

# EXPERT GROUP ON AGRICULTURAL COMMODITY DERIVATIVES AND SPOT MARKETS

## TRANSPARENCY IN AGRICULTURAL COMMODITY MARKETS

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March 7, 2013



# Presentation Topics

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- ❑ Overview of the CFTC
- ❑ Key provisions of the Dodd-Frank Act
- ❑ Transparency to regulators (reporting to SDRs)
- ❑ Swap Transparency Provisions
  - ▣ Pre-trade (execution mandate)
  - ▣ Post-trade (real time reporting)
- ❑ *Futurization* of swaps
- ❑ Transparency & benchmarks
- ❑ Speculative limits for physical commodities

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# The CFTC



# CFTC Mission

- Regulate commodity futures and option markets in the United States
- Protect market participants against manipulation, abusive trade practices and fraud
- Enable the markets to serve their important functions in the Nation's economy
  - Providing a mechanism for price discovery and a means of offsetting price risk.



# History of U.S. Derivatives Regulation

Year	Title of Act	Highlights
1922	Grain Futures Act	Required futures contracts to be traded on exchanges
1936	Commodity Exchange Act	Required customer funds be segregated; bans option trading
1974	Commodity Futures Trading Commission Act	Created the CFTC with jurisdiction over all futures and provided for the NFA
1982	Futures Trading Act (Shad/Johnson Accord)	Grants CFTC jurisdiction over broad based equity indices; bans single stock futures; allows options
2000	Commodity Futures Modernization Act	Codified OTC swaps not under CFTC jurisdiction; allowed principles based regulation; permitted forex contracts; and single stock futures trading
2008	Food, conservation and Energy Act	Grants CFTC jurisdiction over certain price discovery contracts; closed loopholes in forex regulation
2010	Dodd Frank Wall Street	Grants CFTC jurisdiction over the over-the-



# CFTC Jurisdiction

- Exclusive jurisdiction over
  - Futures, options, and swaps on financial, energy, metals and agricultural commodities, instruments, rights, etc.
    - Only onions and movie futures are banned
  - Retail foreign currency futures
  - Broad-based security indices
- Joint jurisdiction with SEC on single-stock and narrow-based security futures and swap products

