

COMMODITY FUTURES TRADING COMMISSION

**17 CFR Parts 1, 4, 41, and 190**

**RIN 3038-AE67**

**Bankruptcy Regulations**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Commodity Futures Trading Commission (the “Commission”) is proposing amendments to its regulations governing bankruptcy proceedings of commodity brokers. The proposed amendments are meant to comprehensively update those regulations to reflect current market practices and lessons learned from past commodity broker bankruptcies.

**DATES:** Comments must be received on or before July 13, 2020.

**ADDRESSES:** You may submit comments, identified by “Part 190 Bankruptcy Regulations” and RIN 3038-AE67, by any of the following methods:

- *CFTC Comments Portal:* <https://comments.cftc.gov>. Select the “Submit Comments” link for this rulemaking and follow the instructions on the Public Comment Form.
- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.
- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. To avoid possible delays with mail or in-person deliveries, submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <https://comments.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (FOIA), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission's regulations.<sup>1</sup>

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from <https://comments.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the FOIA.

**FOR FURTHER INFORMATION CONTACT:** Robert B. Wasserman, Chief Counsel and Senior Advisor, 202-418-5092, [rwasserman@cftc.gov](mailto:rwasserman@cftc.gov) or Kirsten Robbins, Associate Director, 202-418-5313, [krobbins@cftc.gov](mailto:krobbins@cftc.gov), Division of Clearing and Risk; Andree Goldsmith, Special Counsel, 202-418-6624, [agoldsmith@cftc.gov](mailto:agoldsmith@cftc.gov) or Carmen

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<sup>1</sup> 17 CFR 145.9. Commission regulations referred to in this release are found at 17 CFR chapter I (2019), and are accessible on the Commission's website at <https://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm>.

Moncada-Terry, Special Counsel, 202-418-5795, *cmoncadaterry@cftc.gov*, Division of Swap Dealer and Intermediary Oversight, in each case at the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

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## **I. Background**

### *A. Background of the NPRM*

The basic structure of the Commission’s bankruptcy regulations, part 190 of title 17 of the Code of Federal Regulations, was proposed in 1981 and finalized in 1983.

While there have been a number of rulemakings that have amended part 190 in light of specific issues or statutory changes, this is the first comprehensive revision of part 190.

The Commission is proposing to revise part 190 comprehensively in light of several major changes to the industry over the past 37 years, including the exponential growth in the speed of transactions and trade processing. In addition, important lessons have been learned over prior bankruptcies, including the need for administrative arrangements that are specific to the circumstances of the individual bankruptcy and the success of an approach, consistent with applicable statutes, that prioritizes cost effectiveness and promptness over precision.<sup>2</sup> Finally, derivatives clearing organizations (“DCOs”) have become increasingly important to the financial system.

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<sup>2</sup> The concept of prioritizing cost effectiveness and promptness over precision is discussed in detail in overarching concept three in the cost-benefit considerations, section IV.C.3 below.

In proposing these rules, the Commission is exercising its broad power under the Commodity Exchange Act (“CEA” or “Act”) to make regulations with respect to commodity broker debtors. Specifically, section 20(a) states that notwithstanding title 11, the Commission may provide, with respect to a commodity broker that is a debtor under chapter 7 of title 11, by rule or regulation (1) that certain cash, securities, other property, or commodity contracts are to be included in or excluded from customer property or member property; (2) that certain cash, securities, other property, or commodity contracts are to be specifically identifiable to a particular customer in a specific capacity; (3) the method by which the business of such commodity broker is to be conducted or liquidated after the date of the filing of the petition under such chapter, including the payment and allocation of margin with respect to commodity contracts not specifically identifiable to a particular customer pending their orderly liquidation; (4) any persons to which customer property and commodity contracts may be transferred under section 766 of title 11; and (5) how the net equity of a customer is to be determined.<sup>3</sup>

In developing this rulemaking, the Commission benefited from outside contributions.

On September 29, 2017, the Part 190 Subcommittee of the Business Law Section of the American Bar Association (“ABA Committee”) submitted a model set of part 190 rules (the “ABA Submission”) in response to the Commission’s Project KISS (“Request for Information”).<sup>4</sup>

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<sup>3</sup> See CEA section 20(a), 7 U.S.C. 24(a).

<sup>4</sup> 82 FR 23765 (May 3, 2017). The ABA Submission can be found at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61331&SearchText>; the accompanying

As the ABA Committee noted,

The [part 190 regulations] have generally served the industry, bankruptcy professionals and customers well. That said, the [ABA] Committee believes there is a need to update [p]art 190 in a comprehensive manner, as the markets – and how they are regulated – have changed dramatically in the intervening decades. At the same time, it is important to stay true to the sound conceptual elements of the existing rules with respect to account class distinctions, porting of customer positions, and pro rata distribution of customer property by account class, with priority given to public customers. The Committee was also spurred to act by the MF Global and Peregrine Financial Group bankruptcies, and the lessons they revealed on the challenges of liquidating a large [futures commission merchant (“FCM”)] that is severely under-segregated.<sup>5</sup>

The ABA Committee started its work in 2015, conducting a review of the Commission’s part 190 regulations to identify potential areas for improvement, with the plan to draft comprehensive revisions in the form of model rules that the Commission could consider for potential agency rulemaking. The ABA Committee included participants who represented a broad cross-section of interested parties, in particular attorneys who work extensively in the areas of derivatives law, bankruptcy law, or both, including at law firms, futures commission merchants, clearing houses and exchanges, government agencies,<sup>6</sup> and industry associations. The ABA Committee also included attorneys for the trustees in the commodity broker bankruptcy cases of MF Global and

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cover note (“ABA Cover Note”) can be found at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61330&SearchText>.

