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COMMODITY FUTURES TRADING COMMISSION

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Position Limits and Position Accountability for Security Futures Products

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (''CFTC'' or ''Commission'') is issuing a final rule to amend the position limit rules applicable to security futures products (''SFP'') by increasing the default maximum level of equity SFP position limits that designated contract markets (''DCMs'') may set; modifying the criteria for setting a higher position limit and position accountability level by relying primarily on estimated deliverable supply; and adjusting the time during which position limits or position accountability must be in effect. In addition, the final rule will provide DCMs discretion to apply limits to either a person's net position or a person's position on the same side of the market. The rule also includes position limit requirements and related guidance and acceptable practices for DCMs to apply in adopting position limits for SFPs based on products other than an equity security.

DATES: Effective November 26, 2019.

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SUPPLEMENTARY INFORMATION:

I. Background

On December 21, 2000, the Commodity Futures Modernization Act (''CFMA'') became law and amended the Commodity Exchange Act (''CEA'') and the Securities Exchange Act of 1934 (''Exchange Act'').[1] The CFMA removed a long-standing ban on trading futures on single securities and narrow-based security indexes [2] in the United States.[3] Under the CEA as amended by the CFMA, in order for a DCM to list an SFP,[4] the SFP and the securities underlying the SFP 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 the SFP, nor to causing or being used in the manipulation of the price of any underlying security, option on such a 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 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 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.[8] The Commission's existing SFP position limits were set at levels that, when adopted, were generally comparable, but not identical, to the limits that applied to options on individual securities at that time.[9] The CFMA sought comparable regulation of security options and SFPs.

Under existing § 41.25(a)(3), 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.[10] If a security underlying an SFP has either: (i) An average daily trading volume that exceeds 20 million shares; or (ii) an average daily trading volume that exceeds 15 million shares and more than 40 million shares outstanding, then the DCM may establish a position limit for the SFP of no more than 22,500 contracts.[11]

As an alternative to an applicable position limit requirement, existing

[1] *See* Commodity Futures Modernization Act of 2000, Public Law 106–554, 114 Stat. 2763 (Dec. 21, 2000). The CFMA created a joint jurisdictional framework under which the CFTC is the primary regulator for DCMs that list SFPs, and the Securities and Exchange Commission (''SEC'') is the primary regulator for national security exchanges (''NSE''), national securities associations, and alternative trading systems that list SFPs. The other regulator is the secondary regulator. A DCM that elects to list SFPs must first notice register with the SEC (*see* section 252(a) of the CFMA), and an NSE that elects to list SFPs must first notice register with the CFTC (*see* section 202(a) of the CFMA). *See also* Designated Contract Markets in Security Futures Products: Notice-Designation Requirements, Continuing Obligations, Applications for Exemptive Orders, and Exempt Provisions, 66 FR 44960 (Aug. 27, 2001). In that final rule, the Commission adopted new regulations that provide notice registration procedures for a NSE, a national securities association, or an alternative trading system to become a DCM in SFPs. By registering with the Commission, a national securities exchange, a national securities association, or an alternative trading system is, by definition, a DCM for purposes of trading SFPs. SFPs may be listed for trading only on DCMs that are notice-registered as NSEs, including NSEs that are notice-registered with the Commission as DCMs. Security-based swaps are equivalent contracts under the exclusive jurisdiction of the SEC that may be traded over-the-counter or on SEC-regulated security-based swap execution facilities.

[2] *See* 7 U.S.C. 1a(35) for the definition of ''narrow-based security index.''

[3] *See* Section 251(a) of the CFMA. This trading previously was prohibited by 7 U.S.C. 2(a)(1)(B)(v).

[4] The term ''security futures product'' is defined in section 1a(45) of the CEA, 7 U.S.C. 1a(45), and section 3(a)(56) of the Exchange Act, 15 U.S.C. 78c(a)(56), 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, 7 U.S.C. 1a(44), and section 3(a)(55)(A) of the Exchange Act, 15 U.S.C. 78c(a)(55)(A), 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, 7 U.S.C. 1a(35), and section 3(a)(55)(B) of the Exchange Act, 15 U.S.C. 78c(a)(55)(B).

[5] 7 U.S.C. 2(a)(1)(D)(i).

[6] *See* 7 U.S.C. 2(a)(1)(D)(i)(VII).

[7] *See* Listing Standards and Conditions for Trading Security Futures Products, proposed rules, 66 FR 37932, 37933 (Jul. 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] 17 CFR 41.25(a)(3).

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

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

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

rules permit a DCM to adopt a position accountability rule for an SFP on a security that has: (i) An average daily trading volume that exceeds 20 million shares; and (ii) more than 40 million shares outstanding.[12] 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 provide information to the exchange regarding the nature of the position.[13] Under position accountability, traders must also consent to halt increases in the size of their positions upon the direction of the DCM.[14]

Since adoption of 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 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.[15] The CFMA further authorized the Commission and the SEC (collectively ''Commissions'') to allow SFPs to be ''based on securities other than equity securities.'' [16] The Commissions used their authority to allow SFPs on Depositary Receipts; [17] Exchange Traded Funds, Trust Issued Receipts, and Closed End Funds; [18] and debt securities.[19] Since the Commission's initial adoption of SFP position limits, the SEC has granted approval to increase position limits for equity options listed on NSEs, but the Commission has not amended its SFP regulations to reflect those changes, or to take into account the characteristics of other types of SFPs, such as an SFP on one or more debt securities.

II. The Proposal

On July 31, 2018, the Commission published a Notice of Proposed Rulemaking to amend Commission regulation 41.25 to update the position limit rules for SFPs to provide regulatory comparability with equity options, foster innovation by providing a framework for position limits on SFPs that are not covered under the existing rules, and provide flexibility to DCMs in setting position limits for such products (''Proposal'').[20]

Notably, the Commission proposed changes to the default position limit level and the criteria for DCMs adopting position limits and accountability levels for SFPs, relying primarily on estimated deliverable supply, as defined in the rule. For equity SFPs, the Proposal would increase the default position limit level from 13,500 (100-share) contracts to 25,000 (100-share) contracts and would permit a DCM to establish a position limit level higher than 25,000 (100-share) contracts based on the estimated deliverable supply of the underlying security.[21] The Proposal provided guidance on estimating delivery supply, and in connection with this change, would require a DCM to estimate deliverable supply at least semi-annually, rather than calculating the six-month average daily trading volume at least monthly.[22]

Also for equity SFPs, the Proposal would change the criteria that permit a DCM to adopt an exchange rule for position accountability in lieu of position limits. Under the Proposal, for a DCM to adopt an exchange rule for position accountability in lieu of position limits, the underlying security must have an estimated deliverable supply of more than 40 million shares and a total trading volume of more than 2.5 billion shares over a six-month period.[23]

The Proposal also provided that the DCM could have the discretion to adopt limits and accountability levels on either a net basis or gross basis (''on the same side of the market'') and included specific position limit requirements and guidance for a physically-delivered basket of equities SFP, a cash-settled equity index SFP, and an SFP on one or more debt securities.[24] The Proposal further included requirements for recalculating position limits and accountability levels based on updated estimated deliverable supply and trading volume calculations, and it provided guidance to DCMs on granting SFP position limit exemptions.[25]

When adopted, the Commission's existing SFP position limits were set at levels that were generally comparable, but not identical, to the limits that applied to options on individual securities at that time.[26] However, over time, a competitive disparity emerged between the Commission's SFP position limits and security options limits despite both serving economically similar functions.[27] Position limits for security options have increased to higher levels while the Commission's SFP position limits have remained unchanged. To address this disparity, the Commission drafted the Proposal with the goal of providing a level regulatory playing field.

Noting the differences in the position limit rules applicable to SFPs and security options,[28] the Commission determined certain approaches were necessary to effectively oversee the markets, consistent with the obligation

[12] 17 CFR 41.25(a)(3)(i)(B).

[13] *Id.*

[14] *Id.*

[15] 7 U.S.C. 2(a)(1)(D)(i)(III).

[16] 7 U.S.C. 2(a)(1)(D)(v)(I).

[17] *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, (Aug. 20, 2001), *https://www.sec.gov/rules/other/34–44725.htm.*

[18] *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, 67 FR 42760 (Jun. 25, 2002).

[19] *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* Joint Final Rules: Application of the Definition of Narrow-Based Security Index to Debt Securities Indexes and Security Futures on Debt Securities, 71 FR 39534 (Jul. 13, 2006) (describing debt securities to include ''notes, bonds, debentures, or evidences of indebtedness'').

[20] *See* Position Limits and Position Accountability for Security Futures Products, 83 FR 36799 (Jul. 31, 2018) (''Proposal'').

[21] Proposal at 36803–05.

[22] Proposal at 36806–07.

[23] Proposal at 36805.

[24] The SFP definition permits the listing of SFPs on debt securities (other than exempted securities). 17 CFR 41.21(a)(2)(iii). 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. 7 U.S.C. 2(a)(1)(C)(iv).

[25] Proposal at 36806–07, 08, and 13–14.

[26] Section 2(a)(1)(D)(i) of the CEA lists eleven criteria that a DCM must meet to list SFPs. 7 U.S.C. 2(a)(1)(D)(i). The Exchange Act lists twelve listing standards and conditions for trading that an NSE must meet to list SFPs, eleven of which are common to those in the CEA. Among the common criteria that make reference directly or indirectly to security options are: (i) Coordinated surveillance across security, security futures, and security option markets; (ii) coordinated trading halts across security, security futures, and security option markets; and (iii) margin levels for security futures and security options. The Exchange Act requires that listing standards filed by an NSE ''be no less restrictive than comparable listing standards for options traded on a national securities exchange.'' 15 U.S.C. 78f(h)(3)(C). Notably, the CEA lacks such a criterion.

[27] 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. Such deep-in-the-money call or put options behave this way, with a delta at or near one, because there is a high probability that such options will expire in-the-money.

