Public Statements & Remarks

Statement of Chairman Heath P. Tarbert in Support of Amending the Registration Exemption for Foreign CPOs

May 28, 2020

In his second inaugural address in 1893, President Grover Cleveland remarked that "[u]nder our scheme of government the waste of public money is a crime against the citizen."[1] 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.

The CFTC's framework for regulating foreign commodity pool operators ("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 funds 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.

Consequently, I am pleased to support today's proposal to amend the exemption for CPOs in regulation 3.10(c) ("3.10 Exemption"). If adopted, the proposal would eliminate 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 proposal would additionally exempt U.S.-based affiliates of fund sponsors who put seed money into offshore funds that have only foreign investors. In so doing, the proposal would provide 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 proposal would amend the conditions under which a foreign CPO, in connection with commodity interest transactions on behalf of persons located outside the United States, would qualify for an exemption from CPO registration and regulation with respect to that offshore pool. Specifically, through amendments to our regulation 3.10(c), a non-U.S. CPO would be able to claim an exemption from registration for its qualifying offshore commodity pools, without being required to register as a CPO with respect to the operation of other commodity pools.[2]

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.[3] The protection of non-U.S. customers of non-U.S. firms is best left to foreign regulators with the relevant jurisdiction and mandate.[4] Therefore, I believe it is appropriate for the proposed 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 all its funds, the CFTC ends up regulating some foreign-based funds without any U.S. investors. Second, if the CPO refuses to register 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, today's proposal would amend the 3.10 Exemption to align the plain text of the exemption with our longstanding policy goal of regulating only foreign CPOs that offer their funds to U.S. investors. In effect, the Commission's walk would finally conform to our talk.[5]

Affiliate Investment Exemption

In addition to ensuring the CFTC's resources are focused on commodity pools with U.S. investors, we must also strive to protect those who are truly arms-length, third-party investors. To that end, the proposal would permit certain U.S. control 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 proposal would simply allow a U.S. parent company of a foreign CPO to invest in what is effectively its own offshore fund, without triggering registration requirements.

It is hard to imagine how an entity that ultimately controls 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 same foreign CPO. In short, a U.S. controlling 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 parent company 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, taxpayer-funded resources of the CFTC to protect U.S. parents of foreign CPOs who are far better positioned than our federal agency to safeguard their own interests.

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[1] 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)

[2] The proposal also would add 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.

[3] 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 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 952, 955 (Jan. 8, 2020).

[4] 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).

[5] 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 proposal, if adopted, would vindicate their reading.

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