

Client Update

Final CFTC Rules on Aggregation of Positions

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On December 5, 2016, the Commodity Futures Trading Commission (the “CFTC”) adopted final rules (the “Final Aggregation Rules”)¹ amending the aggregation provisions of Part 150. The Final Aggregation Rules maintain the general aggregation requirement in current Regulation 150.4 (for a person exercising trading control or holding certain ownership or equity interests in positions or accounts), and add an additional aggregation requirement for a person who holds or controls positions in more than one account that employ substantially identical trading strategies. The Final Aggregation Rules also provide a number of exemptions from aggregation requirements.

On the same day, the CFTC issued a new set of proposed rules (the “Proposed Position Limits Rules”) establishing position limits for 25 exempt and agricultural commodity (*i.e.*, “physical commodity”) futures and option contracts, and swaps that are economically equivalent to such contracts. While the Final Aggregation Rules will initially apply only to those futures and option contracts on nine agricultural commodities that are currently subject to the position limits regime in Part 150, the CFTC notes that if the Proposed Position Limits Rules are finalized, the Final Aggregation Rules will also apply to the position limits regime for those futures and option contracts and swaps under the new position limits rules.

The Final Aggregation Rules will be effective 60 days after publication in the Federal Register.

¹ The text of the Final Aggregation Rules is available at:
<http://www.cftc.gov/PressRoom/PressReleases/pr7495-16>.

POSITIONS TO BE AGGREGATED: CONTROL AND OWNERSHIP

General Requirements

The Final Aggregation Rules maintain a long-standing principle that for purposes of applying the position limits, unless an exemption applies, the positions held and trading done by a person must be aggregated with all positions² in accounts for which the person, by power of attorney or otherwise, directly or indirectly (1) controls³ trading or (2) holds a 10% or greater ownership or equity interest.

For this purpose, two or more persons acting pursuant to an express or implied agreement or understanding must be treated as if the positions or ownership or equity interests were held by, or the trading were done or controlled by, a single person. Therefore, for example, if two persons each own an account and agree to trade in a coordinated manner, then each person will be deemed to own the positions held in the other person's account as well as in its own account.

The Final Aggregation Rules require any person that, by power of attorney or otherwise, holds or controls the trading of positions in more than one account or pool with "substantially identical trading strategies" to aggregate all such positions (but on a pro rata basis). This aggregation rule is unique in that (1) it requires aggregation regardless of ownership level; (2) it limits aggregation to the person's pro rata ownership of the relevant accounts and pools; and (3) it is not subject to any exemption permitting disaggregation.

Aggregation by Limited Partners, Shareholders or Other Pool Participants

A person that is a limited partner, limited member, shareholder or other similar type of participant in a pool holding, directly or indirectly, by power of attorney or otherwise, a 10% or greater ownership or equity interest in such pooled account must aggregate the accounts or positions of the pool with its other accounts or positions only if such person:

² The Final Aggregation Rules require that, where an owned entity's position is aggregated with the owner's positions, the entire position of the owned entity be included in determining whether the limits are exceeded (rather than aggregating pro rata based on the equity owner's interest).

³ Control is not defined under the Final Aggregation Rules. Based on a number of CFTC releases, including the 1979 Statement of Aggregation Policy, control will exist if a trader has the authority to make a trading decision on the acquisition or liquidation of a specific position or if a trader has the authority to direct all or a portion of trading for an account even though others make specific trading decisions.

- is the CPO of the pooled account;
- has, by power of attorney or otherwise, directly or indirectly, a 25% or greater ownership or equity interest in a commodity pool, the CPO of which is exempt from registration under Regulation 4.13; or
- is a principal or affiliate of the pool's CPO, unless (where such person is a principal or affiliate of the pool's CPO) the following conditions are met:
 - the CPO has, and enforces, written procedures to preclude the pool participant from having knowledge of, gaining access to or receiving data about the trading or positions of the pool;
 - the pool participant does not have direct, day-to-day supervisory authority or control over the pool's trading decisions;
 - the pool participant, if a principal of the CPO, maintains only such minimum control over the CPO as is consistent with its responsibilities as a principal and necessary to fulfill its duty to supervise the trading activities of the pool; and
 - the CPO has filed a Notice of Exemption with the CFTC.

