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Client Alert Commentary

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CFTC Re-Proposes Position Limits Rule and Proposes Revised Aggregation Requirements

If the Re-Proposed Rule is finalized as proposed, many market participants will likely be affected by the rule even if they do not exceed or approach the actual position limits levels.

The US Commodity Futures Trading Commission (CFTC), on November 5, 2013, re-proposed a rulemaking (the Re-Proposed Rule)[1] that would establish specific limits on speculative positions in 28 physical commodity futures and option contracts (Core Referenced Futures Contracts) as well as swaps that are economically equivalent to such contracts in the agriculture, energy and metals markets. On the same date, the CFTC proposed another rule addressing the circumstances under which market participants would be required to aggregate their positions with other persons under common ownership or control (the Proposed Aggregation Requirements).[2]

The CFTC issued the Re-Proposed Rule in response to a US District court order vacating the CFTC's previous rule on position limits (the Original Position Limits Rule)[3] and directing the CFTC to resolve certain ambiguities concerning its statutory authority to implement position limits under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act). While the preamble of the Re-Proposed Rule attempts to reconcile the ambiguities identified in the court's order, the substance of the Re-Proposed Rule is largely similar to the Original Position Limits Rule. Specifically, as with the Original Position Limits Rule, the Re-Proposed Rule would, among other things:

- Identify which contracts are subject to speculative position limits
- Set thresholds that restrict the number of speculative positions that a person may hold in a spot month, individual month, and all months combined (described further below)
- Create an exemption for positions that constitute *bona fide* hedging transactions
- Impose responsibilities on designated contract markets (DCMs) and swap execution facilities (SEFs) to establish position limits or, in some cases, position accountability rules
- Most importantly, apply to both futures and swaps across four relevant venues: over-the-counter (OTC), DCMs, SEFs as well as non-US located platforms[4]

The Re-Proposed Rule will not, however, establish the federal position visibility reporting that was required in the Original Position Limits Rule. The Re-Proposed Rule will be open for comment for 60 days after its publication in the Federal Register. Thus, the comment period will close on February 10, 2014.

Unlike the Original Position Limits Rule, which created a different set of rules applicable to swaps versus futures and options on futures, the Re-Proposed Rule would create one set of federal rules that would

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apply to futures, options on futures and their economically equivalent swaps on the 28 Core Futures Referenced Contracts. The Re-Proposed Rule also contains new appendices that did not appear in the CFTC's previous position limits rules. These appendices provide guidance on risk management exemptions and basis contracts, and provide proposed forms for market participants to file with the CFTC pursuant to certain requirements described below.

This *Client Alert* briefly summarizes the Re-Proposed Rule, the Proposed Aggregation Requirements and their potential implications for various types of market participants. Because this *Client Alert* offers only a brief summary of these lengthy and complex proposals, however, please contact the authors identified below for further clarification and guidance.

Background

As amended by the Dodd-Frank Act, sections 4a(a)(2) and 4a(a)(5) of the Commodity Exchange Act (CEA) authorize the CFTC to establish limits, "as appropriate," for futures, options on futures and economically equivalent swaps. Pursuant to this authority, the CFTC, on October 18, 2011, adopted the Original Position Limits Rule with respect to the Core Referenced Futures Contracts and their economically equivalent swaps. The Original Position Limits Rule was to become effective on October 12, 2012; however, on September 28, 2012, the US District Court for the District of Columbia (the District Court) vacated the Original Position Limits Rule and remanded the Rule to the CFTC.

The District Court's ruling was issued in response to a lawsuit filed by two leading trade associations in December 2011, which alleged that the CFTC misinterpreted its statutory authority under the CEA when adopting the Original Position Limits Rule.[5] Specifically, the plaintiffs charged that the CEA, as amended by the Dodd-Frank Act, unambiguously requires the CFTC to make a determination that the new position limits were "necessary" and "appropriate" and that the CFTC wholly failed to make such a determination in promulgating the Original Position Limits Rule.[6] For its part, the CFTC claimed that Congress mandated the CFTC to set position limits and stripped the agency of any discretion to not impose such limits.[7]

In its ruling, the District Court concluded that the CEA, as amended, is ambiguous as to whether the CFTC is required to make a determination that the new position limits are "necessary" and "appropriate" before imposing such limits.[8] The District Court further concluded that the CFTC erroneously concluded that the CEA, as amended, unambiguously requires the CFTC to adopt position limits and, therefore, remanded the Rule to the CFTC for further consideration.

