Alternative Investment Management Association

David A. Stawick,
Secretary of the Commission,
Commodity Futures Trading Commission,
Three Lafayette Centre,
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Submitted via email: secretary@cftc.gov

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Dear Mr Stawick,

CFTC Notice of Proposed Rulemaking - Aggregation Under Part 151, Position Limits for Futures and Swaps

The Alternative Investment Management Association (AIMA)[1] appreciates the opportunity to provide comment on the Commodity Futures Trading Commission (CFTC) Notice of Proposed Rulemaking on aggregation under Part 151, Position Limits for Futures and Swaps (the Notice). The Notice proposes clarification and amendment of the CFTC Final Rule and Interim Final Rule of 18 November 2011, which established a position limits regime for 28 exempt and agricultural commodity futures and options contracts and the physical commodity swaps which are economically equivalent to such contracts.

1. Introduction

AIMA's members are active participants in the US commodity markets and play a key role in providing liquidity to aid price discovery by acting as willing buyers for producers and willing sellers for end users. As set out in our previous responses to the CFTC, we continue to believe that the participation of financial institutions in the commodity markets, including the derivatives market, is of genuine utility and that little evidence exists of a direct causal relationship between market volatility, higher prices and the participation of financial institutions within the market.

AIMA believes that the Notice is a positive development in relation to the CFTC position limits regime and welcomes the CFTC's willingness to take the reasoned opinions of industry stakeholders into account. In particular, we welcome the CFTC's clarification of how the violation of laws exemption would be applied to circumstances involving a 'reasonable risk' of breach and the proposed extension of the latter exemption to include the provisions of US states and foreign jurisdictions.

We are keen to assist the CFTC's work in ensuring that its position limit rules are effective and proportionate in achieving their objectives. We, therefore, set out below a number of constructive comments on the proposed rules contained within the Notice, in particular regarding the owned entity exemption, along with suggestions for amendment and further guidance.

2. AIMA's Detailed Comments

a) *Owned Entity Exemption*

AIMA largely agrees that aggregation should be on the basis of control. This is especially so in the context of investment funds, where an individual managed capital investor may technically own, directly or indirectly, a greater than 10% stake in an entity, yet be entirely passive regarding the commercial decision-making of that entity. The requirement for investors to aggregate positions held by such accounts with their own is disproportionately burdensome on managed capital investors and should be amended.

[1] AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,300 corporate bodies in 45 countries.

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AIMA, therefore, welcomes the possibility of an exemption from aggregation of the positions held by an entity in which a person holds greater than 10% equity or ownership interest with the latter person's own positions. However, we would highlight the following key areas which we believe merit further amendment, clarification and guidance:

i) Greater than 50% Equity or Ownership Threshold

AIMA appreciates the CFTC's concerns that it may be inconsistent with the statutory requirement to aggregate on the basis of ownership positions held by an entity in which a person has a greater than 50% ownership or equity interest are excluded from the aggregation requirement.

However, for the purpose of CFTC concerns regarding direct or indirect influence on, or coordination of, positions as a result of high levels of ownership, AIMA considers that the greater than 50% threshold is unnecessary.

The combined effect of the other criteria contained within the Owned Entity Exemption would render the 50% ownership threshold less relevant. Taken together (a) enforcement of the mutual prohibition of knowledge of the others' trading decisions; (b) the requirement for the adoption of procedural barriers to the sharing of knowledge of and access to each others' trades; (c) the prohibition on sharing employees who control trading decisions; and (d) the requirement for trading to be pursuant to independent trading systems would mean that entities could not coordinate or exert influence upon decisions as they would have no knowledge of, and be procedurally separate from, the decision making process. Nonetheless, if the CFTC wishes to maintain the greater than 50% ownership threshold, AIMA believes that there should be the possibility of a case-by-case application for relief.

ii) Shared Employees with Control

Proposed Rule 151.7(b)(1)(i)(D) prevents the sharing of employees which control the trading decisions owned entities. However, when combined with Proposed Rule 151.7(b)(1)(i)(A), this requirement is seemingly extended to prohibit the sharing of any employees which may be able to attribute knowledge of the trading decisions of the opposing entity. AIMA strongly believes that any sharing of employees who are held to attribute 'knowledge' to an entity for the purpose of Proposed Rule 157(b)(1)(i)(A) should not include any individual who does not have control of the trading decisions of his/her respective entity. In response to the CFTC's direct query regarding the suitability of sharing 'attorneys, accountants, risk managers, compliance and other mid- and back-office personnel' which do not have the authority to influence trading decisions, we do not believe that such sharing would involve any loss or compromise of independence.

iii) Application of the Exemption Criteria to both Investor and Owned Entity

As currently drafted, Proposed rules 151.7(b)(1)(i)(A)&(C) within the Notice would appear to prohibit either party from having knowledge of the other's trading decisions and to require both parties to have enforced written procedures to preclude any such knowledge of, access to and reception of trade data regarding the trades of the other. AIMA questions the necessity of applying the aforementioned requirements to the relevant owned entity in which the person has invested.