[28] Specifically, these differences were: (1) The specification that position limits for SFPs are on a net, rather than a gross 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. *See* 2001 Final SFP Rules at 55081.

of a DCM to prevent manipulation of the price of an SFP and its underlying security or securities.[29] In light of its experience since the first adoption of a position limits regime for SFPs in 2001,[30] the Commission believes it is appropriate to update Commission regulation 41.25 to permit DCMs to set position limits above a default level in appropriate circumstances based on an estimate of deliverable supply.[31]

In addition to requesting comments on the Proposal, the Commission solicited comments on, among other things, the impact of the Proposal on small entities, the Commission's cost-benefit considerations, and any anti-competitive effects of the Proposal. The comment period for the Proposal closed on October 1, 2018. The Commission received one substantive comment letter on the Proposal, from OneChicago, LLC (''OneChicago'' or the ''Exchange'').[32] OneChicago, a DCM that is notice registered with the SEC, is the only domestic exchange listing SFPs.[33] The Commission addresses OneChicago's comments on the Proposal within the discussion of each section of the final rule.

III. Final Rule

The Commission has considered the comments received in response to the Proposal and is adopting it as proposed but with a few modifications.

A. General Comments

OneChicago challenged what it viewed as the Commission's assumption that SFPs and security options are economically equivalent.[34] Focusing its comment letter on single stock futures (''SSFs''), a subset of SFPs, the Exchange stated that the Commission should not treat SSFs the same as security options, because the market views them differently.[35] The Exchange opined that options are exercised for two reasons: (i) To harvest dividends; and (ii) to invest the proceeds from selling stock through exercise of deep in-the-money puts.[36] The Exchange contrasted these reasons with the use of SSFs to transfer securities through the clearing process at the Options Clearing Corporation (''OCC'') and National Securities Clearing Corporation.[37] OneChicago believes that while the price of a deep in-the-money put would, in theory, move in tandem with the price of a short SFP, in practice deep in-the-money puts are exercised early by their holders to collect and invest proceeds from the sale of the stock and to get the benefit of re-investment.[38]

OneChicago commented that SSF contracts do not contain any optionality and, accordingly, have a delta of one, where delta means the rate of change in the price of a derivative relative to the rate of change in price of the underlying instrument.[39] The Exchange noted such an instrument is called a Delta One derivative and that exchange-traded SSFs and OTC Total Return Swaps, such as Master Securities Lending Agreements (''MSLA'') and Master Securities Repurchase Agreements (''MSRP''), are all Delta One derivatives.[40] The Exchange noted further that the OCC clears securities lending agreements in the same risk pools as OneChicago's contracts, and that those securities lending agreements have no position limits and receive risk-based margining treatment.[41]

According to OneChicago, because only a Delta One derivative can avoid a tax event (from the transfer of a security), no other derivative is equivalent to a Delta One derivative.[42] The Exchange noted that no option, or combination of options, can be used without triggering a tax event.[43]

The Exchange recommended regulating Delta One derivatives, whether traded OTC or on an exchange, comparably.[44] The Exchange opined that different regulation of Delta One derivatives creates an uneven playing field, and disagreed with trying to achieve regulatory parity between Delta One derivatives and security options, which are non-Delta One derivatives.[45] The Exchange noted Delta One derivatives are used primarily in financing transactions, where a financing counterparty provides a customer with synthetic (long) exposure to a notional amount of a security and pre-hedges that exposure by accumulating an identical notional value in the underlying shares.[46] Furthermore, the Exchange noted that securities lending rebate rates are decided in the OTC market and have a direct effect on listed equity derivatives.[47] The Exchange believes that entities who determine the rebate rate do so in relative secrecy and may front run the equity derivatives market prior to disclosure of a change in the rebate rate.[48] OneChicago requested that the Commission and the SEC update the Risk Disclosure Documents for options and SFPs to discuss this risk.[49]

OneChicago noted that, in its experience, its market participants hedge a short SFP position with a long stock position and hedge a long SFP position with a short sale of stock (with a stock borrow).[50] According to the Exchange, when such parties extend financing, they do so in order to take the position through expiration.[51] They use the stock held to satisfy the short SFP obligation, without the need for another transaction to unwind the positions, as the best way to extinguish a hedged position.[52] The Exchange noted that in the last four years (since 2015), at least 53 percent of open interest, as of the first of the month, goes through delivery.[53] The Exchange contrasted this percentage with Options Industry

[29] In 2001, the Commission noted:

The differences mainly reflect certain provisions adopted for commodity futures contracts that reflect the special characteristics of those markets. In this regard, the proposed position limit requirements for security futures differ from individual security option position limit rules in that the limits would apply only to net positions in an expiring security futures contract during its five last trading days. The Commission believes that this provision is appropriate since, consistent with its experience in conducting surveillance of other futures markets, it is during the time period near contract expiration that the potential for manipulation based on an extraordinarily large net futures position would most likely occur.

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 below, render position limits ineffective.

[30] The Commission observed the experience of NSEs over several years with higher position limit levels on security options. Absent apparent significant issues, the Commission believes that it is reasonable to establish default SFP position limits that closely resemble existing contract limits for equity options at NSEs.

[31] To allow DCMs to adapt as NSE position limits change, the proposal was designed to provide a formula for a DCM to set a level above a default in cases where estimated deliverable supply exceeds a certain threshold, rather than setting a default that does not change as deliverable supply changes.

[32] OneChicago Comment Letter No. 61824 (''OneChicago Letter''), dated Oct. 1, 2018, *available at https://comments.cftc.gov/PublicComments/CommentList.aspx?id=2899.* The Commission also received another comment letter, which was not substantive and appears to have been posted in error.

[33] OneChicago Letter at 1.

[34] OneChicago Letter at 3.

[35] OneChicago Letter at 5–6.

[36] *Id.*

[37] *Id.*

[38] OneChicago Letter at 4.

[39] OneChicago Letter at 2.

[40] *Id.*

[41] OneChicago Letter at 5.

[42] OneChicago Letter at 3.

[43] *Id.*

[44] *Id.*

[45] *Id.*

[46] OneChicago Letter at 2.

[47] OneChicago Letter at 4.

[48] *Id.*

[49] OneChicago's request regarding Risk Disclosure Documents for options and SFPs is beyond the scope this rule and is not addressed here.

[50] OneChicago Letter at 5.

[51] *Id.*

[52] *Id.*

[53] *Id.*

Council data that shows only 7 percent of options get exercised.[54]

The Commission's regulations distinguish between cash market transactions, such as securities lending agreements, and derivative market transactions. Delta One derivatives, as defined by the Exchange, include certain cash market forward transactions. The Commission notes that it does not directly regulate cash market transactions but has certain anti-fraud and anti-manipulation authority over cash markets.[55]

The CFMA lifted the ban on security futures and sought to ensure comparable regulation of SFPs and security options on NSEs. The Commission appreciates that SFPs may not be identical to equity options. The Commission also notes that use of SFPs as lending transactions is not the only way in which SFPs may be used. As such, the Commission's approach reflects the concept of economic equivalence of SFPs and security options contained in the CFMA.[56]

B. Definitions—Commission Regulation 41.25(a)[57]

To facilitate implementation of its proposed changes to its SFP rules, the Commission proposed definitions for two new terms: ''estimated deliverable supply'' and ''same side of the market.'' The Commission also proposed guidance on estimating deliverable supply.

1. ''Estimated Deliverable Supply''

The Commission proposed to define ''estimated deliverable supply'' as the quantity of the security underlying a SFP 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 also included guidance for estimating deliverable supply in proposed appendix A to Commission regulation 41.25.[58] Specifically, the proposed guidance provided that deliverable supply for an equity security should be no greater than the free float of the security, while deliverable supply should not include securities that are committed for long-term agreements (*e.g.,* closed-end investment companies, structured products, or similar securities).[59] Free float of the security would generally mean issued and outstanding shares less restricted shares. Restricted shares would include restricted and control securities, which are not registered with the SEC to sell in a public marketplace. The Commission suggested that the estimate of deliverable supply in an exchange traded fund (''ETF'') should be equal to the existing shares of the ETF.[60] The Commission requested comment on whether there are any other adjustments that should be made in estimating deliverable supply for equities and whether an estimate of deliverable supply for an ETF should include an allowance for the creation of ETF shares.[61]

OneChicago opined that the Commission's proposed guidance for estimating deliverable supply is inadequate. In this respect, OneChicago noted that cash market participants going through settlement are more likely to borrow shares rather than purchase shares.[62] The Exchange noted that to find out how much of the float of shares is available for lending, one would need to inquire with the ''Securities Lending world'' [sic]. The Exchange is not concerned with this issue because it believes that ''Broker-Dealers . . . are well positioned to determine supply, and will not allow themselves to be put into a position where they cannot deliver.''[63]

The Commission is adopting the definition of ''estimated deliverable supply,'' and the associated guidance for calculating it, as proposed. The Commission notes that the deliverable supply of equity securities in the cash market may be estimated in many ways. A maximum estimate of deliverable supply could be the total number of shares that could be authorized by a corporation. However, there may be a significant time lag before a corporation actually issues additional shares. Accordingly, a more conservative estimate of deliverable supply is based on the number of shares issued and outstanding. The Commission proposed to estimate deliverable supply based on free float, that is, shares issued and outstanding, excluding shares that either: (i) Are restricted from transfer (*e.g.,* restricted stock units) or (ii) have been repurchased by the issuing corporation (*i.e.,* treasury shares). Such free float shares should be more readily available for delivery than shares that are: (i) Authorized but not issued; (ii) issued but held in treasury; or (iii) subject to transfer restriction.

The Commission notes that a short position holder in an SFP may obtain shares for delivery either through purchase of shares or through a securities lending or securities repurchase agreement. The Commission further notes that, at a particular point in time, there can be no more shares available for lending than there are shares outstanding. The Commission acknowledges that, when certain shares are on loan, the borrower of such shares may enter a subsequent transaction to lend such security. However, subsequent lending transactions (resulting in repetitive re-lending of the same shares) should not be used as a basis to increase an estimate of deliverable supply. Once shares are obtained by a market participant, either to deliver on a short SFP position, or in an attempt to corner the readily available supply of such security, then such shares presumably would not be made available for lending during the SFP delivery period. Further, at the termination of a securities lending agreement, the borrower must return securities to the lender. A borrower who has re-sold securities would need to purchase shares (or borrow such shares again) to close out the securities lending agreement.