The ABA Cover Note cautions that “[t]he views expressed in this letter, and the proposed Model Part 190 Rules, are presented on behalf of the [ABA] Committee. They have not been approved by the House of Delegates or Board of Governors of the ABA and, accordingly, should not be construed as representing the policy of the ABA. In addition, they do not represent the position of the ABA Business Law Section, nor do they necessarily reflect the views of all members of the Committee.”

<sup>5</sup> ABA Cover Note at 2.

<sup>6</sup> The Committee members included staff at government agencies other than the Commission. Current Commission staff participated in a few meetings of the Committee (in the form of “brainstorming exercises”) to discuss their understanding of the current regulations. Commission staff “expressly conveyed that they did not want to direct the Committee’s deliberations, and they were careful not to offer comments that could be construed as trying to persuade the Committee to any particular viewpoint on any particular issue. They were also clear that their comments did not represent the views of the Commission, or of anyone other than the person expressing them.” ABA Cover Note at 3 n. 5.

Peregrine Financial Group, as well as attorneys who were formerly staff at the Commission, including one of the drafters of the original rules.<sup>7</sup> Each of the members devoted significant amounts of time to this project.

The resulting ABA Submission represents a consensus across this broad range of interests, thoughtfully and comprehensively addressing the issues presented in part 190, and assisting the Commission in developing a deeper understanding of the practical issues involved in commodity broker bankruptcy proceedings. Today's notice of proposed rulemaking ("NPRM") has benefited significantly from the ABA Submission, as well as conversations between Commission staff and members of the ABA Committee, both individually and collectively, to understand their thinking with respect to various aspects of the ABA Submission.

*B. Major themes in the proposed revisions to part 190*

While the proposed revised part 190 carries forward significant portions of existing part 190, there are important changes that are proposed. The major themes in changes to part 190 include the following:

- 1) The Commission is proposing to add § 190.00, which is designed to set out the statutory authority, organization, core concepts, scope, and rules of construction for part 190. This section is intended to set out, subject to notice and comment rulemaking, the Commission's thinking and intent regarding part 190 in order to benefit and to enhance the understanding of DCOs, FCMs, their customers, trustees,<sup>8</sup> and the public at large.

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<sup>7</sup> See generally *id.* at 3.

<sup>8</sup> Including bankruptcy and SIPA trustees, as well as the FDIC in its role as a receiver.

- 2) Some of the changes would further support the implementation of the requirements, established consistent with section 4d of the CEA, that shortfalls in segregated property should be made up from the FCM's general assets, while others further the preferences, established in title 11 of the United States Code (*i.e.*, the "Bankruptcy Code"), section 766(h), that with respect to customer property, public customers are favored over non-public customers, and that public customers are entitled *inter se* to a pro rata distribution based on their respective claims.
- 3) Other changes would foster the longstanding and continuing policy preference for transferring (as opposed to liquidating) positions of public customers and those customers' proportionate share of associated collateral.<sup>9</sup> Some of the benefits, for both customers and the markets as a whole, arising from this policy are addressed in the discussion of proposed § 190.00(c)(4) in section II.A.1 below.
- 4) The Commission is proposing a new subpart C to part 190, governing the bankruptcy of a clearing organization. As explained in further detail in connection with proposed § 190.11, the Commission is proposing to establish ex ante the approach to be taken in addressing such a bankruptcy, in order to foster prompt action in the event such a bankruptcy occurs, and in order to establish a clear counterfactual (*i.e.*, "what would creditors receive in a liquidation in bankruptcy?") in the event of a resolution of a

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<sup>9</sup> This policy preference is manifest in section 764(b) of the Bankruptcy Code, 11 U.S.C. 764(b) (protecting from avoidance transfers approved by the Commission up to seven days *after* the order for relief); *see also* current § 190.06(g) (approving a wide variety of pre-relief and post-relief transfers).

clearing organization pursuant to Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>10</sup> (hereinafter, “Title II” and “Dodd-Frank”).<sup>11</sup> The Commission’s approach toward a DCO bankruptcy is characterized by three overarching concepts:

- a. First, the trustee should follow, to the extent practicable and appropriate, the DCO’s pre-existing default management rules and procedures and recovery and wind-down plans that have been submitted to the Commission.<sup>12</sup> These rules, procedures, and plans will, in most cases,<sup>13</sup> have been developed pursuant to the Commission’s regulations in part 39, and subject to staff oversight. This approach relieves the trustee of the burden of developing, in the moment, models to address an extraordinarily complex situation. It would also enhance the clarity of the counterfactual for purposes of resolution under Title II.
- b. Second, resources that are intended to flow through to members as part of daily settlement (including both daily variation payments and default resources) should be devoted to that purpose, rather than to the general estate.<sup>14</sup>

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<sup>10</sup> P.L. 111-203 (July 21, 2010).

