that it is the purpose of the CEA to serve the public interests described in the statute "through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission."[1781] This is an overarching statement of purpose by Congress, and is the lens through which all other provisions of the CEA – including its position limit provisions – must be interpreted. And nothing in the amendments to those position limit provisions enacted as part of the Dodd-Frank Act indicate otherwise.

Second, the rules we are adopting do not delegate any authority of the Commission to the exchanges. With respect to applications for non-enumerated bona fide hedges in particular, the Commission will be informed by an exchange's determination whether to recognize the hedge for purposes of exchange-set limits. But the determination whether to do so with respect to Federal limits is the Commission's alone to make, and a trader who trades in reliance on an exchange determination risks having to reduce the position if the Commission subsequently disagrees with the exchange's determination.

Third, the exchanges know their markets.[1782] They have a comprehensive understanding of the traders that participate in those markets as well as current hedging practices in agricultural, energy, and metals commodities. Indeed, the expertise of the

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[1781] CEA Section 3(b), 7 U.S.C. 5(b).

[1782] It is notable that, due to certain trading dynamics unique to natural gas contracts, including the existence of liquid cash-settled contracts trading on three different exchanges, the final rulemaking for the Federal conditional spot-month limit is derived from the existing exchange framework that has been in place for approximately a decade.

exchanges makes them uniquely well-suited to make the initial determination on requests for non-enumerated bona fide hedges in real-time.

Finally, I return once again to my foundational principles: Reasonable, balanced, and workable. A system in which a business must put its economic needs and risk management efforts on hold while the Commission undertakes to learn about its operations and hedging activities in order to pass upon a request for a non-enumerated bona fide hedge violates all three principles.

Conclusion

After nearly a decade of trying, we stand on the cusp of amending the Commission's position limit rules, which are sorely in need of updating. Before us is a thorough and well-reasoned final rulemaking release that considers the extensive comments we received, and clearly presents the Commission's rationale in addressing those comments and adopting the rules in the form that we are adopting them. The fact that this release is before us less than nine months after we issued the proposal – in the midst of a pandemic, no less – is a tribute to the dedication, perseverance, and analytical capabilities of the professionals in the Commission's Division of Market Oversight, Office of General Counsel, and Chief Economist's Office. Their work on this rulemaking has been nothing short of amazing.

My fellow Commissioners and I have each publicly committed that we would work to finish a position limits rulemaking. The time has come to fulfill that commitment. The release that staff has presented is reasonable in design, balanced in approach, and workable for both market participants and the Commission. I am pleased to support it.

Appendix 6 – Dissenting Statement of Commissioner Dan M. Berkovitz

I. Introduction

I dissent from today's position limits final rule ("Final Rule"). The Final Rule fails to achieve the most fundamental objective of position limits: to prevent the harms arising from excessive speculation. It is another disappointing chapter in the Commission's 10-year saga to implement Congress's mandate in the Dodd-Frank Act to impose speculative position limits in the energy, metals, and agricultural markets. In a number of instances, the Final Rule appears more intent on limiting the actions and discretion of the Commission than it does on actually limiting such speculation.

As I previously observed, the proposed rule demoted the Commission from head coach to Monday-morning quarterback. The Final Rule declares that the players on the field are the referees. In this arena, the public interest loses.

I support effective position limits to restrain excessive speculation in physical commodity markets, coupled with legitimate bona fide hedge exemptions for commercial market participants. The Final Rule, however, fails to address excessive speculation in several key respects:

First, the Final Rule impermissibly permits private entities to devise new bona fide hedge exemptions, while simultaneously constricting the Commission's review and enforcement of such privately-created exemptions.

Second, the Final Rule fails to address trading at settlement ("TAS") transactions. The potential for market manipulation through the use of TAS is well documented. The Final Rule was a valuable but wasted opportunity to address an important type of transaction in many commodity markets that, if abused, can present risks to orderly trading and price discovery.

Third, while the Final Rule eliminates the risk management exemptions that had been granted to a limited number of index funds, it also increases the non-spot month limits to accommodate the speculative positions of these funds in the futures markets. Cumulatively, index funds can have a substantial price impact and exacerbate volatility.

