sifma

asset management group

Dec. 17, 2018

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
3 Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: **Comment Letter on the Proposed Amendments to Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors (RIN 3038-AE76)**

Dear Mr. Kirkpatrick:

The Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA AMG" or "AMG")[1] appreciates the opportunity to provide the Commodity Futures Trading Commission (the "Commission") with comments on the Commission's Notice of Proposed Rulemaking regarding Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors (the "Proposal").[2] AMG members recognize and value the Commission's achievements over the past decade in strengthening the markets and protecting investors through core regulatory changes, and welcome the Commission's thoughtful consideration of the regulatory regime governing commodity pool operators ("CPOs") and commodity trading advisors ("CTAs") now reflected in this formal rulemaking. The release accompanying the Proposal (the "Proposing Release") clearly demonstrates the commitment of the Commission, and in particular the Division of Swap Dealer and Intermediary Oversight ("DSIO"), to improving the Commission's regulation of CPOs and CTAs in a manner consistent with the goals of Project KISS, which has served as the framework for the Proposal.

AMG's members have a keen interest in the regulatory regime addressed by the Proposal and have participated actively in the Project KISS initiative.[3] We strongly support the Commission's Project

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1 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.

2 Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors, 83 Fed. Reg. 52,902 (Oct. 18, 2018).

3 AMG's Project KISS submission on registration is available at https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61341 for reference. While the AMG KISS submission addresses many areas that are not expressly addressed by the Proposal, some of the discussions in the submission support our recommendations in this comment letter, and we refer to them where relevant.

KISS goals of simplifying and modernizing the regulation of CPOs and CTAs, with a view toward reducing unnecessary regulatory costs and burdens. AMG also supports the more specific regulatory themes underlying the individual components of the Proposal that are expressed throughout the Proposing Release. These include:

- Focusing the Commission's limited and valuable resources on areas of the most significant regulatory interest;
- Protecting U.S. investors and the U.S. markets;
- Reducing unnecessary regulatory burdens for dual registrants;
- Increasing regulatory certainty;
- Providing comprehensive and flexible exemption options for the Commission's cross border regulation of CPOs and CTAs, in a manner consistent with the above themes; and
- Harmonizing the Commission's CPO and CTA rules with those of its sister regulators, in particular the Securities and Exchange Commission (the "SEC"), where the regulatory goals overlap and where consistent with the Commission's regulatory mandate.

AMG strongly supports the Proposal as a step in the Commission's efforts to simplify the regulatory obligations for CPOs and CTAs, and believes that the great majority of the individual components of the Proposal effectively achieve the KISS objectives. However, we believe that certain specific components of the Proposal will, in practice, have the contrary effect, by adding, rather than reducing, regulatory burdens, and by introducing, rather than eliminating, regulatory uncertainty. Paradoxically, these additional regulatory burdens will have a disproportionate adverse impact in two areas where the Commission's regulatory interest is the most attenuated – offshore activities involving non-U.S. investors and private funds engaging only in *de minimis* commodity interest trading. We believe that the potential adverse impact of these components on our members is both substantial and contrary to the Commission's goals.

The Proposing Release, statements by the Chairman accompanying the Proposal, and Project KISS in general all emphasize the importance of hearing industry comment on what the practical impact of each aspect of the Proposal will be. In that spirit, we identify our specific comments and provide recommendations of alternatives for achieving the Commission's goals without the adverse impact of increasing regulatory burdens and uncertainty that we believe will otherwise follow if the components of the Proposal that we address are adopted as proposed.

I. SUMMARY OF AMG'S COMMENTS AND RECOMMENDATIONS

A. The Proposed 18-96 Exemption and Interaction with Rule 3.10(c)(3)(i)

AMG recommends that the Commission:

1. Adjust the conditions of the proposed "18-96 Exemption" — which would, by their terms, prohibit investment by even a single U.S. person (even if inadvertent), contribution of even a single dollar of U.S. seed money (whether directly or indirectly), or any administrative activity in the U.S.

— to make the exemption both workable in practice and more consistent with the Commission's level of regulatory interest; these adjustments should include:

(a) acknowledging the sufficiency of reasonable efforts to comply with the conditions;

(b) providing a clear and widely understood definition of U.S. person; and

(c) incorporating no-action relief previously granted by the Commission staff to provide appropriate flexibility for the exempt operation of offshore pools with respect to, among other things, seed money and incidental U.S. administrative activity.

2. Adopt and promulgate guidance on the application of Rule 3.10(c)(3)(i) and its interaction with the proposed 18-96 Exemption that:

(a) is consistent with the Commission's historical activities-based approach to the availability of CPO and CTA exemptions, as well as with the language and history of Rule 3.10(c)(3)(i) and the Commission's pending rule proposal relating specifically to Rule 3.10(c)(3)(i);

(b) achieves the Commission's goal of increasing the comprehensiveness and flexibility of CPO registration exemptions for offshore pools that do not involve soliciting or accepting funds from U.S. investors;

(c) avoids the substantial adverse impact on offshore CPO activities that, as the Proposing Release acknowledges, would follow from an entity-based application of Rule 3.10(c)(3)(i); and

(d) is consistent with appropriate constraints on the Commission's assertion of extraterritorial jurisdiction, in accordance with its statutory authority and current U.S. Supreme Court jurisprudence.

B. The Proposed Addition of a Statutory Disqualification Prohibition to Rule 4.13(a)(3), the Proposed 18-96 Exemption, and Certain Other Existing CPO Exemptions

AMG recommends that the Commission:

1. Collect and analyze data sufficient to determine whether the investor protection concern expressed in the Proposing Release – the possibility of fraud and other illegal conduct in the operation of exempt pools – reflects an existing material risk to investors that warrants adding a new regulatory requirement;

2. If the data, when collected and studied, indicate that such an investor protection concern exists, adopt a statutory disqualification condition tailored to address that concern;

3. Except from any final statutory disqualification condition investment advisers registered under the Investment Advisers Act of 1940 (the "Advisers Act");

4. Clarify the mechanism for implementing the disclosure exception to the new prohibition (for example, with respect to SEC-registered investment advisers, through disclosure in the Form ADV filed by the investment adviser); and

5. Provide clarification that conduct described in Section 8a(3) of the Commodity Exchange Act ("CEA") does not constitute a statutory disqualification until the Commission has made a finding, after notice and an opportunity for a hearing, that such conduct has occurred.

C. The Proposed Family Office CPO Exemption – Definition of Commodity Pool

AMG members generally do not have a direct interest in the operation of family offices. However, since the regulation of family offices under Part 4 is premised on a conclusion that family offices involve commodity pools, we recommend that the Commission consider further in this context developing a principles-based definition of the term "commodity pool," which could serve as a more streamlined regulatory alternative to providing individual registration exemptions both for family offices and other types of pooled vehicles. This approach would be consistent with past staff interpretations cited in the Proposing Release, would take into account the new statutory definition of the term "commodity pool" adopted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), and would reduce burdens both on market participants and the Commission. This approach would also be more aligned with the family office exclusion approach taken by the SEC with respect to the same activities.

We address the reasons supporting each of these recommendations below.