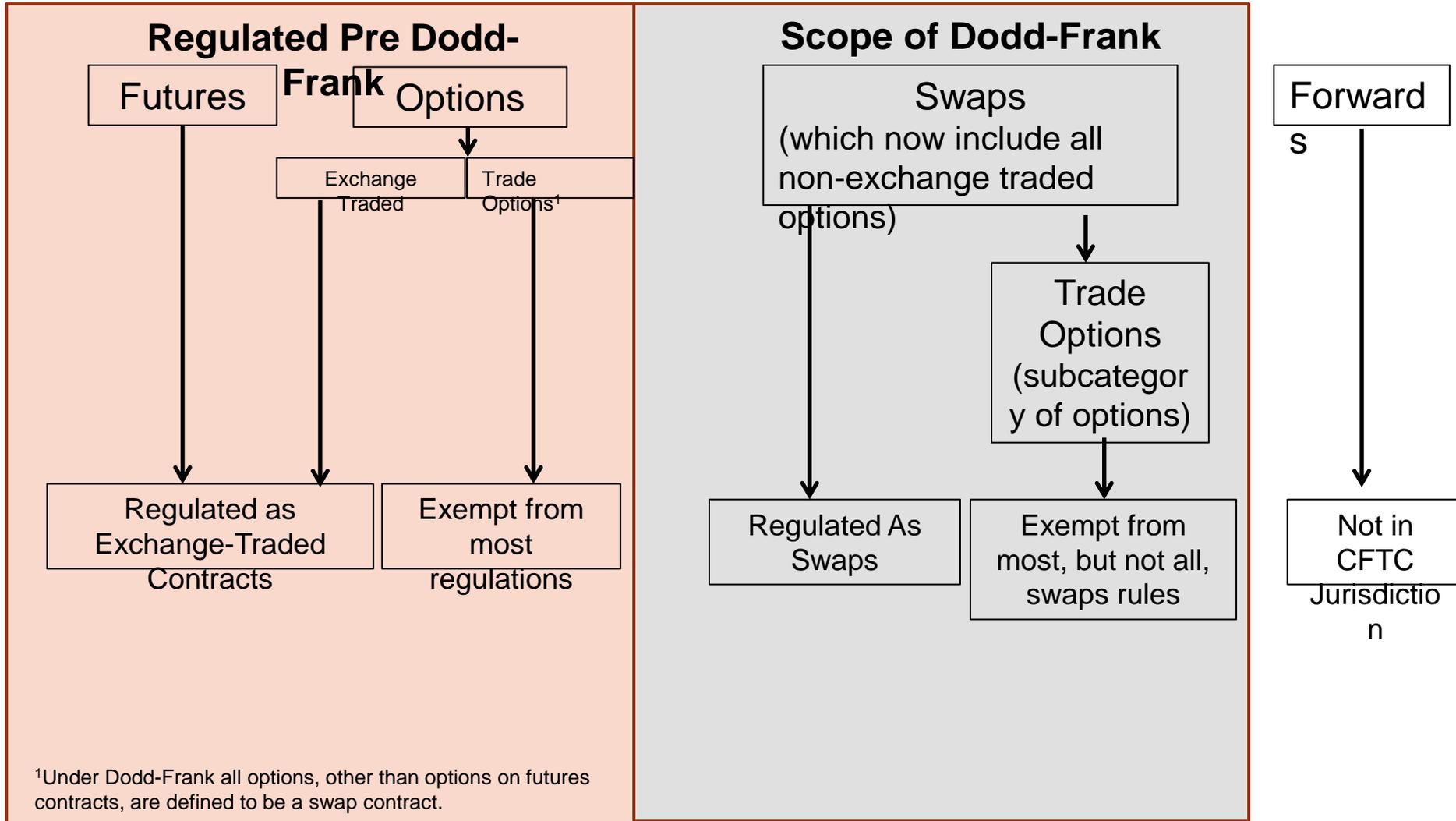


# Products Where CFTC Does Not Have Jurisdiction

- Forward contracts
  - ▣ Contracts where delivery of the commodity or instrument is expected and normally occurs
- Securities
- Banking products
- Insurance



# Regulation of Derivative Contracts in the US





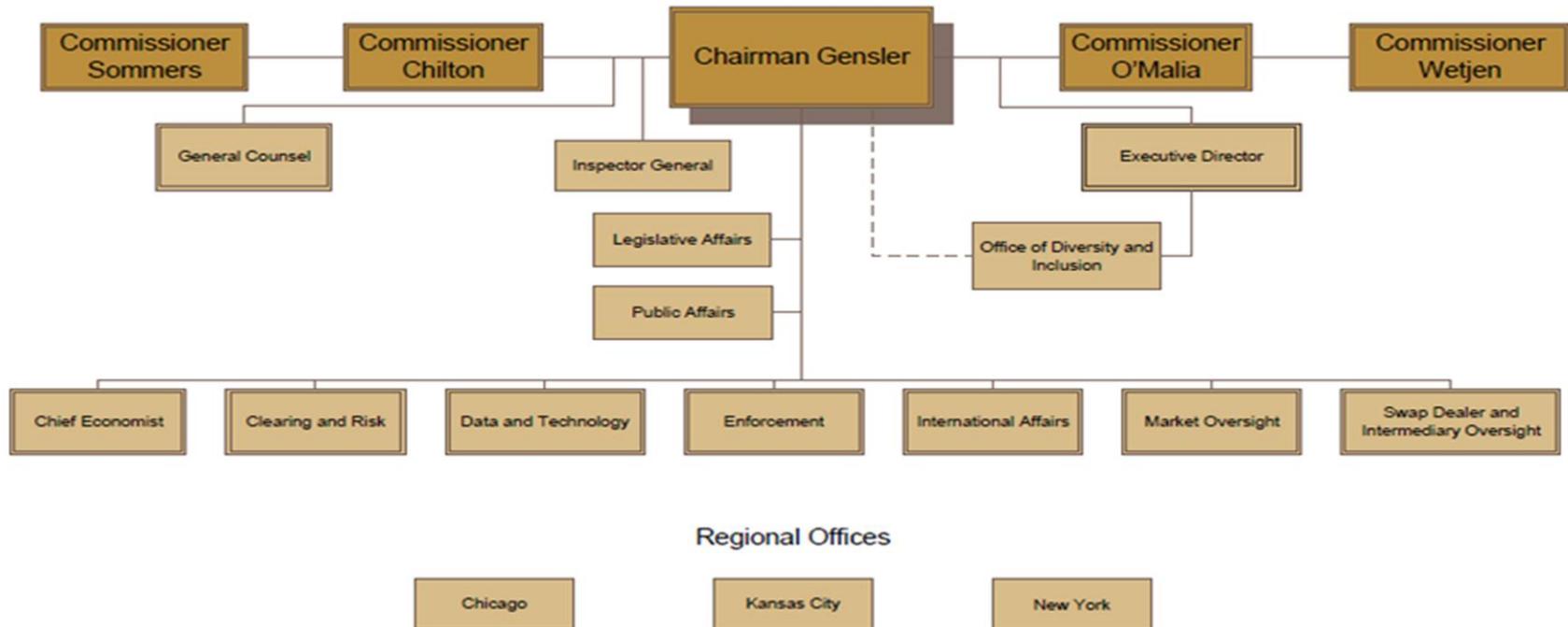
# CFTC Organization

- Five (5) Commissioners
  - ▣ No more than three (3) may be from the same political party
- Headquartered in Washington DC
  - ▣ Three (3) regional offices (Chicago, New York, and Kansas City)
- Approximately 1,000 staff - 700 employees and 300 contractors



# The CFTC Organization

10/25/2011





# CFTC International Arrangements

- Member of IOSCO and technical committees
- Close consultation with regulators in implementing Dodd Frank rules
- The CFTC has entered into Arrangements for Technical Assistance with many jurisdictions. Arrangements for Technical Assistance also address Information Sharing and Cooperation.