<sup>11</sup> Section 210(d)(2), 12 U.S.C. 5390(d)(2), provides that the maximum liability of the FDIC, acting as a receiver for a covered financial company in a resolution under Title II, is the amount the claimant would have received if the FDIC had not been appointed receiver and the covered financial company had instead been liquidated under chapter 7 of the Bankruptcy Code. Thus, in developing resolution strategies for a DCO while mitigating claims against the FDIC as receiver, it is important to understand what would happen if the DCO was instead liquidated pursuant to chapter 7 of the Bankruptcy Code (and this part 190), and such a liquidation is the counterfactual to resolution of that DCO under Title II.

<sup>12</sup> See generally proposed § 190.15.

<sup>13</sup> Only those DCOs that are subject to Subpart C of part 39 (*i.e.*, those that have been designated as systemically important by the FSOC or that have elected to be subject to subpart C of part 39) are subject to § 39.35 (Default rules and procedures) and § 39.39 (Recovery and wind-down).

<sup>14</sup> See generally proposed § 190.19.

- c. Third, other provisions would draw, with appropriate adaptations, from provisions applicable to FCMs.<sup>15</sup>
- 5) The Commission is proposing to note the applicability of part 190 in the context of proceedings under the Securities Investors Protection Act (“SIPA”) in the case of FCMs subject to a SIPA proceeding,<sup>16</sup> and Title II of Dodd-Frank in the case of a commodity broker where the Federal Deposit Insurance Corporation (“FDIC”) is acting as a receiver.
- 6) In light of lessons learned from the MF Global bankruptcy, the Commission is proposing changes to the treatment of letters of credit as collateral, both during business as usual and during bankruptcy, in order to ensure that, consistent with the pro rata distribution principle discussed in proposed § 190.00(c)(5) in section II.A.1 below, customers who post letters of credit as collateral suffer the same proportional loss as customers who post other types of collateral.
- 7) The Commission is proposing in a number of areas to grant trustees enhanced discretion, based on both practical necessity and positive experience.
  - a. Recent commodity broker bankruptcies have involved many thousands of customers, with as many as hundreds of thousands of commodity contracts. Trustees must make decisions as to how to handle such customers and contracts in the days—in some cases, the hours—after

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<sup>15</sup> See, e.g., proposed §§ 190.16, 190.17(c).

<sup>16</sup> Those would be FCMs that are also registered as broker-dealers with the Securities and Exchange Commission. See generally SIPA, 15 U.S.C. 78aaa *et. seq.*

being appointed. Moreover, each commodity broker bankruptcy has unique characteristics, and bankruptcy trustees need to adapt correspondingly quickly to those unique characteristics.

- i. In order to foster the ability of the trustee to operate effectively, some of the changes would permit the trustee enhanced discretion generally.
  - ii. Others, recognizing the difficulty in treating large numbers of customers on a bespoke basis, would permit the trustee to treat them on an aggregate basis. These changes represent a move from a model where the trustee receives/complies with instructions from individual customers to a model –reflecting actual practice in commodity broker bankruptcies in recent decades – where the trustee transfers as many open commodity contracts as possible
- b. These grants of discretion are also supported by the Commission’s positive experience working in cooperation and consultation with bankruptcy and SIPA trustees.
  - c. On a related note, and as discussed further as the third overarching concept in the section below on cost-benefit considerations,<sup>17</sup> both the current and proposed versions of part 190 favor cost effectiveness and promptness over precision in certain respects, particularly with respect to the concept of pro rata treatment. Following the policy choice made by Congress in section 766(h) of the Bankruptcy Code, the Commission is proposing that it is more important to be cost effective and prompt in the

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<sup>17</sup> See the overarching concept discussed in section IV.C.3 below.

distribution of customer property (*i.e.*, in terms of being able to treat customers as part of a class) than it is to value each customer's entitlements on an individual basis. Doing so fosters transfer rather than liquidation of customer positions, and return of most funds to customers in time periods of days or weeks rather than months or years. Similarly, calculations of each customer's funded balance are directed in proposed § 190.05 to be "as accurate as reasonably practicable under the circumstances, including the reliability and availability of information." The quoted language would allow the trustee to avoid more precise calculations where such precision would not be cost effective or could not reasonably be accomplished on a prompt basis (for example, in a situation where price information for particular assets or contracts at particular times was not readily available). The Commission believes that this approach would lead to (1) in general, a faster administration of the proceeding, (2) customers receiving their share of the debtor's customer property more quickly, and (3) a decrease in administrative costs (and thus, in case of a shortfall in customer property, a greater return to customers).

