Understanding and Implementing the CFTC's New Position Limits Rule

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THE PROCESS DMO FOLLOWED IN WRITING THE FINAL RULE

The Process DMO Followed

- Assembled the largest rulemaking team within DMO, including over 10 attorneys and economists
- Reviewed and considered over 75 public comment letters in response to the January 2020 proposed rulemaking
- Met with numerous constituencies, including exchanges, industry associations, commercial end-users, and financial firms
- Drafted the final rule and preamble, taking into consideration a variety of views and interests all while insuring compliance with the Commission's statutory obligations

Effective Date of the Final Rule

- The Final Rule will be effective 60 days after publication in the Federal Register.
- 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); and
  - The updated federal position limits for the nine legacy agricultural contracts.
- However, absent a hedge exemption market participants still cannot exceed exchange speculative position limits, which currently are substantially below the new federal position limits.

Compliance Dates

- The Final Rule has staggered compliance dates to provide market participants and exchanges with time to implement policies and procedures reasonably designed to ensure compliance with federal position limits

- January 1, 2022:

  - Market participants must comply with the federal position limits on the 16 non-legacy core referenced futures contracts and any referenced contracts (other than economically equivalent swaps) related to those 16 futures contracts;

  - Exchanges must establish position limits and grant hedge exemptions.

Compliance Dates (cont'd)

- January 1, 2023:
  - Market participants must comply with federal position limits on economically equivalent swaps.
  - All positions established pursuant to previously-granted risk management exemptions must comply with federal and exchange position limits.
  - The CFTC will reevaluate whether DCMs/SEFs can enforce speculative position limits on economically equivalent swaps.

Referenced Contracts

- The CFTC-set limits apply to "referenced contracts."
  - Core referenced futures contracts;
  - Linked futures and linked options on futures contracts; and
  - Economically equivalent swaps.
- There are 25 futures contracts subject to CFTC limits – "core referenced futures contracts" – the same 25 futures contracts from the 2020 proposed rule.

Core Referenced Futures Contracts

CFTC Rule 150.2(d) – Core Referenced Futures Contracts	
Legacy Agricultural • CBOT Corn • CBOT Oats • CBOT Soybeans • CBOT Soybean oil • CBOT Soybean meal • CBOT Wheat • MGEX Hard Red Spring Wheat • CBOT KC Hard Red Winter Wheat • ICE Cotton No. 2 **Non-Legacy Agricultural** • CBOT Rough Rice • ICE Cocoa • ICE Coffee C • ICE FCOJ-A • ICE U.S. Sugar No. 11 • ICE US Sugar No. 16 • CME Live Cattle	**Metals** • COMEX Gold • COMEX Silver • COMEX Copper • NYMEX Platinum • NYMEX Palladium **Energy** • NYMEX Henry Hub Natural Gas • NYMEX Light Sweet Crude Oil • NYMEX New York Harbor ULSD Heating Oil • NYMEX New York Harbor RBOB Gasoline

Futures Contracts and Options on Futures Contracts Linked to Core Referenced Contracts

- In addition to the core referenced futures contracts, a futures contract or an option on a futures contract is a referenced 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 that particular core referenced futures contract; or
  - 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.

Economically Equivalent Swaps

- Swaps that meet the definition of an economically equivalent swap will be subject to CFTC-set position limits.
- 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.
- "Material" specifications are limited to those provisions that drive the economic value of a swap, for example:
    - the underlying commodity, including commodity reference price and grade differentials;
    - maturity or termination dates; and
    - settlement type (*i.e.*, cash-settled versus physically-settled).

Economically Equivalent Swaps (cont'd)

- Material contractual specifications do not include:
  - lot size specifications or notional amounts;
  - delivery dates diverging by less than one calendar day (less than two days for natural gas), or
  - different post-trade risk management arrangements.
- The narrow definition of an economically equivalent swap means that only a small population of swaps will be subject CFTC-set limits.

Contracts Excluded from the Definition of Referenced Contract

- Location basis contracts
- Commodity index contracts
- Trade options
- Swap guarantees
- Monthly average pricing contracts
- Outright price reporting agency index contracts

CFTC Staff Workbook

- The CFTC Staff intend to publish on the CFTC website a “Workbook” with a non-exhaustive list of *futures contracts* that meet the definition of a referenced contract.
- The Workbook will not address:
  - Economically equivalent swaps; and
  - Futures contracts that the Staff believe do not meet the definition of a referenced contract.