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~~DOBB FRANK ACT~~

REFORM FOR SWAPS

MARKET



# Reform Objectives

- Bring public market transparency and the benefits of competition to the swaps marketplace;
- Lower the risk of the interconnected financial system by bringing standardized swaps into centralized clearing; and
- Ensure that swap dealers and major swap participants are specifically regulated for their swaps activity



# Key Elements of Dodd Frank Act for Swaps Market

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- ❑ Regulation of Swap Market Participants (dealers & MSPs)
- ❑ Transparency to Regulators
  - ❑ Reporting to regulated *Swap Data Repositories*
- ❑ Clearing & Trading Mandates
  - ❑ Reduce risk by moving “*standardized*” swaps onto clearinghouses
  - ❑ Competitive trading for “*standardized*” swaps
- ❑ Trading Oversight
  - ❑ Regulation of swaps trading platforms
- ❑ Post-trade transparency (real-time reporting)



# Swap Dealer Registration

- What is a swap dealer?
  - ▣ Holds itself out as a dealer in swaps
  - ▣ Is a market-maker in swaps
  - ▣ Regularly purchases and sells swaps as an ordinary course of business or
  - ▣ Engages in activity that causes a person to be known in the trade as a dealer or market-maker in swaps.
  
- De Minimis Exemption: Aggregate notional amount of the swaps that the entity enters into over the prior 12 months must not exceed \$8 billion
  - ▣ Initial phase-in period of 4-5 years



# Swap Dealer Requirements

- ❑ Register with the National Futures Association
- ❑ Maintain daily trading records/audit trail
- ❑ Reporting and recordkeeping obligations
- ❑ Internal business conduct (e.g., risk management)
- ❑ External business conduct (e.g., avoid conflicts, provide pricing disclosures, ensure customer suitability)
- ❑ Designate chief compliance officer



# Swap Dealer Registration Timing

- Starting October 12, an entity that exceeds the *de minimis* level of dealing must register no later than two months after the end of the month in which the level is surpassed.
  
- To date, over 70 dealers & 2 MSPs have registered
  - Available on NFA Website



# Mandatory Clearing

## Role of Derivatives Clearing Organizations (DCOs)

- Enable swap counterparties to substitute the credit of the DCO for the credit of each of the counterparties
- Provide settlement and netting of positions on a multilateral basis.



# Mandatory Clearing Considerations

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- Key Factors Considered
  - ▣ Notional exposures, liquidity and pricing data
  - ▣ Operational expertise and resources and credit support infrastructure
  - ▣ Effect on mitigation of systemic risk (considering size of market and resources of clearing house)
  - ▣ Effect on competition (considering clearing fees, etc)
- CFTC focusing on swaps already being cleared



# Phased Compliance for Clearing

- Schedule based on type of trader
  - Category 1 (90 days). For swap dealers, major swap participants, and active funds
  - Category 2 (180 days). For commodity pools, private funds, and entities engaged in banking or financial activities
  - Category 3 (270 days). All other swaps, including those involving third-party subaccounts, ERISA plans, and those not excepted from the clearing requirement



# Mandatory Clearing Determinations

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- Initial focus on interest rate and credit default swap indexes
  - Achieves greatest effect on risk mitigation
  - Start date of March 11 for swap dealers and large funds
  - Other compliance dates in June & September
  
- Interest rate swaps
  - Four currency classes (US dollar, euro, GBP & yen)
  - Swaps based on LIBOR, Euribor
  - Tenors from 28 days to 30+ years
  
- Indexes of credit default swaps
  - Corporate, North America & Europe
  - Specified by index & series



# Mandatory Clearing of Swaps Commodities Asset Class

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- Includes swaps on agricultural products
- CFTC staff evaluating clearing house filings
- Considering the recent shift by DCOs to clearing energy swaps as futures
  - Note: All futures must be cleared; however, traders are not required to execute swaps as futures



# Exemptions for “End Users”

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- End users are exempted from both the clearing and trading mandates
  
- What are “end users”?
  - They are not financial entities
    - Are not banks or bank-like entities, swap dealers, MSPs, pension plans, etc.
  - They use swaps to hedge commercial risk
    - “Economically appropriate to reduction of risk in management of a commercial enterprise”
  - If swaps are not cleared, they must explain how financial obligations are met
    - Cash, credit arrangements, margin, 3<sup>rd</sup> party guarantee

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# TRANSPARENCY TO REGULATORS