By way of example, when estimating the deliverable supply of wheat, the Commission does not count both the wheat in a warehouse and a warehouse receipt representing ownership of that same wheat; a warehouse receipt is simply the ownership of the commodity, and is not an increase in the amount of the commodity. Likewise, a forward purchase of wheat would not increase the estimated deliverable supply. Similarly, a single share of stock and a securities lending agreement that transfers ownership of that single share

[54] *Id.*

[55] The CEA includes various prohibitions against the manipulation of the price of commodities, including in cash market transactions. 7 U.S.C. 9(1), 9(3) and 13(a)(2).

[56] The concept of economic equivalence of SFPs and security options evident in the CFMA includes among the listing standards for SFPs in the Exchange Act (but not the CEA) the requirement that listing standards for SFPs ''be no less restrictive than comparable listing standards for options traded on a national securities exchange or national securities association. . . .'' 15 U.S.C. 78f(h)(3)(C). If a security is not eligible to underlie an option, then it may not underlie an SFP. This is consistent with the view that SFPs and security options have some degree of economic equivalence.

[57] The insertion of new paragraph (a) necessitates re-designating existing paragraph (a) as (b), existing paragraph (b) as (c), existing paragraph (c) as (d), and existing paragraph (d) as (e). With the exception of the amended re-designated paragraph (b)(3), the Commission is not amending these paragraphs except for the cross references contained in the text of these paragraphs.

[58] Proposal at 36807 and 13.

[59] 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. *See* appendix C to part 38 of the Commission's regulations. 17 CFR part 38.

[60] *See* Proposal at 36807.

[61] *Id.*

[62] OneChicago Letter at 8.

[63] *Id.*

of stock, do not result in two shares of stock.

2. ''Same Side of the Market''

The Proposal defined ''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.[64] The Commission invited 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.[65] The Commission received no comment on its definition of ''same side of the market'' and is adopting it as proposed.[66]

C. Position Limits or Accountability Rules Required—Commission Regulation 41.25(b)(3)

The Commission proposed to continue to require DCMs to establish position limits or position accountability rules in each SFP for the expiring futures contract month. OneChicago argued that position limits for SSFs are not significant to the market in light of margin requirements.[67] The Commission notes that margin levels currently applicable to SFPs, which are generally set equivalent to margin levels on security options, are outside the scope of this rulemaking.[68]

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

The Commission proposed in § 41.25(b)(3)(i) to increase the default level of a DCM's position limits in an equity SFP from no greater than 13,500 100-share contracts on a net basis to no greater than 25,000 100-share contracts (or the equivalent if the contract size is different than 100 shares per contract), either on a net basis or on the same side of the market.[69] The Proposal would include, in the requirements for limits for equity SFPs, securities such as ETFs and other securities that represent ownership in a group of underlying securities.[70] The Commission invited comment on the appropriateness of both the proposed default limit level and the inclusion of ETFs.[71]

OneChicago believes that increasing the default position limit level to 25,000 contracts is an improvement over the status quo but commented that the proposal did not level the playing field between SFPs and OTC Delta One products.[72]

The Commission is adopting Commission regulation 41.25(b)(3)(i) as proposed. 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.[73] 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. Accordingly, for SFPs in equity securities with less than 20 million shares of estimated deliverable supply, 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,[74] as discussed further below.

The Commission notes that the lowest position limits adopted for equity option positions on NSEs are 25,000 100-share option contracts on the same side of the market.[75] Thus, the final rule allows a DCM to harmonize the default position limit level for SFPs to that of equity options traded on an NSE. Accordingly, this 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. 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, which may place SFPs at a competitive disadvantage. Comparability of limit levels is intended to provide a more level regulatory playing field.

Because limit levels would not apply to a market participant's combined position between SFPs and security options, the Commission did not propose a default limit level for an SFP higher than 12.5 percent of estimated deliverable supply. That is, under the final rule, 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.[76]

2. Higher Position Limits in Equity SFPs—Commission Regulation 41.25(b)(3)(i)(A)

The Proposal would change the criteria that DCMs use to set equity SFP speculative position limit levels above the default level. Under the existing rules, a DCM may establish a position limit for an equity SFP of no more than 22,500 contracts (rather than the default level of no greater than 13,500 (100-share) contracts) if the security underlying the 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.[77] Under the Proposal, a DCM would be able to establish a position limit for an equity SFP of no more than 12.5 percent of the estimated deliverable supply of the relevant underlying security (rather than the default level of no greater than 25,000 100-share contracts) if the estimated deliverable supply of the underlying security exceeds 20 million shares and the limit would be ''appropriate in light of the liquidity of

[64] Proposal at 36812.

[65] 7 U.S.C. 2(a)(1)(D)(iii). Generally, under existing industry practice, 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.

[66] The defined terms are added to Commission regulation 41.25 in a new paragraph (a). In connection with adding the definitions into a new paragraph (a), paragraphs (a) through (d) would be re-designated as paragraphs (b) through (e).

[67] OneChicago Letter at 1 (''OneChicago does not have strong feelings one way or the other about the Commission's proposal because it will not significantly impact our market so long as margins remain at punitive levels.''). OneChicago previously submitted a petition for joint rulemaking for margin relief. *Id.*

[68] *See* Customer Margin Rules Relating to Security Futures, 84 FR 36434 (Jul. 26, 2019).

[69] Proposal at 36803.

[70] *Id.*

[71] *Id.*

[72] OneChicago Letter at 7.

[73] As discussed below, for an SFP on a single equity security where the estimated deliverable supply of the underlying security exceeds 20 million shares, a DCM may adopt a higher position limit. Furthermore, as discussed below, given that SFPs and security options may serve economically equivalent or similar functions, 12.5 percent of estimated deliverable supply is half the level for DCM-set spot month speculative position limits for physical delivery contracts in current Commission regulation 150.5(c).

[74] 7 U.S.C. 7(d)(3) and 7 U.S.C. 7(d)(5).

[75] *See, e.g.,* the Cboe Exchange, Inc. (''CBOE'') rule 4.11, Nasdaq ISE, LLC (''ISE'') rule 412, NYSE American LLC (''NYSE'') rule 904, and Nasdaq PHLX LLC (''PHLX'') rule 1001.

[76] *See* appendix C to 17 CFR part 38, noting the guidance of 17 CFR 150.5.

[77] 17 CFR 41.25(a)(3)(i)(A).

trading'' in that security.[78] The Commission invited comment on whether providing a DCM with discretion in its assessment of liquidity in the underlying security, rather than the Commission imposing a volume requirement, would be appropriate and on whether estimated deliverable supply alone serves as an adequate proxy for market impact.[79]

OneChicago recommended using 25 percent of estimated deliverable supply, as opposed to the 12.5 percent proposed by the Commission, to set the level of the position limit, because, in the Exchange's view, there is no justification for a lower level, other than the misconception that SFPs and security options compete.[80] The Exchange believes the 25 percent level is justified for two reasons: (i) To reduce the regulatory disparity between OTC and SSF markets; and (ii) SSFs are almost exclusively used for riskless financing and transfer transactions.[81] OneChicago agreed that it is appropriate to use a linear approach to set position limit levels based on estimated deliverable supply.[82] That is, a doubling of estimated deliverable supply of a security would result in the doubling of the level of the position limit on an SFP based on that security.

OneChicago supported the proposal to give DCMs the discretion to determine if the liquidity in an SFP justifies setting the position limit lower than the default level. OneChicago stated that DCMs are flexible and can adjust to changing market conditions quickly.[83] Moreover, OneChicago believes the Commission's approach may not accurately take account of borrowable shares.[84]

For underlying securities with more than 20 million shares of estimated deliverable supply, the Commission is adopting as proposed the rule that permits DCMs to set the position limit equivalent to no more than 12.5 percent of estimated deliverable supply. By way of example, if the estimated deliverable supply were 40 million shares, then the rule 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.[85]

While this provision for SFP position limits more closely resembles existing limits on security options, the final rule permits a DCM to use its discretion in assessing the liquidity of trading in the underlying security, rather than imposing a prescriptive trading volume requirement.[86] The Commission does not believe that trading volume alone is an appropriate indicator of liquidity. Thus, the rule permits a DCM to set a position limit at a level lower than 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 acquire to make delivery.

Under the current SFP-listing practices of DCMs (with OneChicago being the only domestic DCM that lists SFPs), SFPs require delivery of the underlying shares. Relatedly, NSEs also may list equity options that require delivery of the underlying shares. Given this situation, the Commission believes that in adopting the SFP position limit rule the Commission should take into consideration the impact on deliverable supply of both an option on a particular security being listed for trading on an NSE and an SFP on that same security being listed for trading on a DCM.[87]

The Commission notes that the criterion of 12.5 percent of estimated deliverable supply is half the level for DCM-set spot month speculative position limits for physical delivery contracts in current Commission regulation 150.5(c).[88] That provision requires that for spot month limit levels of no greater than one-quarter of the estimated spot month deliverable supply.[89] The Commission is adopting a lower percent of estimated deliverable supply for SFPs in light of current limits on equity options listed at NSEs. In this regard, the final rule results 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 or a combination of trading volume and shares currently outstanding have been met. For example, a position at a 50,000 (100-share) option contract limit is equivalent to five million shares. Twelve and one-half percent of 40 million shares equals five million shares; that is, the criterion for a DCM to set a limit is similar to that of the criteria for an NSE to set such a limit. Under this final rule, a similar 50,000 contract position limit on an SFP on such a security is an increase from the 22,500 contract limit currently permitted for such an SFP. The Commission believes this 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 options listed by NSEs.