Their monthly position rolls can also distort inter-month spreads. Yet the Commission performed no assessment of the impact of potential increases in this type of speculation that these higher limits would permit.[1783]

Fourth, the Final Rule misinterprets the Dodd-Frank Act and reverses decades of precedent by declaring, for the first time, that the Commission must make antecedent necessity findings on a commodity-by-commodity basis prior to imposing Federal speculative position limits.

II. Physical Commodity Markets Benefit from Position Limits and Appropriate Bona Fide Hedge Exemptions

Position limits help prevent market manipulation and price distortion arising from excessively large speculative positions in futures, options, and swaps tied to physical commodities. Section 4a of the CEA reflects Congress's long-standing determination that excessive speculation in a commodity can cause "sudden," "unreasonable," or "unwarranted" fluctuations and changes in commodity prices.[1784] Section 4a directs the Commission to establish speculative position limits to address these harms, while also providing that such limits shall not apply to "transactions or positions which are shown to be bona fide hedging transactions or positions, *as those terms are defined by the Commission . . . .*"[1785]

Experience from decades of limits in agricultural commodities teaches that a properly crafted position limits regime is an "effective prophylactic measure" to protect American businesses, consumers, and market participants that rely on physical commodity derivatives markets.[1786] The parameters of an effective position limits regime are well established. They include: (1) meaningful limits on excessive speculation to

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[1783] For detailed comments on the effects of large speculative positions of index funds, *see* Better Markets Comments Letter, at 8-12 (May 15, 2020).

[1784] 7 U.S.C. 6a.

[1785] 7 U.S.C. 6a(c)(1) (emphasis added).

[1786] Establishment of Speculative Position Limits, 46 FR 50938 (Oct. 16, 1981).

help prevent market manipulation and price distortion; (2) recognition of bona fide hedging activities and exemptions to permit producers, end-users, merchants, and others to manage their commercial risks; and (3) clear divisions of responsibility, consistent with the CEA, that recognize the complimentary but distinct roles of exchanges, the Commission, and market participants in administering a position limits regime.

Federal speculative position limits have been in place to protect derivatives markets since the 1930s. The Commission or its predecessors adopted position limits for grains in 1938, cotton in 1940, and soybeans in 1951. In 1981, the Commission adopted rules requiring exchange limits for all commodities for which there were no Federal limits—a rule which notably did not require an antecedent, commodity-by-commodity necessity finding. The Commission has also consistently relied on exchanges to help administer the position limits regime, including position accountability and enumerated bona fide hedge exemptions.

These efforts, spanning over 80 years, have helped prevent manipulation and price distortion through a complementary system that relies on the respective expertise of Commission, exchange, and market participant stakeholders. The Final Rule discards this balance. The Final Rule relies excessively on exchanges and market participants to permit positions as bona fide hedges, and in so doing impermissibly delegates the Commission's statutory responsibility to determine what constitutes a bona fide hedge.[1787]

III. Significant Flaws in the Final Rule

A. *The Final Rule Permits Market Participants to Violate Federal Speculative Position Limits with No Prior Commission Recognition of a Bona Fide Hedge Exemption*

[1787] "[W]hile Federal agency officials may sub-delegate their decision-making authority to subordinates absent evidence of contrary congressional intent, they may not sub-delegate to outside entities—private or sovereign—absent affirmative evidence of authority to do so.'' *U.S. Telecom Ass'n v. FCC*, 359 F.3d 554, 565–68 (D.C. Cir. 2004) (citations omitted).

The Final Rule explicitly permits market participants to violate Federal speculative position limits with no bona fide hedge exemption from the Commission. It impermissibly delegates the Commission's statutory responsibility to define bona fide hedging to the very market participants with large speculative positions that section 4a is intended to restrain, as well as to the exchanges, who have no authority to determine what is a hedge under Federal law.