# Reporting to *Swap Data Repositories*

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- What is an SDR?
  - ▣ An entity that collects and maintains data for the centralized recordkeeping of swap transactions, including the terms and conditions of the transactions
- SDRs must insure access by regulators
  - ▣ Market surveillance, investigations, prudential supervision, systemic risk supervision, position limit monitoring
- SDRs choose asset class(es) and must accept all swaps in that class
  - ▣ 5 asset classes: interest rates, credit, foreign exchange, equity, and other commodity



# Registration of SDRs

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- CFTC adopted final rules for
  - ▣ Registration of *Swap Data Repositories* (SDRs)
  - ▣ Required swap data reporting
  
- Registered SDRs to Date
  - ▣ DTCC Data Repository (all asset classes)
  - ▣ ICE Trade Vault (credit, FX and commodities)
  - ▣ CME (all asset classes)



# Swap Data Reporting to an SDR

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## □ Purposes

- Regulatory oversight and identify concentrations of risk
- Creation of unique identifiers and robust data management systems

## □ Types of data reported

### ■ SWAP CREATION DATA

- *Primary Economic Terms (PET data)*
- Confirmation Data

### ■ SWAP CONTINUATION DATA

- *Valuation data*
- *Reportable events throughout the life of the swap*



# Swap Data Reporting Implementation

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- **December 31, 2012:** Reporting by registered swap dealers began for **interest rates and credit**
- **February 28, 2013:** Reporting by registered swap dealers began for **Forex, equity and commodities**
- **April 10, 2013:** Reporting required for all counterparties in all asset classes



# Hierarchy for Reporting Swap Trades

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- Exchange traded swaps
  - DCM or SEF reports
  
- Off-facility (bilateral) swaps
  - If between 2 US registered swap dealers, they decide
  - If between a US registered swap dealer and an end user, the swap dealer reports
  - If between 2 end users, they decide



# Unique Identifiers

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- ❑ **Counterparty identifier -- Legal Entity Identifier (LEI)**
  - ❑ CFTC designated DTCC-SWIFT to provide CFTC Interim Compliant Identifiers (CICIs) for 2 years
  - ❑ CICI will transition into global LEI system once established
- ❑ **Product Type**
  - ❑ CFTC in process of developing a system of product classification and unique product identifier (UPI)
  - ❑ Receiving input from various sources
- ❑ **Unique swap identifier (USI)**
  - ❑ Facilitate aggregation of data into a single record
  - ❑ Track a swap over its life
  - ❑ Assure transactions are not double counted



# Ongoing Reporting Issues

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- Reporting of cleared swaps
  - Issue: do cleared swaps constitute 1 or 3 swaps?
  - CME rule 1001 provides that CME Clearing House sends swap data to its SDR
    - CFTC reviewing the rule filing
- Mutual acceptance of pre-LEIs
  - Issue: whether CFTC and ESMA will both accept pre-LEIs recognized by the Global LEI ROC (such as WM Datenservice)
  - CFTC working with ESMA and the ROC



# Cross Border Reporting Considerations

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- CFTC issued “cross-border” exemptive order in December 2012
  - ▣ **Purpose** : Time-limited relief for non-U.S. swap dealers and MSPs (and foreign branches of U.S. swap dealers and MSPs) from certain CFTC swap requirements
  - ▣ **Expires**: July 12, 2013
- For purposes of the Order, a phase-in definition of “U.S. person” applies
  - Applies a territorial-based definition, reflective of public comments and continuing dialogue with international regulators.
- CFTC staff is reviewing comments and developing interpretive guidance on cross-border application of swap requirements
- Expected to further address policy/procedural framework for substituted compliance determinations



# Cross Border Exemptive Order - Reporting

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- By non-U.S. person registered as swap dealers or MSPs
  - SDR reporting until July 12, 2013
    - Required for swaps with U.S. counterparties
    - Not required for swaps with non-U.S. counterparties
      - However, if ultimate parent is a U.S. swap dealer, MSP or banking entity, swaps with non-U.S. counterparties must be reported
  - Real-time public reporting until July 12, 2013
    - Required for swaps with U.S. counterparties
- For swaps with non-U.S. counterparties, only as may be required by local jurisdiction of non-U.S. swap dealer/MSP

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# PRE-TRADE PRICE TRANSPARENCY AND COMPETITIVE OPEN TRADING



# Pre-Trade Transparency

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- Dodd-Frank Act includes a mandatory trade execution requirement
- What is pre-trade transparency?
  - Open and competitive trading where traders interact
  - Visibility of bids, offers and transaction prices to market participants
- Mandate applies to “standardized” swaps



# Benefits of Pre-Trade Transparency

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- Transacting in an open and competitive setting promotes
  - ▣ Availability of information on current prices
  - ▣ Creation of incentives for new participants to enter the market, increasing competition
  - ▣ Reduced concentration can narrow bid/ask spreads and lowers costs of swaps
- Benefits provided to
  - ▣ Swap executing firms and the industry
  - ▣ The public through lower prices of goods and services



