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SIDLEY UPDATE

CFTC Adopts Long-Awaited Federal Position Limit Rules

December 2, 2020

At an open meeting of the Commodity Futures Trading Commission (CFTC) held via video conference on October 15, 2020, the CFTC adopted final amendments to the federal position limits rules for commodity futures contracts and new position limit rules for economically equivalent swaps (the Final Rules).[1] The Final Rules implement provisions enacted by Congress in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) in 2010. They represent the CFTC's fifth attempt to adopt federal position limit rules.

A more fulsome description of the Final Rules is included below, but the salient details of the Final Rules are as follows:

- Federal position limits will apply to "referenced contracts," which include (1) 25 "core referenced futures contracts" (made up of nine "legacy agricultural contracts" and 16 "non-legacy contracts"), (2) futures contracts and options on futures contracts directly or indirectly linked to a core referenced futures contract, and (3) "economically equivalent swaps."

- CFTC-set position limits will apply to all 25 core referenced futures contracts in the spot month.

- The CFTC-set spot-month position limits will apply in the aggregate across exchange-traded and over-the-counter (OTC) positions except with respect to natural gas contracts. Natural gas contracts will be subject to per-exchange position limits, as described below.

- CFTC-set position limits will apply in the spot month separately to physically settled and cash-settled referenced contracts except with respect to natural gas contracts. Natural gas contracts will be subject to per-exchange position limits, as described below.

[1] Commodity Futures Trading Commission, Position Limits for Derivatives, Voting Draft (Approved October 15, 2020) ([***not yet published in the Federal Register as of the date of this Sidley Update***]). References to the Final Rules in this Sidley Update refer to the publicly available Voting Draft *available at* https://www.cftc.gov/media/5066/votingdraft101520PositionLimits/download.

- CFTC-set non-spot-month position limits will apply only to the nine legacy agricultural contracts. The 16 nonlegacy contracts will be subject only to exchange-set position limits and accountability levels.

- An exchange that lists a futures contract that is subject to CFTC-set position limits must set its own limit at a level that is no higher than the CFTC-set limit.

- Economically equivalent swaps entered into in good faith prior to the effective date of the Final Rule will not be subject to CFTC-set position limits. Pre-existing futures and options on futures will be subject to CFTC-set position limits.

- The Final Rule expands the list of self-effectuating "bona fide hedges," loosens restrictions on certain existing enumerated hedges, and adopts a new "spread transaction" exemption. The Final Rule also eliminates "risk management" exemptions.

I. Background and History

The Commodity Exchange Act (CEA) authorizes the CFTC to impose limits on positions in futures contracts to prevent the harms caused by excessive speculation. In 2010, Congress enacted Section 737 of the Dodd-Frank Act, which amended the CEA to *require* the CFTC to 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 futures contracts or options on the futures contracts in accordance with the standards set forth in pre-existing Section 4a(a)(1) of the CEA.[2] Section 4a(a)(1) of the CEA requires the CFTC to establish position limits as it "finds are necessary to diminish, eliminate, or prevent" certain enumerated burdens on interstate commerce.[3]

In 2011, the CFTC adopted regulations implementing the amendments to the CEA made by Section 737 of the Dodd-Frank Act.[4] In the 2011 Final Rules, the CFTC interpreted the amendments made by Section 737 to the CEA to *require* the CFTC to adopt position limits, without first finding that such position limits were "necessary to diminish, eliminate, or prevent" the burdens of excessive speculation on interstate commerce.[5] Various industry groups disagreed with this interpretation and filed a lawsuit in federal court, arguing that the CFTC was required to make a finding that position limits were "necessary" and that the CFTC had not made that finding. In 2012, a federal district court judge agreed with these arguments and ordered that most aspects of the 2011 be vacated.[6] The CFTC did not appeal the decision, and most aspects of the 2011 Final Rules never went into effect.[7]

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[2] Dodd-Frank Act § 737(a).
[3] 7 U.S.C. § 6a(a)(1).
[4] Commodity Futures Trading Commission, Position Limits for Futures and Swaps, Final rule and interim final rule, 76 Fed. Reg. 71626 (November 18, 2011) (the 2011 Final Rules).
[5] *Id.* at 71627.
[6] *International Swaps and Derivatives Association, et al. v. United States Commodity Futures Trading Commission,* 887 F.Supp.2d 259 (2012).
[7] The 2011 Final Rules nevertheless remain incorporated into Parts 150 and 151 of the CFTC rulebook, which causes occasional confusion among casual readers of the rules.

