

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

INVESTMENT COMPANY INSTITUTE,  
CHAMBER OF COMMERCE OF THE  
UNITED STATES OF AMERICA,  
Plaintiffs,

v.

UNITED STATES COMMODITY FUTURES  
TRADING COMMISSION,  
Defendant.

Case No. 1:12-cv-00612 (BAH)

**DEFENDANT COMMODITY FUTURES TRADING COMMISSION'S  
NOTICE OF CLARIFICATION REGARDING  
THE ALTERNATIVE NET NOTIONAL TEST AND SUBMISSION OF CITATION**

1. At the October 5, 2012 hearing in the above-captioned matter, counsel for the CFTC stated, in substance, that the “Alternative Net Notional Test” set forth in 17 C.F.R. § 4.5(c)(2)(iii)(B), exempts registered investment companies from the requirement to register unless their commodity derivative investments place at risk more than 100 percent of the total value of the fund in question. (10/5/2012 Hearing Tr. at 56.) It would be more precise to say that the 100-percent test is designed to include within the definition of “commodity pool operator” only entities with significant exposure to the commodity derivative markets. *See* 77 Fed. Reg. 11252, 11257-58 (Feb. 24, 2012) (stating that the test provides relief “for entities whose portfolios only contain a limited amount of derivatives positions”); *see generally* CFTC Br. 8 (ECF Doc. No. 15 at 17 of 75) (describing concept of notional value). Derivative investments with a notional value exceeding the liquidation value of the fund’s portfolio in many cases will place the entire value of the portfolio at risk, but it is not necessarily true in all cases: the value at risk under a given derivative contract may be less than the notional value, depending on the terms of the contract. Because the Alternative Net Notional Test permits exclusion from

the registration requirement regardless of the percentage of the liquidation value of the fund that is committed to initial margin and premium payments, the Alternative Net Notional Test can be “less restrictive” for some entities than the 5% threshold test and “provide additional flexibility in determining eligibility for exclusion.” 77 Fed. Reg. at 11257-58.

2. Additionally, at argument, counsel for the Commission informed the Court that a citation for the Commission’s estimate of the number of entities affected by the Rule 4.5 amendments would be forthcoming. That estimate of 416 entities, which (as stated at argument) was based on data that preceded the adoption of the Alternative Net Notional Test and therefore is likely higher than the true number, is explained at 77 Fed. Reg. 11345, 11349 (Feb. 24, 2012).

Respectfully submitted,

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Dated: October 15, 2012

**CERTIFICATE OF SERVICE**

I hereby certify that on October 15, 2012, I caused the foregoing document to be served on the following counsel through the Court's CM/ECF system:

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**DEFENDANT COMMODITY FUTURES TRADING COMMISSION'S STATEMENT  
IN RESPONSE TO THE COURT'S INQUIRY CONCERNING THE  
DEFINITION OF "BONA FIDE HEDGING"**

Pursuant to the Court's Minute Order dated October 5, 2012, in the above-captioned matter, the Commodity Futures Trading Commission ("CFTC" or "Commission") respectfully submits this Statement concerning the impact of *International Swaps & Derivatives Ass'n v. CFTC*, \_ F. Supp. 2d. \_, 2012 WL 4466311 (D.D.C. Sept. 28, 2012) ("*ISDA*"), on the bona fide hedging exclusion from the definitional criteria for commodity pool operators set forth in 17 C.F.R. § 4.5(c)(2)(iii), as amended. Rule 4.5(c)(2)(iii) states that, in determining eligibility for exclusion from the definition, a registered investment company need not count any positions used "for bona fide hedging purposes *within the meaning and intent* of Rules 1.3(z)(1) and 151.5." 17 C.F.R. § 4.5(c)(2)(iii)(A)-(B) (emphasis added). As explained below, notwithstanding the *ISDA* decision, registered investment companies may still exclude from their eligibility determinations all bona fide hedges within the meaning and intent of amended Rule 1.3(z)(1) and new rule 151.5.<sup>1</sup> Although the court's order in *ISDA* vacating the Commission's

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<sup>1</sup> As noted in the release adopting amendments to Rule 4.5, these provisions may not be construed to permit a "risk management" exception for purposes of determining compliance with the trading thresholds in Rule 4.5. 77 Fed. Reg. 11252, 11256-57 n.49 (Feb. 24, 2012).