# Swaps Subject to Pre-Trade Transparency

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- Mandatory trade execution applies only to certain “standardized” swaps
  - Swaps that are subject to mandatory clearing and
  - Swaps that are “*Made available to trade*” by a DCM or SEF
  - *Made available to trade* not defined



# Swaps Exempted from Pre-Trade Transparency

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- ❑ Swaps not subject to the clearing mandate
- ❑ Swaps subject to clearing mandate but have not been deemed “made available to trade”
- ❑ Large sized trades (block trades) in swaps deemed *made available to trade*
- ❑ Any swap transaction where a counterparty is eligible for the end user exception



# Swaps *Made Available to Trade*

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- **Criteria Proposed by CFTC**
  - Liquidity
  - Number of participants
  - Volume
  - Open interest
  - Bid/ask spreads



# Swaps Made Available to Trade

# Ensuring *Pre-Trade*

# *Transparency*

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If traded on a DCM

Trades done via its trading facility

CLOB or equivalent

Such platforms ensure pre-trade transparency

If traded on a SEF

CFTC considering several pre-trade execution provisions (CLOB, RFQ to 5, 15-second exposure to market)

Considering role of voice communications as DF mentions "any means of interstate commerce"



## Swaps “Made Available to Trade”

# Issues Being Considered

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- Who decides which swaps are subject to the trading mandate
  - ▣ CFTC, SEFs, an independent industry group?
  - ▣ Is mere listing sufficient?
- What criteria should be used
- How to treat swaps that no longer meet the criteria
- Dealing with evasion
  - ▣ Listing “economically equivalent” swaps



# Role of Voice on a SEF: Proposed

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- CFTC considering what types of voice facilitated trades are permitted
- For swaps subject to pre-trade price transparency
  - Voice can be used for trade facilitation
    - To communicate a message to an employee of a SEF (i.e., RFQs; indications of interest; firm quotes; orders)
- For all other swap trades
  - Can be used for any aspect of transaction
- Audit trail requirements satisfied by entry into electronic affirmation systems

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# *FUTURIZATION OF SWAPS*



# What is *Futurization* of Swaps

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- Generally refers to the trading of derivative products as futures that were formerly traded as swaps
- Examples
  - CME lists many bullet-swap-like energy derivatives as futures
  - ICE converted their energy swaps to futures that are now listed on the ICE Futures US DCM
  - CME lists interest rate swap futures
  - ICE & CME planning to list credit swap futures



# Purported Motives for *Futurization*

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- Operational benefits
  - ▣ Ease of termination
  - ▣ No need for compression
  - ▣ Ability to use existing infrastructure and technology
- Avoidance of rules related to swap dealing, trading and clearing
  - ▣ Registration as a swap dealer or MSP
  - ▣ Business conduct requirements
  - ▣ Real time public reporting and regulatory reporting of swap data
- Margin requirements
- Block trading thresholds
- Uncertainty about SEF rules



# What is a Swap Under Dodd Frank Act

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- Definition is very broad
  
- DF excludes from swap definition
  - ▣ Exchange listed futures
  - ▣ Exchange-listed options on futures



# Swaps and Futures Under Dodd-Frank

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- DF does not differentiate between swaps and futures in terms of economic uses or purposes
- Futures
  - ▣ Standardized products designed and listed by a futures exchange
  - ▣ Vertically integrated trading and clearing
  - ▣ Traded must be on regulated futures exchange (DCM)
- Swaps
  - ▣ Can be standardized or customized products
  - ▣ Open access provision for clearing
  - ▣ Can be traded on DCMs or SEFs
- Regulatory treatment
  - ▣ The same derivatives product can be listed as a future or a swap



# Futurization & Swaps Trading Venues

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- Swap trading exchanges can register as a
  - ▣ Futures exchange (DCM)
  - ▣ Swap Execution Facility (SEF)
- DCMs and SEFs must comply with *Core Principles*
  - ▣ Audit trail/recordkeeping/regulatory oversight and surveillance of trading/financial requirements/system safeguards/position limits/etc.



# Swap Trading on Futures Exchanges

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- *Designated Contract Markets* can trade swaps as well as futures
  - ▣ Retail traders allowed
- Must comply with 23 DCM Core Principles
  - ▣ Core principle 9 requires DCMs to protect price discovery of centralized market
- And, must comply with swaps requirements
  - ▣ Real time reporting of trades to the public
  - ▣ Reporting to an SDR
  - ▣ Open access for clearing



# DCM Core Principle 9

50

- ❑ Requires DCMs to “*protect the price discovery of trading on the centralized market*”
- ❑ Types of allowed off-market trading on DCMs
  - ❑ Block trades (large trades that result in a price movement)
  - ❑ Exchanges of related products (swaps/physicals) for futures
- ❑ Issue: For some products, off-market trades represent all or most trading activity
  - ❑ Does predominant off-market trading undermine open, competitive trading and price discovery?