FEDERAL LIMITS

Spot Month Limits

- The CFTC will impose spot month limits across all 25 core referenced futures contracts and the related referenced contracts.
- The size of the spot limits in the final rule were the same as proposed except for the spot limit for cotton, which decreased relative to the proposal
- The CFTC spot limits include a limit on physical delivery referenced contracts and a separate limit on cash-settled referenced contracts.
  - Spot limits on physical delivery referenced contacts apply on an aggregate basis.
  - With the exception of natural gas, spot limits on cash-settled referenced contracts apply on an aggregate basis.
  - For natural gas only, spot limits on cash-settled referenced contracts apply on a per-exchange basis and a separate limit for OTC referenced contracts.

Spot Month Limits Table – Legacy Agricultural

Core Referenced Futures Contract	Final Federal Spot Limit[1]	Existing Exchange Spot Month Limit
Legacy Agricultural Contracts		
CBOT Corn (C)	1,200	600
CBOT Oats (O)	600	600
CBOT Soybeans (S)	1,200	600
CBOT Soybean Meal (SM)	1,500	720
CBOT Soybean Oil (SO)	1,100	540
CBOT Wheat (W)	1,200	600/500/400/300/220[2]
CBOT KC HRW Wheat (KW)	1,200	600
MGEX HRS Wheat (MWE)	1,200	600
ICE Cotton No. 2 (CT)	900	300

[1] A red number indicates that the final federal spot limit is lower than the proposed federal spot limit. A black number indicates that the final federal spot limit is the same as the proposed federal spot limit.

[2] CBOT's existing exchange-set limit for Wheat (W) is 600 contracts. However, for its May contract month, CBOT has a variable spot limit that is dependent upon the deliverable supply that it publishes from the CBOT's Stocks and Grain report on the Friday preceding the first notice day for the May contract month.

Spot Month Limits Table – Non-Legacy Agricultural

Core Referenced Futures Contract	Final Federal Spot Limit	Existing Exchange Spot Month Limit
Other Agricultural Contracts		
CME Live Cattle (LC)	600/300/200[3]	600/300/200[4]
CBOT Rough Rice (RR)	800	600/200/250[5]
Ice Cocoa (CC)	4,900	1,000
Ice Coffee C (KC)	1,700	500
ICE FCOJ-A (OJ)	2,200	300
ICE U.S. Sugar No. 11 (SB)	25,800	5,000
ICE U.S. Sugar No. 16 (SF)	6,400	n/a

[3] The final federal spot month limit for Live Cattle (LC) 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.

[4] CME's existing exchange-set limit for Live Cattle (LC) has a step-down spot month limit: (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.

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

Spot Month Limits Table – Metals

Core Referenced Futures Contract	Final Federal Spot Limit	Existing Exchange Spot Month Limit
Metal Contracts		
COMEX Gold (GC)	6,000	6,000
COMEX Silver (SI)	3,000	1,500
COMEX Copper (HG)	1,000	1,000
NYMEX Platinum (PL)	500	500
NYMEX Palladium (PA)	50	50

Spot Month Limits Table – Energy

Core Referenced Futures Contract	Final Federal Spot Limit	Existing Exchange Spot Month Limit
Energy Contracts		
NYMEX Henry Hub Natural Gas (NG)	2,000[6]	1,000[7]
NYMEX Light Sweet Crude Oil (CL)	6,000/5,000/4,000	3,000
NYMEX NYH ULSD Heating Oil (HO)	2,000	1,000
NYMEX NYH RBOB Gasoline (RB)	2,000	1,000

[6] The NYMEX Henry Hub Natural Gas (NG) federal spot limits for cash-settled look-alike referenced contracts will apply on a per-exchange basis rather than on an aggregate basis across exchanges.

[7] 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, ICE, and Nodal. As a result, a market participant may hold up to 3,000 equivalent cash-settled natural gas contracts under existing exchange-set limits. If these exchanges increase their spot limits in response to this Final Rule, a market participant will be allowed to hold a total position of 8,000 cash-settled NYMEX NG referenced contracts across the four markets (NYMEX, ICE, Nodal, and the OTC swaps markets), as well as 2,000 physically-settled referenced contracts.