EXEMPTIONS FROM AGGREGATION

The Final Aggregation Rules include several new exemptions from the aggregation requirement.

Exemption for Information Sharing Restriction

A person need not aggregate the positions or accounts of a separately organized entity (an "owned entity") if the sharing of information associated with such aggregation (including information reflecting the transactions and positions of such person and the owned entity) creates a "reasonable risk" that such person or owned entity could violate state or federal law or the law of a foreign jurisdiction, or regulations adopted thereunder,⁴ so long as such person does not have actual knowledge of such information. This exemption is not available for potential violations of local or international law.

Prior to relying on this exemption, a person must file a Notice of Exemption (as defined below) with the CFTC, along with a written legal memorandum (which may be prepared by an employee of the person or its affiliates) explaining in detail the basis for the conclusion that the information sharing creates such a

⁴ This exemption is not available where the law or regulation "serves as a means to evade the aggregation of accounts or positions."

risk. Where there is a reasonable risk that persons in general could violate a federal, state or foreign law of general applicability, the written legal memorandum may be prepared in a “general manner” (*i.e.*, not specific to the person providing the memorandum, such as a memo commissioned by a trade association), and may be provided by more than one person to satisfy the requirement, so long as it is clear from the memorandum how the risk applies to the person providing the memorandum.

Exemptions for Ownership of Greater than 10% in an Owned Entity

The Final Aggregation Rules establish a notice filing procedure, effective upon submission, to permit a person with either an ownership or an equity interest in an owned entity of more than 10% (other than an interest in a pooled account) to disaggregate the positions of the owned entity in specified circumstances.

In order to qualify for this exemption from the aggregation requirement,⁵ a person holding such an interest in an owned entity (and any other entity such person must aggregate)⁶ and the owned entity (to the extent such person is aware or should be aware⁷ of the activities and practices of the aggregated entity or the owned entity) must:

- not have knowledge⁸ of the trading decisions of the other;
- trade pursuant to separately developed and independent trading systems;⁹

⁵ The CFTC notes that seeking disaggregation relief is only one option for groups of affiliates that may exceed a limit in the aggregate but remain below the limit individually. Another option is adopting procedures to avoid exceeding the limits on an aggregate basis (*e.g.*, assigning each subsidiary of a holding company an internal limit).

⁶ In order for a person to rely on this exemption, the conditions must be satisfied with respect to any entity that such person is required to aggregate. For instance, if company A desires to rely on the exemption to disaggregate its 30% equity interest in company B, and company A controls the trading of company C, then company A must demonstrate independence between company B and company C (in its Notice of Exemption filing), in addition to independence between company A and company B.

⁷ The CFTC clarifies that the phrase “should be aware” means that the owner is deemed to have knowledge of the owned entity’s activities if it is, in effect, able to control the owned entity or routinely has access to relevant information about the owned entity.

⁸ This condition would generally not require aggregation solely based on knowledge a party obtains during execution of a transaction regarding the trading of its counterparty, or knowledge that an entity obtains when carrying out due diligence under a fiduciary duty (so long as such knowledge is not directly used to affect the entity’s trading).

⁹ This condition will not prevent an owner and an owned entity from both using the same “off-the-shelf” system developed by a third party, or the same customized or in-house software, so long as the software could not be used by multiple parties to indirectly

- have and enforce written procedures to preclude each entity from having knowledge of, gaining access to or receiving data about, trades of the other;¹⁰
- not share employees that control the trading decisions of either;¹¹ and
- not have risk management systems that permit the sharing of its trades or its trading strategy with employees that control the trading decisions of the other.¹²

Any person relying on this exemption must file a Notice of Exemption with the CFTC.

Exemptions for Accounts Carried by an Independent Account Controller

Aggregation is not required with respect to the client positions or accounts of an “eligible entity” carried by an authorized “independent account controller” (“IAC”), except for the spot month in physical-delivery contracts, so long as the IAC does not exceed the federal limits. To rely on this exemption, the eligible entity must deliver a Notice of Exemption to the CFTC.

