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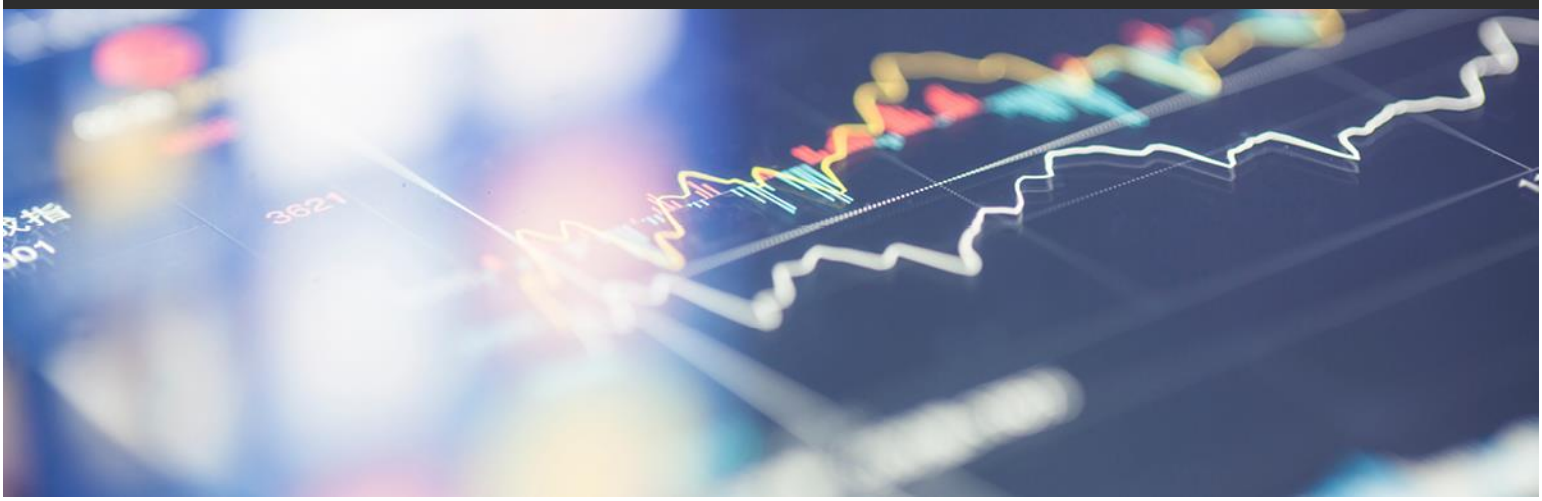

June 2020

CFTC Proposes Expanding Exemption for Non-U.S. Commodity Pool Operators

On May 28, 2020, the Commodity Futures Trading Commission (CFTC or the Commission) proposed a rule (the 2020 Proposal) broadening the exemption under which non-U.S. commodity pool operators (CPOs) operating non-U.S. funds are permitted to engage in activities that would otherwise subject such persons to regulation by the CFTC. One of the key policy considerations underlying the 2020 Proposal was expressed by CFTC Commissioner Dan Berkovitz in his statement accompanying the 2020 Proposal. Commissioner Berkovitz stated that "the business of commodity investment management has become more global in nature, increasing the complexity of cross border activities by the firms that operate commodity pools."

Current CFTC Rule 3.10(c)(3) (the 3.10 Exemption), adopted in 2007 and based on no-action guidance dating back to 1976 from the Commission's Office of General Counsel, contains three primary requirements:

1. The pool operator must be located outside the United States, its territories, and possessions (the United States or U.S.);

2. The pool operator acts only on behalf of persons located outside the United States; and

3. Any commodity interest transactions are submitted for clearing through a registered futures commission merchant.

The 2020 Proposal is premised on three factors: (i) the Commission's assessment of increasing "global nature" of the commodity pool industry; (ii) broader Commission jurisdiction since 2007 to include CPOs who operate funds that engage in swaps or spot retail foreign exchange transactions; and (iii) the Commission's mandate, as described in the 2020 Proposal, to protect "customers in the U.S. commodity interest markets with respect to the operation of commodity pools is primarily focused on protecting U.S. pool participants, not commodity pools located outside the United States that have only non-U.S. pool participants."