position limits rulemaking made no exception for the amendments contained therein to Rule 1.3(z) or the establishment of new Rule 151.5, the *ISDA* decision did not indicate that those specific provisions were in any way flawed. Accordingly, on October 12, 2012, the Commission's Division of Swap Dealer and Intermediary Oversight published interpretive and no-action relief confirming that the bona fide hedging exclusion from the CPO definitional thresholds is distinct and does not depend on the continued force of the position limits regulations, and assuring market participants that they may exclude such positions as stated in amended Rule 4.5 by reference to the language set forth originally in Rule 151.5 and amended Rule 1.3(z)(1). A copy of this release ("DSIO Release") is attached as Exhibit A.<sup>2</sup>

1. In Title VII of the Dodd-Frank Act, Congress provided for the CFTC to establish limits on speculative positions in certain derivative instruments, subject to an exception for "bona fide hedging" transactions. 7 U.S.C. §§ 6a(a)(2)-(5). Congress also directed the Commission to define "bona fide hedging" according to criteria more restrictive than those the CFTC had previously applied to exempt hedging transactions from pre-Dodd-Frank position limits. *Id.* § 6a(c); *see also Position Limits for Derivatives*, 76 Fed. Reg. 4752, 4760-61 (proposed Jan. 26, 2011).

2. The Commission interpreted the Title VII position limits provisions to mandate the establishment of limits, without independent findings of necessity by the Commission, and it promulgated the regulations accordingly in a release published November 18, 2011. *ISDA*, 2012 WL 4466311, at \*1, 4 (citing *Position Limits for Futures & Swaps*, 76 Fed. Reg. 71626 (Nov. 18, 2011)). In the same release, the Commission established the required new definition of bona fide hedging transactions to which the position limits would not apply. 76 Fed. Reg. at 71683-84,

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<sup>2</sup> See also <http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-19.pdf>

71688-91. It promulgated this definition in a new provision, 17 C.F.R. § 151.5, applicable to bona fide hedging in certain agricultural, metals, and energy contracts. Rule 151.5 enumerated several types of hedges not previously enumerated under Rule 1.3(z). The Commission also retained and amended Rule 1.3(z), so that it would be applicable to financial contracts only. Amended Rule 1.3(z) also included swap contracts in financial commodities brought within the Commission's jurisdiction as a result of Dodd-Frank. For the Court's convenience, a redline comparison showing the amendments to Rule 1.3(z) is attached as Exhibit B.

3. In *ISDA*, the court held that, rather than “a clear and unambiguous mandate to set position limits” without independent findings by the Commission as to the need for such limits, as the Commission interpreted, the statute is susceptible to “at least two plausible readings” and there exist “fundamental ambiguities” in these provisions as to whether a separate necessity finding is required. 2012 WL 4466311, at \*20-21, 24. In light of the ambiguity that the court discerned, the court held that the Commission “must bring its expertise to bear in light of the competing interests at stake to resolve the ambiguities,” and it vacated and remanded the rule in its entirety, making no exception for the changes to the bona fide hedging definition. *Id.* at \*23, 25.

The *ISDA* decision rested on interpretation of statutory provisions not at issue here, and involved no finding of any flaw in the Commission's new definition of bona fide hedging under 17 C.F.R. §§ 1.3(z) or 151.5. Nor does the decision affect any of the considerations cited by the Commission in amending the exclusions from the definition of CPO under Rule 4.5, with respect to bona fide hedging or otherwise.

4. In light of *ISDA*, on October 12, 2012, the Division of Swap Dealer and Intermediary Oversight published, pursuant to its authority under 17 C.F.R. § 140.99, a “no action” letter and

interpretation explaining that, in amending Rule 4.5 with cross-references to the “meaning and intent of” Rules 1.3(z)(1) and 151.5, the Commission intended to establish an exclusion from the CPO trading thresholds that was based on, but independent of, the position limits regulations. *See* DSIO Release at 1-2. Therefore, the Rule 4.5 exclusion for “bona fide hedging” transactions does not depend on the continued force of the position limits regulations, and market participants may continue to rely on the “meaning and intent of” the language cross-referenced for convenience in the amendments to Rule 4.5, including the newly enumerated hedges listed in Rule 151.5:

[T]he context indicates, that, in promulgating amended Regulation 4.5, the Commission intended to incorporate the substance of amended Regulation 1.3(z)(1) and new Regulation 151.5 as an exception to the trading threshold test in Commission Regulation 4.5(c)(2)(iii), independently of whether amended Regulation 1.3(z)(1) and Regulation 151.5 remain effective in connection with position limits. This intent of the Commission is not inconsistent with the judgment in *ISDA*, because the appropriate standard for bona fide hedging in the context of the definition of a CPO was not before the court in that case and the court’s decision did not purport to address the issue.

