
CFTC Updates Position Limits Rule

SEPTEMBER 29, 2015

Summary: On September 22, 2015, the Commodity Futures Trading Commission (CFTC or Commission) unanimously approved the publication of a “supplemental” proposed rule on position limits. The supplemental proposal would modify the requirements in the proposed rules regarding the aggregation of positions subject to the Commission’s speculative position limits. Specifically, the proposal would modify the eligibility criteria and simplify the process for claiming an exemption from the aggregation requirements for owners of more than 50 percent of another entity. On the same date, the CFTC’s Agriculture Advisory Committee (AAC) held a public meeting to discuss the CFTC’s 2013 position limits proposal.¹ Among the topics discussed was the possibility of the Commission delegating to the exchanges the responsibility for granting hedge exemptions to position limits. Section I of this alert discusses the Commission’s latest supplemental proposal on aggregation and Section II discusses the concept proposal on delegation.

I. Aggregation Supplemental Proposal

The supplemental proposal modifies the Commission’s November 2013 proposal for aggregation of positions under the CFTC’s position limits regime for futures and swaps. The supplement revises the process by which a person who owns more than 50 percent of a separately organized entity (Owned Entity) would be permitted to disaggregate positions held by the owned entity. The November 2013 proposal required more than 50 percent owners to file an application with the Commission certifying compliance with certain conditions.² These owners would then need to wait for the Commission’s approval before being permitted to disaggregate.³ Under the supplemental proposal, any person with more than a 10 percent interest in an Owned Entity would be able to disaggregate upon filing a notice with the Commission attesting that it meets certain requirements.⁴ The supplemental proposal would provide the same process for disaggregation of Owned Entity positions for owners with more than 50 percent that was previously proposed for owners of between 10 and 50 percent.

The CFTC’s position limits regime currently requires that persons determine which accounts and positions be aggregated for the purpose of determining compliance with position limits. Current CFTC Rule 150.4 requires a person to aggregate (1) all positions for which that person controls the trading decisions, (2) all positions and accounts in which that person has a 10 percent or greater ownership interest, and (3) the positions of any persons with which that person acts pursuant to an

express or implied agreement or understanding.⁵ Rule 150.4 includes certain exemptions from aggregation, including for limited partners or shareholders in commodity pools who do not control trading decisions; positions held by a futures commission merchant (FCM) in an account that is controlled by a trader other than the FCM, where the trading decisions are made independently of the trading decisions in the FCM's other accounts; and positions held by an independent account controller. Persons claiming an exemption from aggregation are subject to a call for information from the Commission, but are otherwise not required to make any affirmative filing with the CFTC or National Futures Association.⁶

In November 2013, the CFTC proposed to amend the current aggregation rules.⁷ Under that proposal, a person would still be required to aggregate all positions or accounts in which it has a 10 percent or greater interest, as well as all positions held by an entity of which that person owns at least 10 percent.⁸ The 2013 proposal includes several new exceptions to the aggregation requirements, including two exemptions based on the level of ownership in an owned entity.⁹ With respect to positions held by an owned entity, the proposal would establish a notice filing procedure to permit a person with a 10 to 50 percent interest in that entity to disaggregate the positions of the owned entity in specific circumstances.¹⁰ The filing would be self-executing, although the Commission would reserve the right to call for additional information, as well as to amend, terminate or otherwise modify the exemption if the person fails to comply with the conditions of the rule.¹¹

The proposal also would have permitted persons with a more than 50 percent interest in an owned entity to apply on a case-by-case basis to the Commission for permission to disaggregate.¹² The proposal would not have imposed any time limits on the Commission's process for making the determination and the applicant would only have been permitted to disaggregate if the Commission granted the request for relief.¹³

Many commenters criticized this exemption process on both substantive and procedural grounds. The process was criticized substantively with respect to the criteria required to qualify for disaggregation, and procedurally for being an open-ended process with no definite timeframe for the Commission to act. Regarding the criteria, one industry association asserted that the proposed exemption's condition prohibiting consolidation of financial results lacked any rationale and that consolidating financial results was simply a way to track investor returns, and not meant to control trading.¹⁴ Regarding procedure, another industry association argued that if the CFTC did not permit a notice filing that was effective upon submission, its members would need to file "thousands of applications prophylactically," likely placing significant strain on Commission staff resources.¹⁵ The unlimited waiting period for Commission review was also criticized for creating uncertainty for applicants.¹⁶

The Commission's supplemental proposal would simplify the exemption process. It would permit owners of more than 50 percent to follow the same procedure as owners of between 10 and 50 percent.¹⁷ Thus, any person with more than a 10 percent interest in an owned entity would be able to disaggregate upon filing a notice with the Commission attesting that the person and the owned entity:

- do not have knowledge of the trading decisions of the other;
- trade pursuant to separately developed and independent trading systems;
- have written procedures to prevent access to information about the trades of the other, including separate physical locations;
- do not share employees that control trading decisions; and
- do not have risk management systems that permit the sharing of trades or trading strategy.¹⁸

Comments on the supplemental proposal must be submitted to the CFTC on or before November 13, 2015.

