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**Via Electronic Submission:** http://comments.cftc.gov

Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581
Attn: Mr. David Stawick, Secretary

RE: Notice of Proposed Rulemaking on Position Limits for Derivatives
*76 F.R. 4752* (January 26, 2011) (the "Proposal")

Dear Mr. Stawick:

Willkie Farr & Gallagher LLP respectfully submits comments on those aspects of the Proposal that restructure the rules (the "Proposed Aggregation Rules") regarding the aggregation of futures positions and economically equivalent swaps for the purposes of federal position limits, promulgated as part of the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[1] We have numerous clients that have a particular interest in this issue. Willkie advises commodity pool operators ("CPOs"), their single and multi-advisor commodity pools, family offices, asset allocators, commodity trading advisors ("CTAs"), futures commission merchants and administrators, among other participants in the commodity futures and swaps markets. If enacted, the Proposed Aggregation Rules would significantly and adversely affect our clients, as well others similarly situated, and may negatively impact the futures market in general as explained below.

## I. Departure from Historical Aggregation Framework

Currently, the Commission's regulations generally focus on common control over trading when determining whether positions should be aggregated; disaggregation is permitted in situations where control is effectively separated from ownership. This is consistent with Section 4a of the Commodity Exchange Act (the "Act"), which requires that positions held in and trading done under common control, or by two or more persons acting pursuant to an express or implied

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) (the "Dodd-Frank Act").

agreement, be aggregated. The Dodd–Frank Act did not amend Section 4a to require that ownership be the sole determinant with respect to aggregation. Additionally, as described below, the Commission's longstanding policies regarding aggregation have acknowledged that control, and not just ownership, is a key factor in determining whether aggregation is required.

Proposed Rule 151.7 would require the aggregation of positions held by a trader in accounts in which such trader, directly or indirectly, has an ownership or equity interest of 10% or greater or controls trading. Currently, the Commission's rules require aggregation only where such trader is also a principal or an affiliate of the pool operator and certain operational procedures are not in place. Those procedures are intended to prevent the trader from gaining knowledge of the pool's positions and to restrict the trader's ability to supervise or control the trading decisions made on behalf of the pool.[2] We acknowledge that Proposed Rule 151.7 contains a limited exemption available to certain persons with ownership interests in pools ranging from 10% to just below 25%, provided that any such person has no control over, and no knowledge of, the pool's trading or positions. The hard cap of 25% does not address the entirely reasonable situation where ownership exceeds that level but where neither control nor knowledge of the trading activity is present. As explained below, this limited exemption is simply insufficient to solve the many problems created by the proposed rule.

The Commission's current rules also contain a 25% pool ownership limitation at and beyond which point an investor must aggregate the pool's positions with its own. The current 25% aggregation provision, however, applies only if the pool's operator is exempt from registration pursuant to Rule 4.13.[3] Moreover, the existing "independent account controller" exemption is available under certain circumstances even for 25% owners, as discussed below. At the time the 25% ownership limit was established in Rule 150.4, Rule 4.13 CPO registration exemptions were available in very limited circumstances. Control by a 25% owner was more likely for a 4.13 pool prior to 2003 due in part to the closely held nature of such pools.[4] The Rule 4.13 registration exemptions were expanded in 2003 to cover CPOs of pools that (i) trade a *de minimis* amount of futures[5] and (ii) admit only sophisticated investors.[6] Where the CPO relies on Rule 4.13(a)(3) or (4), control of the pool by investors is less likely to exist; neither the relative portion of a pool devoted to futures trading nor the sophistication of a pool's investors, absent other factors, serves as a proxy for investor control over a pool. In the Rule 4.13(a)(1) and (2) contexts, control and access to information regarding the pool's trading activities may in fact be

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2 *See* CFTC Rule 150.4(c)(2).

3 CFTC Rule 150.4(c)(3).

4 *See* CFTC Rule 4.13(a)(1)-(2). Generally, Rule 4.13(a)(1) exempts from registration a CPO that operates only one pool, receives no fees and does not advertise the pool. Rule 4.13(a)(2) generally exempts from registration a CPO that operates pools that in the aggregate have 15 or fewer investors and less than $400,000 in capital contributions from persons unrelated to the CPO.

