6351-01-P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 41

RIN 3038-AE61

Position Limits and Position Accountability for Security Futures Products

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed rule.

SUMMARY: The Commodity Futures Trading Commission ("CFTC" or "Commission") is proposing to amend its position limits rules for security futures products ("SFPs") by: increasing the default level of equity SFP position limits, and modifying the criteria for setting a higher level of position limits and position accountability levels. In addition, the proposed amended position limit regulation would provide discretion to a designated contract market ("DCM") to apply limits to either a person's net position or a person's position on the same side of the market. The Commission also proposes criteria for setting position limits on an SFP on other than an equity security, generally based on an estimate of deliverable supply.

DATES: Comments must be received on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: You may submit comments, identified by RIN 3038-AE61 and "Position Limits and Position Accountability for Security Futures Products," by any of the following methods:

- *CFTC Web site: http://comments.cftc.gov*. Follow the instructions for submitting comments through the Comments Online process on the Web site.

- *Mail*: Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.
- *Hand delivery/courier*: Same as Mail above.

Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *http://www.cftc.gov*. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures set forth in section 145.9 of the Commission's regulations.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from *http://www.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT: Thomas M. Leahy, Jr., Associate Director, Product Review, Division of Market Oversight, 202-418-5278, *TLeahy@cftc.gov*; or Riva Spear Adriance, Senior Special Counsel, Chief Counsel's

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[1] All Commission regulations referred to herein are found in chapter I of title 17 of the Code of Federal Regulations. Commission regulations are accessible on the Commission's Web site, *http://www.cftc.gov*.

Office, Division of Market Oversight, 202-418-5494, *radriance@cftc.gov*; Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, D.C. 20581.

SUPPLEMENTARY INFORMATION:

I. Background

A. Overview

On December 21, 2000, the Commodity Futures Modernization Act ("CFMA") became law and amended the Commodity Exchange Act ("CEA"). The CFMA removed a long-standing ban[2] on trading futures on single securities and narrow-based security indexes[3] in the United States. As amended by the CFMA, in order for a DCM to list SFPs,[4] the SFPs and the securities underlying the SFPs must meet a number of criteria.[5] One of the criteria requires that trading in the SFP is not readily susceptible to manipulation of the price of such SFP, nor to causing or being used in the manipulation of the price of any underlying security, option on such security, or option on a group or index including such securities.[6]

As the Commission noted when it proposed to adopt criteria for trading of SFPs:

> It is important that the listing standards and conditions in the CEA and the [Securities Exchange Act of 1934 ("Exchange Act")] be easily understood and applied by [DCMs]. The rules proposed today address issues related to these standards and establish uniform requirements related to position

[2] *See* section 251(a) of the CFMA. This trading previously was prohibited by 7 U.S.C. 2(a)(1)(B)(v).
[3] *See* 7 U.S.C. 1a(35) for the definition of "narrow-based security index."
[4] The term "security futures product" is defined in section 1a(45) of the CEA and section 3(a)(56) of the Exchange Act to mean a security future or any put, call, straddle, option, or privilege on any security future. The term "security future" is defined in section 1a(44) of the CEA and section 3(a)(55)(A) of the Exchange Act to include futures contracts on individual securities and on narrow-based security indexes. The term "narrow-based security index" is defined in section 1a(35) of the CEA and section 3(a)(55)(B) of the Exchange Act.
[5] *See* 7 U.S.C. 2(a)(1)(D)(i).
[6] 7 U.S.C. 2(a)(1)(D)(i)(VII).

> limits, as well as provisions to minimize the potential for manipulation and disruption to the futures markets and underlying securities markets.[7]

Among those provisions is current Commission regulation 41.25(a)(3), which requires a DCM that lists SFPs to establish position limits or position accountability standards. The Commission's SFP position limits regulations were set at levels that are generally comparable but not identical to the limits that currently apply to options on individual securities.[8]

Under the existing regulations, a DCM is required to establish for each SFP a position limit, applicable to positions held during the last five trading days of an expiring contract month, of no greater than 13,500 (100-share) contracts, except under specific conditions.[9] If a security underlying an SFP has either (i) an average daily trading volume of at least 20 million shares; or (ii) an average daily trading volume of at least 15 million shares and at least 40 million shares outstanding, then the DCM may establish a position limit for the SFP of no more than 22,500 contracts.[10] A DCM may adopt position accountability for an SFP on a security that has: (i) an average daily trading volume of at least 20 million shares; and (ii) at least 40 million shares outstanding.[11] Under any position accountability regime, upon a request from a DCM, traders holding a position of greater than 22,500 contracts, or such lower threshold as specified by the DCM, must

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[7] *See* Listing Standards and Conditions for Trading Security Futures Products, proposed rules, 66 FR 37932, 37933 (July 20, 2001) ("2001 Proposed SFP Rules"). The Commission further noted, "The speculative position limit level adopted by a [DCM] should be consistent with the obligation in section 2(a)(1)(D)(i)(VII) of the CEA that the [DCM] maintain procedures to prevent manipulation of the price of the [SFP] and the underlying security or securities." *Id*. at 37935.

[8] *See* Listing Standards and Conditions for Trading Security Futures Products, 66 FR 55078, 55082 (November 1, 2001) ("2001 Final SFP Rules").

[9] 17 CFR 41.25(a)(3)(i). The 13,500 limit level is premised on an SFP contract size of 100 shares of an underlying equity security.

[10] 17 CFR 41.25(a)(3)(i)(A).

[11] 17 CFR 41.25(a)(3)(i)(B).

provide information to the exchange regarding the nature of the position.[12] Under position accountability, traders must also consent to halt increases in the size of their positions upon the direction of the DCM.[13] The position limits and position accountability trigger levels specified in the Commission's regulations are based on a contract size of 100 shares in the underlying security. DCMs may use part 150 of the Commission's regulations as guidance when approving exemptions from SFP position limit rules.[14]

B. Differences Between Initially Adopted SFP and Equity Option Position Limit Rules

In response to the 2001 Proposed SFP rules, three commenters noted several differences between the SFP position limit regulations and position limit rules for equity security options listed on national security exchanges or associations ("NSE") approved by the Securities and Exchange Commission ("SEC"): (1) the specification that position limits for SFPs are on a net, rather than a gross,[15] basis; (2) the numerical limits on SFPs differ from those on security options; and (3) the position limits for SFPs are applicable only during the last five trading days prior to expiration, rather than at any time in the lifespan of a security option contract.[16] Commenters also requested that the Commission coordinate with the SEC so that the SFP position limit regulations are the same as those applicable to security and securities index options, or, alternatively, that such position limit regulations more closely resemble existing limits on security and securities index

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[12] *Id*.
[13] *Id*.
[14] Although part 150 previously provided requirements for exchange-set position limits, it was rendered "mere guidance" by the CFMA. *See, e.g.*, 81 FR 96704, 96742 (Dec. 30, 2016); *see also* 74 FR 12178, 12183 (March 23, 2009) (noting "the part 150 rules essentially constitute guidance for DCMs administering position limits regimes").
[15] The Commission understands that "gross" in this context means on the same side of the market, as discussed *infra*.
[16] 2001 Final SFP Rules at 55081.

options.[17] The Commission noted that the provisions in Commission regulation 41.25(a)(3) as finalized were consistent with the Commission's customary approach for all other futures markets,[18] were necessary to effectively oversee the markets, and were consistent with the obligation of a DCM to prevent manipulation of the price of an SFP and its underlying security or securities.[19]

There was one other difference between the position limit rules for SFPs and security options, on which no one commented. Specifically, the volume test adopted by the Commission for position limits on SFPs was based on *average* trading volume over a six-month period while the volume test for security options was based on *total* trading volume over a six-month period. This difference typically results in position limits for SFPs that are more restrictive than those on analogous security options.[20]

C. Subsequent Developments in SFP Position Limit Regulations

Since the 2001 Final SFP Rules, the Commission's SFP position limit regulations have not been substantively amended to account for SFPs on securities other than common stock, although the statute authorizes it. CEA section 2(a)(1)(D)(i) authorizes DCMs to list for trading SFPs based upon common stock and such other equity securities as the Commission and the Securities and Exchange Commission jointly determine appropriate.[21] The CFMA further authorized the Commission and the SEC (collectively

[17] *Id*. at 55082.
[18] *See infra* discussion regarding part 150 of the Commission's regulations.
[19] 2001 Final SFP Rules at 55082.
[20] Although DCMs may adopt for certain SFPs position accountability provisions with an accountability level of 22,500 (100-share) SFP contracts, in lieu of position limits, the analogous security option is subject to a position limit likely to be set at a level of 250,000 (100-share) option contracts, as shown below in Table A.
[21] 7 U.S.C. 2(a)(1)(D)(i)(III).

"Commissions") to allow SFPs to be based on securities other than equity securities.[22] The Commissions used their authority to allow SFPs on Depositary Receipts;[23] Exchange Traded Funds, Trust Issued Receipts and Closed End Funds;[24] and debt securities.[25]

D. Subsequent Equity Security Option Position Limit Increases

Since the Commission's initial adoption of SFP position limits, the SEC has granted approval to increase position limits for equity security options listed on NSEs, but the Commission has not amended its SFP regulations to reflect those changes. For example, under current position limits for equity security options that are uniform across rules of NSEs,[26] position limits are at least 25,000 option contacts.[27] Also, as noted above, NSEs set higher levels based on six-month total trading volume or, alternatively, a combination of six-month total trading volume and shares outstanding, as shown in Table A.[28]

Table A: NSE Equity Security Option Position Limits (as of Dec. 6, 2017)

Option Contract Limit (100 shares/contract)	Six-month total trading volume is at least:	Or, if six-month total trading volume and shares currently outstanding are at least:	
	Trading Volume (shares)	Trading Volume (shares)	Shares outstanding
25,000	Default	Default	Default

[22] 7 U.S.C. 2(a)(1)(D)(v)(I).
[23] *See* Joint Order Granting the Modification of Listing Standards Requirements under section 6(h) of the Securities Exchange Act of 1934 and the Criteria under section 2(a)(1) of the Commodity Exchange Act, August 20, 2001 *https://www.sec.gov/rules/other/34-44725.htm*.
[24] *See* 67 FR 42760 (June 25, 2002).
[25] *See* 17 CFR 41.21(a)(2)(iii) (providing that the underlying security of an SFP may include a note, bond, debenture, or evidence of indebtedness); *see also* 71 FR 39534 (July 13, 2006) (describing debt securities to include notes, bonds, debentures, or evidences of indebtedness).
[26] *See, e.g.,* the Cboe Exchange, Inc. ("Cboe") rule 4.11, Nasdaq ISE, LLC ("ISE") rule 412, NYSE American LLC ("NYSE American") rule 904, Nasdaq PHLX LLC ("Phlx") rule 1001.
[27] *See, e.g.,* 73 FR 10076 (February 25, 2008) (granting permanent approval of an increase in position and exercise limits for equity security options).
[28] *Id*. at 10076-77.