- 8) Many of the changes are intended to update part 190 in light of changes to the regulatory framework over the past three decades, including cross-references to other Commission regulations. Some of these codify actual practice in prior bankruptcies, such as a requirement that an FCM notify the Commission of its imminent intention to file for voluntary bankruptcy.

In another case, the Commission is addressing for the first time the interaction between part 190 and recent revisions to the Commission's customer protection rules.<sup>18</sup>

- 9) Other changes follow from changes to the technological ecosystem, in particular changes from paper-based to electronic-based means of communication, (for example, the use of communication to customers' electronic addresses rather than by paper mail, as well as the use of websites as a means for the trustee to communicate with customers on a regular basis). The proposal would also recognize the change from paper-based to electronic recording of "documents of title." Many of these changes also recognize the actual practice in prior bankruptcies.
- 10) As discussed further below, many of the changes are intended to clarify language in existing regulations, without any intent to change substantive results. While some of these changes will, as discussed below, address ambiguities that have complicated past bankruptcies, this comprehensive revision of part 190 has also provided opportunities to clarify language in order to avoid future ambiguities, and to add provisions to address circumstances that have not yet arisen, in order to accomplish better and more reliably the goals of promptly and cost-effectively resolving commodity broker bankruptcies while mitigating systemic risk and protecting the commodity broker's customers.

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<sup>18</sup> 78 FR 68506 (Nov. 14, 2013). This refers to proposed new § 190.05(f) in section II.B.3 below.

The Commission seeks comment on these major themes. Do commenters agree or disagree with these themes and the analysis presented? Do commenters view proposed revised part 190 as appropriately implementing these major themes, or are some of the proposed changes inconsistent with (or does the proposal in some areas insufficiently address) these themes? General comments concerning these major themes are welcome, however, adding more specific suggestions for changes to the proposed regulations would be most helpful.

## **II. Proposed Regulations**

### *A. Subpart A—General Provisions*<sup>19</sup>

#### 1. Regulation 190.00: Statutory Authority, Organization, Core Concepts, Scope, and Construction

The Commission is proposing a new § 190.00, which would contain general provisions applicable to all of part 190. Proposed § 190.00 is intended to assist trustees, bankruptcy courts, customers, clearing members, clearing organizations, and other interested parties in understanding the Commission’s rationale for, and intent in promulgating, the specific provisions of this proposed part. Moreover, this regulation may be particularly useful in a time of crisis for those individuals who may not have extensive experience with the CEA or Commission regulations. This provision generally would state facts and concepts that exist in the Commission’s bankruptcy regulations.<sup>20</sup>

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<sup>19</sup> The Commission is proposing technical corrections and updates to parts 1, 4 and 41, which are discussed in II.F. below

<sup>20</sup> See ABA Cover Note at 6:

The Committee recommends adding a rule to Subpart A that provides context and sets forth the general framework for the Part 190 Rules to assist a trustee or bankruptcy court in understanding the reasons for the specific requirements set forth in the other rules. If the individual appointed as the trustee, or the bankruptcy court, does not have extensive experience with the CEA or CFTC rules, in particular with requirements relating to

To the extent there are changes reflected in this proposed § 190.00, these changes will be identified and the reasoning for these changes will be further detailed in the relevant section below.

Proposed § 190.00(a) would set forth the Commission’s statutory authority to adopt the proposed part 190 regulations under section 8a(5) of the CEA, which empowers the Commission to “make and promulgate such rules and regulations as are necessary to effectuate any of the provisions or to accomplish any of the purposes of” the CEA, and section 20 of the CEA, which provides that the Commission may, notwithstanding the Bankruptcy Code, adopt certain rules or regulations governing a proceeding involving a commodity broker that is a debtor under subchapter IV of chapter 7 of the Bankruptcy Code.

Proposed § 190.00(b) would explain that the proposed part 190 regulations are organized into three subparts. Subpart A would contain general provisions applicable in all cases. Subpart B would contain provisions that apply when the debtor is a FCM, the

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clearing and customer funds segregation, the Part 190 Rules may well prove difficult to comprehend, particularly in the critical early days when the trustee is expected to act in circumstances that are likely chaotic and stressful. This context and description of the general framework will also be important to customers and other stakeholders that may not have experience with a subchapter IV proceeding.

Thus, the Committee has proposed Rule 190.00, which explains:

- The Commission’s statutory authority to adopt the Part 190 Rules.
- The organization of the rules into the three subparts described above.
- The core principles reflected in the rules.
- The scope of the rules in terms of proceedings, account classes, customer property and commodity contracts.

Although Rule 190.00 adds to the length of the rules, on balance, we believe it provides useful explanation that will benefit trustees, bankruptcy judges, customers and other stakeholders applying the rules in practice.

definition of which includes acting as a foreign FCM.<sup>21</sup> Subpart C would contain provisions that apply when the debtor is a DCO as defined by the CEA.

