

November 7, 2013

CFTC Proposes Revised Aggregation Rules

At a public meeting on November 5, the Commodity Futures Trading Commission (CFTC) voted to propose amendments to its rules requiring the aggregation of certain accounts for purposes of complying with CFTC speculative position limits. The proposed aggregation rules would continue the current practice of evaluating positions on the basis of both ownership and control. These rules require the aggregation of all positions in accounts in which a trader either (i) holds a direct or indirect ownership of 10 percent or more, or (ii) controls trading, by power of attorney or otherwise. As summarized below, the proposal notably retains (with some modifications) many of the “disaggregation” exemptions that are available under existing CFTC Regulations and would also create certain new exemptions.

- **Independent Account Controller Exemption.** The proposed rule retains the independent account controller exemption, which provides that an “eligible entity” is not required to aggregate client positions controlled by an authorized “independent account controller” (which terms are defined in substantially the same manner as under the CFTC’s current rules). The proposal clarifies that this exemption is applicable only to the positions of the eligible entity’s clients (and not the eligible entity itself) and is not available for physically delivered commodity contracts during the spot month. Persons utilizing the independent account controller exemption are required to file a notice with the CFTC.
- **Passive Pool Exemption.** The proposal also retains the exemption for certain limited partners, shareholders and similar types of passive investors in commodity pools, including an investor that is a principal or affiliate of the pool operator, provided the principal or affiliate meets certain criteria to demonstrate its independence and fulfills a newly proposed filing requirement.
- **FCM Customer Trading Programs.** The proposed aggregation rule retains an existing exemption for customer trading programs offered by a futures commission merchant (FCM) if a person other than the FCM or its affiliates directs the trading in such an account, but imposes a new filing requirement for FCMs that rely upon this exemption.
- **Owned Entity Exemption (10 Percent to 50 Percent Ownership).** Under proposed CFTC Regulation 150.4(b)(2), a person whose ownership or equity interest in another entity is between 10 percent and 50 percent would not be required to aggregate its positions with that entity’s positions if such person files a notice with the CFTC and both parties: (i) do not have knowledge of each other’s trading decisions; (ii) trade pursuant to separately developed and independent trading systems; (iii) have established written information barriers that include documented routing procedures, security procedures and separate physical locations to maintain independence; (iv) do not share employees that control trading decisions; and (v) do not share risk management systems. This

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amendment is intended to expand the availability of disaggregation to any person whose ownership interest in an underlying entity exceeds the 10 percent threshold currently reflected in the CFTC's aggregation rules.

- **Owned Entity Exemption (Greater Than 50 Percent Ownership).** A person with an ownership interest of greater than 50 percent would be permitted to apply to the CFTC for an aggregation exemption if: (i) the applicant does not and is not required by US generally accepted accounting principles to consolidate the owned entity under the applicant's financial statements; (ii) trading is independently controlled; (iii) each representative of the applicant on the owned entity's board certifies that he or she does not control the trading decisions of the owned entity; and (iv) the owned entity's positions are held for bona fide hedging purposes or do not exceed 20 percent of the position limit. However, this exemption is not automatic, and the CFTC has the authority to grant or deny these applications. The owned-entity exemption would also apply to higher-tier entities (such as upstream holding companies) that comply with the applicable requirements.
- **Underwriting and Broker-Dealer Activities.** The proposed rule provides an exemption for a broker-dealer that acquires an equity interest in an entity as a result of certain underwriting or market-making activities.
- **Information-Sharing Prohibitions.** The proposed rule includes a new conditional exemption where aggregation would create a reasonable risk of violating applicable laws governing the sharing of information between the aggregated entities. To utilize this exemption, a person must file a notice with the CFTC that includes, among other things, a written memorandum of law explaining why the sharing of information creates a reasonable risk of violating applicable law.
- **Identical Trading Strategies.** The proposed rule also clarifies that these various exemptions do not apply to any person that holds an ownership interest or controls the trading of more than one account or pool with substantially identical trading strategies.

At the same meeting, the CFTC approved a separate companion release that would expand the CFTC's position limit authority over 28 physical commodity futures contracts and certain economically equivalent instruments, which will be the subject of a separate client advisory. Each of these rule proposals will be open for public comment for a period of 60 days following its publication in the *Federal Register*.

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