While the CFTC had initially appealed the District Court's ruling, the CFTC has since decided to abandon that appeal and instead has attempted to address the District Court's order in the Re-Proposed Rule by purporting to resolve the statutory ambiguities in Section 4(a) of the CEA and finding that Congress did in fact mandate that the CFTC adopt position limits. The CFTC also made a finding in the preamble of the Proposed Rule, in an abundance of caution, that speculative position limits are in fact necessary and appropriate to diminish, eliminate, or prevent excessive speculation causing sudden or unreasonable fluctuations in commodity prices.[9]

The Re-Proposed Rule

Contracts Subject to Position Limits

Before Dodd-Frank, position limits applied to a limited number of agriculture futures contracts specified in Part 150 of the CFTC's regulations and to futures contracts traded on DCMs and set by DCM Rules. As with the Original Position Limits Rule, however, the Re-Proposed Rule would apply to 28 physical

commodity futures and option contracts as well as swaps that are economically equivalent to such contracts.[10] The contracts that have been designated as Core Referenced Futures Contracts are specific contracts in a particular commodity, for delivery at a particular location and transacted on a specified futures exchange. For example, the Core Referenced Futures Contracts in the energy space are New York Mercantile Exchange (NYMEX) Light Sweet Crude Oil, NYMEX NY Harbor ULSD, NYMEX RBOB Gasoline and NYMEX Henry Hub Natural Gas.[11] For purposes of the Re-Proposed Rule, swaps are considered economically equivalent to a Core Referenced Futures Contract if they are linked or priced at a fixed differential to the price of a particular Core Referenced Futures Contract or the price of the same commodity underlying a Core Referenced Futures Contract with the same delivery location as the Core Referenced Futures Contract.[12] The Core Referenced Futures Contracts together with their economically equivalent swaps are referred to collectively as "Referenced Contracts." Under the Re-Proposed Rule, the definition of Referenced Contract would not include, however, a guarantee of a swap, a basis contract[13] or a commodity index contract.[14]

The CFTC is also seeking public comment on whether instruments that qualify as trade options should be exempt from position limits.[15] While trade options are exempt from many of the CFTC's regulatory requirements applicable to "swaps," trade options are subject to position limits. Accordingly, absent an exemption, market participants would be required to count trade options toward the position limit levels.

Persons Subject to Position Limits

The Re-Proposed Rule generally applies to any market participant transacting in Referenced Contracts, regardless of whether the participant is registered with the CFTC or whether it is a financial entity. The Re-Proposed Rule does not describe the circumstances under which the Rule would apply to non-US persons, but the CFTC recently stated in its "cross-border guidance" that any position limits rules "apply regardless of the counterparty's status (US person or not)."[16] The Re-Proposed Rule may therefore have broad extraterritorial scope.

Position Limit Levels

The Re-Proposed Rule sets the maximum number of Referenced Contracts that a market participant may hold or control, either net long or net short, absent an exemption.[17] Like the Original Position Limits Rule, the Re-Proposed Rule would impose separate positions limits for: (i) spot months and (ii) single months and all months combined. The most significant exemption is for bona fide hedging positions. Entities that exceed position limits as a result of bona fide hedging positions would not be in violation of the Re-Proposed Rule, but would have significant reporting requirements associated with reliance on the exemption.

1. Spot Month Limits

The term "spot month" does not refer to a month of time.[18] Rather, the spot month is the trading period immediately preceding the delivery period for physical-delivery futures contracts as well as for any cash-settled futures contracts that are linked to the physical-delivery contracts.[19] For physical-delivery contracts, the Re-Proposed Rule continues to define the spot month as the period of time beginning at the close of trading on the trading day preceding the first day on which delivery notices can be issued until the contract is no longer listed for trading, and for contracts with delivery beginning after the last trading day, the Re-Proposed Rule defines the spot month as the period from the close of trading on the trading day preceding the third-to-last trading day until the contract is no longer listed for trading.[20] For example, for the NYMEX light sweet crude oil contract that can be delivered between January 1, 2014 and January 31, 2014, trading terminates on December 19, 2013. The spot month for that contract means the period beginning at the close of business on December 16, 2013 and ending when the contract is no longer available for trading on December 19, 2013. For cash-settled contracts, the spot month begins at

the earlier of the start of the period in which the underlying cash-settlement price is calculated or the close of trading on the trading day preceding the third-to-last trading day, and continues until the contract cash-settlement price is determined.[21] However, if the cash-settlement price is determined based on prices of a Core Referenced Futures Contract during the spot month period for that Core Referenced Futures Contract, then the spot month for that cash-settled contract is the same as the spot month for that Core Referenced Contract.

