



CFTC final position rule limits enter into effect March 15

Commodities News and Trends

10 March 2021

By: Robert J. Gruendel | Glenn A. Reitman | Deanna R. Reitman | Jesse Medlong | Jeffrey Bourdon

Bringing to an end a decade-long journey, the CFTC in October adopted final position limit rules (the Final Rules) which aim to “prevent excessive speculation” and thus implement one of the remaining key provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Before these limits were adopted, federal position limits (established by the CFTC) had been imposed on nine futures contracts and options on futures contracts in agricultural commodities. The Final Rules amend these limits and establish federal limits for the first time on 16 additional futures contracts on agricultural, metals, and energy contracts. Futures contracts linked to these contracts, as well as economically equivalent swaps, are also subject to these limits.

The Final Rules further add to the enumerated bona fide hedge exemptions from position limits and establish a process for determining non-enumerated hedge exemptions through the exchanges, subject to CFTC review. The Final Rules were published in the Federal Register on January 14, 2021 and become effective March 15, 2021.

The Final Rules establish position limits that apply to “referenced contracts,” which includes:

- Core referenced futures contracts

- Futures and futures options referenced contracts
- Economically equivalent swaps.

There are 25 “core referenced futures contracts” subject to limits under the Final Rules. These futures contracts include contracts on nine “legacy” agricultural commodities that already are subject to CFTC-set limits (“legacy agricultural contracts”), as well as 16 futures contracts on seven additional agricultural contracts, five metals contracts and four energy contracts. These 16 contracts have not been subject to CFTC-set position limits before and are referred to in the release as “non-legacy contracts.”

In addition, the Final Rules provide that any futures contract or option on futures contract that meets certain criteria is considered a “referenced contract” subject to CFTC limits. Specifically, a futures contract or futures option 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 deliver at the same location or locations as specified in that particular core referenced future contract.

A swap that meets the definition of an “economically equivalent swap” will also be subject to the CFTC limits. Economically equivalent swap means, with respect to a particular referenced contract, any swap that has “identical material” contractual specifications, terms and conditions to the referenced contract. The narrow definition of economically equivalent swap means that only a small number of swaps will be subject to the CFTC limits.

Spot month: The Final Rules impose a CFTC spot month limit across all 25 core referenced futures contracts and related referenced futures contracts. The limit is set at or below 25 percent of deliverable supply (with some exceptions, including natural gas where the spot month limits are set at 2,000 per exchange and over-the-counter referenced contracts).

Conditional spot month limit exemption: If a market participant meets the conditions of the “conditional” spot month limit exemption for natural gas, the size of the CFTC spot month limit increases from 2,000 to 10,000 contracts per exchange and over-the-counter referenced contracts.

Bona fide hedge exemption: Under the bona fide hedge exemption in the Final Rules, the transaction or position must satisfy the following:

- The Temporary Substitute Test
- The Economically Appropriate Test and
- The Change in Value Requirements.

There are also specific enumerated bona fide hedges, including:

- Hedges of inventory and cash commodity fixed-price sales 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)
- Hedges of unfilled anticipated requirements (existing but expanded)
- Hedges of anticipated merchandising (new but subject to a number of conditions)
- Hedges by agent (new)Hedges of anticipated mineral royalties (new)
- Hedges of anticipated services (new)
- Offsets of commodity trade options (new)
- Cross-commodity hedges (existing).

The Final Rules also eliminate the restriction on holding certain enumerated bona fide hedge positions in excess of the CFTC limits during the last five days of trading (the “5-Day Rule”). The Final Rule, instead, gives exchanges discretion to limit, condition or otherwise restrict exchange limits based on enumerated bona fide hedges.

There are also non-enumerated bona fide hedges. There are two processes to apply for a non-enumerated bona fide

hedge exemption:

- the market participant can apply to the exchange for an exemption from both the CFTC and exchange set limit, subject to CFTC review or
- the market participant can apply to the CFTC and separately to the relevant exchanges.

Compliance dates: The Final Rules have staggered compliance dates:

January 1, 2022: For position limits on the sixteen (16) non-legacy core referenced futures contracts and any referenced contracts (other than economically equivalent swaps) related to those sixteen (16) futures contracts, market participants must comply by January 1, 2020.

January 1, 2023: For positions in economically equivalent swaps, market participants must comply by January 1, 2023. All positions established pursuant to the previously granted risk management exemptions must also comply by this date.

AUTHORS



Robert J. Gruendel

Partner
New York | T: +1 212 335 4500
Houston | T: +1 713 425 8400
robert.gruendel@dlapiper.com



Glenn A. Reitman

Partner
Houston | T: +1 713 425 8400
New York | T: +1 212 335 4500
glenn.reitman@dlapiper.com



Deanna R. Reitman

Of Counsel
Houston | T: +1 713 425 8400
New York | T: +1 212 335 4500
deanna.reitman@dlapiper.com



Jesse Medlong

Associate
San Francisco | T: +1 415 836 2500
jesse.medlong@dlapiper.com



Jeffrey Bourdon

Associate
Houston | T: +1 713 425 8400
jeffrey.bourdon@dlapiper.com