Proposed § 190.00(c) would present the core concepts<sup>22</sup> of proposed part 190. These core concepts are central to understanding how a commodity broker bankruptcy works. These include those related to commodity brokers and commodity contracts; account classes; public customers and non-public customers, Commission segregation requirements, and member property<sup>23</sup>; porting of public customer commodity contract positions; pro rata distribution; and deliveries. More specifically, this section would explain the following concepts:

- Proposed § 190.00(c)(1) would explain that subchapter IV of chapter 7 of the Bankruptcy Code applies to a debtor that is a “commodity broker,” the definition of which requires a “customer.”<sup>24</sup> Proposed § 190.00(c)(1) would further state that the rules in proposed part 190 apply to commodity brokers that are FCMs as defined by the Act, or DCOs as defined by the Act.
- Proposed § 190.00(c)(2) would explain that the CEA and Commission regulations provide separate treatment and protections for different types of cleared commodity contracts or account classes. The four account

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<sup>21</sup> See CEA section 1a(28), 7 U.S.C. 1a(28). The definition of foreign FCM involves soliciting or accepting orders for the purchase or sale of a commodity for future delivery executed on a foreign board of trade, or by accepting property or extending credit to margin, guarantee or secure any trade or contract that results from such a solicitation or acceptance. See section 761(12) of the Bankruptcy Code, 11 U.S.C. 761(12).

<sup>22</sup> The Commission is proposing to use the term “core concepts” to avoid confusion with the core principles applicable to registered entities. Cf. CEA section 5b(c)(2), 7 U.S.C. 7a-1(c)(2).

<sup>23</sup> “Member property” would be defined in proposed § 190.01 and would be used to identify cash, securities, or property available to pay the net equity claims of clearing members based on their house account at the clearing organization. Cf. 11 U.S.C. 761(16).

<sup>24</sup> See 11 U.S.C. 101(6) (definition of “commodity broker”), 761(9) (definition of “customer” referred to in 101(6)).

classes would include the (domestic) futures account class (including options on futures),<sup>25</sup> the foreign futures account class (including options on foreign futures),<sup>26</sup> the cleared swaps account class for swaps cleared by a registered DCO (including cleared options other than options on futures or foreign futures),<sup>27</sup> and the delivery account class for property held in an account designated as a delivery account. Delivery accounts would be used for effecting delivery under commodity contracts that provide for settlement via delivery of the underlying when a commodity contract would be held to expiration or, in the case of an option on a commodity, would be exercised.<sup>28</sup>

- Proposed § 190.00(c)(3)(i) would explain that in a bankruptcy, public customers are generally entitled to a priority distribution of cash, securities, or other customer property over “non-public customers,”<sup>29</sup> and both are given a priority over all other claimants (except for claims relating to the administration of customer property) pursuant to section 766(h) of the Bankruptcy Code.<sup>30</sup> That provision of the Code states explicitly that the trustee shall distribute customer property ratably to

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<sup>25</sup> This corresponds to segregation pursuant to section 4d(a) of the CEA, 7 U.S.C. 6d(a).

<sup>26</sup> This corresponds to segregation pursuant to section 30.7 (enacted pursuant to section 4(b)(2)(A) of the CEA, 7 U.S.C. 6(b)(2)(A)).

<sup>27</sup> This corresponds to segregation pursuant to section 4d(f) of the CEA, 7 U.S.C. 6d(f).

<sup>28</sup> Delivery accounts are discussed further below in, *e.g.*, §§ 190.00(c)(6), 190.01 (definition of delivery account, cash delivery property, physical delivery property) and 190.06.

<sup>29</sup> Non-public customers are customers who bear certain proprietary or other “insider” relationships to an FCM. This term would be more precisely defined in § 190.01.

<sup>30</sup> Thus, as discussed further below, all customer property will be allocated to public customers so long as the funded balance in any account class for public customers is less than one hundred percent of public customer net equity claims. Once all account classes for public customers are fully funded (*i.e.*, at one hundred percent of net equity claims), any excess would be allocated to non-public customers’ net equity claims until all of those are fully funded.

customers in priority to all other claims, except claims that are attributable to the administration of customer property. Notwithstanding any other provision of this subsection, a customer net equity claim based on a proprietary account may not be paid either in whole or in part, directly or indirectly, out of customer property unless all other customer net equity claims have been paid in full.

As noted in proposed § 190.00(c)(3)(i)(A), the cash, securities, or other property of public customers are subject to special segregation requirements under the CEA<sup>31</sup> and Commission regulations<sup>32</sup> for each class of account except delivery accounts. Although the transactions and property of non-public customers are not subject to segregation requirements, such transactions and property are deemed part of customer property. In the distribution of customer property, customer net equity claims of public customers are prioritized over those of non-public customers.

As noted in proposed § 190.00(c)(3)(i)(B), the property in delivery accounts nonetheless constitutes “customer property,” and thus claims of public customers enjoy the same priority over claims of non-public customers in the distribution of delivery account property.

- Proposed § 190.00(c)(3)(ii) would address the division of customer property and member property in proceedings in which the debtor is a clearing organization. The classification of customers as non-public

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<sup>31</sup> See, e.g., section 4d of the CEA, 7 U.S.C. 6d.