As confirmed within the Notice, aggregation under the CFTC regime is justified on the basis of both ownership and control. Individuals who own less than 10% of an entity are considered not to have control, whereas if an individual owns an equal to or greater than 10% equity stake in an entity, that individual is subject to a rebuttable presumption that he does exercise control. In both situations, the owned entity itself has no such ownership or control interest in its investor, and therefore, should not be required to adopt any procedures or incur undue costs associated with the regime. Whether the owned entity has knowledge of its investors' trading decisions is entirely irrelevant for the purposive intention of the strict conditions under Proposed rule 151.7(b)(1)(i), namely to prevent circumvention of the position aggregation regime by individuals in control of an owned entity.

In addition, a requirement for an individual to confirm to the CFTC that an owned entity in fact complies with the criteria is not practically viable.

AIMA would suggest that, in order to ensure the proportionality of the regime, the conditions for the Owned Entity Exemption be applied to the individual seeking application and not to the owned entity.

iv) Requirement for Separately Developed and Independent Trading Systems

AIMA agrees with the CFTC that, in order to prevent the circumvention of the aggregation rules and the exploitation of the Owned Entity Exemption, the conditions for its application must be rigorous. In this regard, we support the requirement within the Notice for the exemption applicant and owned entity to operate independent trading systems so that knowledge of trading decisions and other data is not shared between the two, thus leading to potential collaboration and direct or indirect influence.

However, we believe that the requirement under Proposed rule 151.7(b)(1)(i)(B) for trading to be pursuant to 'separately developed' trading systems would place a disproportionate burden upon market participants, which could be difficult to overcome.

Many trading systems operated by investment firms are developed by specialist third-party entities which license their products to numerous participants across the market; this is especially so for off-the-shelf execution algorithms used by many investment managers. Such specialist development, through comparative advantage, enables higher quality and more efficient systems to be created than would otherwise be possible, thus resulting in more consistent and efficient markets and greater profitability for all participants.

Economically, if participants do choose to comply with the separate development requirement, this would mean that specialist systems developers would suffer a large fall in demand; possibly leading to unnecessary business failures. Accordingly, this would require individual participants to develop their own systems, thereby losing all efficiency benefits of the comparative advantage currently enjoyed by specialist third party developers since each would lack the consolidated expertise or the economies of scale to undertake the extensive research and development of successful systems and algorithmic products.

From the viewpoint of optimising proportionality, the requirement for the use of separately developed systems would also result in the arbitrary withholding of the aggregation exemption due to the incidental fact that the individual applicant for the exemption had licensed the same system as the relevant owned entity. This would have the counterintuitive result of barring the possibility of an Owned Entity Exemption, even though the individual and owned entity's systems were, in practice, entirely separate and operated independently of each other.

The requirement, as currently formulated, is not a suitable means by which to achieve the objective of preventing surreptitious collaboration and goes far beyond that which is necessary by imposing undue costs upon participants and the markets as a whole.

AIMA, therefore, proposes that the owned entity exemption condition be amended so that, as long as the trading systems operate independently and no information may be leaked between them, it should not matter whether the systems were originally developed by a common party.

v) Requirement to Have and Enforce Written Procedures to Preclude Each Other from Having Knowledge of, Gaining Access to or Receiving Data about Trades of the Other

AIMA has concerns that the requirement and examples contained within Proposed rule 151.7(b)(1)(i)(C) are overly broad and too vague.

Certain of our members, in particular, have inquired as to what is meant by the terms 'document routing' and whether the notion of 'separate physical locations' is simply a requirement for firms to document the fact that all clients must be geographically separate. In addition, we would question whether the necessity for procedures to 'maintain the independence of their activities' is consistent with the principal requirement under Proposed rule 151.7(b)(1)(i)(C), which relates not to independence of activities, but to knowledge, access and trade data. AIMA's members would be especially grateful for further guidance to be provided by the CFTC on this procedural criterion, in a similar manner as has been undertaken, for example, for Proposed rule 151.7(b)(1)(i)(A).