II. THE PROPOSED 18-96 EXEMPTION AND INTERACTION WITH RULE 3.10(c)(3)(i)

A. Summary of the Proposal

1. Proposed Rule 4.13(a)(4)

The Commission is proposing to add a new exemption for CPOs of offshore pools that would codify and expand the relief currently provided by Staff Advisory 18-96, and which is referred to in the Proposal as the "18-96 Exemption." Staff Advisory 18-96 ("Advisory 18-96") currently provides registered CPOs with limited relief from the Commission's Part 4 CPO regulations, with respect to the registered CPO's operation of offshore pools that meet the criteria of the Advisory.[4]

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[4] *See* 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). Advisory 18-96 is not an exemption from registration, but rather an exemption from certain regulatory requirements for CPOs that are already registered as such, with respect to their operation of offshore pools. Under Advisory 18-96, the registered CPO is required to comply fully with Part 4 with respect to pools and activities that do not meet the criteria for the exemption.

In connection with codifying Advisory 18-96, the Commission has also proposed amendments to Rule 4.23, the recordkeeping rule applicable to registered CPOs, that would revise the "main business office" requirement of the rule. The Commission has not, however, proposed to amend the main business office provisions of Rule 4.23 to codify exemptive relief previously granted by DSIO for third-party recordkeepers. *See* CFTC Letter No. 14-114

The 18-96 Exemption would be set forth in a new Rule 4.13(a)(4), and would be available to both registered and exempt CPOs with respect to any pool that meets all of the following criteria:

(i) The pool is, and will remain, organized and operated outside of the United States;

(ii) The pool will not hold meetings or conduct administrative activities within the United States;

(iii) No shareholder of or other participant in the pool is or will be a U.S. person;

(iv) The pool will not receive, hold or invest any capital directly or indirectly contributed from sources within the United States; and

(v) The person claiming the exemption, the pool, and any person affiliated therewith will not undertake any marketing activity for the purpose, or that could reasonably be expected to have the effect, of soliciting participation in the pool from U.S. persons.

As an additional condition of proposed Rule 4.13(a)(4), the person claiming the exemption, and its principals, would be subject to the new proposed statutory disqualification prohibition discussed below, which is similar to a condition currently imposed by Advisory 18-96 for registered CPOs.

Like Advisory 18-96, the new exemption would be available on a pool-by-pool basis. However, unlike Advisory 18-96, which is available only to registered CPOs, the 18-96 Exemption would be available to exempt as well as registered CPOs.

A person relying on Rule 4.13(a)(4) would be required to file a notice with the National Futures Association ("NFA"), using the NFA's electronic filing system, identifying each pool for which it is relying on the exemption and representing compliance with the eligibility criteria of the exemption for each pool, and to re-affirm compliance with the criteria for each pool on an annual basis.

2. Interaction with Rule 3.10(c)(3)(i)

The Proposal does not include amendments to Rule 3.10(c)(3)(i), which is currently the subject of a separate pending rulemaking. However, certain statements in the Proposing Release, in particular in the cost-benefit analysis for the proposed 18-96 Exemption, appear to be based on a restrictive "all or nothing" or entity-based interpretation of Rule 3.10(c)(3)(i) that is not widely understood. Under this interpretation, an exempt offshore fund manager relying on Rule 3.10(c)(3)(i) for funds meeting all of the requirements of the rule (for example UCITS established and operated in Europe and

(Sept. 8, 2014) (providing exemptive relief that expands the categories of permitted third-party recordkeepers beyond those identified in the rule). Taking this opportunity to codify the exemptive relief for third-party recordkeepers in Rule 4.23 would increase regulatory efficiency and certainty by reducing confusion on the part of persons who consult Rule 4.23 and may not be aware of the exemptive letter.

distributed in Europe and Asia and whose offering documents prohibit U.S. investors)[5] would forfeit the ability to rely on Rule 3.10(c)(3)(i) for those funds if the manager offered to U.S. investors an entirely separate *de minimis* commodity pool, for which it met all of the Rule 4.13(a)(3) eligibility requirements.[6] Thus, if the offshore UCITS manager wished to sponsor the Rule 4.13(a)(3) fund, it would currently have only two options, both of which, as the Proposing Release acknowledges, would be extremely costly, burdensome, and disruptive. These options would be: (1) registering as a CPO and listing with the Commission all former Rule 3.10(c)(3)(i) funds (of which for some CPOs there could be dozens or even hundreds); or (2) establishing a separate entity for the Rule 4.13(a)(3) fund, at the cost of substantial initial start-up expenses and ongoing operational inefficiencies.[7]

B. The Commission's Regulatory Goals

The Proposing Release describes the practical purpose of Rule 4.13(a)(4) as follows:

> to permit CPOs that solicit and/or accept funds from only non-U.S. persons for participation in offshore commodity pools to claim an exemption from CPO registration requirements with respect to such pools, while permitting the maintenance of registration with respect to commodity pools for which CPO registration is required.[8]

From a policy point of view, the goals specifically addressed in this component of the Proposal are described as follows:

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5 The term UCITS refers to funds established pursuant to the Undertakings for Collective Investments in Transferable Securities Directive.

6 As stated in the Proposing Release, "such reliance [on Rule 3.10(c)(3)(i)] would no longer be permitted, however, once the person is required to register **or claim a CPO exemption** with respect to a commodity pool that is marketed to U.S. persons, that contains funds belonging to U.S. persons, or that is otherwise operated in the U.S., its territories, or possessions" (emphasis added). *See* Proposing Release, 83 Fed. Reg. at 52,914.

7 The Proposing Release explains the costs and burdens of this interpretation as follows:

> Under [Rule] 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.

Id. at 52, 921. The Proposing Release goes on to state that, in contrast to Rule 3.10(c)(3)(i), the proposed 18-96 Exemption would enable the CPO to claim a Rule 4.13(a)(3) exemption with respect to its commodity pools offered to U.S. persons while remaining exempt from CPO registration under proposed Rule 4.13(a)(4) with respect to its qualifying offshore pools, and thus CPOs of offshore pools could transition from Rule 3.10(c)(3)(i) to the 18-96 Exemption as a more flexible option. However, as explained below, widespread transitioning of offshore funds for which offshore entities currently may rely on Rule 3.10(c)(3)(i) to the 18-96 Exemption is not an economically or operationally viable option for offshore funds and managers, and would involve the expenditure of substantial Commission resources as well.

8 *Id.* at 52,903.

- codification, modernization, and expansion of Advisory 18-96, thus eliminating the need for persons to search for a 20-year old staff advisory that still requires paper filings and does not take into account regulatory requirements added since 1996;
- preservation of the Commission's limited resources for U.S. investors, consistent with its historic statements, as noted in the Proposing Release, regarding its jurisdictional scope:

  > "'[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][;]'"[9] and

- benefiting industry participants by providing more comprehensive and flexible relief from CPO and pool regulation than is currently available under existing exemptions.[10]

C. The Commission's Request for Comment

The Commission requests comment on all aspects of the Proposal and on a number of specific matters relating to the proposed 18-96 Exemption. We would like to respond in particular to the following matters on which the Commission has specifically asked for comments:

- whether the interaction between Rule 3.10(c)(3)(i) and the 18-96 Exemption, as described in the Proposing Release, is understood;
- whether the Commission has accurately identified the costs and benefits of the Proposal;
- whether there are additional costs to market participants or the public that may result from the adoption of the Proposal that the Commission should consider (with specific examples and explanations of such costs); and
- whether 30 days would be sufficient time for a qualifying CPO transitioning from reliance on Rule 3.10(c)(3)(i) to the 18-96 Exemption to claim the 18-96 Exemption.

