

Clients & Friends Memo

CFTC Finalizes Aggregation of Positions Rule

December 5, 2016

On December 5, 2016, the Commodity Futures Trading Commission (“CFTC”) unanimously approved a final rule amending the requirements to aggregate positions subject to a CFTC-set speculative position limit (“**Final Aggregation Rule**”).¹ At present, the CFTC imposes federal position limits on nine agricultural futures contracts. Accordingly, the Final Aggregation Rule applies initially only to the aggregation of positions subject to the CFTC-set position limits for those nine futures contracts.² The Final Aggregation Rule takes effect 60 days after publication in the Federal Register, which should occur within the next two or three weeks.

Separate from the Final Aggregation Rule, the CFTC unanimously re-proposed establishing position limits on 25 futures contracts and economically equivalent swaps (“**CFTC Position Limits Re-proposal**”).³ The CFTC Position Limits Re-proposal includes a 60-day public comment period upon publication in the Federal Register. If and when the CFTC adopts a final position limits rule, the Final Aggregation Rule sets the requirements for aggregating positions subject to any final federal position limits. Below is a summary of the key aspects of the Final Aggregation Rule.

General Aggregation Requirement

The Final Aggregation Rule continues to require market participants to aggregate positions if (1) the positions are commonly controlled;⁴ or (2) a person holds a 10 percent or greater ownership interest in an account or another person who holds a position. Although market participants must aggregate based on common control or ownership, the Final Aggregation Rule establishes various

¹ A copy of the Final Aggregation Rule is available here

<http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/federalregister120516a.pdf>.

² The nine agricultural futures contracts include (1) Chicago Board of Trade (“**CBOT**”) Corn; (2) CBOT Oats; (3) CBOT Soybeans; (4) CBOT Soybean Oil; (5) CBOT Soybean Meal; (6) CBOT Wheat; (7) Minneapolis Grain Exchange Hard Red Spring Wheat; (8) ICE Futures US Cotton No. 2; and (9) Kansas City Board of Trade Hard Winter Wheat.

³ A copy of the CFTC Position Limits Re-proposal is available here

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⁴ Common control also includes market participants who coordinate trading through an express or implied agreement.

exemptions from aggregation based upon ownership in order to make common control of trading the primary driver of the requirement to aggregate positions.

Owned Entity Exemption

The Final Aggregation Rule provides an exemption from aggregation if a market participant holds a 10 percent or greater interest in an owned entity, and the two entities meet certain conditions demonstrating independence of trading (“**Owned Entity Exemption**”).

To qualify for the Owned Entity Exemption, the owner, and the owned entity:

- (1) cannot have knowledge of the trading decisions of the other;
- (2) must trade pursuant to separately developed and independent trading systems;
- (3) must have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about the trades of the other;
- (4) cannot share employees that control trading decisions; and
- (5) cannot have risk management systems that permit the sharing of its trades or trading strategy with employees that control trading.

In order to rely on the Owned Entity Exemption, a market participant must make a notice filing with the CFTC. The exemption from aggregation is effective upon filing the notice.

The Final Aggregation Rule also incorporates additional flexibility for the Owned Entity Exemption that was not available under the proposed version of the same exemption.⁵ First, a market participant only needs to demonstrate compliance with the relevant indicia of independence if the owner and owned entity are aware of, or should be aware of, the activities and practices of the other. The CFTC incorporated this provision to address passive investments where the owner and the owned entity may not know about the derivative activities of the other. Second, if a market participant acquires a new entity, the Final Aggregation Rule provides a 60-day grace period after the acquisition to submit a notice filing for the Owned Entity Exemption. Third, failure to submit a timely notice does not constitute a violation of the CFTC’s position limit rules if the market participant submits the notice within five business days after the person is aware, or should have been aware, that such notice has not been timely filed.

⁵ Compare *Aggregation of Positions*, 80 Fed. Reg. 58365 (Sept. 29, 2015) (supplemental proposal); and *Aggregation, Position Limits for Futures and Swaps*, 78 Fed. Reg. 68946 (Nov. 15, 2013) (collectively “**CFTC Aggregation Proposals**”).

