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CFTC Proposes Position Limits and Exemptions for Certain Energy Contracts

The Commodity Futures Trading Commission's proposed rules establishing federal speculative position limits for futures and options on futures contracts on four energy contracts—Henry Hub natural gas, West Texas Intermediate light sweet crude oil, New York Harbor No. 2 heating oil and New York Harbor gasoline blendstock—were published for comment in the Federal Register on January 26. The CFTC voted to request comment on its proposal at an open meeting on January 14. Commissioner Sommers was the lone dissenting vote. Commissioners Dunn and O'Malia agreed to release the proposal for comment, but they did not commit to supporting final position limit rules.

The proposed rules, to be set out in a new Part 151, would establish both exchange-specific and aggregate federal position limits for the affected commodities, which would be independent of existing exchange-set position limits and position accountability levels. The new limits would include the following:

- All-months-combined and single-month limits on aggregate positions across all reporting markets and settlement methods (e.g., New York Mercantile Exchange (NYMEX) physically-settled and cash-settled Henry Hub Natural Gas contracts and IntercontinentalExchange (ICE) cash-settled Henry Hub Natural Gas Swap contracts). The aggregate all-months-combined limit would be set at a level equal to 10% of the aggregate open interest value of the relevant contracts (calculated as described in the proposed rules), up to an open interest level of 25,000 contracts, with a marginal increase of 2.5% of aggregate open interest value thereafter. The corresponding single-month limit would be equal to two-thirds of the all-months-combined limit.
- Exchange-specific all-months-combined and single-month limits for all economically similar contracts in the same commodity that settle in the same manner (for example, NYMEX physically-settled futures, options and calendar spreads on Henry Hub Natural Gas). The exchange-specific all-months-combined limit for all such contracts would be set at a level equal to the lesser of (i) the aggregate position limit applicable to such contracts (as described above) and (ii) 30% of the relevant exchange's open interest value in such contracts (calculated as described in the proposed rules), in each case subject to a minimum position limit of 5,000 contracts or 1% of the aggregate open interest of such contracts across all reporting markets, whichever is greater). The corresponding single-month limit would be equal to two-thirds of the all-months-combined limit.

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- Spot-month limits for aggregate positions across reporting markets in contracts that expire on the same day and settle in the same manner. Physically-settled contracts would be subject to a spot-month limit equal to one-quarter of the estimated deliverable supply, generally based upon supply estimates reported by the applicable market. Cash-settled contracts would be subject to a conditional position limit equal to that of the corresponding physically-settled contract, but traders that hold no physically-settled contracts in the spot month would be permitted to hold positions of up to five times that amount (subject to compliance with certain reporting requirements). By defining the relevant "class" of contracts more narrowly for purposes of applying the spot-month limits, the CFTC seeks to prohibit the netting of spot-month positions that expire on different days for purposes of applying the limits (e.g., by netting the legs of a spread position that expire on different days).

The CFTC limits would be reset on an annual basis, pursuant to the applicable formula described above, and would not apply to basis contracts and diversified commodity index futures contracts.

The CFTC proposal also sets out several exemptions from the proposed position limits:

- A *bona fide* hedge exemption would be available upon application to the relevant reporting market(s). Traders relying on hedge exemptions, however, would no longer be permitted to hold speculative positions over and above their hedge exemption, except that traders relying on a hedge exemption with respect to spot-month positions only would not be prohibited from holding speculative positions outside of the spot month. In addition, if a trader's *bona fide* hedge position outside the spot month is over two times the applicable position limit, such trader would also be prohibited from holding positions in reliance on a swap dealer exemption (described below).
- The proposal also provides for a limited risk management exemption outside the spot month for swap dealers, which would be limited to two times the applicable all-months-combined or single-month position limit. Similar to the *bona fide* hedge exemption, traders who hold positions in excess of the applicable position limit pursuant to a risk management exemption generally would be prohibited from holding speculative positions in excess of their risk management exemption. Swap dealers seeking a risk management exemption would be required to apply to the CFTC, as provided in the proposed rules.
- Certain delta-neutral positions, which would have exceeded the applicable position limit when adjusted by the previous day's risk factors (as is contemplated in current CFTC rules), but which would not exceed the applicable limit when calculated using an appropriate contemporaneous risk factor, would also be exempt from otherwise applicable position limits.

The CFTC proposal also sets out modified rules for the aggregation of positions for position limit purposes. As is currently the case for agricultural commodities under the CFTC's Part 150 rules, the proposed rules would provide that positions under common ownership (i.e., a direct or indirect interest equal to or greater than 10%) or control generally must be aggregated for purposes of applying position limits, subject to a limited exception with respect to commodity pool interests. However, unlike the Part 150 rules, the proposed rules do not permit disaggregation for positions that are traded by third-party advisors ("independent account controllers") and would instead require aggregation at both the owner and account controller levels for position limit purposes.

In addition to the proposed rules, the CFTC has requested comment on several related issues, including:

- Whether the proposed position limit regime should be applied to various other commodities, including domestic agricultural commodities, soft commodities and precious metals.
- Whether pending legislation, which would authorize the CFTC to set position limits for over-the-counter and certain foreign-listed instruments, should be taken into account in proposing federal speculative position limits.
- Whether commodity index funds holding passive, unleveraged and long-only positions in futures contracts should be subject to different regulatory standards.

- Whether a “look-through” exemption from speculative position limits for swap dealers (i.e., granting an exemption to swap dealers who are offsetting risks from swaps with counterparties that would have been entitled to a hedge exemption had they hedged their own exposure directly) is feasible.

The comment period for the CFTC proposal ends on April 26.

For information regarding the CFTC proposal, click here.

To view the Federal Register release, click here.