

March 1, 2021

CFTC Adopts Position Limits Rule and Extends Regulations on Aggregation of Positions

Earlier this year, the Commodity Futures Trading Commission (“CFTC”) voted to finalize a new set of rules regarding position limits for certain physical commodity derivatives (the “Final Position Limits Rule”).¹ The Final Position Limits Rule establishes new and amended position limits for 25 commodity futures and options contracts as well as swaps that are economically equivalent to those contracts. The CFTC also voted to finalize amendments to expand the aggregation requirements applicable to position limits to all commodity derivative contracts subject to position limits.

Position Limits

How Does the Final Position Limits Rule Relate to Previous CFTC Position Limits Rulemakings?

On October 18, 2011, the CFTC adopted a final rule establishing position limits for 28 commodity futures contracts as well as futures, options and swaps that are economically equivalent to those contracts (the “Original Position Limits Rule”).² The International Swaps and Derivatives Association and the Securities Industry and Financial Markets Association challenged the Original Position Limits Rule in the U.S. District Court for the District of Columbia (the “District Court”),³ claiming that the CFTC erred in concluding that the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) required the CFTC to establish position limits without first determining whether such rules were necessary and that the CFTC conducted a flawed rulemaking process. On September 28, 2012, the District Court vacated the Original Position Limits Rule citing insufficient consideration of the need for such position limits by the CFTC.

¹ 17 C.F.R. Parts 1, 15, 17, 19, 40, 140, 150 and 151 - Position Limits for Derivatives, available at https://www.cftc.gov/sites/default/files/2021/01/2020-25332a.pdf?utm_source=govdelivery.

² 76 FR 71626 (November 18, 2011) (17 C.F.R. Part 151 - Position Limits for Futures and Swaps), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister101811c.pdf>. For a more detailed summary of the CFTC’s Original Position Limits Rule, see Client Memorandum entitled “*CFTC Adopts Position Limits Rule, Proposes to Extend Temporary Exemptive Relief From the Applicability of Certain Swap Provisions of the Dodd-Frank Act*” available at <http://www.paulweiss.com/media/102309/10Nov11-DF.pdf>.

³ *International Swaps and Derivatives Association et al. v. United States Commodity Futures Trading Commission*, United States District Court for the District of Columbia, Docket No. 1:11-cv-02146-RLW (December 2, 2011).

Responding to the District Court's decision, in late 2013 the CFTC proposed a new rule establishing position limits, which included a general finding that the Commodity Exchange Act (the "CEA"), as amended by Title VII of the Dodd-Frank Act, mandates the imposition of speculative position limits. The CFTC further supplemented the 2013 proposal in June 2016 and December 2016. On February 27, 2020, the CFTC withdrew the previous proposals from further consideration and proposed a new set of rules on which the Final Position Limits Rule is based.

How Does the Final Position Limits Rule Modify Existing Position Limits?

Current federal speculative position limits apply to nine commodity futures contracts and futures equivalent option contracts.⁴ The Final Position Limits Rule establishes spot-month and non-spot-month position limits applicable to 25 commodity futures contracts ("Core Referenced Futures Contracts")⁵ and the economically equivalent futures, options and swaps (collectively, "Referenced Contracts").⁶ Referenced Contracts include the Core Referenced Futures Contract, as well as (i) "look-alike" futures contracts and related options (i.e., those that are directly or indirectly related to, or are priced at a fixed differential to, the price of the Core Referenced Futures Contract) and (ii) economically equivalent swaps. Referenced Contracts do not include any guarantee of a swap, location basis contract, commodity index contract (referencing commodities that are not the same or substantially the same), contract based on prices across a month, outright contract that is settled based on an index published by a price reporting agency or trade option that meets certain regulatory requirements.⁷

What Is an Economically Equivalent Swap?

An economically equivalent swap is any swap that has identical material contractual terms to a Referenced Contract. Material contractual terms are those that drive the economic value of the swap, including those

⁴ The nine "Legacy Agricultural Contracts" are: CBOT Corn (C); CBOT Oats (O); CBOT Soybeans (S); CBOT Soybean Meal (SM); CBOT Soybean Oil (SO); CBOT Wheat (W); ICE Futures U.S. Cotton No.2 (CT); KCBT Hard Winter Wheat (KW); and MGEX Hard Red Spring Wheat (MWE).

⁵ The 25 Core Referenced Futures Contracts include the Legacy Agricultural Contracts as well as 16 new "Non-Legacy Agricultural Contracts": CME Live Cattle (LC); CBOT Rough Rice (RR); ICE Futures U.S. Cocoa (CC); ICE Futures U.S. Coffee C (KC); ICE Futures U.S. FCOJ-A (OJ); ICE Futures U.S. Sugar No. 11 (SB); ICE Futures U.S. Sugar No. 16 (SF); COMEX Copper (HG); COMEX Gold (GC); COMEX Silver (SI); NYMEX Palladium (PA); NYMEX Platinum (PL); NYMEX Henry Hub Natural Gas (NG); NYMEX Light Sweet Crude Oil (CL); NYMEX RBOB Gasoline (RB); and NYMEX New York Harbor ULSD (HO).

