

MEMO# 32500

June 1, 2020

CFTC Proposes to Amend Conditions of Exemption for Non-US CPOs

[32500]

June 1, 2020 TO: ICI Global Regulated Funds Committee
Registered Fund CPO Advisory Committee RE: CFTC Proposes to Amend Conditions of Exemption for Non-US CPOs

On May 28, the Commodity Futures Trading Commission (CFTC or “Commission”), in a unanimous vote, proposed to amend the conditions of CFTC Regulation 3.10(c)(3), which exempts from registration certain non-US operators of offshore commodity pools (“Proposal”).[\[1\]](#) The Proposal is summarized briefly below. Please contact Sarah Bessin at sarah.bessin@ici.org by June 19 if you have questions or comments on the Proposal.

Background

Regulation 3.10(c)(3) generally provides that a person engaged in the activity of an introducing broker (IB), a commodity trading advisor (CTA), or commodity pool operator (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 with the CFTC, provided that:

- The person is located outside the United States, its territories, and possessions;
- The person acts only on behalf of persons located outside the United States; and
- The commodity interest transaction is submitted for clearing through a registered futures commission merchant.

In 2016, the CFTC proposed to amend Regulation 3.10(c)(3) to reflect positions in prior staff no-action letters that provided relief: (i) with respect to transactions in swaps not subject to a CFTC clearing requirement; and (ii) from registration as an IB or CTA for intermediaries acting solely for international financial institutions.[\[2\]](#) In addition to the elements described below, the Proposal re-opens the comment period for the 2016 proposal for 60 days following the publication of the Proposal in the *Federal Register*.

In 2018, the CFTC proposed to add a new exemption in Commission Regulation 4.13 that would have codified and expanded the relief provided in CFTC Staff Advisory 18-96.[\[3\]](#) The 2018 proposal was withdrawn in 2019.[\[4\]](#)

Proposal

The CFTC proposes amendments to Regulation 3.10(c)(3) that would:

- *Allow non-US CPOs to rely on the exemption on a pool-by-pool basis.* Currently, Regulation 3.10(c)(3) prohibits persons from relying on the exemption with respect to certain pools but not others. As a result, a non-US CPO that operates both offshore pools and pools offered to US person cannot rely on the exemption.
- *Include a conditional safe harbor with respect to inadvertent participation by US participants in offshore pools.* Regulation 3.10(c)(3) currently requires that the non-US CPO relying on the exemption be acting “only on behalf of persons located outside the United States, its territories, or possessions.” However, non-US CPOs of offshore pools may not have sufficient transparency into the pool to represent that it has no US participants. The proposed amendment would permit a non-US CPO to rely on the exemption if it undertakes reasonable efforts to minimize the possibility of US persons being solicited for or sold participation units in the offshore pool.[\[5\]](#)
- *Make the exemption available to non-US CPOs, along with other exemptions and exclusions.* This proposed amendment would allow “stacking” of CPO registration exemptions and exclusions, such that the non-US CPO could rely on Regulation 3.10(c)(3) with respect to certain of its operated pools, and rely on other exemptions and exclusions, such as Regulation 4.13(a)(3) or Regulation 4.5, or register, with respect to other of its operated pools.
- *Provide an exception from the US participant prohibition in Regulation 3.10(c)(3) for initial capital contributions received from a US controlling affiliate.* This proposed amendment is intended to allow “seed capital” contributions by a US controlling affiliate to the non-US CPO’s offshore pool. For purposes of the exemption, the US controlling affiliate would not be considered a “participant” in the offshore pool.[\[6\]](#)

The proposed seed capital exception does not include an explicit time limit on contributions, although the CFTC intends to limit the exception to contributions made by a US controlling affiliate at or near the time of a pool’s inception “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.”[\[7\]](#) Although Commissioners Berkovitz and Behnam voted in favor of the proposal, they expressed concern about the potential for this exception to be used to evade the Commission’s CPO registration requirements.[\[8\]](#) Reflecting those concerns, the Proposal includes several specific requests for comment on this issue.

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Associate General Counsel

endnotes

[\[1\]](#) See *Exemption from Registration for Certain Foreign Persons Acting as Commodity Pool Operators of Offshore Commodity Pools*, available at <https://www.cftc.gov/media/3911/votingdraft052820/download>. Comments are due to the CFTC 60 days after the Proposal is published in the *Federal Register*.

[2] See *Exemption from Registration for Certain Foreign Persons*, 81 Fed. Reg. 51824 (Aug. 5, 2016). ICI submitted a comment letter on this proposal jointly with other trade associations, which is available at <https://www.ici.org/pdf/30209.pdf>.

[3] *Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors*, 83 Fed. Reg. 52902 (Oct. 18, 2018); CFTC Staff Advisory 18-96 (Apr. 11, 1996). Staff Advisory 18-96 provides relief from certain CFTC regulatory requirements to CFTC registered CPOs that operate offshore commodity pools.

[4] *Registration and Compliance Requirements for Commodity Pool Operators (CPOs) and Commodity Trading Advisors: Family Offices and Exempt CPOs*, 84 Fed. Reg. 67355, 67357 (Dec. 10, 2019). Under the Proposal, Staff Advisory 18-96 would remain available.

[5] Specifically, the non-US CPO would be required to meet the following conditions with respect to the offshore pool:

- The offshore pool is organized and operated outside the United States, its territories, or possessions;
- 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 US ownership of the offshore pool's participation units;
- The offshore pool's constitutional documents and offering materials: (i) are reasonably designed to preclude persons located in the United States from participating in the pool, and (ii) 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;
- The non-US CPO exclusively uses non-US intermediaries for the distribution of participations in the offshore pool (the Commission believes that a non-US intermediary would include a non-US branch or office of a US entity, or a non-US affiliate of a US entity, provided that the distribution takes place exclusively outside of the United States);
- The non-US 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
- 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-US CPO has reasonably determined participation by persons located in the United States is unlikely.

[6] For purposes of the proposed amendment, "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." The Proposal includes conditions on this exception, including: (i) the control affiliate and its principals are not subject to a statutory disqualification, and (ii) interests in the control affiliate are not marketed as providing access to trading in commodity interest markets in the United States.

[7] The Commission also recognizes that certain control affiliates may be subject to time limitations on seed capital contributions to affiliated covered funds under the Volcker Rule.

[8] *Statement of Commissioner Dan M. Berkovitz on Proposed Amendments to Registration Requirements for Certain Foreign Persons Acting as Commodity Pool Operators of Offshore Commodity Pools* (May 28, 2020), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement052820>; *Statement of Commissioner Rostin Behnam Regarding Notice of Proposed Rulemaking Regarding an Exemption from Registration for Certain Foreign Persons Acting as Commodity Pool Operators of Offshore Commodity Pools and Reopening of Comment Period* (May 28, 2020), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement052820b>.

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