

**COMMODITY FUTURES TRADING COMMISSION****17 CFR Part 3****RIN 3038-AE46****Exemption from Registration for Certain Foreign Intermediaries**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Final rule.

**SUMMARY:** The Commodity Futures Trading Commission (CFTC or Commission) is adopting amendments (Final Rule) revising the conditions set forth in the Commission regulation under which a person located outside of the United States (each, a foreign located person) engaged in the activity of a commodity pool operator (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. The Final Rule provides that the exemption under the applicable Commission regulation for foreign located persons acting as a CPO (a non-U.S. CPO) on behalf of offshore commodity pools may be claimed by such non-U.S. CPOs on a pool-by-pool basis. The Commission is also adopting a provision clarifying that a non-U.S. CPO may claim an exemption from registration under the applicable Commission regulation with respect to a qualifying offshore commodity pool, while maintaining another exemption from CPO registration, relying on a CPO exclusion, or even registering as a CPO, with respect to its operation of other commodity pools. Additionally, the Commission is adopting a safe harbor by which a non-U.S. CPO of an offshore pool may rely upon that exemption, if it

satisfies several enumerated factors related to its operation of the offshore commodity pool. The Commission is also adopting an amendment permitting U.S. affiliates of a non-U.S. CPO to contribute initial capital to such non-U.S. CPO's offshore pools, without affecting the eligibility of the non-U.S. CPO for an exemption from registration under the applicable Commission regulation. The Commission is also adopting amendments to the applicable Commission regulation originally proposed in 2016 that clarify whether clearing of commodity interest transactions through a registered futures commission merchant (FCM) is required as a condition of the registration exemptions for foreign intermediaries, and whether such exemption is available for foreign intermediaries acting on behalf of international financial institutions.

**DATES:** The effective date for this Final Rule is [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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**I. Background**

**A. Statutory and Regulatory Background**

Section 1a(11) of the Commodity Exchange Act (CEA or Act)<sup>1</sup> defines the term “commodity pool operator” as any person<sup>2</sup> engaged in a business that is of the nature of a 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. 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.<sup>3</sup> CEA section 4m(1) generally requires each person who satisfies the CPO definition to register as such with the Commission.<sup>4</sup> 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.<sup>5</sup>

Additionally, CEA section 4(c), in relevant part with respect to the Final Rule, provides that the Commission, to promote responsible economic or financial innovation and fair competition, by rule, regulation, or order, after notice and opportunity for

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<sup>1</sup> 7 U.S.C. 1a(11). *See also* 17 CFR 1.3 (defining “commodity interest” to include, inter alia, 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). The Act is found at 7 U.S.C. 1, *et seq.* (2018), and the Commission’s regulations are found at 17 CFR Ch. I (2020). Both are accessible through the Commission’s website, <https://www.cftc.gov>.

<sup>2</sup> 7 U.S.C. 1a(38); 17 CFR 1.3 (defining “person” to include individuals, associations, partnerships, corporations, and trusts).

<sup>3</sup> 7 U.S.C. 1a(10).

<sup>4</sup> 7 U.S.C. 6m(1).

<sup>5</sup> 7 U.S.C. 1a(11)(B).

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.<sup>6</sup> CEA 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.”<sup>7</sup>

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.<sup>8</sup> 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.<sup>9</sup> The term “appropriate person” as used in CEA section 4(c) includes “a commodity pool formed or operated by a person subject to regulation under the Act.”<sup>10</sup> 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.<sup>11</sup>

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<sup>6</sup> 7 U.S.C. 6(c)(1).

<sup>7</sup> 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.”).

<sup>8</sup> 7 U.S.C. 6(c)(2)(A).

<sup>9</sup> 7 U.S.C. 6(c)(2)(B).

<sup>10</sup> 7 U.S.C. 6(c)(3)(E).

<sup>11</sup> 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”).

Part 3 of the Commission's regulations governs the registration of intermediaries engaged in the offering and selling of, and the provision of advice concerning, all commodity interest transactions. Commission regulation 3.10 establishes the procedure that intermediaries, including CPOs, must use to register with the Commission,<sup>12</sup> and also sets forth certain exemptions from registration.<sup>13</sup> In particular, Commission regulation 3.10(c)(3)(i), discussed in further detail below, provides, inter alia, that a person engaged in the activity of a CPO, commodity trading advisor (CTA), or introducing broker (IB), in connection with any commodity interest transaction executed bilaterally or made on or subject to the rules of any designated contract market (DCM) or swap execution facility (SEF), is not required to register as a CPO, CTA, or IB (relief referred to herein as the 3.10 Exemption), provided that:

1. The person is located outside the United States, its territories, and possessions (the United States or U.S.);
2. The person acts only on behalf of persons located outside the United States; and
3. The commodity interest transaction is submitted for clearing through a registered FCM.<sup>14</sup>

Commission regulation 3.10(c)(2)(i) provides a similar exemption from registration for a person located outside the United States acting as an FCM.<sup>15</sup>

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<sup>12</sup> See, e.g., 17 CFR 3.10(a)(1)(i) (requiring the filing of a Form 7-R with the National Futures Association (NFA)).

<sup>13</sup> 17 CFR 3.10(c) (providing exemptions from registration for certain persons).

<sup>14</sup> 17 CFR 3.10(c)(3)(i).

<sup>15</sup> 17 CFR 3.10(c)(2)(i).

A person acting in accordance with the 3.10 Exemption remains subject to the antifraud provisions of, inter alia, CEA section 4o,<sup>16</sup> but is otherwise not required to comply with those provisions of the CEA or Commission regulations applicable to any person registered in the relevant intermediary capacity,<sup>17</sup> or persons required to be so registered.<sup>18</sup> Of particular relevance to the amendments adopted herein regarding non-U.S. CPOs, 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 DCM or SEF, are confined to acting on behalf of offshore commodity pools.<sup>19</sup> This exemption was first adopted in 2007 (2007 Final Rule) and was based on a long-standing no-action position articulated by the Commission's Office of General Counsel in 1976.<sup>20</sup>

In adopting the 2007 Final Rule, 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.”<sup>21</sup> The Commission further stated that the protection of non-U.S. customers of

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<sup>16</sup> 7 U.S.C. 6o.

<sup>17</sup> For purposes of this adopting release, the term “intermediary” includes persons acting in the capacity of an FCM, IB, CPO, or CTA. For more information, see “Intermediaries,” CFTC, available at <https://www.cftc.gov/IndustryOversight/Intermediaries/index.htm>.

<sup>18</sup> 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. *See, e.g.*, 7 U.S.C. 9 (prohibiting manipulation by any person with respect to a swap or futures transaction).

<sup>19</sup> 17 CFR 3.10(c)(3)(i).

<sup>20</sup> Exemption from Registration for Certain Foreign Persons, 72 FR 63976, 63977 (Nov. 14, 2007) (2007 Final Rule). *See also* CFTC Staff Interpretative Letter 76-21.

<sup>21</sup> 2007 Final Rule, 72 FR 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).

non-U.S. firms may be best deferred to foreign regulators.<sup>22</sup> 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 orders.”<sup>23</sup> 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.”<sup>24</sup>

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)<sup>25</sup> amended the definitions of “commodity pool operator” and “commodity pool” in the CEA to include those persons operating collective investment vehicles that engage in swaps,<sup>26</sup> which resulted in an expansion of the universe of persons captured within both statutory definitions.<sup>27</sup> When combined with the rescission of Commission regulation 4.13(a)(4) in 2012,<sup>28</sup> 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, regardless of whether such pools were offshore or offered to U.S. participants.

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<sup>22</sup> *Id.* The Commission also cited this policy position in the initial proposal discussing what ultimately would be adopted as Commission regulation 3.10(c)(3)(i). Exemption from Registration for Certain Foreign Persons, 72 FR 15637, 15638 (Apr. 2, 2007).

<sup>23</sup> 2007 Final Rule, 72 FR at 63977-63978.

<sup>24</sup> *Id.* at 63978.

<sup>25</sup> Pub. L. 111-203, H.R. 4173 (2010) (Dodd-Frank Act).

<sup>26</sup> Section 721 of the Dodd-Frank Act.

<sup>27</sup> See also Adaptation of Regulation to Incorporate Swaps, 77 FR 66288 (Nov. 2, 2012) (incorporating this expanded jurisdiction over swaps into existing Commission regulations).

<sup>28</sup> 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).



## **B. Recent Regulatory Proposals Related to Commission Regulation 3.10(c)**

As discussed further below, on July 27, 2016, the Commission proposed to amend Commission regulation 3.10(c) (2016 Proposal) revising the conditions under which the exemption from intermediary registration would apply.<sup>29</sup> Generally, the 2016 Proposal would permit a foreign located person acting in the capacity of an FCM, IB, CTA, or CPO, to utilize an exemption from registration as such, provided that the foreign located person, in connection with any commodity interest transaction, acts solely on behalf of (1) other foreign located persons, or (2) international financial institutions (IFIs, which were further defined in the 2016 Proposal's proposed Commission regulation (c)(6)). The proposed amendments provided an exemption from registration without regard to whether such foreign located person cleared the commodity interest transaction.<sup>30</sup> In response to the 2016 Proposal, the Commission received six comments, most of which were supportive of those proposed amendments.<sup>31</sup> The Commission, however, did not finalize the 2016 Proposal at that time.

In 2018, the Commission proposed, among other changes to its part 4 regulations, adding a new exemption from CPO registration to Commission regulation 4.13 (2018 Proposal) that would formally incorporate the relief provided by CFTC Staff Advisory 18-96 (Advisory 18-96) in the Commission's CPO regulatory provisions.<sup>32</sup> In the 2018 Proposal, the Commission noted that the proposed exemption based on Advisory 18-96

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<sup>29</sup> Exemption from Registration for Certain Foreign Persons, 81 FR 51824 (Aug. 5, 2016) (2016 Proposal).

<sup>30</sup> 2016 Proposal, 81 FR at 51827.

<sup>31</sup> The public comment file for the 2016 Proposal is available on the Commission's website. Comments for Proposed Rule 81 FR 51824, *available at* <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=1724>. See *infra* pt. II.B. for additional discussion of the 2016 Proposal and Commission responses to those public comments.

<sup>32</sup> Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors, 83 FR 52902 (Oct. 18, 2018) (2018 Proposal); CFTC Staff Advisory 18-96 (Apr. 11, 1996).

was intended to 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.<sup>33</sup> The Commission received several comments regarding the 2018 Proposal’s discussion of the differences between the proposed amendment to Commission regulation 4.13 and the existing 3.10 Exemption.<sup>34</sup>

For instance, 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.”<sup>35</sup> 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.<sup>36</sup> 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.”<sup>37</sup> Several other commenters expressed similar views and requested that the Commission affirm CPOs’ 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.<sup>38</sup>

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<sup>33</sup> 2018 Proposal, 83 FR at 52914.

<sup>34</sup> The comment file for the 2018 Proposal is also available on the Commission’s website. Comments for Proposed Rule 83 FR 52902, *available at* <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=2925>.

<sup>35</sup> 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=.](https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61922&SearchText=)

<sup>36</sup> *Id.* at 12.

<sup>37</sup> 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=.](https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61920&SearchText=)

<sup>38</sup> *See, e.g.*, Comment Letter from Willkie, Farr, and Gallagher, LLP (Willkie), at 6 (Dec. 17, 2018), *available at* [https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61927&SearchText=;](https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61927&SearchText=) and

In 2019, the Commission withdrew the portion of the 2018 Proposal related to adopting the relief provided in Advisory 18-96 as a CPO registration exemption, and, in light of the comments received in response to its discussion of the 3.10 Exemption, 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.<sup>39</sup> Based on the foregoing experience and history, and in consideration of the increasingly global nature of the commodity pool space, the Commission proposed certain amendments to the 3.10 Exemption on May 28, 2020, which were subsequently published in the Federal Register on June 12, 2020 (2020 Proposal).<sup>40</sup>

### **C. The 2020 Proposal**

The 2020 Proposal consisted of several proposed amendments to the 3.10 Exemption. Specifically, the Commission proposed amendments to the 3.10 Exemption such that non-U.S. CPOs may rely on that relief on a pool-by-pool basis.<sup>41</sup> The Commission also proposed an amendment confirming that the 3.10 Exemption, as revised, may be utilized along with other exemptions or exclusions available to CPOs generally, or CPO registration.<sup>42</sup> The Commission further proposed a conditional safe harbor for non-U.S. CPOs who, by virtue of a pool's structure, cannot represent with absolute certainty that there are no U.S. participants in their operated offshore pool.<sup>43</sup>

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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=>.

<sup>39</sup> 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).

<sup>40</sup> Exemption from Registration for Certain Foreign Persons Acting as Commodity Pool Operators of Offshore Commodity Pools, 85 FR 35820 (Jun. 12, 2020) (2020 Proposal).

<sup>41</sup> 2020 Proposal, 85 FR at 35822.

<sup>42</sup> 2020 Proposal, 85 FR at 35824.

<sup>43</sup> 2020 Proposal, 85 FR at 35823.

Finally, the Commission also proposed to provide an exception from the 3.10 Exemption's prohibition on U.S. participants, such that a U.S. controlling affiliate could provide initial capital to an offshore pool operated by its affiliated non-U.S. CPO without being considered a U.S. participant in that offshore pool.<sup>44</sup> In addition to the substantive amendments to the 3.10 Exemption proposed for the first time as part of the 2020 Proposal, the Commission also reopened the comment period associated with the 2016 Proposal for a period of 60 days.<sup>45</sup>

## **II. Final Rule**

After considering all of the comments received, and for the reasons stated by the Commission herein, the Commission is amending Commission regulation 3.10(c), in a manner generally consistent with the 2016 and 2020 Proposals, with certain adjustments resulting from commenters' suggestions and after additional consideration of the proposed regulatory text. The Commission will first generally summarize the public comments received addressing both the 2016 and 2020 Proposals. Then, in addition to the rulemaking history of Commission regulation 3.10(c) set forth above, the Commission will briefly explain the 2016 Proposal, respond to all of the relevant public comments received, and detail the amendments derived from the 2016 Proposal adopted in the Final Rule.<sup>46</sup> The Commission will then discuss the remaining 2020 Proposal amendments with respect to non-U.S. CPOs operating offshore pools pursuant to the 3.10 Exemption, summarize the 3.10 Exemption amendments being adopted, respond to the relevant public comments received, and explain the substance and rationale of any

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<sup>44</sup> 2020 Proposal, 85 FR at 35825.

<sup>45</sup> 2020 Proposal, 85 FR at 35826-35827.

<sup>46</sup> See *infra* pt. II.B.

adjustments in approach from the 2020 Proposal to what the Commission is adopting in the Final Rule today.<sup>47</sup> Finally, the Commission will explain its efforts to reconcile proposed amendments from both the 2016 and 2020 Proposals, which includes a non-substantive reorganization of Commission regulation 3.10(c).<sup>48</sup>

### **A. General Comments in Response to the 2016 and 2020 Proposals**

The Commission requested comment generally on all aspects of the 2020 Proposal, and specifically asked questions about potential additional conditions or limitations to the proposed relief that might be incorporated during finalization.<sup>49</sup> The comment period for the 2020 Proposal, along with the reopened comment period for the 2016 Proposal, expired on August 11, 2020, and the Commission received four relevant comment letters: one from an individual, one from a foreign intergovernmental organization, one submitted jointly by five industry professional and trade associations (collectively, the Industry Groups), and one submitted by an asset manager that operates globally.<sup>50</sup> Two of those comment letters also provided new or additional comments with

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<sup>47</sup> See *infra* pts. II.C-G.

<sup>48</sup> See *infra* pt. II.H.

<sup>49</sup> 2020 Proposal, 85 FR at 35826 (asking three questions regarding the conditions of the proposed exception from the 3.10 Exemption for initial capital investments in a non-U.S. CPO's offshore pool by a U.S. controlling affiliate). See also *id.* at 35827 (asking, with respect to the 2016 Proposal, an additional question about the clearing of transactions otherwise covered by the 3.10 Exemption).