Option Contract Limit (100 shares/contract)	Six-month total trading volume is at least:	Or, if six-month total trading volume and shares currently outstanding are at least:	
50,000	20 million	15 million	40 million
75,000	40 million	30 million	120 million
200,000	80 million	60 million	240 million
250,000	100 million	75 million	300 million

Each equity security option contract limit is applicable on a gross basis to option positions on both sides of the market.[29] The NSEs permit certain exemptions, including for qualified hedging transactions and positions and for facilitation of orders with customers. Generally, limits for options on registered investment companies, organized as open-end management companies, unit investment trusts or similar entities, are the same as the positions limits applicable to equity options.[30]

In addition to position limits under NSE rules, NSEs establish uniform exercise limits for the aggregate exercise of a long position in any option contract within any five consecutive business days, generally at the levels of the applicable position limits.[31] This exercise limit may serve to reduce the potential for manipulation (such as a squeeze on

[29] For example, Cboe applies limits to an aggregate position in an option contract "of the put type and call type on the same side of the market." Cboe rule 4.11. For this purpose, under the rule, long positions in put options are combined with short positions in call options; and short positions in put options are combined with long position in call options.

[30] NSEs have established position limits higher than shown in Table A for certain security options on products with broad-based holdings of underlying securities; for example, the Cboe position limit in the DIAMONDS Trust option is 300,000 contracts, iShares Russell 2000 Index Fund option is 500,000 contracts, PowerShares QQQ Trust option is 900,000 contracts, and iShares MSCI Emerging Markets Index Fund option is 500,000 contracts. Similarly, BOX Options Exchange, Inc., Cboe, Nasdaq ISE, LLC, Nasdaq PHLX, LLC, NYSE American, LLC, and NYSE Arca, Inc. all recently adopted position limits for security options on the Standard and Poor's Depositary Receipts Trust that are 1,800,000 contracts. *See, e.g.*, 83 FR 28274 (June 18, 2018) (allowing the SPY Pilot Program to terminate and making immediately effective the new limit).

[31] *See, e.g.,* Cboe rule 4.12, ISE rule 414, NYSE American rule 905, and Phlx rule 1001.

short option position holders) by restricting the number of shares demanded for delivery by a long call option position holder, in a similar manner to a DCM's position limit, under current Commission regulation 41.25(a)(3), thus restricting the number of shares that may be demanded during the last five days of trading.

E. Commission's Position Limit Approach in Other Commodity Futures

The Commission's customary approach for position limits in futures contracts other than SFPs is found in part 150 of the Commission's regulations, which establishes a position limits regime that generally includes three components: (1) the level of the limits, which sets a threshold that restricts the number of speculative positions that a person may hold in the spot-month, individual month, and all months combined; (2) exemptions for positions that constitute bona fide hedging transactions and certain other types of transactions; and (3) rules to determine which accounts and positions a person must aggregate for the purpose of determining compliance with the position limit levels. For exchange-set position limits, on physically-delivered contracts, the spot month limit level should be no greater than one-quarter of the estimated spot month deliverable supply, calculated separately for each month to be listed, and for cash settled contracts, the spot month limit level should be no greater than necessary to minimize the potential for manipulation or distortion of the contract's or the underlying commodity's price.[32]

II. The Proposal

A. Overview

[32] *See* 17 CFR 150.5(b)(1); *see also supra* note 14.

The Commission notes that SFPs and security options may serve economically equivalent or similar functions.[33] As noted above, when adopted, the Commission's SFP position limits regulations were set at levels that are generally comparable but not identical to the limits that currently apply to options on individual securities. However, over time, while the default level for position limits for SFPs did not change, those of security options on the same security have in some cases changed, allowing the position limit for the security option, as observed above, to be set at a much higher default level. This may place SFPs at a competitive disadvantage. One goal of this proposal, therefore, is to provide a level regulatory playing field.[34]

When determining appropriate limit levels, the Commission took note of the experience of NSEs over several years with higher position limit levels on security options, with no apparent significant issues, suggesting, therefore, that it may be reasonable for SFP position limits to closely resemble existing contract limits for equity options at NSEs. To allow DCMs to adapt as NSE position limits change, the current draft would be flexible, providing a formula for a DCM to set a higher level, rather than the specific levels in a current rule of an NSE.

However, as has been noted, some aspects of the position limits regime under current Commission regulation 41.25 differ from those on security options as the Commission determined certain approaches were necessary to effectively oversee the

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[33] For example, the price of a long call option with a strike price well below the prevailing market price of the underlying security is expected to move almost in lock step with the price of a long SFP on the same underlying security. Similarly, the price of a long put option with a strike price well above the prevailing market price of the underlying security is expected to move almost in lock step with the price of a short SFP on the same underlying security.

[34] As the Commission notes above, commenters also requested that the SFP position limit regulations be the same as those applicable to security and securities index options, or, alternatively, that such position limit regulations more closely resemble existing limits on security and securities index options. *See supra* note 17 and accompanying text.

markets, and consistent with the obligation of a DCM to prevent manipulation of the price of an SFP and its underlying security or securities.[35] In light of its experience since the first adoption of a position limits regime for SFPs in 2001, the Commission believes in the merit of updating Commission regulation 41.25 under an incremental approach, for example, by providing DCMs with discretion to increase limits, generally consistent with those currently permitted for equity options listed by an NSE, while allowing the Commission to assess the impact on SFP markets.

The Commission proposes to maintain the requirement in current Commission regulation 41.25(a)(3) that DCMs establish position limits or, in certain cases, accountability standards for SFPs. The proposal would increase the default level for speculative position limits in SFPs in equity securities to 25,000 100-share contracts (or the equivalent if the contract size is different than 100 shares per contract) from 13,500 100-share contracts. The proposal would change the criterion that DCMs use to set higher levels of speculative position limits to no more than 12.5 percent of the estimated deliverable supply[36] of the relevant underlying security, from no greater than 22,500 100-share contracts if certain criteria are met in current Commission regulation 41.25(a)(3)(i).[37] The proposed 12.5 percent criterion is discussed further below. In this regard, the Commission believes that exchange-set position limits for SFPs based on estimated deliverable supply would provide flexibility to DCMs while ensuring that

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[35] *See* 2001 Final SFP Rules at 55082. The approach NSEs may use to set an equity option's position limit is not consistent with existing Commission policy and may, in the Commission's opinion, as noted previously, render position limits ineffective.
[36] *See infra* regarding proposed guidance on estimated deliverable supply.
[37] The current criteria for a level higher than 13,500 100-share contracts are six-month average daily trading volume in the underlying security exceeds 20 million shares, or exceeds 15 million shares and there are more than 40 million shares of the underlying security outstanding.

position limits appropriately reflect current market conditions for the specific securities that underlie their SFPs.

The Commission also proposes to amend the position accountability provisions so that a DCM could substitute position accountability for position limits when six-month total trading volume in the underlying security exceeds 2.5 billion shares and there are more than 40 million shares of estimated deliverable supply, rather than the current criteria of six-month average daily trading volume in the underlying security exceeds 20 million shares and there are more than 40 million outstanding shares. In addition, the maximum accountability level under the position accountability regime would be increased to 25,000 contracts, from the current level of 22,500 contracts.

This proposal also addresses SFPs based on products other than a single equity security. As discussed below, these products are a physically-delivered basket equity SFP, a cash-settled equity index SFP, and an SFP on one or more debt securities.[38]

The Commission proposes to maintain the provision that requires position limits to be applied during a period of time of no shorter than the last five trading days in an expiring contract month. However, the proposed regulation would require a longer period than five trading days in the event the terms of an SFP provide for delivery prior to the last five trading days.

The Commission proposes that a DCM should have discretion to apply position limits or position accountability levels either on a net basis, as under current regulations,

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[38] The SFP definition permits the listing of SFPs on debt securities (other than exempted securities). *See supra* note 22 and accompanying text. While an SFP may not be listed on a debt security that is an exempted security, futures contracts may be listed on an exempted security. *See infra* note 69 and accompanying text.

or on the same side of the market.[39] If a DCM imposes limits on the same side of the market, then the DCM could not net positions in SFPs in the same security on opposite sides of the market.

This proposal permits DCMs to approve exemptions to limits, provided such exemptions are consistent with the guidance in current Commission regulation 150.5, which addresses exchange-set position limits, rather than consistent with current Commission regulation 150.3, which addresses exemptions to Commission-set position limits. In addition, the proposal permits DCMs to approve exemptions consistent with those of an NSE.

Under this proposal, DCMs would be required to calculate estimated deliverable supply and six-month total trading volume no less frequently than semi-annually, rather than the monthly requirement under the current regulations. The proposal requires that a DCM lower the position limit levels if the estimated deliverable supply justifies lower position limits. Similarly, the proposal requires that a DCM adopt position limits if the estimated deliverable supply or six-month total trading volume no longer supports position accountability provisions.

Finally, as discussed further below, these proposed regulations provide the definitions for "estimated deliverable supply and "same side of the market", terms used in Commission regulation 41.25, by adding those definitions into a new paragraph (a).[40]

B. Section-by-Section Discussion

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[39] The Commission notes that, although it has not proposed an aggregation rule that would define "person" for purposes of SFP position limits, current 17 CFR 150.5(g) provides guidance to DCMs in setting aggregation standards for exchange-set position limits. The Commission believes a DCM should have reasonable discretion to set aggregate standards based on a person's control or ownership of SFP positions, including in the same manner as that of an NSE for equity security options.

[40] In connection with adding the definitions into a new paragraph (a), paragraphs (a) through (d) would be re-designated as paragraphs (b) through (e).

1. Commission Regulation 41.25(a), Definitions.

The proposal includes two definitions used in Commission regulation 41.25: estimated deliverable supply; and same side of the market. These definitions are included in new paragraph (a).

Estimated deliverable supply is defined under the proposal as the quantity of the security underlying a security futures product that reasonably can be expected to be readily available to short traders and salable by long traders at its market value in normal cash marketing channels during the specified delivery period. The proposal provides guidance for estimating deliverable supply in proposed appendix A to subpart C of part 41, as discussed below.