Over the next eight years, the CFTC attempted multiple times to adopt federal position limit rules without managing to get a final rulemaking over the finish line, although in 2016 the CFTC did successfully adopt regulations related to the aggregation of positions for purposes of applying federal position limits.[8]

The CFTC has now adopted final position limit regulations. In his opening statement at the virtual CFTC meeting at which the rules were adopted, current CFTC Chairman Heath Tarbert said that he promised in his Senate confirmation hearing to work to finalize these rules and that he has now kept that promise. He also referred to the position limits rulemaking process as "a cloud that has hung over both the CFTC and the derivatives markets for a decade" and to the completion of the Final Rules as "one of the most difficult undertakings in CFTC history." Evidence of this difficulty can be found in the fact that the voting draft of the *Federal Register* release runs some 900 pages and 1,700 footnotes. Further, the Final Rules were not adopted without controversy — they were enacted on a 3-2 vote of the Commissioners, with the two Democratic Commissioners issuing lengthy, detailed, and vigorous dissents.[9]

II. Federal Position Limits for Physical Commodity Futures

Federal position limits have been in place for many years for futures contracts and options on futures contracts on nine agricultural commodities, including corn, wheat, and soybeans. The Final Rules refer to these contracts as the "nine legacy agricultural contracts."

The Final Rules create new federal position limits for 16 additional physical commodity futures contracts, bringing the total contracts subject to CFTC-set position limits to 25. The Final Rules refer to the 16 new contracts as "non-legacy contracts."

The CFTC's existing position limit rules work in tandem with position limits and position accountability levels set by futures exchanges (i.e., the CEA calls futures exchanges "designated contract markets" (DCMs)). The nine legacy agricultural contracts therefore currently are subject to both CFTC-set and DCM-set position limits and in some cases DCM-set accountability levels, and the nonlegacy contracts currently are subject only to position limits and accountability levels set by the DCMs listing the contracts.

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[8] Commodity Futures Trading Commission, Aggregation of Positions, 81 Fed. Reg. 91454 (December 16, 2016) (the Final Aggregation Rulemaking).

[9] See Dissenting Statement of Commissioner Dan M. Berkovitz Regarding Final Rule on Position Limits for Derivatives, available at https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatementb101520b; Statement of Dissent of Commissioner Rostin Behnam Regarding Position Limits for Derivatives, available at https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement101520c. The dissents of the Democratic Commissions may foreshadow future CFTC rulemaking in this area, as the composition of the CFTC will soon switch from majority Republican to majority Democrat, and President-elect Joe Biden will appoint a Democratic Chairman.

A. Core “Referenced Contracts” and Linked Contracts

The Final Rule imposes federal position limits on the following 25 physically settled core referenced futures contracts:

Agricultural		**Metals** (federal position limits during spot month only)
Legacy (federal position limits in spot month and outside spot month)	**Nonlegacy** (federal position limits in spot month only)	
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 U.S. Sugar No. 11 (SB)	NYMEX Palladium (PA)
CBOT Soybean Meal (SM)	ICE U.S. Sugar No. 16 (SF)	
MGEX Hard Red Spring Wheat (MWE)	CME Live Cattle (LC)	
ICE Cotton No. 2 (CT)	**Energy** (federal position limits in spot month only)	
CBOT KC Hard Red Winter Wheat (KW)	NYMEX Henry Hub Natural Gas (NG)	NYMEX New York Harbor ULSD Heating Oil (HO)
	NYMEX Light Sweet Crude Oil (CL)	NYMEX New York Harbor RBOB Gasoline (RB)

The Final Rules define the term “referenced contract” to *include* the contracts listed in the table above as well as any futures contract and any option on a futures contract that is

- directly or indirectly linked to the price of a core referenced futures contract or
- 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.[10]

[10] Concurrently with approval of the Final Rules, the CFTC published a Staff Workbook that provides a nonexhaustive list of exchange-traded referenced contracts to assist market participants in determining which contracts other than those listed in the table above qualify as “referenced contracts.” See https://www.cftc.gov/sites/default/files/2020-03/poslimitsworkbookJan2020.xls.