<sup>50</sup> The Commission received a total of five comment letters, one of which was either spam or otherwise not substantively relevant to the 2020 Proposal in any respect. For relevant comments on the 2020 Proposal, see Comment Letter from Mr. Chris Barnard (Aug. 11, 2020) (Barnard); Comment Letter from the European Stability Mechanism (Aug. 6, 2020) (ESM); Joint Comment Letter from AIMA, SIFMA AMG, the Investment Advisers Association (IAA), Investment Company Institute Global (ICI Global), and the Managed Funds Association (MFA) (Aug. 11, 2020) (Industry Group Letter), and Comment Letter from the Vanguard Group (Aug. 11, 2020) (Vanguard).

respect to the 2016 Proposal.<sup>51</sup> Finally, Commission staff also hosted one ex parte meeting to discuss aspects of the 2020 Proposal with an Industry Group.<sup>52</sup>

The comments received by the Commission were, in general, strongly supportive of the 2020 Proposal.<sup>53</sup> Commenters largely agreed with the proposed amendments, positing that, if adopted, the 2020 Proposal “would simplify compliance by eliminating the potential need for the CFTC to require registration and oversight of non-U.S. CPOs whose pools have no U.S. investors.”<sup>54</sup> The Industry Groups also “applaud[ed] the Commission’s actions in turning its attention to the increasingly global nature of the asset management space and proposing rule changes that will better align the express terms of its regulations with both the Commission’s policy goals and current global practices.”<sup>55</sup> Although offering support for the 2020 Proposal overall, commenters also suggested additional regulatory edits with respect to several specific issues raised by that release, and provided responses to the questions posed by the Commission.<sup>56</sup>

As noted above, the Commission requested comment generally on the 2020 Proposal, but also posed several targeted questions about potential additional conditions for the proposed exception regarding the initial capital contributions of U.S. controlling affiliates in a non-U.S. CPO’s offshore pool (Affiliate Contribution Exception).<sup>57</sup> In addition to commenting generally on the 2020 Proposal, the Industry Groups submitted

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<sup>51</sup> Industry Group Letter, at 12-13, and ESM, at 1-3.

<sup>52</sup> The complete comment file for the 2020 Proposal can be found on the Commission’s website. Comments for Proposed Rule 85 FR 35820, available at <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=3122>.

<sup>53</sup> Industry Group Letter, at 2; Vanguard, at 2; Barnard, at 2; ESM, at 1.

<sup>54</sup> Barnard, at 2.

<sup>55</sup> Industry Group Letter, at 1.

<sup>56</sup> See, e.g., Vanguard, at 2-3; Industry Group Letter, at 2-15, app. A.

<sup>57</sup> 2020 Proposal, 85 FR at 35826. See *infra* pt. II.F for a more detailed discussion on the Affiliate Contribution Exception adopted in the Final Rule.

the sole comment letter specifically responding to those questions. The Industry Groups stated that they do not support additional conditions on the Affiliate Contribution Exception, and that they believe such limitations “would not provide any additional protection to U.S. investors, customers, or the U.S. commodity interest markets.”<sup>58</sup> For instance, the Commission queried whether the Affiliate Contribution Exception should more explicitly be intended for “seeding purposes,” including whether it should “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?”<sup>59</sup> Alternatively, the Industry Groups suggested a defined “purpose” for affiliate contributions, “for the purpose of establishing, or providing ongoing support to, the pool.”<sup>60</sup>

Regarding the nature of controlling affiliates, the Commission also queried whether the Affiliate Contribution Exception should “be limited to entities or persons that are otherwise financial institutions that are regulated in the United States to provide investor protections?”<sup>61</sup> The Commission additionally inquired whether the Affiliate Contribution Exception should “only be available to U.S. controlling affiliates regulated by the Securities and Exchange Commission, a federal banking regulator, or an insurance regulator?”<sup>62</sup> The Industry Groups stated that they do not believe any benefit would result from “limiting the affiliates that contribute capital to regulated entities” because it would further introduce the Commission “into the decision-making process for

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<sup>58</sup> Industry Group Letter, at 17.

<sup>59</sup> 2020 Proposal, 85 FR at 35826.

<sup>60</sup> Industry Group Letter, at 17.

<sup>61</sup> 2020 Proposal, 85 FR at 35826.

<sup>62</sup> *Id.*

commercial decisions and resource allocation of global organizations,” and “also prevent the use of common practices for this type of funding, including holding companies and trust companies.”<sup>63</sup> One commenter also stated that a U.S. affiliate should not be required to “be regulated in the United States in order to qualify” for the Affiliate Contribution Exception.<sup>64</sup>

The Commission also noted in the 2020 Proposal that one of the rationales behind the Affiliate Contribution Exception is the affiliate’s likely ability to demand that the non-U.S. CPO provide it with information necessary to assess the offshore pool’s operations and performance.<sup>65</sup> Because it may not be possible to ascertain with certainty whether such information must be provided to a U.S. controlling affiliate under laws applicable to the non-U.S. CPO, the Commission queried in the 2020 Proposal whether the Affiliate Contribution Exception should 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?”<sup>66</sup> The Industry Groups noted that “an organization’s decision to contribute capital to support the operations of an offshore CPO is a commercial business decision, not an investment decision of the type that Part 4 information addresses.”<sup>67</sup> Therefore, the Industry Groups stated, there is “no need for the Commission to determine what type of information global business organizations will need to exercise their business judgment in this regard or for the Commission otherwise

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<sup>63</sup> Industry Group Letter, at 18.

<sup>64</sup> Vanguard, at 2.

<sup>65</sup> 2020 Proposal, 85 FR at 35826.

<sup>66</sup> *Id.*

<sup>67</sup> Industry Group Letter, at 18.



to intervene in the organization’s decision-making process.”<sup>68</sup> The Commission did not receive any comments supporting the additional limitations for which the Commission specifically solicited public feedback in the 2020 Proposal.

## **B. Reconsidering the 2016 Proposal and Comments Received**

In addition to reopening the comment period with respect to the 2016 Proposal, the Commission queried specifically whether Commission regulation 3.10 should require commodity interest transactions of foreign located persons or IFIs that are required or intended to be cleared on a registered derivatives clearing organization (DCO) to be submitted for clearing through an FCM registered in accordance with section 4d of the Act, unless such foreign located person or IFI is itself a clearing member of such registered DCO.<sup>69</sup> As mentioned above, the Commission received two additional comments relevant to the 2016 Proposal as a result of the reopening of the 2016 Proposal’s comment period. After a brief explanation of the 2016 Proposal, the Commission will discuss and address these additional comments, along with the public comments originally received in 2016, and outline the Final Rule amendments resulting from the 2016 Proposal below.

### **1. The 2016 Proposal’s Amendments to Commission Regulation 3.10(c)**

At the time the 2016 Proposal was published, and until the Final Rule’s amendments become effective, Commission regulation 3.10(c)(2)-(c)(3) generally provides an exemption from registration, subject to specific conditions, for certain

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<sup>68</sup> *Id.* (noting that “requiring this exception to be conditioned on there being a legally binding obligation in the non-U.S. CPO’s home jurisdiction would create unnecessary non-U.S. legal analysis on the part of the affiliate”).

<sup>69</sup> 2020 Proposal, 85 FR at 35827.

foreign located persons acting as intermediaries (collectively, Foreign Intermediaries) with respect to persons also located outside the U.S., even though such transactions may be executed bilaterally, or on or subject to the rules of a DCM or SEF.<sup>70</sup> With respect to activities involving commodity interest transactions executed bilaterally, or made on or subject to the rules of any DCM or SEF, Commission regulation 3.10(c)(3)(i) provides an exemption from registration as a CPO, CTA, or IB, where the person is a foreign located person, acting only on behalf of other foreign located persons, and the commodity interest transaction is submitted for clearing through a registered FCM.<sup>71</sup> Commission regulation 3.10(c)(2)(i) currently provides a similar exemption from registration for any Foreign Intermediary acting as an FCM.<sup>72</sup>

Pursuant to the 2016 Proposal, the Commission proposed to amend Commission regulations 3.10(c)(2) and (c)(3) to revise the conditions under which those exemptions from registration would apply.<sup>73</sup> Specifically, the 2016 Proposal's amendments would permit a Foreign Intermediary to be eligible for an exemption from registration, if the Foreign Intermediary, in connection with a commodity interest transaction, only acts on behalf of (1) foreign located persons, or (2) IFIs,<sup>74</sup> without regard to whether such

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<sup>70</sup> 17 CFR 3.10(c)(2)-(c)(3). *See supra* pt. I.A.

<sup>71</sup> 17 CFR 3.10(c)(3)(i).

<sup>72</sup> 17 CFR 3.10(c)(2)(i).

<sup>73</sup> 2016 Proposal.

<sup>74</sup> For purposes of the 2016 Proposal, the Commission defined IFIs as those multinational institutions defined in the Commission's previous rulemakings and staff no-action letters, *i.e.*, International Monetary Fund, International Bank for Reconstruction and Development, European Bank for Reconstruction and Development, International Development Association, International Finance Corporation, Multilateral Investment Guarantee Agency, African Development Bank, African Development Fund, Asian Development Bank, Inter-American Development Bank, Bank for Economic Cooperation and Development in the Middle East and North Africa, Inter-American Investment Corporation, Council of Europe Development Bank, Nordic Investment Bank, Caribbean Development Bank, European Investment Bank and European Investment Fund (the International Bank for Reconstruction and Development, International Finance Corporation, and Multilateral Investment Guarantee Agency are parts of the World Bank Group). 2016 Proposal, 81 FR at 51825, *citing* Further Definition of "Swap Dealer," "Security-Based

persons or institutions clear such commodity interest transaction.<sup>75</sup> It was the Commission's intention in 2016 – and remains so now – to promulgate regulations consistent with its longstanding policy of focusing its customer protection activities upon domestic firms, and upon firms soliciting or accepting orders from domestic participants.<sup>76</sup>

## 2. Responsive Comments Received Regarding the 2016 Proposal

In response to the 2016 Proposal, the Commission originally received six comments<sup>77</sup> and subsequently received two additional comments,<sup>78</sup> as a result of reopening the comment period pursuant to the 2020 Proposal. AIMA, CME, MFA, and the Industry Groups commented that the 2016 Proposal would improve market efficiency and increase liquidity in U.S. markets by eliminating the regulatory burden associated with Commission registration imposed on Foreign Intermediaries acting solely on behalf of other foreign located persons.<sup>79</sup> In particular, MFA also commented that foreign

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Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant,” and “Eligible Contract Participant,” 77 FR 30596, 30692, n.1180 (May 23, 2012) (Entities Final Rule).

<sup>75</sup> 2016 Proposal, 81 FR at 51826.

<sup>76</sup> *Id.*

<sup>77</sup> The original six comments were submitted by: AIMA; the CME Group, Inc. (CME); IAA; MFA; and two individuals unaffiliated with any registrant or derivatives industry organization. Comments for Proposed Rule 81 FR 51824, available at <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=1724>. See specifically, Comment Letter from AIMA (Sept. 6, 2016) (AIMA), available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61002&SearchText=>; Comment Letter from CME (Aug. 23, 2016) (CME), available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60997&SearchText=>; Comment Letter from IAA (Sept. 6, 2016) (IAA), available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61003&SearchText=>; Comment Letter from MFA (Sept. 2, 2016) (MFA), available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61000&SearchText=>.

<sup>78</sup> The two additional 2020 comment letters addressing the 2016 Proposal are the jointly submitted Industry Group Letter and the comment letter from ESM, described above as a foreign intergovernmental organization. Comments for Proposed Rule 85 FR 35820, available at <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=3122>. See *supra* pt. II.A.

<sup>79</sup> AIMA, at 1; CME, at 1-2; MFA, at 1; Industry Group Letter, at 12-13.

located persons would generally not have any expectation that a Foreign Intermediary would be subject to Commission oversight.<sup>80</sup> The CME also noted that the proposed amendments would positively impact the likelihood of productive cooperation concerning the regulation of derivatives across all jurisdictions going forward.<sup>81</sup> One individual commented that Foreign Intermediaries should be required to register with the Commission no matter the circumstance.<sup>82</sup> The other individual did not address the 2016 Proposal in any manner. Regarding the two additional comment letters received after the 2020 Proposal, the Industry Groups and ESM were both strongly supportive of the Commission finalizing amendments from the 2016 Proposal; additionally, ESM requested that it be explicitly included in the definition of “international financial institution.”<sup>83</sup>

### **3. Finalizing the 2016 Proposal**

After considering all of the comments, the Commission is finalizing its amendments to Commission regulation 3.10(c) from the 2016 Proposal, with two modifications. First, the Commission originally proposed to amend the language of the exemptions to remove the requirement that any commodity interest transaction shall be submitted for clearing through a registered FCM.<sup>84</sup> In doing so, the Commission recognized that not all commodity interest transactions are subject to a clearing requirement under the CEA or Commission regulations, or even available for clearing by any DCO.<sup>85</sup> However, by removing the clearing condition, the Commission inadvertently

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<sup>80</sup> MFA, at 1.

<sup>81</sup> CME, at 2.

<sup>82</sup> Comment Letter from “Jean Publieee” (Aug. 8, 2016), *available at* [https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60987&SearchText=.](https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60987&SearchText=)

<sup>83</sup> Industry Group Letter, at 13; ESM, at 2.

<sup>84</sup> 2016 Proposal, 81 FR at 51826.

<sup>85</sup> *Id.*

failed to reiterate that those transactions that are required to be cleared must be cleared by a clearing member of the relevant DCO. The proposed removal of such language may have had the unintended consequence of leading some market participants to misconstrue the Commission's purpose as an intention to permit unregistered foreign located persons to become clearing members on a DCO to clear commodity interest transactions on behalf of customers that were also foreign located persons. Thus, the Final Rule provides that the exemptions from registration in Commission regulation 3.10(c) are conditioned on (1) clearing on a DCO any commodity interest transaction that is required or intended to be cleared on a registered DCO; and (2) an additional requirement that such transactions must be cleared through a registered FCM, unless the Foreign Intermediary's customer is a clearing member of the relevant DCO.

Second, the Commission is modifying the definition of "international financial institution" proposed in 2016 to be consistent with the definition of U.S. person recently adopted by the Commission in its final cross-border rules for swap dealers (SDs) and major swap participants (MSPs) (Cross-Border Final Rule), which generally excludes IFIs from the definition of U.S. person.<sup>86</sup> Consistent with the Cross-Border Final Rule, the Commission is defining the term "international financial institutions" in Commission regulation 3.10(c) to include the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, the IFIs that are defined in 22 U.S.C. 262r(c)(2), those institutions that are defined as "multilateral

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<sup>86</sup> Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 FR 56924, 56937-38 (Cross-Border Final Rule).

development banks” in the European Union’s regulation on “OTC derivatives, central counterparties and trade repositories,”<sup>87</sup> their agencies and pension plans, and any other similar international organizations, and their agencies and pension plans.<sup>88</sup>

The IFI definition adopted by the Final Rule also includes two additional institutions identified in CFTC Staff Letters 17-34<sup>89</sup> and 18-13.<sup>90</sup> In CFTC Staff Letter 17-34, Commission staff provided relief from CFTC margin requirements to swaps between SDs and ESM,<sup>91</sup> and in CFTC Staff Letter 18-13, Commission staff identified the North American Development Bank as an additional entity that should be considered an IFI for purposes of applying the SD and MSP definitions.<sup>92</sup> The Commission concludes that it is appropriate to include these two entities in the IFI definition adopted

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<sup>87</sup> Cross-Border Final Rule, 85 FR at 56937-56938; Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC Derivative Transactions, Central Counterparties and Trade Repositories, Article 1(5(a)) (July 4, 2012), *available at* <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32012R0648>. Article 1(5(a)) references Section 4.2 of Part 1 of Annex VI to Directive 2006/48/EC, *available at* <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32006L0048>. The definitions overlap, but together they include the following: the International Monetary Fund, International Bank for Reconstruction and Development, European Bank for Reconstruction and Development, International Development Association, International Finance Corporation, Multilateral Investment Guarantee Agency, African Development Bank, African Development Fund, Asian Development Bank, Inter-American Development Bank, Bank for Economic Cooperation and Development in the Middle East and North Africa, Inter-American Investment Corporation, Council of Europe Development Bank, Nordic Investment Bank, Caribbean Development Bank, European Investment Bank and European Investment Fund. As noted above, the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation, and the Multilateral Investment Guarantee Agency are parts of the World Bank Group.

<sup>88</sup> *See infra* new Commission regulation 3.10(c)(1)(iii) (adopting a formal IFI definition for purposes of applying the exemptions otherwise established by that provision).

<sup>89</sup> CFTC Staff Letter No. 17-34 (Jul, 24, 2017), *available at* <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/17-34.pdf>. *See also* CFTC Staff Letter No. 19-22 (Oct. 16, 2019), *available at* <https://www.cftc.gov/csl/19-22/download>.

<sup>90</sup> CFTC Staff Letter No. 18-13 (May 16, 2018), *available at* <https://www.cftc.gov/csl/18-13/download>.

<sup>91</sup> CFTC Staff Letter No. 17-34. In addition, in May 2020, the Commission adopted an amendment to Commission regulation 23.151 to exclude ESM from the definition of “financial end user,” which will have the effect of excluding swaps between certain SDs and ESM from the Commission’s uncleared swap margin requirements. Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 85 FR 27674 (May 11, 2020).