Non-Spot Month Limits

- The CFTC will impose single month and all-months-combined limits across all nine of the agricultural contracts that are currently subject to CFTC-set limits ("legacy agricultural contracts").
- The size of the non-spot month limits on the legacy agricultural were the same as proposed except the CFTC adopted a single month limit for cotton that is lower than the all-months-combined limit for cotton.
    - For all other legacy agricultural contracts the single month limit is set at the same size as the all-months-combined limit

Non-Spot Month Limits Table (Legacy Agricultural)

Core Referenced Futures Contract	Existing Single Month and All-Months Combined Limit	2020 Final Single Month and All-Months Combined Limit[1]
CBOT Corn (C)	33,000	57,800
CBOT Oats (O)	2,000	2,000
CBOT Soybeans (S)	15,000	27,300
CBOT Soybean Meal (SM)	6,500	16,900
CBOT Soybean Oil (SO)	8,000	17,400
CBOT Wheat (W)	12,000	19,300
CBOT KC HRW Wheat (KW)	12,000	12,000
MGEX HRS Wheat (MWE)	12,000	12,000
ICE Cotton No. 2 (CT)	5,000	5,950 (single month) 11,000 (all-months-combined)

[1] A red number indicates that the final federal spot limit is lower than the proposed federal spot limit. A black number indicates that the final federal spot limit is the same as the proposed federal spot limit.

Netting

- Spot Month Limits
  - The CFTC spot limits apply to physical delivery referenced contracts on a net basis.
  - With the exception of natural gas, the CFTC spot limits apply to cash-settled referenced contracts on a net basis, but market participants cannot net physical delivery and cash-settled referenced contracts.
  - For natural gas, spot limits apply to cash-settled referenced contracts on a per-exchange basis and separate OTC limit, so market participants cannot net contracts across exchanges or net exchange referenced contracts with OTC referenced contracts.
- Non-Spot Month Limits
  - The CFTC non-spot limits apply to physical delivery and cash-settled referenced contracts on a net basis.

EXCHANGE LIMITS

Exchange Limits

- For contracts subject to CFTC-set limits, there will be separate exchange limits that will be no higher than the CFTC limits.
- Given that the CFTC limits in the final rule are generally higher than the existing exchange limits, market participants should continue to monitor the size of both CFTC and exchange limits.
- The CFTC will continue to monitor whether the exchanges have the ability to set, monitor and enforce limits on economically equivalent swaps.
- For physical commodity contracts that are not subject to CFTC-set limits and excluded commodity contracts, the final rule provides a framework for the exchanges to set spot and non-spot month limits or accountability levels.

Status of Exchange-Set Position Limits

- By when do the exchanges expect to adjust exchange-set position limits on futures contract subject to federal position limits?
- Will they be raised up to the new federal limits?
- What factors are the exchanges considering in setting the levels of exchange-set position limits?
- Prior to the adjustment of exchange-set position limits, what is the benefit to market participants of the Effective Date of the CFTC's Position Limits Rule?
- What are the exchanges' plans for accountability levels?

EXEMPTIONS FROM LIMITS

Bona Fide Hedging Transactions or Positions

- *Bona fide* hedging transactions or positions must satisfy three conjunctive requirements:
  - The Temporary Substitute Test;
  - The Economically Appropriate Test; and
  - The Change in Value Requirement.
- The Final Rule eliminated the Incidental Test and the Orderly Trading Requirement.
- A pass-through swap and pass-through swap offset pair is a *bona fide* hedging position.

Bona Fide Hedging Transactions or Positions (cont'd)

- To be consistent with the statutory Temporary Substitute Test, a *bona fide* hedging position in physical commodities must ***always*** (and not just "normally" as under the historical definition) be in connection with the production, sale, or use of a physical cash-market commodity.

- The CFTC codified its "long-standing practice" that the reduction of "risks," as set forth in the Economically Appropriate Test, refers to (and is limited to) the reduction of price risks.

  - The reduction of price risk in the Economically Appropriate Test can be informed by other types of risks, such as geopolitical turmoil, weather, or counterparty credit risks, but non-price risk cannot be a substitute for price risk associated with the underlying cash commodity.

