

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 3

RIN 3038-XXXX

Exemption from Registration for Certain Foreign Persons Acting as Commodity Pool Operators of Offshore Commodity Pools

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of Proposed Rulemaking; Reopening of Comment Period.

SUMMARY: The Commodity Futures Trading Commission (Commission) is proposing to amend the conditions in Commission regulation 3.10(c) under which a person located outside of the United States engaged in the activity of a commodity pool operator (CPO; each person located outside of the United States a non-U.S. CPO) in connection with commodity interest transactions on behalf of persons located outside the United States (collectively, an offshore commodity pool or offshore pool) would qualify for an exemption from CPO registration and regulation with respect to that offshore pool. Specifically, through amendments to Commission regulation 3.10(c), the Commission is proposing that non-U.S. CPOs may claim an exemption from registration with respect to its qualifying offshore commodity pools, while maintaining another exemption from registration, relying on an exclusion, or registering as a CPO with respect to the operation of other commodity pools. The Commission is also proposing to add a safe harbor by which a non-U.S. CPO of an offshore commodity pool may rely upon the proposed exemption in Commission regulation 3.10(c) if they satisfy enumerated factors related to the operation of the offshore commodity pool. Additionally, the Commission is proposing to permit certain U.S. control affiliates of a non-U.S. CPO to contribute capital to such CPO's

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offshore pools as part of the initial capitalization without rendering the non-U.S. CPO ineligible for the exemption from registration under Commission regulation 3.10.

DATES: Comments must be received on or before [Insert date 60 days from publication in the Federal Register].

ADDRESSES: You may submit comments, identified by RIN 3038-XXXX, by any of the following methods:

CFTC Comments Portal: <http://comments.cftc.gov>. Select the “Submit Comments” link for this rulemaking and follow the instructions on the Public Comment Form.

Mail: Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Center, 1155 21st Street NW, Washington, DC 20581.

Hand Delivery/ Courier: Same as mail above.

Please submit your comments using only one of these methods. To avoid possible delays with mail or in-person deliveries, submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <https://comments.cftc.gov>. You should submit only information that you wish to make publicly available. If you wish the Commission to consider information that may be exempt from disclosure under the Freedom of Information

Act (FOIA), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission’s regulations.¹

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from <https://comments.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under FOIA.

FOR FURTHER INFORMATION CONTACT: Joshua B. Sterling, Director, (202) 418-6056, jsterling@cftc.gov, Amanda Leshler Olear, Deputy Director, (202) 418-5283, aolear@cftc.gov, or regarding Section III of this Notice of Proposed Rulemaking, Frank Fisanich, Chief Counsel, (202) 418-5949, ffisanich@cftc.gov, Division of Swap Dealer and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

Section 1a(11) of the Commodity Exchange Act (CEA or Act)² defines the term “commodity pool operator” as any person³ engaged in a business that is of the nature of a

¹ 17 CFR 145.9. Commission regulations referred to herein are found at 17 CFR Chapter I (2019).

² See 7 U.S.C. 1, *et seq.* (2019). The CEA and the Commission’s regulations are accessible through the Commission’s website, <https://www.cftc.gov>.

³ See 17 CFR 1.3 (defining “person” to include individuals, associations, partnerships, corporations, and trusts).

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commodity pool, investment trust, syndicate, or similar form of enterprise, and who, with respect to that commodity pool, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in commodity interests.⁴ CEA section 1a(10) defines a “commodity pool” as any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests.⁵ CEA section 4m(1) generally requires each person who satisfies the CPO definition to register as such with the Commission.⁶ With respect to CPOs, the CEA also authorizes the Commission, acting by rule or regulation, to include within or exclude from the term “commodity pool operator” any person engaged in the business of operating a commodity pool if the Commission determines that the rule or regulation will effectuate the purposes of the CEA.⁷

Additionally, CEA section 4(c), in relevant part with respect to this proposal, provides that the Commission, to promote responsible economic or financial innovation and fair competition, by rule, regulation, or order, after notice and opportunity for hearing, may exempt, among other things, any person or class of persons offering, entering into, rendering advice, or rendering other services with respect to commodity interests from any provision of the Act.⁸

⁴ 7 U.S.C. 1a(11). *See also* 17 CFR 1.3 (defining “commodity interest” to include any contract for the purchase or sale of a commodity for future delivery, and any swap as defined in the CEA); Adaptation of Regulations to Incorporate Swaps, 77 FR 66288, 66295 (Nov. 2, 2012) (discussing the modification of the term “commodity interest” to include swaps).

⁵ 7 U.S.C. 1a(10).

⁶ 7 U.S.C. 6m(1).

⁷ 7 U.S.C. 1a(11)(B).

⁸ 7 U.S.C. 6(c)(1).

Section 4(c) authorizes the Commission to grant exemptive relief if the Commission determines, *inter alia*, that the exemption would be consistent with the “public interest.”⁹

To provide an exemption pursuant to section 4(c) of the Act with respect to registration as a CPO, the Commission must determine that the agreements, contracts, or transactions undertaken by the exempt CPO should not require registration and that the exemption from registration would be consistent with the public interest and the Act.¹⁰ The Commission must further determine that the agreement, contract, or transaction will be entered into solely between appropriate persons and that it will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory duties under the Act.¹¹ The term “appropriate person” as used in Section 4(c) includes “a commodity pool formed or operated by a person subject to regulation under the Act.”¹² The Commission has previously interpreted the clause “subject to regulation under the Act” as including persons who are exempt from registration or excluded from the definition of a registration category.¹³

Part 3 of the Commission’s regulations governs the registration of intermediaries engaged in, *inter alia*, the offering and selling of, and the provision of advice concerning, all

⁹ See Conference Report, H.R. Report 102–978 at 8 (Oct. 2, 1992) (“The goal of providing the Commission with broad exemptive powers . . . is to give the Commission a means of providing certainty and stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner.”).

¹⁰ 7 U.S.C. 6(c)(2)(A).

¹¹ *Id.* at 6(c)(2)(B).

¹² *Id.* at 6(c)(3)(E).

¹³ See, Further Definition of “Swap Dealer”, 77 FR 30596, 30655 (May 23, 2012) (finding, in the context of the eligible contract participant definition, that “construing the phrase ‘formed and operated by a person subject to regulation under the [CEA]’ to refer to a person excluded from the CPO definition, registered as a CPO or properly exempt from CPO registration appropriately reflects Congressional intent”).

commodity interest transactions. Commission regulation 3.10 establishes the procedure that intermediaries, including CPOs, must use to register with the Commission.¹⁴ Commission regulation 3.10 also establishes certain exemptions from registration.¹⁵ In particular, Commission regulation 3.10(c)(3) (referred to herein as the 3.10 Exemption) provides that, *inter alia*, a person engaged in the activity of a CPO, in connection with any commodity interest transaction executed bilaterally or made on or subject to the rules of any designated contract market or swap execution facility, is not required to register as a CPO, provided that:

1. The person is located outside the United States, its territories, and possessions (the United States or U.S.) (a non-U.S. CPO);
2. The person acts only on behalf of persons located outside the United States (an offshore commodity pool); and
3. The commodity interest transaction is submitted for clearing through a registered futures commission merchant.¹⁶

A person acting in accordance with the 3.10 Exemption remains subject to the antifraud provisions of CEA section 4o,¹⁷ but is otherwise not required to comply with those provisions of

¹⁴ See, e.g., 17 CFR 3.10(a)(1)(i) (requiring the filing of a Form 7-R with the National Futures Association (NFA)).

¹⁵ See 17 CFR 3.10(c) (exemption from registration for certain persons).

¹⁶ 17 CFR 3.10(c)(3)(i). *But see* CFTC Staff Letters No. 16-08 and 15-37. Pursuant to these letters, Commission staff in the Division of Swap Dealer and Intermediary Oversight (DSIO) recognized that not all swaps are required to be cleared, and thus provided relief from registration for certain intermediaries acting on behalf of persons located outside the United States or on behalf of certain International Financial Institutions in connection with swaps not subject to a Commission clearing requirement. In 2016, the Commission published a proposed rule that would codify the position articulated in these DSIO staff letters. See Exemption from Registration for Certain Foreign Persons, 81 FR 51824 (Aug. 5, 2016). The Commission is reopening the comment period on such proposed rule pursuant to this Proposal. See Section III, *infra*.

¹⁷ 7 U.S.C. 6o.

