

CFTC Proposes Federal Position Limits on Physically-Settled Derivatives

February 6, 2020

On January 30, 2020, the U.S. Commodity Futures Trading Commission (CFTC) issued a proposed rulemaking on speculative position limits (the Proposal).¹ This Proposal marks the CFTC's fourth attempt since 2010 at establishing new federal speculative position limits in commodity derivatives markets pursuant to the Dodd-Frank Act. The CFTC has indicated that this Proposal is one of its top priorities.

Expansion of Contracts Subject to Position Limits

The Proposal expands the list of commodity derivatives subject to federal speculative position limits to 25 physically settled core referenced futures contracts. The contracts include metals, energy and agricultural futures, including the nine legacy agricultural futures already covered by existing federal position limits. Additionally, "referenced contracts" would include (i) futures and options directly or indirectly linked to a core referenced futures contract and (ii) economically equivalent swaps, defined as swaps with "identical material" contractual specifications, terms and conditions to a referenced contract. The limits will be set at or below 25 percent of the deliverable supply of each commodity.

Under the Proposal, speculative position limits would apply only during the spot months, with the exception of the nine legacy agricultural contracts, which would continue to be subject to limits in nonspot months. Additionally, the 16 nonlegacy contracts, if listed on an exchange, would also be subject to exchange-set limits and/or accountability levels.

Exemptions

The Proposal specifies exemptions that would be available for position limits, such as exemptions for bona fide hedging, spread transactions and instances where a market participant takes on the positions and associated risk of another market participant during a period of financial distress. To qualify for the bona fide hedge exemption, positions would have to satisfy three separate tests.

The Proposal would also expand the list of enumerated bona fide hedges. Enumerated bona fide hedges are self-effectuating, meaning that traders holding such positions would not be required to request approval from the CFTC to qualify the positions for an exemption from position limits. For traders that do have to request approval, the CFTC has proposed a streamlined process for requesting bona fide hedge exemptions for both exchange-set limits and CFTC limits. Additionally, the CFTC has

noted that it is open to adding additional enumerated hedges in the future as it “becomes more comfortable with evolving hedging practices.”

Impact of the Proposal

The fact that this is the CFTC’s fourth attempt to put in place federal position limits in the nearly 10 years since Dodd-Frank was enacted should give some sense of how controversial and difficult this issue has become. If the CFTC adopts federal position limits pursuant to the Proposal, it will have a substantial effect on many traders. Existing position limits will change and may require traders to modify their current strategies. Further, certain over-the-counter derivatives that had not been subject to any position limits would become subject to such limits. This will affect traders that have become accustomed to using the over-the-counter markets to take larger positions than might be allowed in the futures markets.

Comments on the Proposal

Comments on the Proposal must be submitted by April 29, 2020. The CFTC will not take into account comments submitted on previous position limits proposals. Those who have submitted previous comments should resubmit their comments, modified for the new Proposal, if they wish to have them considered as part of the formal rulemaking process. All prior CFTC position limits proposals have been withdrawn from further consideration.

¹ See Proposed Rule: Position Limits for Derivatives (January 30, 2020), available at <https://www.cftc.gov/media/3366/federalregister013020b/download>.

CONTACTS

If you have any questions regarding this Sidley Update, please contact the Sidley lawyer with whom you usually work, or

Nathan A. Howell, Partner

+1 312 853 2655, nhowell@sidley.com

Attorney Advertising—Sidley Austin LLP is a global law firm. Our addresses and contact information can be found at www.sidley.com/en/locations/offices.

Sidley provides this information as a service to clients and other friends for educational purposes only. It should not be construed or relied on as legal advice or to create a lawyer-client relationship. Readers should not act upon this information without seeking advice from professional advisers. Sidley and Sidley Austin refer to Sidley Austin LLP and affiliated partnerships as explained at www.sidley.com/disclaimer.

© Sidley Austin LLP