Pass-Through Swap and Pass-Through Swap Offset Pairs

- If a pass-through swap counterparty (usually a swap dealer) executes a swap opposite a *bona fide* hedging counterparty, then the swap dealer is eligible to treat the swap as a *bona fide* hedge provided certain conditions are met.

- The swap dealer or non-hedging counterparty must:

  - receive from the *bona fide* hedging swap counterparty a written representation that the pass-through swap qualifies as a *bona fide* hedge; and

  - enter into a pass-through swap offset to reduce the price risk attendant to the pass-through swap.

- The pass-through swap counterparty may rely in good faith on a written representation 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.

Pass-Through Swaps (cont'd)

- The Final Rule does not prescribe the form of, or manner by which the pass-through swap counterparty obtains, the written representation.
    - The Commission declined 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 CFTC 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.
- The Commission deleted the language in the proposed pass-through swap provision that would have required the offset to be in the "same physical commodity" as the pass-through swap.

Hedging Net or Gross

- The CFTC expects most market participants to hedge the price exposure of their net cash market position, but provided guidance in Appendix B(a) concerning when hedging on a gross basis is permitted.

- Gross hedging positions must satisfy the *bona fide* hedging definition. In addition:

  - The manner in which the hedger measures risk must be consistent and must follow the hedger's historical practice;

  - The hedger cannot measure risk on a gross basis to evade the speculative position limits or the aggregation rules; and

  - Upon request by the CFTC or an exchange, the hedger must be able to demonstrate compliance with these first two requirements.

Grandfathering of *Bona Fide* Hedging Transactions

- Existing *bona fide* hedge transactions and positions that meet the definition of a *bona fide* hedge are grandfathered for purposes of CFTC limits.

- The grandfathering of existing *bona fide* hedge transactions does not include positions taken in reliance upon risk management exemptions after January 1, 2023.

Enumerated Hedges

- The list of enumerated hedges is in Appendix A, which is incorporated by reference into Rule 150.3(a)(1)(i).

- ***Enumerated bona fide hedges are self-effectuating*** for purposes of federal position limits, provided that a market participant separately requests an exemption from the applicable exchange-set limit established pursuant to Rule 150.5(a).

- The enumerated hedges are:

  - Hedges of inventory and cash commodity fixed-price purchase contracts (existing);

  - Hedges of cash commodity fixed-price sales contracts (existing);

  - Hedges of offsetting unfixed-price cash commodity sales and purchases (existing but expanded to 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 in the same calendar month);

Enumerated Hedges (cont'd)

- Hedges of unsold anticipated production (existing but expanded by removing the historical limitation that a market participant could only hedge 12 months of unsold anticipated production, and removing the 5-day rule);
- Hedges of unfilled anticipated requirements (existing but expanded as above);
- Hedges of anticipated merchandising (new but subject to a number of conditions to prevent misuse – limited to 12 months supply and limited to merchants);
- Hedges by agents (new);
- Hedges of anticipated mineral royalties (new; short positions only);
- Hedges of anticipated services (new);
- Offsets of commodity trade options (new);
- Cross-commodity hedges (existing but expanded by removing the 5-day rule).

Effectuating Enumerated Hedges

- The enumerated *bona fide* hedges automatically qualify as a *bona fide* hedge for purposes of CFTC-set limits.

- However, a market participant still must apply to an exchange for a *bona fide* hedge exemption, even for enumerated *bona fide* hedges.

  - An exchange has the discretion to limit, condition or otherwise restrict the ability to exceed an exchange limit based upon enumerated *bona fide* hedges.

  - For example, an exchange could limit the ability to rely upon an enumerated *bona fide* during the last five days of trading (so-called "5-Day Rule")

Non-Enumerated Hedges

- To the extent a market participant's physical hedging needs are not addressed in the list of enumerated *bona fide* hedges, a market participant can apply for a non-enumerated *bona fide* hedge exemption from CFTC and exchange limits.

- A market participant can apply to an exchange or the CFTC for a non-enumerated *bona fide* hedge, however, the following considerations likely mean that market participants will apply to the exchanges:

  - The CFTC will review an exchange-granted non-enumerated hedge exemption, so an application to the exchange will address both CFTC and exchange limits.

