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Recent CFTC Enforcement Action against Non-U.S. Fund Manager for Violation of U.S. Position Limits Highlights Traps for Unwary

On July 2, 2019, the United States Commodity Futures Trading Commission (“CFTC”) issued an [order](#) (the “Order”) filing and simultaneously settling charges against Elephas Investment Management Limited (“Elephas”), a hedge fund manager located in Hong Kong that is not registered with the CFTC, for violating speculative position limits on wheat futures. A simultaneous [action](#) was brought and settled by the Chicago Board of Trade (“CBOT”). The Order found that Elephas carried into the spot month a futures equivalent net long position of 1,680 December 2017 CBOT soft red winter wheat futures contracts, which exceeded the CFTC and CBOT spot month limit by over 1,000 contracts (180%). Elephas reduced its position below the limit the next day. As a result of the violation, Elephas was ordered to pay a civil monetary penalty to the CFTC of \$160,000, a fine of \$50,000 to the CBOT and a disgorgement of the \$165,590 benefit it received in reduced losses.¹

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The actions against Elephas highlight the traps for unwary asset managers who trade futures, and options thereon, in U.S. markets. Below is a list of some of the key considerations that asset managers should take into account when designing their position limits compliance program to avoid these pitfalls.

- Position limits are applicable to all market participants regardless of whether they are in the U.S. or not, and regardless of whether they are registered with the CFTC or not. By trading on a U.S. exchange, market participants are subject to these limits.
- Futures position limits also apply to options on futures. Options positions must be converted to their futures equivalent positions using a formula established by the exchange on which the contract is listed and aggregated with existing futures positions.
- Position limits may change throughout the life of a contract. In particular, once a contract enters the spot month it may be subject to a limit that is materially lower than the prior limit.
- Position limits may be amended by the CFTC and the exchanges from time to time. The amended limits are published by the CFTC and the exchanges in advance of the effective date.
- The date on which the spot month begins is set on a contract-by-contract basis and may change from month to month.
- Position limit violations are subject to strict liability, so intent is irrelevant, and it is relatively straightforward for regulators to determine that a violation occurred.
- Position limits generally apply to the aggregate of all positions owned or controlled by an asset manager. Subject to certain exceptions, an asset manager must aggregate all positions in accounts or funds for which it directly or indirectly controls trading or holds a 10% or greater ownership interest, as well as those held by any other person with whom it trades pursuant to an express or implied agreement.

¹ Elephas’ loss on the position would have been greater had it reduced its position before entering the spot month. The CBOT therefore ordered Elephas to disgorge the amount by which its loss was reduced as a result of the violation.

- Penalties for position limit violations typically include a fine, which may be assessed by multiple regulators for the same violation, and the disgorgement of any benefit received as a result of the overage, such as any profit or reduction in loss. In addition, the violation will be publicly announced by the regulator(s) that brought the action and published in databases available to the public.

The Elephas action highlights the importance of having a thorough understanding of the applicable rules and how they work, and of having a robust position limit compliance program. Looking forward, asset managers should keep in mind that the [CFTC has proposed](#) to expand the scope of products subject to position limits to include additional futures contracts (and options thereon) as well as certain swaps.

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