<sup>92</sup> CFTC Staff Letter 18-13. *See also* CFTC Staff Letter 17-59 (Nov. 17, 2017) (providing no-action relief from the swap clearing requirement of section 2(h)(1) of the CEA), *available at* <https://www.cftc.gov/csl/17-59/download>.

by the Final Rule because the status of both entities as multinational organizations formed for public purposes is the same as that of the other already identified IFIs. Therefore, new Commission regulation 3.10(c)(1)(iii) lists specific IFIs, with these two additions. The IFI definition also includes a catch-all for “any other similar international organizations, and their agencies and pension plans,” which the Commission intends to extend the definition to any of the entities discussed above that are not explicitly listed in the definition.

As the Commission recognized in the 2016 Proposal, IFIs are operated to satisfy public purposes and have as their members sovereign nations from around the world. Although such institutions may have headquarters or another significant presence in the United States, the Commission recognizes that the unique attributes and multinational status of these institutions do not warrant treating them as domestic persons for purposes of the intermediary registration exemptions in Commission regulation 3.10(c). The status of IFIs as multinational member agencies leads the Commission to recognize a need to mitigate restraints on the ability of IFIs to enter into transactions in all member countries in conjunction with promoting global economic development and fulfilling other public purposes. The Commission has determined that this purpose is better served by defining “international financial institution” to be consistent with the Cross-Border Final Rule because the list of IFIs as proposed in the 2016 Proposal was limited to a specified list and may have required amendment from time to time.

### **C. Pool-by-Pool Exemption**

The 2020 Proposal would amend the 3.10 Exemption such that non-U.S. CPOs could avail themselves of the relief thereunder 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 commodity pool are located outside the United States.<sup>93</sup> The Commission stated its preliminary belief that this amendment would appropriately focus Commission oversight on those pools that solicit and/or accept persons located in the United States as pool participants.<sup>94</sup> The Commission further noted several developments in the pooled investment space since the original adoption of the 3.10 Exemption that, in the Commission’s preliminary opinion, also supported the amendments in the 2020 Proposal.<sup>95</sup> Specifically, the Commission observed that Congress in 2010, through the Dodd-Frank Act, expanded the Commission’s jurisdiction to include swaps and rolling spot retail foreign exchange transactions, and that, when combined with the rescission or revision of certain CPO exemptions and exclusions, this expanded authority resulted in a significant increase in the number of entities captured within the definition of CPO.<sup>96</sup>

In considering the propriety of the pool-by-pool exemption set forth in the 2020 Proposal, the Commission also noted the increasing globalization of the commodity pool industry, observing that, in contrast with the pool industry at the time of the original adoption of Commission regulation 3.10(c)(3)(i), several of today’s largest CPOs, when measured by assets under management, are located outside the United States.<sup>97</sup> The Commission noted further that these larger CPOs typically operate many different commodity pools simultaneously, including some pools for U.S. investors and other

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<sup>93</sup> 2020 Proposal, 85 FR at 35822-35823.

<sup>94</sup> 2020 Proposal, 85 FR at 35823.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*



pools for investors outside of the United States.<sup>98</sup> Therefore, the Commission 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, which the Commission preliminarily believed would be accomplished through the 2020 Proposal.<sup>99</sup>

The Commission received one comment explicitly addressing the proposed pool-by-pool availability of the 3.10 Exemption in the 2020 Proposal.<sup>100</sup> The Industry Groups stated their strong support for “the revised structure of the 3.10 Exemption that the Commission has proposed, which clearly and expressly provides for reliance on the exemption on a pool-by-pool basis.”<sup>101</sup> The Industry Groups further stated their agreement with the Commission’s preliminary belief that the proposed amendments “better reflect the current state of operations of CPOs’ and more clearly align the text of the rule with the Commission’s policy goals.”<sup>102</sup> They also noted their belief that “[t]he intention to permit an exempt or registered non-U.S. offshore CPO to rely on the 3.10 Exemption on a pool-by-pool basis is crystal clear, both in the language of the proposed amendment and the Release.”<sup>103</sup>

After considering the comments received, the Commission has determined to finalize the 2020 Proposal so that non-U.S. CPOs may utilize the 3.10 Exemption for their offshore commodity pools on a pool-by-pool basis. As such, the Commission is

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<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> Industry Group Letter, at 10. *See also* Vanguard, at 2 (expressing support for the 2020 Proposal in general and the substantive comments from the Industry Groups); Barnard, at 2 (expressing support for the 2020 Proposal generally).

<sup>101</sup> Industry Group Letter, at 10.

<sup>102</sup> *Id.*, quoting 2020 Proposal, 85 FR at 35822.

<sup>103</sup> *Id.* at 11.

amending the 3.10 Exemption for non-U.S. CPOs, as proposed, to specify that its availability would be determined, in part, by whether all of the participants in a particular offshore pool are foreign located persons.<sup>104</sup> Permitting non-U.S. CPOs to rely upon the relief provided by the 3.10 Exemption on a pool-by-pool basis will further allow the Commission to focus its resources on the oversight of CPOs operating pools offered and sold to participants located in the U.S., *i.e.*, the Commission’s primary customary protection mandate. Therefore, the Commission concludes that the Final Rule properly tailors the 3.10 Exemption to address the increasingly global nature of the investment management space since 2007, without compromising the Commission’s mission of protecting U.S. pool participants and effectively regulating CPOs managing U.S. assets.

For the reasons stated above, the Commission determines that amending the 3.10 Exemption to provide relief from registration to non-U.S. CPOs for their offshore pools on a pool-by-pool basis is an appropriate exercise of its exemptive authority under CEA section 4(c). The persons involved in the transactions subject to the exemptive relief provided herein are “appropriate persons,” as discussed in the 2020 Proposal, because the term “appropriate person” as used in CEA section 4(c) includes “a commodity pool formed or operated by a person subject to regulation under the Act.”<sup>105</sup> 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

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<sup>104</sup> 2020 Proposal, 85 FR at 35831 (proposing Commission regulation 3.10(c)(3)(ii) to provide this relief on a pool-by-pool basis to qualifying non-U.S. CPOs for their offshore pools). *See infra* new Commission regulation 3.10(c)(5)(i) (retaining that proposed language and updating solely to reflect the adoption of defined terms from the 2016 Proposal, including “foreign located person”).

<sup>105</sup> 7 U.S.C. 6(c)(3)(E).

registration category.<sup>106</sup> Consistent with its preliminary belief in the 2020 Proposal, the Commission believes that clearly enabling non-U.S. CPOs to avoid the additional organizational complexity associated with separately organizing their offshore and domestic facing commodity pool businesses may result in more non-U.S. CPOs undertaking to design and offer pools for persons in the United States. Moreover, this could, in turn, result in a greater diversity of commodity pools offered and/or sold to persons in the United States, and this increased competition amongst commodity pools and their CPOs could broadly foster additional innovation in the commodity pool space, already one of the more dynamic sectors regulated by the Commission. Further, this potential for increased competition and variation in commodity pools and CPOs resulting from the Final Rule will further promote the vibrancy of the U.S. commodity interest markets.

The Commission concludes that the amendments adopted herein will not have a material adverse effect on the ability of the Commission or any DCM to discharge their duties under the Act, because non-U.S. CPOs relying on the 3.10 Exemption, as amended by the Final Rule, with respect to their offshore commodity pools will remain subject to the statutory and regulatory obligations imposed on all participants in the U.S. commodity interest markets.<sup>107</sup> This conclusion is consistent with section 4(d) of the Act, which provides that any exemption granted pursuant to CEA section 4(c) will not affect the authority of the Commission to conduct investigations in order to determine

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<sup>106</sup> 77 FR at 30655 (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).

<sup>107</sup> *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).

compliance with the requirements or conditions of such exemption or to take enforcement action for any violation of any provision of the Act or any rule, regulation or order thereunder caused by the failure to comply with or satisfy such conditions or requirements.<sup>108</sup> Further, to the extent a non-U.S. CPO operates both offshore and domestic commodity pools, these amendments to the 3.10 Exemption do not restrict or negatively affect the Commission's statutory and regulatory authority applicable to the commodity pool and intermediary activities of the non-U.S. CPO involving persons located in the United States. Rather, this aspect of the Final Rule simply reflects the Commission focusing its regulatory resources on U.S. pool participants and the firms soliciting them for trading commodity interests, which are squarely within its customer protection mandate.<sup>109</sup> Finally, under the Final Rule, the Commission retains the authority to take enforcement action against any non-U.S. CPO claiming the 3.10 Exemption based on its activities within the U.S. commodity interest markets, consistent with the Commission's authority regarding market participants generally.

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

As discussed above, the Commission proposed that the 3.10 Exemption for non-U.S. CPOs be available on a pool-by-pool basis. Consistent with those proposed amendments, and to address the concerns articulated by commenters to the 2018 Proposal,<sup>110</sup> the Commission also proposed to explicitly provide that a non-U.S. CPO may claim the 3.10 Exemption for its offshore pool(s), while such non-U.S. CPO also

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<sup>108</sup> 7 U.S.C. 6(d).

<sup>109</sup> 2020 Proposal, 85 FR at 35823.

<sup>110</sup> *See, e.g.*, AIMA, at 6; Willkie, at 6.

claims another registration exemption or regulatory exclusion with respect to other pools it operates, *e.g.*, the *de minimis* exemption under Commission regulation 4.13(a)(3),<sup>111</sup> an exclusion from the CPO definition under Commission regulation 4.5,<sup>112</sup> or registers with respect to such pools.<sup>113</sup> As noted in the 2020 Proposal and confirmed by the responsive comments received, the Commission understands that this practice is known colloquially as the ability to “stack” exemptions.

Absent the finalization of this amendment, the 3.10 Exemption would not have a provision that expressly contemplates its simultaneous use with other exemptions or exclusions available under other Commission regulations. This contrasts with the language in Commission regulation 4.13(f), for example, which states that the filing of a notice of exemption from registration under that section will not affect the ability of a person to qualify for exclusion from the definition of the term “commodity pool operator” under § 4.5 in connection with its operation of another trading vehicle that is not covered under § 4.13.<sup>114</sup> In the 2020 Proposal, the Commission stated its preliminary belief that non-U.S. CPOs relying on the 3.10 Exemption should have the ability to rely on other regulatory exemptions or exclusions that they qualify for, just like any other CPO.<sup>115</sup> The Commission noted that it 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 other regulatory relief available to CPOs generally.<sup>116</sup> The

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<sup>111</sup> 17 CFR 4.13(a)(3).

<sup>112</sup> 17 CFR 4.5.

<sup>113</sup> 2020 Proposal, 85 FR at 35824-25. *See infra* new Commission regulation 3.10(c)(5)(iv).

<sup>114</sup> 17 CFR 4.13(f).

<sup>115</sup> 2020 Proposal, 85 FR at 35825.

<sup>116</sup> *Id.*

Commission therefore preliminarily concluded that a non-U.S. CPO relying upon the 3.10 Exemption for one or more of its offshore pools should not, by virtue of that reliance, be foreclosed from utilizing other relief generally available to CPOs of U.S. pools.<sup>117</sup>

The Commission received one comment regarding the ability to combine the 3.10 Exemption with either registration or other available CPO exemptions or exclusions. The Industry Groups strongly supported this aspect of the 2020 Proposal because it “clearly and expressly provides for reliance on the [3.10 E]xemption on a pool-by-pool basis and also, in a separate provision, expressly acknowledges the ability to combine or ‘stack’ exemptions.”<sup>118</sup> They did, however, suggest removing from the proposed amendment the specific references to Commission regulations 4.13 and 4.5, so as to better align the provision with the Commission’s stated intentions in the 2020 Proposal, *i.e.*, to permit the 3.10 Exemption to be broadly combinable with other available exemptions or exclusions, or registration.<sup>119</sup>

After considering the comments received, and for the reasons stated in the 2020 Proposal, the Commission is adopting the proposed amendment permitting the 3.10 Exemption to be maintained concurrently with CPO registration and/or other exemptions or exclusions otherwise available to the claiming non-U.S. CPO. The Commission agrees that it is not necessary for the exclusions and exemptions available under Commission regulations 4.5 and 4.13 to be explicitly enumerated therein. Although the

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<sup>117</sup> *Id.*

<sup>118</sup> Industry Group Letter, at 10.

<sup>119</sup> *Id.* at 12 (citing the 2020 Proposal, 85 FR at 25824-25, and stating that the Commission repeatedly describes the provision “as permitting simultaneous reliance on different exemptions or registration, giving examples of such exemptions, but without limiting the exemptions in question”).

relief provided by Commission regulations 4.5 and 4.13 is the predominant means by which commodity pools are operated without the registration of a CPO, those provisions are not the sole source of such relief available to CPOs for their pools. Therefore, the Final Rule adopts the provision permitting the “stacking” of the 3.10 Exemption with either registration or other available relief from CPO regulation by the Commission, without the specific references to Commission regulations 4.5 and 4.13.<sup>120</sup>

**E. The Safe Harbor for Non-U.S. CPOs With Respect to Inadvertent U.S. Participants in Their Offshore Pools**

The 2020 Proposal also proposed a safe harbor for non-U.S. CPOs that have taken reasonable actions designed to minimize the possibility that participation units in the operated offshore pool are being offered or sold to persons located in the United States. The Commission understands that some non-U.S. CPOs may not be able to represent with absolute certainty that they are acting only on behalf of foreign located persons invested in their offshore pools, as such non-U.S. CPOs may not have complete visibility into the ultimate beneficial ownership of their offshore pool participation units. Pursuant to the proposed safe harbor, a non-U.S. CPO would be permitted to engage in the U.S. commodity interest markets on behalf of an offshore pool for which it cannot represent with absolute certainty that all of the pool participants are offshore, as required by the 3.10 Exemption, provided that such non-U.S. CPO meets the following conditions:

1. The offshore pool’s offering materials and any underwriting or distribution agreements include clear, written prohibitions on the offshore pool’s offering to

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<sup>120</sup> See *infra* new Commission regulation 3.10(c)(5)(iv).

participants located in the United States and on U.S. ownership of the offshore pool's participation units;

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 non-U.S. 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.

With respect to this proposed safe harbor, the Commission stated its preliminary expectation 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.<sup>121</sup>

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<sup>121</sup> 2020 Proposal, 85 FR at 35824.



The Commission also stated its preliminary belief that satisfying the criteria of the proposed safe harbor would serve as an indication that a non-U.S. CPO is exercising sufficient diligence with respect to those circumstances within its control to minimize the possibility of engaging with persons located in the United States concerning the offered offshore pool.<sup>122</sup> Moreover, the Commission stated its preliminary belief that, if a non-U.S. CPO meets the five factors in the proposed safe harbor, the likely absence of U.S. participants is sufficiently ensured so as to allow reliance on the 3.10 Exemption.<sup>123</sup> As with any of the Commission’s other registration exemptions available to CPOs generally, the Commission expressed in the 2020 Proposal its expectation that non-U.S. CPOs claiming the 3.10 Exemption would maintain adequate documentation to demonstrate compliance with the terms of the safe harbor.<sup>124</sup>

The Commission received only one comment regarding the proposed safe harbor. The commenter supported it, saying that “[t]he proposed safe harbor provides adequate provisions that will simplify compliance with no loss of regulatory amenity.”<sup>125</sup>

Accordingly, upon consideration of the comments, and consistent with the rationale expressed in the 2020 Proposal, the Commission is adopting the safe harbor as proposed. The Commission believes, as it did in the 2020 Proposal, that this amendment is an appropriate exercise of the Commission’s exemptive authority under CEA section 4(c). The persons involved in the transactions subject to the exemptive relief provided herein are “appropriate persons,” as discussed in the 2020 Proposal, because the term

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<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> Barnard, at 2.

“appropriate person” as used in CEA section 4(c) includes “a commodity pool formed or operated by a person subject to regulation under the Act.”<sup>126</sup> 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.<sup>127</sup> This safe harbor may promote responsible economic or financial innovation and fair competition in the U.S. commodity interest markets generally, thereby increasing their vibrancy and liquidity.<sup>128</sup> The safe harbor adopted herein permits a non-U.S. CPO of an offshore pool, by taking defined steps designed to mitigate the risk of U.S. participation in the offshore pool, to continue to qualify for the 3.10 Exemption, and thus, avoid being regulated both by its regulatory authority in its home jurisdiction and by the Commission. This effectively places the non-U.S. CPO on an equal footing with those domestic CPOs solely regulated by the Commission because each is generally subject to a single, appropriate regulatory regime with respect to the operation of its commodity pools. Additionally, the presence and activity of additional offshore pools with trading strategies developed outside the United States creates a diversity of viewpoint in the U.S. commodity interest markets, which could encourage innovation and competition by domestic CPOs as well.

Moreover, providing a safe harbor enabling non-U.S. CPOs to utilize the 3.10 Exemption, subject to appropriate conditions minimizing possible U.S. participants in the covered offshore pools, may result in more non-U.S. CPOs and their offshore pools

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<sup>126</sup> 7 U.S.C. 6(c)(3)(E).

<sup>127</sup> 77 FR at 30655 (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).