Accordingly, the Division interprets Commission Regulations 4.5(c)(2)(iii)(A) and (B) as continuing to incorporate the substance of amended Commission Regulation 1.3(z)(1) and Commission Regulation 151.5, for purposes of that provision. The Division further states that, in any event, the Division will not recommend that the Commission commence an enforcement action against any person based on any application of the trading threshold test of Commission Regulation 4.5(c)(2)(iii) that excludes transactions falling within the substance of amended Commission Regulations 1.3(z)(1) and 151.5.

By this guidance, the Division restates those terms that were incorporated by reference in the adopting release for Commission Regulation 4.5[.]

DSIO Release at 1-2 (footnotes omitted).

Thus, the *ISDA* decision will not impact the operation of amended Rule 4.5.

Respectfully submitted,

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Division of Swap Dealer and  
Intermediary Oversight

Gary Barnett  
Director

CFTC Letter No. 12-19  
Interpretation  
October 12, 2012  
Division of Swap Dealer and Intermediary Oversight

### **Re: Interpretation of Bona Fide Hedging in Commission Regulation 4.5: Restatement of Terms Incorporated by Reference**

Ladies and Gentlemen:

This letter is in response to requests from multiple parties received by the Division of Swap Dealer and Intermediary Oversight (“Division”) of the Commodity Futures Trading Commission (“Commission”) requesting clarification regarding the bona fide hedging exclusion from the threshold calculation of Commission Regulation 4.5.

On February 24, 2012, the Commission adopted amendments to Commission Regulation 4.5 in the release “Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations.”<sup>1</sup> The Commission amended Regulation 4.5 to include, among other things, a commodity interest trading threshold above which the operator of a registered investment company would be included within the definition of commodity pool operator (“CPO”).<sup>2</sup> Specifically, these commodity interest trading thresholds were established as an aggregate initial margin of 5 percent of the liquidation value of the pool’s portfolio, or a notional exposure of 100 percent of the liquidation value of the pool’s portfolio. The release excluded from the calculation of these thresholds any positions that would qualify as “bona fide hedging” within the “meaning and intent” of Commission Regulations 1.3(z)(1) and 151.5, regulations defining “bona fide hedging” for the separate purpose of exclusion from position limits for futures and swaps.

Following the adoption of amended 4.5, the position limits rule that promulgated Commission Regulation 151.5, and amended Commission Regulation 1.3(z)(1), was vacated by a court of law. *See International Swaps & Derivatives Ass’n v. CFTC*, \_ F. Supp. 2d. \_, 2012 WL 4466311 (D.D.C. Sept. 28, 2012) (“*ISDA*”). However, the context indicates, that, in promulgating amended Regulation 4.5, the Commission intended to incorporate the substance of amended Regulation 1.3(z)(1) and new Regulation 151.5 as an exception to the trading threshold

<sup>1</sup> 77 FR 11252 (Feb. 24, 2012); correction 77 FR 17328 (March 26, 2012).

<sup>2</sup> 17 CFR 4.5(c)(2)(iii)(A) and 17 CFR 4.5(c)(2)(iii)(B).

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test in Commission Regulation 4.5(c)(2)(iii), independently of whether amended Regulation 1.3(z)(1) and Regulation 151.5 remain effective in connection with position limits. This intent of the Commission is not inconsistent with the judgment in *ISDA*, because the appropriate standard for bona fide hedging in the context of the definition of a CPO was not before the court in that case and the court's decision did not purport to address the issue.<sup>3</sup>

Accordingly, the Division interprets Commission Regulations 4.5(c)(2)(iii)(A) and (B) as continuing to incorporate the substance of amended Commission Regulation 1.3(z)(1) and Commission Regulation 151.5, for purposes of that provision. The Division further states that, in any event, the Division will not recommend that the Commission commence an enforcement action against any person based on any application of the trading threshold test of Commission Regulation 4.5(c)(2)(iii) that excludes transactions falling within the substance of amended Commission Regulations 1.3(z)(1) and 151.5.<sup>4</sup>

By this guidance, the Division restates those terms that were incorporated by reference in the adopting release for Commission Regulation 4.5, which are as follows<sup>5</sup>:

**Commission Regulation 1.3(z)(1)**

(z) Bona fide hedging transactions and positions for excluded commodities. (1) General definition. Bona fide hedging transactions and positions shall mean any agreement, contract or transaction in an excluded commodity on a designated contract market or swap execution facility that is a trading facility, where such transactions or positions normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, and where they arise from:

(i) The potential change in the value of assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising,

(ii) The potential change in the value of liabilities which a person owns or anticipates incurring, or

(iii) The potential change in the value of services which a person provides, purchases, or anticipates providing or purchasing.

