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WILLKIE FARR & GALLAGHER LLP | FRIED FRANK

September 13, 2019

Joshua B. Sterling
Director, Division of Swap Dealer and Intermediary Oversight
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Request for Clarification of Cross-Border Statements in Part 4 Proposal Preamble

Dear Mr. Sterling:

Congratulations on your new position as the Director of the Commission's Division of Swap Dealer and Intermediary Oversight ("DSIO"). Like many participants and practitioners in the global asset management arena, we are pleased that DSIO is now focused on Part 4 of the Commission's regulations with a view to improving the Commission's regulation of commodity pool operators ("CPOs") and commodity trading advisors ("CTAs"), as demonstrated by the pending proposal of amendments to Part 4 that was published for comment last fall (the "Part 4 Proposal").[1] We know there are many demands on your time and the resources of your hardworking staff and write this letter to highlight and synthesize the comments on what we believe is an important aspect of the Proposal that merits DSIO's attention as DSIO and the Commission progress toward final adoption of some or all elements of the Proposal.

In particular, we are writing to call your attention to, and request clarification of, statements made in the Preamble to the Part 4 Proposal that have raised widespread concerns among industry participants about the potential for adverse and unintended cross-border impact. These statements relate to Rule 3.10(c)(3)(i), the Commission's existing exemption for offshore CPO and CTA activities that is widely relied on, on a self-executing basis, by a broad range of non-U.S. asset managers and fund sponsors all over the world with respect to their activities on behalf of non-U.S. investors. The statements appear to assume an interpretation of the existing Rule 3.10(c)(3)(i) exemption that would represent a significant departure from both widespread understanding of how the exemption currently operates and the Commission's longstanding activities-based approach to applying its CPO exemptions. This interpretation would also be contrary to the stated goals of

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[1] Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors, 83 Fed. Reg. 52902 (Oct. 18, 2018). *See also* CFTC Proposes to Streamline Regulations for Commodity Pool Operators and Commodity Trading Advisors, CFTC Release No. 7825-18 (Oct. 9, 2018) (press release). Most of the components of the Part 4 Proposal involve codifying (and in some cases expanding) existing staff no-action positions and other staff guidance that currently provide relief from CPO and/or CTA registration or regulation in a number of areas, including, among others, family offices, business development companies, reporting and recordkeeping requirements, activities permitted under Securities and Exchange Commission rules implementing the "JOBS" Act, and offshore pools operated by registered CPOs.

the Part 4 Proposal and the Commission's historical restraint in asserting extraterritorial jurisdiction over offshore CPOs, where U.S. investors are not involved.

The Part 4 Proposal is comprised of five distinct sets of rule amendments (the "components") united by the common theme of streamlining the regulatory regime for CPOs and CTAs and making it less burdensome. The Proposal was inspired by the Commission's Project KISS initiative, an agency-wide review of the Commission's regulations and practices launched in March of 2017 with the goal of identifying those areas that could be simplified to make them less burdensome and less costly while maintaining their regulatory benefits.[2] Project KISS, in turn, was inspired by the core principles for regulation of the U.S. financial system articulated in the President's February 2017 executive order, including to "make regulation efficient, effective, and appropriately tailored" and to "advance American interests in international financial regulatory negotiations and meetings."[3]

The Proposal also reflects the Commission's longstanding regulatory philosophy of restraint in asserting extraterritorial CPO jurisdiction. The Preamble cites the Commission's "own historic statements regarding its jurisdictional scope," reflecting a tradition of focusing Commission resources on protecting U.S customers, while relying on national regulators of other jurisdictions to safeguard the interests of their citizens:

> [G]iven this agency's limited resources, it is appropriate at this time to focus [the Commission's] customer protection activities upon domestic firms and upon firms soliciting or accepting orders from domestic users of the futures markets and that the protection of foreign customers of firms confining their activities to areas outside this country, its territories, and possessions may best be for local authorities in such [jurisdictions].[4]

The Preamble invoked this philosophy of extraterritorial restraint in connection with one component of the Proposal, a proposed new exemption for CPOs of offshore funds designed to codify and expand an existing staff advisory that currently provides limited relief for registered CPOs; the Preamble calls the proposed new exemption the "18-96 exemption," referring to Staff Advisory 18-96, the current staff advisory on which it is based.[5] The 18-96 exemption was proposed in order to provide additional exemption options for registered CPOs as well as for other CPOs that operate offshore pools.[6]

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2 *See* Project KISS, 82 Fed. Reg. 21494 (May 9, 2017).