The proposal defines same side of the market to mean long positions in physically-delivered security futures contracts and cash settled security futures contracts, in the same security, and, separately, short positions in physically-delivered security futures contracts and cash settled security futures contracts, in the same security. The Commission invites comment on whether it should also include options on security futures contracts in this definition, although options on SFPs are not currently permitted to be listed.[41] Generally, a long call and a short put, on a futures equivalent basis, would be aggregated with a long futures contract; and a short call and a long put, on a futures equivalent basis, would be aggregated with a short futures contract.

2. Commission Regulation 41.25(b)(3), Position Limits or Accountability Rules Required.

As with current Commission regulation 41.25(a)(3), under this proposal, the paragraph, as re-designated regulation 41.25(b)(3), would continue to require a DCM to

[41] Under CEA section 2(a)(1)(D)(iii)(II), the CFTC and SEC may, by Order, jointly determine to permit the listing of options on SFPs; that authority has not been exercised.

establish position limits or position accountability rules in each SFP for the expiring futures contract month.

3. Commission Regulation 41.25(b)(3)(i), Limits for Equity SFPs.

Proposed changes to regulation 41.25(a)(3)(i), re-designated as regulation 41.25(b)(3)(i), would increase the default level of position limits in an equity SPF to no greater than 25,000 100-share contracts (or the equivalent if the contract size is different than 100 shares per contract), either net or on the same side of the market, from the existing regulation's default level of no greater than 13,500 100-share contracts on a net basis. The default level of 25,000 100-share contracts is equal to 2,500,000 shares. The Commission notes that 12.5 percent of 20 million shares equals 2,500,000 shares. Thus, for an equity security with less than 20 million shares of estimated deliverable supply, the default position limit level for the equity SFP would be larger than 12.5 percent of estimated deliverable supply. While a DCM could adopt the default position limit for SFPs in equity securities with fewer than 20 million shares, consistent with a position limit applicable to an option on that security, the Commission would expect a DCM to assess the liquidity of trading in the underlying security to determine whether the DCM should set a lower position limit level, as appropriate to ensure compliance with DCM Core Principles 3 and 5. In this regard, the Commission seeks comment on whether it should provide greater specificity with respect to this liquidity assessment and whether there are circumstances where the position limit level should be set lower than 25,000

100-share contracts (for example, no greater than 12.5 percent of estimated deliverable supply).[42]

The Commission notes that minimum position limits for equity security option positions on NSEs are 25,000 100-share option contracts on the same side of the market. Thus, the proposal would allow a DCM to coordinate the default position limit level for SFPs to that of an equity option traded on a NSE. Accordingly, as previously requested by commenters in the context of the CFTC's adoption of its current SFP position limit requirements, this proposed default level for SFP limits would closely resemble existing minimum limit levels on security options.

As noted above, SFPs and security options may serve economically equivalent or similar functions.[43] However, under current Commission regulation 41.25(a)(3), as previously detailed, the default level for position limits for SFPs must be set no greater than 13,500 (100-share) contracts, while security options on the same security may be, and currently are, set at a much higher default level of 25,000 contracts,[44] which may place SFPs at a competitive disadvantage. Closer coordination of limit levels is intended to provide a level regulatory playing field.

However, because limit levels would not apply to a market participant's combined position between SFPs and security options, the Commission is not proposing a default

[42] Core Principle 3, 7 U.S.C. 7(d)(3), provides that DCMs shall list only contracts that are not readily susceptible to manipulation, while Core Principle 5, 7 U.S.C. 7(d)(5), provides for the adoption of position limits and position accountability, as is necessary and appropriate, to deter the threat of manipulation. Moreover, 7 U.S.C. 2(a)(1)(D)(i)(VII) and 17 CFR 41.22(f) require that trading in an SFP: (i) be not readily susceptible to manipulation of the SFP; or (ii) cause the manipulation of any underlying security, an option on such security, or an option on a group or index including such security or securities.

[43] For example, the price of a long call option with a strike price well below the prevailing market price of the underlying security is expected to move almost in lock step with the price of a long SFP on the same underlying security. Similarly, the price of a long put option with a strike price well above the prevailing market price of the underlying security is expected to move almost in lock step with the price of a short SFP on the same underlying security.

[44] *See* current Cboe rule 4.11.

limit level for an SFP higher than 12.5 percent of estimated deliverable supply. That is, under the proposal, a market participant with positions at the limits in each of an SFP and a security option on the same underlying security might be equivalent to about 25 percent of estimated deliverable supply, which is at the outer bound of where the Commission has historically permitted spot month limit levels. The Commission invites comment on whether this proposed default level is appropriate.

The proposal would include, in the requirements for limits for equity SFPs, securities such as exchange trading funds ("ETFs") and other securities that represent ownership in a group of underlying securities. The Commission requests comment on whether this is appropriate and invites further comment, below, in the discussion of estimated deliverable supply.

This proposal would provide discretion to a DCM to apply position limits on a gross basis ("on the same side of the market") or net basis, rather than the current regulation's net basis. For example, if there were a physically-delivered SFP on equity XYZ, a dividend-adjusted SFP on equity XYZ, and a cash-settled SFP on equity XYZ, then a DCM's rules could provide that long positions held by the same person across each of these classes of SFP based on equity XYZ would be aggregated for the purpose of determining compliance with the position limit. A gross position in a futures contract is larger than a net position in the event a person holds positions on opposite sides of the market. That is, a net basis is computed by subtracting a person's short futures position from that person's long futures positions, and, under current regulations, a single position limit applies on a net basis to that net long or net short position. Under the proposal, at the discretion of a DCM, a person's long futures position would be subject to the position limit and, separately, a person's short futures position also would be subject to the position limit. As previously requested by commenters, adding this proposed gross basis approach (in addition to net basis) to SFP limits would more closely resemble existing limits on security options that apply on the same side of the market per the rules of the NSEs. A DCM that elects to implement limits on a gross basis would be providing its market participants with the same metric for position limit compliance as is currently the case on NSEs, which may reduce compliance costs and encourage cross-market participation. However, limits on a gross basis may be more restrictive than limits on a net basis, which could reduce the position sizes that may be held, without an applicable exemption.

In addition, the Commission would continue to permit DCMs to apply limits on a net basis at the DCM's discretion. In this regard, the Commission believes it is possible for a DCM's application of limits to further the goals of the CEA whether applied on a net or a gross basis.[45] This would be true, for example, if a DCM applied limits on a net basis and did not permit netting of physically-delivered contracts with cash settled contracts. But if, instead, the DCM permitted netting of physically-delivered contracts and cash settled contracts in the same security, it would render position limits ineffective.[46] For example, a person should not be permitted to avoid limits by obtaining

[45] CEA section 2(a)(1)(D)(i)(VII) requires that trading in SFPs is not readily susceptible to manipulation of the price of the SFP, the SFP's underlying security, or an option on the SFP's underlying security.

[46] Although no DCM currently lists both physically-delivered SFPs contracts and cash-settled SFP contracts for the same underlying security, and this concern may be theoretical, the Commission believes that providing clarity reduces uncertainty regarding netting in such circumstances, which may facilitate listing of such contracts in the future. Therefore, the Commission proposes to provide in 17 CFR 41.25(b)(3)(vii) that, for a DCM applying limits on a net basis, netting of physically-delivered contracts and cash settled-contracts in the same security is not permitted as it would render position limits ineffective. This concern is not applicable to a DCM applying limits on the same side of the market, as limits are applied separately to long positions and to short positions.

a large long position in a physically-delivered contract (which could be used to corner or squeeze) and a similarly large short position in a cash settled contract that would net to zero.

4. Commission Regulation 41.25(b)(3)(i)(A), Higher Position Limits in Equity SFPs.[47]

For an SFP based on an underlying security with an estimated deliverable supply of more than 20 million shares, the proposal would permit a DCM to set a higher limit level based on 12.5 percent of the estimated deliverable supply of the underlying security, if appropriate in light of the liquidity of trading in the underlying security. By way of example, if the estimated deliverable supply were 40 million shares, then the proposed regulation would permit a DCM to set a limit level of no greater than 50,000 100-share contracts; computed as 40 million shares times 12.5 percent divided by 100 shares per contract.

This level of 50,000 100-share contracts is the same as permitted under current rules of NSEs for an underlying security with 40 million shares outstanding, although an NSE would also require the most recent six-month trading volume of the underlying security to have totaled at least 15 million shares. While this proposed provision for SFP position limits would more closely resemble existing limits on security options, the Commission is proposing to permit a DCM to use its discretion in assessing the liquidity of trading in the underlying security, rather than imposing a prescriptive trading volume requirement.[48] The Commission preliminarily does not believe that trading volume alone

[47] As noted above, the proposal would re-designate 17 CFR 41.25(a)(3)(i)(A) as 17 CFR 41.25(b)(3)(i)(A).
[48] Generally, under CEA section 5(d)(1)(B), unless otherwise restricted by a Commission regulation, a DCM has reasonable discretion in establishing the manner in which it complies with core principles, including Core Principle 5 regarding position limits or position accountability. *See* 7 U.S.C. 7(d)(1) and (5).

is an appropriate indicator of liquidity.[49] In this regard, the proposed regulation would permit a DCM to set a position limit at a level lower than 12.5 percent of estimated deliverable supply. The Commission invites comment on whether it is appropriate to provide a DCM with discretion in its assessment of liquidity in the underlying security, rather than the Commission imposing a liquidity requirement. Core Principle 5 requires DCMs to adopt, as is necessary and appropriate, position limits to deter the adverse market impact of manipulation. The Commission invites comment on whether estimated deliverable supply alone serves as an adequate proxy for market impact.

Although the Commission is proposing a criterion of 12.5 percent of estimated deliverable supply, the Commission expects a DCM to conduct a reasoned analysis as to whether setting a level for a limit based on such criterion is appropriate. In this regard, for example, assume security QRS and security XYZ have equal free float of shares. Assume, however, that trading in QRS is not as liquid as trading in XYZ. Under these assumptions, it may be appropriate for a DCM to adopt a position limit for XYZ equivalent to 12.5 percent of deliverable supply, but to adopt a lower limit for QRS because a lesser number of shares would be readily available for shorts to make delivery.

The Commission notes that the proposed criterion of 12.5 percent of estimated deliverable supply is half the level for DCM-set spot month speculative position limits in current Commission regulation 150.5(c),[50] which, as previously noted, has been rendered

[49] Under current 17 CFR 41.25(a)(3)(i)(A), for example, a DCM may adopt a net position limit no greater than 22,500 shares, provided the six-month average daily trading volume exceeds 15 million shares and there are more than 40 million shares of the security outstanding. The Commission notes that almost all stocks with at least 40 million shares outstanding also had a six-month average trading volume of at least 15 million shares. Thus, the current trading volume criterion generally is not a meaningful restriction.