<sup>32</sup> See, e.g., §§ 1.20-1.29, part 22, § 30.7.

customers in contrast to public customers also would be relevant, in that each member of the clearing organization would have separate claims against the clearing organization with respect to (A) transactions cleared for its own account or for any of its non-public customers and (B) transactions cleared on behalf of the public customers of the member. In such a proceeding, customer property would consist of member property, which could be distributed to pay member claims based on members' house accounts, and customer property other than member property, which would be reserved for payment of claims for the benefit of members' public customers.

- Proposed § 190.00(c)(3)(iii) would address preferential assignment of property among customer classes and account classes in clearing organization bankruptcies: (1) Certain customer property, as specified in § 190.18(c), would be preferentially assigned to “customer property other than member property” instead of “member property” to the extent that there is a shortfall in funded balances for members' public customer claims. Moreover, to the extent that there are excess funded balances for members' claims in any customer class/account class combination, that excess also would be assigned preferentially to “customer property other than member property” for other account classes to the extent of any shortfall in funded balances for members' public customer claims in such account classes; (2) Where property would be assigned to a particular

customer class with more than one account class, it would be assigned on a least funded to most funded basis among the account classes.

- Proposed § 190.00(c)(4) would explain that, in a proceeding in which the debtor is an FCM, part 190 details the policy preference for transferring to another FCM, (commonly known as “porting”) open commodity contract positions of the debtor’s customers along with all or a portion of such customers’ account equity. Porting mitigates risks to both the customers of the debtor FCM and to the markets. Specifically, porting (rather than the alternative, liquidation) of customer positions protects customers’ hedges from changes in value between the time they are liquidated and the time, if any, that the customer may be able to re-establish them (and thus mitigates the market risk that some customers use the futures markets to counteract), and similarly protects customers’ directional positions . Moreover, not all customers may be able to re-establish positions with the same speed – in particular, smaller customers may be subject to longer delays in re-establishing their positions. In addition, liquidation of an FCM’s book of positions can increase volatility in the markets, to the detriment of all market participants (and also contribute to making it more expensive for customers to re-establish their hedges and other positions).
- Proposed § 190.00(c)(5) would address pro rata distribution. It would explain that, if the aggregate value of customer property in a particular account class is less than the amount needed to satisfy the net equity claims of public customers in that account class (*i.e.*, there is a

“shortfall”), customer property in that account class would be distributed pro rata to those public customers. The pro rata distribution principle carries forth the statutory direction in section 766(h) of the Bankruptcy Code. It would ensure that all public customers within an account class will suffer the same proportional loss, including those public customers that post as collateral letters of credit or specifically identifiable property.<sup>33</sup>

Moreover, any customer property that would not be attributable to any particular account class or which is in excess of public customer net equity claims for the account class to which it is attributed, would be distributed to public customers in respect of net equity claims in other account classes where there is a shortfall. Thus, as noted in § 190.00(c)(3), all public customer net equity claims would receive priority over non-public customer claims.

- Proposed § 190.00(c)(6) would address deliveries. It would explain that the delivery provisions of part 190 apply to any commodity that is subject to delivery under a commodity contract, including agricultural commodities, other non-financial commodities (such as metals or energy) and commodities that are financial in nature (including virtual currencies). In the ordinary course of business, commodity contracts with delivery obligations are offset before reaching the delivery stage (*i.e.*, prior to

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<sup>33</sup> In prior bankruptcies, some customers posting letters of credit or specifically identifiable property as collateral sought to escape pro rata treatment for these categories of collateral, contrary to the Commission’s intent. *See* discussion of § 190.04(d)(3) in section II.B. below.

triggering bilateral delivery obligations). Nonetheless, when delivery obligations do arise, a delivery default could have a disruptive effect on the cash market for the commodity and could adversely impact the parties to the transaction.<sup>34</sup>

In a proceeding in which the debtor is an FCM, the delivery provisions in proposed part 190 would reflect the policy preferences (A) to liquidate commodity contracts that settle via delivery before they move into a delivery position and (B) when contracts do move into a delivery position, to allow the delivery to occur, where practicable, outside the administration of the debtor's estate (*i.e.*, directly between the debtor's customer and the delivery counterparty assigned by the clearing organization).

Proposed § 190.00(d)(1)(i) would acknowledge that section 101(6) of the Bankruptcy Code recognizes “commodity options dealers” and “leverage transaction merchants” as defined in sections 761(6) and (13) of the Bankruptcy Code, as separate categories of commodity brokers. However, since there are no commodity options dealers or leverage transaction merchants currently registered,<sup>35</sup> in proposed § 190.00(d)(1), the Commission would declare its intent to adopt regulations with respect to commodity options dealers and leverage transaction merchants, respectively, at such time as an entity registers as such.

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<sup>34</sup> See ABA Cover Note at 12 (“It is important to address deliveries to avoid disruption to the cash market for the commodity or adverse consequences to parties that may be relying on delivery taking place in connection with their business operations.”).