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

Further, the Commission notes that limits for equity options at NSEs do not increase in a linear manner for all increases in shares outstanding.[90] For example, upon a tripling of shares outstanding from 40 million shares to 120 million shares, the 100-share equity option contract limit increases only to 75,000 contracts from 50,000 contracts,[91] while, under similar circumstances of a doubling of estimated deliverable supply, the Commission proposes to permit a linear

[78] Proposal at 36804–05 and 12.

[79] Core Principle 5 requires DCMs to adopt, as is necessary and appropriate, position limits to reduce the potential threat of market manipulation or congestion. 7 U.S.C. 7(d)(5).

[80] OneChicago Letter at 8.

[81] *Id.*

[82] *Id.*

[83] *Id.*

[84] *Id.*

[85] *See, e.g.,* CBOE rule 4.11, ISE rule 412, NYSE rule 904, and PHLX rule 1001.

[86] 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).

[87] It should be noted that the SEC, as the secondary regulator of OneChicago, has the authority to abrogate a rule change proposed by OneChicago if it appears to the SEC that such proposed rule change unduly burdens competition or efficiency, conflicts with the securities laws, or is inconsistent with the public interest and the protection of investors. *See* Section 202(b) of the CFMA, which added section 19(b)(7)(C) to the Exchange Act. Public Law 106–554, 114 Stat. 2763 (2000).

[88] 17 CFR 150.5(c).

[89] 17 CFR 150.5(c)(1).

[90] Proposal at 36801.

[91] In this example using shares outstanding, in order to increase the equity option position limit, the total six-month trading volume also would have had to increase to at least 30 million shares from at least 15 million shares.

increase for a SFP limit to 100,000 contracts from 50,000 contracts.

The Commission will continue to monitor trading activity and positions in the SFP market to assess whether the levels of position limits unduly restrict trading.

3. 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 invited 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.[92] OneChicago opposed this proposed alternative because, according to OneChicago, it perpetuates the myth that the two products are equivalent.[93]

The Commission is not adopting this proposed alternative. NSEs may set an equity option's position limit by the use of trading volume as a sole criterion.[94] 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.[95] 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 of outstanding shares when the underlying security exhibits a very high degree of turnover and a relatively low number of shares outstanding.[96] Such a resulting high limit level would render position limits ineffective.

4. Position Accountability in Lieu of Limits—Commission Regulation 41.25(b)(3)(i)(B)

The Commission proposed to change the criteria for when a DCM would be permitted to substitute position accountability for a position limit in an equity SFP.[97] Specifically, under the Proposal, a DCM would be permitted to adopt a position accountability rule where the underlying security has an estimated deliverable supply of more than 40 million shares and a six-month total trading volume that exceeds 2.5 billion shares,[98] instead of the existing criteria that the underlying security has an average daily trading volume that exceeds 20 million shares and more than 40 million shares outstanding.[99] In addition, the Proposal stated that the maximum accountability level would be increased from 22,500 contracts to 25,000 contracts.[100]

OneChicago recommended that the Commission authorize position accountability for all SFPs based on ETFs at a level of 25,000 contracts, or perhaps at a lower level for ETFs with low liquidity.[101] Because authorized participants may increase or decrease the number of outstanding shares to keep the price of the ETF in line with the value of the underlying assets, the Exchange believes that estimated deliverable supply of an ETF and trading volume of an ETF are unsuitable for assessing an ETF's liquidity.[102] The Exchange suggested setting a lower position accountability level, in lieu of position limits, for an ETF with lower estimated deliverable supply of the ETF's underlying components.[103] The Exchange believes that a DCM could assess whether a participant had the ability to deliver, and whether a participant was attempting to manipulate the market, under a position accountability regime.[104]

The Commission is adopting, as proposed, the amended position accountability provisions in Commission regulation 41.25(b)(3)(i)(B).[105] Under this provision, 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. This provision is roughly equivalent to the existing criteria of more than 20 million shares of six-month average daily trading volume in the underlying security and of more than 40 million outstanding shares of the underlying security.[106]

Rather than the existing requirement that the underlying security have more than 40 million shares outstanding, the rule requires 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 use of estimated deliverable supply of underlying shares in setting a position limit as discussed above. 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 be able 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, such as shares held by the corporation as treasury stock. Therefore, to ensure that short position holders generally will 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.[107]

In addition, the Commission is increasing the maximum position accountability level to 25,000 contracts from the current level of 22,500 contracts. The Commission notes a DCM would be able to set a lower accountability level, should it desire. The Commission 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 as to the nature of the position and to order such position holders not to increase positions.[108] As stated in the Proposal, the Commission believes a maximum position accountability level of 25,000 contracts is at the outer bounds for purposes of

[92] Proposal at 36805.

[93] OneChicago Letter at 8.

[94] *See, e.g.,* the CBOE rule 4.11, ISE rule 412, NYSE rule 904, and PHLX rule 1001.

[95] 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. *See, e.g.,* the CBOE rule 4.11, and 17 CFR 150.5(c)(1).

[96] For example, suppose a company has issued 21 million shares which are so frequently traded that the trading volume for those shares over a six month period is 275 million shares. Under the rules of an NSE, the position limit for an option on that security could be 250,000 100-share contracts, which is equivalent to 25 million shares, which is greater than the number of shares outstanding.

[97] Proposal at 36805 and 12–13.

[98] *Id.*

[99] *See* 17 CFR 41.25(a)(3)(i)(B).

[100] Proposal at 36805 and 12–13.

[101] OneChicago Letter at 7.

[102] *Id.*

[103] *Id.*

[104] *Id.*

[105] The Commission has added clarifying language to Commission regulation 41.25(b)(3)(i)(B) articulating that a position accountability level is in lieu of a position limit level, as set forth in Commission regulation 41.25(b)(3)(i)(A).

[106] Twenty 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.

[107] *See* appendix C to part 38, paragraph (b)(1)(i).

[108] 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.

providing a DCM with authority to obtain information from position holders.[109]

The Commission is not adopting a position accountability rule as the default for all SFPs based on ETFs. The Commission notes that ETFs are structured such that pre-approved groups of institutional firms, known as authorized participants, are the only set of persons permitted to create or redeem shares in an ETF. Moreover, to create ETF shares, the authorized participant must have the requisite shares in the securities underlying the ETF. It is not clear that the process to create new shares in an ETF could be accomplished quickly enough during the period leading to delivery to ensure that the ETF's price remains in line with the prices in the underlying shares. Therefore, the Commission will require in Commission regulation 41.25(b)(3)(i)(A) position limits on ETFs as appropriate.

In addition, the Commission is adopting its proposed guidance, including paragraph (d) to appendix A, which provides that a DCM may adopt a position accountability rule for any SFP, *in addition* to a position limit rule required or adopted under this section.[110] Consistent with the requirements of the amended Commission regulation 41.25(b)(3)(i)(B), the DCM's position accountability rule must provide, at a minimum, that the DCM have authority to obtain any information it would need 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 halt increasing their position. Position accountability can work in tandem with a position limit rule, particularly where the accountability level is set below the level of the position limit. Further, the 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.

D. Limits for Other SFPs—Commission Regulation 41.25(b)(3)(ii)–(iv)

The Proposal also included specific position limits requirements and guidance directed at SFPs based on products other than a single equity security: A physically-delivered basket equity SFP, a cash-settled equity index SFP, and an SFP on one or more debt securities.

[109] Proposal at 36805.

[110] Proposal at 36814.

1. Limits for SFPs on More Than One Equity Security—Commission Regulation 41.25(b)(3)(ii) and (iii)

The existing SFP rule provides that, for an SFP comprised of more than one equity security, the DCM must apply the position limit or position accountability level applicable to the security in the index with the lowest average daily trading volume.[111] The Proposal distinguished between physically-delivered basket equity SFPs and cash-settled equity index SFPs, though the Commission notes that neither currently is listed for trading on a DCM.

OneChicago believes the current general framework is sufficient and recommended that the Commission not finalize regulations for types of SFPs that currently are not listed for trading, unless there is interest in listing such SFPs.[112] OneChicago expressed concern that issuing these regulations would risk stifling innovation.[113] Rather, OneChicago believes the Commission should have a regulatory scheme that can quickly adapt to market developments.[114]

The Commission is adopting the changes to the general framework for types of SFPs not currently listed for trading, as proposed. The Commission is concerned that the existing general framework applicable to SFPs, as noted in the Proposal, does not take into account the characteristics of other types of SFPs, such as an SFP on one or more debt securities, SFPs based on physically-delivered baskets of equities, and cash-settled SFPs based on equity indexes. Absent revisions, the Commission is concerned that the existing general framework could impede innovation because a DCM may not be able to tailor a product's terms to comply with the framework.[115]

a. Physically-Delivered Basket Equity SFPs—Commission Regulation 41.25(b)(3)(ii)

With respect to a physically-delivered SFP on more than one equity security, the Proposal provided that the DCM must adopt the position limit for the SFP based on the underlying security with the lowest estimated deliverable supply and that the position accountability level would only be allowable if each of the underlying equity securities in the basket of deliverable securities is eligible for a position accountability level.[116] The Commission proposed the existing position limits and position accountability provisions for a physically-delivered SFP comprised of more than one equity security[117] by basing the criteria on the underlying equity security with the lowest estimated deliverable supply, rather than the lowest average daily trading volume.[118]

[111] 17 CFR 41.25(a)(3)(ii).

[112] OneChicago Letter at 9.

[113] *Id.*

[114] *Id.*

[115] *See* Proposal at 36807.

[116] Proposal at 36805–06 and 13.