The term “referenced contract” *excludes* the following types of contract:

Location basis contracts	Location basis contracts are derivative contracts that are cash-settled based on the difference in • the direct or indirect price of a particular core referenced futures contract or a commodity deliverable on a particular core referenced futures contract and • the direct or indirect price, at a different delivery location or pricing point, of a commodity deliverable on the same particular core referenced futures contract, or a commodity that is listed in **Appendix D** to Part 150 as being “substantially the same” as a commodity underlying the same core referenced futures contract **Appendix D** to Part 150 includes a table listing the commodities that will be treated as being “substantially the same” as the commodities underlying the listed core referenced futures contracts, regardless of delivery location.
Commodity index contracts	A contract that is based on an index of prices of different commodities and that is not • A location basis contract (see above), • A calendar spread contract (i.e., a cash-settled contract that represents the difference between the settlement price in one or a series of contract months of a contract and the settlement price of another contract month or another series of contract months’ settlement prices for the same contract), or • An intercommodity spread contract (i.e., a cash-settled contract that represents the difference between the settlement price of a referenced contract and the settlement price of another contract that is based on a different commodity)
Contracts based on prices across a month	Includes contracts commonly referred to as • calendar month average contracts • trade month average contracts • balance of month contracts
Outright price reporting agency index contracts	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. 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.
Swap guarantees	Guarantees of obligations under a swap, including a parent guaranty of an affiliate.
Certain trade options	Trade options that meet the requirements of CFTC Regulation § 32.3.

B. Federal Position Limit Levels in the Spot Month

The new CFTC-set position limits will apply to all 25 core referenced futures. The position limits will apply on a futures equivalent basis,[11] based on the size of the trading unit of the contract. The new CFTC-set spot-month position limits are set forth in the table below, along with the existing

[11] The term “futures equivalent” refers to the method set forth in CFTC Regulation § 150.1(f) for converting a position in an option on a futures contract into an economically equivalent futures position.

federal (where applicable) and exchange spot-month position limits. In most cases, the new CFTC-set spot-month limits are higher than the existing position limits.

Spot-Month Position Limit Levels[12]			
Core Referenced Futures Contract	**Existing Federal Position Limit**	**Existing DCM Position Limit**	**New Federal Position Limit**
Legacy Agricultural Contracts			
CBOT Corn (C)	600	600	1,200
CBOT Oats (O)	600	600	600
CBOT Soybeans (S)	600	600	1,200
CBOT Soybean Meal (SM)	720	720	1,500
CBOT Soybean Oil (SO)	540	540	1,100
CBOT Wheat (W)	600	600/500/400/300/220	1,200
CBOT KC Hard Red Winter Wheat (KW)	600	600	1,200
MGEX Hard Red Spring Wheat (MWE)	600	600	1,200
ICE Cotton No. 2 (CT)	300	300	900
Other Agricultural Contracts			
CME Live Cattle (LC)	—	450/300/200	600/300/200
CBOT Rough Rice (RR)	—	600/200/250	800
ICE Cocoa (CC)	—	1,000	4,900
ICE Coffee C (KC)	—	500	1,700
ICE FCOJ-A (OJ)	—	300	2,200
ICE U.S. Sugar No. 11 (SB)	—	5,000	25,800
ICE U.S. Sugar No. 16 (SF)	—	1,000[13]	6,400

[12] If multiple numbers are listed in the same cell, there may be step-down limits (i.e., the limits and decrease on a set schedule during the spot month), position limits may be different for different delivery months, or the spot-month limit may differ based on the deliverable supply of the underlying commodity.
[13] The ICE position limit for the SF contract is technically a single-month limit, which effectively operates as a spot-month limit.