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the CEA or Commission regulations applicable to any person registered in such intermediary capacity or persons required to be so registered.¹⁸ The 3.10 Exemption provides that it is available to non-U.S. CPOs whose activities, in connection with any commodity interest transaction executed bilaterally or made on or subject to the rules of any designated contract market or swap execution facility, are confined to acting on behalf of offshore commodity pools.¹⁹ This exemption was first adopted in 2007 and was based on a long-standing no-action position articulated by the Commission’s Office of General Counsel in 1976.²⁰

In adopting the final rule amending Commission regulation 3.10, the Commission agreed with commenters who cited its longstanding policy of focusing “customer protection activities upon domestic firms and upon firms soliciting or accepting orders from domestic users of the futures markets.”²¹ The Commission further stated that the protection of non-U.S. customers of non-U.S. firms may be best deferred to foreign regulators.²² The Commission noted its understanding that, pursuant to the terms of the 3.10 Exemption, “[a]ny person seeking to act in accordance with any of the foregoing exemptions from registration should note that the prohibition on contact with U.S. customers applies to solicitation as well as acceptance of

¹⁸ 17 CFR 3.10(c)(3)(ii). As market participants, however, such persons remain subject to all other applicable provisions of the CEA and the Commission’s regulations promulgated thereunder.

¹⁹ 17 CFR 3.10(c)(3)(i).

²⁰ Exemption from Registration for Certain Foreign Persons, 72 FR 63976, 63977 (Nov. 14, 2007). See CFTC Staff Interpretative Letter 76-21.

²¹ *Id.* at 63977, quoting Introducing Brokers and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators; Registration and Other Regulatory Requirements, 48 FR 35248, 35261 (Aug. 3, 1983).

²² *Id.* The Commission also cited this policy position in the initial proposal for what ultimately became Commission regulation 3.10(c)(3)(i). See Exemption from Registration for Certain Foreign Persons, 72 FR 15637, 15638 (Apr. 2, 2007).

orders.”²³ Moreover, the Commission stated that “[if] a person located outside the U.S. were to solicit prospective customers located in the U.S. as well as outside of the U.S., these exemptions would not be available, even if the only customers resulting from the efforts were located outside the U.S.”²⁴

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)²⁵ amended the definition of “commodity pool operator” and “commodity pool” to include those persons operating collective investment vehicles that engage in swaps,²⁶ which resulted in an expansion of the universe of persons captured within the statutory definitions of both CPOs and commodity pools. When combined with the rescission of Commission regulation 4.13(a)(4) in 2012,²⁷ an increasing number of non-U.S. CPOs were required to either register with the Commission or claim an available exemption or exclusion with respect to the operation of their commodity pools, both offshore pools and those offered to U.S. participants.

In 2018, the Commission proposed adding a new exemption in Commission regulation 4.13 to codify the relief provided in CFTC Staff Advisory 18-96 (Advisory 18-96).²⁸ As part of that proposal, the Commission noted that the proposed exemption based on Advisory 18-96

²³ Exemption From Registration for Certain Foreign Persons, 72 FR at 63977-78.

²⁴ *Id.* at 63978.

²⁵ Pub. L. 111-203, H.R. 4173 (2010).

²⁶ See Section 721 of the Dodd-Frank Act.

²⁷ See Commodity Pool Operators and Commodity Trading Advisors; Compliance Obligations, 77 FR 11252, 11264 (Feb. 24, 2012). Former Commission regulation 4.13(a)(4) provided an exemption from registration as a CPO for operators of commodity pools offered and sold to sophisticated participants. See, 17 CFR 4.13(a)(4) (2010).

²⁸ Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors, 83 FR 52902 (Oct. 18, 2018); CFTC Staff Advisory 18-96 (Apr. 11, 1996).

could be claimed on a pool-by-pool basis, and stated that “[t]his characteristic would effectively differentiate the [proposed exemption] from the relief currently provided” under the 3.10 Exemption.²⁹ The Commission received several comments regarding that aspect of the proposal. One commenter noted that the 3.10 Exemption “is widely relied on around the world by non-U.S. managers of offshore funds that are not offered to U.S. investors but that may trade in the U.S. commodity interest markets.”³⁰ This commenter further noted that “CPO registration for these offshore entities with global operations is not a viable option[,]” due to the logistical and regulatory issues involved.³¹ Another commenter stated that, “it is critical to bear in mind that the Commission ... to our knowledge has never addressed, the separate and distinct question of whether an offshore CPO may rely on Rule 3.10(c)(3)(i) with respect to some of its offshore pools in combination with relying on other exemptions with respect to its other pools.”³² Several other commenters expressed similar views and requested that the Commission affirm the ability to claim the 3.10 Exemption on a pool-by-pool basis and to rely upon that exemption in addition to other exemptions, exclusions, or registration.³³

²⁹ Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors, 83 FR at 52914.

³⁰ See Comment letter from the Asset Management Group of the Securities Industry and Financial Markets Association (SIFMA AMG) at 9 (Dec. 17, 2018), available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61922&SearchText=>.

³¹ *Id.* at 12.

³² See Comment letter from Fried, Frank, Harris, Shriver, & Jacobson, LLP (Fried Frank) at 6 (Dec. 17, 2018), available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61920&SearchText=>.

³³ See, e.g., Comment letter from Willkie, Farr, and Gallagher, LLP (Willkie) at 6 (Dec. 11, 2018), available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61927&SearchText=>; Comment letter from Alternative Investment Management Association (AIMA) at 6 (Dec. 17, 2018), available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61907&SearchText=>.

In 2019, the Commission withdrew its proposal to codify the relief provided in Advisory 18-96, and, in light of the comments received in response to the discussion of the 3.10 Exemption, instead undertook an inquiry as to whether the 3.10 Exemption should be amended to respond to the current CPO space and the issues articulated by commenters.³⁴ Based on the foregoing, and in light of the increasingly global nature of the commodity pool space, the Commission preliminarily believes that the statutory and regulatory developments since 2007 have resulted in a growing mismatch between the Commission's stated policy purposes underlying the 3.10 Exemption, which are to focus the Commission's resources on the protection of U.S. persons, and the 3.10 Exemption as adopted in 2007. Therefore, the Commission has preliminarily determined that it is appropriate to amend the 3.10 Exemption to better align the terms of the exemption with the Commission's continued policy goals. The result is this proposal.

II. The Proposal

The Commission is proposing, pursuant to its authority under CEA section 4(c), several amendments to the current 3.10 Exemption (the Proposal). Specifically, the Commission is proposing amendments to the 3.10 Exemption such that non-U.S. CPOs may rely on that exemption on a pool-by-pool basis to better reflect the current state of operations of CPOs. The Commission is also proposing a conditional safe harbor to enable non-U.S. CPOs who, by virtue of the structure of their offshore pool, cannot with certainty represent that there are no U.S. participants in their operated pool, to rely on the 3.10 Exemption. The Commission is further proposing that the revised 3.10 Exemption be available to be claimed along with other

³⁴ Registration and Compliance Requirements for Commodity Pool Operators (CPOs) and Commodity Trading Advisors: Family Offices and Exempt CPOs, 84 FR 67355, 67357 (Dec. 10, 2019).

exemptions or exclusions available to CPOs generally and to provide an exception from the U.S. participant prohibition in the 3.10 Exemption for initial capital contributions received from a U.S. controlling affiliate of an offshore pool's non-U.S. CPO.

a. Pool-by-Pool Exemption

The Commission understands that non-U.S. CPOs may operate both offshore commodity pools and commodity pools on behalf of persons located inside the United States (U.S. commodity pools or U.S. pools). As stated previously, however, the 3.10 Exemption prohibits persons from relying on that relief with respect to certain pools, but not others. Under a categorical prohibition on contact with U.S. persons by non-U.S. CPOs seeking to rely on the 3.10 Exemption, a non-U.S. CPO that operates both offshore pools and pools offered to U.S. persons would not be eligible for registration relief under Commission regulation 3.10(c). As a result, a non-U.S. CPO that operates a combination of offshore and onshore commodity pools would be required to either list its offshore pools with the Commission and comply with part 4 of the Commission's regulations with respect to the operation of those pools as if those pools were no different from U.S. commodity pools, find another available exemption from registration, or claim a regulatory exclusion with respect to those offshore pools.

The Commission continues to believe that it is advisable to focus its customer protection activities on U.S. persons and on the persons and firms that solicit derivatives transactions from those U.S. person customers.³⁵ The Commission's regulatory regime was designed with a view to ensuring U.S. persons solicited for and participating in commodity pools receive the full benefit of the customer protections provided under the Act. The current terms of the 3.10

³⁵ See, *id.* at 63977.

Exemption may result in the Commission overseeing the operation of commodity pools that are themselves not domestic either in terms of their location or participants. The Commission's mandate regarding protection of customers in the U.S. commodity interest markets with respect to the operation of commodity pools is primarily focused on protecting U.S. pool participants, not commodity pools located outside the United States that have only non-U.S. pool participants. Reducing regulation of commodity pools that are outside of the Commission's primary customer protection mandate also allows the Commission to more effectively apply its resources for this purpose. Therefore, the Commission is proposing to amend Commission regulation 3.10(c)(3) such that non-U.S. CPOs may avail themselves of the 3.10 Exemption on a pool-by-pool basis by specifying that the availability of the 3.10 Exemption would be determined by whether all of the participants in a particular offshore pool are located outside the United States. The Commission preliminarily believes that amending the 3.10 Exemption such that non-U.S. CPOs may claim relief on a pool-by-pool basis appropriately focuses Commission oversight on those pools that solicit and/or accept U.S. persons as pool participants.