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<sup>3</sup> The provisions of Commission Regulation 151.5 defined "bona fide hedging" only with respect to certain "Referenced Contracts." These contracts, to be included for purposes of defining bona fide hedging in Commission Regulation 151.5, were enumerated in Commission Regulation 151.2; the terms of which the Commission implicitly also adopted by reference. Commission Regulation 151.2 was also subject to vacatur. Accordingly, the terms of vacated Commission Regulation 151.2 will, as will the terms of Commission Regulation 151.5, be restated *infra* in separate sections.

<sup>4</sup> See generally 17 C.F.R. § 140.99.

<sup>5</sup> The sections below are restatements of Commission Regulations 1.3(z)(1), 151.5, and 151.2 as they existed prior to vacatur, and as incorporated by reference by the Commission in Commission Regulation 4.5.

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(iv) Notwithstanding the foregoing, no transactions or positions shall be classified as bona fide hedging unless their purpose is to offset price risks incidental to commercial cash or spot operations and such positions are established and liquidated in an orderly manner in accordance with sound commercial practices and, for transactions or positions on contract markets subject to trading and position limits in effect pursuant to section 4a of the Act, unless the provisions of paragraphs (z)(2) and (3) of this section have been satisfied.

**Commission Regulation 151.5**

Bona fide hedging and other exemptions for Referenced Contracts.

(a) Bona fide hedging transactions or positions. (1) Any person that complies with the requirements of this section may exceed the position limits set forth in § 151.4 to the extent that a transaction or position in a Referenced Contract:

(i) Represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel;

(ii) Is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise; and

(iii) Arises from the potential change in the value of one or several—

(A) Assets that a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;

(B) Liabilities that a person owns or anticipates incurring; or

(C) Services that a person provides, purchases, or anticipates providing or purchasing; or

(iv) Reduces risks attendant to a position resulting from a swap that—

(A) Was executed opposite a counterparty for which the transaction would qualify as a bona fide hedging transaction pursuant to paragraph (a)(1)(i) through (iii) of this section; or

(B) Meets the requirements of paragraphs (a)(1)(i) through (iii) of this section.

(v) Notwithstanding the foregoing, no transactions or positions shall be classified as bona fide hedging for purposes of § 151.4 unless such transactions or positions are established and liquidated in an orderly manner in accordance with sound commercial practices and the provisions of paragraph (a)(2) of this section regarding enumerated hedging transactions and positions or paragraphs (a)(3) or (4) of this section regarding pass-through swaps of this section have been satisfied.

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(2) Enumerated hedging transactions and positions. Bona fide hedging transactions and positions for the purposes of this paragraph mean any of the following specific transactions and positions:

(i) Sales of Referenced Contracts that do not exceed in quantity:

(A) Ownership or fixed-price purchase of the contract's underlying cash commodity by the same person; and

(B) Unsold anticipated production of the same commodity, which may not exceed one year of production for an agricultural commodity, by the same person provided that no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(ii) Purchases of Referenced Contracts that do not exceed in quantity:

(A) The fixed-price sale of the contract's underlying cash commodity by the same person;

(B) The quantity equivalent of fixed-price sales of the cash products and by-products of such commodity by the same person; and

(C) Unfilled anticipated requirements of the same cash commodity, which may not exceed one year for agricultural Referenced Contracts, for processing, manufacturing, or use by the same person, provided that no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(iii) Offsetting sales and purchases in Referenced Contracts that do not exceed in quantity that amount of the same cash commodity that has been bought and sold by the same person at unfixed prices basis different delivery months, provided that no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(iv) Purchases or sales by an agent who does not own or has not contracted to sell or purchase the offsetting cash commodity at a fixed price, provided that the agent is responsible for the merchandising of the cash positions that is being offset in Referenced Contracts and the agent has a contractual arrangement with the person who owns the commodity or holds the cash market commitment being offset.

(v) Anticipated merchandising hedges. Offsetting sales and purchases in Referenced Contracts that do not exceed in quantity the amount of the same cash commodity that is anticipated to be merchandised, provided that:

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(A) The quantity of offsetting sales and purchases is not larger than the current or anticipated unfilled storage capacity owned or leased by the same person during the period of anticipated merchandising activity, which may not exceed one year;

(B) The offsetting sales and purchases in Referenced Contracts are in different contract months, which settle in not more than one year; and

(C) No such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(vi) Anticipated royalty hedges. Sales or purchases in Referenced Contracts offset by the anticipated change in value of royalty rights that are owned by the same person provided that:

(A) The royalty rights arise out of the production, manufacturing, processing, use, or transportation of the commodity underlying the Referenced Contract, which may not exceed one year for agricultural Referenced Contracts; and

