Public Statements & Remarks

Statement of Commissioner Dan M. Berkovitz on Proposed Amendments to Registration Requirements for Certain Foreign Persons Acting as Commodity Pool Operators of Offshore Commodity Pools

May 28, 2020

Introduction

I support the proposal to amend regulation 3.10(c)(3) addressing the exemption from registration for foreign persons who operate commodity pools for customers located outside of the United States ("Proposal"). The Commission should focus its limited resources on commodity pools in which U.S. persons participate, rather than commodity pools located outside the U.S. in which only non-U.S. persons participate. The Proposal addresses several specific scenarios in which the registration exemption would apply, and which previously created potential uncertainty for market participants.

I am concerned, however, that the provision in the Proposal that would enable controlling affiliates—U.S. entities with U.S. investors that provide capital to non-U.S. pools—to rely on the exemption could be used by CPOs who take funds directly from U.S. persons to evade the CPO registration and regulatory requirements. I look forward to reviewing comments on whether that provision is appropriate and whether additional conditions or limitations should apply to prevent such abuse.

Non-U.S. Pools with no U.S. Customers

It is longstanding CFTC policy that an entity that meets the CPO definition and trades commodity interests in our markets is not required to register as a CPO if the entity is located offshore and only operates pools for persons located outside of the United States.[1] In 2007, the Commission expressly codified the exemption in regulation 3.10(c)(3). Customer protection is a primary goal of the Commission's registration and regulatory requirements for CPOs.[2] The rationale for the exemption for foreign pools has been that the CFTC's customer protection regulations generally should focus on regulating activities that have an impact on U.S. customers and commerce.[3] To the extent the commodity pools that would be exempt from registration under the Proposal trade derivatives on U.S. exchanges, those activities are subject to oversight by the exchanges and through the Commission's exchange regulations.

Since the adoption of the regulation 3.10(c)(3) registration exemption, two developments have increased the need for greater clarity in the rule. First, changes to CFTC regulations since the 2008 financial crisis, particularly adding swap regulation and placing needed limits on other CPO registration exemptions, have led to a significant increase in the number of pool operators that are technically subject to registration. Second, 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.

The Proposal would exempt 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.[4] The Proposal also provides that this exemption for some pools may be used with other exemptions or exclusions permitted under our regulations. These changes largely reflect the pre-existing policy that non-U.S. CPOs need not register their offshore pools.

The Proposal would provide a safe harbor to the non-U.S. CPOs in the event that U.S. persons become inadvertently invested in the offshore pools. The Proposal appears to provide adequate conditions on the safe harbor to prevent abuse thereof. I look forward to comments on whether the proposed conditions should be expanded, reduced, or otherwise modified.

Finally, the Proposal would permit a non-U.S. CPO to rely on the exemption even if a U.S. entity that controls the non-U.S. CPO contributes capital in the initial funding of the exempt offshore pools. This provision could be beneficial for U.S. fund managers seeking to compete in foreign markets and may be acceptable with appropriate limits.

I am concerned, however, that the controlling affiliate provision would enable persons in the U.S. to indirectly invest—either knowingly or unknowingly—in unregulated foreign commodity pools. Under this provision, partnerships and corporations could take in investment funds from U.S. persons and invest those funds in commodity pools operated by non-U.S. pool operators that they "control." Neither the controlling affiliates nor the pool operators would be regulated by the CFTC. The U.S. investors in the U.S. control affiliate would receive none of the CPO disclosures or other protections afforded by our laws and regulations. In fact, they may never know that the entity they are investing in is placing their funds in offshore commodity pools. There is no requirement to disclose this information to U.S. persons investing in the controlling affiliate.

Furthermore, the Proposal permits an unregistered non-U.S. CPO to accept "initial capital contributions" from a control affiliate that is a U.S. person, but does not provide any limitations on the duration or extent of such contributions. Arguably, under the proposed provision, the controlling affiliate could fund the *entire* pool investment with funds from U.S. persons and leave that amount in the pool with no time limitation, thus allowing a complete end-run around our CPO regulations.

The Proposal expressly acknowledges that evasion of our CPO rules is possible and says that such evasion would be unlawful. I want to thank the CFTC staff who drafted the Proposal for working with my office to add some conditions to the provision. However, I am still concerned there may be insufficient safeguards to prevent abuse. For these reasons, I requested that several questions be added to the Proposal to address which additional conditions could appropriately be added to achieve the purpose of the provision and still provide sufficient protections to the U.S. investors in the controlling affiliate. I look forward to the comments on this issue.

Exercising Commodity Exchange Act Section 4(c) Authority

Finally, the Proposal relies on authority provided to the Commission in CEA section 4(c) to adopt exemptions from regulatory requirements if certain public policy goals are better served and if certain conditions are satisfied. Generally, I am not in favor of using this authority unless no other direct legal authority exists and doing so clearly falls within the intent of Congress in giving the Commission that power. During the development of the draft Proposal, I raised a number of concerns regarding the use of section 4(c) and I want to commend the CFTC staff for their efforts to address my concerns by more fully explaining in the Proposal why the use of section 4(c) authority is appropriate in this instance.

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[1] *See* CFTC Staff Interpretative Letter 76-21 (Aug. 15, 1976).

[2] The regulation of CPOs also facilitates the Commission's oversight of the derivative markets, management of systemic risks, and mandate to ensure safe trading practices. *See, e.g.*, Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 Fed. Reg. 11252, 11253, 11275 (Feb. 24, 2012); *upheld in Investment Company Institute v. CFTC*, 720 F.3d 370 (D.C. Cir. 2013).

[3] *See e.g.*, Commodity Exchange Act ("CEA") section 2(i). In contrast to this focus on customers, a primary policy goal of swap dealer regulation is preventing systemic risk. This goal necessitates oversight of swap trading activity outside of the United States that can have a significant impact on U.S. commerce if risks from that activity come back into the U.S. financial system through regulated swap dealers. *See generally* Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292 (July 26, 2013).

[4] 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.

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