D. AMG's Comments

While AMG is supportive of a new exemption for CPOs of offshore pools that would expand the relief currently available under Advisory 18-96 for registered CPOs, and that could potentially be useful for some categories of exempt CPOs, AMG has two significant concerns with this aspect of the Proposal. The first concern relates to the terms of the proposed exemption itself, and the

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9 *Id.* at 52,904 (alterations in original) (quoting Exemption from Registration for Certain Foreign Persons, 72 Fed. Reg. 63,976, 63,976-77 (Nov. 14, 2007) (citing 48 Fed. Reg. 35,248, 35,261 (Aug. 3, 1983))).

10 The Proposing Release also identifies potential benefits to U.S. investors. The Commission preliminary believes that the proposed 18-96 Exemption may result in additional investment choices to domestic participants and additional competition for CPOs already operating onshore, by making it more likely that more offshore CPOs may choose to create pools available to U.S. participants. *See* Proposing Release, 83 Fed. Reg. at 52,921.

second relates to the unnecessarily restrictive interpretation of Rule 3.10(c)(3)(i) suggested in the Proposing Release.

1. The Terms of Proposed Rule 4.13(a)(4)

a. The Proposed Criteria

The proposed criteria for relying on Rule 4.13(a)(4) are so restrictive that, in practice, many CPOs that might find the new exemption useful in concept may not be able to make the necessary representations.

To demonstrate the lack of flexibility of the conditions, under the express terms of the proposed rule each of the following would eliminate the CPO's ability to rely on the exemption:

- A single U.S. investor in an offshore pool (including an "inadvertent U.S. investor" that was a non-U.S. person at the time of investment but later moved to the United States), even where the pool was offered only to offshore investors with reasonable procedures in place to prevent U.S. investment;
- A single dollar of seed money deemed to come "indirectly" from a U.S. source; or
- A single e-mail or phone call to or from a U.S. person serving as a director of an offshore pool (which is currently contemplated under a series of staff no-action letters).[11]

The restrictive nature of these criteria is at odds with the Commission's intended goals in providing a useful exemption and preserving its resources for the protection of U.S. investors, as well as the Commission's acknowledgment, in other contexts, of the importance of recognizing a *de minimis* level of relevant activity, below which the Commission's regulatory interest is not sufficient to justify regulation.[12] Moreover, the proposed criteria do not take into account prior staff positions, or the regulatory policies underlying these positions, that have previously provided flexibility with respect to U.S. seed money or incidental U.S. administrative activities.[13]

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[11] *See, e.g.,* CFTC Letter No. 00-95 (Oct. 3, 2000); CFTC Letter No. 96-63 (Apr. 25, 1996); and CFTC Letter No. 94-22 (Jan. 24, 1994) (granting relief from CPO registration for U.S. directors of offshore funds, subject to specified representations, which differ in each of the letters). Where U.S. persons serve as directors of offshore funds, as permitted by these letters, it is unrealistic to prohibit, as a condition of the exemption, a single email or phone call to the U.S. director in the United States.

[12] For a discussion of the benefits served by a workable *de minimis* threshold, *see* De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 56,666, 56,668 (Nov. 13, 2018). These include, among others, increasing regulatory efficiency, encouraging new market participants, and focusing the Commission's limited resources.

[13] With respect to seed money, *see, e.g.*, CFTC Letter No. 03-18 (April 4, 2003) ("While [two SEC-registered investment advisers with principal places of business in the United States and affiliates of a U.K. investment adviser] may contribute seed capital to the . . . Funds, the Division does not believe that these contributions constitute participation by U.S. persons."); CFTC Letter No. 97-48 (May 6, 1997) ("[W]e note that the Division has taken the position that the relief available under [Advisory 18-96] (or pursuant to previously issued no-action relief) is not rendered unavailable by the participation in an offshore pool of a U.S. person where that person is, *e.g.*, the pool's CPO, CTA or a principal thereof.").

b. Absence of U.S. Person Definition

While the exemption prohibits even a single U.S. investor, it does not define the category of investors that would be included in this prohibition. This absence of a definition, particularly in a "zero tolerance" context, introduces regulatory uncertainty that is inconsistent with the goals of the exemption and will necessarily present hurdles for scrupulous CPOs required to make, and re-certify annually, the required representations.

Accordingly, we recommend that the Commission adopt a widely used definition of U.S. person as part of the proposed 18-96 Exemption. As described in the AMG KISS Submission, we suggest using the definitions in the SEC's Regulation S. In addition, we suggest that any person falling within the definition of non-U.S. person in Rule 4.7 would also be considered a non-U.S. person for this purpose.[14]

2. "All or Nothing" Entity-Based Interpretation of Rule 3.10(c)(3)(i)

As indicated above, statements in the Proposing Release relating to Rule 3.10(c)(3)(i) appear to suggest an interpretation of the exemption that is not widely understood by market participants. These statements at best introduce significant new uncertainty about the application of Rule 3.10(c)(3)(i) to offshore exempt CPOs and, at worst, articulate an interpretation of the exemption that, if adopted, would cause major disruption to the regulatory status quo and impose substantial new costs and regulatory burdens on offshore market participants.

As discussed further below, such an interpretation of Rule 3.10(c)(3)(i) is neither apparent from nor dictated by the words or history of the rule. Moreover it would be in contrast to the Commission's sound and longstanding application of its other CPO exemptions and exclusions (as well as its CTA exemptions and exclusions), which are available on a pool-by-pool or activities-related basis, so that each discrete set of a CPO's (or CTA's) activities is governed by the appropriate regulatory requirements.

a. Scope of Global Market Participant Reliance on Rule 3.10(c)(3)(i)

Rule 3.10(c)(3)(i) is widely relied on around the world by non-U.S. managers of offshore funds that are not offered to U.S. investors but that may trade in the U.S. commodity interest markets. The types of funds for which offshore firms commonly rely on Rule 3.10(c)(3)(i) are highly diverse and include, for example, UCITS and alternative investments funds ("AIFs") organized as Luxembourg SICAVs, U.K. or Irish OEICs, or French FCPs and sold in Europe and Asia; Toshin Trusts organized and sold in Japan; Australian and Canadian trusts sold respectively in those countries; investment funds organized and distributed in South America and Mexico; and Cayman Segregated Portfolios, which are privately placed and made available primarily to the institutional, high net worth, and other non-retail markets across the globe. The funds for which offshore managers may rely on Rule 3.10(c)(3)(i) span jurisdictions and markets around the world and could number in the thousands. Accordingly, the number of funds, geographic scope, and extent of assets under

14 *See* AMG KISS Submission, *supra* note 3, at 39-42.

management for which offshore managers may rely on Rule 3.10(c)(3)(i) dwarf by comparison the universe of CPOs relying on Advisory 18-96.[15]

b. No Common Understanding that Rule 3.10(c)(3)(i) is Entity-Based

For a number of reasons, we believe there is no widespread or common understanding of the entity-based "all or nothing" interpretation suggested by the Proposing Release.[16] These reasons include:

1. To our knowledge, the Commission has never formally articulated such an interpretation.[17]

2. The language of current Rule 3.10(c)(3)(i), which focuses on transactions on behalf of non-U.S. persons, does not support such an interpretation.[18]

3. The history of Rule 3.10(c)(3)(i) does not dictate such an approach. It is essentially a function of the procedural history of the rule that the exemption is contained in a Part 3 Rule rather

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15 The Proposing Release indicates that the Commission estimates that 50 CPOs currently rely on Advisory 18-96. *See* Proposing Release, 83 Fed. Reg. at 52,923 & n.180. Perhaps related to the limited use of Advisory 18-96, we are aware of no KISS submission that mentioned Advisory 18-96 as a matter on which industry participants sought regulatory action.

