CFTC Adopts New Position Limits Requirements

October 16, 2020

On October 15, the Commodity Futures Trading Commission adopted new rules on position limits. The new rules mark an important step forward in a decade-long journey to enact one of the remaining key provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank). The Commissioners voted 3-2 in favor of the new rules, with Chairman Heath Tarbert and Commissioners Brian Quintenz and Dawn Stump voting in favor and Commissioners Rostin Behnam and Dan Berkovitz dissenting.

As described in greater detail below, the new rules (1) set forth federal position limits for 25 different futures contracts, (2) enhance the roles played by exchanges in setting limits and granting exemptions, (3) modify exemptions from federal position limits, and (4) eliminate Form 204 (Statement of Cash Positions in Grains) and portions of Form 304 (Statement of Cash Positions in Cotton).

- **Federal position limits for 25 futures contracts.** The new rules modify existing spot month, single month and all-months-combined position limits for nine "legacy" futures contracts on certain agricultural products and adopt new spot month position limits for 16 "non-legacy" futures contracts, including additional agricultural products, and certain metals and energy products. There are no single month or all-months-combined federal position limits for the 16 "non-legacy" futures contracts.

  Under the new rules, position limits apply to any contract that is directly or indirectly linked to, or that has a pricing relationship with, one of the 25 referenced futures contracts, including economically equivalent swaps. All spot month limits are separately calculated with respect to cash-settled and physically settled positions. In other words, in the spot month, a person can net positions within but not across each settlement category. There is no such distinction for non-spot month limits, so cash-settled and physically settled positions can be netted against each other.

- **Exchange-set position limits and exemptions.** Similar to the existing regulatory framework, the new rules prohibit exchanges from adopting position limits that are more lenient than any limit set for the same futures contract at the federal level. In addition, with respect to contracts with no federal limit, the new rules provide exchanges with greater flexibility in setting position limits or position accountability levels by, among other things, allowing the exchanges to adopt alternative approaches that are "necessary and appropriate to reduce the potential threat of market manipulation or price distortion of the contract's or the underlying commodity's price or index." The new rules also allow the exchanges flexibility to grant exemptions from exchange-set position limits.

- **Exemptions from federal position limits.** The new rules change the bona fide hedge exemption by, among other things, expanding the list of enumerated bona fide hedges. An enumerated bona fide hedge exemption is "self-effectuating" for federal position limit purposes, and a market participant that qualifies for an enumerated bona fide hedge would not be required to request prior approval from the CFTC in order to hold a hedge position in excess of a federal position limit. However, the practical benefit of this "self-effectuating" exemption is limited given that market participants may still need to request an exemption from the relevant exchange for any limits set by the exchange.

The CFTC also approved an expedited regime for market participants to exceed federal position limits for a non-enumerated bona fide hedging transaction or position. Under this regime, a market participant may choose whether to apply directly to the Commission or, alternatively, apply indirectly to the Commission through the applicable exchange. If any exchange approves the non-enumerated hedge exemption, the Commission will generally have ten days to reject the exchange's determination, after which the hedge exemption would be valid for both exchange and CFTC purposes. In the interim, once an exchange approval a non-enumerated hedge exemption, a market participant could exceed the federal position limits during the Commission's 10 business-day review period. If the Commission subsequently denies the exemption, the market participant would have to liquidate positions excess of the speculative position limit within a commercially reasonable amount of time.

The new rules also clarify that market participants generally may hedge positions on a gross basis or on a net basis, provided that the market participant has done so over time in a consistent, non-evasive manner.

- **Forms 204 and 304.** Under the new rules, hedgers are no longer required to file Form 204 or Parts I and II of Form 304 on a monthly basis. Instead, the CFTC will obtain the relevant cash market position information from the relevant exchanges.

The new rules will become effective 60 days after publication in the *Federal Register*. However, the new rules have a general compliance date of January 1, 2022, and later compliance date of January 1, 2023 with respect to swaps-related requirements and the elimination of previously granted risk management exemptions.

The publication of these final position limits rules ends a long effort by the CFTC to implement position limits rules pursuant to Dodd-Frank that began with publication of proposed and final rules in 2011 that were mostly set aside by a federal district court in September 2012.

Katten will release a more fulsome client advisory on the new position limits rules in the near future.

More information, including a link to the new position limit rules, is available here.

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