Spot month limits apply separately to physically-delivered Referenced Contracts and cash-settled Referenced Contracts. Therefore, a market participant may hold positions up to the spot month limit in physical-delivery contracts, as well as positions up to the applicable spot month limit in cash-settled contracts (*i.e*., cash-settled futures and swaps). However, a market participant in the spot month may not net across physical-delivery and cash-settled contracts.[22]

The levels of the initial spot month limits are set forth in an appendix to the Re-Proposed Rule.[23] These levels are based on existing DCM-set levels for the Core Referenced Futures Contracts and would become effective 60 days after publication in the Federal Register of a final rule adopted by the CFTC.[24] After two years, the CFTC will then set spot month limits at 25 percent of estimated deliverable supply.[25]

2. Single Month and All Months Combined

In addition to spot month limits, the Re-Proposed Rule would establish limits for a "single month" and "all months combined," where single month refers to each separate futures trading month (*e.g.,* delivery in February 2014, delivery in March 2014, *etc*.) and all months refers to the sum of all futures trading months.[26] In contrast to spot month limits, which are set based on estimated deliverable supply, the single month and all months combined limits are based on total open interest for all Referenced Contracts in a commodity.[27] The actual position limit levels will be set based on a formula: 10 percent of the open interest for the first 25,000 contracts and 2.5 percent of the open interest thereafter.[28]

For setting the initial single month and all months combined limits, the CFTC proposes to use the open interest reported to it for calendar years 2011 and 2012 in futures contracts and options thereon, and in swaps reported under its large-trader reporting rules.[29] For setting subsequent limits for single months and all months combined, the Re-Proposed Rule would identify the level of open interest in Referenced Contracts by including data that the CFTC obtains from market participants in connection with its new swap reporting rules.[30]

Exemptions from the Position Limits

1. Bona Fide Hedging Transactions

As authorized by the Dodd-Frank Act, the Re-Proposed Rule would exempt from the position limits contracts that qualify as "bona fide hedging transactions." The Re-Proposed Rule would delete the CFTC's historic definition of "bona fide hedging transactions or positions" in CFTC Regulation § 1.3(z) and replace it with a new definition of "bona fide hedging positions" in Part 150. This new definition would be applicable in connection with all futures, options on futures and swaps that are subject to position limits.[31]

<u>General</u> In all cases, for any position to qualify as a bona fide hedging position, two requirements must be met:

i. The purpose of the position must be to offset price risks incidental to commercial cash operations.

ii. The position must be established and liquidated in an orderly manner in accordance with sound commercial practices.

Excluded Commodities For positions in "excluded commodities" (including interest rates and foreign exchange rates, among other types of underliers), the Re-Proposed Rule would require that the position be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise (the "economically appropriate" test) and be either (a) specifically enumerated, as described below; or (b) recognized as a bona fide hedging position by a DCM or SEF in accordance with the guidance under the Re-Proposed Rule.

Physical Commodities For physical commodity positions, the Re-Proposed Rule would require the position to (a) represent a substitute for transactions or positions taken or to be taken at a later time in a physical marketing channel; (b) be economically appropriate to the reduction of risks; and (c) arise from the potential change in value of assets that the person owns, produces, manufactures, processes or merchandises, or for which it anticipates any of the foregoing; liabilities that the person owes or anticipates incurring; or services provided or purchased, or anticipated to be provided or purchased, by such person, provided the position is also enumerated as described below.

Pass-Through Swap Offsets for Physical Commodities A position in a derivative contract on a physical commodity would also qualify as a bona fide hedging position if the position reduces the risk from another swap that qualified as a bona fide hedging position. However, the Re-Proposed Rule would not recognize as bona fide the offset of such swaps with physical-delivery contracts during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery commodity derivative contract.

Enumerated Hedges In addition to the requirements above, positions in excluded and physical commodities must qualify as enumerated hedges in order to qualify as bona fide hedging positions. Enumerated hedges include: hedges of inventory and cash commodity purchase contracts, hedges of cash commodity sales contracts, hedges of unfilled anticipated requirements and hedges by agents. Hedges of unsold anticipated production, anticipated royalty hedges, service hedges, and cross-commodity hedges are also enumerated hedges. For physical delivery contracts, however, these types of hedges cannot be maintained during the lesser of the last five days of trading or the spot month.

