THE COMMITTEE ON FUTURES AND DERIVATIVES

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January 4, 2019

Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St., N.W.
Washington, D.C. 20581
Via email: secretary@cftc.gov

Re: RIN 3038-AE76—Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors, 83 *Federal Register* 52902 (October 18, 2018)

Dear Mr. Kirkpatrick:

We write on behalf of the Committee on Futures and Derivatives (the "Committee") of the New York City Bar Association (the "Association") to provide our comments with respect to the Commodity Futures Trading Commission's ("Commission") notice of proposed rulemaking entitled, "Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors," 83 *Federal Register* 52902 (October 18, 2018) ("Proposal").[1]

I. NEW YORK CITY BAR ASSOCIATION

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.

[1] The comment period on the Proposal expired on December 17, 2018. We respectfully request that the Commission nevertheless consider this late-filed comment,

II. THE PROPOSED RULE

Among other provisions, the Proposal proposes an exemption that would permit a Commodity Pool Operator ("CPO") that accepts funds solely from persons located outside the U.S. for participation in an offshore commodity pool operated by it to claim a registration exemption with respect to such pool. Proposed rule 4.13(a)(4) is modeled after the relief afforded to U.S. CPOs under CFTC Advisory 18-96.[2] That advisory provides relief to registered CPOs from registration and reporting requirements with respect to pools that they operate which are organized and operated outside of the U.S. and which have no U.S. participants, no direct or indirect source of capital from within the U.S., and which do not market to or solicit U.S. persons.[3] Additional conditions apply for relief from reporting requirements.

The Commission states that it

> preliminarily believes that the adoption of a CPO registration exemption based on the conditions of Advisory 18–96 (18–96 Exemption) would benefit industry participants, prioritize the use of Commission resources on the customer protection of actual and potential commodity pool participants located in the U.S., and provide relief to persons with respect to their commodity pool operations that have a limited nexus with markets or participants within the Commission's jurisdiction.[4]

The Association commends the Commission for proposing rule 4.13(a)(4) and incorporating the relief available under Advisory 18-96 into Commission rules. Wherever possible, rulemaking should be favored over providing relief through long-standing guidance, advisories or no-action letters. It is important to enshrine such long-standing regulatory provisions in Commission rules, in order to enhance their transparency and accessibility. The Association particularly encourages the Commission to codify long-standing advisories, guidance or no-actions that relate to implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).[5] It becomes increasingly important to codify these provisions into rules as we move further from initial implementation and memory fades. Advisory 18-96 is a prime example of an important source of regulatory relief remaining available as an advisory long-term; the Commission is to be commended for proposing to codify it now as part of its KISS initiative.

III. INTENT OF PROPOSED RULE 4.13(A)(4)

In proposing rule 4.13(a)(4), the Commission stated its intent to concentrate its focus and resources on protecting U.S. customers from fraud and abuse and to recognize that the national regulators of other jurisdictions should be relied upon to safeguard the interests of their citizens. The Commission reaffirms its prior policy determination that

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[2] https://www.cftc.gov/sites/default/files/tm/advisory18-96.htm. (All websites cited in this letter were last visited on January 2, 2019.)

[3] Proposal at 52905.

[4] Proposal at 52906.

[5] Public Law 111–203, H.R. 4173 (2010).

> '[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].' '' The Commission preliminarily believes that this rationale continues to be true with respect to CPOs and commodity pools, notwithstanding the expansion of CFTC jurisdiction after the passage of the Dodd-Frank Act.[6]

We concur with the Commission's assessment that the protection of foreign customers of firms outside the U.S. are best left to the authorities in those jurisdictions.

It has long been understood that the U.S. does not have, or refrains from exercising, jurisdiction over a non-U.S. CPO which operates offshore commodity pools that are not offered to U.S. persons, except with respect to the rules that apply to any trader in U.S. markets. It has also been understood that the Commission approaches the application of exemptive relief on a pool-by-pool basis, permitting CPOs to claim all applicable exemptive relief that may apply with respect to its operation of a particular pool.