Moreover, since the adoption of the 3.10 Exemption in 2007, Congress expanded the Commission's jurisdiction to include, among other things, transactions in swaps³⁶ and rolling spot retail foreign exchange transactions.³⁷ When combined with amendments to, as well as the rescission of, various regulatory exemptions, this has necessarily resulted in an increase in the

³⁶ Wall Street Transparency and Accountability Act of 2010, Pub. L. 111–203, 124 Stat. 1376 (2010).

³⁷ Food, Conservation, and Energy Act of 2008, Pub. L. 110-246, 122 Stat. 1651, 2189-2204 (2008).

variety of persons captured within the definition of a CPO.³⁸ Additionally, the Commission notes the increasing globalization of the commodity pool industry. For example, unlike when Commission regulation 3.10(c)(3)(i) was originally adopted, when measured by assets under management, today several of the largest CPOs are located outside the United States, and these larger CPOs typically operate many different commodity pools including some pools for U.S. investors and other pools for non-U.S. investors. Upon consideration of these developments, the Commission has preliminarily concluded that the 3.10 Exemption should be amended to reflect the Commission's regulatory interests in such an integrated international investment management environment. Therefore, the Commission preliminarily believes that the Proposal, if adopted, would provide much-needed regulatory flexibility for non-U.S. CPOs operating offshore commodity pools by taking into account the global nature of their operations without compromising the Commission's mission of protecting U.S. pool participants.

For the reasons stated above, the Commission preliminarily believes that amending the 3.10 Exemption such that non-U.S. CPOs may claim the exemption from registration with respect to the operation of their offshore pools, while claiming an alternative exemption or exclusion, or registering regarding the operations of their commodity pools that are offered or sold to U.S. persons, is an appropriate exercise of its exemptive authority under section 4(c) of the CEA. Additionally, the Commission preliminarily believes that clearly enabling non-U.S. CPOs to avoid the additional organizational complexity associated with separately organizing

³⁸ See, e.g., 17 CFR 4.13(a)(3) (swaps added to the enumerated commodity interests subject to the de minimis threshold following the Dodd-Frank Act, which effectively narrowed the availability of the exemption); Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 FR 7976 (Feb. 11, 2011) (rescinding Regulation 4.13(a)(4), which provided an exemption from registration for certain privately offered commodity pools).

their offshore and domestic facing businesses in an effort to comply with the provisions of the 3.10 Exemption may result in more non-U.S. CPOs undertaking to design and offer commodity pools for persons in the United States. Moreover, the Commission preliminarily believes that this could result in greater diversity of pool participation opportunities for U.S. persons and that this increased competition amongst commodity pools and CPOs could foster additional innovation regarding commodity pool operations, which is already one of the more dynamic sectors of the Commission’s responsibility. The Commission further preliminarily believes that this potential for increased competition and variation in commodity pools and CPOs would further promote the vibrancy of the U.S. commodity interest markets.

The Commission has preliminarily determined that the proposed revisions to the 3.10 Exemption set forth herein will not have a material adverse effect on the ability of the Commission or any contract market to discharge their duties under the Act, because non-U.S. CPOs that would be exempt under the terms of this Proposal would remain subject to the statutory and regulatory obligations imposed on all participants in the U.S. commodity interest markets.³⁹ The Commission notes that this preliminary conclusion is consistent with section 4(d) of the Act, which provides that any exemption granted pursuant to section 4(c) will “not affect the authority of the Commission to conduct investigations in order to determine compliance with the requirements or conditions of such exemption or to take enforcement action for any violation of any provision of the CEA or any rule, regulation or order thereunder

³⁹ See, e.g., 7 U.S.C. 9 (prohibiting the use or employment of any manipulative or deceptive device in connection with any swap or contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity).

caused by the failure to comply with or satisfy such conditions or requirements.”⁴⁰ Moreover, the Commission would retain the authority to take enforcement action against any non-U.S. CPO claiming the 3.10 Exemption based on their activities within the U.S. commodity interest markets consistent with its authority regarding market participants generally.

b. Proposed Safe Harbor with Respect to Inadvertent Participation of U.S. Participants in Offshore Pools

As discussed above, one of the criteria for relief in current Commission regulation 3.10(c)(3)(i) is that, in connection with any commodity interest transaction executed bilaterally or made on or subject to the rules of any designated contract market or swap execution facility, the claiming non-U.S. CPO be acting “only on behalf of persons located outside the United States, its territories, or possessions.”⁴¹ The Commission understands that non-U.S. CPOs of offshore pools that are traded in offshore secondary markets may not have the ability to make such a representation with certainty as they cannot be assured that only persons located outside the U.S. would be accepted as participants because the participation units are not purchased directly from the offshore pool. Moreover, the Commission also understands that, given the common use of complex entity structures for tax purposes, a non-U.S. CPO may not have complete visibility into the ultimate beneficial owners of its offshore pool’s participation units, even in the absence of secondary market trading.

Despite this fairly common lack of visibility into the ultimate ownership of some offshore pools, the Commission preliminarily believes that a non-U.S. CPO should be able to rely on the

⁴⁰ 7 U.S.C. 6(d).

⁴¹ 17 CFR 3.10(c)(3)(i).

3.10 Exemption provided that the non-U.S. CPO undertakes reasonable efforts to minimize the possibility of U.S. persons being solicited for or sold participation units in the offshore pool. The Commission preliminarily believes that non-U.S. CPOs should not be foreclosed from relying upon the relief available under the 3.10 Exemption solely due to the nature and structure of the operated offshore pool preventing them from representing with absolute certainty that no U.S. persons are participating in that pool, provided that such non-U.S. CPOs take reasonable actions available to them to ensure that only non-U.S. persons are solicited and admitted as pool participants.

Therefore, the Commission is proposing to add a safe harbor as new Commission regulation 3.10(c)(3)(iv) for non-U.S. CPOs that have taken, what the Commission preliminarily believes are, reasonable steps designed to ensure that participation units in the operated offshore pool are not being offered or sold to persons located in the United States. Pursuant to that proposed safe harbor, a non-U.S. CPO would be permitted to engage in the U.S. commodity interest markets on behalf of offshore pools for which it cannot represent with absolute certainty that all of the pool participants are offshore, consistent with the requirements under the 3.10 Exemption, provided that such non-U.S. CPO meets the following conditions with respect to the operated offshore pool:

1. The offshore pool's offering materials and any underwriting or distribution agreements include clear, written prohibitions on the offshore pool's offering to participants located in the United States and on U.S. ownership of the offshore pool's participation units;⁴²

⁴² The Commission notes that, for purposes of the safe harbor, and consistent with the proposed exception for initial capital contributions from a U.S. controlling affiliate, proposed Commission regulation 3.10(c)(3)(iii) discussed *infra*, such U.S. controlling affiliate is not considered to be a "participant."

2. The offshore pool's constitutional documents and offering materials: (a) are reasonably designed to preclude persons located in the United States from participating therein, and (b) include mechanisms reasonably designed to enable the CPO to exclude any persons located in the United States who attempt to participate in the offshore pool notwithstanding those prohibitions;
3. The non-U.S. CPO exclusively uses non-U.S. intermediaries for the distribution of participations in the offshore pool;
4. The non-U.S. CPO uses reasonable investor due diligence methods at the time of sale to preclude persons located in the United States from participating in the offshore pool; and
5. The offshore pool's participation units are directed and distributed to participants outside the United States, including by means of listing and trading such units on secondary markets organized and operated outside of the United States, and in which the non-U.S. CPO has reasonably determined participation by persons located in the United States is unlikely.

For this purpose, the Commission has preliminarily determined that a non-U.S. intermediary would include a non-U.S. branch or office of a U.S. entity, or a non-U.S. affiliate of a U.S. entity, provided that the distribution takes place exclusively outside of the United States.

By satisfying the factors of the safe harbor, for example, that the offshore pool's offering materials clearly prohibit ownership by participants that are U.S. persons,⁴³ and by using offshore distribution channels and exchanges, the Commission preliminarily believes that the

⁴³ See note 45, *supra*.

non-U.S. CPO is exercising sufficient diligence with respect to those circumstances within its control to demonstrate its intention to avoid engaging with U.S. persons concerning the offered offshore pool. Moreover, the Commission preliminarily believes that if a non-U.S. CPO meets the five factors in the safe harbor, the absence of U.S. participants is sufficiently ensured so as to allow reliance on the 3.10 Exemption. As with any of the Commission's other registration exemptions available to CPOs, whether domestic or offshore, the Commission would expect non-U.S. CPOs claiming the 3.10 Exemption to maintain adequate documentation to demonstrate compliance with the terms of the safe harbor.