[50] 17 CFR 150.5(c).

"mere guidance" since the CFMA.[51] That regulation provides that, for physically-delivered contracts, the spot month limit level should be no greater than one-quarter of the estimated spot month deliverable supply.[52] The Commission is proposing a lower percent of estimated deliverable supply in light of current limits on equity security options listed at NSEs. In this regard, the proposal would result in SFP position limits that closely resemble the existing 25,000 and 50,000 contract limits for equity options at NSEs, set when certain trading volume has been reached or a combination of trading volume and shares currently outstanding, as shown in Table A above. For example, a position at a 50,000 (100-share) option contract limit is equivalent to 5 million shares. 12.5 percent of 40 million shares equals 5 million shares; that is, the proposed criterion for a DCM to set a limit would be similar to that of the criteria for an NSE to set such a limit. Under this proposal, a similar 50,000 contract position limit on an SFP on such a security would be an increase from the 22,500 contract limit currently permitted for such an SFP. The Commission believes the proposed incremental approach to increasing SFP limits is a measured response to changes in the SFP markets, while retaining consistency with the existing requirements for equity security options listed by NSEs.

However, as noted above, SFPs and equity security options in the same underlying security are not subject to a combined position limit across DCMs and NSEs. Accordingly, the Commission is proposing a maximum SFP limit level that is half the guidance level for DCM-set spot month futures contract limits of 25 percent of estimated deliverable supply.

[51] *See supra* discussion of the impact of the CFMA on part 150; *see also* 74 FR 12177 at 12183 (March 23, 2009).

[52] 17 CFR 150.5(c)(1).

Further, as shown in Table A above, the Commission notes that limits for equity security options at NSEs do not increase in a linear manner for all increases in shares outstanding; for example, upon a doubling of shares outstanding, the 100-share equity security option contract limit increases only to 75,000 contracts from 50,000 contracts, while, under similar circumstances of a doubling of estimated deliverable supply, the Commission proposes to permit a linear increase for a SFP limit to 100,000 contracts from 50,000 contracts. The Commission invites comments as to whether the proposed linear approach based on estimated deliverable supply is appropriate.

Alternative Criteria for Setting Levels of Limits. As an alternative to the proposed criteria for setting position limit levels based on estimated deliverable supply, the Commission invites comments on whether the Commission should permit a DCM to mirror the position limit level set by an NSE in a security option with the same underlying security or securities as that of the DCM's SFP. This alternative has the advantage of consistency in position limits across exchange-traded derivatives based on the same security.

However, the Commission notes that NSEs may set an equity option's position limit by the use of trading volume as a sole criterion. That approach is not consistent with existing Commission policy regarding use of estimated deliverable supply to support position limits in an expiring contract month, as stated in part 150 of the Commission's regulations.[53] The Commission notes that use of trading volume as a sole criterion for setting the level of a position limit could result in a position limit that exceeds the number

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[53] For example, Cboe rules also permit a 50,000 contract position limit based on the total most recent six-month trading volume of 20 million shares, without regard to shares outstanding.

of outstanding shares when the underlying security exhibits a very high degree of turnover. Such a resulting high limit level would render position limits ineffective.

5. Commission Regulation 41.25(b)(3)(i)(B), Position Accountability in Lieu of Limits.[54]

This proposal would continue to permit a DCM to substitute position accountability for a position limit in an equity SFP that meets two criteria. The proposal would require six-month total trading volume of at least 2.5 billion shares, which generally is equivalent to the current first criterion that six-month average daily trading volume in the underlying security must exceed 20 million shares.[55] The proposal would tighten the second criterion. Rather than require that the underlying security have more than 40 million shares outstanding, under the proposal the second criterion would require the underlying security to have more than 40 million shares of estimated deliverable supply, which generally would be smaller than shares outstanding. This change conforms to the proposed use of estimated deliverable supply in setting a position limit. The Commission believes an appropriate refinement to its criterion for position accountability is to quantify those equity shares that are readily available in the market, rather than all shares outstanding. Generally, a short position holder may expect to obtain at or close to fair value shares that are readily available in the market and a long position holder may expect to sell such shares at or close to fair value. However, in contrast, shares that are issued and outstanding by a corporation may not be readily available in a timely manner,

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[54] As noted above, the proposal would re-designate 17 CFR 41.25(a)(3)(i)(B) as 17 CFR 41.25(b)(3)(i)(B).

[55] 20 million shares times 125 trading days in a typical six-month period equals 2.5 billion shares. In regards to total trading volume rather than average daily trading volume, the Commission notes that use of total trading volume is consistent with the rules of NSEs, which use six-month total trading volume in their criteria for setting position limits, as shown in Table A above.

such as shares held by the corporation as treasury stock.[56] Therefore, to ensure that position holders will generally be able to obtain equity shares at or close to fair value, the DCM should consider whether the shares are readily available in the market when estimating deliverable supply.

In addition, the proposal would amend the accountability level to no greater than 25,000 contracts, either net or on the same side of the market, from 22,500 contracts net, conforming to the proposed default position limit level. The Commission notes a DCM would be able to set a lower accountability level, should it desire. The Commission preliminarily believes it is appropriate to set a position accountability level no higher than 25,000 contracts because the Commission believes a DCM should have the authority, but not the obligation, to inquire with very large position holders and to order such position holders not to increase positions.[57] The Commission preliminarily believes a maximum position accountability level of 25,000 contracts is at the outer bounds for purposes of providing a DCM with authority to obtain information from position holders; for example, a position of 25,000 100-share contracts has a notional size of $125 million when the price of the underlying stock is $50 per share.

6. Commission Regulation 41.25(b)(3)(ii), Limits for Physically-Delivered Basket Equity SFPs.

This proposal would amend the existing position limits and position accountability provisions for a physically-delivered SFP comprised of more than one

[56] Treasury stock means any shares that a company holds itself. Such treasury stock may be authorized by the corporate charter but not yet issued to the public or, in contrast, may have been previously issued to the public but was the subject of a stock repurchase program to buy back the shares from the public.

[57] By way of comparison, under 17 CFR 15.03, the Commission's reporting level for large traders ("reportable position") is 1,000 contracts for individual equity SFPs and 200 contracts for narrow-based SFPs. Under 17 CFR 18.05, the Commission may request any pertinent information concerning such a reportable position.

equity security[58] by basing the criteria on the underlying equity security with the lowest estimated deliverable supply, rather than the lowest average daily trading volume.[59] Specifically, under the proposal, for an SFP on more than one security, the criteria in proposed regulations 41.25(b)(3)(i)(A) and (B)[60] would apply to the underlying security with the lowest estimated deliverable supply in the basket, with an appropriate adjustment to the level of the position limit or accountability level for a contract size different than 100 shares per underlying security.

The proposal is based on the premise that the limit on a physically-delivered basket equity SFP should be consistent with the most restrictive of each limit that would be applicable to SFPs based on each component of such basket of deliverable securities. This would restrict a person from obtaining a larger exposure to a particular security through a physically-delivered basket equity SFP, than could be obtained directly in a single equity SFP. However, this proposal would not aggregate positions in single equity SFPs with positions in basket deliverable SFPs.

7. Commission Regulation 41.25(b)(3)(iii), Limits for Cash-Settled Equity Index SFPs.

For setting levels of limits on an SFP comprised of more than one security, current Commission regulation 41.25(a)(3)(ii) specifies certain criteria for trading volume and shares outstanding that must be applied to the security in the index with the lowest

[58] The Commission notes that there is not a limit *per se* on the maximum number of securities in a narrow-based security index. Rather, under CEA section 1a(35), a narrow-based security index generally means, among other criteria, an index that has 9 or fewer component securities; in which a component security comprises more than 30 percent of the index's weighting; in which the five highest weighted component securities in the aggregate comprise more than 60 percent of the index's weight; or in which the lowest weighted component securities, comprising the lowest 25 percent of the index's weight, have an aggregate dollar value of average daily trading volume of less than $50 million.

[59] This means that, under proposed 17 CFR 41.25(b)(3)(i), the default level position limit would be no greater than 25,000 100-share contracts, unless the underlying equity security with the lowest estimated deliverable supply supports a higher level.

[60] As noted above, as proposed, 17 CFR 41.25(a)(3)(i)(A) and (B) would be re-designated as 17 CFR 41.25(b)(3)(i)(A) and (B).

average daily trading volume. However, the Commission is not proposing to retain those criteria for setting levels of limits for cash-settled equity index SFPs for a number of reasons. For an equity index that is price weighted, it appears that use of shares outstanding or trading volume may result in an inappropriately restrictive level for a position limit.[61] For an equity index that is value weighted, it also appears that such use may result in an inappropriately restrictive level for a position limit.[62] The Commission observes that while trading volume, as an indicator of liquidity, may be an appropriate factor for a DCM to consider in setting position limits, trading volume is not generally used in construction of equity indexes.

Proposed appendix A to subpart C provides guidance and acceptable practices for setting the limit level for a cash-settled equity index SFP, discussed below. However, as noted above, the proposal would continue to require a DCM, for cash-settled equity index SFPs, to establish position limits or position accountability rules in each SFP for the expiring futures contract month in the last five trading days of an expiring contract month. As also discussed above, the proposal provides discretion to a DCM to set such a limit either net or on the same side of the market.

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[61] For example, assume the level of a simple price-weighted index is computed by adding the price of each equity security in the index and dividing by the number of different equity securities. For such a simple index, a given percentage change in the price of a company with a higher share price would have a greater impact on the index than a given percentage change in the price of a company with a lower share price. In such a circumstance, the Commission preliminarily believes the DCM should have discretion, in setting the position limit, to give consideration to the equity (or equities) with the greater weight(s) in the index, rather than only with regard to the equity with the lowest number of shares outstanding.

[62] For example, the level of a value-weighted index will change in relation to the change in the market capitalization of each component equity security. In such a circumstance, a given percentage change in the market value of a higher capitalized company would have a greater impact on the index than a given percentage change in the market value of a lower capitalized company. In such a circumstance, the Commission preliminarily believes the DCM should have discretion, in setting the position limit, to give consideration to the equity (or equities) with the greater weight(s) in the index, rather than only with regard to the equity with the lowest number of shares outstanding.