The Commission is adopting Commission regulation 41.25(b)(3)(ii) as proposed. The rule is based on the premise that the limit on a physically-delivered equity basket SFP should be consistent with the most restrictive limit applicable to SFPs based on each component of such basket of deliverable securities. This restricts a person from obtaining a larger exposure to a particular component security through a physically-delivered basket equity SFP than could be obtained directly in a single equity SFP. However, the rule does not aggregate positions in single equity SFPs with positions in basket deliverable SFPs.

b. Cash-Settled Equity Index SFPs—Commission Regulation 41.25(b)(3)(iii)

With respect to a cash-settled SFP based on a narrow-based security index of equity securities, the Proposal simply provided that the DCM must adopt a position limit level and offered relevant guidance and acceptable practices.[119] Under the proposed guidance a DCM could set the position limit for a cash-settled SFP on a narrow-based equity security index equal to that of a similar narrow-based equity security index option listed on an NSE.[120] As an alternative for setting the level based on that of a similar equity index option, the proposal provided 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

[117] 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 an index that has nine or fewer component securities; a component security comprises more than 30 percent of the index's weighting; the five highest weighted component securities in the aggregate comprise more than 60 percent of the index's weight; or the lowest weighted component securities, comprising no more than 25 percent of the index's weight, have an aggregate dollar value of average daily trading volume of less than $50 million. 7 U.S.C. 1a(35).

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

[119] Proposal at 36806, 13, and 14.

[120] Proposal at 36814.

equity index weighting and SFP contract multiplier.[121]

As an example of an acceptable practice in paragraph (b)(2) of appendix A, for a cash-settled equity index SFP on an equity 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.[122] As with 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.

The Commission is adopting Commission regulation 41.25(b)(3)(iii) and its associated guidance and acceptable practices as proposed. For setting levels of limits on an SFP comprised of more than one security, existing 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 did not propose to retain those criteria for setting levels of limits for cash-settled equity index SFPs. 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. 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. For example, suppose a price weighted index has a component with a high price and a large number of shares outstanding, but a low trading volume. Specifically, this stock has the lowest trading volume in this index. If trading volume is used to establish the position limit for an SFP based on this index, then the position limit would be excessively restrictive because this specific component with a high index weight and low trading volume would force such a tight position limit to ensure that a trader could not attain a notional position in this stock that is in excess of a position limit that would apply to an SFP on that stock. 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.

2. Debt SFPs—Commission Regulation 41.25(b)(3)(iv)

Although no DCM currently lists for trading SFPs based on one or more debt securities, the Proposal provided that if a DCM listed such SFPs, the DCM must adopt a position limit level and offered relevant guidance.[123] The Proposal provided 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.[124] Similarly, the Proposal provided guidance that an appropriate level for limits on an index composed of debt securities generally should be set based on the component debt security with the lowest estimated deliverable supply.[125] The Commission invited comment on whether a level based on par value is appropriate, or whether some other metric would be appropriate.[126] The Commission received no comments on this question.

The Commission is adopting Commission regulation 41.25(b)(3)(iv) and the associated guidance as proposed. 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.

The Commission is adopting this approach as guidance because there may be other reasonable bases for setting position limits for debt SFPs, 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. The Commission elected not to apply the criteria of trading volume and shares outstanding 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.

E. General Requirements

1. Time Period During Which Position Limits Must Be Effective

The Commission proposed to maintain the requirement that position limits and position accountability levels be applied during a period of time no shorter than the last five trading days in an expiring contract month.[127] The Commission also proposed a new requirement that position limits become effective no later than the first day that long position holders may be assigned delivery notices in the event that the terms of an SFP provided for delivery prior to the last five trading days.[128]

OneChicago believes positions limits should only be in effect on the expiration day, because its experience has been that the short side is always pre-hedged and prepared to go through delivery, and the long side simply needs money to pay for delivery at its brokerage firm. The Exchange stated, ''All FCM customers roll their positions forward or extinguish the positions prior to expiration as taking delivery of securities, while theoretically possible, is not practical and the FCM [sic] make the process uneconomical for the customers.'' [129]

The Commission is amending the existing provision in Commission regulation 41.25(a)(3) that requires position limits to be applied in an expiring contract month for at least the last five trading days of the contract month. Specifically, the Commission is decreasing the time during which position limits must be in effect to at least the last three trading days of the contract month. However, Commission regulation 41.25(b)(3) of the final rule nevertheless requires position limits be in effect for a period longer than three trading days in the event that the terms of an SFP provide for delivery prior to

[121] *Id.*

[122] *Id.*

[123] The requirements for a security underlying an SFP permit the listing of SFPs on debt securities (other than exempted securities). *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 (Jul. 13, 2006) (describing debt securities to include ''notes, bonds, debentures, or evidences of indebtedness''). 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.

[124] Proposal at 36807–08 and 14.

[125] Proposal at 36814.

[126] Proposal at 36808.

[127] Proposal at 36806 and 13.

[128] *Id.*

[129] OneChicago Letter at 6.

the last three trading days.[130] For example, if a DCM's rules provide for delivery notices to be assigned to long traders beginning on the first day of the contract month, then a position limit would have to be in effect no later than the trading day prior to the first day of the delivery month.

The Commission notes that other DCMs have experience in applying spot month position limits to the last few days of trading, where delivery occurs after the close of trading on the last trading day.[131] The Commission has noted that in its experience with surveillance of futures markets, the potential for manipulation and price distortion based on extraordinarily large positions is highest during the time period near contract expirations.[132] The Commission required position limits on SFPs during the last five trading days when settlement of security transactions was on a T+3 basis. This provided a two day buffer during which short hedgers could acquire shares in the underlying market to make delivery. Currently, settlement of security transactions in the underlying market occurs on a T+2 basis. The Commission notes that the two-day buffer may be longer than is necessary to prevent market distortions caused by extraordinarily large positions and believes that a one-day buffer is adequate. Therefore, the Commission believes that positions limits that are in effect during the last three days of trading should be sufficient to minimize potential distortion if traders need to acquire securities in order to deliver on an expiring SFP.

The time period during which position limits are in effect for SFPs need not be consistent with that of position limits on security options, which are in effect at all times, because security options typically have American-style exercise provisions and can be exercised at any time prior to expiration. The unanticipated need to acquire securities to make delivery on an exercised security option, therefore, does not exist with SFPs. For the reasons noted above, the Commission is decreasing to three days from five days the period during which SFP position limits will be in effect.

[130] Currently, there are no SFPs that allow delivery prior to the last trading day.

[131] For example, position limits for NYMEX's WTI Crude Oil and Natural Gas futures contracts are in effect during the last three days of trading. Delivery on those contracts occurs after expiration.

[132] *See* 2001 Final SFP Rules at 55082.

2. Applying Position Limits and Accountability Levels on a Net and Gross Basis

The Proposal generally allowed DCMs the discretion to apply position limits and position accountability levels on either a net, as under existing regulations, or a gross (''same side of the market'') basis.[133] 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. The Proposal provided, however, that if a DCM lists both physically-delivered contracts and cash-settled contracts in the same security, it may not permit netting of positions in the physically-delivered contract with that of the cash-settled contract for purposes of determining compliance with position limits.[134]

OneChicago did not support the use of gross position limits for SSFs. The Exchange noted that it does not permit a customer to hold both a long and short SSF with the same symbol and expiration, making the application of this proposed rule meaningless under the Exchange's rules.[135]

The Exchange believes cash-settled and physically-delivered SFPs on the same underlying security should be combined for the same expiration date for purposes of position limits.[136] The Exchange agrees with the proposal to expand the limits for physically-delivered contracts, but believes that cash-settled contracts pose a greater danger of manipulation on the closing price of the underlying security and should be constrained at the position limit levels that are currently in force.[137] The Exchange noted that with physical settlement, a long position holder taking delivery, in an attempt to manipulate the underlying security price upwards, would take delivery at an artificial price ''which should correct the next day.'' [138] The Exchange noted that with cash settlement, a long holder attempting to manipulate the underlying security price, does not take delivery at an artificial price, but collects profits through variation margin based on a higher artificial price.[139] According to the Exchange, this difference between physical delivery and cash settlement produces an incentive to attempt a distortion in the price of the underlying market.[140]

[133] Proposal at 36803 and 12.

[134] Proposal at 36802, 03–04, and 13.

[135] OneChicago Letter at 8.

[136] OneChicago Letter at 5.

[137] *Id.*

[138] *Id.*

[139] *Id.*

[140] *Id.*

The Commission is adopting its proposal to give a DCM discretion to apply position limits or position accountability levels either on a net basis, as under current regulations, or on the same side of the market.[141] Under Commission regulation 41.25(b)(3)(vii), if a DCM imposes limits based upon positions 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.

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 position, and, under current regulations, a single position limit applies on a net basis to that net long or net short position. Under the final rule, at the discretion of a DCM, a person's long futures position is subject to the position limit and, separately, a person's short futures position also is subject to the position limit.

Adding this gross basis approach (in addition to net basis) to SFP limits more closely resembles existing limits on security options that apply on the same side of the market per the rules of the NSEs.[142] 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

[141] The Commission notes that, although it did not propose or adopt an aggregation rule to define ''person'' for purposes of SFP position limits, current 17 CFR 150.5(g) addresses aggregation standards for exchange-set position limits. The Commission believes a DCM should have reasonable discretion to set aggregation standards based on a person's control or ownership of SFP positions, including using any aggregation standards used by an NSE in connection with equity options.

[142] 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.

on a net basis, which could reduce the position sizes that may be held without an applicable exemption.

The Commission notes that a DCM need not use this alternative approach. The Commission continues to permit DCMs to apply SFP 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.[143] This is 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.[144] For example, a person should not be permitted to avoid limits by obtaining 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.

3. Requirements for Resetting Position Limit Levels—Commission Regulation 41.25(b)(3)(vi)

The Commission proposed to require a DCM to consider, on at least a semi-annual basis, whether SFP position limits were set at appropriate levels, through consideration of estimated deliverable supply.[145] Under the 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 existing requirement to calculate average daily trading volume on a monthly basis.[146] 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 for that contract. 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.[147]

OneChicago supported the proposal to allow DCMs to recalculate levels of position limits on a semiannual basis, instead of a monthly basis. In this regard, OneChicago noted that in its experience resetting levels monthly provides very little value.[148]

The Commission is adopting Commission regulation 41.25(b)(3)(vi) as proposed. 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 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.