⁶ The Original Position Limits Rule and subsequent proposed rules applied to 28 Core Referenced Contracts and the economically equivalent Referenced Contracts. The CFTC has deferred action on cash-settled CME Class III Milk, CME Feeder Cattle and CME Lean Hogs contracts for which limits were proposed in the Original Position Limits Rule.

⁷ 17 C.F.R. Part 150.1.

impacting pricing and risk.⁸ Swaps may be economically equivalent to a Referenced Contract for purposes of the position limits even if they have a different notional amount than the relevant Referenced Contract, a different delivery date⁹ from the Referenced Contract or a different day count convention from the Referenced Contract if the other material contractual terms are identical. Swaps that reference another Referenced Contract or incorporate its terms by reference are also economically equivalent swaps.

How Are the Position Limits Calculated?

Spot-Month Position Limits

Spot-month position limits apply to all trades of a market participant in any Referenced Contract in the period immediately before delivery obligations are incurred for physically-settled contracts or the period immediately before contracts are liquidated by a clearinghouse based on a reference price for cash-settled contracts and are specific to each Referenced Contract. Generally, spot-month position limits will be set at or below 25% of the estimated spot-month deliverable supply of each respective Referenced Contract,¹⁰ applied separately to physically-settled and cash-settled contracts.¹¹ Physically-settled and cash-settled positions cannot be netted to determine whether spot-month position limits have been exceeded.

Non-Spot-Month Position Limits

Non-spot-month position limits apply to aggregated positions in all available trading months combined, as well as to positions in a single month, in each case, for the Legacy Agricultural Contracts only. For each Referenced Contract, the non-spot-month position limit will be set at 10% of the open interest in the first 50,000 contracts and 2.5% of the open interest thereafter. All positions in a Referenced Contract will be netted to determine whether the non-spot-month position limits have been exceeded. Non-Legacy Agricultural Contracts are subject to position limits or position accountability levels outside the spot-month set by the relevant exchange but are not subject to CFTC position limits.

⁸ The CFTC considers settlement type a material contractual term. As a result, cash-settled swaps will not be considered economically equivalent swaps unless there is an equivalent cash-settled futures contract.

⁹ The delivery date for economically equivalent physically-settled natural gas contracts can diverge from the Referenced Contract by up to two calendar days. If the delivery date for a physically-settled natural gas swap differs from the relevant Referenced Contract by more than two calendar days, it is not an economically equivalent swap for purposes of the position limits.

¹⁰ The spot-month deliverable supply is estimated by the relevant designated contract market that lists the Core Referenced Futures Contract and verified by the CFTC.

¹¹ Cash-settled NYMEX Henry Hub Natural Gas contracts will be limited to 2,000 contracts per exchange and 2,000 OTC contracts. Physically delivered NYMEX Henry Hub Natural Gas contracts will also be limited to 2,000 contracts.

Does the CFTC Provide for Any Exemptions from the Position Limits?

The Final Position Limits Rule includes exemptions for enumerated bona fide hedging transactions, pass-through swaps (swaps offsetting the risks of a position resulting from a bona fide hedging transaction) and certain anticipatory hedges. The Final Position Limits Rule also includes new exemptions for conditional spot-month positions in natural gas, pre-existing positions acquired in good faith and, in limited circumstances (including financial distress), upon request to the CFTC. Previously granted risk management exemptions will not be available after January 1, 2023. Any person claiming an exemption under the Final Position Limits Rule must keep books and records concerning all details of transactions that would otherwise be subject to position limits (including contracts for services, anticipated requirements, information on trade options, pass-through swap counterparties, etc.).

Aggregation of Positions

What Are the Aggregation Requirements?

On December 5, 2016, the CFTC finalized amendments to the aggregation requirements applicable to position limits (the “Aggregation Rule”). These rules applied only to Legacy Agricultural Contracts. The Final Position Limits Rule expands the aggregation requirements to positions in all Referenced Contracts (both Legacy and Non-Legacy Agricultural Contracts) held by separate but related entities for purposes of determining compliance with position limits. Absent an applicable exemption, aggregation is required across accounts in which a market participant (the “aggregating entity”) holds at least a 10% equity interest or where multiple accounts with identical trading strategies are controlled by such aggregating entity.

Are There Exemptions from the Aggregation Requirements?

The Aggregation Rule provides relief from the aggregation requirements with respect to accounts owned by an aggregating entity (the “owned account”) where the aggregating entity has no knowledge of, or control over, the trades of the owned account. Exemptions are also available where ownership results from broker-dealer activities, for underwriting and where sharing of information would violate, or create a reasonable risk of violating, U.S. federal or state law or the law or regulation of a foreign jurisdiction. Disaggregation relief is not available to aggregating entities that control the trading of multiple accounts or entities with substantially identical trading strategies. Notice must be filed with the CFTC to obtain relief from the aggregation requirements under most of the available exemptions.