# DCM Core Principle 9 Proposal

51

- CFTC proposed a trading volume standard
  - ▣ Contracts below that standard must be delisted
  - ▣ Grace period for newly listed contracts
  - ▣ Delisted contracts could be listed as swaps (no CP 9 equivalent standard for SEFs)
- The related product (swap/physical) to be exchanged must be bona fide
  - ▣ Not contingent upon some other occurrence (such as acceptance for clearing)



# DCM Core Principle 9: Issues Raised

52

- Commenters questioned how CFTC should interpret the Core Principle
  - ▣ Not all contracts serve price discovery
  - ▣ Some just used for hedging
- DCMs should be given an opportunity to comply
  - ▣ Adopt mechanisms to foster competitive trading
  - ▣ Establish incentive plans
  - ▣ Design innovative trading systems
- CFTC re-evaluating proposal



# CFTC Focus on Futurization and Transparency of Swaps

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- CFTC staff held a public roundtable on *Futurization* in January
  - ▣ Available on CFTC Website
- Diverse views expressed – no consensus
  - ▣ Concerns about regulatory arbitrage
  - ▣ Issue; how should block thresholds be set for swaps and futures
  - ▣ Should margin requirements be reconsidered?

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# POST TRADE TRANSPARENCY



# Real Time Reporting of Swaps

# Post Trade Transparency

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## □ Purpose

- ▣ Enhance the price discovery process for market participants and the public
- ▣ May improve monitoring of systemic risk

## □ What is to be Reported

- ▣ Time of execution
- ▣ Whether cleared or uncleared
- ▣ Price
- ▣ Notional amount
- ▣ Contract type and sub-type (including underlying asset)
- ▣ Payment frequency
- ▣ Tenor



# Real Time Reporting of Swaps

## Who & When

56

- **Who** publishes swaps trade data
  - ▣ The SDR
  - ▣ Obligation can be delegated to a third party
- **When** will real time data be reported
  - ▣ The law says “*as soon as technologically practicable*”
  - ▣ Delays for large sized block trades
  - ▣ Until block rules are final, all trades to be treated as blocks and subject to a reporting delay



# Swap Block Trades

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- Blocks are large sized swap trades
  - ▣ Minimum size varies by asset class and type of swap
  
- Block trades are excepted from
  - ▣ Mandatory trade execution requirement
  - ▣ Real time reporting
  
- However, block trades must be reported, but subject to a delay



# Delayed Reporting Times for Block Trades

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- On-facility swaps on a facility/involving a swap dealer or MSP
  - Year 1 – 30 minutes
  - Year 2 – 15 minutes
  
- Off-facility swaps subject to mandatory clearing involving 2 end users
  - Year 1 -- 4 hours
  - Year 2 – 2 hours
  - Year 3 – 1 hour
  
- Off-facility swaps not subject to mandatory clearing involving end users
  - Year 1 -- 48 business hours
  - Year 2 – 36 business hours
  - Year 3 – 24 business hours



# Minimum Block Sizes Calculation

59

- CFTC proposed a 67-percent Notional Amount Calculation for All Swap Categories (excluding Equities)
- Would ensure that 2/3rds of notional amounts of swaps in a category are reported in real-time to enhance price transparency



# Anonymity Protections for Swaps Not Traded on a DCM or SEF

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- ❑ All swaps must be reported
- ❑ Protections generally apply to customized swaps
- ❑ Set a notional cap to mask transaction size
  - ▣ Maximum value of the principal amount of the trade that is publicly reported
  - ▣ Masks the actual size of large swap trades
- ❑ For commodity swaps, also limit geographic detail
  - ▣ However, no limit on geographic detail for
    - swaps executed on a SEF or DCM
    - swaps referencing or economically related to one of the contracts described in appendix B

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# TRANSPARENCY & BENCHMARKS USED FOR SETTLING DERIVATIVE CONTRACTS



# Price Formation in Physically Settled and Cash Settled Contracts

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- Prices of physically settled contracts are linked to cash market through trading
  - ▣ Delivery process and arbitrage encourage convergence
- However, prices of cash settled contracts depend on price indices or assessments set elsewhere
  - ▣ Final settlement is based on a “benchmark” price, usually set by a third party
- Cash settled contracts are more common
  - ▣ All existing OTC and cleared swaps are cash settled