5 Rule 4.13(a)(3).

6 Rule 4.13(a)(4).

reasonably presumed. Where there exists, however, a real separation of functions and operations, a contractual restriction on an investor's ability to influence the CPO and effective information barriers, aggregation is not necessary in order to effect the objectives of the Act. The existing aggregation rules appropriately allow the non-controlling participants in such pools to avail themselves of an exemption from aggregation.[7] In a 1999 adopting release that further expanded the relief available under the Commission's aggregation rules, the Commission took note of commentary that many scenarios may exist where pool ownership, while concentrated, is not indicative of control. Examples cited by the Commission included single investor pools used for the purpose of investing ERISA funds, the use of seed money to launch the pool of a newly established CPO and other start-up situations; and situations where, upon securing one or two large investments, a pool's initial offering is closed so that trading may commence.[8] The Proposed Aggregation Rules would dismantle a framework that has developed over time with considerable deliberation and avoids unintended consequences.[9]

Additionally, under the CFTC's current rules, certain eligible entities, such as CPOs and CTAs, may avail themselves of the "independent account controller exemption" from aggregation.[10] This exemption is available where, for example, the independent pool operator (i) authorizes an independent account controller to independently control all trading decisions for positions it holds directly or indirectly, or on its behalf, but without its day-to-day direction and (ii) only maintains such minimum control over the independent account controller as is consistent with its fiduciary responsibilities and necessary to fulfill its duty to supervise diligently the trading done on its behalf. An independent account controller must (i) trade independently of the pool operator, and of any other independent account controller trading for such pool operator, without the day-to-day direction of such pool operator, (ii) have no knowledge of trading decisions by any other independent account controller and (iii) if affiliated with the pool operator or another independent account controller, have and enforce written procedures to preclude the affiliated entities from having knowledge of, gaining access to, or receiving data about, trades of the others.[11] By definition, an independent account controller must also be registered with the CFTC or be exempt from registration under Rule 4.13.[12] As a result of this exemption, many of our clients are able to provide diversified investment opportunities to their customers, including certain investors who have very few alternative investment options. A multi-advisor commodity pool, for example, permits an investor with a modest amount of money to invest in, and to access the trading strategies of multiple CTAs whose high minimum account sizes would be beyond the

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7 *See* CFTC Rule 150.1(e).

8 *See* Revision of Federal Speculative Position Limits and Associated Rules, 64 F.R. 24038 (May 5, 1999).

9 The CFTC's aggregation rules have evolved over more than 30 years. *See* Statement of Policy on Aggregation of Accounts and Adoption of Related Reporting Rules, 44 F.R. 33839 (June 13, 1979).

10 *See generally* CFTC Rule 150.1(e), CFTC Rule 150.3(a)(4).

11 CFTC Rule 150.1(e); CFTC Rule 150.4(c).

12 CFTC Rule 150.1(e)(5).

reach of such investors. Eliminating the independent account controller exemption may effectively render the offering of multi-advisor pools impossible, or prohibitively expensive.[13] Moreover, the CTAs who currently trade such pools would be faced with the choice of terminating their relationships with the pools or altering their trading strategies, potentially to the detriment of the pool and its participants. The CPO of a multi-advisor pool would be compelled to allocate a portion of the position limit to each of the pool's CTAs. In other words, a preset number of contracts in absolute value terms would be allocated to each CTA. No matter what the size of the pool, the level of pool assets allocated to a particular CTA or the size of that allocation relative to other accounts traded by the CTA, the CTA would be permitted to establish only its preset number of contracts for the pool. This allocation methodology would not take into account the possibility that one CTA's program may call for a short position to be established while another CTA's program may call for a long position to be established, thereby reducing the overall open interest in the market, rather than increasing it. Necessitating such a process could (i) limit the ability of each CTA to effectively trade its proprietary strategy on behalf of the pool, and (ii) require each CTA to modify its trading strategies to the potential detriment of the pool and its participants. The Commission can monitor the trading of multi-advisor pools through its regular surveillance program (*e.g.*, the Form 40). If the Commission is concerned about the positions in a particular pool – likely to happen only in extraordinary circumstances – the Commission could instruct the CPO or any of the CTAs to modify or reduce positions.

The Commission asserts that the proposed "non-financial entity exemption" would address the concerns of eliminating the independent account controller exemption. We respectfully disagree. The proposed exemption is extremely limited in scope. The non-financial entity exemption would not be available to many entities who by their mere ownership interest in a pool would be required to aggregate the pool's positions despite the fact that they possess no control over, and have no knowledge of, the positions held in such pool. Moreover, the Proposal provides no rationale for treating financial entities different from non-financial entities in situations where neither type of entity exerts control.