<sup>35</sup> See ABA Cover Note at 5 (“To our knowledge, no person is currently registered or operating as a commodity option dealer or leverage transaction merchant. ... Thus, we recommend uncluttering the rules by limiting their scope to subchapter IV proceedings of commodity brokers that are FCMs or DCOs, with respect to commodity contracts that are cleared.”).

Proposed § 190.00(d)(1)(ii) would provide that, pursuant to the Securities Investor Protection Act (“SIPA”),<sup>36</sup> the trustee in a SIPA proceeding where the debtor is also a commodity broker has the same duties as a trustee in a proceeding under subchapter IV of chapter 7 of the Bankruptcy Code, to the extent consistent with SIPA or as ordered by the court.<sup>37</sup> This part would implement subchapter IV of chapter 7 by establishing the trustee’s duties thereunder, consistent with the broad authority granted to the Commission pursuant to section 20 of the CEA. Therefore, this part also would apply to a proceeding commenced under SIPA with respect to a debtor that is registered as a broker or dealer under section 15 of the Securities Exchange Act of 1934<sup>38</sup> when the debtor also is an FCM.

Moreover, in the context of a resolution proceeding under Title II of Dodd-Frank, section 210(m)(1)(B)<sup>39</sup> provides that the FDIC (in its role as resolution authority) must apply the provisions of subchapter IV of chapter 7 of the Bankruptcy Code in respect of the distribution of customer property and member property of a resolution entity<sup>40</sup> that is a commodity broker as if the resolution entity were a debtor for purposes of subchapter IV. Proposed § 190.00(d)(1)(iii) would explain that this part shall serve as guidance with

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<sup>36</sup> 15 U.S.C. 78aaa, *et. seq.*

<sup>37</sup> *See* SIPA section 7(b), 15 U.S.C. 78fff-1(b) (To the extent consistent with the provisions of SIPA or as otherwise ordered by the court, a trustee shall be subject to the same duties as a trustee in a case under chapter 7 of title 11, including, if the debtor is a commodity broker, as defined under section 101 of such title, the duties specified in subchapter IV of such chapter 7).

<sup>38</sup> 15 U.S.C. 78o.

<sup>39</sup> 12 U.S.C. 5390(m)(1)(B).

<sup>40</sup> That is, the entity being resolved under Title II. Section 210(m)(1)(b) refers to “any covered financial company or bridge financial company.”

respect to distribution of property in a proceeding in which the FDIC acts as a receiver for an FCM or DCO pursuant to Title II of Dodd-Frank.<sup>41</sup>

Proposed § 190.00(d)(2)(i) would clarify that a trustee may not recognize any account classes not explicitly provided for in proposed part 190.

Proposed § 190.00(d)(2)(ii) would provide that no property that would otherwise be included in customer property, as defined in proposed § 190.01 of this part, shall be excluded from customer property because it is considered to be held in a constructive trust, resulting trust, or other trust that is implied in equity.<sup>42</sup> Generally, in a commodity broker bankruptcy, the basis for distributing segregated customer property is pro rata treatment and transparency. To achieve this goal, the FCM's segregation records (including account statements) and reporting to the Commission and self-regulatory organizations ("SROs") and DCOs must reflect what is actually available for customers. This allows FCMs, SROs, DCOs, and the Commission to ensure, during business as usual, that (a) customer property is being properly protected pursuant to the segregation requirements of section 4d of the CEA and the regulations thereunder, and (b) customer property is not subject to hidden arrangements that cannot be accounted for transparently and reliably. Through this regulation, the Commission is making clear that customer

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<sup>41</sup> 12 U.S.C. 5390(m)(1)(B) provides that the FDIC must apply the provisions of subchapter IV of chapter 7 of the Code with respect to the distribution of customer property and member property in connection with the liquidation of a commodity broker that is a "covered financial company" or "bridge financial company" (terms defined in 12 U.S.C. 5381(a)).

<sup>42</sup> This is in contrast to the (ultimately unsuccessful) claims of certain retail customers in the Peregrine bankruptcy, who claimed that their off-exchange retail foreign currency transactions and associated margin collateral were held in a constructive or resulting trust by Peregrine. An off-exchange retail foreign currency transaction is not defined as "commodity contract" under section 761(4) of the Bankruptcy code. Accordingly, counterparties that engage in off-exchange retail transactions with an FCM are not subject to the protections provided by part 190 with respect to their accounts in the event of the FCM's bankruptcy. *See generally Secure Leverage Group, Inc. v. Bodenstein*, 558 B.R. 226 (N.D. Ill. 2016) *aff'd* 866 F.3d 775 (7th Cir. 2017).

property cannot be burdened by equitable trusts. Attempting to account for such equitable trusts in a bankruptcy proceeding under part 190 would undermine the Commission's implementation and enforcement of the statutory scheme under the CEA.<sup>43</sup>