With respect to cross-commodity hedges specifically, the Re-Proposed Rule would require that the fluctuation in the value of a position be "substantially related" to the fluctuations in the value of the actual or anticipated cash position.[32] In particular, there must be a reason that the prices of the two commodities move in relation to each other, rather than a correlation that does not have a clear cause. The Re-Proposed Rule provides for a non-exclusive safe harbor for cross-commodity hedges that are deemed to meet the substantially related test based on certain qualitative and quantitative factors. If a cross-commodity hedge does not satisfy the safe harbor, the CFTC would presume that the positions are not bona fide cross-commodity hedging positions.[33] However, a market participant may rebut this presumption upon presentation of facts and circumstances demonstrating a reasonable relationship between the spot price series for the commodity to be hedged and either the spot price series for the commodity underlying the commodity derivative contract or the price series for the commodity derivative contract to be used for hedging.[34]

2. Additional Exemptions

Section 4a(a)(7) of the CEA provides that the CFTC by rule, regulation, or order may exempt any person or class of persons from any requirement that the CFTC may establish. Pursuant to this authority, the Re-Proposed Rule would add exemptions for:

i. Financial Distress The Re-Proposed Rule would add an exemption from position limits for certain market participants under financial distress. Financial distress circumstances would include situations involving the potential default or bankruptcy of a customer of the requesting person or persons, an affiliate of the requesting person or persons, or a potential acquisition target of the requesting person or persons.

ii. Conditional Spot Month Limit Market participants would be permitted to acquire positions up to five times the spot month limit if such positions are exclusively in cash-settled contracts.[35] This conditional exemption would only be available to traders who do not hold or control positions in the spot month physical-delivery Referenced Contracts.

iii. Pre-Enactment and Transition Swaps The Re-Proposed Rules would also provide an exemption from the position limits for swaps entered into prior to the enactment of the Dodd-Frank Act and for swaps entered into prior to 60 days after publication of a final rule on position limits in the Federal Register. The CFTC would allow these swaps to be netted with contracts acquired more than 60 days after publication of a final rule in the Federal Register.[36]

iv. Other Exemptions Any person engaging in risk-reducing practices commonly used in the market, which they believe may not be specifically enumerated in the definition of bona fide hedging position in the Re-Proposed Rule, may request an interpretive letter from the CFTC staff or exemptive relief from the CFTC.

3. Previously Granted Exemptions Will Not Apply

If the Re-Proposed Rule becomes effective, the CFTC would not permit market participants to rely on previously-granted risk-management exemptions.[37] Thus, anyone who has been relying on such relief may need to request a new interpretive letter or exemptive relief.

4. Recordkeeping

Under the Re-Proposed Rule, market participants claiming an exemption are required to maintain complete books and records in connection with all of their related cash, forward, futures, option and swap positions.[38] The CFTC would be entitled to make "special calls" for such records, requiring market participants to provide the CFTC with such information upon request.

5. Reporting

The Re-Proposed Rule would also impose significant reporting requirements. Specifically, market participants seeking exemptions from the Re-Proposed Rule would be required to submit an '04 series report. Market participants relying on the bona fide hedging exemption would be required to submit a Form 204 on a monthly basis showing their cash market positions as of the last Friday of the month. A Form 304 is required for merchants and dealers in cotton showing their cash positions on a weekly basis. Those market participants relying on a conditional spot month limit exemption would be required to file a form 504 daily for contracts specified by the CFTC. Market participants relying on the pass-through exemption would file a form 604. Finally, market participants seeking to rely on the anticipatory hedging exemption would be required to file an initial statement on Form 704 at least 10 days in advance of the date that such positions would be in excess of the proposed position limits. Unless rejected by the CFTC,

Form 704 filings would become effective 10 days after submission; however, the Re-Proposed Rule would require that a market participant relying on the anticipatory hedging exemption file a supplemental report when its position increases beyond its most recent filing. Moreover, market participants submitting a Form 704 would be required to provide annual updates regarding their actual cash-market activities and a monthly cash commodity position update on Form 204.

DCMs/SEFs

The Re-Proposed Rule adds several requirements that a DCM or SEF must adhere to when setting position limits for contracts that are subject to the CFTC's federal position limits — *i.e.,* those position limits established by the CFTC as opposed to the DCM or SEF. For example, a DCM or SEF that lists a contract on a commodity that is subject to federal position limits must adopt position limits for that contract at a level that is no higher than the federal position limit.[39] In addition, any hedge exemption adopted by a DCM or SEF in respect of position limits for Referenced Contracts must conform to the definition of bona fide hedging under the Re-Proposed Rule and must have aggregation rules that are consistent with those imposed by the CFTC.[40]

