U.S. COMMODITY FUTURES TRADING COMMISSION
ENSURING THE INTEGRITY OF THE FUTURES & OPTIONS MARKETS

SPECULATIVE LIMITS

To protect futures markets from excessive speculation that can cause unreasonable or unwarranted price fluctuations, the Commodity Exchange Act (CEA) authorizes the Commission to impose limits on the size of speculative positions in futures markets.

Core Principle 5, of Section 5(d) of the CEA, requires designated contract markets to adopt speculative position limits or position accountability for speculators, where necessary and appropriate, to reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month.

There are three basic elements to the regulatory framework for **speculative position limits**. They are:

- the size (or levels) of the limits themselves;
- the **exemptions** from the limits (for example, hedged positions); and
- the **policy on aggregating** accounts for purposes of applying the limits.

SPECULATIVE POSITION LIMITS

Section 4a(a) of the CEA, **7 USC 6a(a)**, specifically holds that excessive speculation in a commodity traded for future delivery may cause "sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity." Section 4a(a) provides that, for the purpose of diminishing, eliminating, or preventing such problems, the Commission may impose limits on the amount of speculative trading that may be done or speculative positions that may be held in contracts for future delivery.

Most physical delivery and many financial futures and option contracts are subject to speculative position limits. For several markets (corn, oats, wheat, soybeans, soybean oil, soybean meal, and cotton), the limits are determined by the Commission and set out in Federal regulations (**CFTC Regulation 150.2**, 17 CFR 150.2). For other markets, the limits are determined by the exchanges. The Commission has adopted “Acceptable Practices” for the establishment of exchange-set limits (**Appendix B to Part 38** of the CFTC’s regulations). Violations of exchange-set limits are subject to exchange disciplinary action. Violations of exchange speculative limit rules approved by the Commission are subject to enforcement action by the Commission.

Speculative limits in physical delivery markets are generally set at a more strict level during the spot month (the month when the futures contract matures and becomes deliverable). Stricter limits in the spot month are important because that is when physical delivery may be required and, therefore; may be more vulnerable to price fluctuation caused by abnormally large positions or disorderly trading practices.

The Commission’s Acceptable Practices under Core Principle 5 specifies that spot month levels for physical delivery markets should be based upon an analysis of deliverable supplies and the history of spot month liquidations. For cash-settled markets, spot month position limits should be set at a level no greater than necessary to minimize the potential for manipulation or distortion of the contract and the underlying commodity price.

In general, position limits are not needed for markets where the threat of market manipulation is non-existent or very low. Thus, speculative position limits are not necessary for contracts on major foreign currencies and other financial commodities that have highly liquid and deep underlying cash markets. A contract market may impose for position accountability provisions in lieu of position limits for contracts on financial instruments, intangible commodities, or certain tangible commodities, which have large open interest, high daily trading volumes, and liquid cash markets.

EXEMPTIONS

The Commission and exchanges grant exemptions to their position limits for bona fide hedging, as defined in **CFTC Regulation 1.3(z)**, 17 CFR 1.3(z). A hedge is a derivative transaction or position that represents a substitute for transactions or positions to be taken at a later time in a physical marketing channel.

Hedges must reduce risk for a commercial enterprise and must arise from a change in the value of the hedger's (current or anticipated) assets or liabilities. For example, a short hedge includes sales for future delivery (short futures positions) that do not exceed its physical exposure in the commodity in terms of inventory, fixed-price purchases and anticipated production over the next 12 months.

A long hedge includes purchases of future delivery (long futures positions) that do not exceed its physical exposure in the commodity in terms of the hedger's fixed-price sales and 12 months' unfilled anticipated requirements for processing or manufacturing.

There are a number of technical provisions with regard to the eligibility for hedge exemptions. For example, the treatment of cross hedging and exemptions under special circumstances are reviewed by the Commission on a case-by-case basis.

CFTC Regulation 1.3(z) requires that "no transactions or position will be classified as bona fide hedging...unless their purpose is to offset price risks incidental to commercial cash or spot operations and such positions are established and liquidated in an orderly manner in accordance with sound commercial practices. …"

The exchanges may also grant exemptions for spreads, straddles, arbitrage positions, or other positions consistent with the purposes of position limit rules. The Commission's Acceptable Practices state that exchanges should establish a program for traders to apply for these exemptions. If the exemption is granted, an exemption level is set at an amount higher than the applicable speculative limit so as not to give a limitless hedge exemption. Exchanges sometimes disallow hedge exemptions or place severe restrictions on exemptions during the last several days of trading in a delivery month.

The Commission periodically reviews how each exchange grants exemptions, how it monitors compliance with its limits, and what types of regulatory action (warnings, fines, trading suspensions, etc.) the exchange takes once a violation of a position limit or exemption is detected.

In the several markets with Federal limits, hedgers must file a report with the Commission if their futures/option positions exceed speculative position limits. **17 CFR Part 19**. The report must be filed monthly or in response to a request by the Commission. The report shows traders' positions in the cash market, and it is used to check whether or not the trader has a sufficient cash position to justify any futures/option position in excess of the speculative position limits.

AGGREGATION REQUIREMENTS

In order to achieve the intended effect of the **speculative position limits**, the Commission and the exchanges treat multiple positions subject to common ownership or control as if they were a single trader. Accounts are considered to be under a common ownership if there is a 10 percent or greater financial interest.

The rules are applied in a manner calculated to aggregate related accounts. For example, each participant with a 10 percent or greater interest in a partnership account must aggregate the entire position of the partnership—not just the participant's fractional share—together with each position they may hold separately from the partnership.

Likewise, a pool comprised of many traders is allowed only to hold positions as if it were a single trader. The Commission also treats accounts that are not otherwise related, but are acting pursuant to an express or implied agreement, as a single aggregated position for purposes of applying the limits.

Narrow exceptions to the aggregation rules exist for limited partners and pool participants that have no knowledge of, or control over, the positions of the pool. Also exempted are commodity pool operators or commodity trading advisors with commonly-owned but independently-controlled market positions. Entities claiming this exemption are required, upon call by the Commission, to provide information supporting their claim that the account controllers for these positions are acting completely independently of each other.