16 The Proposing Release states that some market participants take this approach. "The Commission is aware of some offshore CPOs that are currently limiting their CPO activities solely to offshore pools with offshore participants precisely to remain eligible for the exemption provided by [Rule] 3.10(c)(3)(i)." Proposing Release, 83 Fed. Reg. at 52,921. This statement appears to recognize that such an approach is not universal or even widespread.

17 The Proposing Release, 83 Fed. Reg. at 52,094 n.24, states that "[i]n adopting [Rule] 3.10(c)(3)(i), the Commission emphasized the significance of solicitation as a CPO activity, stating '[a]ny person seeking to act in accordance with any of the foregoing exemptions from registration should note that the prohibition on contact with U.S. customers applies to solicitation as well as acceptance of orders. If a person located outside the U.S. were to solicit prospective customers located in the U.S. as well as outside of the U.S., these exemptions would *not* be available, even if the only customers resulting from the efforts were located outside the U.S.' [Exemption From Registration for Certain Foreign Persons, 72 Fed. Reg. 63,976, 63,977-78 (Nov. 14, 2007)] (emphasis in original) (footnote omitted)." However, in light of the Commission's general activities-based approach to exemptions, this would reasonably be read to mean that soliciting prospective U.S. investors in a particular fund would disqualify the CPO from relying on Rule 3.10(c)(3)(i) with respect to that fund, not on an entity-wide basis with respect to offshore pools that did not solicit U.S. investors.

18 In its current form, as adjusted to reflect no-action relief provided by DSIO in 2016, Rule 3.10(c)(3)(i) provides an exemption from CPO registration for a person located outside the United States, its territories or possessions engaged in the activity of a commodity pool operator, in connection with any commodity interest transaction executed bilaterally or made on or subject to the rules of any designated contract market or swap execution facility only on behalf of persons located outside the United States, its territories or possessions, provided that any such commodity interest transaction that is subject to a Commission clearing requirement is submitted for clearing through a futures commission merchant registered in accordance with section 4d of the CEA. *See* CFTC Staff Letter No. 16-08 (Feb. 12, 2016). As the language of the rule indicates, Rule 3.10(c)(3)(i) is a transactional exemption; that is, it provides an exemption for the person engaging in U.S. commodity interest transactions, provided that the other conditions of the exemption are met. Importantly, the phrase "only on behalf of persons located outside the United States" is part of the phrase that describes the transaction.

Rule 3.10(c)(3)(i) is self-executing, and no filing with the NFA or the CFTC is required. Persons relying on Rule 3.10(c)(3)(i) remain subject to the anti-fraud provisions of the CEA.

than a Part 4 Rule. Amendments to Rule 3.10(c) were proposed by the Commission in 2007 with respect to other types of intermediaries (foreign brokers) and Rule 3.10(c)(3)(i) was added in the final rule to provide relief for CPOs as well, without a re-proposal, at the suggestion of the NFA.[19]

4. The amendments to Rule 3.10(c)(3)(i) that are currently proposed in a separate pending rulemaking, which are designed to codify no-action relief provided by DSIO with respect to the types of transactions permitted, support a pool-by-pool rather than an entity-based approach.[20] These amendments would restructure Rule 3.10(c)(3)(i) to be more similar to Rule 4.14(a)(8), which is commonly applied on an activities basis rather than an entity basis (as discussed below in note 21).

5. An entity-based interpretation of Rule 3.10(c)(3)(i) would be contrary to the Commission's longstanding historical approach to CPO and CTA regulation, which is to permit persons engaged in such activities to rely on different exemptions or registration requirements for different activities, as long as the person relying on the exemption for each set of activities complies with the eligibility criteria for the exemption. This approach ensures that each area of the person's activities is appropriately regulated (either pursuant to registration or in accordance with the terms of the relevant exemption), while avoiding unnecessary over-regulation of properly exempt activities where the Commission's regulatory interest is not triggered, and is deeply engrained in the Commission's CPO and CTA regulatory framework.[21]

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19 The 2007 amendments to Rule 3.10(c) were originally proposed as a Part 3 registration rule because they were designed for foreign brokers, for which Part 4 exemptions are not available. The NFA's comment that led to the addition of Rule 3.10(c)(3)(i) to the amendments as proposed is described in the adopting release for the 2007 amendments as follows:

> Similarly, NFA referred to the no-action position taken by the Commission's Office of General Counsel stating that: (1) A person who operates a commodity pool outside of the territorial U.S. is not required to register as a CPO when such a person confines the pool activities to areas outside the territorial U.S., none of the participants in the pool is a resident or citizen of the U.S., and none of the funds or capital contributed to the pool is from U.S. sources . . . .

Exemption From Registration for Certain Foreign Persons, 72 Fed. Reg. 63,976, 63,977 (Nov. 14, 2007).

When, in response to this comment, the Commission determined in the final rule to provide an exemption for CPOs as well, it made sense to include them in the rule as already proposed, rather than create a separate Part 4 rule. Whether included in Part 3 or Part 4, exemptions from CPO registration (unlike exemptions from introducing broker and futures commission merchant registration) relate to the registration requirement imposed by Section 4m(1) of the CEA.

20 *See* Exemption From Registration for Certain Foreign Persons, 81 Fed. Reg. 51,824 (Aug. 5, 2016) (proposal).

21 In some cases, this activities-based approach is expressly incorporated into Commission rules (such as Rule 4.14(c)(2), which permits registered CTAs to treat certain clients as exempt, and Rule 4.14(a)(10), which permits offshore CTAs not to count offshore clients for purposes of complying with the 15 person limit in Section 4m(1)). Importantly, however, the activities-based approach is not limited to these express rules. The Commission and its staff have confirmed that the activities-based approach works as a matter of principle to permit a person to combine exemptions, where each set of activities meets the requirements for the exemption claimed. Specifically, in the release accompanying its adoption of Rule 4.14(a)(8), the Commission confirmed that a CTA could claim an exemption under Section 4m(1) of the CEA for one set of clients and new Rule 4.14(a)(8) for a different set of clients. In this context, the Commission explained this principle as follows:

c. Potential Adverse Impact and Additional Costs of an "All or Nothing" Interpretation

The Proposing Release itself describes the additional costs that would be imposed by an "all or nothing" approach to Rule 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."[22]

The options the Proposing Release offers an offshore CPO wishing to offer both Rule 3.10(c)(3)(i) eligible offshore pools to non-U.S. investors and Rule 4.13(a)(3) eligible *de minimis* funds to qualified U.S. investors are costly indeed. An offshore management company (sometimes referred to as a "ManCo"), which may operate dozens or even hundreds of UCITS, AIFs, or other types of foreign funds around the world, could either (1) register with the Commission with respect to all of its offshore pools; or (2) spin-off the Rule 4.13(a)(3) activities to another entity.