First, the Final Rule authorizes market participants to create their own bona fide hedge exemptions and exceed speculative position limits for "sudden or unforeseen increases in their bona fide hedging needs." No prior approval from the Commission or an exchange is required to exceed the limits established by the Commission, and market participants may file their hedge applications up to five days *after* violating the applicable position limit. The Final Rule offers no guardrails on what can be considered a "sudden or unforeseen" circumstance. In an efficient market, all future price movements are inherently unforeseeable; that is the reason for hedging to begin with.[1788] Further, in today's interconnected markets, where the speed of light is the limiting factor on the transmission of information, sudden and unforeseen circumstances arise virtually every millisecond. This provision may swallow the Final Rule.

Second, the Final Rule authorizes a market participant to exceed *Federal* speculative positon limits if an exchange permits it to exceed the *exchange's* position limits. In other words, an exchange determination can enable a market participant to violate *Federal* limits even in the absence of a Commission determination. Here again, the Final Rule ignores the Commission's statutory responsibility to define bona fide

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[1788] "The basic efficient market hypothesis positions that the market cannot be beaten because it incorporates all important determining information into current share prices. Therefore, stocks trade at the fairest value, meaning that they can't be purchased undervalued or sold overvalued. The theory determines that the only opportunity investors have to gain higher returns on their investments is through purely speculative investments that pose a substantial risk." J. B. Maverick, The Weak, Strong, and Semi-Strong Efficient Market Hypotheses, Investopedia, available at https://www.investopedia.com/ask/answers/032615/what-are-differences-between-weak-strong-and-semistrong-versions-efficient-market-hypothesis.asp (updated Sept. 30, 2020). The unpredictability of the market has long been recognized. "If you can look into the seeds of time, and say which grain will grow and which will not, speak then unto me." William Shakespeare, Macbeth, Act 1, Scene 3 (1623).

hedging. Exchanges have a critical role in any properly balanced position limits regime, but they are not authorized by the CEA to define Federal hedge exemptions, nor are they authorized to green-light violations of Federal position limits.

This process for market participants to "self-recognize" non-enumerated hedges that they wish had been enumerated under Federal law undoes the existing, Commission-led procedures that have worked well for decades.

The Final Rule reflects a multi-year, iterative process of notice and comment rulemaking to comprehensively determine which practices should constitute bona fide hedging. Members of the public and industry participants have enjoyed multiple opportunities to inform the Commission on this topic, including through additional proposed position limits rules in 2013 and twice in 2016. The Final Rule's enumerated hedges reflect the Commission's extensive dialogue and reasoned deliberations, and they recognize a wide array of hedging practices identified by commenters. To my knowledge, the Commission is not aware of any novel hedging practices that were not addressed during this rulemaking process.

Commission regulations currently allow for the recognition of non-enumerated bona fide hedges through a 30-day, Commission-led review process. The Commission must recognize the requested hedge as bona fide before a market participant can put the hedge on the exchange and exceed position limits. This process has worked well for decades. The Final Rule replaces it with a new system that allows market participants to make their own bona fide hedge determinations and exceed Federal position limits in advance of any reasoned, considered evaluation by the Commission.

1. *The 10 and 2 Day Review Periods are Inadequate for the Commission to Consider Applications for Exemptions after an Exchange Determination*

The Final Rule attempts to cure the impermissible statutory delegation described above through crammed, after-the-fact reviews of market participants' hedge applications and violations of position limits rules.

Market participants who request prospective non-enumerated bona fide hedge exemptions from an exchange may violate Federal speculative position limits upon being granted the exemption. The exchange must then forward the application and other materials to the Commission for the beginning of a constricted 10-day review period.

The Commission, for its part, must complete the difficult task of evaluating the law, facts, and circumstances with respect to cash market risks that have already been incurred and commodity positions that have already been posted on an exchange. Commission determinations regarding the validity of positions that have already been entered into will be complicated by the commercial implications involved in unwinding such positions. Further, in the event that the Commission determines to deny the application, the Commission must provide the applicant with notice and opportunity to respond. In the case of positions established due to "sudden or unforeseen" events, the Final Rule calls for a two-day review. This is an unrealistic and unworkable timeframe. This fig leaf of a "review" cannot provide legal cover for the impermissible delegation.