Spot-Month Position Limit Levels[12]			
Core Referenced Futures Contract	**Existing Federal Position Limit**	**Existing DCM Position Limit**	**New Federal Position Limit**
Metals Contracts			
COMEX Gold (GC)	—	3,000	6,000
COMEX Silver (SI)	—	1,500	3,000
COMEX Copper (HG)	—	1,000	1,000
NYMEX Platinum (PL)	—	500	500
NYMEX Palladium (PA)	—	50	50
Energy Contracts			
NYMEX Henry Hub Natural Gas (NG)	—	1,000	2,000[14]
NYMEX Light Sweet Crude Oil (CL)	—	3,000	6,000/5,000/4,000
NYMEX New York Harbor ULSD Heating Oil (HO)	—	1,000	2,000
NYMEX New York Harbor RBOB Gasoline (RB)	—	1,000	2,000

C. Application of Federal Spot-Month Position Limits

With the exception of natural gas referenced contracts (NG), the spot-month position limits set forth in the table above apply in the aggregate across DCMs and OTC markets and "separately" to physically settled and cash-settled reference contracts. A market participant must aggregate its net physically settled futures and OTC contracts and aggregate its net cash-settled futures and OTC contracts. Each netting set must independently comply with applicable position limits. No netting is allowed between physically settled and cash-settled reference contracts.

Application of the new federal position limits to natural gas positions differs slightly from the foregoing, because three different DCMs (NYMEX, ICE, and Nodal)[15] currently list cash-settled natural gas futures contracts. Similar to the current DCM position limit rules, market participants will be subject to position limits on these cash-settled natural gas reference contracts on a "per exchange" basis — that is, a market participant may hold up to 2,000 contracts on *each* of the three DCMs for a total of 6,000 cash-settled natural gas futures contracts. The same market participant may also hold 2,000 OTC cash-settled NG reference OTC swap positions, bringing its total to 8,000 cash-settled NG reference contracts. Because the position limits are applied "separately" to

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[14] Applied on a per-exchange basis.
[15] ICE and Nodal list "lookalike" contracts that reference the NYMEX NG contract.

physically settled and cash-settled contracts, the market participant may also hold 2,000 physically settled NG reference contracts for a total of 10,000 NG reference contracts.[16]

D. Federal Position Limits Outside the Spot Month

The Final Rules impose position limits outside the spot month only for the nine legacy agricultural contracts and their referenced contracts. These contracts were already subject to non-spot-month position limits, but the Final Rules alter those limits. The other 16 core referenced futures contracts will not be subject to federal position limits outside the spot month, but will remain subject to exchange position limits outside the spot month.

The following table sets forth the existing single-month and all-months combined position limits (DCM and CFTC) for the nine legacy agricultural contracts, and the new CFTC single-month and all-months combined position limits. The Final Rules do not alter the existing DCM position limits, but the DCMs may separately amend their rules to align the position limits with the new CFTC position limits. The new CFTC position limits for ICE Cotton No. 2 (CT) differ for single month versus all-months combined. For all other contracts, the single-month and all-months combined limits are identical.

<table>
<tr><th colspan="5">Single Month and All-Months Combined Position Limits</th></tr>
<tr><th>Core Referenced Futures Contract</th><th>Existing DCM Limits</th><th>Existing CFTC Limits</th><th colspan="2">New CFTC Limits</th></tr>
<tr><td>CBOT Corn (C)</td><td>33,000</td><td>33,000</td><td colspan="2">57,800</td></tr>
<tr><td>CBOT Oats (O)</td><td>2,000</td><td>2,000</td><td colspan="2">2,000</td></tr>
<tr><td>CBOT Soybeans (S)</td><td>15,000</td><td>15,000</td><td colspan="2">27,300</td></tr>
<tr><td>CBOT Soybean Meal (SM)</td><td>6,500</td><td>6,500</td><td colspan="2">16,900</td></tr>
<tr><td>CBOT Soybean Oil (SO)</td><td>8,000</td><td>8,000</td><td colspan="2">17,400</td></tr>
<tr><td>CBOT Wheat (W)</td><td>12,000</td><td>12,000</td><td colspan="2">19,300</td></tr>
<tr><td>CBOT KC Hard Red Winter Wheat (KW)</td><td>12,000</td><td>12,000</td><td colspan="2">12,000</td></tr>
<tr><td>MGEX Hard Red Spring Wheat (MWE)</td><td>12,000</td><td>12,000</td><td colspan="2">12,000</td></tr>
<tr><td rowspan="2">ICE Cotton No. 2 (CT)</td><td rowspan="2">5,000</td><td rowspan="2">5,000</td><th>Single Month</th><th>All Months</th></tr>
<tr><td>5,950</td><td>11,900</td></tr>
</table>

[16] Market participants may also hold additional cash-settled NG referenced contracts if they satisfy certain requirements, but those conditional limits are beyond the scope of this Sidley Update.