8. Commission Regulation 41.25(b)(3)(iv), Limits for Debt SFPs.[63]

As previously detailed, for setting levels of limits on an SFP comprised of more than one security, current Commission regulation 41.25(a)(3)(ii) specifies certain criteria for trading volume and shares outstanding that must be applied to the security in the index with the lowest average daily trading volume. However, the Commission is not proposing to retain those criteria for setting levels of limits for debt SFPs because debt securities generally are neither issued in terms of shares nor trading volume measured in terms of shares.

Proposed appendix A to subpart C provides guidance and acceptable practices for setting the limit level for a debt SFP, discussed below. This proposal would require a DCM to set a position limit on a debt SFP, either net or on the same side of the market, applicable to positions held during the last five trading days of an expiring contract month, as is the case for equity SFPs under the proposal.

9. Commission Regulation 41.25(b)(3)(v), Required Minimum Position Limit Time Period.

Although DCMs do not currently list SFPs where the product permits delivery before the close of trading, the Commission proposes that, for such a product, the DCM would be required to apply position limits beginning no later than the first day that long position holders may be assigned delivery notices, if such period is longer than the last five trading days of an expiring contract month. The Commission notes that the current DCM practice for other commodity futures contracts is to apply spot month position limits at the close of business before delivery notices are assigned to holders of long

[63] As noted above, as proposed, 17 CFR 41.25(a)(3) would be re-designated as 17 CFR 41.25(b)(3).

positions in futures contracts that provide for physical delivery prior to the close of trading. Further, this provision is analogous to provisions of NSEs that apply exercise limits for any five consecutive business days, applicable to American exercise style equity options.[64]

10. Commission Regulation 41.25(b)(3)(vi), Requirements for Re-Setting Levels of Position Limits.[65]

This proposal would require a DCM to consider, on at least a semi-annual basis, whether position limits were set at appropriate levels, through consideration of estimated deliverable supply. In the event that estimated deliverable supply has decreased, then a DCM would be required to lower the level of a position limit in light of that decreased deliverable supply. In the event that estimated deliverable supply has increased, then a DCM would have discretion to increase the level of a position limit. In addition, a DCM that has substituted a position accountability rule for a position limit would be required to consider whether estimated deliverable supply and total six-month trading volume continue to justify that position accountability rule.

Current provisions require a DCM to calculate trading volume monthly. The Commission believes that review of position limit levels and position accountability rules on at least a semi-annual basis rather than a monthly basis generally should be adequate to ensure appropriate levels because deliverable supply generally does not change to a great degree from month to month. For example, the number of shares outstanding may increase through periodic issuance of additional shares, and may decrease through stock

[64] American exercise style refers to the right of an option holder to exercise the option at any time prior to, and including, expiration. In contrast, a European exercise style option only can be exercised at expiration.

[65] The proposal would re-designate 17 CFR 41.25(a)(3)(iv) to 17 CFR 41.25(b)(3)(vi).

repurchase programs, but, as a general observation, such issuance or repurchases are not a large percentage of free float. Of course, there could be situations where deliverable supply changes to a great degree before the semi-annual period and the rule does not prevent a DCM from considering those changes before such period.

The Commission also proposes a technical change to the filing requirement whenever a DCM makes such changes to limit levels. While the proposal continues to provide that changes to limit levels be filed pursuant to the requirements of Commission regulation 41.24, it removes the superfluous provision in the current regulation that provides that the change be effective no earlier than the day after the DCM has provided notification to the Commission and to the public. Instead, the regulation simply cites to Commission regulation 41.24, which specifies that changes must be received by the Commission no later than the day prior to the implementation.

11. Appendix A to Subpart C of Part 41, Guidance and Acceptable Practices for Position Limits and Position Accountability for SFPs.

Section (a), Guidance on Estimating Deliverable Supply. The proposal provides guidance for estimating deliverable supply. For an equity security, deliverable supply should be no greater than the free float of the security. For a debt security, deliverable supply should not include securities that are committed for long-term agreements (e.g., closed-end investment companies, structured products, or similar securities).

Regarding the guidance for estimating deliverable supply for equity securities, free float of the security generally means issued and outstanding shares less restricted shares. Restricted shares include restricted and control securities, which are not registered with the SEC to sell in a public marketplace.[66] The Commission requests comment on whether there are any other adjustments that should be made in estimating deliverable supply for equities. For example, should the guidance exclude from deliverable supply any equity shares held by ETFs, mutual funds, or similar investment vehicles? If so, how would such counts of shares be determined or estimated?

Also regarding the guidance for estimating deliverable supply for equity securities, the Commission notes that authorized participants may increase the number of outstanding shares in an ETF.[67] In setting a position limit for an ETF, the Commission has not proposed that DCMs look through the ETF to the lowest deliverable supply in an underlying security, as is the case in the proposal for limits for physically-delivered basket equity SFPs. Rather, the Commission has proposed to restrict the estimate of deliverable supply in an ETF to existing shares of the ETF. As an alternative, the Commission requests comment on whether an estimate of deliverable supply for an ETF should include an allowance for the creation of ETF shares. If so, how would one estimate such an allowance?

Section (b), Guidance on Setting Limits on Cash-Settled Equity Index SFPs. As noted above, the Commission is proposing guidance for setting limits on cash-settled equity index SFPs. This proposed guidance would permit a DCM to set the limit level for a cash-settled SFP on a narrow-based security index of equity securities to that of a

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[66] For a general discussion of restricted and control securities, *see* https://www.sec.gov/reportspubs/investor-publications/investorpubsrule144htm.html.

[67] An authorized participant generally is an institutional investor, such as a broker dealer, who acts to create or redeem ETF shares. The authorized participant buys shares that underlie the ETF and exchanges those underlying shares with the ETF sponsor for shares in the ETF, thus creating new ETF shares that it may sell to the public. An authorized participant may also purchase ETF shares in the market place and redeem those shares with the ETF sponsor, thus reducing the number of ETF shares outstanding.

similar narrow-based security index equity option listed on an NSE. As an alternative for setting the level based on that of a similar equity option, the proposal provides guidance and acceptable practices that would allow a DCM, in setting a limit, to consider the deliverable supply of securities underlying the equity index, and the equity index weighting and SFP contract multiplier.

As an example of an acceptable practice, for a cash-settled equity index SFP on a security index weighted by the number of shares outstanding, a DCM could set a position limit as follows: first, compute the limit on an SFP on each underlying security under proposed regulation (b)(3)(i)(A) (currently designated as (a)(3)(i)(A)); second, multiply each such limit by the ratio of the 100-share contract size and the shares of the security in the index; and third, determine the minimum level from step two and set the limit to that level, given a contract size of one dollar times the index, or for a larger contract size, reduce the level proportionately. As the Commission is proposing for physically-delivered basket equity SFPs, the proposal is based on the premise that the limit on a cash-settled SFP on a narrow-based security index of equity securities should be as restrictive as the limit for an SFP based on the underlying security with the most restrictive limit.

Section (c), Guidance on Setting Limits on Debt SFPs. The proposal would provide guidance that an appropriate level for limits on debt SFPs generally would be no greater than the equivalent of 12.5 percent of the par value of the estimated deliverable supply of the underlying debt security. The Commission notes that this approach is guidance because there may be other reasonable bases for setting levels of debt SFPs position limits and the Commission does not want to foreclose those bases. For example, a coupon stripped from an interest bearing corporate bond does not have a par value in terms of such corporate bond, but instead such coupon is the amount of interest due at the time the corporate issuer is scheduled to pay such coupon under the corporate bond indenture.[68]

Although no DCM currently lists an SFP based on a debt security, the Commission believes a framework for position limits may reduce uncertainty regarding acceptable practices for listing such contracts on non-exempted securities and, thereby, may facilitate listing of such contracts. The Commission notes that futures contracts in exempted securities, such as U.S. Treasury notes, have been listed for many years.[69] The Commission is proposing 12.5 percent of the par value of the estimated deliverable supply of the underlying debt security as guidance on an appropriate basis based on the existing levels of limits for equity option contracts on NSEs. The Commission invites comment on whether a level based on par value is appropriate, or whether some other metric would be appropriate.

Section (d), Guidance on Position Accountability. The Commission proposes, as guidance, that a DCM may adopt a position accountability rule for any SFP, including an SFP where a position limit is required or adopted. Under the proposal, a position accountability rule would provide, at a minimum, that the DCM have authority to obtain information from a market participant with a position at or above the accountability level and that the DCM have authority, in its discretion, to order such a market participant to

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[68] An interest bearing bond may be structured in a conduit and divided into separate obligations, where the cash flow from the principal of the bond and the cash flow from each coupon may be sold as separate securities. Each such separate security is a zero-coupon security.

[69] In this regard, an exempted security refers to certain exempted securities under the Securities Act of 1933 or the Securities Exchange Act of 1934. *See* CEA section 2(a)(1)(C).

halt increasing their position. The Commission notes that position accountability can work in tandem with a position limit rule, particularly where the accountability level is set at a low level, in comparison to the level of the position limit. Further, the Commission notes that a DCM may adopt a position accountability rule to provide authority to the DCM to order market participants to reduce position sizes, for example, to maintain orderly trading or to ensure an orderly delivery.

Section (e), Guidance for Exemptions.[70] The proposed regulation would continue to provide a DCM with discretion to grant exemptions to position limits. The proposal provides guidance that such exemptions may be consistent with current Commission regulation 150.5 regarding exchange-set position limits or consistent with rules of an NSE regarding securities option exemptions. This guidance differs from the provisions of the current regulation, which references Commission regulation 150.3 regarding federal position limits in certain physical commodity futures contracts. The Commission believes the guidance should reference exemption provisions applicable to exchange-set limits in Commission regulation 150.5, rather than federal limits, because the exemptions for federal limits are written largely in terms of the federal limits on physical commodity contracts in Commission regulation 150.2.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'')[71] requires that federal agencies consider whether a proposed rule will have a significant economic impact on a substantial number

[70] In addition to re-designating 17 CFR 41.25(a)(3) as 17 CFR 41.25(b)(3), the proposal would re-designate current 17 CFR 41.25(a)(3)(iii) to appendix A to subpart C.
[71] 5 U.S.C. 601 *et seq.*

of small entities and, if so, provide a regulatory flexibility analysis of the impact. The proposed amendments generally apply to exchange-set position limits. The proposed amendments would permit a DCM to increase the level of position limits for SFPs and may change the application of those limits from a trader's net position to a trader's gross position. The proposed amendments would affect DCMs. The Commission has previously established certain definitions of "small entities" to be used in evaluating the impact of its rules on small entities in accordance with the RFA, and has previously determined that DCMs are not small entities for purpose of the RFA.[72]

Therefore, the Commission believes that the amendments to the SFP position limits regulations would not have a significant economic impact on a substantial number of small entities. Accordingly, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed amendments will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 ("PRA")[73] provides that a federal agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number issued by the Office of Management and Budget ("OMB"). The collection of information related to this proposed rule is OMB control number 3038-0059—Security Futures Products.[74] As a general matter, the proposed amendments to the SFP position limits regulation (1) permit

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[72] *See* Policy Statement and Establishment of Definitions of "Small Entities" for Purposes of the Regulatory Flexibility Act, 47 FR 18618, 18619 (Apr. 30, 1982).
[73] 44 U.S.C. 3501 *et seq.*
[74] Regarding Security Futures Products (OMB Control No. 3038-0059), the Commission recently published a notice of a request for extension of the currently approved information collection. *See* 82 FR 48496 (Oct. 18, 2017).

a DCM to increase the level of limits; and (2) may change the application of exchange-set limits from a net basis to a gross basis. The Commission believes that the proposed amendments will not impose any new information collection requirements that require approval of OMB under the PRA. As such, the proposed amendments do not impose any new burden or any new information collection requirements in addition to those that already exist in connection with filing to list SFPs under Commission regulation 41.23 or to amend exchange rules for SFPs under Commission regulation 41.24.[75]

C. Cost-Benefit Considerations

1. Introduction

Section 15(a) of the CEA requires the CFTC to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.[76] CEA section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The CFTC considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors below.