(B) No such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(vii) Service hedges. Sales or purchases in Referenced Contracts offset by the anticipated change in value of receipts or payments due or expected to be due under an executed contract for services held by the same person provided that:

(A) The contract for services arises out of the production, manufacturing, processing, use, or transportation of the commodity underlying the Referenced Contract, which may not exceed one year for agricultural Referenced Contracts;

(B) The fluctuations in the value of the position in Referenced Contracts are substantially related to the fluctuations in value of receipts or payments due or expected to be due under a contract for services; and

(C) No such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(viii) Cross-commodity hedges. Sales or purchases in Referenced Contracts described in paragraphs (a)(2)(i) through (vii) of this section may also be offset other than by the same quantity of the same cash commodity, provided that:

(A) The fluctuations in value of the position in Referenced Contracts are substantially related to the fluctuations in value of the actual or anticipated cash position; and

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(B) No such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(3) Pass-through swaps. Bona fide hedging transactions and positions for the purposes of this paragraph include the purchase or sales of Referenced Contracts that reduce the risks attendant to a position resulting from a swap that was executed opposite a counterparty for whom the swap transaction would qualify as a bona fide hedging transaction pursuant to paragraph (a)(2) of this section (“pass-through swaps”), provided that no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts unless such pass-through swap position continues to offset the cash market commodity price risk of the bona fide hedging counterparty.

(4) Pass-through swap offsets. For swaps executed opposite a counterparty for whom the swap transaction would qualify as a bona fide hedging transaction pursuant to paragraph (a)(2) of this section (pass-through swaps), such pass-through swaps shall also be classified as a bona fide hedging transaction for the counterparty for whom the swap would not otherwise qualify as a bona fide hedging transaction pursuant to paragraph (a)(2) of this section (“non-hedging counterparty”), provided that the non-hedging counterparty purchases or sells Referenced Contracts that reduce the risks attendant to such pass-through swaps. Provided further, that the pass-through swap shall constitute a bona fide hedging transaction only to the extent the non-hedging counterparty purchases or sells Referenced Contracts that reduce the risks attendant to the pass-through swap.

(5) Any person engaging in other risk-reducing practices commonly used in the market which they believe may not be specifically enumerated in § 151.5(a)(2) may request relief from Commission staff under § 140.99 of this chapter or the Commission under section 4a(a)(7) of the Act concerning the applicability of the bona fide hedging transaction exemption.

(b) Aggregation of accounts. Entities required to aggregate accounts or positions under § 151.7 shall be considered the same person for the purpose of determining whether a person or persons are eligible for a bona fide hedge exemption under § 151.5(a).

(c) Information on cash market commodity activities. Any person with a position that exceeds the position limits set forth in § 151.4 pursuant to paragraphs (a)(2)(i)(A), (a)(2)(ii)(A), (a)(2)(ii)(B), (a)(2)(iii), or (a)(2)(iv) of this section shall submit to the Commission a 404 filing, in the form and manner provided for in § 151.10.

(1) The 404 filing shall contain the following information with respect to such position for each business day the same person exceeds the limits set forth in § 151.4, up to and through the day the person's position first falls below the position limits:

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(i) The date of the bona fide hedging position, an indication of under which enumerated hedge exemption or exemptions the position qualifies for bona fide hedging, the corresponding Core Referenced Futures Contract, the cash market commodity hedged, and the units in which the cash market commodity is measured;

(ii) The entire quantity of stocks owned of the cash market commodity that is being hedged;

(iii) The entire quantity of fixed-price purchase commitments of the cash market commodity that is being hedged;

(iv) The sum of the entire quantity of stocks owned of the cash market commodity and the entire quantity of fixed-price purchase commitments of the cash market commodity that is being hedged;

(v) The entire quantity of fixed-price sale commitments of the cash commodity that is being hedged;

(vi) The quantity of long and short Referenced Contracts, measured on a futures-equivalent basis to the applicable Core Referenced Futures Contract, in the nearby contract month that are being used to hedge the long and short cash market positions;

(viii) The total number of long and short Referenced Contracts, measured on a futures equivalent basis to the applicable Core Referenced Futures Contract, that are being used to hedge the long and short cash market positions; and

(viii) Cross-commodity hedging information as required under paragraph (g) of this section.

(2) Notice filing. Persons seeking an exemption under this paragraph shall file a notice with the Commission, which shall be effective upon the date of the submission of the notice.