III. Exchange-Set Position Limits and Exemptions

DCMs set their own position limits, including position limits for those contracts that are subject to federal position limits, but the DCM-set limits may not be higher than the CFTC-set limits. DCMs may also grant exemptions from their position limits, allowing a market participant to hold positions that exceed the federal limits, but only if the exemptions are "self-effectuating" (see below), for example bona fide hedges or spreads that satisfy the CFTC's new "spread exemption" or exemptions that are otherwise recognized by the CFTC for federal position limit purposes. To the extent that a DCM sets a position limit at a level lower than the federal limit in that contract, the DCM can grant exemptions from the DCM's limit that are not recognized under the Final Rules, but the exemption may not be at a level that exceeds the applicable federal position limit.

For physical commodity contracts that are not subject to federal position limits, DCMs are generally required to set their own position limits. Outside of the spot month, DCMs have flexibility to set either position limits or position accountability levels, which are levels a market participant may exceed without violating the DCMs rules but at which the DCM may ask the market participant to provide information relating to the position, including the nature and size of the position, the trading strategy used with respect to the position, and any applicable hedging information. Failure to provide this information may result in an order from the DCM to reduce the position or other disciplinary action.

IV. Position Limits for Economically Equivalent Swaps

The Final Rules define a "referenced contract" to include economically equivalent swaps, which are "swaps"[17] with identical material contractual specifications, terms, and conditions to a referenced contract. The material contractual specifications, terms, and conditions are those provisions of a swap that drive the economic value of that swap, including with respect to pricing and risk.

Solely by way of example, the following provisions generally would be viewed as being "material" to a swap:

- the underlying commodity, including commodity reference price and grade differentials
- maturity or termination dates
- whether the swap is physically settled or cash settled
- for physically deliverable swaps, the delivery specifications, including quality standards and delivery locations

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[17] The term "swap" is defined in the CEA and CFTC regulations. It is a complex definition, but notably for present purposes, it does not include physically settled commodity-forward contracts.

Swaps that have identical material specifications, terms, and conditions to a referenced contract will nevertheless be deemed economically equivalent swaps even if they differ from the referenced contract with respect to one or more of the following:

- lot size specifications or notional amounts,
- delivery dates diverging by less than one calendar day for physically settled swaps (two calendar days for physically settled natural gas swaps), or
- post-trade risk management arrangement (e.g., uncleared swaps versus cleared futures contracts).

V. Exemptions From Federal Position Limits

The Final Rules set forth five exemptions from otherwise applicable federal position limits:

1. bona fide hedging transactions or positions
2. spread transactions
3. financial distress positions
4. conditional spot month limit exemption positions in natural gas
5. pre-enactment and transition period swaps exemption

The details of each of these exemptions are set forth below.

A. Bona Fide Hedging

Transactions or positions may exceed federal position limits if they are "bona fide hedging transactions or positions" *and* they are either (a) on the list of enumerated bona fide hedges or (b) otherwise recognized by the CFTC as bona fide hedges. Market participants generally may hedge on either a gross or net basis, both with respect to enumerated and nonenumerated hedge exemptions, as long as they have done so consistently over time and do so in a nonevasive manner.[18]

As described below, a person who holds an *enumerated* bona fide hedging position need not obtain any prior approval to exceed applicable position limits. The exemption with respect to these *enumerated* bona fide hedges is "self-effectuating." However, the person may nevertheless need to request an exemption from the exchange's position limit if the person is also seeking to exceed that limit. A person may seek recognition of a nonenumerated hedging position or transaction by applying to the CFTC pursuant to the Final Rules.

[18] New **Appendix B** to Part 150 includes guidance on gross hedging positions.

The definition of "bona fide hedging transactions or positions" includes three types of transactions and positions:

- any transaction or position that satisfies *all three* elements of the CFTC's general bona fide hedging definition, which are set forth below
- any two transactions or positions that together qualify as a "pass-through swap and pass-through swap offset pair"
- any offset of a qualified bona fide hedger's qualifying swap position

Each of these types of transactions and positions of the "bona fide hedging transaction or position" definition is described below.