<sup>128</sup> 7 U.S.C. 6(c).

choosing to trade in the U.S. commodity interest markets, which adds liquidity to those markets and thereby promotes more efficient price discovery therein. Importantly, the adoption of the safe harbor will not have a material adverse effect on the ability of the Commission to discharge its regulatory duties under the Act. Pursuant to CEA section 4(d), 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, notwithstanding this amendment.<sup>129</sup> Finally, as noted above, the Commission retains 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. Nothing in the Final Rule, including the adoption of this safe harbor, negatively affects or restricts the Commission's statutory and regulatory authority applicable to the commodity pool and intermediary activities of a non-U.S. CPO involving persons located in the United States. Therefore, the Commission concludes that the safe harbor, as adopted herein, is an appropriate exercise of its authority pursuant to section 4(c) of the Act.<sup>130</sup>

**F. Exception for Initial Capital Contributions by U.S. Affiliates of a Non-U.S. CPO to its Offshore Pools**

The 2020 Proposal also proposed an Affiliate Contribution Exception, providing that initial capital contributed by a non-U.S. CPO's U.S. controlling affiliate to the non-

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<sup>129</sup> 7 U.S.C. 6(d).

<sup>130</sup> See *infra* new Commission regulation 3.10(c)(5)(iii).

U.S. CPO’s offshore commodity pool would not affect the eligibility of the non-U.S. CPO for the 3.10 Exemption with respect to that offshore pool.<sup>131</sup> To that end, despite its initial capital contribution(s), the U.S. controlling affiliate would not be considered a “participant” for purposes of determining whether all of the offshore pool’s participants are located outside of the United States, as required by the 3.10 Exemption.<sup>132</sup> The Commission noted that the term “control” in this proposed provision: (1) was intended to 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; and (2) would be defined, consistent with part 49 of its regulations, 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.<sup>133</sup> As discussed in more detail below, the Commission proposed multiple conditions and limitations to the Affiliate Contribution Exception: (1) the U.S. affiliate must “control,” as defined in Commission regulation 49.2(a)(4), the non-U.S. CPO of the offshore pool; (2) only contributions considered to be “initial capital contributions,” *i.e.*, those made at or near the inception of an offshore commodity pool, are covered by the exception; (3) interests in the U.S. affiliate are not being marketed as an investment or asset that provides exposure to the U.S. commodity interest markets; and (4) the U.S. affiliate must not be subject to a statutory disqualification, ongoing

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<sup>131</sup> 2020 Proposal, 85 FR at 35825-35826.

<sup>132</sup> *Id.* at 35825.

<sup>133</sup> *Id.* (explaining that this definition of “control” stems from Commission regulation 49.2(a)(4) and was recently incorporated into the Commission’s approach in the cross-border regulation of SDs); *Id.* at 35832 (proposing Commission regulation 3.10(c)(3)(iii)).

registration suspension or bar, prohibition on acting as a principal, or trading ban with respect to the U.S. commodity interest markets.<sup>134</sup>

The Commission received two comment letters addressing and discussing the Affiliate Contribution Exception in the 2020 Proposal. Both commenters generally supported the Commission’s proposed Affiliate Contribution Exception. Vanguard strongly supported this aspect of the 2020 Proposal, but stated its belief that “two changes would enhance the Proposal, consistent with the Commission’s mandate to protect U.S. commodity pool participants.”<sup>135</sup> The Industry Groups also strongly supported the proposed Affiliate Contribution Exception. This approach, the Industry Groups explained, as reflected in the Commission’s own staff relief letters and certain regulatory provisions, “recognizes that these [affiliate] capital contributions are not ‘investments’ made for the purpose of seeking returns from a pooled vehicle,” and that prior Commission staff letters have previously recognized that capital contributions to a pool by the CPO’s U.S. affiliate or the CPO’s U.S. principals do not constitute “participation” in the pool that would otherwise require the protections of the Commission’s CPO regulatory program in 17 CFR part 4.<sup>136</sup>

Specifically, the Industry Groups noted that the proposed approach recognizes that affiliate contributions “reflect ‘commercial’ business decisions” to further the CPO’s business goals and support the CPO’s innovation and investment opportunities.<sup>137</sup> Both comment letters also recommended that, in finalizing the 2020 Proposal, the Commission

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<sup>134</sup> 2020 Proposal, 85 FR at 35825, 35831-35832.

<sup>135</sup> Vanguard, at 2. The two changes urged by Vanguard are discussed in more detail below.

<sup>136</sup> Industry Group Letter, at 5.

<sup>137</sup> Industry Group Letter, at 5.

adopt certain modifications that would generally expand the proposed availability of the Affiliate Contribution Exception.<sup>138</sup> The Commission will now explain the proposed conditions, responsive comments, and finally, the approach it is taking in the Final Rule, including the Commission’s analysis pursuant to CEA section 4(c).

### **1. U.S. “Controlling” Affiliates**

In the 2020 Proposal, the Commission proposed to permit U.S. controlling affiliates to contribute initial capital to offshore pools operated by their affiliated non-U.S. CPOs, because it preliminarily believed that the control typically exercised by a U.S. controlling affiliate over its non-U.S. CPO affiliate should provide a meaningful degree of protection and transparency with respect to the U.S. controlling affiliate’s contribution of initial capital to a non-U.S. CPO’s offshore commodity pool.<sup>139</sup> For purposes of determining what constitutes a “controlling affiliate,” as that term was used in the 2020 Proposal,<sup>140</sup> the Commission used the definition of “affiliate” set forth in Commission regulation 4.7(a)(1)(i), which defines an “affiliate” as a person that directly or indirectly through one or more persons, controls, is controlled by, or is under common control with the specified person,<sup>141</sup> and the definition of “control” as set forth in Commission regulation 49.2(a)(4), which defines “control” 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 securities, by contract, or otherwise.<sup>142</sup>

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<sup>138</sup> Industry Group Letter, at 2-3; Vanguard, at 2.

<sup>139</sup> 2020 Proposal, 85 FR at 35825.

<sup>140</sup> The proposed Affiliate Contribution Exception referred to the qualifying contributing affiliate as “the control affiliate.” *See, e.g.*, 2020 Proposal, 85 FR at 35832.

<sup>141</sup> 17 CFR 4.7(a)(1)(i).

<sup>142</sup> 17 CFR 49.2(a)(4).

The Commission further noted that the majority of a registered CPO’s compliance obligations focus on customer protection through a variety of disclosures regarding a person’s participation in a pool, which information a controlling affiliate would likely already be in a position to obtain, independent of the Commission’s regulations.<sup>143</sup> The Commission preliminarily believed that a controlling person would have the corporate or other legal authority to require the controlled non-U.S. CPO to provide information equivalent to that required by the Commission, such as detailed information about the non-U.S. CPO’s finances, management, and operations, and more relevant to the proposed amendment, access to investment and performance information for the offshore pool.<sup>144</sup> Based on that understanding, the Commission preliminarily concluded that, due to the fundamentally different features of the relationship between a controlling affiliate and a non-U.S. CPO, as compared with that between an outside investor and that CPO, initial capital contributions by a U.S. controlling affiliate to an offshore pool operated by an affiliated non-U.S. CPO do not raise the same customer protection concerns as investments in those pools by unaffiliated persons located in the United States.<sup>145</sup>

As noted above, both responsive comments supported the general concept of the proposed Affiliate Contribution Exception. Although the commenters agreed that employing the definition of “affiliate” from Commission regulation 4.7(a)(1)(i) for this purpose is appropriate, they both opposed the additional proposed condition of “control,” as defined in Commission regulation 49.2(a)(4).<sup>146</sup> Vanguard recommended that the

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<sup>143</sup> 2020 Proposal, 85 FR at 35825, *citing* 17 CFR 4.22(c)(8) (providing that a registered 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).

<sup>144</sup> 2020 Proposal, 85 FR at 35825.

<sup>145</sup> *Id.*

<sup>146</sup> Vanguard, at 2; Industry Group Letter, at 5.

Commission not require that the U.S. affiliate contributing capital to an offshore pool managed by a non-U.S. CPO “be a controlling affiliate of the non-U.S. CPO or be regulated in the United States in order to qualify for” the Affiliate Contribution Exception.<sup>147</sup> Likewise, the Industry Groups specifically recommended that the Affiliate Contribution Exception be applicable to offshore pool contributions by *all* affiliates, as defined in Commission regulation 4.7(a)(1)(i), rather than just controlling affiliates, and further stated their belief that limiting the exception to contributions from controlling affiliates serves no regulatory need for the Commission.<sup>148</sup>

Additionally, the Industry Groups stated that the Commission’s motivation in requiring such control, that the U.S. controlling affiliate would therefore have access to any and all information on the non-U.S. CPO and the offshore pool otherwise required for participants by virtue of 17 CFR part 4, was misplaced because, they argued, capital contributions to a pool by affiliates of its CPO “reflect commercial business decisions intended for the purpose of supporting the organization’s business operations.”<sup>149</sup> The Industry Groups emphasized, moreover, that limiting the Affiliate Contribution Exception to controlling affiliates is “neither necessary nor appropriate to ensure that global organizations can obtain the information they need for commercial decision-making.”<sup>150</sup> They stated that requiring control in the Affiliate Contribution Exception

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<sup>147</sup> Vanguard, at 2 (citing other 17 CFR part 4 regulations as provisions that “acknowledge that a CPO’s affiliate that contributes capital to offshore pools does not need to receive the information that is otherwise provided by a CPO to other investors for their protection”).

<sup>148</sup> Industry Group Letter, at 5-6 (stating that, “[a]s proposed, the [Affiliate Contribution Exception] would be available only to contributions by those entities in an organizational structure that are upstream of the CPO, and would exclude contributions from all other affiliates”).

<sup>149</sup> *Id.* at 6.

<sup>150</sup> *Id.* (noting further that this proposed condition does not “accurately reflect the realities of enterprise decision-making and information flow”).



“would in no way further the protection of U.S. investors,” because affiliate contributions to an offshore pool are “not properly viewed as participant investments requiring Part 4 protection[s].”<sup>151</sup> The Industry Groups also argued that the proposed condition would “prevent many global organizations from being able to rely on the exemption in circumstances that do not present any of the concerns” raised in the 2020 Proposal.<sup>152</sup> Finally, the Industry Groups stated that “there is no basis for requiring the entity directly contributing capital to control the [non-U.S.] CPO,” as long as all of the entities involved remain, “under [the] common control of an entity responsible for the success of the enterprise.”<sup>153</sup>

After further consideration of the proposed Affiliate Contribution Exception and the comments received, the Commission does not believe that requiring the U.S. affiliate to “control” the non-U.S. CPO is necessary to address the Commission’s stated policy concerns. The definition of “affiliate” in Commission regulation 4.7(a)(1)(i) already incorporates the idea of “control,”<sup>154</sup> which is substantively identical to that in Commission regulation 49.2(a)(4).<sup>155</sup> Therefore, as noted by commenters, control is

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<sup>151</sup> Industry Group Letter, at 8.

<sup>152</sup> *Id.* at 7-8.

<sup>153</sup> *Id.* at 6.

<sup>154</sup> 17 CFR 4.7(a)(1)(i).

<sup>155</sup> When the Commission proposed the definition of “affiliate” in Commission regulation 4.7, which it later adopted without modification, it stated that the definition was identical to that in the Securities and Exchange Commission’s (SEC’s) Regulation D. Exemption for Commodity Pool Operators With Respect to Offerings to Qualified Eligible Participants; Exemption for Commodity Trading Advisors With Respect to Advising Qualified Eligible Clients, 65 FR 11253, 11256 (Mar. 2, 2000) (stating that the proposed definition is based upon the “affiliate” definition in Rule 501 of Regulation D under the Securities Act of 1933.); 17 CFR 230.501(b). The definition of “affiliate” in Regulation D is identical to that in SEC Rule 405 of Regulation C. Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers or Sales, 47 FR 11251, 11255 (Mar. 16, 1982); 17 CFR 230.405. Rule 405 of Regulation C, in turn, defines “control” as used in the definition of “affiliate” in both Regulation D and – pertinent to this Final Rule – Commission regulation 4.7(a)(1)(i), 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 securities, by contract, or otherwise. 17 CFR 203.405, *control*.

already required between or among related entities for those entities to be considered “affiliates” under Commission regulation 4.7(a)(1)(i), as “control” is inherent to that “affiliate” definition.

Because control is a fundamental element of the relationship between a U.S. affiliate and non-U.S. CPO, and therefore is incorporated into the proposed Affiliate Contribution Exception due to its reference to Commission regulation 4.7(a)(1)(i), the Commission believes that including an additional reference to “control” from Commission regulation 49.2(a)(4) is redundant and unnecessary to ensure there is “a meaningful degree of protection and transparency,” or adequate information and disclosure flowing between those entities. Upon consideration of the comments and the Commission’s concerns delineated in the 2020 Proposal about sufficient information regarding an offshore pool investment being available to a contributing U.S. affiliate, the Commission believes that such U.S. affiliate does not have to control the non-U.S. CPO, as contemplated by the 2020 Proposal, for the Commission to be reasonably confident that the U.S. affiliate has a meaningful degree of visibility into the operations of the non-U.S. CPO and the offshore pool, absent the protections provided by part 4 of the Commission’s regulations. Therefore, the Commission concludes in the Final Rule that it is not necessary for the U.S. affiliate to be a controlling affiliate, provided that “control,” as articulated by the affiliate definition in Commission regulation 4.7(a)(1)(i), is present.<sup>156</sup>

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<sup>156</sup> 2020 Proposal, 85 FR at 35825. The Commission notes that, in the 2020 Proposal, this discussion focused on the relationship between a “U.S. controlling affiliate” and the non-U.S. CPO because the Commission believed that, for purposes of the proposed Affiliate Contribution Exception, 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 non-U.S. CPO’s offshore pool. *Id.* at 35825-35826.

In arriving at this conclusion, the Commission reflected upon the nature and characteristics of the types of relationships generally included within the definition of “affiliate” under Commission regulation 4.7(a)(1)(i), as incorporated in both the 2020 Proposal and the Final Rule. As explained above, entities meet the definition of “affiliate” in Commission regulation 4.7(a)(1)(i) primarily by virtue of the control in their relationships to one another; this obviates the need for the Commission, through its regulations or otherwise, to mandate the provision of information to the contributing affiliate.

For instance, if the U.S. affiliate controls the non-U.S. CPO, as discussed in the 2020 Proposal, the U.S. affiliate would have the direct authority to obtain any information it needs related to its capital contribution to the offshore pool operated by its controlled non-U.S. CPO. Alternatively, if a U.S. affiliate is controlled by the non-U.S. CPO of an offshore pool, as a corporate subsidiary, in the Commission’s experience, the U.S. affiliate typically has increased access to information about the operations of its parent, as compared to a third-party participant, because the controlled U.S. affiliate may obtain such information as needed, and otherwise has the ability to access internal information regarding its parent’s operations, including information regarding an offshore pool. Moreover, where the U.S. affiliate and the non-U.S. CPO are under common control of a third entity, that third-party controlling affiliate, due to its interest in the continued viability of the U.S. affiliate, the non-U.S. CPO, and the enterprise as a whole, would, in the Commission’s experience, ensure that its controlled U.S. affiliate was in possession of any and all relevant information regarding the offshore pool necessary to assess the propriety of the U.S. affiliate contributing initial capital to that vehicle. In each

instance, the U.S. affiliate, regardless of whether it is controlling, controlled by, or under common control with a non-U.S. CPO of an offshore pool, would have a mechanism to obtain information regarding the operations of that offshore pool, independent of the Commission's regulatory requirements under 17 CFR part 4. This conclusion is also consistent with the Commission's determination to exempt certain affiliated pool participants from the disclosure and reporting requirements in part 4 of its regulations, based on similar analyses of the nature of those contributions and of the relationships between such affiliated participants and the CPO.<sup>157</sup>

Based on the foregoing, the Commission concludes that the general nature of such affiliate relationships assuages its stated concerns in the 2020 Proposal in the context of the Affiliate Contribution Exception. The Commission believes that where the U.S. affiliate contributing initial capital to the offshore pool controls, is controlled by, or is under common control with, the offshore pool's non-U.S. CPO, consistent with the "affiliate" definition in Commission regulation 4.7(a)(1)(i), this provides such U.S. affiliate with sufficient access to the information it needs about the non-U.S. CPO or the offshore pool to make properly informed decisions regarding any initial capital contributions to that offshore pool. Thus, the Commission concludes that such U.S. affiliate of a non-U.S. CPO contributing to its offshore pool should be eligible for the Affiliate Contribution Exception, provided the other conditions are met. The Final Rule

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<sup>157</sup> See, e.g., 17 CFR 4.21(a)(2) (stating that, for purposes of distributing disclosure documents to prospective participants, a CPO is not required to distribute to a commodity pool operated by a pool operator that is the same as, or that controls, is controlled by, or is under common control with, the pool operator of the offered pool); 17 CFR 4.22(c)(8) (providing that, for purposes of the Annual Report distribution requirement, the term "participant" does not include a commodity pool operated by a pool operator that is the same as, or that controls, is controlled by, or is under common control with the pool operator of a pool in which the commodity pool is invested).

therefore adopts the Affiliate Contribution Exception, without additionally requiring that the U.S. affiliate control the affiliated non-U.S. CPO, and without reference to Commission regulation 49.2(a)(4).<sup>158</sup>

## **2. The Timing of a U.S. Affiliate's Capital Contributions to an Offshore Pool**

In the 2020 Proposal, the Commission also stated its preliminary intent to limit the Affiliate Contribution Exception to capital contributed by a U.S. controlling affiliate at or near the inception of a non-U.S. CPO's offshore pool.<sup>159</sup> The Commission explained that such initial capital contributions generally result from commercial decisions by the U.S. controlling affiliate, typically in conjunction and coordination with the non-U.S. CPO, to support the offshore pool until such time as it has an established performance history for solicitation purposes, notwithstanding that the affiliate's capital may remain invested for the life of the offshore pool.<sup>160</sup> Limiting the Affiliate Contribution Exception to initial capital contributions, the Commission preliminarily believed, is 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.<sup>161</sup>

The Commission also discussed in the 2020 Proposal whether such contributions should be time-limited in any regard. The Commission acknowledged a staff letter issued by the Division of Swap Dealer and Intermediary Oversight (DSIO), wherein DSIO staff

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<sup>158</sup> See *infra* new Commission regulation 3.10(c)(5)(ii).

