

CFTC BEGINS DESIGNATING SIGNIFICANT PRICE DISCOVERY CONTRACTS

In 2008, Congress gave the Commodity Futures Trading Commission additional authority over certain contracts traded on exempt commercial markets (“ECMs”). Generally, contracts traded on a principal-to-principal basis in “exempt commodities”¹ between eligible commercial entities on ECMs (and ECMs themselves) are exempt from substantive CFTC regulation. If, however, the CFTC determines that a contract traded on an ECM performs a “significant price discovery function,” the contract will be deemed to be a “significant price discovery contract” (an “SPDC”) and the ECM will become subject to certain regulatory requirements with respect to that contract.²

CFTC Rule 36.3(c)(3) sets forth the notice and comment procedure by which the CFTC will determine whether a contract traded on an ECM is an SPDC. The CFTC will consider, among other things, the contract’s volume and liquidity, its potential for arbitrage with contracts traded on designated contract markets and the use of the contract’s prices to price or settle other transactions.

If the CFTC determines that a contract trading on an ECM is an SPDC, the ECM must comply with nine “core principles” with respect to that contract. These principles require the ECM to perform self-regulatory functions and to: (i) list only those SPDCs that are not readily susceptible to manipulation; (ii) monitor trading to prevent market manipulation, price distortion and disruptions of the delivery or cash-settlement process; (iii) establish rules that ensure the ability of the ECM to obtain any necessary information from market users and provide such information to the CFTC; (iv) adopt position limits or accountability rules for speculators in SPDCs; (v) establish rules granting the ECM emergency authority, including the authority to liquidate open positions and/or suspend trading in SPDCs; (vi) publish daily reports of trading information such as price, trading volume and other trading data relevant to SPDCs; (vii) monitor and enforce compliance with the ECM’s rules that are applicable to SPDCs; (viii) establish rules to minimize and resolve conflicts of interest; and (ix) avoid the adoption of rules that would result in unreasonable restraints on trade or impose any material anticompetitive burden. The ECM must submit to the CFTC, among other things, copies of the ECM’s rules, manuals, guides and documents describing the ECM’s governance structure. The ECM must also certify that each SPDC trading on such ECM complies with the Commodity Exchange Act.

In July 2009, the CFTC designated as an SPDC the Henry Financial LD1 Fixed Price contract, a natural gas contract traded on the IntercontinentalExchange, Inc. Since then, the CFTC has undertaken to review more than forty additional contracts. The vast majority of the CFTC’s reviews thus far were initiated in October 2009.

¹ “Exempt commodities” generally include all commodities except for agricultural commodities and “excluded commodities” (such as currency and interest rate futures contracts and securities indexes) and include energy and metals. 7 U.S.C. § 1a(14) (2006).

² Pursuant to CFTC Rule 36.2(c)(2), the CFTC also has authority to determine that certain contracts traded on exempt boards of trade (“EBOTs”) should be categorized as SPDCs. The CFTC has not yet undertaken to review contracts that trade on EBOTs. If the CFTC were to make a determination that a contract traded on an EBOT is an SPDC, the consequences would be different than for SPDCs traded on ECMs.

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