1. The General Bona Fide Hedging Definition

The general bona fide hedging definition includes three separate elements, each of which must be present for a position to qualify as a "bona fide hedging transaction or position": (1) The position must represent a substitute for transactions or positions made or to be made at a later time in a physical marketing channel (the "temporary substitute test"); (2) the position must be economically appropriate to the reduction of price risks in the conduct and management of a commercial enterprise (the "economically appropriate test"); and (3) the position must arise from the potential change in value of actual or anticipated assets, liabilities, or services (the "change in value requirement").

2. Pass-Through Swaps and Offsets of Bona Fide Hedges

In lieu of satisfying the three elements of the "general" bona fide hedging definition, a transaction or position will be a "bona fide hedging transaction or position" if it is either of the following:

Pass-through swap and pass-through swap offset pair	The pair of swaps must satisfy three requirements: • 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 the general bona fide hedging test (the bona fide hedging swap counterparty) that is opposite another person (the pass-through swap counterparty). • 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. • 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 the general bona fide hedging test, 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.

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 the general bona fide hedging test.

3. Enumerated Bona Fide Hedges

The Final Rules expand the existing list of enumerated bona fide hedges to cover additional hedging practices, including by adding a new exemption for anticipated merchandizing, and codify the approved enumerated bona fide hedges in a new **Appendix A** to Part 150 of the CFTC rules.

The new list of enumerated bona fide hedges is as follows:[19]

Bona Fide Hedge Exemption	Description
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.
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 byproducts of such commodity.
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: • basis different delivery months in the same commodity derivative contract or • basis different commodity derivative contracts in the same commodity, regardless of whether the commodity derivative contracts are in the same calendar month.
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.
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.

[19] The enumerated bona fide hedges are not mutually exclusive. The same transaction or position may satisfy multiple bond fide hedge exemptions.

Bona Fide Hedge Exemption	Description
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* • the positions in the commodity derivative contracts do not exceed in quantity 12 months' of current or anticipated purchase or sale requirements of the same cash commodity that is anticipated to be purchased or sold • the person is a merchant handling the underlying commodity that is subject to the anticipatory merchandising hedge, and 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
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.
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.
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.
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.[20] Such commodity trade option transaction may be deemed as either a cash commodity purchase or sales contract.
Cross-commodity hedges	A position in a "pass-through swap and pass-through swap offset pair," an "offset of a bona fide hedger's qualifying swap position," or in any derivative contract described in any of the 10 foregoing bona fide hedge exemptions 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.

[20] The commodity trade option must satisfy the requirements of CFTC Regulation 32.3.

The Final Rules eliminate the requirements under certain existing bona fide hedge exemptions that disallowed the exemptions during the last five days of trading— the so-called "five-day rule." However, exchanges retain discretion to adopt such restrictions.

Market participants may avail themselves of the expanded availability of enumerated bona fide hedge exemptions as soon as the Final Rules become effective.

B. Spread Transactions

A transaction or position may exceed federal position limits if it qualifies as a "spread transaction." The Final Rules define a "spread transaction" as any of the following:

Intramarket spread	A long (short) position in one or more commodity derivative contracts in a particular commodity, or its products or byproducts, and a short (long) position in one or more commodity derivative contracts in the same, or similar commodity, or its products or byproducts, on the same designated contract market or swap execution facility.
Intermarket spread	A long (short) position in one or more commodity derivative contracts in a particular commodity, or its products or byproducts, 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 byproducts, away from that particular designated contract market or swap execution facility.
Intracommodity spread	A long (short) position in one or more commodity derivatives contracts in a particular commodity, or its product or byproducts, and a short (long) position in one or more commodity derivative contracts in the same, or similar, commodity, or its products or byproducts.
Intercommodity spread	A long (short) position in one or more commodity derivatives contracts in a particular commodity, or its product or byproducts, and a short (long) position in one or more commodity derivative contracts in a different commodity or its products or byproducts.

Examples of spread transactions are calendar spreads, quality differential spreads, processing spreads (e.g., "crack" spreads in energy derivatives or "crush" spreads in soybean derivatives), product or byproduct differential spreads, and futures-options spreads.