<sup>159</sup> 2020 Proposal, 85 FR at 35826.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

determined that a limitation on how long U.S. contributions could remain invested in an offshore pool without the non-U.S. CPO registering as such was appropriate, because some of the U.S. derived capital came from U.S. natural persons employed by the non-U.S. CPO's affiliated U.S. investment advisers.<sup>162</sup> In the 2020 Proposal, the Commission preliminarily concluded that imposing a similar time limit on the proposed Affiliate Contribution Exception was not necessary, where the initial capital contributions are derived not from natural person employees, but rather from the corporate funds of the contributing affiliate.<sup>163</sup>

In response, the Industry Groups commented that the Commission's rationale supporting the Affiliate Contribution Exception "applies equally to affiliate support provided at other points in a pool's life cycle, and that limiting the [exception] to 'initial' contributions would thus reduce the effectiveness of the exemption without serving any U.S. investor protection purpose."<sup>164</sup> Vanguard supported the Commission's belief that any contribution of capital by a U.S. affiliate should be done to support the operations of an offshore pool at a time when its viability is being tested.<sup>165</sup> However, Vanguard noted that limiting contributions to "at or near a pool's inception" would have the unintended consequence of "limiting [an] affiliate's ability to support its non-U.S. CPO," and accordingly, recommended that the Commission not limit the Affiliate Contribution Exception to initial capital contributions.<sup>166</sup>

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<sup>162</sup> *Id.* at 35825, citing CFTC Staff Letter 15-46 (May 8, 2015), available at <https://www.cftc.gov/csl/15-46/download>.

<sup>163</sup> 2020 Proposal, 85 FR at 35825.

<sup>164</sup> Industry Group Letter, at 8.

<sup>165</sup> Vanguard, at 3.

<sup>166</sup> *Id.*

Additionally, the Industry Groups stated that there are “many situations in the life of an offshore pool, after the initial startup period, where it is beneficial, and may be essential, to the pool’s viability and to its participants for the CPO or its affiliates to provide additional support for the pool.”<sup>167</sup> The Industry Groups noted that there are matters beyond a CPO’s control “such as shareholder redemption activity and market disruptions” that make it important for the offshore pool to have continued access to affiliate capital support.<sup>168</sup> Alternatively, the Industry Groups stated that they would not be opposed to the Commission including in the Affiliate Contribution Exception a specific “purpose” provision, to ensure it is used “properly” or in good faith; their suggested language would require that, ““contributions of the affiliate will be for the purpose of establishing, or providing ongoing support to, the [offshore] pool to attract or retain non-U.S. investors and will not be used as a mechanism for the U.S. affiliate to generate returns for its own investors.””<sup>169</sup>

After considering the comments received, the Commission is limiting the Affiliate Contribution Exception to initial capital contributions to an offshore pool by U.S. affiliates of the pool’s non-U.S. CPO, as proposed. Specifically, commenters confirmed the Commission’s preliminary belief that affiliates commonly support offshore pools by making capital contributions at or near the pool’s inception to facilitate the establishment of performance history for solicitation purposes, although the affiliate’s capital may remain invested as long as the offshore pool operates. The Commission was clear in the

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<sup>167</sup> Industry Group Letter, at 8-9 (describing regulatory and business reasons, such as limits on owner concentration, investment diversification, internal guidelines, ensuring qualified purchaser status, or seeding a new share class for an existing offshore pool).

<sup>168</sup> Industry Group Letter, at 9.

<sup>169</sup> *Id.*

2020 Proposal that it was comfortable excepting from regulation, via the proposed Affiliate Contribution Exception, those capital contributions from a non-U.S. CPO's U.S. affiliate to an offshore pool that are contributed "at or near a pool's inception" for the specific purposes of generating performance history resulting from innovative or new trading programs.<sup>170</sup> The Commission stated that, consistent with its authority under CEA section 4(c), the Commission intended the proposed Affiliate Contribution Exception to allow such non-U.S. CPOs to test novel trading programs or otherwise engage in proof of concept testing in the collective investment industry that might otherwise not be possible due to a lack of a performance history for the offshore pool.<sup>171</sup>

Conversely, commenters have recommended expanding the time frame for affiliate capital contributions to permit them at any point during an offshore pool's existence, such that affiliate contributions may be made for a variety of reasons, other than testing a novel trading strategy or establishing a performance history for solicitation purposes.<sup>172</sup> Such circumstances would permit a U.S. affiliate to provide ongoing support to an offshore pool, either to facilitate the offshore pool's ongoing operations in times of distress, or to attract and retain participants later in the offshore pool's lifecycle, well beyond its inception. The Commission has concerns that expanding the time frame for the Affiliate Contribution Exception in this manner could result in a U.S. affiliate being used by its affiliated non-U.S. CPO to financially support an otherwise poorly performing or even failing offshore pool, which could, in turn, adversely affect the

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<sup>170</sup> 2020 Proposal, 85 FR at 35826.

<sup>171</sup> *Id.*

<sup>172</sup> *See, e.g.*, Industry Group Letter, at 8-9.



financial condition of (and potentially result in the failure of) the U.S. affiliate, and ultimately, cause harm to the U.S. financial system and investors.

Moreover, the Commission believes that it would be difficult to craft a regulatory provision that appropriately expands the time frame and/or circumstances under which U.S. affiliates would be permitted to make capital contributions to an offshore pool, without rendering the Affiliate Contribution Exception overbroad or impermissibly vague. As noted above, commenters suggested rule text requiring that, “contributions of the affiliate will be for the purpose of establishing, or providing ongoing support to, the [offshore] pool to attract or retain non-U.S. investors and will not be used as a mechanism for the U.S. affiliate to generate returns for its own investors.”<sup>173</sup> This suggested language, in the Commission’s opinion, provides such minimal limitations on the circumstances under which a U.S. affiliate could contribute capital to an offshore pool (with the only prohibition being the outright evasive generation of profits for investors in the U.S. affiliate), as to render the limitation meaningless in practice. As noted above, the Commission intended the proposed Affiliate Contribution Exception to be available for specific purposes related to the start-up or inception of an offshore pool, and to generating performance history for its new trading program or strategy. The Commission finds that broadening the exception’s purpose as suggested by commenters could result in undue risk from offshore pools flowing back onto U.S. shores, and thus, to U.S. investors. Therefore, the Commission declines to broaden the time frame, and is

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<sup>173</sup> *Id.*

adopting the Affiliate Contribution Exception as proposed, with the limitation to initial capital contributions by U.S. affiliates.<sup>174</sup>

The Industry Groups also suggested that the Commission consider clarifying that, for purposes of the 3.10 Exemption, including the Affiliate Contribution Exception, when the Commission or one of its regulations refers to a “pool,” it should generally be construed as also referring to series, sub-funds, and/or segregated portfolios of business organizations that provide statutory ring-fencing of assets and liabilities for each series, sub-fund, or segregated portfolio.<sup>175</sup> The Commission notes that the 2020 Proposal did not address the treatment of series, sub-funds, and/or segregated portfolios of structures that provide limited liability amongst such subdivisions. Furthermore, the Commission notes that, to date, it has not revised the definition of the term “pool” in Commission regulation 4.10(d) to recognize such subdivisions as individual pools, nor did the Commission propose such amendment in the 2020 Proposal.<sup>176</sup> Finally, given that the term “pool” is used throughout the Commission’s regulations, the Commission believes that it would be more appropriate to address the issue of how a pool may be organized more globally within its regulations, which it is unable to accomplish through this Final

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<sup>174</sup> Any non-U.S. CPO contemplating accepting additional capital contributions for an offshore pool from one or more of its U.S. affiliates outside the period of initial capitalization would have to separately qualify for, rely upon, or claim other relief from registration as a CPO with the Commission. Any such investment would not be eligible for this Affiliate Contribution Exception.

<sup>175</sup> Industry Group Letter, at 11, n. 25 (noting that, despite the different terminology between domestic series trusts and “segregated portfolios,” the latter is an analogous corporate structure frequently used in jurisdictions outside of the United States).

<sup>176</sup> 17 CFR 4.10(d)(1) (defining “pool” as any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests).

Rule.<sup>177</sup> Therefore, the Commission is not adopting a definition of “pool” for purposes of the 3.10 Exemption.

### **3. Additional Anti-Evasion Conditions: The Marketing Prohibition and Prohibiting “Bad Actor” U.S. Affiliates**

The Commission acknowledged in the 2020 Proposal that the proposed Affiliate Contribution Exception could result in evasion of the Commission’s regulations generally with respect to offshore pools.<sup>178</sup> As an example, the Commission described a situation where a U.S. controlling affiliate could invest in its affiliated non-U.S. CPO’s offshore commodity pool, and then solicit persons located in the United States for investment in the U.S. controlling affiliate, in an effort to provide such U.S. investors with indirect exposure to the offshore pool.<sup>179</sup> The Commission then stated its preliminary belief that, under those circumstances, the Commission would consider such practices as constituting evasion of the Commission’s CPO regulations, and would thus render the non-U.S. CPO ineligible for the 3.10 Exemption.<sup>180</sup> The Commission therefore proposed an “anti-evasion” requirement in the Affiliate Contribution Exception that, interests in the U.S. controlling affiliate are not marketed as providing access to trading in commodity interest markets in the United States, its territories or possessions.<sup>181</sup>

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<sup>177</sup> See Administrative Procedure Act, Pub. L. No. 404, 60 Stat. 237, ch. 324, sections 1-12 (1946) (APA); codified by Pub. L. No. 89-554 (1966) at 5 U.S.C. 551-559, 701-706, 1305, 3105, 3344, 5372, 7521 (2011). Specifically, see APA, 5 U.S.C. 553(b).

<sup>178</sup> 2020 Proposal, 85 FR at 35826.

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

<sup>181</sup> *Id.* at 35832 (proposing Commission regulation 3.10(c)(3)(iii)(B)). If interests in a U.S. entity including an affiliate of a CPO are marketed to U.S. persons as providing access to trading in commodity interest markets *outside* the United States, its territories or possessions, then that entity may be required to register with the Commission pursuant to Commission regulation 30.4(c). 17 CFR 30.4(c).

In the 2020 Proposal, the Commission further stated its preliminary belief that U.S. controlling affiliates who are barred from participating in the U.S. commodity interest markets should not be permitted to utilize the Affiliate Contribution Exception as a method to gain indirect access to those markets via an affiliated non-U.S. CPO's offshore pool, which would undermine the efficacy of such a bar.<sup>182</sup> Therefore, the Commission also proposed to limit the Affiliate Control Exception to U.S. controlling affiliates, which themselves and their 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.<sup>183</sup>

Regarding the Commission's concerns about the Affiliate Contribution Exception being used to evade other of the Commission's part 4 regulatory protections, the Industry Groups concluded that the "anti-evasion condition of the [2020] Proposal," prohibiting the marketing of interests in the U.S. affiliate as providing access to trading in U.S. commodity interest markets, addresses this concern and "is well-tailored to achieve its purpose."<sup>184</sup> The Industry Groups did suggest, however, that the Commission could also "specify in the rule text, or in the final adopting release, that only affiliated entities, and not natural person affiliates, are contemplated by the [Affiliate Contribution Exception]."<sup>185</sup> The Commission agrees that it would further its intention of limiting the Affiliate Contribution Exception to juridical persons, rather than natural persons, as stated in the 2020 Proposal, to specifically limit the availability of that provision to

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<sup>182</sup> 2020 Proposal, 85 FR at 35826.

<sup>183</sup> *Id.* at 35832 (proposing Commission regulation 3.10(c)(3)(iii)(A)).

<sup>184</sup> Industry Group Letter, at 7.

<sup>185</sup> *Id.*

entities, and not natural persons, in the regulatory text. As discussed in the 2020 Proposal, the Commission declined to propose a limit on the time in which capital contributions from U.S. affiliates can remain in the offshore pool because it was envisioning such contributions deriving from entity affiliates rather than natural persons.<sup>186</sup> For the reasons stated in the 2020 Proposal, the Commission is therefore adopting, as proposed, but with the additional limitation suggested by commenters, the “anti-evasion” requirement designed to prohibit evasive conduct, in which U.S. participant capital could be solicited for investment in the U.S. affiliate, providing indirect exposure to the offshore pool.<sup>187</sup>

With respect to the proposed condition prohibiting those U.S. controlling affiliates that are 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 from relying on the Affiliate Contribution Exception, the Industry Groups stated that the proposed condition goes far beyond its purpose as stated by the Commission.<sup>188</sup> The Industry Groups explained that the “regulatory purpose is to keep out affiliates that are barred from participating in the U.S. commodity interest markets,” but the proposed condition “applies to the vague and far broader universe of persons that are ‘subject to a statutory disqualification.’”<sup>189</sup> Consequently, the Industry Groups recommended that the Commission remove any reference to statutory disqualification in this provision, for the purpose of eliminating

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<sup>186</sup> 2020 Proposal, 85 FR at 35825.

<sup>187</sup> See *infra* new Commission regulation 3.10(c)(5)(ii)(C).

<sup>188</sup> Industry Group Letter, at 10.

<sup>189</sup> *Id.*

confusion, and that the Commission focus this condition on prohibiting “entities that are in fact barred from participating in the U.S. commodity interest markets,” from utilizing the Affiliate Contribution Exception.<sup>190</sup>

The Commission agrees that including statutory disqualifications in this provision does not further its goal of mitigating the risk that persons no longer permitted to participate in the U.S. commodity interest markets directly use the Affiliate Contribution Exception to access such markets through indirect means. The Commission notes that the issue of statutory disqualifications is related to registration with the Commission and generally concerns judgments regarding fitness to intermediate transactions on behalf of third parties.<sup>191</sup> Those concerns are not present in the context of the Affiliate Contribution Exception, where the Commission is more focused on foreclosing a potential loophole that could permit persons that are barred or prohibited from trading in the U.S. commodity interest markets to do so indirectly via offshore pool investments. Therefore, in response to commenters and to more clearly tailor this provision to the rationale the Commission articulated in the 2020 Proposal, the Commission is adopting the Affiliate Contribution Exception with the condition that the affiliate and its principals are not barred or suspended from participating in commodity interest markets in the United States, its territories or possessions.<sup>192</sup>

#### **4. Analysis under Section 4(c) of the Act**

Consistent with its authority under section 4(c) of the Act, the Commission concludes that providing the Affiliate Contribution Exception, subject to the conditions

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<sup>190</sup> *Id.*

<sup>191</sup> *See* 7 U.S.C. 12a(2) and 12a(3).

<sup>192</sup> *See infra* new Commission regulation 3.10(c)(5)(ii)(B).

included in the Final Rule as detailed above, 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 persons involved in the transactions subject to the exemptive relief provided herein are “appropriate persons,” as discussed in the 2020 Proposal, because the term “appropriate person” as used in CEA section 4(c) includes a commodity pool formed or operated by a person subject to regulation under the Act.<sup>193</sup> 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.<sup>194</sup> The Commission continues to believe that enabling U.S. 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.

Additionally, the adoption of the Affiliate Contribution Exception will not have a material adverse effect on the ability of the Commission to discharge its regulatory duties under the CEA. The U.S. affiliates contributing initial capital to offshore pools operated by their affiliated non-U.S. CPO will typically have access to the information and disclosures necessary for such U.S. affiliate to independently evaluate the propriety of its contribution to a specific offshore pool, absent the protections typically provided by part

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<sup>193</sup> 7 U.S.C. 6(c)(3)(E).

<sup>194</sup> 77 FR at 30655 (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).

4 of the Commission's regulations. Based on its analysis above, the Commission concludes that the contributions subject to the Affiliate Contribution Exception are distinguishable from offshore pool contributions sourced from the general public in the United States that otherwise make such offshore pool ineligible for the 3.10 Exemption. Also, pursuant to CEA section 4(d), 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, notwithstanding this amendment.<sup>195</sup> Further, the Commission retains the authority to take enforcement action against any non-U.S. CPO claiming the 3.10 Exemption based on its activities within the U.S. commodity interest markets, and nothing in the Final Rule, including the adoption of the Affiliate Contribution Exception, negatively affects or restricts the Commission's statutory and regulatory authority applicable to the commodity pool and intermediary activities of a non-U.S. CPO involving persons located in the United States. For the reasons stated in the 2020 Proposal and the analysis provided in this Final Rule, the Commission concludes that it is appropriate to provide the Affiliate Contribution Exception from the U.S. participant prohibition in the 3.10 Exemption, pursuant to section 4(c) of the Act.

#### **G. Additional Relief for Commodity Trading Advisors**

The Industry Groups recommended that the Commission adopt relief for non-U.S. CTAs, substantially similar to that proposed for non-U.S. CPOs in the 2020 Proposal,

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<sup>195</sup> 7 U.S.C. 6(d).



because, they argued, “[t]he regulatory goals in the 2020 Release apply equally to CTAs.”<sup>196</sup> Specifically, the Industry Groups requested that the Commission amend Commission regulation 3.10(c) to “permit non-U.S. CTAs to claim the relief under Commission regulation 3.10(c) on an account-by-account basis ... and [to] simultaneously rely on registration or other exemptions or exclusions for CTA activities on behalf of U.S. investors, in the same manner as the proposed amendments provide for CPOs.”<sup>197</sup> They argued that this amendment would also make it clear that a non-U.S. CTA providing advice to an offshore pool operated pursuant to the 3.10 Exemption would be eligible for relief from registration with the Commission.<sup>198</sup> In support of their arguments, the Industry Groups cited multiple instances of the Commission and its staff historically permitting the “stacking” of statutory and regulatory exemptions with registration for CTAs, and stated that “the Commission’s focus on [commodity trading] advice to U.S. investors [is] well established in the Commission’s regulatory framework.”<sup>199</sup>

Despite these comments, the Commission is not adopting the suggested amendments to Commission regulation 3.10(c) regarding the activities of non-U.S. CTAs. The 2020 Proposal, which dealt primarily with amendments impacting the operations of CPOs, did not contemplate or discuss any such comparable modifications to Commission regulation 3.10(c) with respect to the activities of non-U.S. CTAs on behalf

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<sup>196</sup> Industry Group Letter, at 13.

<sup>197</sup> *Id.*

<sup>198</sup> *Id.*

<sup>199</sup> *Id.* at 13-14.

of foreign located persons.<sup>200</sup> The 2020 Proposal also did not query whether the amendments impacting non-U.S. CPOs and their offshore pools should likewise be extended to include any of the activities of non-U.S. CTAs; nor did it address or consider the regulatory impact, positive or negative, such policy choices could have on the Commission’s regulatory program for CTAs. Under these circumstances, the Commission does not believe that the public would have had sufficient notice regarding the issue of adopting parallel provisions for non-U.S. CTAs, such that the public could provide meaningful comment as required by the Administrative Procedure Act.<sup>201</sup> Therefore, the Commission declines to amend revised Commission regulation 3.10(c)(4) in a manner that would substantively alter or change the relief currently provided by that regulation to qualifying non-U.S. CTAs.

#### **H. Reorganization of Commission Regulation 3.10(c)**

As recognized by certain commenters, and as mentioned above, adopting the Final Rule as proposed in both the 2020 Proposal and the 2016 Proposal requires modification of the rule text as presented in each proposal. Thus, the Final Rule reorganizes that provision to accommodate the adopted changes and to increase the regulation’s overall readability and clarity. Other than the changes specifically explained

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<sup>200</sup> The Commission is adopting as final herein other amendments to Commission regulation 3.10(c) applicable to non-U.S. CTAs consistent with the 2016 Proposal. The Commission notes that those amendments broadly applied to non-U.S. IBs, non-U.S. CPOs, and non-U.S. CTAs, and did not impact or alter the specific conditions of eligibility for non-U.S. CTAs relying on the exemptive relief in that regulation.

<sup>201</sup> APA, 5 U.S.C. 553(b)-(c). The Commission notes that it does not disagree with the Industry Groups’ characterization of the Commission’s or its staff’s past positions with respect to the “stacking” of statutory and/or regulatory exemptions from CTA registration, or their combination with registration as such, being permissible. The Commission is, however, declining to adopt in revised Commission regulation 3.10(c)(4) relief for non-U.S. CTAs, comparable to that adopted herein for non-U.S. CPOs, without a prior published rulemaking proposal raising, addressing, and soliciting public comment on that specific policy question.

in this adopting release, this reorganization is not intended to make substantive changes to the regulatory obligations of any affected market participant.

Commission regulation 3.10(c), as adopted in the Final Rule, is reorganized. New paragraph 3.10(c)(1) now provides certain definitions of terms that are used throughout the remainder of paragraph (c), including: “covered transaction,” defined to mean a commodity interest<sup>202</sup> transaction executed bilaterally or made on or subject to the rules of any DCM or registered SEF; “foreign located person,” defined to mean a person located outside the United States, its territories, or possessions; and “international financial institution,” the definition of which is discussed above in section II.B.3. The remainder of paragraph (c) is organized so that its enumerated sub-paragraphs refer to registration exemptions available to each type of intermediary. Thus, new paragraph 3.10(c)(2) sets forth exemptions applicable to market participants engaged in the activities of an FCM; new paragraph 3.10(c)(3) sets forth exemptions applicable to those persons engaged in the activities of an IB; new paragraph 3.10(c)(4) refers to an exemption for CTAs; and new paragraph 3.10(c)(5) provides an exemption for CPOs, and contains the conditions thereto and related provisions discussed above. Finally, new paragraph 3.10(c)(6) contains the rule text previously presented in Commission regulation 3.10(c)(5).

### **III. Related Matters**

#### **A. Regulatory Flexibility Act**

The Regulatory Flexibility Act (RFA) requires Federal agencies, when promulgating regulations, to consider whether the rules they propose will have a

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<sup>202</sup> “Commodity interest” is defined in Commission regulation 1.3. 17 CFR 1.3, *commodity interest*.

significant economic impact on a substantial number of small entities. If the rules are determined to have a significant economic impact, such agencies must provide a regulatory flexibility analysis regarding such economic impact. 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.<sup>203</sup>

The Final Rule adopted by the Commission today would affect FCMs, IBs, CTAs, and CPOs. The Commission has 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.<sup>204</sup> The Commission has previously determined that FCMs are not small entities for purposes of the RFA. Therefore, the RFA does not apply to FCMs.<sup>205</sup>

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).<sup>206</sup> With respect to small CPOs operating pursuant to Commission regulation 4.13(a)(2), the Commission has concluded 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

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<sup>203</sup> 5 U.S.C. 601, *et seq.*

<sup>204</sup> *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).

<sup>205</sup> *Id.*

<sup>206</sup> *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. 17 CFR 4.13(a)(2).

could provide additional opportunities to develop their operations not currently available to them.<sup>207</sup> 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) 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 does not believe that the Final Rule will result in a significant economic impact on a substantial number of small CPOs. Further, the Commission notes that the Final Rule would impose no new obligation, significant or otherwise, on any affected small CPO. Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the Final Rule will not have a significant impact on a substantial number of small entities with respect to CPOs.

With respect to CTAs and IBs, the Commission has found it appropriate to consider whether such registrants should be deemed small entities for purposes of the RFA on a case-by-case basis, in the context of the particular Commission regulation at issue.<sup>208</sup> As certain of these registrants may be small entities for purposes of the RFA, the Commission considered whether these amendments would have a significant economic impact on such registrants.<sup>209</sup> By combining amendments from the 2016 and 2020 Proposals, the Final Rule will clarify in what circumstances certain foreign located persons acting in the capacity of an IB or CTA are exempt from registration under

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<sup>207</sup> 2020 Proposal, 85 FR at 35827.

<sup>208</sup> See 47 FR at 18620 (CTAs); and Introducing Brokers and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators; Registration and Other Regulatory Requirements, 48 FR 35248, 35276 (Aug. 3, 1983) (IBs).

<sup>209</sup> 2016 Proposal, 81 FR at 51826.

Commission regulation 3.10(c), in connection with commodity interest transactions solely on behalf of other foreign located persons. The Final Rule thus would not impose any new burdens on these market participants. Rather, to the extent that the Final Rule provides an exemption from generally required intermediary registration, the Commission believes it is reasonable to infer that operating pursuant to the exemption, as amended by the Final Rule, will be less burdensome to such participants. The Commission does not, therefore, expect IBs or CTAs that are small entities to incur any additional costs as a result of the Final Rule amendments. Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the Final Rule will not have a significant impact on a substantial number of small entities with respect to IBs and CTAs.

#### **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.<sup>210</sup> 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. In the 2020 Proposal, the Commission preliminarily determined that the proposed amendments, if adopted, would 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.<sup>211</sup>

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<sup>210</sup> 44 U.S.C. 3501, *et seq.*

<sup>211</sup> 2020 Proposal, 85 FR at 35827.

The Commission invited the public and other interested parties to comment on any aspect of the information collection requirements discussed in the 2020 Proposal.<sup>212</sup> The Commission did not receive any such comments. The Commission similarly invited the public and other interested parties to comment on any aspect of the reporting burdens under the 2016 Proposal,<sup>213</sup> but also did not receive any such comments. Therefore, the Commission concludes that the Final Rule, by adopting amendments to Commission regulation 3.10(c) derived from both the 2016 Proposal and the 2020 Proposal, does not impose any new recordkeeping or information collection requirements, or other collections of information that require OMB approval under the PRA.

### **C. Cost-Benefit Considerations**

Section 15(a) of the Act requires the Commission to consider the costs and benefits of its actions before issuing new regulations under the CEA.<sup>214</sup> Section 15(a) of the Act further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) 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

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<sup>212</sup> *Id.*

<sup>213</sup> 2016 Proposal, 81 FR at 51827.

<sup>214</sup> 7 U.S.C. 19(a).

CEA. The Commission invited public comment on the cost-benefit considerations in both the 2016 and 2020 Proposals, but received no comments on those analyses.<sup>215</sup>

As discussed above, pursuant to the 2016 Proposal, the Commission proposed to amend Commission regulations 3.10(c)(2) and (c)(3) to revise the conditions under which those exemptions from registration would apply. Specifically, the 2016 Proposal would permit a Foreign Intermediary to be eligible for an exemption from registration, if the Foreign Intermediary, in connection with a commodity interest transaction, only acts on behalf of (1) foreign located persons, or (2) IFIs, without regard to whether such persons or institutions clear such commodity interest transaction.<sup>216</sup> The Final Rule adopts the exemptions as proposed in the 2016 Proposal, but clarifies that commodity interest transactions effected by Foreign Intermediaries on behalf of foreign located persons that are required or intended to be cleared on a registered DCO, must be cleared through a registered FCM, unless the foreign located person is a clearing member of the DCO (and thus may clear for itself).<sup>217</sup>

As described above, the Commission is adopting several amendments to Commission regulation 3.10(c). Specifically, the Commission is amending the 3.10 Exemption such that non-U.S. CPOs may rely on that relief on a pool-by-pool basis through new Commission regulation 3.10(c)(5)(i). Next, new Commission regulation 3.10(c)(5)(ii) contains the finalized Affiliate Contribution Exception, which makes it clear that a non-U.S. CPO's eligibility for the 3.10 Exemption is unaffected by initial capital contributions from a U.S. affiliate of the non-U.S. CPO to the non-U.S. CPO's

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<sup>215</sup> 2016 Proposal, 81 FR at 51827; 2020 Proposal, 85 FR at 35827.

<sup>216</sup> 2016 Proposal, 81 FR at 51826.

<sup>217</sup> *See supra* pt. II.B.3.



offshore pools, provided certain conditions are met. The Commission is also adding new Commission regulation 3.10(c)(5)(iii), which establishes a conditional safe harbor permitting non-U.S. CPOs, who cannot represent with absolute certainty that there are no U.S. participants in their offshore pools, to nonetheless utilize the 3.10 Exemption for those offshore pools. Finally, the Commission is adopting Commission regulation 3.10(c)(5)(iv), which explicitly permits a non-U.S. CPO utilizing the 3.10 Exemption for one or more offshore pools to register as a CPO, claim an available exemption from CPO registration, claim an exclusion from the CPO definition, or claim other available relief from CPO regulation, with respect to other pools it operates. These regulatory amendments adopted by the Final Rule 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 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).<sup>218</sup>

### **1. Costs and Benefits Related to Finalizing the 2016 Proposal**

Pursuant to the Final Rule, the Commission has recognized that not all commodity interest transactions are required to be cleared.<sup>219</sup> This aspect of the Final Rule should provide the benefit of reducing inefficiencies in the commodity interest activities of foreign located persons by eliminating confusion over whether the relevant exemption from registration is dependent on clearing commodity interest transactions through a registered FCM. With respect to commodity interest transactions that are required or intended to be cleared by a registered DCO, the Final Rule should provide the benefit of increased market efficiency by clearly delineating that such transactions must be cleared through a registered FCM, unless the Foreign Intermediary's customer is a member of the DCO (and thus, may clear for itself). The Commission further believes that the legal certainty provided by this aspect of the Final Rule may increase participation in the U.S. commodity interest markets by foreign located persons, and thus, ensure greater depth in such markets accessed by U.S. persons. The Commission has not identified any additional costs attributable to this aspect of the Final Rule.

### **2. Commission Regulation 3.10 (c)(5)(i): Claiming the 3.10 Exemption on a Pool-by-Pool Basis**

Pursuant to the Final Rule, a non-U.S. CPO will be able to claim the 3.10 Exemption with respect to its qualifying offshore pools, while registering as a CPO or claiming another CPO exemption or exclusion for its other pools that do not qualify for

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<sup>218</sup> 7 U.S.C. 2(i).

<sup>219</sup> See *supra* pt. II.B.3.

the 3.10 Exemption because they are either domiciled in the U.S., or they solicit and/or accept as participants persons located within the United States. Absent this amendment, such non-U.S. CPOs face some costs and compliance burdens associated with the operation of their offshore pools,<sup>220</sup> 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-U.S. 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 Commission regulation 4.27.<sup>221</sup> 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 its offshore location, rather than at the CPO's main business office in the United States.<sup>222</sup>

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 Advisory 18-96 notices. However, the Commission 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 notices must be filed by hardcopy, the Commission

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<sup>220</sup> Such costs vary widely because certain registered CPOs may be eligible for significant compliance relief for their pools pursuant to Advisory 18-96.

<sup>221</sup> Advisory 18-96, at 1-2.

<sup>222</sup> *Id.*

believes the administrative costs are low.<sup>223</sup> CPOs must employ at least one employee 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 the CPO and its principals are not statutorily disqualified; enumerated rules from which the CPO seeks relief; and contact information for person(s) who will maintain the offshore books and records.<sup>224</sup>

Pursuant to the Final Rule, the current 23 registered non-U.S. CPOs that file Advisory 18-96 notices will be able to delist their offshore pools and no longer file Advisory 18-96 notices claiming relief for the 84 offshore pools. Upon delisting 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 a relatively substantial cost savings for those non-U.S. CPOs and their offshore pool operations. The 20 U.S. CPOs, however, currently claiming relief under Advisory 18-96 will continue to do so because they remain ineligible for the 3.10 Exemption, due to their location in the United States, and as such, are not directly impacted by the Final Rule.

Currently, any registered CPO may avoid the requirement to list its offshore pools with the Commission by establishing a separate, foreign-domiciled non-U.S. CPO for all of the operated offshore pools qualifying for the 3.10 Exemption. The Commission believes that the Final Rule will effectively eliminate this incentive to establish a separately organized CPO solely for the purpose of operating offshore pools that qualify

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<sup>223</sup> *Exemptions Available to CPOs*, NFA, available at <https://www.nfa.futures.org/members/cpo/cpo-exemptions.html> (noting that, while CPOs must generally claim exemptions electronically through NFA's Exemption System, "[e]xemptions pursuant to CFTC Advisory No. 18-96 must be filed with NFA in hardcopy").