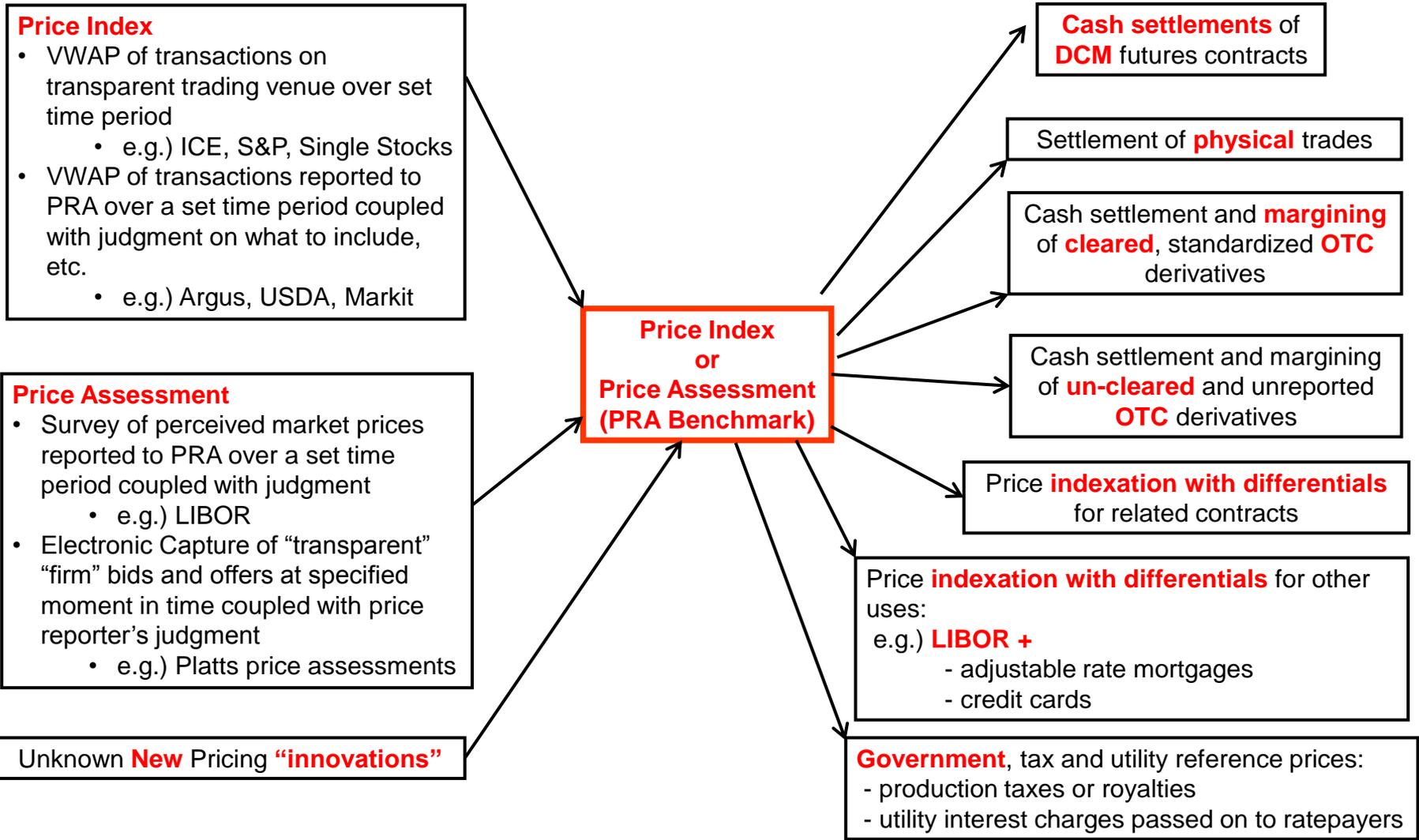
# Benchmarks in US Agricultural Derivative Contracts

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<u>Price Reporting Agency</u>	<u>Number of Contracts</u>
Bursa Malaysia Derivatives Berhad	1
CBOT Futures Settlement Price	13
DTN	5
FOEX Indexes Ltd.	1
ICE US Futures Settlement Price	7
KCBOT Futures Settlement Price	1
USDA	8
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	36
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# Sources and Uses of Price Indexes





# Issues Involving Benchmark Prices Used for Cash Settlement

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- Integrity & independence of price assessor
- Reliability of input values
  - ▣ Do they reflect actual transactions or just “assessments (guesses?)
  - ▣ How are values confirmed or validated
- Presence of a robust underlying market
  - ▣ Issues related to setting of LIBOR



# Recent Initiatives

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- IOSCO Oct 2012 report on price reporting agencies (PRAs)
  - ▣ Set forth principles for oil markets reports
  - ▣ To assess implementation over next year
  - ▣ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD391.pdf>
- IOSCO task force on benchmarks
  - ▣ To develop principles for benchmarks more broadly
  - ▣ Report in summer 2013
- CFTC/IOSCO roundtables
- CFTC staff dialogue with US exchanges
  - ▣ Requests for justification of benchmarks used for cash settlement
  - ▣ Analysis of traders' derivatives positions and related positions



# Undertakings in Barclays' Order to Ensure Integrity of Benchmark Prices

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- ❑ Focus on transaction-based submissions
- ❑ Implementation of firewalls to prevent improper communications with submitters
- ❑ Requirement for documentation and retention
- ❑ Enhancement of monitoring, auditing and training
- ❑ Implementation of policies, procedures and controls
- ❑ Participation in efforts to ensure the reliability of benchmark prices