Appendix G of Part 150 includes a nonexhaustive list of five spread strategies deemed to satisfy the "spread transaction" definition:

- an intermarket spread transaction in which the legs of the transaction are futures contracts in the same or similar commodity, or its products or its byproducts, and that have the same calendar month or expiration

- a spread transaction in which one leg is a referenced contract and the other leg is a commodity derivative contract that is not a referenced contract (including OTC commodity derivative contracts)

- a spread transaction between a physically settled contract and a cash-settled contract

- a spread transaction between two cash-settled contracts
- spread transactions that are
    - o “legged in” — that is, carried out in two steps — or
    - o “combination trades” — that is, all components of the spread are executed simultaneously or contemporaneously

A single cash-settled agreement, contract, or transaction that by its terms 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 that does not comprise separate long and short positions is not a “spread transaction” for purposes of the Final Rules. Further, a spread position involving a commodity index contract and one or more referenced contracts is not a “spread transaction” for purposes of the Final Rules.

Transactions or positions that do not satisfy the CFTC’s definition of “spread transactions” may nevertheless be recognized by the CFTC as spread transactions pursuant to a process set forth in the Final Rules.

Appendix G of Part 150 also includes guidance on so-called “cash-and-carry trades.” These are trades where a market participant enters into a long futures position in the spot month and an equivalent short futures position in the following month to guarantee a return that, at minimum, covers the costs of its carrying charges, including the cost of financing, insuring, and storing the physical inventory until the next expiration (e.g., insurance, storage fees, financing costs, and other costs such as aging discounts that are specific to individual commodities). The Final Rules permit cash-and-carry trades to be treated as spread transactions and allow a market participant to take physical delivery of the product in the nearby month and redeliver the same product in a deferred month.

Market participants may avail themselves of the new spread transaction as soon as the Final Rules become effective.

C. Financial Distress Exemption

The Final Rules include a new exemption that will, on a case-by-case basis and subject to approval by the CFTC, allow a person to exceed federal position limits if doing so is necessary to take on the positions and associated risk of another market participant during a potential default or bankruptcy situation.

D. Conditional Spot-Month Limit Exemption in Natural Gas

A market participant that holds no physically settled NYMEX NG contracts may exceed the NYMEX NG federal spot-month position limit of 2,000 cash-settled referenced contracts per exchange (and an additional 2,000 equivalent-size economically equivalent OTC swaps) by holding 10,000 cash-settled NYMEX NG referenced contracts per exchange that lists cash-settled NYMEX NG referenced contracts. The market participant may hold an additional 10,000 equivalent-size cash-settled economically equivalent NYMEX NG swaps. Market participants may not use a spread exemption to exceed the conditional spot-month limit for natural gas.

E. Risk Management Exemptions

The Final Rules modify the "temporary substitute test," which is one of the elements required for a position to be a bona fide hedge, to require that the transaction or position must "always" be connected to the production, sale, or use of a physical cash-market commodity. The test previously required only that the transaction or position "normally" be so connected. Of particular importance, market participants will no longer be allowed to treat a position entered into for "risk management purposes" as a bona fide hedge.

A "risk management" position refers to a derivative position, typically held by a dealer, that is used by the dealer to offset a swap position, such as a commodity index swap, with another entity for which the swap *is not* a bona fide hedge. Going forward, such a position must comply with applicable position limits or must qualify 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 *does* qualify 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.

Previously granted risk management exemptions will be eliminated effective January 1, 2023. Positions based on previously granted risk management exemptions will need to be reduced to levels that comply with applicable position limits or satisfy one of the foregoing exemptions by no later than that date. The CFTC had initially proposed that the elimination of previously granted risk management exemptions be effective 60 days after final rules were published in the *Federal Register*.

F. Process for Requesting Bona Fide Hedge Recognitions and Spread Exemptions

A market participant may hold a position in excess of federal position limits in reliance on an enumerated bona fide hedge exemption without applying for the exemption. The enumerated bona fide hedge exemptions from federal position limits are said to be "self-effectuating." However, a market participant may need to apply to the relevant exchange for an exemption from position limits set by the exchange.

A market participant seeking to exceed federal position limits for a nonenumerated bona fide hedge must seek recognition of the hedge by applying directly to the CFTC or indirectly to the CFTC via the applicable DCM. The market participant must separately apply to the DCM for recognition of the nonenumerated bona fide hedge exemption from the exchange's position limit.