The Re-Proposed Rules also provide that DCMs and SEFs may, in their discretion:

i. Impose additional restrictions on a person with a long position in the spot month of a physical-delivery contract who stands for delivery, takes that delivery, then re-establishes a long position

ii. Establish limits on the amount of delivery instruments that a person may hold in a physical-delivery contract

iii. Impose such other restrictions as the DCM or SEF deems necessary to reduce the potential threat of market manipulation or congestion, to maintain orderly execution of transactions, or for such other purposes consistent with its responsibilities[41]

With respect to contracts that are not covered by the CFTC's position limits, the Re-Proposed Rule provides that DCMs and SEFs should establish speculative position limits for the spot month based on measurable deliverable supply (where a measurable deliverable supply exists) or as necessary or appropriate to reduce the potential threat of market manipulation (where a measurable deliverable supply does not exist). For non-spot month limits, the Re-Proposed Rule provides that the levels should be capped at a specific number of contracts.[42] The Re-Proposed Rules further provide that DCMs and SEFs should review their speculative limit levels at least every 2 years.[43]

As an alternative to setting position limits, the Re-Proposed Rule would allow DCMs and SEFs to adopt position accountability rules, which allow the platform to require trading participants to consent to provide information about their position upon request by the exchange and to consent to stop increasing a position or to reduce a position upon request by the exchange under certain specific circumstances enumerated under the Re-Proposed Rule.

The Proposed Aggregation Requirements

Under the CFTC's existing position limits requirements and the Re-Proposed Rule, a market participant is generally required to aggregate all positions for which that participant controls the trading decisions with all positions for which that participant has a 10 percent or greater ownership interest in an account or position, as well as the positions of two or more persons acting pursuant to an express or implied agreement or understanding.[44] The existing position limits requirements have historically provided certain exemptions from these aggregation requirements, and the Proposed Aggregation Requirements generally

incorporate and expand upon these existing exemptions. For example, the Commission has proposed loosening the aggregation requirement for entities where the party making the determination has less than 50 percent ownership of a subsidiary entity, subject to certain prohibitions on information sharing and coordinated trading, but has not proposed comparable relief for majority-owned entities even where trading decisions are wholly separate. The Commission has proposed limited relief for majority-owned entities only when the entities are not, and are not required to be, consolidated under generally accepted accounting principles (GAAP), and has explicitly stated that (i) the Commission must approve any application for such relief and (ii) no time limit applies to the Commission's decision-making process in connection with any such application. Thus, as a practical matter, this additional exception may not be available even where the conditions for relief appear to be met.

Other proposed exemptions from aggregation generally rely on barriers to information sharing and lack (or delegation) of decision-making authority. For instance, a number of regulated entities, such as commodity pool operators (CPO), banks and insurance companies, would be able to avoid aggregating customer accounts to the extent they use an independent account controller (IAC) to manage positions in referenced contracts. Holders of limited partnership interests in commodity pools would be able to exclude those interests from aggregation if the holder does not have decision-making authority over the pool.

The Commission has also proposed relief where the information sharing necessary to determine aggregate positions creates a reasonable risk of a violation of state, federal or foreign law. The Commission has also proposed to loosen the requirements to establish the legal risk of such a violation, requiring a legal memo (which can be from a trade association for multiple market participants) rather than a legal opinion.

Notwithstanding these broader proposed exemptions, aggregation is likely to be a significant issue for many market participants. The Commission has suggested managing aggregation issues by allocating the position limit among multiple entities and requiring each to trade within their share of the limit. In many cases, however — especially where a parent entity does not have control of trading decisions or where subsidiary entities may need to engage in significant hedging activity that individually or collectively require claiming the hedging exemption — this may not be a workable solution. For fund complexes and entities with large numbers of subsidiaries that may engage in trading, exceptions from aggregation may be unavailable or limited, and managing position limits across entities may be very difficult.

The table below describes the exemptions from aggregation that the CFTC has proposed. None of these exceptions applies to the extent that both entities are engaged in substantially identical strategies.

EXCEPTION	CONDITIONS	NOTICE REQUIRED
Minority owned entities	A person is permitted to disaggregate the positions of an entity in which the person has no greater than a 50% ownership or equity interest, provided that the persons: i. Do not have knowledge of the trading decisions of one another; ii. Trade pursuant to separately developed and independent trading systems; iii. Have and enforce written procedures to preclude	Yes, notice is required to be submitted to the CFTC, which would be effective upon filing. The notice must include a certification by a senior officer that the conditions of the exception are met.