The Commission preliminarily believes that providing a safe harbor with appropriate conditions for non-U.S. CPOs of commodity pools, regarding the absence of U.S. participants in their offshore pools to avail themselves of the exemptive relief in the 3.10 Exemption, may result in more offshore pools choosing to engage in the commodity interest markets in the United States. Moreover, as noted above, pursuant to section 4(d) of the Act, the Commission expressly retains the statutory authority to conduct investigations in order to determine compliance with the requirements or conditions of such exemption or to take enforcement action for any violation of any provision of the CEA or any rule, regulation or order thereunder caused by the failure to comply with or satisfy such conditions or requirements.⁴⁴ Moreover, again as noted above, the Commission would retain the authority to take enforcement action against any non-U.S. CPO claiming the 3.10 Exemption based on their activities within the U.S. commodity interest markets. Therefore, the Commission preliminarily believes that the safe harbor proposed herein is an appropriate exercise of its authority pursuant to section 4(c) of the Act.

⁴⁴ 7 U.S.C. 6(d).

c. Utilizing the 3.10 Exemption Concurrent with Other Regulatory Relief Available to CPOs

As discussed above, the Commission is proposing that the 3.10 Exemption for non-U.S. CPOs be available on a pool-by-pool basis. Consistent with these proposed amendments, the Commission also preliminarily believes it is appropriate to propose amendments to explicitly provide that non-U.S. CPOs may claim the 3.10 Exemption while that CPO also claims other registration exemptions or regulatory exclusions with respect to other pools it operates, *e.g.*, the *de minimis* exemption under Commission regulation 4.13(a)(3),⁴⁵ or an exclusion from the definition of CPO under Commission regulation 4.5,⁴⁶ or to register with respect to such pools,⁴⁷ in order to address the concerns articulated by commenters to the 2018 Proposal.⁴⁸ The Commission understands that this practice is known colloquially as the ability to “stack” exemptions.

Currently, the 3.10 Exemption does not have a provision that contemplates its simultaneous use with other exemptions available under other Commission regulations. This stands in contrast with the language in Commission regulation 4.13(f), for example, which states, “[t]he filing of a notice of exemption from registration under this section will not affect the ability of a person to qualify for exclusion from the definition of the term ‘commodity pool

⁴⁵ 17 CFR 4.13(a)(3).

⁴⁶ 17 CFR 4.5.

⁴⁷ The Commission notes that including registration among the provisions a non-U.S. CPO may “stack” with the 3.10 Exemption is not strictly necessary, as such status is implied given the amendments described earlier to allow the 3.10 Exemption to apply on a pool-by-pool basis. Nevertheless, the Commission is explicitly stating that such a status is possible to provide certainty to affected non-U.S. CPOs.

⁴⁸ See, *e.g.*, AIMA, at 6; Willkie, at 6.

operator’ under § 4.5 in connection with its operation of another trading vehicle that is not covered under this § 4.13.”⁴⁹

With respect to those non-U.S. CPOs that operate both U.S. pools and pools that meet the terms of the 3.10 Exemption, the Commission preliminarily believes that such non-U.S. CPOs should have the ability to rely on other regulatory exemptions or exclusions that they qualify for, just like any other CPO. The Commission preliminarily believes that the fact that the CPO of a U.S. commodity pool that otherwise meets the criteria for its operator to claim registration relief under Commission regulation 4.13(a)(3), for example, has also claimed the 3.10 Exemption for one or more of its offshore pools does not raise heightened regulatory concerns regarding the operation of the U.S. pool. The Commission has independently developed the terms under which CPOs of U.S. commodity pools may claim registration relief, and the fact that a non-U.S. CPO operates both offshore and U.S. commodity pools does not undermine the rationale providing the foundation for the Commission’s other regulatory exemptions available to CPOs generally.

The Commission therefore preliminarily concludes that a non-U.S. CPO relying upon the 3.10 Exemption for one or more of its offshore pools should not be, by virtue of that reliance, foreclosed from utilizing other relief generally available to CPOs of U.S. pools. Thus, the Commission is also proposing to add Commission regulation 3.10(c)(3)(iv) to establish that a non-U.S. CPO’s reliance upon the 3.10 Exemption for one or more pools will not affect that CPO’s ability to claim other exclusions or exemptions, including those in Commission regulations 4.5 or 4.13, or to register with respect to the other pools that it operates.

⁴⁹ 17 CFR 4.13(f).

d. Affiliate Investment Exception

The Commission is also proposing to add Commission regulation 3.10(c)(3)(iii), which provides that initial capital contributed by a non-U.S. CPO's U.S. controlling affiliate to that CPO's offshore commodity pool would not be considered in assessing whether that pool is an offshore pool for purposes of the 3.10 Exemption because the U.S. controlling affiliate would not be considered a "participant" for purposes of either proposed Commission regulation 3.10(c)(3)(ii) or 3.10(c)(3)(iv). For the purpose of this proposed amendment, the term "control" would be defined as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise.⁵⁰

Although the 3.10 Exemption is intended to focus the Commission's resources on protecting U.S. participants, the Commission preliminarily believes that the control typically exercised by a controlling affiliate over its non-U.S. CPO affiliate should provide a meaningful degree of protection and transparency with respect to the controlling affiliate's contribution of initial capital to the non-U.S. CPO's offshore commodity pool. Moreover, the majority of a CPO's compliance obligations generally focus on customer protection through a variety of disclosures regarding a person's participation in a pool, which is information the controlling affiliate would likely already be in a position to obtain independent of the Commission's

⁵⁰ The Commission currently uses this definition of "control" in its part 49 regulations on swap data reporting. See 17 CFR § 49.2(a)(4). In January 2020, the Commission also proposed to implement this definition of "control" in the context of cross-border regulation of swap dealers. See Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 FR 952, 1002 (Jan. 8, 2020) (proposing to add the "control" definition at § 23.23(a)(1)).

regulations, thereby obviating the need for the Commission to mandate such disclosure and reporting.⁵¹

A controlling person must, by definition, have the corporate or other legal authority to require the controlled CPO to provide more information than is required by the Commission, such as detailed information about the non-U.S. CPO's finances, management and operations, and, more relevant to the proposal herein, access to investment and performance information for the offshore pool. Accordingly, the Commission preliminarily believes that due to the fundamentally different features of the relationship between a controlling affiliate and a non-U.S. CPO as compared to an outside investor and a CPO, a U.S. controlling affiliate's participation, through an initial investment, in its affiliated non-U.S. CPO's offshore pool does not raise the same customer protection concerns as similar investments in the same pool by unaffiliated persons located in the United States.

Commission staff in the Division of Swap Dealer and Intermediary Oversight (DSIO) previously granted staff no-action relief for a non-U.S. CPO of offshore pools that received initial capital contributions from U.S. sources affiliated with the non-U.S. CPO for a limited period of time.⁵² Specifically, in CFTC Staff Letter 15-46, DSIO articulated a no-action position related to initial capital contributions provided to offshore pools operated by a non-U.S. CPO derived from the U.S. employees of the affiliated U.S. investment advisers to the offshore

⁵¹ See 17 CFR 4.22(c)(8) (providing that a CPO need not distribute an annual report to pools operated by persons controlling, controlled by, or under common control with the CPO, provided that information regarding the underlying pool is contained in the investor pool's annual financial statement).

⁵² See CFTC Staff Letter 15-46 (May 8, 2015).

pools.⁵³ In that instance, in part because the participants were natural person employees of the affiliated U.S. investment advisers, staff determined that it was appropriate to limit the time in which the U.S. derived capital could remain in the offshore pools without the non-U.S. CPO registering with the Commission.⁵⁴

With respect to the exception proposed herein, the Commission preliminarily believes that imposing a time limit is not necessary where the initial investment capital is deriving not from natural person employees, but rather the corporate funds of a U.S. controlling affiliate. Unlike the facts presented in CFTC Staff Letter 15-46, the Commission preliminarily believes that the control that a U.S. controlling affiliate is able to exercise with respect to the operations of the non-U.S. CPO and its offshore pools provides adequate assurances that the U.S. controlling affiliate is able to obtain and act upon the information relevant to its participation in the offshore pool.⁵⁵

The Commission preliminarily intends to limit the exception for U.S. controlling affiliate capital contributions to those made at or near a pool's inception, which generally result from commercial decisions by the U.S. controlling affiliate, typically in conjunction with the non-U.S. CPO, to support the offshore pool until such time as it has an established performance history for solicitation purposes, although the contributed capital may remain in the offshore pool for the duration of its operations. The Commission preliminarily believes that this limitation is

⁵³ *Id.* at 2.