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# POSITION LIMITS



# Types of Position Limit & Monitoring Procedures

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## □ Position Limits

- Limit on a trader's position in a single month or the net position in all months combined
- Applies to all traders initially
- Exemptions allowed for certain types of activity
  - Hedging/risk management
  - Spreads

## □ Position Accountability

- No hard limit on trader's position size
- Exchange sets accountability levels for each contract, whereby a trader exceeding that level agrees to, upon request:
  - Provide information on its cash and derivatives positions and strategy
  - Not increase its position or reduce the position
- Set by exchanges, no CFTC provision



# Position Limit Regime in the US

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- CFTC imposes position limits on several ag. commodities
  - ▣ Wheat, corn, soybeans, soybean oil, soybean meal, cotton, and oats
  - ▣ Spot month, other months and all months combined
- Exchanges impose position limits, position accountability, or a combination thereof
- For contracts on physical commodities
  - ▣ Position limits in the spot month
  - ▣ Position accountability for other months & all months combined
- For contracts on financial instruments
  - ▣ Position accountability (few exceptions)



# US Exchanges' Obligations

71

- **Commodities with CFTC limits**
  - Impose position limits no greater than CFTC limits
  - Adopt position accountability at lower levels
    - Provides flexibility not available to CFTC with respect to open positions
- **Commodities without CFTC limits**
  - Adopt position limits or accountability as appropriate
  - CFTC provides guidance



# Position Limits: Congressional Directive in Dodd Frank Act

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- Dodd-Frank instructed CFTC to establish limits for physical commodities
  - ▣ Bright line test vs. discretionary position accountability
- To apply to traders' aggregate positions, including swaps economically equivalent to DCM contracts
- CFTC adopted final rules
  - ▣ Phased in implementation spot month limits first
- Final rules vacated by court



# CFTC Position Limit Rulemaking

## Major Components

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- Physical commodities subject to limits
- Position limit levels for each commodity
- Hedge exemption provisions
- Procedures for aggregation of positions under common ownership or control
- Collecting necessary swap data
  - ▣ Swap Large Trader Rulemaking (Part 20)



# Application of CFTC Position Limits

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- Limits apply to a trader's combined position in the
  - ▣ Core referenced contract plus
  - ▣ All economically equivalent contracts
  
- Economically equivalent contracts
  - ▣ Contracts that settle off of the Core Referenced futures contract
  - ▣ Contracts based on the same commodity at same delivery location
  - ▣ Contracts based on at least one Referenced contract price
  - ▣ Contracts priced at a fixed differential to a Core Referenced futures contract



# Proposed Contracts Subject to Limits

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- 28 contracts on enumerated physical commodities
  
- Contracts chosen because they are
  - Traded on US exchanges
  - Actively traded (large volume and open interest) or
  - Widely used for price discovery in the cash market



# Agriculture Contracts with CFTC Position Limits

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- Wheat
- Corn
- Oats
- Soybeans, Soybean Oil, Soybean Meal
- Cotton
- Coffee
- Cocoa
- US Sugar & World Sugar
- Rough Rice
- Cattle & Feeder Cattle
- Milk
- Frozen Concentrated Orange Juice



# Types of Position Limits

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- *Spot Month* limit
  - ▣ Applies during specified “spot” period
    - For agricultural contracts – generally, the last month of trading
  
- Non spot, single-month limit & all-months-combined limit
  - ▣ Applies to a trader’s overall net position in futures, options and swaps
  - ▣ Based on open interest in all derivatives
    - Futures, options and swaps



# Position Limits for Spot Months

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- Concern is manipulation (corners and squeezes)
  - Want to constrain a trader's ability to exert market power to influence prices
  - Want to promote convergence at contract expiration
  
- Levels are set at 25% of *deliverable supply*
  - Defined as the amount of the commodity estimated to be readily available for delivery at the delivery points
  - Long standing CFTC standard
  - To be adjusted every 1 or 2 years



# Position Limits for Individual & All-Months-Combined

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- 10% of first 25,000 of open interest and 2.5% thereafter
- Based on a rule of thumb -- that if a trader made a demand of 2.5% of OI, that demand could be satisfied by at least 40 other traders
  - Adopted by CFTC in early 1990s
- The formula has been found to work well to limit concentrated positions in certain agricultural commodities



# Exemption for Hedging

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- ❑ Congress modified the definition of bona fide hedging
- ❑ Removed the word “normally” from the definition
  - ❑ Transaction must represent a substitute to a transaction made or taken in the physical marketing channel
- ❑ Swap dealer qualifies if its trade is opposite a counterparty eligible for a hedging exemption
  - ❑ A look-through provision



# Position Limit Rulemaking Current Status

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- Court vacated the rules
- CFTC appealed the decision
- CFTC considering whether to propose a new rulemaking

**END OF  
PRESENTATION**