  - If a market participant applies to the CFTC, the market participant must apply separately to the exchange for a non-enumerated hedge exemption.

  - Although there are time limits for the CFTC to review an exchange-granted non-enumerated hedge exemption, there are no time limits for the CFTC to respond to a non-enumerated hedge exemption application made directly to the CFTC.

The Process for Applying to an Exchange for Non-Enumerated Hedge Exemptions

- A market participant must apply to an exchange in advance of exceeding the applicable CFTC or exchange limit, however, an exchange may adopt rules that allow a market participant to apply within 5 days of exceeding a limit due to sudden and unforeseen hedging needs.

- Each exchange-granted non-enumerated hedge exemption is subject to CFTC-review:

  - 10-day review period for typical non-enumerated hedge exemptions, 2-day review period for non-enumerated hedge exemptions due to sudden and unforeseen circumstances

  - The CFTC (not the Staff) must act to deny or stay the exchange-granted exemption.

  - Absent CFTC action during the review period, the non-enumerated hedge exemption is deemed granted.

Exchange-Granted Non-Enumerated Hedge Exemptions

- A market participant may exceed the CFTC and exchange limits upon the exchange granting the non-enumerated hedge exemption – if the CFTC subsequently denies the exemption – the market participant is provided a reasonable period of time to reduce its positions below the applicable limit.

- Even after the 10-day or 2-day review period, the CFTC retains the ability to determine that a previously granted non-enumerated hedge exemption does not meet the definition of a *bona fide* hedge.

    - If the CFTC makes such a determination, an impacted market participant would be provided the opportunity to respond.

    - If the CFTC revokes the exemption, the market participant would be afforded a reasonable period of time to reduce its position below the applicable limit.

Hedge Exemption Update from the Exchanges

- Exchanges will have to update their rules and the application process to accommodate new enumerated exemptions and to process non-enumerated exemptions

- Non Enumerated exemptions would need to include additional information:

  - An explanation of the hedging strategy, including a statement that the position complies with the requirements of CEA section 4a(c)(2) and the definition of bona fide hedging transaction or position in Rule 150.1, and information to demonstrate why the position satisfies such requirements and definition

  - A statement concerning the maximum size of all gross positions in commodity derivative contracts for which the application is submitted; and

  - 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.

Hedge Exemption Update from the Exchanges (cont'd)

- Market participants should continue to monitor the Exchanges' rules, advisories and notices regarding position limits and exemptions
- New exchange hedge exemption rules will have to go through the CFTC Rule 40.6 self-certification process
- Will market participants have an opportunity to comment on the exchanges' new hedge exemption rules?
- By when do the exchanges expect to amend their rules for applying for enumerated and non-enumerated hedge exemptions?
- Prior to the exchanges amending their hedge exemption rules, what is the benefit to market participants of the Effective Date of the CFTC's Position Limits Rule?

Renewing an Exchange-Granted Non-Enumerated Hedge Exemptions

- Market participants must renew non-enumerated hedge exemptions with the exchange on an annual basis.

- The renewal application does not trigger a re-review by the CFTC, unless the facts and circumstances underlying a renewal application are materially different than the initial application. If the facts are materially different, the exchange must treat the application as an initial application for a non-enumerated hedge exemption and follow the CFTC-review process.

Risk Management Exemptions

- The Final Rule eliminated previously-granted risk management exemptions as of January 1, 2023. By that date, all open positions must comply with federal and exchange position limits.

- The Commission interpreted the Dodd-Frank Act's removal of the word "normally" from the CEA's statutory temporary substitute test as precluding it from continuing to grant risk management exemptions.

  - The Commission noted that it has other authority, including under CEA section 4a(a)(7), to exempt risk management positions from federal position limits.

- Exchanges may continue to recognize risk management positions for contracts that are not subject to federal limits, including for excluded commodities.

Elimination of (Nearly All) Position Limit Forms

- The final rule eliminates the CFTC Form 204 and the monthly version of the Form 304.
  - The Form 204 was a monthly report that market participants typically filed if they were relying upon a *bona fide* hedge exemption from a CFTC-set position limit.
  - The monthly Form 304 was a report that market participants filed if they were relying upon a *bona fide* hedge exemption in cotton.
- Note that market participants that currently file the Form 204 and 304 must continue to do so until the exchanges implement new *bona fide* hedge exemption rules consistent with the final rule.
  - This likely means that Form 204 and the monthly Form 304 will continue to be filed after the effective date of the final rule.
- The final rule retains the weekly "cotton-on-call" Form 304 applicable to merchants and dealers in cotton.