Where reasonably feasible, the CFTC has endeavored to estimate quantifiable costs and benefits. Where quantification is not feasible, the CFTC identifies and describes costs and benefits qualitatively.

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[75] Similarly, the Commission previously determined that a rule expanding the listing standards for security futures did not require a new collection of information on the part of any entities. *See* 71 FR 39534 at 39539 (July 13, 2006) (adopting a rule to permit security futures to be based on individual debt securities or a narrow-based security index comprised of such securities).

[76] 7 U.S.C. 19(a).

The CFTC requests comment on the costs and benefits associated with the proposed rule amendments. In particular, the CFTC requests that commenters provide data and any other information or statistics that the commenters relied on to reach any conclusions regarding the CFTC's proposed considerations of costs and benefits.

2. Economic Baseline

The CFTC's economic baseline for this proposed rule amendment analysis is the SFP position limits rule requirement that exists today. In the 2001 Final SFP Rules, the Commission adopted an SFP position limits rule that is consistent with the statutory requirements of CEA section 2(a)(1)(D). In particular, CEA section 2(a)(1)(D)(i)(VII) requires generally that trading in an SFP is not readily susceptible to manipulation of the price of that SFP or its underlying security. The CFTC regulation that is in effect currently states that, "the [DCM] shall have rules in place establishing position limits or position accountability procedures for the expiring futures contract month."[77] The 2001 Final SFP Rules also provide criteria for a maximum level of position limits and criteria that permit a DCM to adopt an exchange rule for position accountability in lieu of position limits.[78] In addition, the 2001 Final SFP Rules permit a DCM to approve exemptions from position limits pursuant to exchange rules that are consistent with CFTC regulation 150.3.

The CFTC will analyze the costs and benefits of the rules in this proposal against the current default net position limit level of 13,500 (100-share) contracts; or a higher net position limit level of 22,500 (100-share) contracts for equity SFPs meeting either a criterion of at least 20 million shares of average daily trading volume, or criteria of at

[77] 17 CFR 41.25(a)(3).
[78] 17 CFR 41.25(a)(3).

least 15 million shares of average daily trading volume and more than 40 million shares of the underlying security outstanding.

The current regulation permits (but does not require) a DCM to adopt an exchange rule for position accountability in lieu of position limits, provided that average daily trading volume in the underlying security exceeds 20 million shares and there are more than 40 million shares of the underlying security outstanding.

3. Summary of Proposed Requirements

For equity SFPs, the proposed amendment would increase the default position limit level from 13,500 (100-share) contracts to 25,000 (100-share) contracts. The proposed amendment also permits a DCM to establish a higher position limit level than 25,000 (100-share) contracts, equivalent to 12.5 percent of estimated deliverable supply of the underlying security (which, under proposed guidance, should not exceed the free float of the underlying security). In connection with this change, a DCM would be required to estimate deliverable supply at least semi-annually, rather than to calculate the average daily trading volume at least monthly.

Also for equity SFPs, the proposed amendment would change one of the criteria that permit a DCM to adopt an exchange rule for position accountability in lieu of position limits, from more than 40 million shares of the underlying security outstanding, to an estimated deliverable supply of more than 40 million shares. The proposal generally would retain the other criterion, namely six-month average daily trading volume in the underlying security exceeding 20 million shares, but convert that criterion to 2.5 billion shares of six-month total trading volume, based on 125 trading days in a typical six-month period.

For physically-delivered basket equity SFPs, the proposed amendment would change the criteria for the position limit to the underlying security with the lowest estimated deliverable supply, from the security in the index with the lowest average daily trading volume. The proposed amendment also would clarify that an appropriate adjustment would be made to the level of the limit for a contract size different than 100 shares per underlying security.

For SFPs that are cash settled to a narrow-based security index of equity securities, the proposed amendment provides guidance that a DCM may set the limit level to that of a similar narrow-based security index equity option. The proposal also provides guidance and an acceptable practice, which would provide a safe harbor for a DCM itself to set such a limit level.

For SFPs in debt securities, the proposal would establish a requirement that a DCM must adopt a position limit either net or on the same side of the market, and would provide guidance that the level of such limit generally should be set no greater than the equivalent of 12.5 percent of the par value of the estimated deliverable supply of the underlying debt security. There currently are no SFPs in debt securities listed for trading.

The proposal would establish a required minimum position limit time period beginning no later than the first day that a holder of a long position may be assigned a delivery notice, if such period is longer than the last five trading days, where the SFP permits delivery before the close of trading. There currently are no SFPs listed for trading that provide for delivery before the close of trading.

The proposed amendment would provide DCMs with the discretion to alter the basis for applying a position limit from a net position to a gross position on the same side of the market.[79]

The proposal would establish guidance that a DCM may adopt an exchange rule for position accountability in addition to an exchange rule for a position limit.

The proposal would amend the guidance for exemptions from position limits by changing the reference to CFTC regulation 150.3, regarding exemptions to federal position limits, to CFTC regulation 150.5, regarding guidance for exchange-set limits. The proposal also would add guidance for exemptions from position limits to permit a DCM to provide exemptions consistent with those of a NSE regarding securities options position limits or exercise limits.

The proposal would amend the requirements for re-setting levels of position limits by changing the required review period from monthly to semi-annually; and imposing a requirement that a DCM must lower the position limit for an SFP with data that no longer justifies a higher limit level, rather than guidance that a DCM may lower such position limit. The proposal also would make clear that a DCM must impose a position limit for an SFP with data that no longer justifies an exchange rule for position accountability in lieu of a position limit. The proposal would continue to permit a DCM to use discretion as to whether to increase the level of a position limit for an SFP with data that justifies a higher level.

[79] In this regard, OneChicago, LLC ("OneChicago"), a DCM listing SFPs, permits concurrent long and short positions to be held. *See* OneChicago exchange rule 424, *available at https://www.onechicago.com/wp-content/uploads/content/OneChicago_Current_Rulebook.pdf*.

The proposal would establish a general definition of estimated deliverable supply, consistent with the guidance on estimating deliverable supply in appendix C to part 38, and provide guidance on estimating delivery supply that is specific to an SFP.

Finally, the proposal would establish a definition of same side of the market, for clarity in the proposed limit levels on a gross basis. The definition would distinguish long positions for an SFP in the same security from short positions in an SFP in the same security.[80]

4. Costs

The proposal would as a general matter reduce costs relative to the existing Commission regulation 41.25(a)(3),[81] since it will reduce the frequency of hedge exemption requests (as discussed in the benefits section) and reduce the frequency of required DCM reviews of position limits from monthly to semi-annually. Under the proposal, DCMs that list SFPs for trading would continue to be required to adopt position limits or position accountability, but the proposal would generally increase the levels of position limits. The Commission preliminarily believes that the proposal would impose certain costs on such DCMs, and that these costs are necessary to establish appropriate position limits or position accountability trigger levels based on deliverable supply and such additional criteria that the listing DCM determines to be appropriate. The Commission also believes that these costs are comparable to those incurred under current regulations (whereby DCMs must calculate average daily trading volume) and notes that these costs will be incurred only semi-annually under the proposal rather than monthly as

[80] These two definitions would be added into a new paragraph (a) of 17 CFR 41.25; in conjunction with the addition of the new paragraph (a), current paragraphs (a) through (d) would be re-designated as paragraphs (b) through (e).
[81] Re-designated under the proposal as 17 CFR 41.25(b)(3).

under current regulations. The Commission believes that DCMs would be able to exercise control over the extent of these costs depending on the degree of standardization such DCMs use to determine position limits and accountability and the Commission anticipates that DCMs will choose from among the lower-cost options. For example, a DCM could, consistent with the proposal, adopt a simple rule for equity securities based on the number of free-float outstanding shares. For equity securities, free-float information is readily available on certain publicly-available market websites and on Bloomberg terminals and similar services (which DCMs are likely to have access to for other business reasons). Reducing the frequency with which DCMs are required to review position limits and accountability to semi-annually from monthly will reduce costs to DCMs. Thus, the Commission anticipates that estimating deliverable supply would not be more costly (and would likely be less costly) than estimating average daily trading volume as required under current regulations.

The Commission notes that under the proposed rule, DCMs have the discretion to implement the default position limit of 25,000 contracts regardless of deliverable supply and that this may result in position limit levels in some contracts greater than 12.5 percent of deliverable supply. However, this discretion is limited by Core Principle 5 (which requires DCMs to set position levels at necessary and appropriate levels to deter manipulation) and by Core Principle 3 (which requires that DCMs may only list contracts that are not readily susceptible to manipulation). To the extent that DCMs comply with these core principles, this DCM discretion should not impair the protection of market participants and the public or otherwise impose significant costs on the markets for SFPs market or related securities.

To the extent that a DCM lists equity SFPs on deliverable baskets, the costs of implementing the proposed position limit provisions for such SFPs would be similar to the costs of the analogous provisions for single stock SFPs, but there are no current costs associated with those proposed changes to the regulations since such SFPs are not currently listed for trading. There are also no listed SFPs at this time on debt securities. To the extent that there is less publicly-available information related to the deliverable supply of debt securities, estimating deliverable supply may be more costly for debt securities than for equity securities. However, these costs will only be incurred in the event that a DCM begins listing security futures on non-exempted debt securities. Moreover, these deliverable supply provisions are set out as guidance so that DCMs are free to implement less costly methods to comply with the rule, which provides only that futures on debt securities must have position limits. While DCMs have not listed debt security SFPs absent the proposed changes to the regulation, it is theoretically possible that the costs associated with estimating deliverable supply or otherwise determining position limit levels may affect future decisions regarding whether or not to list such SFPs. The costs of the proposed regulation for debt securities would be otherwise similar to the costs of the proposed regulation for equity securities.