EXCEPTION	CONDITIONS	NOTICE REQUIRED
	one another from gaining access to, or receiving data about, the trades of one another; iv. Do not share employees that control trading decisions of either person; and v. Do not have risk management systems that permit the sharing of trades or trading strategies.	
Majority owned entities	A person (the Parent) is permitted to disaggregate the positions of an entity (the Subsidiary) in which the Parent has greater than a 50% ownership or equity interest, provided that: i. All of the conditions from the minority-owned entity exemption are satisfied ii. The Parent and Subsidiary demonstrate to the CFTC that they have procedures in place to prevent coordinated trading decisions among the Parent, the Subsidiary, and any other entity that either must aggregate iii. The Parent certifies to the CFTC that its financials are not required to be, and are not, consolidated with those of the Subsidiary under GAAP iv. If any representatives of the Parent are on the board or equivalent body of the Subsidiary, each such director certifies that he or she does not control the trading decisions of the Subsidiary v. The Parent certifies to the CFTC that either: a. All of the Subsidiary's positions are bona fide hedging positions; or b. Any of the Subsidiary's positions that are not bona fide hedging positions do not exceed 20% of any position limits currently in effect; and	Yes, notice is required to be submitted to the CFTC, which would not be effective until the CFTC approves such request. The CFTC is not required to act with respect to such notice in any time period.[45]

EXCEPTION	CONDITIONS	NOTICE REQUIRED
	vi. The Parent agrees to aggregate its Subsidiary's positions if such certification becomes untrue, to notify the CFTC of certain occurrences of coordinated trading, and to respond to special calls from the CFTC.	
Independent Account Controllers (IACs)	Certain entities, including commodity pool operators (whether registered, exempt or excluded), commodity trading advisors, limited partners in exempt commodity pools, banks, trust companies, savings associations, insurance companies and affiliates of such persons (collectively, eligible entities) can disaggregate client accounts for which trading decisions are made by an IAC, provided that: i. The IAC is specifically authorized to control trading decisions, and the eligible entity does not exercise day-to-day control. ii. The eligible entity maintains only a limited amount of control over the IAC as is consistent with its legal responsibilities to its managed accounts and necessary to fulfill its duty to diligently supervise trading in the account (or, for a limited partner, limited member or shareholder of a commodity pool operated pursuant to a Section 4.13 exemption, only such limited control as consistent with its status). iii. The IAC trades independently of the eligible entity and of any other IAC trading for the eligible entity, and with no knowledge of positions taken by any other IAC; and iv. The IAC is registered as an FCM, IB, CTA or AP, or is a general partner (or other type of manager) of a commodity pool that is excluded or exempt from CPO registration under CFTC rules 4.5 or 4.13(a)(3).[46] The IAC exemption does not apply to spot month position limits in physical-delivery commodity contracts. The overall position of the IAC may not exceed the relevant	Yes, notice is required to be submitted to the CFTC, which would be effective upon filing. The notice must include a certification by a senior officer that the conditions of the exception are met.

EXCEPTION	CONDITIONS	NOTICE REQUIRED
	position limits. Additional restrictions relating to information walls and separateness apply if the eligible entity is affiliated with the IAC.	
Pooled accounts	In general, a limited partner, limited member, shareholder or other similar type of pool participant does not have to aggregate the accounts or positions of the pool with any other accounts or positions such person is required to aggregate, *unless* the person: i. Is the commodity pool operator (CPO) of the pooled account ii. Is a principal or affiliate of the CPO, unless certain procedures are in place to limit such person's knowledge of pool trading and positions and day-to-day control over trading decisions; or iii. Has a direct or indirect 25% or greater ownership or equity interest in a commodity pool, the CPO of which is exempt from registration under CFTC Regulation 4.13	Yes, notice is required to be submitted to the CFTC, which would be effective upon filing.[47] The notice may require a certification by a senior officer that the conditions of the exception are met.
FCMs	An FCM or any affiliate of an FCM need not aggregate positions it 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 an FCM or any of the officers, partners, or employees of such FCM or of its affiliates, if: i. A person other than the futures commission merchant or the affiliate directs trading in such an account. ii. 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. iii. Each trading decision of the discretionary account or the customer trading program is determined independently of all trading decisions in other accounts which the futures commission merchant or the affiliate holds, has a financial interest of 10% or more in, or controls; and iv. The FCM or the affiliate filed the requisite notice with the CFTC.	Yes, notice is required to be submitted to the CFTC, which would be effective upon filing. The notice must include a certification by a senior officer that the conditions of the exception are met.