Spread Exemptions

- The following spread transactions are exempt from federal position limits:
  - 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.

Spread Exemptions (cont'd)

- Appendix G provides guidance to exchanges and market participants on the use of spread transaction exemptions granted pursuant to Rule 150.5(a).

- If a spread strategy is not covered by the definition of a spread transaction, a market participant must petition the CFTC pursuant to Rule 150.3(b) for a spread exemption.

Conditional Limit Exemption – Natural Gas

- If a market participant meets the conditions of the "conditional" limit, the size of the CFTC spot limit increases from 2,000 to 10,000 contracts per exchange and OTC.

- To be eligible for the conditional limit, a market participant cannot hold a spot position in the physical delivery referenced contracts.

- Can market participants combine the conditional limit exemption with other exemption types, such as the spread exemption or *bona fide* hedge exemption?

Financial Distress 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.

- Only available in response to a specific request filed with the Commission on a case-by-case basis, depending on the facts and circumstances involved.

Pre-Existing Positions

- There is no exemption from CFTC-set limits for futures contracts entered prior to the effective date of the final rule

- The following pre-existing positions will not be subject to CFTC-set limits:

  - Pre-enactment swaps - swaps entered into prior to enactment of the Dodd-Frank Act of 2010 (July 21, 2010) the terms of which have not expired.

  - Transition period swaps - swaps entered into during the period commencing on July 21, 2010, and ending 60 days after the publication of the final rule in the Federal Register.

- The scope of pre-enactment and transition period swaps that qualify as referenced contracts is likely a null set because these swaps likely lack identical material terms to a referenced contract.

- Note that a person may net pre-enactment and transition period swaps for compliance with CFTC-set non-spot month limits.

Aggregation

Aggregating Contracts Subject to Limits

- The CFTC did not adopt substantive amendments to its aggregation requirements.
- For physical commodity contracts, the exchanges must adopt aggregation requirements that are the same as the CFTC aggregation requirements.
- For excluded commodity contracts, the exchanges are “encouraged” to adopt aggregation requirements that conform to the CFTC’s aggregation requirements.
- Aggregation and *Bona fide* Hedges
  - Entities required to aggregate positions under the CFTC’s aggregation rules shall be considered the same person for the purpose of determining whether they are eligible for an exemption.

General Topics

Anti-Evasion

- CFTC Rule 150.2(i) provides that "[f]or the purposes of applying the speculative position limits in this section, if used to *willfully circumvent or evade* speculative position limits:
  - 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;
  - A *bona fide* hedging transaction or position recognition or spread exemption shall no longer apply; and
  - A swap shall be considered to be an economically equivalent swap."
- Evasion must be willful.

Anti-Evasion (cont'd)

- The determination of whether particular conduct is intended to circumvent or evade requires a facts and circumstances analysis.
- The Commission will consider, among other things, the extent to which the person lacked a legitimate business purpose for structuring the transaction in a particular manner.
- The Commission will consider whether a market participant has a history of structuring its swaps one way, but then starts structuring its swaps differently around the time the market participant risked exceeding a speculative position limit as a result of its swap position, such as by modifying the delivery date or other material terms and conditions so the swap no longer meets the definition of an "economically equivalent swap."
- Fraud, deceit, or unlawful conduct are not prerequisites for evasion.

Necessity Finding

- The Commission determined that CEA section 4a(a)(2)(A) should be interpreted to require that before establishing position limits, the Commission must determine that limits are necessary.
- According to the Commission, position limits on the 25 core referenced futures contracts 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.
- The Commission's 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 delivery of the underlying commodity; and
  - the particular importance to the national economy of the commodities underlying the 25 core referenced futures contracts.

Necessity Finding (cont'd)

- The Commission also found that position limits are necessary:
  - during all months for the nine legacy agricultural contracts; and
  - only during the spot month for the 16 non-legacy core referenced futures contracts.
- According to the CFTC, the CEA 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.

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