

CFTC Proposes Further Amended Position Limit Aggregation Rules

Overview

On November 15, 2013, the Commodity Futures Trading Commission (the “CFTC”) published proposed revised aggregation rules for speculative position limits in certain commodity interests (the “Proposed Rules”). The Proposed Rules modify standards for determining when positions held by two or more persons must be aggregated for determining compliance with CFTC position limit rules. The Proposed Rules continue the CFTC’s existing aggregation policy, which generally requires that a person aggregate all positions in accounts for which a person directly or indirectly controls trading or holds a 10% or greater ownership interest. The Proposed Rules retain modified versions of the existing exemptions from the aggregation requirements and create several new exemptions.¹

Most notably, the Proposed Rules would permit any person with an ownership interest of between 10% and 50% (inclusive) in a separately organized entity (an “owned entity”) to claim an exemption from aggregation by a notice filing demonstrating independence in making trading decisions. In addition, the Proposed Rules would permit a person with greater than 50% ownership of an owned entity to apply to the CFTC for relief from aggregation on a case-by-case basis if certain conditions are met. The Proposed Rules would also institute new notice filing requirements for other exemptions from the aggregation requirements. The CFTC is seeking comments on the Proposed Rules until January 14, 2014.

The CFTC had released amended final rules governing speculative position limits on October 26, 2011 (see our [Alert](#)), and subsequently proposed modifications to the aggregation provisions of these final rules on May 30, 2012 (see our [Alert](#)). However, the final rules were vacated in an Order dated September 28, 2012 by the District Court for the District of Columbia.² As a result, if the Proposed Rules, which are similar to the May 30, 2012 proposals, are adopted, they would apply to futures and options on futures on the nine agricultural commodities currently set forth in Part 150 of the CFTC’s Rules.³ The CFTC has separately proposed new position limit rules, not yet published in the Federal Register, which would establish speculative position limits for 28 agricultural, energy and metals futures as well as economically equivalent futures, options and swaps.⁴ When those rules are adopted, the new aggregation rules would apply to those additional instruments as well. The separately proposed position limit rules will be discussed in a forthcoming Alert.

¹ Note that in addition to the CFTC’s speculative position limits, the exchanges also set speculative position limits. If the CFTC’s separately proposed new position limit rules (discussed below) are adopted, exchanges will be required to have aggregation rules that conform to the CFTC’s final aggregation rules.

² See *International Swaps and Derivatives Association v. United States Commodity Futures Trading Commission*, 887 F. Supp. 2d 259 (D.D.C. 2012).

³ Chicago Board of Trade: Corn and Mini-Corn, Oats, Soybeans and Mini-Soybeans, Wheat and Mini-Wheat, Soybean Oil, Soybean Meal; Minneapolis Grain Exchange: Hard Red Spring Wheat; New York Board of Trade: Cotton No. 2; Kansas City Board of Trade: Hard Winter Wheat.

⁴ Chicago Board of Trade: Corn, Oats, Rough Rice, Soybeans, Soybean Meal, Soybean Oil and Wheat; Chicago Mercantile Exchange Feeder Cattle, Lean Hog, Live Cattle and Class III Milk; Commodity Exchange, Inc. Gold, Silver and Copper; ICE Futures U.S. Cocoa, Coffee C, FCOJ-A, Cotton No. 2, Sugar No. 11 and Sugar No. 16; Kansas City Board of Trade Hard Winter Wheat; Minneapolis Grain Exchange Hard Red Spring Wheat; and New York Mercantile Exchange Palladium, Platinum, Light Sweet Crude Oil, New York Harbor ULSD, RBOB Gasoline, and Henry Hub Natural Gas.

Proposed Exemption from Aggregation Based on Demonstrated Independence

As noted above, the Proposed Rules would permit any person with an ownership interest of between 10% and 50% (inclusive) in an owned entity to claim an exemption from aggregation by a notice filing demonstrating independence in making trading decisions. The owned entity could be a financial or a nonfinancial entity that has passive ownership interests.

Under the Proposed Rules, an exemption from aggregation of positions in an owned entity would be available if the following criteria are met:

- The person and the owned entity do not have knowledge of trading decisions of the other. (Knowledge of overall end-of-day position information will not necessarily constitute knowledge of trading decisions, so long as the position information cannot be used to dictate or infer trading strategies; however, the ability to monitor real-time trading could constitute knowledge of trading decisions.)
- The person and the owned entity trade pursuant to separately developed and independent trading systems.
- The person and the owned entity have and enforce written procedures to preclude one entity from having knowledge of, gaining access to, or receiving data about, the trades of the other. Such procedures must include document routing and other procedures or security arrangements, including separate physical locations, which would maintain the independence of their activities.
- The person and the owned entity do not share employees that control trading decisions.
- The person and the owned entity do not have risk management systems that permit the sharing of trades or trading strategies with the other.

The notice filing with the CFTC must describe how the criteria set forth above are met, and must include a certification by a senior officer with knowledge of the contents of the notice. The notice would be effective upon submission to the CFTC; however, the CFTC subsequently could call for additional information as well as reject, modify, or otherwise condition the exemption. The notice filing would be required to be amended in the event of a material change to the circumstances described therein.