⁵⁴ *Id.*

⁵⁵ The Commission notes that certain control affiliates may be subject to the time limitations imposed on the contribution of initial capital to affiliated covered funds under the Volcker Rule due to their status as banking entities. *See* 17 CFR 75.12. The exemption proposed herein with respect to initial capital contributions does not affect or negate any other limitations imposed by other statutory or regulatory provisions applicable to the control affiliate.

appropriate to ensure that the capital is being contributed in an effort to support the operations of the offshore pool at a time when its viability is being tested, rather than as a mechanism for the U.S. controlling affiliate to generate returns for its own investors.

The Commission notes, however, that the proposed exclusion may not be used to evade the Commission's CPO compliance requirements with respect to offshore commodity pools. For example, a controlling affiliate located in the U.S. could invest in its affiliated non-U.S. CPO's offshore pool, and then solicit persons located in the U.S. for investment in that controlling affiliate, for the purpose of providing such investors indirect exposure to that offshore pool. Under these circumstances, the Commission preliminarily believes that such practices would generally constitute evasion of the Commission's regulation of CPOs and commodity pools soliciting and serving participants located in the U.S. and would render the non-U.S. CPO ineligible for the 3.10 Exemption. Additionally, the Commission preliminarily believes that U.S. controlling affiliates that are barred from participating in the U.S. commodity interest markets should not be permitted to gain indirect access to those markets through an affiliated non-U.S. CPO's offshore pool as this would undermine the purposes of such a ban. Therefore, the Commission is proposing to include provisions in the proposed exemption to prohibit such evasive conduct marked by either pooling of U.S. participant capital in the U.S. controlling affiliate or the contribution of initial capital to an offshore pool by a person subject to a statutory disqualification, ongoing registration suspension or bar, prohibition on acting as a principal, or trading ban with respect to participating in the U.S. commodity interest markets.

Consistent with its authority under section 4(c) of the Act, the Commission preliminarily believes that providing an exception for initial capital contributions by U.S. controlling affiliates in offshore pools operated by affiliated non-U.S. CPOs could result in increased economic or

financial innovation by non-U.S. CPOs and their offshore pools participating in the U.S. commodity interest markets. The Commission further preliminarily believes enabling U.S. controlling affiliates to provide initial capital to offshore pools operated by affiliated non-U.S. CPOs could provide such non-U.S. CPOs with the ability to test novel trading programs or otherwise engage in proof of concept testing with respect to innovations in the collective investment industry that might otherwise not be possible due to a lack of a performance history for the offered pool. For the reasons set forth above, the Commission has preliminarily concluded that it is appropriate to provide an exception for initial capital contributions by U.S. controlling affiliates in offshore pools operated by affiliated non-U.S. CPOs from the U.S. participant prohibition in the 3.10 Exemption pursuant to section 4(c) of the Act.

e. General Request for Comment

The Commission requests comment on all aspects of the Proposal. Specifically, given the concerns regarding potential evasion of CPO regulation using the controlling affiliate provision, the Commission seeks comment on several potential additional conditions on the exception that could be included in the final regulation.

1. To establish that the funds of the controlling affiliate are being used for seeding purposes, should the exception state that the purpose of the investment by the controlling affiliate shall be for establishing the commodity pool and providing sufficient initial equity to permit the pool to attract unaffiliated non-U.S. investors? Similarly, should the exception be conditioned on the investment being limited in time to one, two, or three years after which time the investments of the controlling affiliate must be reduced to a de minimis amount of the pool's capital, such as 3 or 5 percent? What customer protection benefits would such limitations serve?

2. Regarding the nature of controlling affiliates, to protect the U.S. persons invested therein, should the exception be limited to entities or persons that are otherwise financial institutions that are regulated in the United States to provide investor protections? For example, should the exception only be available to U.S. controlling affiliates regulated by the Securities and Exchange Commission, a federal banking regulator, or an insurance regulator?

3. The Proposal notes that one of the reasons underlying the U.S. controlling affiliate exception is the affiliate's likely ability to demand that the non-U.S. CPO provide it with the information necessary to assess the operations and performance of the offshore pool. However, because these offshore pools are by definition non-U.S. entities and it is not possible to ascertain with certainty whether such information must be provided to a U.S. controlling affiliate under the laws applicable to the non-U.S. CPO and offshore pool, should the exception be conditioned on there being an obligation on the non-U.S. CPO that is legally binding in its home jurisdiction to provide the U.S. controlling affiliate with information regarding the operation of the offshore pool by the affiliated non-U.S. CPO?

III. Reopening of Comment Period under 2016 Proposal

On July 27, 2016, the Commission proposed to amend Commission regulation 3.10(c) to amend the conditions under which the exemption from registration would apply.⁵⁶ Generally, the proposed amendment would permit a foreign broker or persons located outside the United States acting in the capacity of an introducing broker, commodity trading advisor, or commodity pool operator, each as defined in Commission regulation 1.3, to be eligible for an exemption from registration with the Commission if the foreign broker or person, in connection

⁵⁶ Exemption from Registration for Certain Foreign Persons, 81 FR 51824 (Aug. 5, 2016) (the "2016 Proposal").

with a commodity interest transaction, only acts on behalf of (1) persons located outside the United States, or (2) International Financial Institutions (as defined in the proposed rule amendments), without regard to whether such persons or institutions clear such commodity interest transaction.

In response to the Proposal, the Commission received six comments,⁵⁷ most of which were supportive of the proposal. Given the passage of time, however, the Commission now requests comment on whether it would be appropriate to finalize the 2016 Proposal along with the other amendments to Commission regulation 3.10 proposed in this release. Thus, the Commission is reopening the comment period on all aspects of the 2016 Proposal for 60 days.

In addition, with respect to the 2016 Proposal, the Commission requests specific comment on whether Commission regulation 3.10 should require commodity interest transactions of persons located outside of the United States or of International Financial Institutions that are required or intended to be cleared on a registered derivatives clearing organization (DCO) to be submitted for clearing through a futures commission merchant registered in accordance with section 4d of the Act, unless such person or International Financial Institution is itself a clearing member of such registered DCO?

IV. Related Matters

a. Regulatory Flexibility Act

⁵⁷ These comment letters are on the Commission's web site at:
<http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1724>.

The Regulatory Flexibility Act (RFA) requires Federal agencies, in promulgating regulations, to consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, to provide a regulatory flexibility analysis regarding the economic impact on those entities. Each Federal agency is required to conduct an initial and final regulatory flexibility analysis for each rule of general applicability for which the agency issues a general notice of proposed rulemaking.⁵⁸

The Proposal by the Commission today would affect only CPOs. The Commission has previously established certain definitions of “small entities” to be used by the Commission in evaluating the impact of its rules on such entities in accordance with the requirements of the RFA.⁵⁹ With respect to CPOs, the Commission previously has determined that a CPO is a small entity for purposes of the RFA, if it meets the criteria for an exemption from registration under Commission regulation 4.13(a)(2).⁶⁰ With respect to small CPOs operating pursuant to Commission regulation 4.13(a)(2), the Commission preliminarily believes that, should the amendments to the 3.10 Exemption be adopted as final, certain of those small CPOs may choose to operate additional pools outside the United States, which could provide additional opportunities to develop their operations not currently available to them. The Commission notes, however, that such small CPOs would remain subject to the total limitations on aggregate gross capital contributions and pool participants set forth in Commission regulation 4.13(a)(2)

⁵⁸ 5 U.S.C. 601, *et seq.*

⁵⁹ *See, e.g.*, Policy Statement and Establishment of Definitions of “Small Entities” for Purposes of the Regulatory Flexibility Act, 47 FR 18618, 18620 (Apr. 30, 1982).

⁶⁰ *Id.* at 18619-20. Commission regulation 4.13(a)(2) exempts a person from registration as a CPO when: 1) none of the pools operated by that person has more than 15 participants at any time, and 2) when excluding certain sources of funding, the total gross capital contributions the person receives for units of participation in all of the pools it operates or intends to operate do not, in the aggregate, exceed \$400,000. *See* 17 CFR 4.13(a)(2).

because that exemption is based on the entirety of the CPO's pool operations. Because investment vehicles operated under the 3.10 Exemption remain commodity pools under the CEA, the Commission preliminarily does not believe that the amendments proposed herein would result in a significant economic impact on a substantial number of small CPOs. Further, the Commission notes that the Proposal would impose no new obligation, significant or otherwise. Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the Proposal, if adopted, will not have a significant economic impact on a substantial number of small entities.

b. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA.⁶¹ An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Commission has preliminarily determined that the proposed amendments, if adopted, will not impose any new recordkeeping or information collection requirements, or other collections of information that require approval of the Office of Management and Budget (OMB) under the PRA.

The Commission invites the public and other interested parties to comment on this PRA determination. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission generally solicits comments in order to: (1) evaluate whether a proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information

⁶¹ 44 U.S.C. 3501, et seq.

will have practical utility; (2) evaluate the accuracy of the Commission's estimate of the burden of a proposed collection of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) mitigate the burden of a collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology. The Commission specifically invites public comment on the accuracy of its estimate that no additional information collection requirements or changes to existing collection requirements would result from the regulatory amendments proposed herein.

