Investment Management Alert

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CFTC Expands Availability of 3.10(c)(3) Registration Exemption for Non-US Commodity Pool Operators and Commodity Trading Advisors

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Commodity Futures Trading Commission (CFTC) Regulation 3.10(c)(3) currently provides an exemption from registration for non-U.S. commodity pool operators (CPOs) and commodity trading advisors (CTAs), if they solely operate non-U.S. commodity pools offered to non-U.S. investors, or provide commodity trading advice solely with respect to non-U.S. clients, and submit their underlying commodity interest transactions for clearing (the "3.10 Exemption").[1] On October 15, 2020, the CFTC unanimously approved a final rule to amend the 3.10 Exemption (the "Final Rule")[2] that largely adopts two separate proposals considered by the CFTC in 2016 and 2020, subject to certain changes. The Final Rule will go into effect 60 days after its publication in the Federal Register, and amends the 3.10 Exemption as follows:

Clearing Requirement. The Final Rule amends the 3.10 Exemption to no longer require commodity interest transactions to be cleared if mandatory clearing is not otherwise required for the contract. Therefore, a CPO or CTA can rely on the 3.10 Exemption even if the commodity pool that it operates, or client that it advises, trades swaps that are not subject to the CFTC's clearing mandate and are therefore not submitted to a registered clearinghouse. In addition, the Final Rule provides that a non-U.S. CPO or CTA can rely on the 3.10 Exemption with respect to commodity interest transactions that are required to be cleared through a registered futures commission merchant or, if the CPO's commodity pool or CTA's client is a clearing member of the relevant clearinghouse, through the client.

Pool-by-Pool Availability. The Final Rule allows non-U.S. CPOs to claim the 3.10 Exemption on a pool-by-pool basis with respect to their qualifying non-U.S. pools. Accordingly, a non-U.S. CPO may be registered with respect to certain pools that are offered to U.S. investors, but claim the 3.10 Exemption with respect to its offshore pools that are offered solely to non-U.S. investors. Non-U.S. CPOs and the pools they operate pursuant to the 3.10 Exemption remain subject to the CFTC's enforcement authority with respect to fraud and manipulation in the U.S. commodity interest markets.

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Exemption Stacking. In addition to being able to rely on the 3.10 Exemption for certain qualifying non-U.S. pools while registered with respect to others, the Final Rule also allows non-U.S. CPOs to rely on the 3.10 Exemption for certain non-U.S. qualifying pools while relying on any other exemptions or exclusions (e.g., the Regulation 4.13 de minimis exemption or Regulation 4.5 exclusion) with respect to their other commodity pool offerings that do not qualify for the 3.10 Exemption (i.e., engage in "stacking" of CPO exemptions). The CFTC specifically declined to include in the Final Rule a similar ability for non-U.S. CTAs to claim the 3.10 Exemption on an account-by-account basis or engage in exemption "stacking" involving the 3.10 Exemption.[3]

Safe Harbor. Recognizing that non-U.S. CPOs cannot always certify with absolute certainty that they are only acting on behalf of non-U.S. investors in their offshore pools, the Final Rule provides a safe harbor. So long as the following provisions are satisfied and adequate documentation thereof is maintained, a non-U.S. CPO would be permitted to claim the 3.10 Exemption on behalf of an offshore pool for which it cannot represent with absolute certainty that all of the pool participants are non-U.S. persons:

- The offshore pool's offering materials and any underwriting or distribution agreements make clear, in writing, that the offshore pool is prohibited from being offered to U.S. persons or participants located in the U.S.
- The offshore pool's offering materials and constitutional documents are reasonably designed to preclude participation by U.S. persons and include mechanisms that enable the non-U.S. CPO to exclude U.S. persons who attempt to participate in the pool.
- The non-U.S. CPO uses only non-U.S. intermediaries (which may include non-U.S. branches, offices or affiliates of a U.S. entity) for the distribution of participations in the offshore pool, provided that such distributions take place exclusively outside of the U.S..
- The non-U.S. CPO conducts reasonable investor due diligence at the time of sale to preclude a U.S. investor from participating in the offshore pool.
- The offshore pool's participation units are directed and distributed to participants located outside of the U.S., including by means of any listing or trading units on secondary markets organized and operated outside of the U.S. in which participation by U.S. persons is unlikely.

Seed Capital. The Final Rule provides that a non-U.S. CPO can rely on the 3.10 Exemption with respect to an offshore pool, notwithstanding the fact that a U.S. affiliate contributes seed capital to the pool at or near its inception. "Affiliate" for purposes of the exception refers to any entity that controls, is controlled by or is under common control with the non-U.S. CPO, provided that such affiliate and its principals are not barred or suspended from participating in commodity interest markets in the U.S.

[1] 17 CFR 3.10(c)(3)(i). The 3.10 Exemption also applies with respect to introducing brokers.

[2] The Final Rule can be found at: https://www.cftc.gov/media/5061/votingdraft101520Part3/download.

[3] The CFTC did, however, recognize past staff letters and interpretive guidance that have allowed for "stacking" of statutory or regulatory exemptions from CTA registration, suggesting that the CFTC's declining to explicitly provide in the Final Rule for stacking of the 3.10 Exemption with other CTA registration exemptions should not have any bearing on a market participant's ability to continue relying on past no-action letters and interpretive guidance regarding the issue. Additionally, CFTC Regulation 4.14(a)(10) specifically contemplates exempting

from registration non-U.S. CTAs that provide commodity trading advice to both clients that are residents of the U.S. and clients that are not residents of the U.S., so long as the number of U.S. clients does not exceed fifteen. See CFTC Regulation 4.14(a)(10)(ii)(C).