4. Proposed Guidance on Exemptions for Limits

Under the existing SFP rule in Commission regulation 41.25(a)(3)(iii), DCMs are authorized to approve exemptions from SFP position limits, provided the exemptions are consistent with Commission regulation 150.3, which addresses exemptions from Commission-set position limits set forth in Commission regulation 150.2.[149] The Proposal would have deleted Commission regulation 41.25(a)(3)(iii) and created guidance that DCMs may approve exemptions provided they are consistent with either Commission regulations 150.5(d), (e), and (f), which addresses exemptions from exchange-set position limits, or the exemptions of an NSE.[150]

OneChicago did not comment on the Commission's proposed guidance regarding exemptions from SFP position limits, but requested that the Commission give DCMs the authority to exempt spread transactions designed to facilitate the transfer and return of securities as a pure financing trade. On OneChicago, such transactions are called Securities Transfer and Return Spreads (''STARS'').[151] In a OneChicago STARS transaction, the front leg in the spread expires on the date of the OneChicago STARS transaction and the deferred leg in the spread will expire at a distant date. The Exchange noted the expiration of the front leg triggers the transfer of securities for cash on T+1, that is, on the next business day following the trade date. According to the Exchange, the spread transactions are similar to an exchange for physical transaction that results in the transfer of the underlying commodity in exchange for a futures transaction on the other side of the market, but the two parties transfer the underlying security via the SFP rather than crossing the stock themselves.

The Exchange stated that it sees no value in requiring market participants to seek a hedge exemption for the expiring nearby contract in the OneChicago STARS transaction. The Exchange noted its rules allow customers to request an exemption for a position that was established the day before, which, for a OneChicago STARS transaction, would be for a nearby leg that no longer exists. Since the market participant can seek an exemption the day after the OneChicago STARS transaction when the nearby leg would no longer exist, the Exchange views such an exemption request as unnecessary paperwork. OneChicago, therefore, requests that the Commission give DCMs the authority to exempt transactions such as OneChicago STARS transactions from SFP position limits.

The Commission is deleting existing Commission regulation 41.25(a)(3)(iii) and adopting the guidance in paragraph (e) to appendix A as proposed. The Commission also believes that OneChicago's recommendation regarding the OneChicago STARS

[143] 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. 7 U.S.C. 2(a)(1)(D)(i)(VII).

[144] Although no DCM currently lists both physically-delivered SFP 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, 17 CFR 41.25(b)(3)(vii) of the final rule provides 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.

[145] Proposal at 36806–07 and 13.

[146] *Id.*

[147] The Commission also proposed a non-substantive change to the filing requirement whenever a DCM makes such changes to limit levels. While the Proposal provided that changes to limit levels be filed pursuant to the requirements of Commission regulation 41.24, it removed 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.

[148] OneChicago Letter at 8.

[149] Commission regulation 150.2 sets forth speculative position limits for nine agricultural commodities. 17 CFR 150.2.

[150] NSEs permit certain exemptions, including for qualified hedging transactions and for facilitation of orders with customers.

[151] OneChicago Letter at 6.

transactions has merit. In this regard, the nearby short position is a hedged (covered) position that would not require a subsequent acquisition of shares to make delivery. Thus, there is no concern regarding a distortion in the underlying cash market caused by acquiring a large number of shares in a short period of time. Therefore, as long as the DCM is aware that nearby short positions created by transactions such as OneChicago STARS transactions are covered, DCMs may adopt rules that exempt positions created through such transactions from position limits. Moreover, a DCM could exempt positions or portions of a total position created by transactions such as OneChicago STARS transactions while enforcing limits on positions created through outright transactions.

IV. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'') [152] requires federal agencies, in promulgating regulations, to consider whether the rules they issue will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis of the impact on those entities. The final rule generally applies to exchange-set position limits. The final rule permits 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 final rule will 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 purposes of the RFA.[153] The Commission requested comments with respect to the Proposal's RFA discussion and received no comments.

For all these reasons, the Commission believes that the amendments to the SFP position limits regulations will 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 final rule will not have a significant economic impact on a substantial number of small entities.

[152] 5 U.S.C. 601 *et seq.*

[153] *See* Policy Statement and Establishment of Definitions of ''Small Entities'' for Purposes of the Regulatory Flexibility Act, 47 FR 18618, 18619 (Apr. 30, 1982).

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (''PRA'') [154] 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 the amended rule is OMB control number 3038–0059—Security Futures Products.[155] As a general matter, the final rule: (i) Permits a DCM to increase the level of limits; (ii) allows a DCM to change the application of exchange-set limits from a net basis to a gross basis; and (iii) reduces the time during which the position limits are in effect from the last five days of the contract month to the last three days of the contract month. The Commission believes that the final rule will not impose any new information collection requirements that require approval of OMB under the PRA. As such, these final rule amendments do not impose any new burden or any new information collection requirements in addition to those that already exist in connection with filings to list SFPs under Commission regulation 41.23 or to amend exchange rules for SFPs under Commission regulation 41.24.[156]

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.[157] 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.

The CFTC requested comments on the costs and benefits associated with the proposed rule amendments. In particular, the CFTC requested 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. The Commission received comments that indirectly address the costs and benefits of the Proposal. These comments are discussed as relevant below.

2. Economic Baseline

The CFTC's economic baseline for this analysis of the final rule is the SFP position limits rule requirement that was adopted in 2001 and exists today in Commission regulation 41.25(a)(3). 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 not be readily susceptible to manipulation of the price of that SFP or its underlying security. In this connection, Commission regulation 41.25(a)(3) currently states that the DCM shall have rules in place establishing position limits or position accountability procedures for the expiring futures contract month.[158] The 2001 Final SFP Rules also provide criteria for a default level of position limits and criteria that permit a DCM to adopt an exchange rule for position accountability in lieu of position limits.[159] In addition, the 2001 Final SFP Rules permit a DCM to approve exemptions from position limits pursuant to exchange rules that are consistent with Commission regulation 150.3.

The CFTC analyzed the costs and benefits of the final rule 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: (i) A criterion of at least 20 million shares of average daily trading volume, or (ii) criteria of at least 15 million shares of average daily trading volume and more than 40

[154] 44 U.S.C. 3501 *et seq.*

[155] 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).

[156] 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 (Jul. 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).

[157] 7 U.S.C. 19(a).

[158] 17 CFR 41.25(a)(3).

[159] 17 CFR 41.25(a)(3).

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. The current regulation specifies that the six-month average daily trading volume in the underlying security be calculated at least monthly and applies limits to positions held during the last five trading days of an expiring contract month.

3. Summary of the Final Rule

For equity SFPs, the final rule increases the default position limit level from 13,500 (100-share) contracts to 25,000 (100-share) contracts and permits a DCM to establish a position limit level higher than 25,000 (100-share) contracts based on the estimated deliverable supply of the underlying security. The final rule provides guidance on estimating delivery supply, and in connection with this change, requires a DCM to estimate deliverable supply at least semi-annually, rather than calculating the six-month average daily trading volume at least monthly.

Also for equity SFPs, the final rule changes the criteria that permit a DCM to adopt an exchange rule for position accountability in lieu of position limits. Under the final rule, for a DCM to adopt an exchange rule for position accountability in lieu of position limits, the underlying security must have an estimated deliverable supply of more than 40 million shares and a total trading volume of more than 2.5 billion shares over a six-month period.

For physically-delivered basket equity SFPs, the final rule, in addition to requiring a position limit, specifies that the position limit be based on the underlying security in the index with the lowest estimated deliverable supply. The final rule also clarifies that an appropriate adjustment must 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 final rule requires a position limit and provides guidance that a DCM may set the limit level to that of a similar narrow-based security index equity option. The final rule also provides guidance and an acceptable practice, which sets forth a safe harbor whereby a DCM itself may establish such a limit level.

For SFPs in debt securities, the final rule establishes a requirement that a DCM must adopt a position limit either net or on the same side of the market, and provides 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.

The final rule shortens the time period during which position limits must be in effect from the last five trading days to the last three trading days. The final rule also establishes 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 three trading days, where the SFP permits delivery notices to be sent to long traders before the termination of trading.

The final rule provides 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.[160]

The final rule establishes guidance that a DCM may adopt an exchange rule for position accountability in addition to an exchange rule for a position limit.

The final rule amends the guidance for exemptions from SFP position limits by changing the reference to CFTC regulation 150.3, regarding exemptions to federal position limits, to CFTC regulation 150.5, regarding exchange-set limits. The final rule also adds guidance for exemptions from SFP position limits to permit a DCM to provide exemptions consistent with those of an NSE regarding securities options position limits or exercise limits.

The final rule amends the requirements for resetting levels of SFP 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 if the data no longer justify a higher limit level. The final rule also makes clear that a DCM must adopt a position limit for an SFP if data no longer justify an exchange rule for position accountability in lieu of a position limit. The final rule continues to permit a DCM to use discretion as to whether to increase the level of a position limit for an SFP if the data justify a higher level.

The final rule establishes a general definition of estimated deliverable supply, consistent with the guidance on estimating deliverable supply in appendix C to part 38 of the Commission's regulations, and provides guidance on estimating deliverable supply that is specific to an SFP.

Lastly, the final rule establishes a definition of ''estimated deliverable supply,'' which reflects the general definition of deliverable supply in the Commission's appendix C to part 38, paragraph (b)(1)(i),[161] and ''same side of the market,'' for clarity regarding the application of the final rule's limit levels on a gross basis. This definition of ''same side of the market'' distinguishes long positions for an SFP in the same security from short positions in an SFP in the same security.[162]

4. Costs

As a general matter, the Commission believes that the final rule will reduce costs relative to existing Commission regulation 41.25(a)(3),[163] since the final rule will likely reduce the need for and number of hedge exemption requests (as discussed in the benefits section, below) and the frequency of required DCM reviews of SFP position limits from monthly to semi-annually. Under the final rule, DCMs that list SFPs for trading will continue to be required to adopt position limits or position accountability, but the final rule is expected to generally increase the levels of any such position limits. The Commission recognizes that the final rule will impose certain compliance, monitoring and implementation costs on such DCMs in connection with establishing new position limits or position accountability trigger levels based on deliverable supply and such additional criteria that the listing DCM determines to be appropriate. Such costs might include those related to the monitoring of positions in the SFP and related underlying security; related filing, reporting, and recordkeeping requirements; and the costs of changes to information technology systems. The Commission believes that these costs will be incremental and are mitigated because DCMs currently are required to comply with comparable requirements such as calculating average daily trading volume.