Comments may be submitted directly to the Office of Information and Regulatory Affairs (OIRA), by fax at (202) 395-6566 or by email at OIRAsubmissions@omb.eop.gov. Please provide the Commission with a copy of submitted comments, so that all comments can be summarized and addressed in the final rule preamble. Refer to the ADDRESSES section of this notice of proposed rulemaking for comment submission instructions to the Commission. OMB is required to make a decision concerning a collection of information between 30 and 60 days after publication of this document in the Federal Register. Therefore, a comment is best assured of having its full effect if OMB receives it within 30 days of publication.

c. Cost-Benefit Considerations

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before issuing new regulations under the CEA.⁶² Section 15(a) of the CEA further specifies that the costs and benefits of the proposed rules shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2)

⁶² 7 U.S.C. 19(a).

efficiency, competitiveness and financial integrity of the futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may, in its discretion, give greater weight to any of the five enumerated areas of concern and may, in its discretion, determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the CEA. The Commission invites public comment on its cost-benefit considerations.

As explained above, the current 3.10 Exemption provides relief from registration to non-U.S. CPOs operating offshore pools with foreign participants.⁶³ The 3.10 Exemption provides that it is only available to non-U.S. CPOs acting on behalf of offshore commodity pools. In a prior proposal that discussed the 3.10 Exemption, the Commission stated that the current registration exemption is not available on a pool-by-pool basis, meaning that a non-U.S. CPO would be unable to claim the exemption with respect to its offshore pools meeting the specified criteria for the 3.10 Exemption while maintaining CPO registration with respect to other pools—*e.g.*, pools, regardless of domicile, with U.S. participants. Therefore, non-U.S. CPOs that operate a mix of some offshore pools that are not available to U.S. participants and other pools that are offered and sold to U.S. participants would have to either register and list all of their operated pools or claim an alternative exemption or exclusion. One such available source of exemptive relief is Staff Advisory 18-96 (Advisory 18-96), which, although still requiring

⁶³ *See, supra*, Section I.

registration of the CPO, does provide relief from the majority of the compliance obligations set forth in part 4 of the Commission's regulations.⁶⁴

The Commission is proposing several amendments to the current 3.10 Exemption. Specifically, the Commission is proposing to amend the 3.10 Exemption such that non-U.S. CPOs may rely on that exemption on a pool-by-pool basis through proposed Commission regulation 3.10(c)(3)(ii). Next, proposed Commission regulation 3.10(c)(3)(iii) would make it clear that a non-U.S. CPO's eligibility to rely upon the 3.10 Exemption is unaffected by any contributions the non-US CPO's offshore pools might receive from the non-US CPO's U.S. controlling affiliate. The Commission is also proposing Commission regulation 3.10(c)(3)(iv), which would establish a regulatory safe harbor for those non-U.S. CPOs that cannot represent with absolute certainty that there are no U.S. participants in the operated offshore pool. Finally, the Commission is proposing Commission regulation 3.10(c)(3)(v), which would permit non-U.S. CPOs to claim an available exemption from registration, claim an exclusion, or register with respect to the other pools they operate. The proposed amendments would grant non-U.S. CPOs relief that will likely generate costs and benefits. The baseline against which these costs and benefits are compared is the regulatory *status quo* set forth in current Commission regulation 3.10(c)(3).

The consideration of costs and benefits below is based on the understanding that the markets function internationally, with many transactions involving U.S. firms taking place across international boundaries; with some Commission registrants being organized outside of the United States; with some leading industry members typically conducting operations both

⁶⁴ CFTC Staff Advisory 18-96 (Apr. 11, 1996).

within and outside the United States; and with industry members commonly following substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the discussion of costs and benefits below refers to the effects of this proposal on all activity subject to the proposed amended regulations, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with activities in or effect on U.S. commerce under CEA section 2(i).⁶⁵

i. Proposed Commission Regulation 3.10 (c)(3)(ii): Providing that the 3.10 Exemption may be Claimed on a Pool-by-Pool Basis

Specifically, pursuant to the Proposal, a non-U.S. CPO would be able to claim the 3.10 Exemption from registration with respect to its eligible offshore pools, while either registering as a CPO or claiming another available exemption or exclusion for its other pools that are either located in the U.S., or that solicit and/or accept as participants persons located within the U.S. Absent the proposed amendment, such CPOs would face some costs and compliance burdens associated with the operation of their offshore pools,⁶⁶ despite the Commission's historical focus on prioritizing customer protection with respect to persons located in the United States. For example, certain registered U.S. and non-US CPOs file self-executing notices pursuant to Advisory 18-96 with respect to their offshore pools. The Advisory provides compliance relief with respect to all of the pool-based disclosures required under the Commission's regulations, as well as many of the reporting and recordkeeping obligations that otherwise would apply to registered CPOs, with the exception of the requirement to file Form CPO-PQR under

⁶⁵ 7 U.S.C. 2(i).

⁶⁶ As discussed, *infra*, certain CPOs may be eligible for significant compliance relief pursuant to Advisory 18-96.

Commission regulation 4.27. The relief pursuant to Advisory 18-96 also allows qualifying, registered U.S. CPOs to maintain their offshore pool's original books and records at the pool's offshore location, rather than at the CPO's main business office in the United States.⁶⁷

Currently, based on the notices filed pursuant to Advisory 18-96, the Commission is aware of 23 non-U.S. CPOs that operate 84 offshore pools and 20 U.S. CPOs that operate 88 offshore pools. In total, 43 CPOs file 18-96 notices. However, the Commission preliminarily believes that there are likely a number of registered non-U.S. CPOs that do not list their offshore pools with the Commission, and, therefore, do not claim relief under Advisory 18-96. Although these exemption notices must be filed by hardcopy, the Commission believes the administrative costs are low.⁶⁸ CPOs must employ at least one staff-person to manage and file the one-time notice under Advisory 18-96. For a notice under Advisory 18-96 to be effective, the CPO must provide, among other things, business-identifying and contact information; representations that its principals are not statutorily disqualified; enumerated rules from which the CPO seeks relief; and contact information for person(s) who will maintain offshore books and records.⁶⁹ Under the Proposal, the current 23 registered non-U.S. CPOs would be able to delist their offshore pools and no longer file 18-96 notices acknowledging that they operate one of the 84 offshore pools. Upon delisting of such pools, those registered non-U.S. CPOs would no longer have to include their offshore pools in their Form CPO-PQR filings, which will result in cost savings for

⁶⁷ See note 28, *supra*.

⁶⁸ See <https://www.nfa.futures.org/members/cpo/cpo-exemptions.html>.

⁶⁹ See note 28, *supra*.

those CPOs. The 20 U.S. CPOs, however, would continue to claim relief under Advisory 18-96, because they remain ineligible for the 3.10 Exemption due to their location in the United States.

Currently, one way that a registered CPO can avoid the requirement to list its offshore pools with the Commission is to establish a separate, foreign-domiciled CPO for all of the pools that are eligible for the 3.10 Exemption. The Commission preliminarily believes that the Proposal would eliminate the incentive to establish a separately organized CPO solely to operate the pools that would qualify for the 3.10 Exemption. The Commission preliminarily believes, however, that the financial expenses associated with establishing a foreign CPO varies depending on the operating size and structure of the registered CPO. The Commission further notes that incentives to establish additional CPOs may also be affected by the amount of the financial outlay to establish foreign-domiciled CPOs given that set-up costs—such as, costs to pay staff and experts; expenses for business licenses and registrations; costs to draft operational and disclosure documents; fees to establish technological services—would be expected to vary by jurisdiction. Therefore, although the Commission believes that there are costs associated with establishing a separate, foreign-domiciled CPO, the Commission preliminarily believes that such costs may be marginal and would be dependent on the organization and domicile of the registered CPO.

The Commission expects that amending the 3.10 Exemption such that non-U.S. CPOs may claim the exemption on a pool-by-pool basis would result in such CPOs saving the costs associated with forming and maintaining a new CPO to operate the other pools in its overall structure, and would thereby remove unnecessary complexity in pool operations. Therefore, by amending the 3.10 Exemption such that non-U.S. CPOs may claim the exemption on a pool-by-pool basis, the Commission preliminarily believes that it would eliminate a large portion of

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(subject to technical corrections)

CFTC-registered, non-U.S. CPOs' compliance costs associated with the operation of their offshore pools, which by their very characteristics implicate fewer of the Commission's regulatory interests. This is only for U.S. compliance costs, as non-U.S. CPOs would still have compliance costs with non-US regulatory regimes. Moreover, the Commission preliminarily believes that this targeting of its CPO oversight appropriately recognizes the global nature of the asset management industry.