(d) Information on anticipated cash market commodity activities —(1) Initial statement. Any person who intends to exceed the position limits set forth in § 151.4 pursuant to paragraph (a)(2)(i)(B), (a)(2)(ii)(C), (a)(2)(v), (a)(2)(vi), or (a)(2)(vii) of this section in order to hedge anticipated production, requirements, merchandising, royalties, or services connected to a commodity underlying a Referenced Contract, shall submit to the Commission a 404A filing in the form and manner provided in § 151.10. The 404A filing shall contain the following information with respect to such activities, by Referenced Contract:

(i) A description of the type of anticipated cash market activity to be hedged; how the purchases or sales of Referenced Contracts are consistent with the provisions of (a)(1) of this section; and the units in which the cash commodity is measured;

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(ii) The time period for which the person claims the anticipatory hedge exemption is required, which may not exceed one year for agricultural commodities or one year for anticipated merchandising activity;

(iii) The actual use, production, processing, merchandising (bought and sold), royalties and service payments and receipts of that cash market commodity during each of the three complete fiscal years preceding the current fiscal year;

(iv) The anticipated use production, or commercial or merchandising requirements (purchases and sales), anticipated royalties, or service contract receipts or payments of that cash market commodity which are applicable to the anticipated activity to be hedged for the period specified in (d)(1)(ii) of this section;

(v) The unsold anticipated production or unfilled anticipated commercial or merchandising requirements of that cash market commodity which are applicable to the anticipated activity to be hedged for the period specified in (d)(1)(ii) of this section;

(vi) The maximum number of Referenced Contracts long and short (on an all-months-combined basis) that are expected to be used for each anticipatory hedging activity for the period specified in (d)(1)(ii) of this section on a futures equivalent basis;

(vii) If the hedge exemption sought is for anticipated merchandising pursuant to (a)(2)(v) of this section, a description of the storage capacity related to the anticipated merchandising transactions, including:

(A) The anticipated total storage capacity, the anticipated merchandising quantity, and purchase and sales commitments for the period specified in (d)(1)(ii) of this section;

(B) Current inventory; and

(C) The total storage capacity and quantity of commodity moved through the storage capacity for each of the three complete fiscal years preceding the current fiscal year; and

(viii) Cross-commodity hedging information as required under paragraph (g) of this section.

(2) Notice filing. Persons seeking an exemption under this paragraph shall file a notice with the Commission. Such a notice shall be filed at least ten days in advance of a date the person expects to exceed the position limits established under this part, and shall be effective after that ten day period unless otherwise notified by the Commission.

(3) Supplemental reports for 404A filings. Whenever a person intends to exceed the amounts determined by the Commission to constitute a bona fide hedge for anticipated activity in the most recent statement or filing, such person shall file with the Commission a statement that

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updates the information provided in the person's most recent filing at least ten days in advance of the date that person wishes to exceed those amounts.

(e) Review of notice filings. (1) The Commission may require persons submitting notice filings provided for under paragraphs (c)(2) and (d)(2) of this section to submit such other information, before or after the effective date of a notice, which is necessary to enable the Commission to make a determination whether the transactions or positions under the notice filing fall within the scope of bona fide hedging transactions or positions described under paragraph (a) of this section.

(2) The transactions and positions described in the notice filing shall not be considered, in part or in whole, as bona fide hedging transactions or positions if such person is so notified by the Commission.

(f) Additional information from swap counterparties to bona fide hedging transactions. All persons that maintain positions in excess of the limits set forth in § 151.4 in reliance upon the exemptions set forth in paragraphs (a)(3) and (4) of this section shall submit to the Commission a 404S filing, in the form and manner provided for in § 151.10. Such 404S filing shall contain the following information with respect to such position for each business day that the same person exceeds the limits set forth in § 151.4, up to and through the day the person's position first falls below the position limit that was exceeded:

(1) By Referenced Contract;

(2) By commodity reference price and units of measurement used for the swaps that would qualify as a bona fide hedging transaction or position gross long and gross short positions; and

(3) Cross-commodity hedging information as required under paragraph (g) of this section.

(g) Conversion methodology for cross-commodity hedges. In addition to the information required under this section, persons who avail themselves of cross-commodity hedges pursuant to (a)(2)(viii) of this section shall submit to the Commission a form 404, 404A, or 404S filing, as appropriate. The first time such a form is filed where a cross-commodity hedge is claimed, it should contain a description of the conversion methodology. That description should explain the conversion from the actual commodity used in the person's normal course of business to the Referenced Contract that is being used for hedging, including an explanation of the methodology used for determining the ratio of conversion between the actual or anticipated cash positions and the person's positions in the Referenced Contract.