The 2020 Proposal would expand the 3.10 Exemption as follows:

1. Apply the 3.10 Exemption on a pool-by-pool basis. This change would harmonize the 3.10 Exemption with relief the CFTC made available in Advisory 18-96 for registered CPOs who operate non-U.S. funds;

2. Create a conditional safe harbor for non-U.S. CPOs who cannot with certainty represent there are no U.S. participants in the pool, provided the following requirements are met:

   (a) the offshore pool's offering materials and any underwriting or distribution agreements include clear, written prohibitions against the pool offering interests to participants located in the United States or U.S. ownership of the pool's interests;

   (b) the offshore pool's constitutive documents and offering materials: (i) are reasonably designed to preclude persons located in the United States from participating; and (ii) include mechanisms reasonably designed to enable the CPO to exclude any persons located in the United States who attempt to participate in the pool notwithstanding those prohibitions;

   (c) the non-U.S. CPO exclusively uses non-U.S. intermediaries for the distribution of participations in the offshore pool. CFTC has proposed including as non-U.S. intermediaries a non-U.S. branch or office of a U.S. entity, or a non-U.S. affiliate of a U.S. entity, provided the distribution takes place exclusively outside of the United States;

   (d) the non-U.S. CPO uses reasonable due diligence methods at the time of sale to preclude persons located in the United States from participating in the offshore pool; and

   (e) interests in the offshore pool are directed and distributed to participants outside the United States, including listing and trading such interests 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;

3. Allow the 3.10 Exemption to be utilized or "stacked" with another exemption such as CFTC Rule 4.13, an exclusion such as CFTC Rule 4.5, or relied upon by a registered CPO; and

4. Permit limited U.S. participation for initial capital contributions made by a U.S. controlling affiliate of an offshore pool's non-U.S. CPO; provided, however, that the affiliate not be subject to a statutory disqualification or other regulatory restriction.

The Commission specifically requested comments with respect to Item 4 above regarding participation by an affiliate of the offshore CPO and whether the 2020 Proposal should:

- state that the purpose of investment by the affiliate is for establishing the commodity pool and providing sufficient initial equity to permit the pool to attract unaffiliated non-U.S. investors;
- be time-limited to a specific period, after which participation by an affiliate must be reduced to a *de minimus* amount;
- be limited to entities or persons that are otherwise regulated in the United States, such as by federal or state securities, banking or insurance regulators; and
- be conditioned on whether the non-U.S. CPO is legally obligated in its home jurisdiction to provide the U.S. affiliate with information regarding operation of the offshore pool.

In addition to the foregoing issues noted by Commission staff, the 2020 Proposal raises other potential questions including:

- Would separate series of a multi-series fund, segregated portfolio companies or feeder funds in a master-feeder arrangement be treated as separate pools;
- Should an offshore pool's offering materials be required to disclose that certain protections and remedies will be not be available to participants in a fund operated in accordance with the 2020 Proposal, if adopted;
- What does the Commission consider "reasonable investor due diligence methods" to preclude persons located in the United States from participating in the offshore pool;
- What features or factors would make participation by persons located in the United States on secondary markets organized and operated outside of the United States "reasonably unlikely";
- Are there circumstances under which a U.S. affiliate could obtain funding from third parties for investment in the non-U.S. pool without such action being considered evasion of CFTC's rules.

The proposed expansion of CFTC Rule 3.10 recognizes the substantial increases in global activities and operations of commodity pools that have occurred in recent years. The comment period for the 2020 Proposal is 60 days from the date the 2020 Proposal is published in the Federal Register.

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