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Division of
Market Oversight

CFTC Letter No. 18-33
No-Action
December 21, 2018
Division of Market Oversight

Re: No-Action Relief from certain Position Aggregation Requirements under Commission Regulation 150.4(b)(2)(i)(D).

This letter responds to a request received by the Division of Market Oversight ("DMO") of the Commodity Futures Trading Commission ("Commission") on behalf of "A" and its affiliates, (collectively, "A") and "B" and its affiliates (collectively, "B") for relief from compliance with certain position aggregation requirements under Commission Regulation 150.4(b)(2)(i)(D) ("the Request Letter").[1] DMO is issuing this time-limited letter to provide the requested relief.

I. Background

On December 16, 2016, the Commission published in the Federal Register a rulemaking entitled Aggregation of Positions, which amended Commission Regulation 150.4.[2] Amended Commission Regulation 150.4 determines which accounts and positions a person must aggregate for the purpose of determining compliance with the applicable position limit levels set forth in Commission Regulation 150.2, and includes a process by which a person may file with the Commission a notice seeking an exemption from such aggregation requirements (*i.e.*, a process by which a person may "disaggregate" its positions from those of another entity with which the person has certain ownership or control relationships). The amendments to Commission Regulation 150.4 became effective on February 14, 2017.

On August 10, 2017, DMO, pursuant to Commission Staff Letter No. 17-37 ("August 10th NAL"), issued relief which, among other things, involved the owned-entity exemption from aggregation in Commission Regulation 150.4(b)(2). Under that

[1] DMO notes that, in this particular case, this relief is not being granted to a regulated banking institution.

[2] Aggregation of Positions, 81 FR 91454 (December 16, 2016) ("Final Aggregation Rule").

regulation, any person with an ownership or equity interest in an owned entity of 10 percent or greater generally need not aggregate the accounts or positions of the owned entity with any other account or position such person is required to aggregate, provided that such person and the owned entity meet the conditions set forth in paragraphs (A)-(E) of 150.4(b)(2)(i) ("firewall conditions").

The owned-entity exemption in § 150.4(b)(2) provides as follows:

> Any person with an ownership or equity interest in an owned entity of 10 percent or greater (other than an interest in a pooled account subject to paragraph (b)(1) of this section), need not aggregate the accounts or positions of the owned entity with any other accounts or positions such person is required to aggregate, provided that:
>
> (i) Such person, including any entity that such person must aggregate, and the owned entity (to the extent that such person is aware or should be aware of the activities and practices of the aggregated entity or the owned entity):
>
> (A) Do not have knowledge of the trading decisions of the other;
> (B) Trade pursuant to separately developed and independent trading systems;
> (C) Have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other. Such procedures must include security arrangements, including separate physical locations, which would maintain the independence of their activities;
> (D) Do not share employees that control the trading decisions of either; and
> (E) Do 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; and
>
> (ii) Such person complies with the requirements of paragraph (c) of this section.

At issue in the Request Letter is the use of the term "trading decisions" in 150.4(b)(2)(i)(D), which provides that to comply with this firewall condition, the owner and owned entity "Do not share employees that control the trading decisions of either…" As noted in the August 10th NAL, while the Final Aggregation Rule does not directly address the scope of the term "trading" as used in any of the firewall conditions (i.e. whether "trading" refers only to derivatives trading, or to both derivatives and cash-

market trading), the firewall conditions do refer to "trading" and "trades" broadly, rather than only in connection with derivatives. Among other things, the August 10th NAL granted relief that effectively limited the scope of the term "trading decisions" in criterion (A) of 150.4(b)(2)(i) to derivatives trading decisions. Accordingly, under the August 10th NAL, owners and owned entities which have knowledge of the cash market trading decisions of the other (but not of the derivatives trading decisions of the other) can satisfy criterion (A) and disaggregate their positions, provided they fully satisfy each of the other firewall conditions. That relief was limited to condition (A) however, and did not extend to conditions (D) through (E) because the entities requesting the August 10th relief only requested such relief in connection with criterion (A).

II. Request for No-Action Relief

According to the Request Letter, "B" owns more than 10 percent of "A,"[3] and thus "B" and "A" are potentially eligible for the owned-entity exemption, provided they meet the firewall conditions. "A" is engaged in the business of originating, buying, handling, selling, and transporting various agricultural commodities.[4] From time to time, "B" hedges its exposure to these commodities by entering into futures contracts based on such commodities.[5] "B" is engaged in the business of marketing such commodities worldwide.[6] "A" and "B" have entered into an agreement whereby A has retained or "borrowed" an employee from "B" ("Shared Employee") who has specialized expertise involving physical grain markets.[7] The Shared Employee is dedicated solely to buying and selling physical grain for export on behalf of "A" and not "B," does not have involvement in any derivatives or hedging decisions for "A" or for "B," and may only become aware of hedges placed by "A" or "B" after such hedges have been placed.[8] Under the terms of the agreement, the services provided by the Shared Employee are limited to physical grain transactions and related activities, but do not include derivatives trading.[9]

[3] Request Letter at 2.

[4] Id.

[5] Id.

[6] Id.

[7] Id.