(h) Recordkeeping. Persons who avail themselves of bona fide hedge exemptions shall keep and maintain complete books and records concerning all of their related cash, futures, and swap positions and transactions and make such books and records, along with a list of pass-through swap counterparties for pass-through swap exemptions under (a)(3) of this section, available to the Commission upon request.

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(i) Additional requirements for pass-through swap counterparties. A party seeking to rely upon § 151.5(a)(3) to exceed the position limits of § 151.4 with respect to such a swap may only do so if its counterparty provides a written representation ( e.g., in the form of a field or other representation contained in a mutually executed trade confirmation) that, as to such counterparty, the swap qualifies in good faith as a bona fide hedging transaction under paragraph (a)(3) of this section at the time the swap was executed. That written representation shall be retained by the parties to the swap for a period of at least two years following the expiration of the swap and furnished to the Commission upon request. Any person that represents to another person that the swap qualifies as a pass-through swap under paragraph (a)(3) of this section shall keep and make available to the Commission upon request all relevant books and records supporting such a representation for a period of at least two years following the expiration of the swap.

(j) Financial distress exemption. Upon specific request made to the Commission, the Commission may exempt a person or related persons under financial distress circumstances for a time certain from any of the requirements of this part. Financial distress circumstances are situations involving the potential default or bankruptcy of a customer of the requesting person or persons, affiliate of the requesting person or persons, or potential acquisition target of the requesting person or persons. Such exemptions shall be granted by Commission order.

## **Commission Regulation 151.2**

### Core Referenced Futures Contracts.

(a) Agricultural commodities. Core Referenced Futures Contracts in agricultural commodities include the following futures contracts and options thereon:

- (1) Core Referenced Futures Contracts in legacy agricultural commodities:
  - (i) Chicago Board of Trade Corn (C);
  - (ii) Chicago Board of Trade Oats (O);
  - (iii) Chicago Board of Trade Soybeans (S);
  - (iv) Chicago Board of Trade Soybean Meal (SM);
  - (v) Chicago Board of Trade Soybean Oil (BO);
  - (vi) Chicago Board of Trade Wheat (W);
  - (vii) ICE Futures U.S. Cotton No. 2 (CT);
  - (viii) Kansas City Board of Trade Hard Winter Wheat (KW); and
  - (ix) Minneapolis Grain Exchange Hard Red Spring Wheat (MWE).
- (2) Core Referenced Futures Contracts in non-legacy agricultural commodities:
  - (i) Chicago Mercantile Exchange Class III Milk (DA);
  - (ii) Chicago Mercantile Exchange Feeder Cattle (FC);
  - (iii) Chicago Mercantile Exchange Lean Hog (LH);
  - (iv) Chicago Mercantile Exchange Live Cattle (LC);
  - (v) Chicago Board of Trade Rough Rice (RR);
  - (vi) ICE Futures U.S. Cocoa (CC);
  - (vii) ICE Futures U.S. Coffee C (KC);

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- (viii) ICE Futures U.S. FCOJ-A(OJ);
- (ix) ICE Futures U.S. Sugar No. 11 (SB); and
- (x) ICE Futures U.S. Sugar No. 16 (SF).

(b) Metal commodities. Core Referenced Futures Contracts in metal commodities include the following futures contracts and options thereon:

- (1) Commodity Exchange, Inc. Copper (HG);
- (2) Commodity Exchange, Inc. Gold (GC);
- (3) Commodity Exchange, Inc. Silver (SI);
- (4) New York Mercantile Exchange Palladium (PA); and
- (5) New York Mercantile Exchange Platinum (PL).

(c) Energy commodities. The Core Referenced Futures Contracts in energy commodities include the following futures contracts and options thereon:

- (1) New York Mercantile Exchange Henry Hub Natural Gas (NG);
- (2) New York Mercantile Exchange Light Sweet Crude Oil (CL);
- (3) New York Mercantile Exchange New York Harbor Gasoline Blendstock (RB); and
- (4) New York Mercantile Exchange New York Harbor Heating Oil (HO).

Therefore, despite the vacatur of Commission Regulation 151.5 and the amendments to Commission Regulation 1.3(z)(1), the Division reaffirms that the provisions of Commission Regulation 4.5 permit any operator of a registered investment company to exclude from the trading thresholds calculation any transaction that satisfies the definition of “bona fide hedging” as those definitions appear as restated above.

This letter, and the positions taken herein, represent the view of this Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The interpretation issued by this letter does not excuse any registrant from compliance with any other applicable requirements contained in the Act or in the Commission’s regulations issued thereunder.

Should you have any questions, please do not hesitate to contact Amanda Olear, Special Counsel, at 202-418-5283 or Michael Ehrstein, Attorney Advisor, at 202-418-5957.