While the Proposing Release acknowledges that both of these options are costly, we believe that the Commission has severely underestimated these costs. CPO registration for these offshore entities with global operations is not a viable option. Nor would we expect the Commission to wish to take on such an additional burden for operations with minimal U.S. contacts. This leaves the option of creating a separate company for the Rule 4.13(a)(3) funds. As the Proposing Release recognizes, this would be at the cost of sacrificing the "operational efficiencies inherent in being able to deploy the same institutional resources across all pools it operates, rather than bifurcating staff and assets across affiliates . . . ."[23] These costs are difficult to quantify but logic and experience dictate that duplication of staff, governance structure, and operations would involve a significant and ongoing drain on economic and human resources. Among other costs not mentioned in the Proposing Release, setting up an additional management company would involve entering into, and possibly renegotiating, duplicate agreements with service providers, confusion for clients and customers, and additional duplicative capital requirements.

Moreover, the Proposing Release does not acknowledge the substantial costs and time involved in the creation of a new management affiliate. In many jurisdictions this involves a lengthy regulatory

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> [T]he Commission wishes to make clear that the relief provided by [Rule] 4.14(a)(8) is mutually exclusive from that provided by section 4m(1), that is, depending upon the nature of its activities a CTA may be exempt from registration as such under either or both provisions. **Thus, the fact that a CTA who is claiming exemption under [Rule] 4.14(a)(8) has more than 15 clients for the purpose of that rule will not affect the CTA's ability to claim exemption under section 4m(1) for a different set of clients – i.e. clients who are other than [Rule] 4.5 trading vehicles**.

See Relief From Regulation as a Commodity Trading Advisor for Certain Persons; Relief From Compliance With Subpart B of Part 4 for Certain Commodity Pool Operators; Disclosure Documents and Annual Reports, 52 Fed. Reg. 41,975, 41,978 (Nov. 2, 1987) (emphasis added); *see also* CFTC Interpretive Letter No. 05-13 (Aug. 15, 2005).

[22] Proposing Release, 83 Fed. Reg. at 52,921.

[23] *Id.*

review and approval process. In the United Kingdom, for example, the process often takes up to a year, and in Luxembourg even longer (from 18 to 24 months). Moreover, such a process is likely to raise questions – and perhaps skepticism – on the part of foreign regulators being asked to devote their resources to considering a second management company.

The Proposing Release also offers, as a third alternative, the option of transitioning from Rule 3.10(c)(3)(i) to the new 18-96 Exemption, and indeed a substantial component of the benefits attributed to the proposed 18-96 Exemption is based on its availability on a pool-by-pool basis. The Proposing Release does not take into account, however, the full extent of the costs that would be involved in transitioning from Rule 3.10(c)(3)(i) to the 18-96 Exemption. As described above, this could involve some thousands of funds and a significant number of new and annually re-certified filings. Rule 3.10(c)(3)(i) is self-executing for good reason. The minimal regulatory interest of the Commission in offshore activities that do not involve U.S. investors or U.S. firms addressed by that exemption, together with the difficulties inherent in regulating on an extraterritorial basis, dictates the hands off approach taken in Rule 3.10(c)(3)(i). The pool-by-pool filing and certification process contemplated by the 18-96 Exemption, which was developed in Advisory 18-96 for CPOs that are already registered with the Commission, is not workable on a global scale. The 18-96 Exemption is not a viable substitute for Rule 3.10(c)(3)(i) for global fund managers.[24]

Requiring such a transition through an entity-based interpretation of Rule 3.10(c)(3)(i) could also have unintended consequences. As this interpretation and its implications are not universally understood, it would be appropriate for the Commission and its staff to engage in outreach and educational efforts to inform the global community of this position. Such efforts, in addition to taxing the Commission's limited resources with respect to activities that do not involve U.S. investors, could have the effect of discouraging offshore participation in the U.S. markets, with a resulting loss of U.S. market liquidity. Offshore fund sponsors and managers receiving such outreach and education from the Commission could well determine that participation in the U.S. commodity interest markets is no longer worth the cost.

Significantly, there is no regulatory need to look to the 18-96 Exemption as a solution for the costs and burdens of an entity-based interpretation of Rule 3.10(c)(3)(i). The far simpler and more streamlined solution is to interpret Rule 3.10(c)(3)(i) in a manner that does not cause these problems in the first place. As indicated above, the entity-based interpretation creating the adverse impact is not required by the language or history of Rule 3.10(c)(3)(i). Such an interpretation is also at odds with the Commission's general approach to CPO regulation and exemptions. The very same benefits that the Proposing Release identifies as flowing from a pool-by-pool application of the 18-96 Exemption – focusing the Commission's limited resources on U.S. investors, providing flexible

24 As one example of the practical difficulties a filing model poses, in contrast to the self-executing model, the 18-96 Exemption would require global managers to determine who is the CPO required to make the filing. As the Commission knows, this is a subject of much Commission and industry debate and has been no easy task even for U.S. governance structures (for example, U.S. registered funds) and has spawned a lengthy regulatory history addressing delegation of the CPO function (which ultimately the Commission decided to address on a self-executing basis). These difficulties are magnified in the case of foreign structures and foreign operational arrangements. The time and legal expense that would be required to perform that analysis for diverse fund structures around the world must be factored into the Commission's cost-benefit analysis. To the extent this process were feasible at all, the 30-day transition period proposed by the Commission would not be adequate.

options for offshore CPOs, and providing more investment options for U.S. investors – can far better be achieved, and with much less additional cost and disruption, under an appropriate interpretation of Rule 3.10(c)(3)(i).[25]

One final point supports an activities rather than entity-based interpretation of Rule 3.10(c)(3)(i). The Dodd-Frank Act gave the Commission substantial authority to strengthen the customer protections available in the U.S. commodity interest markets, independently of its jurisdiction over regulated entities. In the past decade the Commission has successfully employed this authority to adopt reforms applicable to all market participants. These include substantially heightened transparency, reporting, market surveillance, and enforcement powers, all designed to protect the operation of the markets and their participants. These additional regulatory powers, and the market reforms of the past decade, should be considered in addressing the extent of the need for offshore entity regulation.

e. Jurisdictional Constraints on Extraterritorial CPO Regulation

The CEA, from which the Commission draws its regulatory mandate, is silent on the extraterritorial application of the Act's CPO registration and regulation provisions. This Congressional silence calls for restraint in the Commission's regulation of offshore CPO activities that do not involve U.S. investors. As the Supreme Court has stated in the seminal case of *Morrison v. Australian National Bank*, "unless there is the affirmative intention of the Congress clearly expressed to give 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."[26]

The Commission's jurisdiction over offshore funds that do not involve U.S. investors is based on such a fund's use of the U.S. commodity interest markets. We understand that, in the Commission's view, such an offshore fund, by virtue of participation in the U.S. markets, falls within the definition of commodity pool, and its offshore operator within the definition of CPO. Rule 3.10(c)(3)(i), which is self-executing, recognizes the Commission's limited regulatory interest in such funds and managers as entities, and addresses instead their participation in the U.S. markets.