The proposal to permit DCMs to implement position limits on a net basis or on positions on the same side of the market (e.g., on physically-delivered and cash settled contracts on the same security, should a DCM ever list both types of contracts) would not require DCMs to change their current practice, and will thus not impose new costs on DCMs. Any change that imposes new costs on market participants would be made at the discretion of the DCM.

The proposal to establish a required minimum position limit time period beginning no later than the first day that a holder of a long position may be assigned a delivery notice, if such period is longer than the last five trading days, in instances where the SFP permits delivery before the close of trading currently imposes no costs since contracts of this nature are not currently listed for trading. If a DCM listed such contracts, the proposal would require market participants to incur the costs of complying with position limits or applying for hedge exemptions (and would require DCMs to incur the costs of reviewing such applications) earlier in the life of the contract than absent the proposal.

5. Benefits

The Commission reviews its regulations to help ensure they keep pace with technological developments and industry trends, and to reduce regulatory burden where needed. The proposal would allow DCMs to adopt position limits that they deem to be appropriate. The Commission preliminarily believes that DCMs will adopt position limits that are large enough not to significantly inhibit liquidity, but will appropriately mitigate against potential manipulations and other concerns that may be associated with overly large positions in SFPs. Moreover, to the extent that the proposal would lead to position limits that are higher than current position limits, the proposal could alleviate the costs to hedgers of filing hedge exemptions for positions that are larger than a current position limit, but lower than a new position limit under the proposal. In that regard, Commission staff reviewed the largest positions in SFPs that were held during the calendar year 2017 and found that there were 16 positions held during the last five trading days of expiring SFP contract months across all listed SFPs on OneChicago, currently the only DCM to list SFPs for trading. These positions generally appear to have been associated with securities lending agreements[82] and thus appear to have been eligible for hedge exemptions. These 16 positions exceeded the current applicable limit for their underlying securities of the default 13,500 contracts. If the proposed default position limit of 25,000 contracts had been in effect in 2017, fewer than four positions would have been above that default position limit and would have required hedge exemptions. While the Commission believes that the monetary cost of filing a hedge exemption form is very small for an entity large enough to maintain a position that exceeds a position limit (perhaps less than $100), it is possible that the burden of filing a hedge exemption may discourage hedging at sizes exceeding position limits and, thus, that raising position limits may encourage larger hedges. The Commission also notes that to the extent SFPs are now or in the future used for speculation,[83] speculators could establish larger positions under the proposal without a need for concern about position limits and may thus increase their trading activity. Any potential increase in trading activity could improve liquidity in the SFP markets.

Requiring DCMs to set position limits and accountability based on semi-annual deliverable supply estimates should help ensure on an ongoing basis that position limits and accountability are set at levels that are necessary and appropriate to deter manipulation consistent with DCM Core Principles 3 and 5.

The Commission preliminarily believes that the proposed frameworks for position limits in SFPs on deliverable equity baskets and debt securities (all based on deliverable

[82] OneChicago describes itself on its website, *https://onechicago.com*, as "the Securities Finance Exchange" and states that "single stock futures are ideally suited to replace 'agreements' in equity repo and securities lending transactions."

[83] As noted above, SFPs may be used for securities finance transactions that are not speculative in nature.

supply estimates) should help ensure that such products, if they are ever listed for trading, are reasonably protected from manipulation. Further, the Commission preliminarily believes that the proposal may help foster position limits consistent with those in analogous securities options (where applicable).

The proposal to permit DCMs to implement position limits on a net basis or on positions on the same side of the market (such as physically-delivered or cash settled contracts on the same security, should a DCM ever list both types of contracts) will give DCMs the discretion to implement position limits in a manner that they see fit.

The proposal to establish a required minimum position limit time period beginning no later than the first day that a holder of a long position may be assigned a delivery notice, if such period is longer than the last five trading days, where the SFP permits delivery before the close of trading currently provides no benefits since contracts of this nature are not listed for trading. If a DCM listed such contracts, the proposal would help ensure that such contracts are not readily susceptible to manipulation during the entire delivery period.

6. CEA Section 15(a) Factors

i. Protection of Market Participants and the Public

The Commission preliminarily believes that this proposal maintains the protection of market participants and the public provided by the current regulation. The proposal will continue to protect market participants and the public by maintaining the requirement that DCMs that list SFPs adopt and enforce appropriate position limits or position accountability consistent with DCM Core Principle 5 and implementing for SFPs the longstanding Commission policy that spot-month position limits should be set based on estimates of deliverable supply. Linking the levels of position limits and accountability to deliverable supply protects market participants and the public by helping prevent congestion, manipulation, or other problems that can be associated with speculative positions in expiring contracts that are overly large relative to deliverable supply.

ii. Efficiency, Competitiveness, and Financial Integrity of Markets

As discussed above, under the proposal, it is reasonable to anticipate that many or most SFPs would be subject to higher position limits compared to the current position limits. Therefore, hedgers may be able to take larger positions without the need to apply for hedge exemptions. This also could alleviate the DCM's need to review hedge exemptions improving resource allocation efficiency for exchanges and certain market participants. Moreover, with less restrictive position limits, it is theoretically possible that more traders could be enticed into the market and thus improve the liquidity and pricing efficiency of the SFP market.

The current position limit regulation (a default of 13,500 contracts) often leads to position limits that are tighter than analogous position limits for security options (a default of 25,000 contracts). The proposal would raise the default limit level in SFPs to match that in securities options. More closely aligning the position limits in SFPs to those in securities options may enhance the competitiveness of the SFP market relative to the securities option market.

iii. Price Discovery

The Commission believes that price discovery typically occurs in the liquid and generally transparent security markets underlying existing SFPs rather than the relatively low-volume SFPs themselves. Nevertheless, as noted above, to the extent that trading activity in SFP markets increases due to less restrictive position limits, the price discovery function of SFPs could be enhanced by reducing liquidity risk and thereby facilitating arbitrage between the underlying security and SFP markets.

iv. Sound Risk Management Practices

The current position limit regulation often leads to position limits that are tighter than analogous position limits for security options. It is conceivable that this could discourage potential hedgers or other risk managers from using SFPs rather than security options because of burdens associated with the hedge exemption process. Risk managers might also find that the liquidity risk in the current SFP market is too high, due to a lack of speculators in the SFP market (among other causes). In this regard, it is possible that the current position limits might be too tight for speculators to perform adequately their role of providing liquidity in a futures market. Because the proposal raises the default limit to 25,000 contracts to match the default in security options, and thus would likely lead to higher position limits for many SFPs, it is possible that both risk managers and speculators enter or increase trading in the SFP market under the proposal.

v. Other Public Interest Considerations

The Commission has not identified any additional public interest considerations associated with the proposal.

7. Consideration of Alternatives

The Commission considered regulations that would require DCMs to conform the position limits in SFPs to those in securities options to a greater degree than under the proposal (consistent with comments to the original SFP rule proposal), including applying position limits throughout the life of the contract (rather than only in the last five trading days) and no longer permitting position accountability for SFPs on securities with higher trading volume and deliverable supply. The Commission believes that permitting position accountability for certain SFPs and only requiring spot month limits is consistent with Core Principle 5 and that these requirements are sufficient to ensure that SFPs are not readily susceptible to manipulation as required by Core Principle 3. Thus, not permitting position accountability and requiring DCMs to apply position limits throughout the life of the contract would significantly increase costs on market participants while not significantly enhancing protection of market participants and the public or providing significant benefits beyond those of the proposed position limits framework.

The Commission also considered not setting default position limits for equity SFPs and simply requiring that position limits and accountability be set based on deliverable supply, as is done in many other futures products. However, the Commission preliminarily determined not to make such a proposal because some exchanges and market participants (based on past comments)[84] appear to believe that there are benefits to conforming position limits in SFPs to those in securities options to the extent practicable.

8. Request for Comments

The Commission invites public comment on its cost-benefit considerations, including the CEA section 15(a) factors described above. Commenters are also invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the proposal with their comment letters.

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[84] *See supra* discussion of the 2001 Final SFP Rules.

The Commission specifically seeks comment on the following:

1. Are there alternatives to the proposal (whether discussed in this release or not) that would be superior from a cost-benefit standpoint?

2. Would the proposal affect costs for those market participants that seek hedge exemptions?

3. Would DCMs that list for trading SFPs face additional costs in adopting and setting position limits and position accountability levels for SFPs under the proposal that are not discussed in this consideration of costs and benefits?

4. Do DCMs and market participants expect to see benefits under the proposal that are not discussed in this consideration of costs and benefits? Please quantify or describe such benefits.

5. Should the Commission eliminate default position limits for equity SFPs and instead simply require that position limits and accountability be set based on deliverable supply, as is done in many other futures products?

6. Is it feasible to estimate deliverable supply for debt securities at reasonable cost?

7. Are there benefits associated with the Commission implementing rules for types of SFPs that are not currently listed for trading? Does implementing such rules have the potential to impose costs associated with possibly deterring innovation?

D. Anti-trust Considerations

CEA Section 15(b) requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives, polices and purposes of the CEA, in issuing any order or adopting any Commission rule or regulation (including any exemption under section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to CEA section 17.[85]

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requests comment on whether the proposal implicates any other specific public interest to be protected by the antitrust laws. The Commission has considered the proposal to determine whether it is anticompetitive and has preliminarily identified no anticompetitive effects. The Commission requests comment on whether the proposal is anticompetitive and, if it is, what the anticompetitive effects are.

Because the Commission has preliminarily determined that the proposal is not anticompetitive and has no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the Act. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the Act that would further the objective of this proposal, such as leveling the regulatory playing field between SFPs and security options listed on NSEs.

List of Subjects in 17 CFR Part 41

Position accountability, Position limits, Security futures products.

For the reasons discussed in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR part 41 as set forth below:

[85] 7 U.S.C. 19(b).

PART 41—SECURITY FUTURES PRODUCTS

1. The authority citation for part 41 continues to read as follows:

Authority: Sections 206, 251 and 252, Pub. L. 106–554, 114 Stat. 2763, 7 U.S.C. 1a, 2, 6f, 6j, 7a–2, 12a; 15 U.S.C. 78g(c)(2).