EXCEPTION	CONDITIONS	NOTICE REQUIRED
Higher-tiered entities	A parent company of an entity relying on the owned entity exemption would also be permitted to rely on the exemption without submitting a separate notice filing, provided that such person: i. Complies with the conditions applicable to the exemption specified in the owned entity's notice filing, other than the filing requirements; ii. Does not otherwise control trading of the accounts or positions identified in the owned entity's notice; and iii. Provides the CFTC with certain information upon a special call by the CFTC.	No, but upon call by the CFTC, any person relying on this exemption would be required to provide information to the CFTC supporting the basis of the exemption
Information sharing	Persons are not required to aggregate positions or accounts if the sharing of information creates a reasonable risk that either person could violate state, federal or foreign law, provided that such person does not have actual knowledge of information associated with such aggregation.	Yes, notice is required to be submitted to the CFTC with a memorandum of law explaining the basis for the conclusion that sharing information would create a reasonable risk of violating applicable law. The notice must include a certification by a senior officer that the conditions of the exception are met.
Underwriting	Underwriters of securities are not required to aggregate positions or accounts of an owned entity if the ownership or equity interest is all or 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.	No notice filing is required.
Broker-Dealer Activity	A registered broker-dealer is not required to aggregate the positions of an owned entity if the broker-dealer does not have greater than a 50% ownership or equity interest in the owned entity and acquired the ownership in the normal course of business as a dealer. The broker-dealer cannot have actual knowledge of the trading decisions of the owned entity.	No notice filing is required.

Implications for Various Market Participants

If the Re-Proposed Rule is finalized as proposed, many market participants will likely be affected by the rule even if they do not exceed or approach the actual position limits levels. First, every market participant engaging in Referenced Contracts will be required to keep track of its positions to make sure that it does not exceed the specified limits. This task will be complicated by the need to determine whether any positions qualify as bona fide hedging transactions under the complex definition of that term, and by the need to deal with information sharing and aggregation across affiliated entities. Swap dealers will also likely require their counterparties to make written representations that a position is a bona fide hedging transaction so that they may rely on the pass-through exemption. Market participants should therefore consider adopting policies and procedures to monitor their positions, identify whether and where aggregation is required, and assess whether an exemption is available. This may be difficult for firms, however, because an entity will need to have a central monitoring function, or a compliance officer, responsible for monitoring a company's and its subsidiaries' positions, which could prove impractical if information barriers exist, for example, in the cross-border context.

Second, market participants may be subject to additional reporting and recordkeeping requirements, including, for example, reporting requirements for traders seeking an exemption for anticipatory hedging positions and persons holding positions in excess of the speculative position limits for which the person is relying on certain exemptions.[48]

Third, even market participants not engaging in Referenced Contracts may be subject to SEF or DCM-imposed position limits on other types of swaps or futures. SEFs and DCMs may need to develop systems to monitor and enforce position limits for transactions entered into outside of the platform because swaps, in particular, will likely be traded through multiple SEFs as well as over the counter.

The Re-Proposed Rule and Proposed Aggregation Requirements would likely have a particularly dramatic effect on collective investment vehicles such as private equity funds. For example, if a private equity fund owns multiple portfolio companies that engage in swaps, the fund may be required to ensure that all such swaps are entered into for bona fide hedging purposes (and that the proper notices are filed) or aggregate all of those positions. Alternatively, such a private equity fund could seek an exemption for position limits aggregation under the Majority Owned Entity exemption, described above. However, this exemption imposes multiple relatively onerous conditions on market participants and requires CFTC approval before a market participant can rely on it.

Finally, due to the CFTC's broad statement about the cross-border application of its position limits rules, US persons could be required to aggregate the swaps positions of their non-US affiliates even if such swaps are not otherwise subject to US regulations.

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Endnotes

[1] Position Limits for Derivatives, Proposed Rule, 78 Fed. Reg. 75680 (Dec. 12, 2013).

[2] Aggregation of Positions; Proposed Rule, 78 Fed. Reg. 68946 (Nov. 15, 2013).

[3] Position Limits for Futures and Swaps, Final Rule, 76 Fed. Reg. 71626 (November 18, 2011).

[4] Before the Dodd-Frank amendments, position limits were only applicable to a limited set of agriculture futures contracts specified in the CFTC's Part 150 regulations and to futures contracts traded on DCMs based on levels set by DCMS themselves.

[5] *See Int'l Swaps and Derivatives Assoc., et al. v. U.S. Commodity Futures Trading Commission*, Civil Action No. 11-cv-2146, Mem. Op. 5-6 (D.C., Sept. 28, 2012).

[6] *See id.* at p. 10.

[7] *See id.* at p. 12.

[8] *See id.* at p. 41.

[9] *See* Re-Proposed Rule, 78 Fed. Reg. at 75685.

[10] *See id*. at 75724.