<sup>224</sup> Advisory 18-96, at 1.

for the 3.10 Exemption. The costs associated with establishing a non-U.S. CPO vary, depending on the operating size and structure of the registered CPO and its pools, and the jurisdiction where the non-U.S. CPO is formed. For instance, these incentives to establish additional CPOs may be affected by the financial outlay required to establish foreign-domiciled CPOs given that set-up costs, *e.g.*, 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 non-U.S. CPO, the Commission finds that such costs may vary widely and are highly dependent on the organization and footprint of the registered CPO and its operated pools, as well as the relevant jurisdiction where the additional non-U.S. CPO would be formed.

The Commission believes, however, that permitting non-U.S. CPOs to claim the 3.10 Exemption on a pool-by-pool basis pursuant to the Final Rule will likely result in CPO complexes generally saving the costs associated with forming and maintaining separate CPOs to operate the other pools in its structure, thereby reducing unnecessary complexity in overall corporate structure and pool operations. Amending the 3.10 Exemption such that non-U.S. CPOs may claim the exemption on a pool-by-pool basis, the Commission believes, will eliminate a large portion of the compliance costs associated with CFTC-registered, non-U.S. CPOs' offshore pool operations, which, by their very characteristics, implicate fewer of the Commission's regulatory interests.<sup>225</sup> The Commission notes that this reduction only relates to U.S. compliance costs, as the

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<sup>225</sup> See *supra* II.C.

Final Rule has no impact on the costs non-U.S. CPOs incur related to foreign regulatory regimes. As mentioned above, the Commission concludes that targeting its CPO oversight in this manner appropriately recognizes the increasingly global nature of the asset management industry.

The Commission also does not anticipate that non-U.S. CPOs will experience any increased costs associated with claiming the 3.10 Exemption on a pool-by-pool basis. The 3.10 Exemption has never required a filing or notice to claim the relief it provides, and that remains true under the Final Rule. Prior to the Final Rule, the terms of the 3.10 Exemption required a non-U.S. CPO to continuously monitor the operations of its offshore pools to ensure that they are neither offered nor sold to any participants located in the United States. Under the terms of the Final Rule, and with the exception of the safe harbor discussed below, the 3.10 Exemption will continue to require such non-U.S. CPOs to monitor their offshore pool operations to ensure compliance with the 3.10 Exemption, as amended by the Final Rule.

The Commission believes that the Final Rule may result in some loss of information available to the public, specifically regarding offshore pools operated by registered non-U.S. CPOs, because such offshore pools will no longer be required to be listed with the Commission. Consequently, the offshore pools' existence and identifying information will no longer be publicly disclosed on NFA's BASIC database, once the non-U.S. CPO claims the 3.10 Exemption for such offshore pools. The Commission concludes that this loss of information will likely have a minimal practical effect on the investing public because persons located within the United States are typically not

permitted by non-U.S. CPOs to participate in offshore pools, consistent with the conditions of the 3.10 Exemption, as amended by the Final Rule.

**3. Commission Regulation 3.10(c)(5)(iii): Providing A Safe Harbor for Non-U.S. CPOs Whose Offshore Pools May Have Inadvertent U.S.**

**Participants**

As explained previously, the Commission is adopting Commission regulation 3.10(c)(5)(iii), which establishes a 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; the safe harbor requires that such non-U.S. CPOs take specifically enumerated actions to minimize the possibility that U.S. persons are participating in the offshore pool.<sup>226</sup> Commission regulation 3.10(c)(5)(iii), as adopted, benefits non-U.S. CPOs by making the registration relief provided under the 3.10 Exemption more widely available and by recognizing the informational limitations inherent in certain pool structures. Therefore, the Commission believes that this safe harbor could result in more non-U.S. CPOs relying upon the 3.10 Exemption with respect to more offshore pools. At this time, the Commission lacks sufficient information to estimate or quantify the number of non-U.S. CPOs and offshore pools that may claim relief under Commission regulation 3.10(c)(5)(iii), because the Commission does not currently receive the information 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

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<sup>226</sup> See *infra* new Commission regulation 3.10(c)(5)(iii)(A)-(F).

the Commission, the Commission believes, it is reasonable to estimate the number of offshore pools operated in a similar manner to be equally small.

The Commission believes that non-U.S. CPOs that would be eligible for registration relief under the safe harbor in Commission regulation 3.10(c)(5)(iii) will avail themselves of that relief. This could result in the Commission receiving less information regarding the operation of such offshore pools. As noted above, the Commission 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 qualifying non-U.S. CPOs and offshore pools, relative to the total population of registered CPOs and listed pools.

The Commission also anticipates that there may be some inadvertent U.S. participants in offshore pools, who would lose the customer protections 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 in reliance on this safe harbor. The Commission believes that its enumerated conditions, however, should result in a small number of U.S. participants being impacted. Moreover, the Commission believes that such U.S. participants, to the extent that they are aware that they are participating in what is known to be an offshore pool through the purchase of 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.

#### **4. Commission Regulation 3.10(c)(5)(iv): Utilizing the 3.10 Exemption Concurrent with Other Available Exclusions and Exemptions**



As explained above, the Commission is also adding Commission regulation 3.10(c)(5)(iv), such that non-U.S. CPOs may rely upon the 3.10 Exemption concurrent with other exemptions and exclusions, or, alternatively, CPO registration. The Commission believes that Commission regulation 3.10(c)(5)(iv) therefore benefits non-U.S. CPOs due to its consistent treatment of CPOs of pools that are operated in a substantively identical manner, regardless of where the CPO is based. The Commission also anticipates that this amendment will benefit the non-U.S. CPO industry generally by providing regulatory certainty with respect to the ability of all non-U.S. CPOs to simultaneously rely upon the 3.10 Exemption and other applicable exclusions and exemptions under the Commission's regulations. This amendment is consistent with other provisions of the Commission's CPO regulatory program, where the Commission explicitly permits CPOs to claim more than one type of exemption or exclusion, or to register with respect to the variety of commodity pools that they operate.<sup>227</sup>

The Commission further 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 pools that limit their commodity interest exposure to a *de minimis* amount, rather than registering and listing those pools. The Commission 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

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<sup>227</sup> 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 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 2020 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 concludes that any resulting loss of insight into such pools and their CPOs is consistent with the Commission's overall regulatory policy, and therefore, will likely have minimal negative impact on the public.<sup>228</sup>

## **5. Commission Regulation 3.10(c)(5)(ii): The Affiliate Contribution**

### **Exception**

The Commission is also adopting amendments permitting non-U.S. CPOs to rely upon the 3.10 Exemption for the operation of an offshore pool, even if an affiliate within the United States provides initial capital for the offshore pool, pursuant to the Affiliate Contribution Exception. Absent the relief provided by Commission regulation 3.10(c)(5)(ii), a non-U.S. CPO of an offshore pool receiving initial capital from an affiliate within the United States would generally be required to register as a CPO and list

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<sup>228</sup> 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).

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 concluded that participation in an offshore pool by a U.S. affiliate does not raise the same regulatory concerns as an investment in the same pool by an unaffiliated participant located within the United States.<sup>229</sup> In addition to the reasons outlined above, the Commission believes that the Affiliate Contribution Exception will provide regulatory relief for a small number of currently-registered CPOs. As mentioned above, 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. 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 believes that the number of these CPOs that would be eligible for relief under the Affiliate Contribution Exception would likely be less than the 23. The Commission 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 provision 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

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<sup>229</sup> See *supra* pt. II.F.

capital from a U.S. affiliate, it is unable to predict how many pools will utilize the Affiliate Contribution Exception in the future.

The Commission also believes that the Affiliate Contribution Exception will result in reduced costs for non-U.S. CPOs by removing initial capital investments by U.S. affiliates in offshore pools from the analysis for 3.10 Exemption eligibility, and by eliminating any registration and compliance costs for such pools. This amendment will, however, result in U.S. 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 initial capital investments in an offshore pool operated by their affiliated non-U.S. CPO.<sup>230</sup> The Commission believes that this loss will likely be mitigated by a U.S. affiliate's ability to obtain whatever information regarding the offshore pool a U.S. affiliate may deem material to its investment, by virtue of its relationship with the non-U.S. CPO as affiliated entities. Moreover, the Commission believes this approach is consistent with the Commission's focus on protecting U.S. investors participating in commodity pools.

In the event 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. affiliate, and such non-U.S. CPO determines to delist the offshore pool in question and instead rely upon the 3.10 Exemption by virtue of the Affiliate Contribution Exception, the Commission will no longer receive financial reporting with respect to such offshore pool, including on Form CPO-PQR. Because the Commission has determined

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<sup>230</sup> For example, a U.S. 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 affiliate with disclosures and reporting generally mandated by those rules.

that initial capital contributions by a U.S. affiliate do not raise the same customer protection concerns as capital received from other unaffiliated U.S. participants, however, the Commission concludes that any loss of insight into such offshore pools and their non-U.S. CPOs resulting from the Affiliate Contribution Exception is generally consistent with the Commission's overall regulatory policy concerning CPOs and commodity pools.

## **6. Section 15(a) Factors**

### **a. Protection of Market Participants and the Public**

The Commission believes that the Final Rule will not have a material negative effect on the protection of market participants and the public. 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 an affiliate in the United States, the Commission believes that although those offshore pools may no longer be subject to part 4 of the Commission's regulations, such U.S. affiliates, by virtue of their relationship with the non-U.S. CPO, are generally not as dependent upon the customer protections provided by the Commission's regulations. The Commission comes to this conclusion on the basis of its detailed analysis above of "affiliate" relationships generally, finding that, where a U.S. affiliate is controlled by, controlling, or under common control with the non-U.S. CPO of an offshore pool, as set forth in Commission regulation 4.7(a)(1)(i), the U.S. affiliate typically has access to information and disclosures that allow it to make an informed decision regarding its initial capital contributions to that offshore pool, even in the absence of express regulatory requirements from the Commission. The Commission also anticipates that some U.S. participants in offshore pools operated pursuant to the adopted

safe harbor may lose the customer protections afforded by part 4 of the Commission's regulations; however, the Commission believes that the number of impacted U.S. participants will be small, due to the specific criteria required for reliance upon the safe harbor and the small number of exchange-traded commodity pools, generally. With respect to those aspects of the Final Rule that are derived from the 2016 Proposal, the Commission believes that the Final Rule will foster the protection of market participants and the public by providing greater legal certainty with respect to the commodity interest activities of persons located outside the U.S.

**b. Efficiency, Competitiveness and Financial Integrity of the Futures**

**Markets**

Section 15(a)(2)(B) of the CEA requires the Commission to evaluate the costs and benefits of a regulation in light of efficiency, competitiveness, and financial integrity considerations. The Commission believes that the Final Rule will benefit the efficiency, competitiveness and financial integrity of the futures markets because, among other things, the Final Rule will effectively eliminate the current incentive to establish a separately organized CPO solely for the purpose of operating offshore pools that qualify for the 3.10 Exemption. As discussed above, permitting non-U.S. CPOs to claim the 3.10 Exemption on a pool-by-pool basis pursuant to the Final Rule will likely result in CPO complexes generally saving the costs associated with forming and maintaining separate CPOs to operate the other pools in their structure, thereby reducing unnecessary complexity in overall corporate structure and pool operations. The Commission believes this reduction in the complexity of CPO operations, specifically with respect to offshore pool operations, will positively affect the general financial integrity of market

participants, and as discussed further above, may lead to more pools operated by non-U.S. CPOs being offered to U.S. participants, increasing competition and depth in U.S. commodity interest markets.

Additionally, the Commission believes that the adoption of the Affiliate Contribution Exception, the safe harbor, as well as the amendments from the 2016 Proposal, by the Final Rule clarifies Commission regulation 3.10(c), including the 3.10 Exemption, making the provision overall easier to understand and apply, providing additional flexibility in light of the increasingly global nature of the asset management industry as a whole, and likely, increasing the number of non-U.S. CPOs and offshore pools able to participate in the U.S. commodity interest markets without additional requirements. For these reasons, the Commission believes the Final Rule will have a positive impact on the efficiency, competitiveness and financial integrity of the futures markets, as contemplated by CEA section 15(a)(2)(B).

**c. Price Discovery**

Section 15(a)(2)(C) of the CEA requires the Commission to evaluate the costs and benefits of a regulation in light of price discovery considerations. The Commission believes that the legal certainty provided by the amendments to the registration exemptions in the Final Rule may increase participation in the U.S. commodity interest markets by foreign located persons, and thus, ensure greater depth in such markets accessed by persons in the U.S. Thus, the Commission believes that the Final Rule, in its totality, will result in deeper commodity interest markets in the United States, which facilitates the price discovery function thereof.

**d. Sound Risk Management Practices**

Section 15(a)(2)(D) of the CEA requires the Commission to evaluate a regulation in light of sound risk management practices. The Commission believes that the Final Rule, as specifically related to non-U.S. CPOs, will not have a significant impact on the practice of sound risk management because the manner in which various funds, operators, and advisors organize, register, or claim relief from such regulation has only a small influence on how market participants manage their risks overall. The Commission believes, however, that the Final Rule, through the legal certainty provided by the amendments to these registration exemptions may increase participation in the U.S. commodity interest markets by foreign located persons, and thus, ensure greater depth in such markets accessed by persons in the U.S. The greater depth in such markets in turn will facilitate sound risk management.

**e. Other Public Interest Considerations**

Section 15(a)(2)(E) of the CEA requires the Commission to evaluate the costs and benefits of a regulation in light of other public interest considerations. The Commission has not identified any other public interest considerations impacted by the Final Rule beyond those 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 CEA 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 CEA.<sup>231</sup> The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requested comment on whether the 2016 and 2020 Proposals implicate any other specific public interest to be protected by the antitrust laws, and it received no comments addressing this issue.

The Commission has considered the Final Rule to determine whether its amendments are anticompetitive and has identified no anticompetitive effects. Because the Commission has determined the Final Rule amendments are not anticompetitive and have no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA.

### **List of Subjects in 17 CFR Part 3**

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

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 17 CFR part 3 as follows:

### **PART 3 -- REGISTRATION**

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

Authority: 5 U.S.C. 552, 552b; 7 U.S.C. 1a, 2, 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. In § 3.10, revise paragraph (c) to read as follows:

**§ 3.10 Registration of futures commission merchants, retail foreign exchange dealers, introducing brokers, commodity trading advisors, commodity pool**

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<sup>231</sup> 7 U.S.C. 19(b).

**operators, swap dealers, major swap participants, and leverage transaction  
merchants.**

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(c) *Exemption from registration for certain persons—(1) Definitions.* For purposes of this paragraph (c), the following terms shall have the meanings set forth below.

(i) *Covered transaction* means a commodity interest transaction, as defined in § 1.3 of this chapter, executed bilaterally or made on or subject to the rules of any designated contract market or registered swap execution facility.

(ii) *Foreign located person* means a person located outside the United States, its territories, or possessions.

(iii) *International financial institution* means the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, the European Stability Mechanism, the North American Development Bank, those institutions defined as “international financial institutions” in 22 U.S.C. 262r(c)(2), those institutions defined as “multilateral development banks” in Article 1(5(a)) of Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC Derivative Transactions, Central Counterparties and Trade Repositories, their agencies and pension plans, and any other similar international organizations, and their agencies and pension plans.

(2) *Exempt futures commission merchants—(i) Proprietary accounts.* A person trading solely for proprietary accounts, as defined in § 1.3 of this chapter, is not required

to register as a futures commission merchant; *provided*, that such person remains subject to all other provisions of the Act and of the rules, regulations and orders thereunder.

(ii) *Foreign located persons.* (A) A foreign located person engaging in the activity of a futures commission merchant, as defined in § 1.3 of this chapter, in connection with any covered transaction only on behalf of foreign located persons or international financial institutions is not required to register in such capacity; *provided*, that if any such covered transaction is required or intended to be cleared on a registered derivatives clearing organization and the foreign located person or international financial institution that is party to the covered transaction is not a clearing member of such registered derivatives clearing organization, the covered transaction is submitted for clearing through a futures commission merchant registered in accordance with section 4d of the Act.

(B) A foreign located person acting in accordance with paragraph (c)(2)(ii)(A) of this section is not required to comply with those provisions of the Act and of the rules, regulations and orders thereunder applicable solely to any registered futures commission merchant or any person required to be so registered.

(3) *Exempt introducing brokers—(i) Foreign located persons.* (A) A foreign located person engaged in the activity of an introducing broker, as defined in § 1.3 of this chapter, in connection with any covered transaction only on behalf of foreign located persons or international financial institutions is not required to register in such capacity; *provided*, that if any such covered transaction is required or intended to be cleared on a registered derivatives clearing organization and the foreign located person or international financial institution that is party to the covered transaction is not a clearing

member of such registered derivatives clearing organization, the covered transaction is submitted for clearing through a futures commission merchant registered in accordance with section 4d of the Act.