The Proposal, in suggesting the 18-96 Exemption as a viable substitute for Rule 3.10(c)(3)(i), does not recognize these limits. Forcing global managers of the extensive universe of funds outside the United States to choose among CPO registration with the Commission, inefficiently fragmented operations, and burdensome ongoing Commission-mandated filings – as the Proposing Release

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25 While we do not believe that a restrictive entity-based interpretation of Rule 3.10(c)(3)(i) — which the Proposing Release identifies as the source of the problems described in the Release — is dictated by the terms of the rule, if the Commission or staff disagrees and believes that the Commission is constrained by the current wording, another simple and streamlined approach (relative to urging a world-wide transition to an entirely new exemption with burdensome filing requirements) would be to make the necessary adjustments in the context of the pending Rule 3.10(c)(3)(i) rulemaking.

26 *See* Morrison v. National Australia Bank, 561 U.S. 247, 255 (2010) ("*Morrison*") (internal citations omitted); *see also In re* North Sea Brent Crude Oil Futures Litigation, 256 F. Supp. 3d 298 (S.D.N.Y. 2017) (applying the presumption against extraterritoriality to the CEA). The relationship between *Morrison* and the Commission's CPO and CTA regulation is discussed further in the AMG KISS Submission, *supra* note 3, on pages 34-36.

recognizes would be the result of its "all or nothing" Rule 3.10(c)(3)(i) interpretation – would have an extraterritorial impact that is both entirely out of proportion with the Commission's regulatory interest and outside of the dictates of the *Morrison* doctrine.

The Commission's interpretation of Rule 3.10(c)(3)(i) should be guided by the *Morrison* principles and the limits of its statutory extraterritorial mandate.

III. THE PROPOSED PROHIBITION ON STATUTORY DISQUALIFICATIONS

A. Summary of Proposal

The Commission is proposing a new Rule 4.13(a)(6) that would add a statutory disqualification condition for persons claiming the exemptions provided by Rules 4.13(a)(1) through (a)(5). The covered exemptions include Rule 4.13(a)(3), the exemption for CPOs of private funds engaged in *de minimis* commodity trading activities, on which AMG members widely rely, as well as the proposed 18-96 Exemption.

Proposed Rule 4.13(a)(6) would provide that any person who desires to claim an exemption under any of the covered rules must represent that neither the person nor any of its principals is subject to any statutory disqualification under Section 8a(2) or 8a(3) of the CEA, unless such disqualification arises from a matter which was previously disclosed in connection with a previous application, if such registration was granted, or which was disclosed more than thirty days prior to the claim of this exemption.

As with other conditions of the exemptions, the person claiming the exemption must re-affirm annually the accuracy of the representation.

B. The Commission's Regulatory Goals

The Commission's proposal to impose the new statutory disqualification condition on exempt CPOs is primarily based on customer protection concerns. The Proposing Release states that the proposed amendment would provide additional customer protection because "statutorily disqualified, unregisterable persons would no longer be permitted to claim the CPO exemptions under [Rules] 4.13(a)(1) through (a)(5)."[27]

The Proposing Release explains the statutory disqualification provisions as follows:

> Under CEA section 8a(2), for instance, the Commission may refuse to register a person who has been temporarily or permanently enjoined by order not to act as a Commission registrant, or to refrain from engaging in financially criminal activities, or who, within ten years preceding the application for registration with the Commission, has been convicted of a felony for criminal activities involving commodity interests or securities, or been found by the Commission or another

[27] Proposing Release, 83 Fed. Reg. at 52,914.

> governmental body or agency to have violated the CEA, Commission regulations, or securities laws.[28]

Accordingly, the proposed new prohibition on statutory disqualifications would "provid[e] additional protection to members of the public by reducing the possibility of fraud and other illegal conduct in exempt pools offered by such persons."[29]

The statutory disqualification prohibition is based on a condition currently required under Advisory 18-96 for registered CPOs. The Proposing Release states that the Commission preliminarily believes that there are significant benefits to adopting this prohibition as a criterion for all of the exemptions under Rules 4.13(a)(1) through (a)(5). The concern is that, absent the statutory disqualification prohibition, pool participants may be exposed to risk posed by rules permitting the operation of an offered pool by a person who, generally, would not otherwise be permitted to register with the Commission. The Commission believes, at least on a preliminary basis, that "[e]ven if the activities of a CPO do not rise to a level warranting Commission oversight through registration, a prospective participant should be able to be confident that a collective investment vehicle using commodity interests is not operated by a person who, for example, is enjoined from engaging in fraud or embezzlement."[30] Similarly, the proposed prohibition "would permit participants in commodity pools exempt under [Rules] 4.13(a)(1)–(a)(5) to be assured that the CPO managing their assets is, at least not statutorily disqualified."[31]

C. The Commission's Requests for Comments

The Commission has generally requested comment on the impact of adopting this provision on industry participants and currently exempt CPOs. We would like to respond concerning the potential impact in general and, in particular, address the following matters on which the Commission has specifically asked for comment:

- the concerns and benefits associated with the expansion of the prohibition on statutory disqualifications to the covered exemptions;
- whether the limited disclosure exceptions that would permit certain statutory disqualifications would successfully address any unintended consequences of adding the prohibition to Rule 4.13,

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[28] *Id.* at 52,906 n.38.

[29] *Id.* at 52,924.

[30] *Id.* at 52,921-22. The Proposing Release states that the customer protection concerns arose in connection with certain statutorily disqualified CPOs operating commodity pools under the exemption previously available under now rescinded Rule 4.13(a)(4), which prior to 2012 provided a broad exemption for CPOs of certain private funds without a commodity interest trading or marketing restriction. *See id.* at 52,906 n.39. In assessing the current need for a statutory disqualification prohibition for CPOs relying on the covered exemptions, the Commission should consider the different levels of regulatory interest in a CPO that relied on prior Rule 4.13(a)(4), which did not impose *de minimis* trading restrictions or limit pool participants to non-U.S. investors, versus a CPO relying on Rule 4.13(a)(3) or the proposed 18-96 Exemption, which do impose such restrictions, respectively.

[31] *Id.* at 52,922.

while still providing a base level of customer protection by preventing statutorily disqualified individuals from legally operating exempt commodity pools;

- how the Commission should handle the implementation of the statutory disqualification prohibition; and
- whether the Commission has accurately identified the costs and benefits of the Proposal, and whether there are additional costs to market participants or the public that the Commission should consider.

D. AMG's Comments

AMG fully supports the Commission's customer protection goals of reducing the possibility of fraud and other illegal conduct in exempt pools. We have a number of recommendations for adjusting the Commission's approach.