In light of these precepts, many practitioners have long understood the Commission's regulatory interest with respect to foreign CPOs to be limited to the offshore pools that they operate in which U.S. participants may invest. It has been understood that non-U.S. CPOs, operating offshore pools in which no U.S. persons were permitted to invest were not subject to a registration requirement and that the operator of such pools was not subject to Commission jurisdiction, or at least that the U.S. did not have a regulatory interest in their regulation. This understanding is the mirror image of the relief accorded under Advisory 18-96 to U.S. CPOs, excusing them from registration and reporting requirements for offshore commodity pools not offered to U.S. persons, and thus, in which no U.S. persons were invested.

The Proposal does not explicitly address this issue. However, the Commission states in its Cost/Benefit analysis, that

> [u]nder § 3.10(c)(3)(i), an offshore CPO that wished to operate pools offered to U.S. persons would be required to choose between the potentially more costly options of having such pools operated by an affiliate registered with the Commission or otherwise eligible for other relief, operating all pools (regardless of location) consistent with another registration exemption, or registering as a CPO and listing all operated pools with the Commission.[7]

It appears that the Commission is taking the position that the operation of one or more offshore pools by a foreign CPO in which U.S. persons may invest requires the non-U.S. CPO to file a claim for relief under proposed rule 4.13(a)(4) for all of the offshore pools that it operates.

[6] Proposal at 52904. Citations omitted.

[7] Proposal at 52921 (emphasis added).

This will constitute a serious burden for non-U.S. CPOs which may have many offshore pools and only one or a handful of pools that permit investment by U.S. persons. It also constitutes a jurisdictional overreach by the Commission, applying U.S. regulations to non-U.S. CPOs without regard to concepts of deference to foreign regulators. The Commission clearly has a regulatory interest when U.S. persons are investors in a pool, but that interest does not extend to offshore pools, operated by a non-US CPO, which are not offered to U.S. investors. Where a foreign CPO operates a pool which is not offered to U.S. investors, and where there can be no commingling of funds between those pools and a pool in which U.S. persons are invested, it is difficult to discern the Commission's regulatory interest.

The Commission's codification of Advisory 18-96 is a welcome step. However, in doing so, it appears to be altering a long-held understanding of many practioners with respect to limits on the application of Commission jurisdiction, or regulatory interest; extending the application of Commission requirements to offshore pools, operated by offshore CPOs with no U.S. investors. This step should not be taken lightly. It potentially is contrary to the Commission's long-standing recognition that futures trading is a global business and that the Commission should defer to foreign regulatory authorities with comparable regulatory schemes. We note that a possible result, if non-U.S. regulators were to impose a similar framework as the Commission appears to be proposing, would be that U.S. CPOs potentially would be exposed to regulatory requirements in other jurisdictions in respect of all of the domestic U.S. pools that they operate. This would be a serious, unwelcome, yet not unforeseeable result were the application of proposed rule 4.13(a)(4) to be extended to the fully non-U.S. pools of a non-U.S. CPO.

We are of the view that the Commission should reconsider the position that it appears to have taken and recognize that a non-U.S. CPO operating an offshore pool need register as a CPO, unless qualifying for an exemption, only with respect to those offshore pools in which U.S. persons are permitted to invest. The Commission should interpret its jurisdiction, as we believe it has historically, as not reaching offshore pools operated by a non-U.S. CPO that are not offered to U.S. investors. Otherwise, at a minimum, the Commission should repropose the rule and explicitly seek comment on the possible collateral effect of a broad interpretation of its jurisdiction with respect to non-U.S. CPOs.

The Association thanks the Commission for this opportunity to comment on the Proposal.

Respectfully,

Futures and Derivatives Committee
Gary Edward Kalbaugh, Chair

New York City Bar Association
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Gary E. Kalbaugh, Chair

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§ These members of the Committee constitute the working group for this letter.

§§ Chair of the working group.

***** These members of the Committee did not participate in the preparation of this comment letter.

The opinions expressed by members of the Committee in this letter are the individual opinions of the members and not necessarily the opinions of any organization with which they may be employed or affiliated.