2. *The Final Rule Adopts a Policy of Non-Enforcement for Position Limit Violations*

Both the rule text and the preamble to the Final Rule leave no doubt that any person who puts on a position in excess of a position limit prior to receiving Commission approval of the exemption is in violation of the speculative position limits. However, where an application for a non-enumerated bona fide hedge is submitted retroactively to either an exchange or the Commission due to "sudden or unforeseen circumstances," or where an exchange has approved an application for an exemption from the exchange limit, the Commission limits its ability to prosecute such violations by declaring that, "as

a matter of policy," it will not pursue an enforcement action as long as the application was submitted in "good faith."

The Final Rule does not define "good faith." Perhaps this is because the concept of good faith traditionally is used as a safe harbor to protect persons who reasonably believe they are acting in compliance with the law. For example, when exercising its prosecutorial discretion for violations of the swap dealer business conduct standards, the Commission considers whether the swap dealer attempted in "good faith" to follow policies and procedures reasonably designed to comply with the CEA and Commission Regulations.[1789] This application of the good faith doctrine is consistent with the long-established understanding of the term.[1790] In the Final Rule, however, the Commission turns this doctrine on its head and mandates prosecutorial discretion where a market participant knowingly acts *in violation* of the law by putting on a position in excess of the legal limit.

Notably, the Commission describes its position not to enforce these violations as "a matter of policy." So although this non-enforcement policy is adopted as part of this rulemaking, it is nonetheless just that—a statement of policy. As the Supreme Court has recognized, "general statements of policy," or "statements issued by an agency to advise the public prospectively of the manner in which the agency proposes to exercise a discretionary power," are not subject to the notice-and-comment procedures of the Administrative Procedure Act.[1791] Accordingly, the Commission may change this enforcement policy at any time without engaging in a notice-and-comment rulemaking.

[1789] *See* Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 FR 9734, 9744, 9746, 9750 (Feb. 17, 2012).

[1790] *See, e.g.*, *CFTC v. Monex Credit Co*., No. SACV-171868, 2020 WL 1625808, at *4-5 (C.D. Cal. Feb. 12, 2020) (finding that controlling persons did not establish good faith defense to liability under 7 U.S.C. 13b where they knowingly or recklessly violated the CEA or were aware or should have been aware that employees were violating the CEA, or did not reasonably enforce system designed to promote legal compliance) (citing *Monieson v. CFTC*, 996 F.2d 852, 860-861 (7th Cir. 1993)); *U.S. v. Leon*, 468 U.S. 897 (1984) and *Massachusetts v. Sheppard*, 468 U.S. 981 (1984) (establishing good faith doctrine as exemption to Fourth Amendment exclusionary rule when police officer reasonably believed conduct to be legal).

[1791] Nor are blanket statements of policy that abandon an agency's responsibility to enforce the law constitutionally permissible. *Crowley Caribbean Transp., Inc. v. Peña*, 37 F.3d 671, 677 (D.C. Cir. 1994) ("[A]n agency's pronouncement of a broad policy against

Significantly, in its comment letter, the entity with the most experience in retroactive applications for hedge exemptions, the CME Group, pointed out to the Commission the importance of being able to take enforcement action for position limit violations that have occurred when retroactive applications are denied. It stated:

> Today at the exchange level, CME Group considers firms to be in violation of a position limit if they exceed a limit and the exemption application is denied. We believe the Commission should implement this standard rather than permitting the proposed grace period for denial of an exemption application. Otherwise, market participants with excessively large speculative positions could exploit the grace period accompanying an application for an exemption and intentionally go over the applicable limit without consequences—all the while disrupting orderly market operations. In our experience, the prospect of having an application denied and being found in violation of position limits has worked to deter market participants from attempting to exploit the retroactive exemption process.[1792]

Although the Final Rule is replete with deference to the experience of the exchanges in implementing the position limits regime, and creates a process specifically reliant upon the exchange's expertise in granting hedge exemptions, here in the context of enforcing violations and deterring abuse, the Commission oddly rejects that expertise.