In addition, the Proposed Rules include a provision that would permit a person with greater than 50% ownership of an owned entity to apply to the CFTC for relief from aggregation on a case-by-case basis. The person would be required to demonstrate that:

- The owned entity is not required to be, and is not, consolidated on the financial statements of the person;
- The person does not control the trading of the owned entity (based on criteria in the bullet points above), with the person showing that it and the owned entity have procedures in place that are reasonably effective to prevent coordinated trading in spite of the majority ownership;⁵
- Each representative of the person (if any) on the owned entity's board of directors attests that he or she does not control trading of the owned entity; and

⁵ The CFTC notes that since this criterion required a person to certify that the person does not control trading of its owned entity, the criterion could not be met by a natural person or any entity, such as a partnership, where it is not possible to separate knowledge and control of the person from that of the owned entity.

- The person certifies that either (a) all of the owned entity's positions qualify as bona fide hedging transactions or (b) the owned entity's positions that do not so qualify do not exceed 20% of any position limit currently in effect, and the person agrees in either case that:
 - If this certification becomes untrue for the owned entity, the person will aggregate the owned entity for three complete calendar months and if all of the owned entity's positions qualify as bona fide hedging transactions during that time the person would have the opportunity to make the certification again and stop aggregating;
 - Upon any call by the CFTC, the owned entity(ies) will make a filing responsive to the call, reflecting the owned entity's positions and transactions only, at any time (such as when the CFTC believes the owned entities in the aggregate may exceed a visibility level); and
 - The person will provide additional information to the CFTC if any owned entity engages in coordinated activity, short of common control (understanding that if there were common control, the positions of the owned entity(ies) would be aggregated).

Moreover, if a person with greater than 50% ownership of an owned entity did not meet the above conditions, the person could apply for special relief. In any event, however, the Proposed Rules would not impose any time limits on the CFTC's process for making the determination of whether relief is appropriately granted, and relief would be available only if and when the CFTC acted on a particular request for relief.

Finally, the Proposed Rules would provide that if an owned entity has filed a notice claiming an exemption from aggregation, any person with a 10% or greater ownership interest in the owned entity need not file a separate notice for the same positions and accounts, so long as such person does not otherwise control trading of the accounts or positions and such person complies with the conditions applicable to the exemption (other than filing the notice).

Proposed Modifications to Independent Account Controller Exemption

The Proposed Rules would allow managers of employee benefit plans – persons that manage a commodity pool, the operator of which is excluded from registration as a commodity pool operator under Rule 4.5(a)(4) – to be treated as an independent account controller, if the manager files the notice required to be made by independent account controllers.

Persons seeking an aggregation exemption as an independent account controller must file a notice, which will be effective on submission, describing the circumstances warranting disaggregation, and including a statement of a senior officer certifying that the conditions set forth in the exemption have been met. The CFTC subsequently may require information demonstrating compliance.

Proposed Exemption for Ownership Pool Participants

The Proposed Rules would retain the exemption for passive investors in commodity pools who directly or indirectly have a 10% or greater interest in a pool, unless the investor is the commodity pool operator or has a 25% or greater ownership interest in a pool operated under Rule 4.13(a)(3). An investor that is a principal or affiliate of the pool operator and has a 10% or greater interest in a pool can claim an exemption from aggregation by filing a notice demonstrating their independence.

Proposed Exemption Based on Prohibitions on Sharing Information

The Proposed Rules contain an exemption from aggregation where the sharing of information would create a reasonable risk that either person could violate state or federal law or the law of a foreign jurisdiction, or regulations adopted thereunder. As part of the notice filing with the CFTC describing how the criteria set forth above are met and including a certification by a senior officer with knowledge of the contents of the notice, a written memorandum of law (which may be prepared by an employee of the person or its affiliates) which explains the legal basis for determining that information sharing creates a reasonable risk that either person could violate federal, state or foreign law. The memorandum could be prepared in a general manner and may be provided by more than one person in satisfaction of the requirement, as long as it is clear how the risk applies to the person providing the memorandum.

Proposed Exemption Based on Underwriting Activities

The Proposed Rules would provide an exemption from aggregation where an ownership interest is in an unsold allotment of securities in connection with the distribution of such securities by the issuer or an underwriter.

Proposed Exemption for Broker-Dealer Activity

A broker-dealer need not aggregate the positions or accounts of an owned entity if the ownership interest does not exceed 50% and the securities have been acquired in the ordinary course of business as a dealer, so long as the person does not have actual knowledge of the trading decisions of the owned entity.

Exemption for Accounts Held by Futures Commission Merchants

A futures commission merchant (or any affiliate) need not aggregate positions it holds in a discretionary account, or in an account which is part of a customer trading program of a futures commission merchant (or any of the officers, partners, or employees of such futures commission merchant or of its affiliates), if a person other than the futures commission merchant or the affiliate directs trading in such an account; the futures commission merchant or the affiliate maintains only such minimum control over the trading in such an account as is necessary to fulfill its duty to supervise diligently trading in the account; each trading decision of the discretionary account or the customer trading program is determined independently of all trading decisions in other accounts which the futures commission merchant or the affiliate holds, has a financial interest of 10% or more in, or controls; and the futures commission merchant or the affiliate has filed a notice claiming an exemption from aggregation.

No Exemption for Substantially Identical Trading Strategies

Under the Proposed Rules, even if a person qualifies for an exemption from aggregation, the person would nonetheless have to aggregate positions covered by the exemption if the person owns or controls the trading of positions in more than one account or pool with substantially identical trading strategies.

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Please contact [Deborah Monson](#) or the Ropes & Gray attorney who usually advises you with any questions you may have or if you would like additional information.