[8] Id.

[9] Id.

The Request Letter seeks relief where "A" and "B" would otherwise be in compliance with the applicable position limits in 150.2 and with the position aggregation requirements in 150.4(b)(2), but for the fact that "A" and "B" comply with 150.4(b)(2)(i)(D) only in connection with derivatives trading.[10] In other words, "A" would like relief which would allow it to comply with criterion (D) even though "A" and "B" share an employee that controls the cash market trading decisions (but not the derivatives trading decisions) of "A."

According to the Request Letter, the same rationale that applies to the granting of the August 10th relief that effectively limited criterion (A) to derivatives trading should also apply to criterion (D).[11] The Request Letter further asserts that the requested relief would create additional consistency among the criteria and the term "trading decisions," and would be consistent with the focus of the position limits regime on combatting excessive speculation in connection with derivatives trading.[12] The Request Letter also asserts that a failure to limit the scope of "trading decisions" to derivatives trading has the potential to create confusion and unintended consequences, as the term "trading decisions" can cover a wide variety of activities in different markets for global enterprises.[13]

III. Relief Provided

After reviewing the Request Letter, DMO is currently of the view that it should provide a term of no-action relief to allow staff to evaluate whether or not granting relief would hinder the Commission's ability to conduct surveillance, thereby impacting the policy purposes of the Final Aggregation Rules. While the Request Letter indicates that "A" and "B" are sharing an employee that controls the cash-market trading decisions of "A," the Request Letter also indicates that "A" and "B" meet all of the other firewall conditions, meaning the Shared Employee would still have no control over, and no knowledge of, the derivatives trading decisions of "A" and "B."[14] If this ceases to be true, or if the Commission's surveillance functions or other policy goals appear to be impacted by this relief, DMO can modify the terms of relief provided.

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[10] The Request Letter uses the phrase "commodity interest trading" to refer to derivatives trading.

[11] Request Letter at 3.

[12] Id.

[13] Id. at 3-4.

[14] Id. at 4 (indicating that "A" and "B" would otherwise be in compliance with the position aggregation requirements under § 150.4(b)(2) but for the fact that they comply with § 150.4(b)(2)(i)(D) only in connection with derivatives trading).

The relief provided below effectively permits disaggregation even though the Shared Employee controls the cash market trading decisions of the owned entity, as long as the Shared Employee does not control the "derivatives trading decisions" of either the owner or the owned entity.[15] The relief is available provided that all other applicable regulatory requirements, as modified by the August 10th NAL, have been satisfied, including, among others, that the firewall conditions set forth in Commission Regulation 150.4(b)(2)(i)(A), (B), (C), and (E) are otherwise met, that the Commission can continue to rely on its authority to request additional information under Commission Regulation 150.4(c)(3), and that two or more persons acting pursuant to an expressed or implied agreement or understanding will aggregate their positions in compliance with Regulation 150.4(a)(1).

During the period of the relief, DMO will continue to evaluate whether the relief granted is hindering the Commission's ability to conduct surveillance, and may alter the relief if the Commission's surveillance functions or other policy goals appear to be impacted. DMO notes that any long-term solution must, appropriately, be implemented by a notice and comment rulemaking.

Therefore, DMO will not recommend that until August 12, 2019, during the period the no-action relief is in effect, the Commission commence an enforcement action against "A" or "B" for violating any position aggregation requirement in Commission Regulation 150.4, or any applicable position limit, where "A" and "B" otherwise would be in compliance with the applicable position limits in Commission Regulation 150.2 and position aggregation requirements under Commission Regulation 150.4(b)(2), but for the fact that "A" and "B" comply with 150.4(b)(2)(i)(D) only in connection with derivatives trading.

Upon the expiration of this no-action relief, "A" and "B" must meet the criteria in 150.4(b)(2)(i)(A)-(E).

III. Conclusion

The no-action relief provided by this letter shall remain in effect until 12:01 a.m. eastern standard time on August 12, 2019.

[15] For purposes of this no-action letter, the phrase "derivatives trading" refers to the trading of derivatives subject to the Commission's jurisdiction.

The no-action relief provided by this letter is limited to the firewall condition for the owned entity exemption in 150.4(b)(2)(i)(D) in connection with cash-market trading decisions, and does not excuse "A" or "B" from compliance with any other applicable requirements contained in the Commodity Exchange Act ("CEA") or in the Commission regulations issued thereunder. The relief also does not address issues related to aggregation for other purposes under the CEA and regulations, including manipulation or other abusive practices.

This letter and the position taken herein represent the views of DMO only, and do not necessarily represent the views of the Commission or of any other division or office of the Commission. Further, this letter, and the relief contained herein, is based upon the representations made to DMO in the Request Letter. It should be noted that any different, changed, or omitted material facts or circumstances might render this letter void. Finally, as with all no-action letters, DMO retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the relief provided herein in its discretion.

If you have any questions regarding this staff no-action letter, please contact Aaron Brodsky at abrodsky@cftc.gov, 202-418-5349 or Riva Spear Adriance at radriance@cftc.gov, 202-418-5494.

Sincerely,

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Amir Zaidi
Director
Division of Market Oversight