B. *The Final Rule Fails to Address TAS Transactions or the Historic Collapse of WTI Crude Oil Futures*

On April 20, 2020, the price of the May futures contract for West Texas Intermediate ("WTI") crude oil traded on the New York Mercantile Exchange collapsed from $17.73 per barrel at the market open to a closing price of *negative* $37.63. This single-day fall in prices of approximately $55 per barrel is unprecedented, and was accompanied by a massive disconnect between May crude oil futures and the price of crude oil in the physical market.

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enforcement poses special risks that it 'has consciously and expressly adopted a general policy that is so extreme as to amount to an abdication of its statutory responsibilities.'") (citing *Heckler v. Chaney*, 470 U.S. 821, 833 n.4 (1985)).

[1792] CME Comment Letter (May 14, 2020).

WTI crude oil futures are a key benchmark in global energy markets and can impact the overall U.S. economy. Following the WTI event, I called upon the Commission to determine the causes of this unprecedented price movement and divergence from physical markets, and to work with CME to "take whatever measures may be appropriate to ensure that trading in the WTI futures contract is orderly and supports convergence of the futures and physical markets."[1793] Almost six months later, the Commission has yet to complete its investigation or issue even preliminary results. It should not take this long for the world's leading derivatives regulator to understand the historic collapse of a benchmark contract that it has overseen for decades.

Independently of the Commission's investigation, public commentary following the WTI event focused on TAS transactions and the well-known integrity concerns regarding TAS under certain market conditions.[1794] TAS transactions represent the purchase or sale of an underlying exchange commodity at the closing price for that commodity or at a specified differential. Notably, exchange rules may permit TAS transactions to be netted intraday against futures positions in that commodity established via outright purchases and sales. Such netting could permit a trader to establish very large long or short positions in the outright futures contracts, while remaining below speculative position limits on a net basis.

The Final Rule recognizes the importance of netting practices and rules in several regards. For example, it prohibits the spot-month netting of physically settled contracts with linked cash settled contracts. The Final Rule explains that allowing such netting

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[1793] Statement of Commissioner Dan M. Berkovitz on Recent Trading in the WTI Futures Contract before the Energy and Environmental Markets Advisory Committee Meeting (May 7, 2020), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement050720.

[1794] *See, e.g.*, Matt Levine, It's a Good Time to Cut Dividends, Money Stuff (Apr. 29, 2020), available at https://www.bloomberg.com/news/articles/2020-08-04/oil-s-plunge-below-zero-was-500-million-jackpot-for-a-few-london-traders?sref=DzeLiNol ("If you combine these two facts—a lot of TAS contracts and not much volume around the settlement time—you get a well-known theoretical problem. . . . The basic pattern—agree in advance to buy (sell) stuff at the official settlement price at some fixed future time, and then sell (buy) a bunch of that stuff in the minutes leading up to the official settlement time with the effect of pushing down (up) the price at which you are buying (selling)—is incredibly common . . . ."); Craig Pirrong, Streetwise Professor Blog, WTI-WTF? Part 3: Did CLK20 Get TAS-ed? (Apr. 30, 2020), available at https://streetwiseprofessor.com/2020/04/.

during the spot month "could lead to disruptions in the price discovery function of the core referenced futures contract or allow a market participant to manipulate the price of the core referenced futures contract." The Final Rule is silent, however, with respect to any limitations on the netting of TAS with outright futures.

One commenter on the Final Rule reminded the Commission in significant detail of the market integrity issues associated with TAS orders.[1795] But even apart from the comment letters on the proposed rule, and apart from the WTI event, the potential for manipulation through the use of offsetting TAS contracts has been well-known.[1796] Further, the CFTC has direct experience with this issue: it has brought two manipulation cases where WTI TAS orders were an integral part of the manipulative scheme.[1797] Given the Commission's familiarity with the potential for manipulation and disruption of the price discovery process arising from an abuse of the TAS order type, the failure of the Final Rule to address in any manner these well-known dangers to market integrity is inexcusable.