(B) A foreign located person acting in accordance with paragraph (c)(3)(i)(A) of this section is not required to comply with those provisions of the Act and of the rules, regulations and orders thereunder applicable solely to any registered introducing broker or any person required to be so registered.

(ii) *Exempt foreign brokers.* (A) A foreign located person that is exempt from registration as a futures commission merchant in accordance with § 30.10 of this chapter is not required to register as an introducing broker in accordance with section 4d of the Act if:

(1) Such person is affiliated with a futures commission merchant registered in accordance with section 4d of the Act;

(2) Such person introduces, on a fully-disclosed basis in accordance with § 1.57 of this chapter, any institutional customer, as defined in § 1.3 of this chapter, to a registered futures commission merchant for the purpose of trading on a designated contract market;

(3) Such person's affiliated futures commission merchant has filed with the National Futures Association (Attn: Vice President, Compliance) an acknowledgement that the affiliated futures commission merchant will be jointly and severally liable for any violations of the Act or the Commission's regulations committed by such person in connection with those introducing activities, whether or not the affiliated futures

commission merchant submits for clearing any trades resulting from those introducing activities; and

(4) Such person does not solicit any person located in the United States, its territories or possessions for trading on a designated contract market, nor does such person handle the customer funds of any person located in the United States, its territories or possessions for the purpose of trading on any designated contract market.

(B) For the purposes of this paragraph, a person shall be affiliated with a futures commission merchant if such a person owns 50 percent or more of the futures commission merchant, is owned 50 percent or more by the futures commission merchant, or is owned 50 percent or more by a third person that also owns 50 percent or more of the futures commission merchant.

(4) *Exempt commodity trading advisors.* (i) A foreign located person engaging in the activity of a commodity trading advisor, as defined in § 1.3 of this chapter, in connection with any covered transaction only on behalf of foreign located persons or international financial institutions is not required to register in such capacity; *provided*, that if any such covered transaction is required or intended to be cleared on a registered derivatives clearing organization and the foreign located person or international financial institution that is party to the covered transaction is not a clearing member of such registered derivatives clearing organization, the covered transaction is submitted for clearing through a futures commission merchant registered in accordance with section 4d of the Act.

(ii) A foreign located person acting in accordance with paragraph (c)(4)(i) of this section remains subject to section 4o 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 registered commodity trading advisor or any person required to be so registered.

(5) *Exempt commodity pool operators.* (i) A foreign located person engaged in the activity of a commodity pool operator, as defined in § 1.3 of this chapter, in connection with any covered transaction is not required to register in such capacity, when such covered transactions are executed on behalf of a commodity pool, the participants of which are all foreign located persons or international financial institutions; *provided*, that if any such covered transaction is required or intended to be cleared on a registered derivatives clearing organization and the commodity pool that is party to the covered transaction is not a clearing member of such registered derivatives clearing organization, the covered transaction is submitted for clearing through a futures commission merchant registered in accordance with section 4d of the Act.

(ii) With respect to paragraph (c)(5)(i), initial capital contributed to a commodity pool by an affiliate, as defined by § 4.7(a)(1)(i) of this chapter, of the pool's commodity pool operator shall not be considered 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 foreign located persons; *provided*, that:

(A) The affiliate is not a natural person;

(B) The affiliate and its principals are not barred or suspended from participating in commodity interest markets in the United States, its territories or possessions; and

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

(iii) A commodity pool operated by a foreign located person shall be considered to be operated in accordance with the terms of paragraph (c)(5)(i) of this section, if:

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

(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:

(1) are reasonably designed to preclude persons located in the United States from participating therein; and

(2) include mechanisms reasonably designed to enable its operator to exclude any persons located in the United States that 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.

(iv) Utilizing the relief under paragraph (c)(5)(i) of this section for a qualifying commodity pool will not affect the ability of a person to register with the Commission as a commodity pool operator, or to qualify for, rely upon, or claim other relief from regulation as such by the Commission, with respect to the operation of commodity pools or trading vehicles not otherwise eligible for the relief offered in this section.

(v) A person acting in accordance with paragraph (c)(5)(i) of this section remains subject to section 4o 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.

(6) *Associated persons of swap dealers.* In determining whether a person is a swap dealer, the activities of a registered swap dealer with respect to which such person is an associated person shall not be considered.

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Issued in Washington, DC, on October 22, 2020, by the Commission.

Christopher Kirkpatrick,

*Secretary of the Commission.*

NOTE: The following appendices will not appear in the Code of Federal Regulations.

**Appendices to Exemption from Registration for Certain Foreign Intermediaries –  
Commission Voting Summary, Chairman’s Statement, and Commissioners’  
Statements**



## **Appendix 1 – Commission Voting Summary**

On this matter, Chairman Tarbert and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

## **Appendix 2 – Statement of Support of Chairman Heath P. Tarbert**

When the Commission considered the proposal to amend the registration exemption for foreign commodity pool operators (CPOs),<sup>1</sup> I noted that, in his second inaugural address in 1893, President Grover Cleveland remarked “[u]nder our scheme of government the waste of public money is a crime against the citizen.”<sup>2</sup> The CFTC is a taxpayer-funded agency, and Congress expects us to deploy our resources to serve the needs of American taxpayers. That is why as Chairman and Chief Executive, I have sought to revisit our agency’s regulations where there does not appear to be a clear connection to furthering the interests of the United States or our citizens.<sup>3</sup>

The CFTC’s framework for regulating foreign commodity CPOs protects U.S. investors who put their money in commodity investment funds run from outside the United States. But, in some instances, the only benefit of CFTC regulation of offshore CPOs is to *foreign* investors. There is no statutory mandate for the CFTC to regulate pools never offered or sold to U.S. investors. To do so absent a compelling reason would be—in President Cleveland’s words—a waste of public money.

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<sup>1</sup> Exemption From Registration for Certain Foreign Persons Acting as Commodity Pool Operators of Offshore Commodity Pools, 85 FR 35820 (June 12, 2020).

<sup>2</sup> Statement of Chairman Heath P. Tarbert in Support of Amending the Registration Exemption for Foreign CPOs (May 28, 2020), available at:

<https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement052820b>. See Second Inaugural Address of Grover Cleveland (Mar. 4, 1893), reprinted in *American History Through Its Greatest Speeches: A Documentary History of the United States* 278 (Courtney Smith, et al., eds. 2016).

<sup>3</sup> See Statement of Chairman Heath P. Tarbert in Support of Amending the Registration Exemption for Foreign CPOs, *supra* note 2.

Consequently, I am pleased to support today's final rule to amend the exemption for CPOs in regulation 3.10(c) (3.10 Exemption). The final rule eliminates the potential need for the CFTC to require the registration and oversight of non-U.S. CPOs whose pools have no U.S. investors. The final rule additionally exempts U.S.-based affiliates of pool sponsors who put seed money into offshore funds that have only foreign investors. In so doing, the final rule provides much-needed regulatory flexibility for non-U.S. CPOs operating offshore commodity pools, without compromising the CFTC's mission to protect U.S. investors.

***Exemption for Foreign CPOs Sponsoring Funds without U.S. Investors***

The final rule amends the conditions under which a foreign CPO, in connection with commodity interest transactions on behalf of persons located outside the United States, will qualify for an exemption from CPO registration and regulation with respect to an offshore pool. Specifically, through amendments to our regulation 3.10(c), a non-U.S. CPO will be able to operate pools offered to U.S. persons as either a registered or exempt CPO, while simultaneously claiming the 3.10 Exemption with respect to its qualifying offshore commodity pools.<sup>4</sup>

Absent a compelling reason, the CFTC should be focused on U.S. markets and U.S. investors, and refrain from extending our reach outside the United States.<sup>5</sup> The

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<sup>4</sup> The final rule adds a safe harbor as new 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.

<sup>5</sup> For example, section 2(i) of the Commodity Exchange Act provides that the swap provisions of Title VII of the Dodd-Frank Act shall not apply to activities outside the United States unless those activities (1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of Title VII. In interpreting this provision, the Commission has taken the position that "[r]ather than exercising its authority with respect to swap activities outside the United States, the Commission will be guided by international comity principles and will focus its authority on potential

protection of non-U.S. customers of non-U.S. firms is best left to foreign regulators with the relevant jurisdiction and mandate.<sup>6</sup> Therefore, I believe it is appropriate for the final rule to allow foreign CPOs to rely on the 3.10 Exemption for their foreign commodity pools when they have no U.S. investors. Where a foreign CPO does have U.S. investors, other exemptions or exclusions from registration might be available.

Unfortunately, under a strict construction of the current rule, if a foreign CPO has one fund with U.S. investors, then the foreign CPO must register *all* its funds or rely on some other exemption besides the 3.10 Exemption. This “all or nothing” reading of the rule has produced two competing consequences—neither of which makes for good regulatory policy. First, if the CPO chooses to register with respect to all its funds, the CFTC ends up regulating some foreign-based funds without any U.S. investors. Second, if the CPO refuses to register for any of its funds, then U.S. investors are effectively denied the liquidity and investment opportunities offered by foreign commodity pools.

In the last decade, statutory and regulatory developments have produced a growing mismatch between the Commission’s stated policy purposes underlying the 3.10 Exemption (that focus the CFTC’s resources on the protection of U.S. persons) and the strict construction of the 3.10 Exemption (that leads to its “all or nothing” application). To address this mismatch, the final rule amends the 3.10 Exemption to align the plain text of the exemption with our longstanding policy goal of regulating foreign CPOs only

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significant risks to the U.S. financial system.” Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 FR 56924, 56928 (Sep. 14, 2020).

<sup>6</sup> The Commission also cited this policy position in the initial proposal for what ultimately became Commission regulation 3.10(c)(3)(i). *See* 72 FR 15637, 15638 (Apr. 2, 2007).

when they offer their funds to U.S. investors. In effect, the Commission's walk finally conforms to our talk.<sup>7</sup>

### ***Affiliate Investment Exemption***

The final rule also permits U.S. affiliates of a non-U.S. CPO to contribute capital to that CPO's offshore pools as part of the initial capitalization without rendering the non-U.S. CPO ineligible for the 3.10 Exemption. In other words, the final rule allows a U.S. affiliate of a foreign CPO to invest in the offshore fund without triggering registration requirements because of the nature of the relationship between the affiliate and the non-U.S. CPO.

It is hard to imagine how an entity that controls, is controlled by, or is under common control with, a given foreign CPO could lack a sufficient degree of transparency with respect to its own contribution of initial capital to an offshore commodity pool run by that very same foreign CPO. In short, a U.S. affiliate's initial investment in its affiliated non-U.S. CPO's offshore pool does not raise the same investor protection concerns as similar investments in the same pool by unaffiliated persons located in the United States. In many cases, moreover, the affiliate is itself regulated by other U.S. regulators—for instance, state insurance departments in the case of insurance companies that wish to deploy their own general account assets as they best see fit, in keeping with their separate regulatory regimes. Accordingly, I see no reason to deploy the limited,

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<sup>7</sup> Apart from policy incoherence inside the CFTC, the mismatch has also caused confusion among CPOs and their investors. A number of foreign CPOs have not adopted the strict "all or nothing" reading of the 3.10 Exemption, but have instead quite sensibly latched on to the Commission's stated policy behind the rule to conclude that a foreign CPO may rely on the current 3.10 Exemption for non-U.S. pools with only non-U.S. investors even if the foreign CPO operates other non-U.S. pools with U.S. investors. Given that the confusion largely stems from the Commission's own doing, I would not support any enforcement action against foreign CPOs whose interpretation followed the spirit, if not the letter, of the 3.10 Exemption. Furthermore, today's final rule conforms to their reading.

taxpayer-funded resources of the CFTC to protect U.S. affiliates of foreign CPOs who are far better positioned than us to safeguard their own interests.

### **Appendix 3 – Supporting Statement of Commissioner Brian Quintenz**

I am pleased to support today's final rule that expands an existing exemption from registration for foreign commodity pool operators (CPOs) trading on U.S. markets on behalf of foreign investors. Building on previously granted staff no-action relief, the final rule creates new possibilities for fund managers, appropriately focuses the Commission's resources and customer protection activities upon domestic firms and U.S. customers, and provides for simplified compliance. For example, the final rule permits non-U.S. CPOs to claim the exemption on a pool-by-pool basis, which I believe is appropriate given that many large, foreign CPOs operate both U.S. and non-U.S. pools. The final rule also permits a foreign fund manager to satisfy the exemption's requirement that its pool does not contain funds of U.S. customers by complying with certain safe harbors, such as fund documentation requirements. In doing so, the final rule recognizes that the manner in which fund interests are sold in the real world often makes it impossible for a fund manager to make a blanket attestation that there is no U.S. investment in a given commodity pool.

Finally, for the first time, the final rule would permit U.S. affiliates of foreign pools to contribute initial capital to those pools. Allowing U.S. affiliates to contribute seed money to offshore pools operated by their affiliated non-U.S. CPOs should facilitate innovation and fund development by enabling those offshore pools to establish a performance history for solicitation purposes.

#### **Appendix 4 – Statement of Commissioner Dan M. Berkovitz**

I am voting for the final rule amending regulation 3.10(c) (“Final Rule”). Regulation 3.10(c) provides an exemption from registration to foreign persons who operate commodity pools (“CPOs”) located outside of the United States. The Final Rule makes pragmatic adjustments to certain conditions for claiming the exemption that will allow the Commission to focus its limited resources on protecting U.S. persons who participate in commodity pools, rather than on commodity pools operated outside the U.S. in which non-U.S. persons participate.

A fundamental goal of the Commission’s registration and regulation of CPOs is the protection of U.S. customers.<sup>1</sup> The CFTC has long held that CPOs trading commodity interests in our markets are not required to register as CPOs if they are located offshore and only operate pools for non-U.S. persons.<sup>2</sup> In 2007, the Commission codified the exemption in regulation 3.10(c).

The Final Rule: (i) exempts non-U.S. CPOs from registration and regulation with respect to individual commodity pools that do not solicit from U.S. persons or have U.S. investors;<sup>3</sup> (ii) provides that this exemption for some pools may be used with other exemptions or exclusions; and (iii) provides a safe harbor to non-U.S. CPOs in the event that U.S. persons inadvertently become participants in the offshore pools, provided that a number of conditions are met to minimize that possibility. Lastly, the Final Rule permits U.S. affiliates of non-U.S. CPOs to contribute “initial capital” to exempt offshore pools

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<sup>1</sup> The regulation of CPOs also facilitates the Commission’s ability to oversee the derivative markets, manage systemic risks, and fulfill its mandate to ensure safe trading practices. *See, e.g.*, Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 FR 11252, 11253, 11275 (Feb. 24, 2012), upheld by *Investment Company Institute v. CFTC*, 720 F.3d 370 (D.C. Cir. 2013).

<sup>2</sup> *See* CFTC Staff Interpretative Letter 76-21 (Aug. 15, 1976).

<sup>3</sup> The CPO would need to register and comply with CFTC regulations with regard to any other commodity pools it operates that do solicit funds from U.S. persons.

without being treated as “participants” in the pools themselves if certain conditions are satisfied.

In my statement for the proposed amendments to regulation 3.10(c), I noted some concern that the U.S. affiliate provision might result in persons in the U.S. investing—either knowingly or unknowingly—in unregulated foreign commodity pools if they invested in the U.S. affiliates. The proposal included specific “anti-evasion” provisions that would prevent certain “bad actors” from using the exemption and prohibit the marketing of the U.S. affiliate as a vehicle for U.S. commodity interest investments.<sup>4</sup> At my request, several questions regarding potential abuse of the U.S. affiliate provision were included in the proposed rule.

The letters commenting on the proposed rule generally expressed support. A joint letter from asset management industry associations addressed the questions in the proposal regarding the U.S. affiliate provision and provided rationales in support thereof. The letter explained that the initial capital investments from U.S. affiliates intended to help demonstrate fund performance or facilitate fund operations, for example, are not the types of investments that need the full array of customer protections provided for individual commodity pool investors.

Furthermore, comment letters explained how the conditions in the U.S. affiliate provision, coupled with the anti-evasion provisions (with some modifications), balance the flexibility needed by CPOs to make prudent capital allocation decisions with preventive measures reducing the likelihood of abuse. While it is possible that some less

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<sup>4</sup> As noted in section II.F.3 of the Final Rule, if the U.S. affiliate is marketed as providing access to commodity interests traded outside the United States, then the affiliate would be subject to the registration regime provided for such entities in part 30 of the Commission’s regulations.

than forthright actors could attempt to use the regulation 3.10(c) exemption to skirt the CPO registration requirements when soliciting commodity interest investments from U.S. persons, the Final Rule has appropriate restrictions that will facilitate enforcement when necessary.

In conclusion, the Final Rule makes prudent, limited amendments that reduce the burdens on the Commission's limited resources while maintaining the necessary protections intended for U.S. commodity pool participants. I would like to thank the commenters for their contribution to improving the Final Rule and the CFTC staff for working with my office to address my concerns.