However, the Commission notes that these costs will now be incurred only on a semi-annual basis rather than monthly

[160] In this regard, OneChicago permits the holding of concurrent long and short positions. *See* OneChicago exchange rule 424, *available at https://www.onechicago.com/wp-content/uploads/content/OneChicago_Current_Rulebook.pdf.*

[161] *See* 17 CFR part 38 appendix C.

[162] 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).

[163] Re-designated under the proposal as 17 CFR 41.25(b)(3).

as is the case under current regulations. The Commission believes that DCMs will be able to exercise a certain degree of control over the extent of these costs depending on the amount of standardization such DCMs use to determine position limits and accountability. For example, a DCM could, consistent with the final rule, adopt a simple rule for equity SFPs based on the number of free-float outstanding shares of the underlying security. For equity securities, free-float information is readily available on certain publicly-available market websites and on Bloomberg terminals and similar services to which DCMs are likely to have access 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 will not be more costly, and likely will be less costly, than estimating average daily trading volume as required under current regulations.

The Commission notes that under the final rule, DCMs have the discretion to implement the default position limit of 25,000 contracts, 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 limits at necessary and appropriate levels to deter manipulation) and by Core Principle 3 (which requires that DCMs only list contracts that are not readily susceptible to manipulation). To the extent that DCMs comply with these core principles, any such discretion regarding the setting of position limits should not impair the protection of market participants and the public or otherwise impose significant costs on the markets for SFPs or related securities.

To the extent that a DCM lists equity SFPs on deliverable baskets, the costs of implementing the amended position limit provisions for such SFPs would be similar to the costs of the analogous provisions for single stock SFPs. As compared to the existing rule, there is likely to be a small incremental cost to DCMs because a DCM would be required to apply a position limit or position accountability rule based on the security in the basket with the lowest estimated deliverable supply rather than the existing lowest average daily trading volume. The determination of estimated deliverable supply is expected to take more time and effort since it is not merely a formulaic number like ''average daily trading volume'' but instead may require additional subjective analysis. However, since DCMs do not currently list and trade any equity SFPs on deliverable baskets there will be no additional costs associated with the final rule at this time.

For a DCM that may list SFPs on debt securities, the final rule is expected to provide an incremental increase in costs as compared to the existing regulation. Under the current regulation, a DCM is permitted to list an SFP based on a debt security, however, the existing regulation does not specify the position limit or position accountability requirements for SFPs on debt securities largely due to the focus in the existing requirements on equity securities. As a result, a DCM could under the final rule set position limits or position accountability rules for SFPs on a single debt security based on the guideline of 12.5 percent of the par value of the estimated deliverable supply or for a basket of debt securities based on 12.5 percent of the par value of the debt security with the lowest estimated deliverable supply. However, a DCM could, if it has a reasonable basis, adopt a different approach for SFPs based on debt securities. The cost for DCMs applying this position limit framework will be mitigated by the systems currently in place for equity securities and the fact that DCMs do not currently list any SFPs on a single debt security or basket of 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 SFPs 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 SFPs on debt securities must have position limits. Although DCMs have not listed debt security SFPs to date, absent the 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 final rule for SFPs on debt securities would be otherwise similar to the costs of the final rule for equity SFPs.

The rule permitting 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) will not require DCMs to change their current practice, and therefore will not impose new costs on DCMs. Any change that imposes new costs on market participants would be made at the discretion of the DCM (as constrained by DCM Core Principles).

The reduction in the time period during which position limits must be in effect from five to three days imposes no additional costs on DCMs, and the Commission believes the implementation costs for DCMs will be low. This change merely delays by two days the need for a hedger to apply for a hedge exemption and the DCM to process that hedge exemption request, if necessary. The establishment in the final rule of 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 three 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 final rule 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 this rule.

The Commission does not believe that the final rule will impose any significant additional costs or burdens to the market or to market participants. The final rule is likely to impose incremental additional costs on market participants related to compliance, monitoring, and implementation. As noted above for DCMs, these costs may include the monitoring of positions in the SFP and related underlying security; related filing, reporting, and recordkeeping requirements; and the costs of changes to information technology systems. It is likely that these additional costs of the rule will be significantly mitigated because market participants that currently engage in the SFP market are required to comply with existing comparable requirements.

DCMs that list SFPs may adopt position limits that are either equivalent to the default level for security options (*i.e.,* 25,000 100-share contracts) or proportional to estimated deliverable supply. Although the final rule likely will result in position limits for SFPs that are higher than current limits and only require those limits during fewer days of the contract period, the

Commission does not believe these changes will lead to excessive speculation or have an adverse effect on market integrity because the Commission's reporting requirements will provide the Commission with sufficient visibility of positions that are larger than the reporting levels. In this respect, the Commission's large trader reporting rules require FCMs to report to the Commission all positions greater than 1,000 contracts for SFPs based on a single equity and 200 contracts for SFPs based on a narrow-based security index.[164]

5. Benefits

The Commission from time-to-time reviews its regulations to help ensure they keep pace with technological developments and industry trends, and to reduce regulatory burden where needed. The final rule will provide to DCMs greater flexibility to adopt SFP position limits that they deem to be appropriate while not having an adverse effect on market integrity. In this respect, the Commission believes that DCMs will adopt position limits that are large enough not to significantly inhibit liquidity, but also appropriate to mitigate potential manipulations and other concerns that may be associated with overly large positions in SFPs in line with the Core Principles. Moreover, to the extent that the final rule would lead to position limits that are higher than current position limits, the final rule could alleviate the costs to hedgers of filing hedge exemption requests for positions that are larger than a current position limit, but lower than a new position limit under the final rule. The Commission notes, however, that, based on an analysis by Commission staff, there do not appear to have been any positions in SFPs during calendar year 2018 that exceeded current position limits, although there were some SFP positions in 2017 that did exceed current position limits.[165] The Commission also notes that higher limits could lead to increased trading activity that could improve liquidity in the SFP markets.

The Commission believes that the provision requiring DCMs to set position limits and accountability based on deliverable supply estimates calculated no less frequently than semi-annually 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. OneChicago supported this aspect of the proposal, noting that resetting position limits on a monthly basis as required by current rules provides very little value.[166]

The final rule permits 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) and gives DCMs the discretion to choose the alternative they deem appropriate as constrained by DCM core principles, meaning DCMs are unlikely to alter their position limit rules in this regard unless they determine doing so would be beneficial.

The final rule establishes 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 three trading days, where the SFP permits delivery before the close of trading. This provision will ensure that such contracts are subject to appropriate position limits or position accountability during the entire delivery period. Although DCMs do not currently list for trading SFPs of this nature, any future listings would benefit from this change. Reducing the minimum position time limit period from the last five trading days to the last three trading days, while also likely raising limits levels for SFPs, may also reduce monitoring and compliance costs for traders.

6. CEA Section 15(a) Factors

i. Protection of Market Participants and the Public

The Commission believes that the final rule maintains the protection of market participants and the public provided by the current regulation. The final rule 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 position accountability to deliverable supply for equity securities that have an estimated deliverable supply of more than 20 million shares 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. While DCMs will have the discretion to implement the default position limit of 25,000 contracts regardless of deliverable supply, and this may result in position limit levels in some contracts greater than 12.5 percent of deliverable supply, DCMs continue to be required to comply with core principle 3, which states that DCMs shall only list contracts for trading that are not readily susceptible to manipulation, and core principle 5, which requires that positon limits and accountability be set at levels that reduce the threat of manipulation or congestion.

As noted above, DCMs that list other commodity futures contracts providing for delivery after the termination of trading have adopted position limits during the last few days of trading. These DCMs have demonstrated that the underlying cash market and market participants can be protected from congestion and squeezes entering the delivery period for these contracts. Likewise, the Commission believes that the underlying equities market and market participants also can continue to be protected from market manipulation and other distortions after decreasing to three days the time period during which position limits are in effect prior to the termination of trading.

ii. Efficiency, Competitiveness, and Financial Integrity of Markets

As discussed above, it is reasonable to anticipate that many or most SFPs will be subject to higher position limits under the final rule 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 a 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

[164] *See* 17 CFR 15.03. The Commission did not propose to amend, and is not amending, the reporting levels.

[165] As noted in the NPRM, 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 that exceeded current position limits (and which appear to have been eligible for a hedge exemption). If the new default position limit of 25,000 contracts had been in effect in 2017, most of these positions would have been below the default position limit. For this adopting release, Commission staff reviewed the largest positions in SFPs that were held during the calendar year 2018 and found no positions during that year that exceeded current position limits during the last five trading days of a contract month.

[166] OneChicago Letter at 8.

thus improve the liquidity and pricing efficiency of the SFP market.

The current position limit regulation for SFPs (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 final rule raises the default limit level in equity SFPs to match that for security options. More closely aligning the position limits in SFPs to those in securities options may help to enhance the competitiveness of the SFP market relative to the security options market.

iii. Price Discovery

The Commission believes that price discovery occurs in the liquid and 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 encourage potential hedgers or other risk managers to use security options rather than SFPs because of burdens associated with the SFP's 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 final rule 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.

v. Other Public Interest Considerations

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

7. Consideration of Alternatives

The Commission considered the various alternatives put forth in comments. These considerations are discussed in this section. The Commission notes as a general matter that while SFPs are commonly used for securities lending transactions that are eligible for hedge exemptions, SFPs could be used for speculation in the future and that Core Principle 5 requires speculative position limits or accountability as appropriate.