C. *The Final Rule Misconstrues the CEA by Requiring Antecedent, Commodity-by-Commodity Necessity Findings Prior to Imposing Federal Position Limits*

The Final Rule misinterprets the Dodd-Frank Act and reverses decades of Commission interpretation and finds that an antecedent, commodity-by-commodity necessity finding is required prior to imposing Federal speculative position limits. The

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[1795] Better Markets Comment Letter, at 13-14 (May 15, 2020).

[1796] *See, e.g.*, Craig Pirrong, Derived Pricing: Fragmentation, Efficiency, and Manipulation, Bauer College of Business, University of Houston, at 10 (Jan. 14, 2019), available at https://streetwiseprofessor.com/2020/04/ ("The analysis in Section 2 demonstrates that TAS contracts create trading opportunities with asymmetric price impacts. This suggests that TAS may therefore also create opportunities for profitable trade-based manipulation, and this is indeed the case."); *see also* Paul Peterson, Trading at Settlement for Agricultural Futures: Results from the First Month, farmdoc daily (July 29, 2015), available at https://farmdocdaily.illinois.edu/2015/07/trading-at-settlement-for-agricultural-futures.html ("Over the years TAS has been associated with several efforts to artificially influence the daily settlement price through 'banging the close' and other forms of manipulation [citations omitted].").

[1797] *See In re Optiver US LLC*, CFTC No. 08 Civ 6560, 2012 WL 1632613 (Apr. 19, 2012); *In re Shak*, CFTC No. 14-03, 2013 WL 11069360 (Nov. 25, 2013) (consent order).

Final Rule further states that this "is the best interpretation" of CEA section 4a(a)(2), and that the Commission's prior interpretations are "not compelling."

I addressed this issue extensively in my dissenting opinion on the proposed position limits rule, and I reiterate those views now.[1798] Neither the statutory language of CEA section 4a(a)(2), nor the district court's decision in *ISDA v. CFTC*, require an antecedent necessity finding prior to imposing position limits. The Final Rule's new interpretation, which the Commission concedes is a "change" from prior interpretations, is mistaken.[1799]

As articulated in my prior dissent, the Final Rule's interpretation of CEA section 4a(a)(2) "defies history and common sense."[1800] Following hard on the heels of the 2008 financial crisis and the collapse of the Amaranth hedge fund in 2006, it is implausible that the drafters of the Dodd-Frank Act intended what the Commission has now adopted. The Final Rule requires the Commission to believe that a Congress in the midst of the financial crisis, aware the CEA had never been interpreted to require predicate necessity findings for position limits, and engaged in a historic effort to regulate financial markets, would nonetheless make it *harder* for the Commission to impose Federal speculative position limits. The Commission's revisionist legislative history is neither accurate nor credible.

IV. Conclusion

The Final Rule departs from both legal interpretations and policy frameworks that have served commodity markets well for decades.

[1798] *See* Dissenting Statement of Commissioner Dan M. Berkovitz Regarding Proposed Rule on Position Limits for Derivatives (Jan. 30, 2020), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement013020.

[1799] Significantly, however, at the Commission's meeting on the proposal rule, the Commission's Office of General Counsel clarified that a necessity finding is required only with respect to the Commission's establishment of Federal position limits. The Office of General Counsel stated that a necessity finding was neither a prerequisite for a Commission directive to the exchanges to establish limits, nor prior to establishing the standards for such limits. The Commission's legal interpretation in the Final Rule is identical to the interpretation in the proposed rule in this regard as well.

[1800] For a detailed discussion of how the Commission's necessity finding misconstrues the CEA as amended by the Dodd-Frank Act, *see* Dissenting Statement of Commissioner Dan M. Berkovitz Regarding Proposed Rule on Position Limits for Derivatives (Jan. 30, 2020), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement013020b.

Most significantly, the Final Rule impermissibly delegates the authority to recognize non-enumerated hedge exemptions; provides farcically short review periods for private-entity hedge determinations; attempts to enshrine a policy of non-enforcement for position limits violations; fails to address the well-known risks of TAS transactions; and reinterprets the CEA to require antecedent necessity findings prior to imposing Federal position limits.

I cannot support such a flawed rule.

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