3 *See* Core Principles for Regulating the United States Financial System, Executive Order 13772 (Feb. 3, 2017), 82 Fed. Reg. 9965 (Feb. 8, 2017). *See also* Report of the Department of Treasury, Capital Markets at 3 (while the report does not address CPO and CTA regulation, it supports cross border regulation designed "to avoid market fragmentation, redundancies, undue complexity, and conflicts of law" and "regulation that promotes market efficiency and cost-effectiveness and international engagement to ensure that U.S. markets remain attractive to foreign investors and institutions").

4 Preamble at 52904 (citing Exemption From Registration for Certain Foreign Persons, 72 Fed. Reg. 63976, 63976–77 (Nov. 14, 2007) (brackets original) (citing Introducing Brokers and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators; Registration and Other Regulatory Requirements, 48 Fed. Reg. 35248, 35261 (Aug. 3, 1983))).

5 Staff Advisory 18-96, Offshore Commodity Pools—Relief for Certain Registered CPOs From Rules 4.21, 4.22 and 4.23(a)(10) and (a)(11) and From the Location of Books and Records Requirement of Rule 4.23 (Apr. 11, 1996).

6 The Commodity Exchange Act ("CEA"), from which the Commission draws its mandate to regulate CPOs, is silent on the extraterritorial application of the Act's CPO registration and regulation provisions. The Commission's historical restraint in this area when U.S. investors are not involved is thus reinforced by the Supreme Court's holding in *Morrison v. National Australia Bank* that "unless there is the affirmative intention of the Congress clearly expressed to give

Rule 3.10(c)(3)(i) was not the subject of any of the proposed rule amendments. The Preamble, however, addressed Rule 3.10(c)(3)(i) in connection with the 18-96 exemption, primarily in the cost-benefit analysis discussion. The Preamble appeared to assume that, unlike either Staff Advisory 18-96 or the proposed 18-96 exemption, and contrary to the Commission's longstanding activities-based application of its CPO and CTA exemptions, Rule 3.10(c)(3)(i) could not be used on a pool-by-pool basis. Further, the Preamble recognized that the approach to Rule 3.10(c)(3)(i) reflected in the cost-benefit analysis would impose significant limitations on offshore CPOs and could result in substantial regulatory burdens and inefficiencies, even with respect to pools that are neither offered nor sold to U.S. investors.[7]

Six commenters on the Proposal, including the four signatories to this letter, submitted letters raising serious concerns about the implication that Rule 3.10(c)(3)(i) is not available on a pool-by-pool basis and requested clarification.[8] The comment letters unanimously agreed that such an interpretation of Rule 3.10(c)(3)(i) would be contrary to widespread understanding. They pointed out the stark contrast between the practical impact of such a restrictive interpretation and the stated goals of the Proposal, the Commission's tradition of activities-based CPO and CTA regulation, and the Commission's historic restraint in asserting its CPO and CTA jurisdiction on an extraterritorial basis. The commenters also agreed that nothing in the language or history of Rule 3.10(c)(3)(i) requires, or even supports, a conclusion that the Rule 3.10(c)(3)(i) exemption is not available on a pool-by-pool basis.[9]

We believe that, as the comment letters more fully demonstrate, a restrictive application of Rule 3.10(c)(3)(i) in the manner suggested in the Preamble would be both incorrect as a matter of interpretation and contrary to a broad range of the Commission's long held policy goals. If the Commission were to consider issuing a formal interpretation of Rule 3.10(c)(3)(i) with the potential for disruption and increased

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a statute extraterritorial effect, we must presume it is primarily concerned with domestic conditions . . . . When a statute gives no clear indication of an extraterritorial application, it has none." 561 U.S. 247, 255 (2010) (internal quotation marks omitted). In applying the *Morrison* doctrine to the CEA, the U.S. Court of Appeals for the Second Circuit recently held that the CEA is to be interpreted in light of the presumption against extraterritoriality and thus applies to offshore activity only when there is a clear indication of extraterritoriality, or when there is domestic activity involved that implicates the "focus" of the statute. *See* Prime International Trading v. BP P.L.C., No. 17-2233 (2d Cir. Aug. 29, 2019).

[7] Preamble at 52921.

[8] The six comment letters were submitted by the Alternative Investment Management Association Limited ("AIMA"), Fried, Frank, Harris, Shriver & Jacobson LLP ("Fried Frank"), the Investment Adviser Association ("IAA"), the New York City Bar Association, Committee on Futures and Derivatives ("NYCB"), the Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA AMG"), and Willkie Farr & Gallagher LLP ("Willkie Farr"). A description of each commenter, as provided by the respective letters, is included as Appendix A to this letter. NYCB and AIMA are not signatories to this letter for process reasons, but excerpts from their comment letters are included in Appendix B.