1. Further Assessment of the Need for Regulation Prior to Adopting New Rules

The Proposing Release does not provide any data or other information indicating that persons guilty of financial misconduct are, in fact, currently operating exempt pools, and indicates that it lacks data sufficient to determine how many CPOs would be affected.[32] AMG recommends further collection of information and study to determine whether additional customer protections are in fact needed before adopting a new regulation, in order to appropriately conduct the required cost-benefit analysis and develop a rule tailored to address the concerns discovered.

In this connection, it is worth noting that unlike most of the other components of the Proposal, proposed Rule 4.13(a)(6) would not be a codification of existing relief (except in very limited circumstances), nor is it intended to simplify the regulation of CPOs and CTAs.[33] Rather, the proposed rule would impose a substantial new regulatory requirement for CPOs of exempt pools relying on longstanding, pre-existing exemptions that already, under their existing eligibility criteria, impose considerable restrictions on the CPO's regulated activities. Depending on how certain elements of the proposal are interpreted, this new condition could impose substantial new compliance burdens, rather than relieving existing burdens. While preventing fraud and other misconduct in the operation of exempt pools is a goal that AMG members fully share, the compliance burdens must be taken into account in any new regulation, even those designed with this important goal in mind, to ensure that the new burdens are appropriate to the benefits likely to be achieved.

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[32] *See id.* at 52,923 ("With respect to the expansion of the statutory disqualification prohibition to exemption claimants under [Rules] 4.13(a)(1) through (a)(5), the Commission lacks data sufficient to determine how many CPOs might be required to cease operating commodity pools pursuant to the exemptions available thereunder, due to the presence of statutorily disqualified principals.").

[33] The statutory disqualification prohibition is based on a current component of Advisory 18-96, which applies only to a limited number of registered CPOs.

2. Tailoring the Condition to Meet the Regulatory Goals

If the Commission determines that fraudulent or other financial misconduct by exempt CPOs is an existing concern that a statutory disqualification condition would address, we recommend that the condition be tailored to achieving that goal, through the following adjustments to the condition.

a. Carve-Out for SEC-Registered Investment Advisers

SEC-registered investment advisers ("RIAs") and their associated persons are already subject to a statutory disqualification screening and disclosure process under the Advisers Act, and RIAs to SEC-registered investment companies ("Registered Funds") are subject to additional disqualification provisions under the Investment Company Act of 1940 (the "ICA").[34] The SEC may deny, suspend, place limitations upon, or revoke registration as an investment adviser based on specified financial misconduct, and RIAs are required to update disclosure of statutory disqualifications and other disciplinary actions on an ongoing basis.

The SEC's statutory disqualification requirements have the same investor protection goals as those of the Commission. Accordingly, RIAs claiming the relevant exemptions would already be screened by the SEC for conduct indicating a propensity for fraud or financial misconduct, and thus a second set of rules designed to achieve the same objective would be duplicative and unnecessary. Importantly, clients and investors relying on RIAs would have the advantage of disclosure about disciplinary events through the RIA's Form ADV, including in the associated brochures that are delivered to clients at the outset of the relationship, annually, and on an ongoing basis where there is a new required disclosure of a disciplinary matter. Moreover, as part of the investment adviser registration process, the SEC specifically advises RIAs that, as fiduciaries, they have an ongoing obligation to inform their clients of any material information that could affect the advisory relationship.[35]

Customer protection through registration and disclosure presents an ideal opportunity for harmonization with the SEC, a sister regulator that also has a core mission and long history of protecting investors. Imposing an additional set of related regulations would require setting up a new compliance program, training personnel in new rules, and conducting ongoing monitoring for overlapping but not identical circumstances, both of which are designed to achieve the same goal. Accepting the SEC's statutory disqualification and disclosure regime as substituted compliance for

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34 *See* Section 203(e) of the Advisers Act, which allows the SEC to suspend, place limitations upon, or revoke RIA registration based on stated categories of misconduct, and Section 203(f), which allows the SEC to suspend, place limitations upon, or bar associated persons or persons seeking to become associated with an RIA if certain of the criteria of Section 203(e) are applicable, in both cases subject to procedural requirements. Section 203(c)(2)(B) of the Advisers Act identifies the conduct described in Section 203(e) as grounds for denial of registration. *See also* Section 9(a) of the ICA, which prohibits service as an investment adviser or in certain other capacities with respect to a Registered Fund for the person, or an affiliate, based on adjudications of certain types of misconduct, and Section 9(b) of the ICA, which allows the SEC to prohibit such service based on broader categories of misconduct. *See also* Item 11 of Form ADV Part 1A and Item 9 of Form ADV Part 2A, which govern disclosure of financial misconduct.

35 *See* Instructions for Part 2A of Form ADV: Preparing your Firm Brochure, Note to Instruction 2, *available at* https://www.sec.gov/about/forms/formadv-part2.pdf.

purposes of relying on the Commission's CPO exemptions would eliminate these unnecessary costs without sacrificing the Commission's investor protection goals.

b. Limiting the Prohibition to Statutory Disqualifications Identified in Section 8a(2)

The CEA does not provide a definition of the terms "statutory disqualification," "subject to a statutory disqualification," or "statutorily disqualified person." Rather, Sections 8a(2) and 8a(3) set forth two lists of circumstances relating to misconduct under which the CFTC may refuse to grant or may condition a registration application or, under Section 8a(2), revoke or suspend registration. The circumstances in the two sections differ significantly with respect to the severity of the misconduct, whether the misconduct has been adjudicated, and the time period during which the misconduct occurred.

Section 8a(2) identifies circumstances that generally involve (i) more severe misconduct (*e.g.,* financial fraud or theft) and (ii) the existence of formal court or agency action, mostly within a five or ten year period. The CFTC is authorized to refuse, condition, restrict or suspend registration based on the existence of any of the circumstances identified in Section 8a(2), after notice but without the opportunity for a hearing, and may revoke registration based on such conduct after an appropriate hearing.

Section 8a(3) identifies a much broader set of circumstances that could form the basis for the Commission to refuse or condition (but not revoke or suspend) registration, if it is found, after notice and opportunity for a hearing, that the person engaged in the type of misconduct identified. These circumstances are set forth in fourteen paragraphs (A through M), refer to conduct of a less severe nature that may be more remote in time (relative to Section 8a(2)), and include a catchall provision (if "there is other good cause"). The conduct identified in Section 8a(3) goes far beyond the concepts of fraud and financial crime that the Proposing Release identifies as the basis of concern supporting the new condition. Accordingly, we recommend that if the Commission determines to adopt a statutory disqualification prohibition as a criterion for the covered exemptions, it should cover at most Section 8a(2).[36]

3. Clarification of Disclosure Carve-Out

The proposed condition would provide an exception for statutory disqualifications that were disclosed in a registration application, if the registration was granted, or disclosed thirty days prior to the filing of the exemption. However, neither the Proposal nor the Proposing Release indicates how this disclosure would be made for exempt CPOs (that are not subject to the registration process), or what would follow from the disclosure (for example, possible further inquiry or action by the NFA or the Commission).