Common control represents a logical basis for requiring position aggregation. Emphasizing ownership fails to take into account the many legal and practical barriers that prevent investors, and in certain cases CPOs, from effecting control over the trading in a pool or having knowledge of that pool's positions. For example, with respect to a limited partnership, the application of state law and explicit provisions of limited partnership agreements mandate the passive nature of investors as limited partners. These investment vehicles vest in the general partner the authority to manage and control all aspects of the pool's investment activities without interference from

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[13] The Commission has long recognized the need for an aggregation exemption for multi-advisor pools. Rule 150.3(a)(4), exempting, among others, multi-advisor commodity pools using independent account controllers, was adopted by the Commission in 1988. *See* Exemptions from Speculative Position Limits for Positions Which Have a Common Owner But Which are Independently Controlled and for Certain Spread Positions, 53 F.R. 41563 (October 24, 1988). In 1991, the Commission amended Rule 150.3(a)(4) to make it applicable to CTAs. *See* Exemption From Speculative Position Limits for Positions Which Have a Common Owner, But Which Are Independently Controlled, 56 F.R. 14308 (April 9, 1991).

the investors. A limited partner that is found to have participated in management, moreover, could be deemed to have general partner liability. Also of note, the investment management agreement between a third party CTA and a pool generally explicitly states that the general partner will not interfere with the CTA's trading (other than in extraordinary circumstances). Such agreements also implicitly provide that investors retain no rights in the management of, or control over, the pool. The Proposed Aggregation Rules entirely overlook this practical reality in proposing to make ownership, rather than control, the touchstone for mandating aggregation.

## II. Potential Negative Consequences of Proposed Aggregation Rules

The Proposed Aggregation Rules may have adverse effects with respect to:

(a) Information Sharing and "Inadvertent" Aggregation. The Proposed Aggregation Rules may require CPOs to share information with certain investors in order to enable such investors to comply with the position limit requirements. CPOs would not normally share their pools' specific position information with investors. As noted above, if the proposed rules are enacted, an investor may be required to aggregate positions held in a pool over which the investor has no control and no knowledge of positions held. Because that investor remains subject to the position limits set by the Commission, however, it would need to obtain knowledge of the specific activities of the pool and would have to rely on the CPO of the pool to provide accurate and timely information. Of particular concern is the fact that the Proposed Aggregation Rules provide no guidance to an investor on how to obtain access to information to which it is not legally entitled but which is necessary for the investor to ensure its own compliance with position limits. No mechanism exists to compel a CPO to share position information with investors who, by virtue of exceeding ownership thresholds, have a need for such information. The Proposed Aggregation Rules, moreover, may create a conflict of interest for the CPO in potentially favoring one investor over another. Specifically, the proposed rules may encourage the selective disclosure of information to certain investors but not to others.

(b) Information Sharing and Trading Strategies. In connection with the concerns described above, the Proposed Aggregation Rules may result in the creation of an information-sharing framework whereby passive investors in one pool obtain information from which they may derive the trading strategies of another pool or CTA. Most, if not all, CTA trading strategies are proprietary and highly confidential. Investment management contracts invariably stipulate that, while a pool operator may have access to a CTA's trading information, such information is not to be disseminated to any of the pool participants or otherwise used. Notwithstanding the concerns this poses to traders in the event the trading information is made available in the first place, if a passive investor also actively trades for its own or other accounts, the opportunity for abuse of the CTA's proprietary information exists. The fact that CTAs routinely require anyone who has access to their trading information to agree to keep such information confidential underscores the importance of confidentiality to CTAs. The Proposed Aggregation Rules may jeopardize the ability of a CTA to

protect its intellectual property, which is its most valuable asset.[14] Disclosure could cause a CTA to lose its competitive edge and the benefits of its extensive expenditures on research and development of strategies. Such information sharing would also raise the potential for a CTA to leverage this knowledge to force the liquidation of positions in a pool managed by a competing CTA, potentially impacting profitability and harming the pools' investors.

(c) Fiduciary Concerns and Effective "Control". The Proposed Aggregation Rules also may have an undesirable impact on the operation of pools which have an investor who exceeds the proposed ownership thresholds and for whom an exemption is not proposed to be made available. Such an investor could be precluded from taking otherwise desirable commodity market positions because of positions held in a separately operated pool in which that investor has placed funds. Moreover, other investors may suffer lost profits that otherwise would have been achieved, but for the aggregation requirements (and in the absence of control by the "aggregating investor"). These situations may be exacerbated when the investor in question also serves as the advisor or operator of another commodity pool. The Proposed Aggregation Rules would require such an investor to either liquidate positions held in the pool which it operates or advises or attempt to direct the trader of the pool in which it is invested to liquidate its positions. Either possibility is unpalatable; the first option potentially harms the other investors in the investor-operated pool, while the second option circumvents the very activity the Commission's existing rules are intended to prevent by encouraging the attempt to exercise control by an otherwise passive investor.

(d) Constant Monitoring. Because the Proposed Aggregation Rules focus not on control but on ownership, an investor who exceeds (or reasonably believes it may at some point in the future exceed) the proposed ownership thresholds would need to constantly monitor its positions in such pools to ensure it does not run afoul of position limits. Currently, where passive ownership exists (or the operator has registered), such an investor is not subject to these potentially time-intensive and even counterproductive monitoring requirements. As noted above, the investor would not have the information needed to ensure compliance. Unlike an account owner who receives actual position statements from its futures commission merchant, a commodity pool investor does not have access to the brokerage statements received by the pool.

(e) Market Concerns. The Proposed Aggregation Rules would require the aggregation of positions otherwise exempt for the purposes of measuring position limits. As speculative traders may be forced to reduce the overall volume of the positions they

[14] We note that in a matter related to the bankruptcy of Refco, several CTAs successfully opposed the disclosure of the historical database of a multi-advisor commodity pool managed by a Refco affiliate. The database contained trading and position information of several CTAs. That action highlights the value placed by CTAs on information -- no matter how old -- related to their trading strategies and positions.

hold, market liquidity may be reduced, resulting in increasing volatility and negatively impacting the price discovery function of the futures and swaps markets. Reduced liquidity impacts not only speculators, but also end-users and those who enter the commodities markets for hedging against risk.

(f) Multi-Advisor Commodity Pools. The elimination of the independent account controller exemption would hamstring the ability of CPOs to delegate trading authority to multiple CTAs, even where effective information and control barriers exist. That in turn could prevent investors – in particular retail investors who have very few alternative investment options – from having the opportunity to benefit from multiple trading strategies and the efficient allocation of capital. CTAs that currently trade for multi-advisor pools, moreover, may terminate their relationships with such pools, further limiting investor access and options.

(g) Legal, IT and Organizational Framework. Under the Commission's current aggregation rules, many market participants have already expended considerable time and money building an effective framework to separate those with ownership interests in a pool from access to information concerning the positions held by that pool. The Proposed Aggregation Rules do not address these efforts to comply with the law in this respect. The additional legal and back-office work necessary to ensure compliance with the proposed rules (*e.g.*, deciding if, how and when to provide certain investors with information they would need) could come at a significant cost.

## III. Effective Alternatives to the Proposal Exist.

Proposed Rule 151.7(g) would require that non-financial entity exemptions be sought through an application process. This process is vague in that the Proposal only provides the categories of information required and not the standards by which the Commission will judge an application. One way to address this issue would be to grant a conditional exemption upon receipt of an application by the Commission. In the event of a negative determination, the applicant could be given a reasonable time interval to come into compliance. We note that the Commission does not suggest in the Proposal that existing information and control barriers are ineffective or that independent account controllers have abused the exemption. If the Commission in fact believes that ineffective barriers and abuse exist, we respectfully suggest that the current requirements be reviewed and, if appropriate, revised. The application requirement also would impose an additional annual burden on those seeking exemptions (as well as the Commission). The Commission's statement in the Proposal that self-execution is insufficient and inefficient does not acknowledge that alternative means exist to achieve an effective aggregation regime. For example, the Commission could elect to increase its use of Form 40 special calls[15] and otherwise employ its existing surveillance tools to investigate potentially problematic situations in a more targeted manner. The Commission should consider the relative costs and benefits of alternative monitoring regimes.

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[15] Statement of Reporting Trader, *see* Rule 18.04.

Rather than focus on mere ownership, we believe that the Commission's efforts to require aggregation of positions in appropriate situations would be more effectively focused on a combination of ownership and control. In that vein, the linchpin for aggregation should focus on control, and appropriate exemptions should remain available where effective information and control barriers have been implemented, even in the case of significant concentrations of ownership within a pool. Any changes should leave intact the existing independent account controller exemption where pool operators implement and maintain appropriate restrictions on the flow of information and do not, other than in extraordinary circumstances, exercise control over the trading in the pool. While the efforts to thwart collusive trading behavior and the undetected build-up of concentrated market positions through ownership as well as common control are well-intentioned, we believe the Proposed Aggregation Rules may well have the undesirable consequence of encouraging the very conduct sought to be avoided. The proposed rules may also have an adverse impact on the operation of the commodity futures markets and come at significant expense to market participants.

We would be pleased to address our comments or further discuss any of the Proposed Aggregation Rules with the Commissioners or the Staff.

Respectfully submitted,

Rita M. Molesworth

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cc: The Hon. Gary Gensler, CFTC Chairman
The Hon. Michael Dunn, CFTC Commissioner
The Hon. Bart Chilton, CFTC Commissioner
The Hon. Jill E. Sommers, CFTC Commissioner
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