If the IAC is affiliated with the eligible entity or another IAC, in order for the eligible entity to rely on this exemption, each of the affiliated entities must:

- have and enforce written procedures to preclude the affiliated entities from having knowledge of, or gaining access to, or receiving data about, trades of the other;¹³

coordinate their trading. Moreover, this condition would not prevent an owner and an owned entity from using a shared order execution platform (with appropriate firewalls) or shared systems for back-office functions (such as order capture or trade reporting).

¹⁰ Such procedures must include security arrangements, including separate physical locations, which maintain the independence of their activities. While this condition would not necessarily require that relevant personnel be located in separate buildings, there must be a physical barrier preventing access between personnel that would impinge on their independence. For instance, locked doors with restricted access would generally be sufficient, while merely providing the “independent” personnel with desks of their own would not.

¹¹ The sharing of attorneys, accountants, risk managers, compliance and other mid- and back-office personnel between entities would generally not compromise independence so long as the employees do not control, direct or participate in trading decisions. Similarly, sharing of board or advisory committee members, research personnel or sharing of employees for training, operational or compliance purposes would not compromise independence so long as the personnel do not influence (e.g., “have a say in”) or direct trading decisions.

¹² This criterion generally would not prohibit sharing of information used only for risk management and surveillance purposes, when such information is not used for trading purposes and not shared with employees that control, direct or participate in such decisions.

- trade such accounts pursuant to separately developed and independent trading systems;
- market such trading systems separately; and
- solicit funds for such trading by separate disclosure documents (and, where applicable, such disclosure documents must meet the general disclosure requirements for commodity pool operators and commodity trading advisors in Regulations 4.24 and 4.34).

Eligible Entity

The term “eligible entity” means:

- a commodity pool operator (“CPO”);
- the operator of a trading vehicle which is excluded or which itself has qualified for exclusion from the definition of the term “pool” or “commodity pool operator” under Regulation 4.5;
- a limited partner, limited member or shareholder in a commodity pool operated by a CPO that is exempt from registration under Regulation 4.13;
- a commodity trading advisor (“CTA”); a bank or trust company;
- a savings association; an insurance company; or
- any affiliate of the foregoing entities,

which (1) authorizes an IAC independently to control all trading decisions with respect to the eligible entity’s client positions and accounts that the IAC holds (directly or indirectly or on the eligible entity’s behalf) but without the eligible entity’s day-to-day direction and (2) maintains only such minimum control over the IAC as is consistent with its fiduciary responsibilities to the managed positions and accounts and necessary to fulfill its duty to supervise diligently the trading done on its behalf.

Independent Account Controller

The term “independent account controller” means a person:

¹³ Such procedures must include security arrangements, including separate physical locations, which maintain the independence of their activities. However, the procedures may provide for disclosure of information reasonably necessary for an eligible entity to maintain the level of control consistent with its fiduciary responsibilities to the managed positions and accounts and necessary to fulfill its duty to diligently supervise the trading done on its behalf.

- who specifically is authorized by an eligible entity independently to control trading decisions on behalf of, but without the day-to-day direction of, the eligible entity;
- over whose trading the eligible entity maintains only such minimum control as is consistent with its fiduciary responsibilities to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations which may be incumbent upon the eligible entity to fulfill;
- who trades independently of the eligible entity and of any other IAC trading for the eligible entity;
- who has no knowledge of trading decisions by any other IAC; and
- who is either:
 - registered as a futures commission merchant (“FCM”), an introducing broker, a CTA, or an associated person of any such registrant; or
 - a general partner, managing member or manager of a commodity pool operated by a CPO excluded from registration under Regulation 4.5(a)(4) (*i.e.*, the exemption for employee benefit plans) or Regulation 4.13, so long as such general partner, managing member or manager delivers a Notice of Exemption to the CFTC.

Exemptions for Underwriting and Broker-Dealer Activity

A person need not aggregate the positions or accounts of an owned entity if the ownership or equity interest is based on the ownership of securities constituting the whole or a part of an unsold allotment to or subscription by such person as a participant in the distribution of such securities by the issuer or by or through an underwriter.