Very truly yours,

Gary Barnett

**17 CFR 1.3(z)**

**Changes made by Position Limits for Futures and Swaps,  
76 Fed. Reg. 71,626 (Nov. 18, 2011), noted in Red**

(z) *Bona fide hedging transactions and positions--*

(1) *General definition.* Bona fide hedging transactions and positions shall mean any agreement, contract or transaction in an excluded commodity on a designated contract market or swap execution facility that is a trading facility ~~transactions or positions in a contract for future delivery on any contract market, or in a commodity option~~, where such transactions or positions normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, and where they arise from:

- (i) The potential change in the value of assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising,
- (ii) The potential change in the value of liabilities which a person owns or anticipates incurring, or
- (iii) The potential change in the value of services which a person provides, purchases, or anticipates providing or purchasing.

(iv) Notwithstanding the foregoing, no transactions or positions shall be classified as bona fide hedging unless their purpose is to offset price risks incidental to commercial cash or spot operations and such positions are established and liquidated in an orderly manner in accordance with sound commercial practices and, for transactions or positions on contract markets subject to trading and position limits in effect pursuant to section 4a of the Act, unless the provisions of paragraphs (z)(2) and (3) of this section ~~and §§ 1.47 and 1.48 of the regulations~~ have been satisfied.

(2) *Enumerated hedging transactions.* The definitions of bona fide hedging transactions and positions in paragraph (z)(1) of this section includes, but is not limited to, the following specific transactions and positions:

(i) Sales of any agreement, contract, or transaction in an excluded commodity on a designated contract market or swap execution facility that is a trading facility ~~commodity for future delivery on a contract market~~ which do not exceed in quantity:

- (A) Ownership or fixed-price purchase of the same cash commodity by the same person; and
- (B) Twelve months' unsold anticipated production of the same commodity by the same person provided that no such position is maintained in any agreement, contract or transaction ~~future~~ during the five last trading days ~~of that future~~.

(ii) Purchases of any agreement, contract or transaction in an excluded commodity on a designated contract market or swap execution facility that is a trading facility ~~commodity for future delivery on a contract market~~ which do not exceed in quantity.

- (A) The fixed-price sale of the same cash commodity by the same person.
- (B) The quantity equivalent of fixed-price sales of the cash products and by-products of such commodity by the same person; and
- (C) Twelve months' unfilled anticipated requirements of the same cash commodity for processing, manufacturing, or feeding by the same person, provided that such

transactions and positions in the five last trading days of any one future do not exceed the person's unfilled anticipated requirements of the same cash commodity for that month and for the next succeeding month.

(iii) Offsetting sales and purchases in any agreement, contract or transaction in an excluded commodity on a designated contract market or swap execution facility that is a trading facility for future delivery on a contract market which do not exceed in quantity that amount of the same cash commodity which has been bought and sold by the same person at unfixed prices basis different delivery months of the contract market, provided that no such position is maintained in any agreement, contract or transaction future during the five last trading days ~~of that future~~.

(iv) Purchases or sales by an agent who does not own or has not contracted to sell or purchase the offsetting cash commodity at a fixed price, provided that the agent is responsible for the merchandising of the cash position that is being offset, and the agent has a contractual arrangement with the person who owns the commodity or has the cash market commitment being offset.

(iv) Sales and purchases for future delivery described in paragraphs (z)(2)(i), ~~(ii), and (iii)~~ through (iv) of this section may also be offset other than by the same quantity of the same cash commodity, provided that the fluctuations in value of the position for in any agreement, contract or transaction future delivery are substantially related to the fluctuations in value of the actual or anticipated cash position, and provided that the positions in any agreement, contract or transaction one future shall not be maintained during the five last trading days ~~of that future~~.

(3) *Non-Enumerated cases.* ~~Upon specific request made in accordance with § 1.47 of the regulations, the Commission may recognize transactions and positions other than those enumerated in paragraph (z)(2) of this section as bona fide hedging in such amount and under such terms and conditions as it may specify in accordance with the provisions of § 1.47. Such transactions and positions may include, but are not limited to, purchases or sales for future delivery on any contract market by an agent who does not own or who has not contracted to sell or purchase the offsetting cash commodity at a fixed price, provided That the person is responsible for the merchandising of the cash position which is being offset. A designated contract market or swap execution facility that is a trading facility may recognize, consistent with the purposes of this section, transaction and positions other than those enumerated in paragraph (2) of this section as bona fide hedging. Prior to recognizing such non-enumerated transactions and positions, the designated contract market or swap execution facility that is a trading facility shall submit such rules for Commission review under Section 5c of the Act and part 40 of this chapter.~~