OneChicago stated that position limits should only be in effect on expiration day rather than the last five trading days as under current rules and under the proposed rules.[167] OneChicago argued that position limits before expiration are not necessary because OneChicago's traders are pre-hedged and prepared to go to delivery or have rolled over positions. The Commission notes that the transactions described by OneChicago would be eligible for hedge exemptions. The Commission believes that any speculative positions that may arise in SFP markets should be subject to speculative position limits before expiration because such limits would provide the benefit of ensuring that large speculative positions can be wound down in an orderly manner. Additionally, the Commission is reducing in the final rule the applicability of speculative position limits to the last three days of trading rather than the last five days, which may reduce compliance costs for traders.

OneChicago also stated that the Commission should authorize position accountability for all SFPs on ETFs and stated that estimated deliverable supply and trading volume are unsuitable metrics for ETFs because authorized participants can increase or decrease the number of shares.[168] The Commission believes that there likely are benefits in certain instances to implementing position limits on ETF SFPs and that authorized participants may not be able to adjust the number of shares quickly enough to affect the susceptibility of an ETF SFP to manipulation. The Commission notes that exchanges can implement position accountability on ETFs where the underlying security meets the volume and deliverable supply requirements discussed above.

OneChicago also recommended that position limits be set based on 25 percent of estimated deliverable supply, as opposed to the 12.5 percent proposed by the Commission because, in the Exchange's view, there is no justification for a lower level, other than the misconception that SFPs and security options compete.[169] While the Commission understands from OneChicago that SFPs are commonly used for securities lending agreements and security options are not, both security options and SFPs could be used for speculation. Thus, a combined position limit of about 25 percent of deliverable supply for SFPs and security options on the same security may provide a similar benefit of protecting against manipulation as is provided in futures contracts on other commodities.

The Commission invited comment on whether to adopt a rule that would permit DCMs to adopt position limits equivalent to the level of corresponding security option position limits on the same security.[170] OneChicago objected to this proposal because OneChicago believes that SFPs and security options should not be regulated similarly.[171] Although the Commission believes that this alternative method for setting position limits would provide DCMs flexibility in setting position limits and would be easier and less costly than estimating deliverable supply, the Commission is not adopting this proposal. In this regard, the only DCM that currently lists SFPs objected to this alternative, and as noted in the Proposal, the Commission views position limits on security options that are based on trading volume as inconsistent with existing Commission policy regarding use of estimated deliverable supply to support position limits in an expiring contract month.[172]

OneChicago opined that the current position limit framework is ''sufficient to give innovators a clear view of regulation in the SSF marketplace,'' and that issuing regulations for SFPs that currently are not listed for trading ''would risk stifling innovation.''[173] The Commission believes that the frameworks for position limits in SFPs on deliverable equity baskets and debt securities (all based on deliverable supply estimates) in the final rule will help ensure that such products, if they are listed for trading, are reasonably protected from manipulation. Further, the Commission believes that the final rule may help foster position limits consistent with those in analogous securities options (where applicable).

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

[167] OneChicago Letter at 6.

[168] OneChicago Letter at 7.

[169] OneChicago Letter at 8.

[170] Proposal at 36805.

[171] OneChicago Letter at 8.

[172] Proposal at 36805.

[173] OneChicago Letter at 9.

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.[174]

The Commission has determined that the final rule is not anticompetitive and has no anticompetitive effects. In the Proposal, the Commission requested comment on whether there are less anticompetitive means of achieving the relevant purposes of the CEA that would further the objective of the Proposal, such as leveling the regulatory playing field between SFPs and security options listed on NSEs. As noted above, OneChicago argued that it is not appropriate to regulate derivatives containing optionality similarly to derivatives not containing optionality. The Exchange noted different regulation of Delta One derivatives traded on a DCM and Delta One derivatives traded overseas or OTC creates an uneven playing field. The Commission notes, however, that given the statutory constraints that require similar regulation of SFPs and security options, discussed above, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA.

List of Subjects in 17 CFR Part 41

Brokers, Position accountability, Position limits, Reporting and recordkeeping requirements, Securities, Security futures products.

For the reasons discussed in the preamble, the Commodity Futures Trading Commission amends 17 CFR part 41 as follows:

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. Amend § 41.25 as follows:

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

■ b. Add a new paragraph (a); and

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

The addition and revisions read as follows:

[174] 7 U.S.C. 19(b).

§ 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 three 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 three 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 in lieu of a position limit, either net or on the same side of the market, applicable to positions held during the last three 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 three 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 three 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 paragraph (b) of appendix A to 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 three trading days of an expiring contract month. For guidance on setting limits for a debt security futures product, designated contract markets may refer to paragraph (c) of appendix A to 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 three trading days of an expiring contract month.

(vi) *Requirements for resetting 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 (e) shall not operate as an exemption from any Securities and Exchange Commission rule. 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 narrow-based 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 § 41.25. 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 September 17, 2019, by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

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

Appendix to Position Limits and Position Accountability for Security Futures Products—Commission Voting Summary

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

[FR Doc. 2019–20476 Filed 9–26–19; 8:45 am]

BILLING CODE 6351–01–P

DEPARTMENT OF TRANSPORTATION

Federal Highway Administration

23 CFR Part 635

[FHWA Docket No. FHWA–2018–0036]

RIN 2125–AF84

Construction and Maintenance—Promoting Innovation in Use of Patented and Proprietary Products

AGENCY: Federal Highway Administration (FHWA), U.S. Department of Transportation (DOT).

ACTION: Final rule.

SUMMARY: The FHWA is revising its regulations to provide greater flexibility for States to use proprietary or patented materials in Federal-aid highway projects. This final rule rescinds the requirements limiting the use of Federal funds in paying for patented or proprietary materials, specifications, or processes specified in project plans and specifications, thus encouraging innovation in transportation technology and methods.

DATES: This final rule is effective October 28, 2019.

FOR FURTHER INFORMATION CONTACT: Mr. John Huyer, Office of Preconstruction, Construction, and Pavements, (720) 437–0515, or Mr. William Winne, Office of the Chief Counsel, (202) 366–1397, Federal Highway Administration, 1200 New Jersey Avenue SE, Washington, DC 20590. Office hours are from 8 a.m. to 4:30 p.m., e.t., Monday through Friday, except Federal holidays.

SUPPLEMENTARY INFORMATION:

Electronic Access and Filing

This document, the notice of proposed rulemaking (NPRM), supporting materials, and all comments received may be viewed online through the Federal eRulemaking portal at *http://www.regulations.gov.* An electronic copy of this document may also be downloaded from the Office of the Federal Register's home page at: *http://www.archives.gov/federal-register* and the Government Publishing Office's web page at: *http://www.gpo.gov/fdsys.*

Executive Summary

The FHWA is revising its regulations at 23 CFR 635.411 to provide greater flexibility for States to use patented or proprietary materials in Federal-aid highway projects. Based on a century-old Federal requirement, the outdated requirements in 23 CFR 635.411(a)–(e) are being rescinded to encourage innovation in the development of highway transportation technology and methods. As a result, State Departments of Transportation (State DOTs) will no longer be required to provide certifications, make public interest findings, or develop research or experimental work plans to use patented or proprietary products in Federal-aid projects. Federal funds participation will no longer be restricted when State DOTs specify a trade name for approval in Federal-aid contracts. In addition, Federal-aid participation will no longer be restricted when a State DOT specifies patented or proprietary materials in design-build Request-for-Proposal documents.

Background

The FHWA published an NPRM titled ''Construction and Maintenance—Promoting Innovation in Use of Patented and Proprietary Products'' at 83 FR 56758 on November 14, 2018. The NPRM offered two alternative deregulatory options relating to the use of patented and proprietary products. The use of these products has been limited by regulation for over a century (since 1916), and FHWA undertook this rulemaking in an effort to increase innovation and reduce regulatory burdens. The first option (Option 1) proposed removing the requirements of 23 CFR 635.411(a)–(e) and replacing them with a general certification requirement ensuring competition in the selection of materials and products. Alternatively, the second option (Option 2) proposed to rescind the patented and proprietary materials requirements of 23 CFR 635.411(a)–(e) and change the title of section 635.411 to ''Culvert and Storm Sewer Materials Types.'' Under its new title, the former paragraph (f) of section 635.411 would be retained to fulfill the mandate of section 1525 of the Moving Ahead for Progress in the 21st Century Act (MAP–21) (Pub. L. 112–141, 126 Stat. 405, July 6, 2012) for States to retain autonomy for the selection of storm sewer material types.

The NPRM solicited comments regarding this deregulatory initiative. The FHWA received 107 comments to the docket, including comments from 16 State DOTs, 14 associations, 22 manufacturers or suppliers, 4 construction companies, and numerous individuals. The FHWA considered all comments received before the close of business on the comment closing date, and the comments are available for examination in the docket (FHWA–2018–0036) at *http://www.regulations.gov.* The FHWA also considered comments received after the comment closing date and filed in the docket prior to this final rule.

Discussion of Comments

After consideration of the comments, FHWA selected Option 2 for the reasons summarized below. Option 2 reduces the regulatory burden on the States, fosters innovation in highway transportation technology, and provides greater flexibility for State DOTs in making materials and product selections in planning Federal-aid highway projects.

Reducing Regulatory Burdens

Commenters argued Option 2 (rescinding the patented and proprietary materials requirements) better serves the purpose of decreasing unnecessary regulatory burdens on the States. These commenters argue Option 2 eliminates unnecessary regulatory and administrative burdens imposed by the existing regulations. Commenters who support Option 2 further argued that if an objective of the NPRM is to reduce regulatory and administrative burdens imposed on the States by the existing regulation, those burdens should not be replaced by new ones as proposed under Option 1 (replacing existing regulations with a general certification requirement). For example, the American Association of State Highway and Transportation Officials (AASHTO) commented that about half of its member State DOTs consider the paperwork required under the current regulation to be difficult and lengthy. Several State DOTs reported difficulty in: (1) Proving to FHWA Division Offices the availability or non-availability of competitive products; (2) providing the benefit of using one