Temporary Relief

The CFTC has issued several No-Action letters (the “No-Action Letters”) providing temporary relief from some of the aggregation requirements in the Aggregation Rule. The No-Action Letters include relief until August 12, 2022 for aggregating entities that hold or control the trading of multiple accounts or entities

with substantially identical trading strategies unless they hold or control such accounts or entities to willfully evade applicable position limits. The No-Action Letters also provide that, until August 12, 2022, exemption filings are only required upon request from the CFTC or the relevant designated contract market.

Fund Exemptions

The Aggregation Rule includes exemptions for limited partners, limited members, shareholders or other similar participants who own more than 10% of a pooled account so long as such person is not the commodity pool operator (the “CPO”) of the pool and holds less than 25% of a pooled account where the CPO is exempt from registration under CFTC Regulation 4.13. There is no exemption for CPOs that have knowledge of, or access to, trade data or positions or that supervise or control the funds’ trading activities. There is a limited exemption for principals or affiliates of a CPO that participate in the pool if there are written procedures to preclude the principal or affiliate from gaining access to the data about fund’s trading activities or positions, the principal or affiliate does not have day to day control over the fund’s trading decisions and maintains only such minimum control over the fund as is necessary to fulfill its duty to supervise the trading activities of the fund. The CPO must file notice with the CFTC for a principal or affiliate to obtain relief from the aggregation requirement, which is effective upon receipt by the CFTC.

Corporate and Private Equity Exemptions

Disaggregation relief is available for aggregating entities that own, but do not control, an owned entity and file notice with the CFTC. Entities (“higher tier entities”) that own 10% or more of another aggregating entity (the “owned aggregating entity”) may rely on the exemption notice filed by the owned aggregating entity only with respect to the accounts or positions specifically identified in the owned aggregating entity’s exemption notice. The higher tier entity must comply with the conditions applicable to the aggregation exemption specified in such exemption notice.

To obtain relief from the aggregation requirements, aggregating entities that, directly or indirectly, own 10% or more of the interest in accounts with positions in Referenced Contracts are required to file notice with the CFTC demonstrating that both the aggregating entity and the owned account:

- Have no knowledge of the trading decisions of the other,
- Trade separately and have developed separate and independent trading systems,¹²

¹² This condition does not prohibit the use of the same trading systems developed by third parties or the same in-house software so long as such systems or software does not permit parties to directly or indirectly coordinate trading.

- Have written procedures in place to preclude either entity from having knowledge of, gaining access to, or receiving data about, trades of the other,
- Do not share employees who control the trading decisions of the other, and
- Have risk management systems that do not permit the sharing of trades or trading strategies.

The exemption for such aggregating entities is effective upon submission of the required notice filing to the CFTC.

Independent Account Controller Exemption

An “eligible entity”¹³ is not required to aggregate positions or accounts controlled by an independent account controller (“IAC”)¹⁴ other than spot-month position limits in physical-delivery contracts. Each eligible entity affiliated with an IAC must (i) have written procedures in place to preclude either entity from having knowledge of, gaining access to, or receiving data about, trades of the other, (ii) trade separately and have developed separate and independent trading systems, (iii) not share employees who control the trading decisions of the other, and (iv) have risk management systems that do not permit the sharing of trades or trading strategies. The eligible entity must file notice with the CFTC to obtain relief from the aggregation requirement under this exemption, which is effective upon receipt by the CFTC.

Effective Dates

The Final Position Limits Rule will become effective on March 15, 2021, following which market participants will be able to avail themselves of new, higher position limits for the nine Legacy Agricultural Contracts. The Final Position Limits Rule provides that market participants will have until January 21, 2022 to comply with speculative position limits for the 16 Non-Legacy Agricultural Core Referenced Futures Contracts (for which position limits are not currently in place) and all associated Referenced Contracts other than

¹³ “Eligible entities” include CPOs, the operator of a vehicle excluded from the definition of “pool” or CPO under CFTC Regulation 4.5, a limited partner, limited member or shareholder in a pool operated by a CPO exempt from registration under CFTC Regulation 4.13, a commodity trading advisor (“CTA”), bank or trust company, savings association, insurance company, or an affiliate of any of these entities.

¹⁴ An “Independent Account Controller” is an entity that is specifically authorized by an eligible entity to independently control trading decisions and the eligible entity maintains such minimal oversight as is necessary to fulfil its fiduciary duties, trades independently of the eligible entity and any other IAC of the eligible entity, has no knowledge of trading decisions by other IACs and is either (i) registered as a futures commission merchant, introducing broker or CTA or (ii) a general partner, managing member or manager of a pool operated by a CPO exempt from registration under CFTF Regulation 4.5(a)(4) or 4.13 if such general partner, managing member or manager has filed notice with the CFTC to obtain relief as an IAC.

economically equivalent swaps. Economically equivalent swaps will become subject to position limits under the Final Position Limits Rule on January 1, 2023.

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Jessica S. Carey

+1 212 373 3566

jcarey@paulweiss.com

Manuel S. Frey

+1 212 373 3127

mfrey@paulweiss.com

Elanit A. Snow

+1 212 373 3673

esnow@paulweiss.com