2. In § 41.25:

a. Redesignate paragraphs (a) through (d) as paragraphs (b) through (e);

b. Add new paragraph (a);

c. Revise newly redesignated paragraphs (b)(3), (c)(2) and (3), and (e).

The addition and revisions read as follows:

§ 41.25 Additional conditions for trading for security futures products.

(a) *Definitions*. For purposes of this section:

Estimated deliverable supply means the quantity of the security underlying a security futures product that reasonably can be expected to be readily available to short traders and salable by long traders at its market value in normal cash marketing channels during the specified delivery period. For guidance on estimating deliverable supply, designated contract markets may refer to appendix A of this subpart.

Same side of the market means the aggregate of long positions in physically-delivered security futures products and cash-settled security futures products, in the same security, and, separately, the aggregate of short positions in physically-delivered security futures products and cash-settled security futures products, in the same security.

(b) * * *

(3) *Speculative position limits*. A designated contract market shall have rules in place establishing position limits or position accountability procedures for the expiring futures contract month as specified in this paragraph (b)(3).

(i) *Limits for equity security futures products.* For a security futures product on a single equity security, including a security futures product on an underlying security that represents ownership in a group of securities, e.g., an exchange traded fund, a designated contract market shall adopt a position limit no greater than 25,000 100-share contracts (or the equivalent if the contract size is different than 100 shares), either net or on the same side of the market, applicable to positions held during the last five trading days of an expiring contract month; except where:

(A) For a security futures product on a single equity security where the estimated deliverable supply of the underlying security exceeds 20 million shares, a designated contract market may adopt, if appropriate in light of the liquidity of trading in the underlying security, a position limit no greater than the equivalent of 12.5 percent of the estimated deliverable supply of the underlying security, either net or on the same side of the market, applicable to positions held during the last five trading days of an expiring contract month; or

(B) For a security futures product on a single equity security where the six-month total trading volume in the underlying security exceeds 2.5 billion shares and there are more than 40 million shares of estimated deliverable supply, a designated contract market may adopt a position accountability rule, either net or on the same side of the market, applicable to positions held during the last five trading days of an expiring contract month. Upon request by a designated contract market, traders who hold positions greater than 25,000 100-share contracts (or the equivalent if the contract size is different than 100 shares), or such lower level specified pursuant to the rules of the designated contract market, must provide information to the designated contract market and consent to halt increasing their positions when so ordered by the designated contract market.

(ii) *Limits for physically-delivered basket equity security futures products.* For a physically-delivered security futures product on more than one equity security, e.g., a basket of deliverable securities, a designated contract market shall adopt a position limit, either net or on the same side of the market, applicable to positions held during the last five trading days of an expiring contract month and the criteria in paragraph (b)(3)(i) of this section must apply to the underlying security with the lowest estimated deliverable supply. For a physically-delivered security futures product on more than one equity security with a contract size different than 100 shares per underlying security, an appropriate adjustment to the limit must be made. If each of the underlying equity securities in the basket of deliverable securities is eligible for a position accountability level under paragraph (b)(3)(i)(B) of this section, then the security futures product is eligible for a position accountability level in lieu of position limits.

(iii) *Limits for cash-settled equity index security futures products.* For a security futures product cash settled to a narrow-based security index of equity securities, a designated contract market shall adopt a position limit, either net or on the same side of the market, applicable to positions held during the last five trading days of an expiring contract month. For guidance on setting limits for a cash-settled equity index security futures product, designated contract markets may refer to section (b) of appendix A of this subpart.

(iv) *Limits for debt security futures products.* For a security futures product on one or more debt securities, a designated contract market shall adopt a position limit, either net or on the same side of the market, applicable to positions held during the last five trading days of an expiring contract month. For guidance on setting limits for a debt security futures product, designated contract markets may refer to section (c) of appendix A of this subpart.

(v) *Required minimum position limit time period.* For position limits required under this section where the security futures product permits delivery before the termination of trading, a designated contract market shall apply such position limits for a period beginning no later than the first day that long position holders may be assigned delivery notices, if such period is longer than the last five trading days of an expiring contract month.

(vi) *Requirements for re-setting levels of position limits.* A designated contract market shall calculate estimated deliverable supply and six-month total trading volume no less frequently than semi-annually.

(A) If the estimated deliverable supply data supports a lower speculative limit for a security futures product, then the designated contract market shall lower the position limit for that security futures product pursuant to the submission requirements of § 41.24. If the data require imposition of a reduced position limit for a security futures product, the designated contract market may permit any trader holding a position in compliance with the previous position limit, but in excess of the reduced limit, to maintain such position through the expiration of the security futures contract; provided, that the designated contract market does not find that the position poses a threat to the orderly expiration of such contract.

(B) If the estimated deliverable supply or six-month total trading volume data no longer supports a position accountability rule in lieu of a position limit for a security futures product, then the designated contract market shall establish a position limit for that security futures product pursuant to the submission requirements of § 41.24.

(C) If the estimated deliverable supply data supports a higher speculative limit for a security futures product, as provided under paragraph (b)(3)(i)(A) of this section, then the designated contract market may raise the position limit for that security futures product pursuant to the submission requirements of § 41.24.

(vii) *Restriction on netting of positions.* If the designated contract market lists both physically-delivered contracts and cash settled-contracts in the same security, it shall not permit netting of positions in the physically-delivered contract with that of the cash-settled contract for purposes of determining applicability of position limits.

(c) * * *

(2) Notwithstanding paragraph (c)(1) of this section, if an opening price for one or more securities underlying a security futures product is not readily available, the final settlement price of the security futures product shall fairly reflect:

(i) The price of the underlying security or securities during the most recent regular trading session for such security or securities; or

(ii) The next available opening price of the underlying security or securities.

(3) Notwithstanding paragraph (c)(1) or (2) of this section, if a derivatives clearing organization registered under Section 5b of the Act or a clearing agency exempt from registration pursuant to Section 5b(a)(2) of the Act, to which the final settlement price of a security futures product is or would be reported determines, pursuant to its

rules, that such final settlement price is not consistent with the protection of customers and the public interest, taking into account such factors as fairness to buyers and sellers of the affected security futures product, the maintenance of a fair and orderly market in such security futures product, and consistency of interpretation and practice, the clearing organization shall have the authority to determine, under its rules, a final settlement price for such security futures product.

* * * * *

(e) *Exemptions.* The Commission may exempt a designated contract market from the provisions of paragraphs (b)(2) and (c) of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is consistent with the public interest and the protection of customers. An exemption granted pursuant to this paragraph shall not operate as an exemption from any Securities and Exchange Commission rules. Any exemption that may be required from such rules must be obtained separately from the Securities and Exchange Commission.

3. Add appendix A to subpart C to read as follows:

Appendix A to Subpart C of Part 41—Guidance on and Acceptable Practices for Position Limits and Position Accountability for Security Futures Products

(a) *Guidance for estimating deliverable supply*. (1) For an equity security, deliverable supply should be no greater than the free float of the security.

(2) For a debt security, deliverable supply should not include securities that are committed for long-term agreements (e.g., closed-end investment companies, structured products, or similar securities).

(3) Further guidance on estimating deliverable supply, including consideration of whether the underlying security is readily available, is found in appendix C to part 38 of this chapter.

(b) *Guidance and acceptable practices for setting limits on cash-settled equity index security futures products*--(1) *Guidance for setting limits on cash-settled equity index security futures products.* For a security futures product cash settled to a narrow-based security index of equity securities, a designated contract market:

(i) May set the level of a position limit to that of a similar equity index option listed on a national security exchange or association; or

(ii) Should consider the deliverable supply of equity securities underlying the index, and should consider the index weighting and contract multiplier.

(2) *Acceptable practices for setting limits on cash-settled equity index security futures products.* For a security futures product cash settled to a narrow-based security index of equity securities weighted by the number of shares outstanding, a designated contract market may set a position limit as follows: first, determine the limit on a security futures product on each underlying equity security pursuant to § 41.25(b)(3)(i); second, multiply each such limit by the ratio of the 100-share contract size and the shares of the equity securities in the index; and third, determine the minimum level from step two and set the limit to that level, given a contract size of one U.S. dollar times the index, or for a larger contract size, reduce the level proportionately. If under these procedures each of the equity securities underlying the index is determined to be eligible for position accountability levels, the security futures product on the index itself is eligible for a position accountability level.

(c) *Guidance and acceptable practices for setting limits on debt security futures products*--(1) *Guidance for setting limits on debt security futures products*. A designated contract market should set the level of a position limit to no greater than the equivalent of 12.5 percent of the par value of the estimated deliverable supply of the underlying debt security. For a security futures product on more than one debt security, the limit should be based on the underlying debt security with the lowest estimated deliverable supply.

(2) *Acceptable practices for setting limits on debt security futures products*. [Reserved.]

(d) *Guidance on position accountability*. A designated contract market may adopt a position accountability rule for any security futures product, in addition to a position limit rule required or adopted under this section. Upon request by the designated contract market, traders who hold positions, either net or on the same side of the market, greater than such level specified pursuant to the rules of the designated contract market must provide information to the designated contract market and consent to halt increasing their positions when so ordered by the designated contract market.

(e) *Guidance on exemptions from position limits*. A designated contract market may approve exemptions from these position limits pursuant to rules that are consistent with § 150.5 of this chapter, or to rules that are consistent with rules of a national securities exchange or association regarding exemptions to securities option position limits or exercise limits.

Issued in Washington, DC on July 24, 2018, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Position Limits and Position Accountability for Security Futures Products —Commission Voting Summary and Commissioner's Statement

Appendix 1—Commission Voting Summary

On this matter, Chairman Giancarlo and Commissioners Quintenz and Behnam voted in the affirmative. No Commissioner voted in the negative.

Appendix 2—Concurring Statement of Commissioner Rostin Behnam

I respectfully concur with the Commodity Futures Trading Commission's approval of its proposed rule regarding Position Limits and Position Accountability for Security Futures Products (the "Proposal"). I commend staff on their hard work in producing this Proposal, and for their thoughtful responses to my questions. I look forward to hearing from market participants and other stakeholders regarding the amendments to the existing position limits rules for security futures products. In particular, I will be interested in comments regarding the appropriateness of increasing the default level of equity security futures products position limits from 13,500 contracts to 25,000 contracts. While today's Proposal only would amend the Commission's Part 41 rules regarding security futures products, I nonetheless encourage market participants and interested stakeholders to consider how the Proposal might impact or interplay with the Commission's position limits rules in Part 150 and any future amendments to them.

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