Proposed § 190.00(d)(3) would provide that certain transactions, contracts or agreements are excluded from the term "commodity contract." The contracts that would be excluded include: options on commodities unless cleared by a DCO (or, in the context of a foreign futures clearing member, a foreign clearing organization); forwards (defined as such pursuant to the exclusions in sections 1a(27) or § 1a(47)(B)(ii) of the CEA), unless they are cleared by a DCO (or, in the context of a foreign futures clearing member, a foreign clearing organization); security futures products when they are carried in a securities account; retail foreign currency transactions described in sections 2(c)(2)(B) or (C) of the CEA; security-based swaps or other securities carried in a securities account<sup>44</sup> (other than security futures products carried in an enumerated account class); and retail commodity transactions described in section (2)(c)(2)(D) of the CEA (other than transactions executed on or subject to the rules of a designated contract market ("DCM") or foreign board of trade ("FBOT") as if they were futures). The agreements and

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<sup>43</sup> The ABA Submission included a more complex approach to this subsection:

Absent extraordinary circumstances and upon application by the trustee (such as to address transfers of funds initiated prior to, but completed after, the entry of the order for relief), so long as there is any shortfall of customer property needed to satisfy customer net equity claims in the classes enumerated in § 190.01 of this part, no person is entitled to a distribution of any property in which the debtor holds any interest on the basis that the debtor holds such property in a 'constructive trust' for such person. The foregoing does not restrict any rights a person may have to distribution of property held by the debtor that is not covered by an account class on a 'custodial' or express trust basis pursuant to statute, governmental rule, regulation or order, or legally binding written agreement between the debtor and such person.

The Commission concludes that the ABA Submission's approach here is overly complicated (both in the level of detail and, in particular, with relation to evaluating what constitutes "extraordinary circumstances"), and has instead determined to propose the more direct approach discussed above.

<sup>44</sup> Security-based swaps and securities that are carried in a securities account are part of this exclusion because they are protected under SIPA.

transactions that would be so excluded have traditionally not been considered to be commodity contracts for purposes of segregation and customer protection, while those that are excepted from these exclusions are so considered, and thus are covered by part 190.<sup>45</sup>

Positions or transactions that would be covered by part 190 include:

- As part of the cleared swaps account class (discussed in further detail in the definitions section), “swaps” as defined in section 1a(47) of the CEA and § 1.3 that are cleared by a DCO, including options on commodities cleared by a DCO unless otherwise excluded, and non-swap/non-futures contracts that are traded over-the-counter on a swap execution facility and cleared by a DCO as if they were swaps (cleared swaps account class).<sup>46</sup>
- As part of the futures or foreign futures account class (discussed in further detail in the definitions section), futures or options on futures executed on or subject to the rules of a DCM or FBOT, including retail commodity contracts if they were traded on such market “as if” they are futures and forward contracts which are cleared by a DCO as if they were futures.<sup>47</sup>

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<sup>45</sup> As the ABA Cover Note explains:

The Committee believes it is important for the rules to cover cleared OTC transactions in contracts that may be outside the swap definition and futures contract classification, such as foreign exchange forwards or foreign exchange swaps excluded by the Treasury Department or spot forex transactions, because such transactions are already being cleared by DCOs as if they are swaps. It is the Committee’s understanding that the DCOs are clearing such OTC transactions under the account structure, and subject to the customer funds segregation rules, for cleared swaps prescribed in the CFTC Part 22 Rules. Thus, we have included such commodity contracts in the cleared swaps account class.

ABA Cover Note at 8 (footnote omitted).

<sup>46</sup> See the definition of commodity contract in proposed § 190.01 in conjunction with the definition of swap in proposed § 190.01.

<sup>47</sup> See the definition of commodity contract in proposed § 190.01 in conjunction with the definition of swap in proposed § 190.01.

Proposed § 190.00(e) would address the context in which proposed part 190 should be interpreted. It states that any references to other federal rules and regulations refer to the most current versions of these rules and regulations (*i.e.*, “as the same may be amended, superseded or renumbered”). Moreover, where they differ, the definitions set forth in proposed § 190.01 shall be used instead of the defined terms set forth in section 761 of the Bankruptcy Code. It should be noted that the other regulations in proposed part 190 are designed to be consistent with subchapter IV of chapter 7 of the Bankruptcy Code.

Proposed § 190.00(e) also addresses account classes in the context of portfolio margining and cross margining programs. Where commodity contracts (and associated collateral) that would be attributable to one account class are, instead, commingled with the commodity contracts (and associated collateral) in a second account class (the “home field”), then the trustee must treat all such commodity contracts and associated collateral as being held in, and consistent with the regulations applicable to, an account of the second account class. The approach of following the rules of the “home field” also pertains to securities positions held in a commodity account class (and thus treated in accord with the relevant commodity account class) and commodity contract positions (and associated collateral) held in the securities account, in which case the rules applicable to the securities account will apply, consistent with section 16(2)(b)(ii) of SIPA, 15 U.S.C. 78ll(2)(b)(ii).

The Commission requests comment with respect to all aspects of proposed § 190.00. In particular, is a regulation setting forth core concepts useful? Are the core

concepts that are addressed under or over inclusive? Are the definitions and discussions for each core concept helpful?

2. Regulation 190.01: Definitions

The Commission would update the definitions for proposed revised part 190. The current and proposed definitions are in § 190.01. