CLIENT UPDATE

CFTC NO-ACTION RELIEF: TEMPORARY RELIEF FROM AGGREGATION REQUIREMENTS OF POSITION LIMITS RULES

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On July 24, 2012, the Commodity Futures Trading Commission (the "CFTC") granted temporary no-action relief from the aggregation requirements of Part 151 of the CFTC regulations (the "Rule"). The Rule establishes position limits for futures and options contracts on 28 exempt and agricultural commodities and the physical commodity swaps that are economically equivalent to such contracts. The Rule became effective on January 17, 2012, but does not require compliance with certain position limits (including all spot-month limits, and non-spot-month limits for legacy contracts) until 60 days after the further definition of the term "swap," as adopted by the CFTC and the Securities and Exchange Commission (the "SEC"), is published in the Federal Register.[1]

The Rule requires a person to aggregate, among other things, accounts or positions in which the person directly or indirectly has a 10% or greater ownership or equity interest (the "10% Aggregation Rule").

On May 18, 2012, in response to a petition seeking relief from, among other things, the aggregation requirements of the Rule, the CFTC proposed rules to provide additional exemptions, and clarify certain existing exemptions, from such requirements (the "Proposed Rule").

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[1] The CFTC and the SEC jointly adopted final rules further defining the term "swap" on July 10, 2012. As of July 27, 2012, the final rules have not yet been published in the Federal Register.

The Proposed Rule would provide relief from the 10% Aggregation Rule where certain conditions are met (the "Owned-Entity Exemption"). Under the Owned-Entity Exemption, a person with an ownership or equity interest in an entity of 50% or less would be permitted to disaggregate the positions of such entity, provided that the person and the entity: (1) do not have knowledge of the trading decisions of the other; (2) trade pursuant to separately developed and independent trading systems; (3) have and enforce written procedures (including document routing and separate physical locations) to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other; and (4) do not share employees that control the trading decisions of either. In order to rely on this exemption, a person would be required to submit a notice filing describing how it adheres to such conditions (including, among other things, an organizational chart reflecting ownership and control structure of the entities and a description of risk management and information-sharing systems) and a statement of a senior officer of the entity certifying that the conditions listed above have been met.

Additionally, the Proposed Rule would expand the exemption provided in section 151.7(i) of the CFTC regulations, which permits disaggregation if the sharing of information in connection with aggregation "would cause either person to violate federal law or regulations." The Rule requires persons relying on this exemption to file an opinion of counsel that sharing information in connection with aggregation would cause such a violation. In response to market participants' concerns that this exemption would be available only if compliance with the aggregation requirements would, as a matter of certainty, result in a violation of federal law, as well as concerns that the Rule does not provide analogous exemptions for information-sharing restrictions imposed by state or foreign law, the Proposed Rule would permit a person to rely on this exemption if it obtains an opinion of counsel that sharing of information in connection with aggregation "creates a reasonable risk that either person could violate state or federal law or the law of a foreign jurisdiction, or regulations adopted thereunder."

Moreover, the Proposed Rule would expand the exemption for underwriting activities, permitting disaggregation by a broker-dealer that would otherwise be required to aggregate the positions of an owned entity if the broker-dealer's ownership "is based on the ownership of securities acquired as part of reasonable activity in the normal course of business as a dealer," provided the broker-dealer does not have actual knowledge of the trading decisions of the entity.

The Proposed Rule would require an entity relying on specified aggregation exemptions to file a notice with the CFTC, which notice would have to include a certification by a senior officer of such entity that the conditions of the relevant exemption are satisfied.

The no-action letter states that, in order to coordinate the disposition of the Proposed Rule with the implementation of the Part 151 position limits, the Division of Market Oversight (the "Division") will not recommend that the CFTC commence an enforcement action against any person that:

- complies with the Rule, as if it were amended to include the Proposed Rule; or
- complies with the Rule, except that the person does not aggregate any positions in Referenced Contracts (as defined in the Rule) held by another entity that the Rule would require to be aggregated with the person's positions, if:
  - the person believes, based on advice of counsel,[2] that information sharing with that entity would result in a reasonable risk of violating federal, state, or foreign law, rule, or regulation;
  - the person has a 50% or lesser ownership or equity interest in that entity and has taken reasonable steps to ensure independence between the person and that entity, which may include, but need not be limited to, compliance with the current standards for independence set forth in section 150.3(a)(4)(i) or 151.7(f)(1) of the CFTC regulations; or
  - the person acquires a 50% or lesser ownership or equity interest in that entity in the normal course of business as a broker-dealer registered with the SEC or similarly registered with a foreign regulatory authority.

A person intending to rely on this no-action relief must file a notice with the Division indicating that it is relying on such relief and stating the names of any entities holding positions that it is not aggregating as provided above. Notices must be emailed to dmonoaction@cftc.gov prior to the date on which the person intends to rely on the relief.

The letter states that this no-action position will remain effective until the earliest of: (1) 60 days after the CFTC issues an order declining to take further action on the Proposed Rule; (2) 60 days after publication in the Federal Register of a rule finalizing changes to the CFTC's aggregation policy; or (3) December 31, 2012.

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July 27, 2012

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[2] In the no-action letter, the CFTC clarifies that, while written advice of counsel is not a *per se* requirement to rely on this no-action relief, the Division will consider the written advice that a market participant has obtained in determining whether the risk of violating federal, state, or foreign law (including a judicial or administrative order) is reasonable.