The disclosure carve-out could be a useful feature of the proposed provision. We recommend that the Commission provide a clear mechanism for such disclosure as well as a clear indication of what, if anything, follows from such disclosure. With respect to RIAs, if the Commission does not

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36 Note that the term "statutory disqualification" as used in Sections 8a(2) and (3) refers only to conduct described in Section 8a(2). *See* Section 8a(2)(H) and Section 8a(3)(L) of the CEA.

provide the exception for RIAs recommended above, the disclosure mechanism should be satisfied by making the required disclosure in the RIA's Form ADV.

4. Clarification of the Term "Statutory Disqualification" with Respect to Conduct Listed in Section 8a(3)

Whether or not the Commission adopts the proposed prohibition, either in its proposed form or as adjusted to meet concerns raised in the comment process, AMG recommends that the Commission take this opportunity to clarify application of the term "statutory disqualification" to the categories of conduct identified in Section 8a(3). Specifically, we ask the Commission to clarify that a person is not "statutorily disqualified" or "subject to a statutory disqualification" under Section 8a(3) until the Commission has made the required finding with respect to the conduct at issue.

Unlike Section 8a(2), which authorizes the Commission to take adverse registration action without a hearing based on conduct that has already formally been found to have occurred, Section 8a(3) authorizes Commission action only if it is found, after opportunity for a hearing, that the conduct occurred. These procedural protections are critical because the categories of conduct listed in Section 8a(3) are extremely broad and subjective, and do not generally set a time limit on when the conduct occurred (in contrast to most of the categories in Section 8a(2), which generally have a five- or ten-year cut-off). As indicated above, for example, Section 8a(3) includes a catchall provision that applies where "there is other good cause."

Considering a person to be "statutorily disqualified" under Section 8a(3), with adverse regulatory consequences, but without the hearing and finding required by Section 8a(3), would violate the due process protections Congress built into the statute. Since the Commission could not refuse registration under Section 8a(3) without the finding, it would certainly not be fair or consistent with the statute to bar a person from operating an exempt pool absent such a finding. Nor should the person be characterized as "unregisterable" or other adverse regulatory consequences be permitted on the basis of Section 8a(3) unless and until such a finding is made.

Beyond the fundamental fairness issue, as well as inconsistency with the terms of the statute, treating Section 8a(3) conduct as a "statutory disqualification" without a finding would raise insurmountable compliance and monitoring issues. In addition to the "other good cause" category, Section 8a(3) refers to a number of other types of conduct that do not involve objectively determined facts, could relate to remote time periods and/or be minor in nature, or may simply not be known or verifiable at the time a claim is being filed, all without any necessary connection to the person's qualifications for operation of exempt pools. Requiring CPOs to monitor for such a broadly defined range of conduct, both for the entity itself and its principals, would introduce significant additional regulatory burdens, without an apparent commensurate regulatory benefit.[37]

[37] The regulatory burdens and uncertainty involved in monitoring for statutory disqualifications, in particular under Section 8a(3) absent the requirement of a Commission finding, would be especially troublesome for offshore firms as this would involve keeping track of foreign regulatory and enforcement actions that may not easily fit into the Section 8a categories, thus involving interpretive issues for the offshore firm without clear guidance.

IV. THE PROPOSED FAMILY OFFICE EXEMPTIONS – DEFINITION OF COMMODITY POOL

The proposed family office exemptions do not relate specifically to activities that are a central concern to AMG members, and we would defer to the views of family offices themselves on this component of the Proposal. However, AMG would like to comment briefly on the general approach reflected in the proposed exemptions with respect to the definition of the term "commodity pool." The Proposal appears to assume that family offices will be commodity pools, and that persons managing these offices will be CPOs and CTAs, based on a very broad interpretation of the term "commodity pool."

As we discussed in the AMG KISS submission, we have concerns about the overly broad interpretation of the term commodity pool that has been adopted by the Commission and the staff:

1. Interpreting the term broadly – to include any pooled vehicle that holds even a single swap or other commodity interest – effectively reads out of the statutory definition the key phrase "operated for the purpose of trading in commodity interests."

2. Following the Dodd-Frank Act's expansion of the definition of commodity interest, such a broad interpretation means that a virtually limitless universe of financial vehicles could be considered commodity pools, whose sponsors could thus be considered CPOs, and thus (a) creates substantial uncertainty for market participants and (b) places significant resource demands both on the industry and on the Commission and its staff to determine which vehicles are or are not commodity pools.[38]

3. The term commodity pool appears in a broad range of contexts (including the definitions of eligible contract participant and financial entity, which themselves are critical in a range of situations encountered by market participants), and thus clarity about the definition is important far beyond the CPO and CTA context.

In the AMG KISS submission, we recommended development of a principles-based definition that would provide more certainty for market participants and be less of a drain on Commission resources. We recommend that the Commission consider such an approach as either an alternative or adjunct to the family office exemptions.

V. CONCLUSION

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[38] Importantly, characterization of a vehicle as a commodity pool can also have substantial follow-on consequences for market participants. For example, investors in such vehicles would then themselves have to consider their own commodity pool status. Such potential inadvertent consequences have been brought to light recently in connection with notes issued by the Freddie Mac Structured Agency Credit Risk ("STACR") Trust, where the Trust has been deemed a commodity pool by virtue of its holding a "single swap." *See* CFTC Letter No. 14-111 (Aug. 25, 2014). If the Commission does not believe the family office proposal is the appropriate occasion to address these issues more broadly, we hope it will do so in connection with a future proposal. At that time, we believe there will be a number of types of pooled vehicles that deserve special attention in this regard (for example, Rule 529 plans, endowments, and the many types of securitization vehicles).

In closing, AMG would like to emphasize its support for the Commission's KISS initiative and its implementation of the KISS objectives in the Proposal. In this letter, we have limited our comments to specific items raised in the Proposal. However, we look forward to the next round of proposals designed to implement the KISS objectives by streamlining the Commission's regulation of CPOs and CTAs. We hope that in these further proposals, the Commission will look to AMG's KISS submission and those of similarly situated market participants with a view to addressing areas we have identified as our greatest concerns.[39]

* * *

AMG appreciates the Commission's consideration of these comments and stands ready to provide any additional information or assistance concerning these topics that the Commission might find useful. Should you have any questions, contact Jason Silverstein at 212-313-1176 or jsilverstein@sifma.org, or Andrew Ruggiero at 212-313-1128 or aruggiero@sifma.org.

Respectfully submitted,

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cc: The Honorable Chairman J. Christopher Giancarlo
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[39] As one example, we fully support the Commission's intention, as expressed in the Proposing Release, to revisit the bona fide hedging definitions used in the Rule 4.5 *de minimis* trading calculation in connection with the Commission's consideration of bona fide hedging as part of its position limits rulemaking. In this connection, we hope that the Commission will also revisit the appropriate levels at which margin and notional amounts should be set to measure *de minimis* trading in both Rule 4.5 and Rule 4.13(a)(3) in light of: (i) the great increase in the universe of commodity interests represented by the addition of swaps following the implementation of the Dodd-Frank Act (including*, e.g.,* interest rate swaps, which are longer duration and therefore generally have higher margin than futures for a given notional amount); (ii) the prevalent use of these instruments as risk-reducing hedge instruments; and (iii) the systemic benefits of bona fide hedging generally.