II. Hedging Exemptions

The members of the ACC also discussed the possibility of the Commission's delegating to the exchanges the responsibility for granting non-enumerated hedging exemptions from position limits, following up on an earlier discussion at a meeting of the Energy and Environmental Markets Advisory Committee on July 29, 2015.¹⁹

The 2013 position limits proposal would require persons seeking non-enumerated hedge exemptions to petition the Commission for an interpretive letter or exemptive relief under section 4a(a)(7) of the Commodity Exchange Act.²⁰ A representative of the CME Group presented to the ACC a conceptual proposal of how exchanges could administer non-enumerated hedge exemptions. Under the concept proposal, exchanges would be delegated the responsibility for determining what constitutes a permissible non-enumerated hedge exemption and the CFTC would then have the ability to modify or reject any exchange determination on a going-forward basis. Many members of the AAC also emphasized that the list of enumerated hedges included in the 2013 proposal's definition of "bona fide hedging" should be expanded.

Generally, members of the AAC, which is made up almost entirely of end-users, expressed support for the concept of delegating the hedge exemption process to exchanges. Chairman Timothy Massad expressed an openness to delegating the hedge exemption process to exchanges as a change to 2013 proposal.

Background

Current Exchange Hedge Exemption Process

All traders are subject to speculative position limits unless they apply and qualify for a "bona fide" hedging exemption provided for in Rule 150.3, and as defined in Rule 1.3(z).²¹ The definition of "bona fide hedging" includes a list of "enumerated hedges."²² Persons seeking an enumerated hedge exemption from position limits may petition the exchange for relief directly. Persons seeking a non-enumerated hedging exemption, however, must petition the Commission for relief first.

Enumerated Hedge. An exchange participant seeking an enumerated hedge exemption files an application with its exchange prior to exceeding a position limit, requesting an exemption for a particular hedging strategy.²³ The applicant must provide documentation to support its proposal.

The exchange reviews the justification and documentation and may then approve, deny or conditionally approve the exemption, and must provide the applicant a written determination. If granted, the exchange must set an exemption level and conduct ongoing surveillance of the applicant's compliance with the hedge exemption.

Non-Enumerated Hedge. Prior to 2008, an exchange participant seeking a non-enumerated hedge would file with the CFTC an application seeking approval for a non-enumerated position to be recognized as a bona fide hedging position under CFTC Rule 1.47.²⁴ Rule 1.47 provided specific, limited timeframes of 30 days or 10 days for the Commission to determine whether the position may be classified as bona fide hedging.²⁵ In 2008, the Commission stopped considering filings made pursuant to Rule 1.47.²⁶ Since then, the Division of Market Oversight (DMO) has considered revisions to previously recognized filings.²⁷

Current Proposal. The CFTC's 2013 position limits proposal would delete Rule 1.47 and redefine what constitutes a bona fide hedging transaction. Persons seeking non-enumerated hedges would have to petition the Commission for relief from federal position limits by seeking either (1) a staff interpretive letter pursuant to Rule 140.99 or (2) exemptive relief from the Commission under section 4a(a)(7) of the Commodity Exchange Act.²⁸

Many commentators have expressed concerns that the proposed process for obtaining approval for a non-enumerated hedge exemption could place strains on the Commission's resources and that the absence of a time limit will likely result in a much more lengthy application process.²⁹ One commentator noted that seeking exemptive relief under section 4a(a)(7) would "subject the applicant to the notice and comment administrative process which is not conducive to quickly validating the trading activity of commercial market participants."³⁰ This same commentator also noted that, based on its experience, "staff does not interpret Rule 140.99 as mandating an official response to any request," which could contribute to regulatory uncertainty for petitioners.³¹

Concept Proposal

Under the concept proposal, exchanges would be delegated the responsibility for determining what constitutes a permissible non-enumerated hedge exemption. The concept proposal largely mirrors the current process for seeking an enumerated hedge exemption. The application and exchange review processes would be the same for enumerated and non-enumerated hedges. With respect to over-the-counter (OTC) transactions, any person granted an exemption from exchange speculative positions limits (whether for enumerated or non-enumerated hedges) would also be permitted to rely on the exemption in its OTC transactions. The exchange would be tasked with determining the overall exposure for a particular strategy and sending such analysis to the CFTC. The CFTC would be responsible for monitoring the person's OTC positions.

The concept proposal does include certain differences for non-enumerated hedges from the current process for exchange review of enumerated hedges. All approvals and denials for non-enumerated hedges would be forwarded to the Commission. The Commission could subsequently take action to modify or prohibit non-enumerated exemptions granted by an exchange on a going-forward basis. Exchanges would publish on their websites summaries of non-enumerated exemptions that they have granted and make efforts to coordinate their characterizations, where possible. The

exchanges would take steps to maintain the anonymity of the hedger.