AIMA would also be grateful for clarification of the how the criterion within Proposed rule 151.7(b)(1)(i)(C) would interact with that within Proposed rule 151.7(b)(1)(i)(A). For example, page 26 of the Notice asserts that the CFTC 'does not consider knowledge of overall end of day position information to necessarily constitute knowledge of trading decisions', therefore satisfying the criteria within Proposed rule 151.7(b)(1)(i)(A). AIMA is

interested to discover whether this would mean that the provision of end of day position information (in compliance with the above Proposed rule on having knowledge of trading decisions) would still result in non-compliance with Proposed rule 151.7(b)(1)(i)(C) regarding the adoption of procedures to prevent knowledge of/access to/receipt of data on the trading of the other entity.

b) *Violation of Laws Exemption*

AIMA welcomes the CFTC's provisions for the exemption from aggregation of situations when the sharing of information between a person and an owned entity regarding position information would result in the violation of federal law. We are particularly grateful that the CFTC has clarified that the exemption applies in situations when the sharing of such information would result in a 'reasonable risk' of a breach of laws or regulations, and is extended to include both state rules and laws of a foreign jurisdiction.

Our members, however, have certain suggestions which they would like to be considered by the CFTC:

i) Extension to all laws, regulations, administrative rulings and court orders

The Notice currently provides exemptions in situations which risk a breach of the laws or regulations of the US federal government, US states and laws of a foreign jurisdiction. This is a positive step. However, to ensure the equal application of the exemption to all market participants, AIMA believes that it is important for it to be expanded to include all laws, regulations, administrative rulings and court orders from any governmental authority which has jurisdiction over the persons seeking to utilise it.

ii) Requirement to gain an opinion of Counsel

AIMA understands the petitioners' concerns regarding the requirement to obtain an opinion of Counsel - which has been confirmed by the CFTC within the Notice - and agrees that this requirement may impose an unreasonable and disproportionate burden on market participants seeking to utilise the exemption.

We would argue that legal opinions are typically issued by law firms and attorneys on specific matters such as enforceability or security interests and may not be suitable for the issue of violation of laws. In particular, law firms may not be willing, or may not be able, to provide an opinion. This lack of certainty may disincentivise participants from applying in good faith for a prospective exemption in the first place.

AIMA would propose that the requirement of an opinion of counsel be replaced by a 'supporting legal documentation' requirement. Such 'supporting legal documentation' could include:

- a legal opinion prepared by internal or external counsel;
- a legal memorandum prepared by internal or external counsel;
- a copy of a court order;
- a copy of an administrative ruling; or
- any other document(s) which the CFTC considers would enable it to review the facts and circumstances in support of the claimed exemption.

Maximising the flexibility of the regime in this way would place a more proportionate burden on applicants, whilst still achieving the CFTC's legislative aim of providing reliable official documentation by which to evaluate of applications for exemption.

c) *Exemption for Independent Account Controllers (IACs)*

As the CFTC will be aware, investment funds may be structured in numerous different ways, including Limited Liability Companies and Limited Partnerships. AIMA, therefore, welcomes the addition of the manager or managing member of a limited liability company to the definition of an IAC. We would however, like to stress that the rules contained within the Notice do not take the impact of the extraterritorial application of the CFTC's rules into account.

A great number of foreign investment funds and entities could potentially be treated as commodity pools, CTAs or CPOs - despite not being organised as such - and it is vital for such commodity pools which are not structured as limited liability companies or partnerships to be able to make use of the IAC exemption. For this reason, AIMA proposes that the CFTC's rules on the exemption of IACs from the aggregation regime should ensure that any entity or person is included in the definition of an IAC where that entity or person has a role in respect to an entity which is substantially equivalent to the role of a general partner within a limited liability partnership or manager/managing member within a limited liability company.

3. Conclusion

Overall, AIMA supports the policy objectives of the proposed rules contained within the Notice. However, it is vital for industry participants that proportionality is ensured and legal certainty maximised so that they are able to continue providing benefits, such as liquidity, to the commodities market and may confidently budget for, develop and adopt systems and procedures accordingly to ensure their efficient compliance.

We thank you for this opportunity to comment on the Commission's proposed rules and are, of course, happy to discuss any of our comments with you in greater detail if this would assist.

Yours sincerely,

Jiří Król
Director of Government & Regulatory Affairs