[11] New York Harbor USLD is ultra-low-sulfur diesel delivered at New York Harbor; RBOB Gasoline is Reformulated Gasoline Blendstock for Oxygen Blending and Henry Hub is a natural gas distribution hub in Erath, Louisiana.

[12] *See* Re-Proposed Rule, 78 Fed. Reg. at 75724 n.388.

[13] The Re-Proposed Rule would expand upon the definition of "basis contracts" adopted in the Original Position Limits Rule to include a commodity derivative contracts that is cash-settled based on the difference in (1) the price of: (a) a particular Core Referenced Contract; or (b) a commodity deliverable on a Core Referenced Contract; and (2) the price at a different delivery location or pricing point of: (a) a commodity deliverable on the same Core Referenced Contract; or (b) a commodity listed in an appendix to the Re-Proposed Rule as substantially the same as the commodity underlying the Core Referenced Futures Contract. The CFTC noted that the definition of "basis contract" in the Original Position Limits Rule targeted the locational differential whereas the Re-Proposed Rule would include quality differentials as well.

[14] *See* Re-Proposed Rule, 78 Fed. Reg. at 75700 n.194.

[15] *See id.* at 75712.

[16] *See* Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations; Rule, 78 Fed. Reg. 45292, 45337 (July 26, 2013).

[17] *See* Re-Proposed Rule, 78 Fed. Reg. at 75701.

[18] *See id*.

[19] *See id.* at 75701-02.

[20] *See id.* at 75702.

[21] *See id.*

[22] *See id.* at 75724.

[23] *See id.* at Appendix D.

[24] *See id.* at 75727. The Re-Proposed Rule also states that the CFTC is considering two alternative proposals for setting initial spot month levels. Under the first alternative, the CFTC would set initial spot month limits based on estimated deliverable supplies submitted by a single DCM and applying a 25-percent formula. Under the second alternative, the CFTC would have discretion to set initial spot month limits based on each DCM's recommended level or a level set forth in the Appendix to the Propose Rule.

[25] *See id.* at 75765.

[26] *See id.* at 75702.

[27] *See id.* at 75729.

[28] *See id.*

[29] *See id.* at 75730.

[30] *See id.* at 75734.

[31] This differs from the CFTC's approach in the Original Position Limits Rule, where the CFTC created a new definition of bona fide hedging in Part 151 and maintained the old definition in Regulation § 1.3(z) for legacy futures positions. *See* Original Position Limits Rule, 76 Fed. Reg. at 71644.

[32] *See* Re-Proposed Rule, 78 Fed. Reg. at 75717.

[33] *See id*.

[34] *See id.*

[35] Unlike the Original Position Limits Rule, this exemption would apply to all Referenced Contracts rather than natural gas contracts only.

[36] The Re-Proposed Rule provides an exemption for swaps entered into before the effective date of the position limits rule twice: in proposed rules 150.2(f) — applicable to "pre-existing positions" — and 150.3(d) — applicable to "pre-enactment and transition swaps." These types of swaps overlap to some extent, and the two iterations of the rule appear to be inconsistent because proposed rule 150.2(f) states that pre-existing swaps are subject to spot month position limits, but 150.3(d) exempts pre-enactment and transition swaps from spot month and non-spot month position limits.

[37] *See* Re-Proposed Rule, 78 Fed. Reg. at 75739-41.

[38] *See id.* at 75741.

[39] *See id.* at 75828 (to be codified at 17 C.F.R. § 150.5(a)(1)).

[40] *See id.* (to be codified at 17 C.F.R. § 150.5(a)(2)).

[41] *See id.* at 75829 (to be codified at 17 C.F.R. § 150.5(a)(6)).

[42] *See id.* (to be codified at 17 C.F.R. § 150.5(b)(1)(ii)).

[43] *See id.* (to be codified at 17 C.F.R. § 150.5(b)(2)).

[44] *See* 17 C.F.R. § 150.4.

[45] Aggregation of Positions; Proposed Rule, 78 Fed. Reg. at 68960.

[46] If the IAC is affiliated with the eligible entity or another IAC, then certain additional requirements would apply.

[47] The text of the proposed rule appears to contain an incorrect reference when stating that the pooled account exemption would require a notice filing. *See* Aggregation of Positions; Proposed Rule, 78 Fed. Reg. at 68978 (to be codified at 17 C.F.R. § 150.4(c)(1)). However, because the persons seeking a "pooled account" exemption under the previous Part 151 were required to submit a notice, we believe that the CFTC intends for such persons to submit a notice under the Proposed Aggregation Requirements, as well.

[48] *See* Re-Proposed Rule, 78 Fed. Reg. at 75741-47.