[9] The language of the Rule focuses on transactions on behalf of U.S. customers, and provides exemptive relief to: "[a] person located outside the United States, its territories or possessions engaged in the activity of: . . . a commodity trading advisor . . . or a commodity pool operator . . . **in connection with any commodity interest transaction executed [in the U.S. markets] . . . only on behalf of persons located outside the United States, its territories or possessions**" (emphasis added). The phrase "only on behalf of persons located outside the United States" is part of the phrase that describes the transaction. The word "only" in this context in no way indicates that Rule 3.10(c)(3)(i) cannot be applied on a pool-by-pool or activities basis. Many exemptions that the Commission has expressly permitted to be combined with other exemptions, either by rule or interpretation, use words like "only" or "solely," but these words are interpreted as being limited to the activities for which the exemption is relied on. A classic demonstration of this is the Commission's interpretation of Rule 4.14(a)(8). While that rule uses the word "solely" several times to describe the permitted activities to claim the exemption, the Commission has interpreted the rule to permit CTAs that do not "solely" engage in the activities described in Rule 4.14(a)(8) to rely on the rule, as long as the other activities are covered by a different exemption.

regulatory burdens on non-U.S. activities that do not involve U.S. investors, we believe such action would merit, at the very least, a comprehensive consideration of the basis for such an interpretation in the language and history of the rule, as well as its practical and policy implications, with the benefit of notice and comment on the specific interpretation proposed. The goals and scope of the Part 4 Proposal make clear that this Proposal was not intended, nor could it appropriately serve, as a vehicle for such an important departure.[10]

Accordingly, we request that, in connection with the Commission's adoption of the Part 4 Proposal (in whole or part), the Commission make clear that the Preamble for the Proposal was not intended to promulgate an interpretation of Rule 3.10(c)(3)(i) that would impair the ability of offshore CPOs to rely on the rule on a pool-by-pool basis for activities that do not involve U.S. investors. We suggest that the following language could be used or adapted for this purpose:

Proposed Language for Clarification of Preamble Statements on Rule 3.10(c)(3)(i) (to be included in Part 4 Adopting Release)

> The Part 4 Proposal grew out of the Commission's Project KISS initiative, with the goal of streamlining the regulatory regime for CPOs and CTAs and making it less burdensome. An important component of Project KISS was also to take the Commission's existing rules and apply them in ways that are simpler and less burdensome.
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> In connection with proposing the 18-96 exemption and explaining the Commission's cost-benefit analysis, the Preamble discussed a number of ways in which the proposed exemption could provide more flexibility and additional options relative to the current exemptions for offshore CPO activities provided by Staff Advisory 18-96 and Rule 3.10(c)(3)(i). A number of commenters read parts of the discussion relating to Rule 3.10(c)(3)(i) to suggest a restrictive "entity-based" interpretation of the Rule, rather than the more flexible "transaction-" or "activities-" based interpretation which commenters said has been widely understood. All of the industry participants who commented on this interpretation of Rule 3.10(c)(3)(i) raised serious concerns about the interpretation and strongly urged the Commission to reconsider the statements that suggested it.
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> The concerns expressed by the commenters included, among others, that an entity-based application of the Rule 3.10(c)(3)(i) exemption: (i) would be without precedent and contrary to widespread understanding of the Rule; (ii) would be at odds with both the Commission's historical activities-based approach to exemptions for CPOs and CTAs and the stated goals of the Proposal; (iii) would have a substantial adverse impact on offshore CPO activities on behalf of non-U.S. investors, including disruption and increase in regulatory burdens, without serving a commensurate regulatory goal; (iv) would discourage non-U.S. asset managers and fund sponsors from seeking to provide investment opportunities to U.S. investors; (v) would represent a significant departure from the Commission's own historical recognition of the need to focus its scarce resources on domestic firms and protection of U.S. investors; and (vi) would be inconsistent with statutory, judicial, and prudential constraints on the Commission's assertion of extraterritorial jurisdiction. Commenters also stated that an entity-based interpretation is not supported by the language of Rule 3.10(c)(3)(i) or by its regulatory history and relevant precedent.

[10] We note that the Part 4 Proposal Preamble, in which the discussion of Rule 3.10(c)(3) was included, was approved for publication by a seriatim vote, without a Commission meeting or open discussion.

While Rule 3.10(c)(3)(i) was not the subject of the Part 4 Proposal, after consideration of the comments and further review of the Preamble, we recognize that there are certain statements in the Preamble that could give rise to these concerns. It was not the Commission's intent in this Proposal to propose or suggest an interpretation of Rule 3.10(c)(3)(i) that would increase regulatory burdens on offshore CPOs with respect to their offshore activities on behalf of non-U.S. investors. Any such action would require a far more comprehensive review of the practical and policy implications, including the potential for unintended consequences, than was contemplated in the Part 4 Proposal. If the Commission were to undertake such a review, we would certainly take into account the concerns expressed in the comments, as summarized above.