Exemption for Certain FCM Accounts

The Final Aggregation Rule retains the CFTC's existing exemption from aggregation for futures commission merchants ("**FCM**"), or a separately organized affiliate of an FCM, who hold discretionary accounts or manage customer trading programs, provided the FCM meets certain indicia of independence ("**FCM Exemption**"). Although the indicia of independence remain unchanged from prior CFTC rules, the Final Aggregation Rule requires that FCMs (or separately organized affiliates) file a notice to rely on this exemption. Therefore, FCMs (or affiliates) who currently rely on this exemption must submit a notice filing to continue to rely on the exemption before the effective date of the Final Aggregation Rule, *i.e.*, within 60 days after it is published in the Federal Register.

Independent Account Controller Exemption

The Final Aggregation Rule retains the CFTC's existing exemption from aggregation for an eligible entity who delegates the control of a client account to an independent account controller ("**IAC Exemption**"). Similar to the FCM exemption discussed above, the Final Aggregation Rule now includes a notice filing requirement. Accordingly, eligible entities who currently rely on the IAC Exemption must submit a notice filing to continue to rely on the exemption before the effective date of the Final Aggregation Rule.

Broker Dealer and Underwriter Exemptions

The Final Aggregation Rule incorporates a new exemption for a broker-dealer registered with the Securities and Exchange Commission (or similar foreign regulatory authority) for ownership interests acquired in the normal course of business as a dealer ("**Broker-Dealer Exemption**"). In addition, the Final Aggregation Rule includes a new exemption for entities that have an ownership interest in securities constituting an unsold allotment ("**Underwriter Exemption**"). Neither the Broker-Dealer Exemption nor the Underwriter Exemption require a notice filing to rely on the exemption.

Law Information Sharing Restrictions

The Final Aggregation Rule incorporates a new exemption to address scenarios where aggregation of an owned entity creates a reasonable risk that either person could violate state or federal law, or the law of a foreign jurisdiction ("**Law Information Sharing Restriction Exemption**"). To rely on the Law Information Sharing Restriction Exemption, a market participant must file a notice with CFTC, and include within the notice, a written memorandum of law explaining the basis for the conclusion that sharing information would create a reasonable risk of violating state, federal, or foreign law.

Pool Participant Exemption

The Final Aggregation Rule retains an exemption for limited partners, limited members, shareholders, or other similar pool participants (“**Pool Participants**”) from aggregating the positions of a pooled account (“**Pool Participant Exemption**”). However, if any Pool Participants are principals or affiliates of the commodity pool operator managing the pooled account, the pool operator must file a notice on behalf of the principal/affiliate Pool Participants prior to the principal/affiliate Pool Participants relying on the Pool Participant Exemption. Similar to the FCM Exemption and IAC Exemption, in light of the new notice filing requirement, principals and affiliates of a pool operator who currently rely on the Pool Participant exemption must ensure that the pool operator submits a notice filing on behalf of the principal/affiliate in order to continue to rely on the exemption before the effective date of the Final Aggregation Rule.

Conclusion

The Final Aggregation Rule modifies the aggregation rules for the CFTC-set limits on nine agricultural futures contracts. For other contracts currently subject to exchange-set limits, market participants should consult the applicable exchange aggregation rules. The Final Aggregation Rule is substantially similar to the CFTC’s proposed aggregation rule. The main difference is the added flexibility regarding the filing of a notice to rely on certain exemptions from aggregation. Moreover, to the extent that a market participant relies on previously existing exemptions that, under the Final Aggregation Rule, now require a notice filing (e.g., FCM Exemption and IAC Exemption), the participant immediately should begin the process of compiling the information necessary to make a notice filing to the CFTC.

Should you have any questions about this summary please contact Paul J. Pantano, Jr. (paul.pantano@cwt.com); Athena V. Eastwood (Athena.eastwood@cwt.com); or Neal E. Kumar (neal.kumar@cwt.com).