The Final Rules establish a streamlined approach for applying for recognition of nonenumerated bona fide hedges. A market participant may file an application with the exchange for exemption from both the exchange-set and CFTC-position limits. If the exchange grants the exemption from its position limits, the exchange will then notify both the market participant and the CFTC. Ten business days after the issuance by the exchange of its exemption, if the CFTC has not notified the market participant otherwise, the federal exemption will be deemed approved. During the period between the exchange's approval of the exemption and the CFTC's approval or deemed approval of the exemption, the market participant may hold positions in excess of the federal position limits but will do so at the market participant's own risk. If the CFTC ends up denying the exemption, the market participant will not be in violation of the federal position limit as long as the market participant filed the exemption application in good faith and as long as it brings the position below the limit within a commercially reasonable amount of time.

The Final Rules also allow a market participant that has sudden or unforeseen hedging needs to file a request for a bona fide hedging exemption within five business days *after* exceeding the federal position limit — that is, a "retroactive" application. The same streamlined approach as described in the preceding paragraph applies, but the 10-business-day period is shortened to two business days.

Nonenumerated bona fide hedge exemptions generally must be renewed on an annual basis.

Spread exemptions from federal position limits are self-effectuating if they are within the categories set forth in the definition of "spread transaction." Market participants must separately apply to the applicable exchange for an exemption from the exchange's position limits. A market participant may also apply to the CFTC, and separately to the exchange, for a position limit exemption with respect to a spread position that does not satisfy the definition of "spread transaction" under the Final Rules.

VI. Other Aspects of Final Rules

A. Antievasion

The Final Rules include an antievasion provision. In applying the federal position limits, the following contracts, if used to willfully circumvent or evade speculative position limits, will be considered to be "referenced contracts": commodity index contracts, monthly average pricing contracts, outright price reporting agency index contracts, and location basis contracts. Further, a bona fide hedging transaction or position or spread exemption will no longer apply, and a swap on the contract will be considered to be an economically equivalent swap.

B. Elimination of Forms 204 and 304

CFTC Regulation 19.01(a) requires any person holding or controlling a reportable futures or options position, any part of which is a bona fide hedging position, to file a Form 204 report showing the composition of the fixed-price cash position of each commodity hedged for wheat, corn, oats, soybeans, soybean oil, and soybean meal. CFTC Regulation 19.02(a) requires any merchant or dealer in cotton holding or controlling 100 or more contracts for future delivery in cotton to file a Form 304 report 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.

The Final Rules eliminate Forms 204 and 304.

C. Aggregation

In 2016, the CFTC adopted amendments to its "aggregation" rules in Regulation 150.4. The Final Aggregation Rulemaking generally requires a person's positions to be aggregated with positions for which the person controls trading or for which the person holds a 10% or greater ownership interest. The Final Aggregation Rulemaking has to date applied directly only to positions held in the nine legacy agricultural contracts, although each DCM has adopted its own aggregation principles that in most cases parallel the CFTC aggregation rules. Going forward, the CFTC's aggregation rules will apply to the nine legacy agricultural contracts and the 16 nonlegacy contracts.

In 2017, the CFTC's Division of Market Oversight (DMO) issued time-limited no-action relief from some of the aggregation requirements, including (1) temporarily eliminating the requirement that market participants make advance notice filings in order to rely on certain aggregation exemptions; (2) reducing the burden on firms relying on the "owned entity" aggregation exemption; (3) expanding the availability of the "independent account controller" exemption; and (4) limiting application of the aggregation requirements with respect to "substantially identical trading strategies." In 2019, DMO extended the expiration date of this relief. Commenters requested that the CFTC codify this relief in the Final Rules, but the CFTC declined to do so. The DMO relief is scheduled to expire on August 12, 2022.

D. Effective and Compliance Dates

The Final Rule will be phased as follows:

- The Final Rules will be effective 60 days after they are published in the *Federal Register*, which has not occurred as of the date of this Sidley Update. The aspects of the Final Rules related to hedge and other exemptions and the increased CFTC-set spot-month position limits in the nine legacy agricultural commodities will become effective at that time.

- The new federal speculative position limits for the 16 nonlegacy core referenced futures contracts that will be subject to federal speculative position limits for the first time will be effective January 1, 2022.

- Federal speculative position limits for economically equivalent swaps will be effective January 1, 2023.

- Previously granted risk management exemptions, which will no longer be recognized as bona fide hedges, will be eliminated January 1, 2023.

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