The Commission also does not expect that non-U.S. CPOs would experience any increased costs associated with the amendments such that the 3.10 Exemption may be claimed on a pool-by-pool basis. As noted above, the Commission is proposing to permit the exemption to be claimed without any filing by the non-U.S. CPO. This is no different from how the current exemption is implemented. The current terms of the 3.10 Exemption would require a CPO to monitor the operations of its offshore pools to ensure that the pools are not offered in the United States and that they do not have any participants located in the United States. Under the terms of the Proposal, such CPOs would continue to be required to engage in such monitoring.

The Commission preliminarily believes that there may be some loss of information available to the public regarding the existence of the offshore pools operated by registered non-U.S. CPOs because such offshore pools would no longer be listed with the Commission, and consequently, the pools' existence and identifying information would not be publicly disclosed on NFA's BASIC database. The Commission has preliminarily concluded that this loss of information would have a minimal impact on the general public because persons located within the United States would typically not be permitted by the non-U.S. CPO to participate in such pools.

ii. Proposed Commission Regulation 3.10(c)(3)(iv): Regulatory Safe Harbor for non-U.S. CPOs with Possible Inadvertent U.S. Participants in Offshore Pools

As explained previously, the Commission is proposing Commission regulation 3.10(c)(3)(iv) to provide a regulatory safe harbor for those non-U.S. CPOs who, due to the structure of their offshore pools, cannot represent with absolute certainty that there are no U.S. participants in their offshore pools, provided that such non-U.S. CPOs take certain enumerated actions to ensure that no U.S. persons are participating in the offshore pool. The Commission preliminarily believes that proposed Commission regulation 3.10(c)(3)(iv) benefits non-U.S. CPOs by making the registration relief provided under the 3.10 Exemption more widely available by recognizing the informational limitations inherent in certain pool structures. Therefore, the Commission preliminarily believes that this proposed safe harbor could result in more non-U.S. CPOs relying upon the 3.10 Exemption with respect to more pools. At this time, the Commission lacks sufficient information to quantify the number of additional non-U.S. CPOs and offshore pools that may claim relief under proposed Commission regulation 3.10(c)(3)(iv) because the Commission does not currently receive information of the nature necessary to determine which offshore pools currently listed with the Commission are offered and sold solely to offshore participants and what subset of those pools may have participation units traded in the secondary market. Given, however, that exchange traded commodity pools currently comprise less than 1% of the total number of pools listed with the Commission, the Commission preliminarily believes that it is reasonable to estimate the number of offshore pools operated in a similar manner to be equally small.

The Commission preliminarily believes that non-U.S. CPOs that would be eligible for registration relief under proposed Commission regulation 3.10(c)(3)(iv) would avail themselves of that relief. This could result in the Commission receiving less information regarding the operation of such offshore pools operated pursuant to the proposed regulatory safe harbor. As noted above, the Commission preliminarily believes that the amount of information lost as a result of the deregistration of such non-U.S. CPOs and associated delisting of their eligible offshore pools would be minimal due to the expected small number of CPOs and pools relative to the total population of registered CPOs and listed pools.

The Commission also preliminarily expects that there may be some inadvertent U.S. participants in offshore pools who would lose the customer protection afforded by part 4 of the Commission's regulations should a non-U.S. CPO decide to delist its offshore pools and claim relief under the 3.10 Exemption, given the clarity and certainty provided by the regulatory safe harbor. The Commission preliminarily believes that the enumerated actions comprising the regulatory safe harbor provide assurance that the number of U.S. persons so impacted would be small. Moreover, the Commission preliminarily believes that such U.S. persons, to the extent that they are aware that they are participating in what is known to be an offshore pool through the purchase of participation units sold in an offshore secondary market, may not expect to benefit from the customer protection provisions in part 4 of the Commission's regulations, but would instead expect to rely upon the regulatory protections of the offshore pool's home jurisdiction.

**iii. Proposed Commission Regulation 3.10(c)(3)(v): Utilizing the
3.10 Exemption Concurrent with Other Available Exclusions and
Exemptions**

As explained above, the Commission is also proposing to add Commission regulation 3.10(c)(3)(v) such that non-U.S. CPOs may rely upon the 3.10 Exemption concurrent with other exemptions and exclusions, or, alternatively, registration under the Commission's regulations. The Commission preliminarily believes that proposed Commission regulation 3.10(c)(3)(v) therefore benefits non-U.S. CPOs through consistent treatment of CPOs of pools that are operated in a substantively identical manner with respect to their use of derivatives or their size, regardless of where the CPO is based. The Commission has also preliminarily determined that these proposed amendments will benefit the non-U.S. CPO industry generally by providing certainty regarding the ability to simultaneously rely upon the 3.10 Exemption and other exclusions and exemptions available under the Commission's regulations. The Commission also notes that this proposed amendment is consistent with other instances in its CPO regulatory program, where the Commission already permits CPOs to claim more than one type of exemption or exclusion or to register with respect to the variety of commodity pools operated by them.⁷⁰

The Commission further preliminarily believes that by clarifying the permissibility of using Commission regulation 4.13 exemptions, for example, in conjunction with the 3.10 Exemption, non-U.S. CPOs may be more likely to claim the relief under Commission regulation 4.13 for their eligible pools, rather than registering and listing those pools. The Commission preliminarily concludes that clearly establishing the availability of other exemptions and exclusions or, alternatively, registration with respect to the operation of certain pools offered or sold to persons within the United States will further enable the Commission to more efficiently

⁷⁰ See, e.g., 17 CFR 4.13(e)(2) and 4.13(f).

deploy its resources in the oversight of CPOs and commodity pools that it has previously determined more fully implicate its regulatory concerns and interests under the CEA.

If more non-U.S. CPOs claim exemptions under Commission regulation 4.13(a)(3), for example, for some of their U.S. facing pools as a result of the Proposal, this could result in pools that were previously listed and associated with a CPO registration being delisted. Under these circumstances, the Commission would, as a result, no longer receive financial reporting with respect to those pools, including on Form CPO-PQR. Because these commodity pools would in fact already be operated consistent with an existing exemption or exclusion, and because the Commission has previously determined that pools operated in such a manner generally do not require a registered CPO, the Commission has preliminarily determined that any resulting loss of insight into such pools and their CPOs would also be consistent with the Commission's overall regulatory policy concerning CPOs and commodity pools.⁷¹

**iv. Proposed § 3.10(c)(3)(iii): Exclusion of Controlling Affiliate
Investments in Offshore Pools from the 3.10 Exemption
Eligibility Determination**

The Commission is also proposing to permit non-U.S. CPOs to rely upon the 3.10 Exemption for the operation of an offshore pool, even if a controlling affiliate within the United States provides initial capital for the offshore pool. Absent the relief provided by proposed Commission regulation 3.10(c)(3)(iii), a non-U.S. CPO of an offshore pool receiving initial capital from a controlling affiliate within the U.S. would generally be required to register as a

⁷¹ The Commission notes that it retains special call authority with respect to those CPOs claiming an exemption from registration pursuant to Commission regulation 4.13, which enables the Commission to obtain additional information regarding the operation of commodity pools by such exempt CPOs. See 17 CFR 4.13(c)(iii).

CPO and list that pool with the Commission, unless another exemption or exclusion was available. As a registered CPO with respect to that offshore pool, the non-U.S. CPO would then be required to comply with the compliance obligations set forth in part 4 of the Commission's regulations.

As discussed previously, the Commission has preliminarily concluded that participation in an offshore pool by a U.S. controlling affiliate does not raise the same regulatory concerns as would an investment in the same pool by an unaffiliated participant located within the United States. In addition to the reasons outline above, the Commission preliminarily believes that this proposed relief or condition to the proposed 3.10 Exemption would provide regulatory relief for a small number of currently-registered CPOs. Based on the number of claims filed under Advisory 18-96, there are 23 non-U.S. CPOs that operate 84 offshore commodity pools. The Commission is unaware, however, of whether any of the offshore pools operated by those non-U.S. CPOs actually received initial capital contributions from a U.S. controlling affiliate, in part, because the Commission does not collect such information. Nevertheless, because of the small number of claims by non-U.S. CPOs under Advisory 18-96, the Commission preliminarily believes that the number of these CPOs that would be subject to proposed Commission regulation 3.10(c)(3)(iii) would be less than the 23. The Commission preliminarily believes that there may be an unknown number of registered non-U.S. CPOs that have never listed their offshore pools with the Commission, and hence did not seek relief under the Advisory. Therefore, the total number of non-U.S. CPOs utilizing this exemption could also be higher. In addition, as a result of the Commission being unaware of the current number of offshore pools operated by a non-U.S. CPO receiving seed capital from a U.S. controlling affiliate, it is unable

to predict how many pools will utilize this proposed exclusion in the future, if this Proposal is finalized.

The Commission also preliminarily believes that this proposed amendment would result in reduced costs for non-U.S. CPOs with initial capital contributions from U.S. controlling affiliates by removing such investments from consideration for 3.10 Exemption eligibility, thereby eliminating any registration and compliance costs for such pools. The proposed amendment would, however, result in U.S. controlling affiliates not being able to rely upon the protections provided by CPO registration and by part 4 of the Commission's regulations, with respect to their investments in an offshore pool operated by their affiliated non-U.S. CPO.⁷² The Commission preliminarily believes that this loss would be mitigated by such a U.S. controlling affiliate's ability to exercise control over the operations of the affiliated non-U.S. CPO, and thereby obtain whatever information regarding the offshore pool a U.S. controlling affiliate may deem material to its investment. Moreover, the Commission preliminarily believes this approach is consistent with the Commission's focus on protecting U.S. investors participating in commodity pools and recognizes that U.S. controlling affiliates may also be regulated by other federal and state authorities.

In the event, should this proposal be finalized, that a non-U.S. CPO has listed one or more offshore pools with the Commission due to the fact that the offshore pool received initial capital contributions from a U.S. controlling affiliate, and such non-U.S. CPO determines to delist the offshore pool in question and instead rely upon the revised 3.10 Exemption, the

⁷² For example, a U.S. controlling affiliate would not be able to rely upon the Commission's part 4 regulations to require its affiliated non-U.S. CPO to provide the controlling affiliate with disclosures and reporting generally mandated by those rules.

Commission would as a result no longer receive financial reporting with respect to such pool, including on Form CPO-PQR. Because, however, the Commission has preliminarily determined that initial capital contributions by a U.S. controlling affiliate do not raise the same customer protection concerns as capital received from other U.S. participants, the Commission has preliminarily determined that any resulting loss of insight into such pools and their CPOs would also be consistent with the Commission's overall regulatory policy concerning CPOs and commodity pools.

Section 15(a) Factors

1. Protection of Market Participants and the Public

The Commission preliminarily believes that the Proposal would not have a material negative effect on the protection of market participants and the public. The proposed amendments enhance the Commission ability to focus its efforts on protecting U.S. investors. The Commission will continue to receive identifying information from U.S. CPOs operating offshore pools and pools offered to U.S. investors. Regarding a non-U.S. CPO whose offshore pools receive initial capital contributions from a controlling affiliate in the United States, the Commission preliminarily believes that although those offshore pools may no longer be subject to part 4 of the Commission's regulations, controlling affiliates, by virtue of their control over the non-U.S. CPO, need not be as reliant upon the customer protection provided by compliance with the Commission's regulations. The Commission also preliminarily expects that some U.S. participants in offshore pools operated pursuant to the regulatory safe harbor may also lose the customer protections afforded by part 4 of the Commission's regulations; however, the Commission preliminarily expects the number of such U.S. persons to be small due to the criteria required for reliance upon the safe harbor.

2. Efficiency, Competitiveness and Financial Integrity of the Futures Markets

The Commission has not identified any impact that the Proposal would have on the efficiency, competitiveness and financial integrity of the futures markets.

3. Price Discovery

The Commission has not identified any particular impact that the Proposal would have on price discovery.

4. Sound Risk Management Practices

The Commission has not identified any impact that the Proposal would have on sound risk management practices.

5. Other Public Interest Considerations

The Commission has not identified any other public interest considerations impacted by the Proposal beyond those preliminarily identified as part of its analysis supporting the Commission's exercise of its authority under section 4(c) of the Act.

d. Anti-Trust Considerations

Section 15(b) of the Act requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA, in issuing any order or adopting any Commission rule or regulation (including any exemption under CEA section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association

established pursuant to section 17 of the Act.⁷³ The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition.

The Commission has considered the Proposal to determine whether it is anticompetitive and has preliminarily identified no anticompetitive effects. The Commission requests comment on whether the Proposal is anticompetitive and, if it is, what the anticompetitive effects are.

Because the Commission has preliminarily determined that the Proposal is not anticompetitive and has no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the Act. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the Act that would otherwise be served by adopting the Proposal.

v. Request for Comment

The Commission is seeking comment on all aspects of the costs and benefits associated with this Proposal. The Commission specifically seeks comment regarding the treatment of U.S. CPOs operating both U.S. and offshore pools by foreign regulatory bodies.

List of Subjects

17 CFR Part 3

Definitions, Foreign futures, Consumer protection, Foreign options, Registration requirements.

PART 3 -- REGISTRATION

1. The authority citation for part 3 continues to read as follows:

⁷³ 7 U.S.C. 19(b).

Authority: 5 U.S.C. 522, 522b; 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b-1, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6m, 6n, 6o, 6p, 6s, 8, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21, and 23.

2. Amend § 3.10(c) by revising paragraph (c)(3)(i), revising and renumbering paragraph (c)(3)(ii) as (c)(3)(v), and adding new paragraphs (c)(3)(ii), (c)(3)(iii), and (c)(3)(iv), to read as follows:

§ 3.10 Registration of futures commission merchants, retail foreign exchange dealers, introducing brokers, commodity trading advisors, commodity pool operators, swap dealers, major swap participants, and leverage transaction merchants.

* * * * *

(c) * * *

(3)(i) A person located outside the United States, its territories or possessions engaged in the activity of: An introducing broker, as defined in § 1.3 of this chapter; or a commodity trading advisor, as defined in § 1.3 of this chapter, in connection with any commodity interest transaction executed bilaterally or made on or subject to the rules of any designated contract market or swap execution facility only on behalf of persons located outside the United States, its territories or possessions, is not required to register in such capacity provided that any such commodity interest transaction is submitted for clearing through a futures commission merchant registered in accordance with section 4d of the Act.

(ii) A person located outside the United States, its territories or possessions engaged in the activity of a commodity pool operator, as defined in § 1.3 of this chapter, in connection with any commodity interest transactions that are executed bilaterally or made on or subject to the rules of any designated contract market or swap execution facility, is not required to register in

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(subject to technical corrections)

such capacity when such transactions are executed on behalf of a commodity pool the participants of which are all located outside the United States, its territories or possessions, and provided that, any such commodity interest transaction is submitted for clearing through a futures commission merchant registered in accordance with section 4d of the Act.

(iii) With respect to paragraphs (c)(3)(ii) and (c)(3)(iv), initial capital contributed to a commodity pool by an affiliate, as defined by § 4.7(a)(1)(i) of this chapter, that controls, as defined by § 49.2(a)(4) of this chapter, the pool's commodity pool operator shall not be a "participant" for purposes of determining whether such commodity pool operator is executing commodity interest transactions on behalf of a commodity pool, the participants of which are all located outside of the United States, its territories or possessions, *provided that*:

(A) The control affiliate and its principals are not subject to a statutory disqualification, ongoing registration suspension or bar, prohibition on acting as a principal, or trading ban with respect to participating in commodity interest markets in the United States, its territories or possessions; and

(B) Interests in the control affiliate are not marketed as providing access to trading in commodity interest markets in the United States, its territories or possessions.

(iv) With respect to paragraph (c)(3)(ii), a commodity pool operated by a person located outside the United States, its territories or possessions shall be considered to be satisfying the terms of paragraph (c)(3)(ii) if:

(A) The commodity pool is organized and operated outside of the United States, its territories or possessions;

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- (B) The commodity pool's offering materials and any underwriting or distribution agreements include clear, written prohibitions on the commodity pool's offering to participants located in the United States and on U.S. ownership of the commodity pool's participation units;
 - (C) The commodity pool's constitutional documents and offering materials (a) are reasonably designed to preclude persons located in the United States from participating therein and (b) include mechanisms reasonably designed to enable its operator to exclude any persons located in the United States who attempt to participate in the offshore pool notwithstanding those prohibitions;
 - (D) The commodity pool operator exclusively uses non-U.S. intermediaries for the distribution of participations in the commodity pool;
 - (E) The commodity pool operator uses reasonable investor due diligence methods at the time of sale to preclude persons located in the United States from participating in the commodity pool; and
 - (F) The commodity pool's participation units are directed and distributed to participants outside the United States, including by means of listing and trading such units on secondary markets organized and operated outside of the United States, and in which the commodity pool operator has reasonably determined participation by persons located in the United States is unlikely.
- (v) Claiming an exemption under paragraph (c)(3)(ii) will not affect the ability of a person to register with the Commission or qualify for and/or claim an exclusion or exemption otherwise available under § 4.5 or § 4.13 of this chapter, with respect to the operation of a qualifying commodity pool or trading vehicle not covered by the relief in this section.

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(vi) A person acting in accordance with paragraph (c)(3)(i) or (c)(3)(ii) of this section remains subject to section 40 of the Act, but otherwise is not required to comply with those provisions of the Act and of the rules, regulations and orders thereunder applicable solely to any person registered in such capacity, or any person required to be so registered.

* * * * *

Issued in Washington, DC, on May __, 2020, by the Commission.

Christopher J. Kirkpatrick

Secretary of the Commission