Accordingly, to avoid the possibility of confusion or misunderstanding, we hereby withdraw the discussion of Rule 3.10(c)(3)(i) that appeared in the Preamble. We also note that, on the basis of the comment letters received and the Commission's regulatory goals as reflected in the Proposal, we see no reason why Rule 3.10(c)(3)(i) should not be interpreted to apply on a pool-by-pool basis, in a manner consistent with the Commission's historical approach to the applicability of its other exemptions applicable to CPOs and CTAs.

The Preamble recognizes that interpreting the Commission's existing offshore CPO exemption in a manner that precludes reliance on a pool-by-pool basis leaves offshore CPOs with only limited, expensive, and inefficient regulatory options. The comment letters further describe the potential disruption and adverse consequences of such an interpretation, the absence of any regulatory justification, and the inconsistency of this approach with the Commission's stated goals. The simple regulatory solution to the adverse consequences that would follow from such an interpretation, which are recognized by all, is to interpret Rule 3.10(c)(3)(i) in a manner that does not cause them.

We respectfully request that the Division and its staff review and consider the concerns raised herein and in the comment letters and provide the clarification described above. For your assistance in this consideration, SIFMA AMG has prepared a collection of excerpts from the comment letters, organized to address each of the concerns described above, which is attached as Appendix B.

Sincerely yours,

/s/ Jason Silverstein
Jason Silverstein, Esq.
Asset Management Group – Managing Director and Associate General Counsel
Securities Industry and Financial Markets Association

/s/ Gail C. Bernstein
Gail C. Bernstein
General Counsel
Investment Adviser Association

/s/ Rita M. Molesworth
Rita M. Molesworth
Partner
Willkie Farr & Gallagher LLP

/s/ David Mitchell
David Mitchell
Partner
Fried, Frank, Harris, Shriver & Jacobson LLP

cc: Amanda Olear, Acting Deputy Director, DSIO

Elizabeth Groover, Special Counsel

Appendix A -- List of Comment Letters

Alternative Investment Management Association Limited (AIMA) (Dec. 17, 2018)

> AIMA the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA works closely with its members to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes, and sound practice guides. Providing an extensive global network for its members, AIMA's primary membership is drawn from the alternative investment industry whose managers pursue a wide range of sophisticated asset management strategies. AIMA's manager members collectively manage more than $2 trillion in assets.
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> AIMA's members include investment advisers registered with the United States Securities and Exchange Commission ("SEC") and other international regulatory bodies such as the Financial Conduct Authority in the United Kingdom. Particularly since the CFTC adopted major amendments to its regulations governing CPOs and CTAs in 2012, some AIMA members are also CPOs and CTAs for purposes of the U.S. Commodity Exchange Act ("CEA") and regulations thereunder. Accordingly, these AIMA members have either registered under the CEA and/or operate in accordance with exemptions from such registration provided in the CEA or CFTC regulations promulgated thereunder.

Fried, Frank, Harris, Shriver & Jacobson LLP (Dec. 17, 2018)

> Fried Frank advises many clients located in the United States and abroad whose activities would be potentially affected by the Proposals. This letter focuses on several aspects of the Proposals which are of particular significance to our clients and in so doing addresses some of the specific questions on which the Commission is requesting comment, as well as certain related issues.

New York City Bar, The Committee on Futures and Derivatives (Jan. 4, 2019)

> The Association is an organization of over 24,000 members. Most of its members practice in the New York City area. However, the Association also has members in nearly every state and over 50 countries. The Committee consists of attorneys knowledgeable about the trading of futures contracts and over-the-counter derivative products, as well as the regulations applicable to such products and market participants. The Committee has a practice of publishing comments on legal and regulatory developments that have a significant impact on the futures and derivatives markets.

Investment Adviser Association (Dec. 17, 2018).

> The IAA is a not-for-profit association dedicated to advancing the interests of SEC-registered investment advisers. The IAA's more than 650 member firms manage more than $25 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. For more information, please visit our website: www.investmentadviser.org. IAA members, all of which are registered as investment advisers with the Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940, as amended (Advisers Act), are fiduciaries to their clients and are committed to acting in their clients' best interest. The IAA supports effective and meaningful regulation of the commodities markets and market participants, and we thus strongly support the CFTC's Project KISS initiative and its goals to reduce costs and burdens of CFTC regulation.

Asset Management Group of the Securities Industry and Financial Markets Association (Dec. 17, 2018)

SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.

Willkie Farr & Gallagher (Dec. 17, 2018)

We have numerous clients located throughout the United States and abroad with a particular interest in the issues covered by the Proposal. Over the past forty years, Willkie has advised a broad range of U.S. and non-U.S. based CPOs and CTAs, U.S. and non-U.S. commodity pools, and others engaged in activities subject to the Commission's jurisdiction. Our clients also include numerous family investment entities with varying structures.