In addition, broker-dealers registered with the Securities and Exchange Commission, or with a foreign regulatory authority, need not aggregate the positions or accounts of an owned entity if their interest is based on the ownership of securities acquired in the normal course of business as a dealer (so long as the broker-dealer does not have knowledge of the owned entity’s trading decisions).

A person relying on either of these exemptions need not file any notice with the CFTC.

Exemption for Accounts Held by Futures Commission Merchants

Neither an FCM nor any of its affiliates is required to aggregate positions the FCM holds in a discretionary account, or in an account which is part of, or participates in, or receives trading advice from a customer trading program of the FCM or any of its officers, partners or employees or affiliates, if:

- a person other than the FCM or the affiliate directs trading in such an account;
- the FCM 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 FCM or the affiliate holds, has a financial interest of 10% or more in, or controls; and
- the FCM or the affiliate has filed a Notice of Exemption with the CFTC.

Notice of Exemption and Related Requirements

Notice of Exemption

A person¹⁴ must file a Notice of Exemption with the CFTC if such person seeks an exemption for:

- a pool participant that is a principal or affiliate of the pool's operator and has an ownership or equity interest of 10% or greater in a pooled account or positions;
- a person with an ownership or equity interest in an owned entity of 10% or greater;
- accounts held by FCMs;
- accounts carried by an IAC; and

¹⁴ Under the Final Aggregation Rules, where Person X has a 10% or greater ownership or equity interest (directly or indirectly) in Person Y, or vice versa, or a third person has a 10% or greater ownership or equity interest (directly or indirectly) in both Person X and Person Y (where each of Person X and Person Y is a "Person"), if either Person X or Person Y has filed a Notice of Exemption, then the other Person need not file a separate notice identifying any position or account identified in the former Person's filing so long as (1) such other Person complies with the conditions of the applicable exemption (other than filing requirements) and (2) such other Person does not otherwise control trading of any account or position identified in such filing.

- information sharing restrictions.

The Notice of Exemption will be effective upon submission, except that a person that newly acquires an ownership or equity interest in an owned entity of 10% or greater may elect that its Notice of Exemption (for the 10% ownership exemption) will be effective as of the date of acquisition, so long as the notice is filed no later than 60 days after such acquisition.¹⁵

A Notice of Exemption must include:¹⁶

- a description of the relevant circumstances warranting disaggregation; and
- a signed statement of a senior officer of the entity (or, if the entity does not have a senior officer, a person of equivalent authority and responsibility) certifying that the conditions set forth in the applicable exemption provision have been met.

In the event of a material change to the information provided in this notice, an updated or amended notice detailing the change must be filed promptly.

Where a person is eligible to claim an exemption from aggregation but fails to make a filing at the proper time, such failure to file a timely notice will not constitute a violation of the Final Aggregation Rules or any position limit so long as such notice is filed no later than five business days after the person is aware, or should be aware, that such notice has not been filed.

Additional Information Upon CFTC Request

Upon call by the CFTC, any person claiming any exemption from aggregation must provide such information as requested by the CFTC demonstrating that the person meets the requirements of the exemption. Upon notice and opportunity for the affected person to respond, the CFTC can amend, suspend, terminate or otherwise modify a person's exemption.

¹⁵ This 60-day post-acquisition period is intended to provide adequate time for the acquirer to perform due diligence on the newly acquired subsidiary and gather the information necessary to make the notice filing.

¹⁶ Entities may consolidate these notice filings in an efficient manner by, for instance, discussing more than one owned entity in a single filing (so long as the scope of the filing is clear).

Form and Manner of Reports and Filings

Unless otherwise instructed by the CFTC or its designees, any person submitting reports under Regulation 150.4 must submit the required filings and any other required information to the CFTC using the format, coding structure and electronic data transmission procedures approved in writing by the CFTC. Additionally, when the reporting entity discovers errors or omissions in past reports, the entity must so notify the CFTC and file corrected information as instructed by the CFTC or its designee.

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Please do not hesitate to contact us with any questions.