III. Conclusion

It is uncertain when the Commission will finalize the position limits and aggregation rules. Although Chairman Massad has stressed the importance of completing the position limits rulemaking, he has also recognized the complexity of the rules and has stated that the CFTC “intend[s] to take the time necessary to get it right.”³² Finalizing the re-proposed position limits and aggregation rules has been a difficult and involved process. The Commission continues to wrestle with issues that the proposed rules raise and has made efforts to obtain significant public input. Since re-proposing the position limits and aggregation rules in 2013, the Commission has extended or re-opened the comment period five times to solicit additional viewpoints on various issues related to the rules. Moving forward with a proposal to delegate to the exchanges the responsibility for granting non-enumerated hedging exemptions from position limits could necessitate the Commission formally soliciting public comments yet again.

¹ Aggregation, Position Limits for Futures and Swaps, 78 FR 68946 (Nov. 15, 2013). Position Limits for Derivatives, 78 Fed. Reg. 75680, 75739 (December 12, 2015) (Rule Proposal).

² [Aggregation of Positions, Supplemental Notice of Proposed Rulemaking, 80 Fed. Reg. 58365 \(September 29, 2015\)](#).

³ *Id.* at 65.

⁴ *Id.*

⁵ See 17 CFR 150.4(a) and (b).

⁶ 17 C.F.R. 150.3(b), 150.4(e).

⁷ The November 2013 proposal is substantially similar to the proposed rule on aggregation published by the Commission in May 2012. Aggregation, Position Limits for Futures and Swaps, 77 Fed. Reg. 31767 (May 30, 2012). The May 2012 aggregation proposal would have amended the aggregation requirements in the final position limits rule promulgated by the Commission in November 2011 to implement the position limits provisions in the Dodd-Frank Act. Subsequent to the publication of the May 2012 proposed aggregation rule, however, the US District Court for the District of Columbia vacated that underlying final rule, *ISDA v. CFTC*, 887 F. Supp. 2d 259 (D. D.C. Sept. 28, 2012). In November 2013 the Commission also voted to issue a new proposed rule covering other aspects of its position limits regime. Position Limits for Derivatives, 78 Fed. Reg. 75680 (Dec. 12, 2013).

⁸ Aggregation, Position Limits for Futures and Swaps, 78 Fed. Reg. at 68947.

⁹ In addition to the proposed exceptions relating to owned entities, the November 2013 proposal would add exceptions from the aggregation requirements for underwriters, broker-dealers, and for

positions held by entities subject to information-sharing restrictions. The supplemental proposal affects only the proposed exception from aggregation for owned entities.

¹⁰ Aggregation, Position Limits for Futures and Swaps, 78 Fed. Reg. at 68947.

¹¹ *Id.* at 68958.

¹² *Id.* at 68959.

¹³ Supplemental Notice of Proposed Rulemaking, 80 Fed. Reg. at 58368.

¹⁴ SIFMA at 5 (February 10, 2014).

¹⁵ PEGCC Comment Letter at 4, 5 (February 10, 2014).

¹⁶ *Id.*

¹⁷ Supplemental Notice of Proposed Rulemaking, 80 Fed. Reg. at 58371.

¹⁸ *Id.*

¹⁹ An archived webcast and presentation materials from that meeting can be found on the [CFTC's website](#).

²⁰ Position Limits for Derivatives, 78 Fed. Reg. at 75739.

²¹ The permissible exemptions include: (1) bona fide hedging transactions as defined in §1.3(z) of this chapter; (2) [reserved]; (3) spread or arbitrage positions between single months of a futures contract and/or, on a futures-equivalent basis, options thereon, outside of the spot month, in the same crop year; provided however, that such spread or arbitrage positions, when combined with any other net positions in the single month, do not exceed the all-months limit set forth in §150.2. 17 C.F.R. 150.3.

²² See 17 C.F.R. 1.3(z)(2).

²³ See *generally* [CME Rule 559](#); [ICE Exchange Rule 6.29](#).

²⁴ Position Limits for Derivatives, 78 Fed. Reg. at 75739 (Rule Proposal). See also 17 C.F.R. 1.3(z) (3) (A designated contract market or swap execution facility that is a trading facility may recognize, consistent with the purposes of this section, transactions and positions other than those enumerated . . .); 17 C.F.R. 1.47(a) (Any person who wishes to avail himself of the provisions of § 1.3(z)(3) of the regulations and to make purchases or sales of any commodity for future delivery in any commodity in excess of trading and position limits then in effect pursuant to Section 4a of the Act shall file statement with the Commission in conformity with the requirements of this section).

²⁵ Position Limits for Derivatives, 78 Fed. Reg. at 75739.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ See NGS Comment Letter at 8 (August 4, 2014) (Neither process provides any timelines by which market participants can expect to receive relief, and the Section 140.99 process is not binding on the Commission); CME Group Comment Letter at 7-8 (February 10, 2014) ([I]t is uncertain how the Commission might handle a large volume of petitions for non-enumerated hedging exemptions, interpretive guidance and no action relief); CMC Comment Letter at 8-9 (January 22, 2015).

³⁰ CME Group Comment Letter at 54 (February 10, 2014).

³¹ *Id.*

³² See [Remarks of Chairman Timothy Massad before the Natural Gas Roundtable](#).

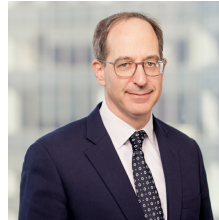
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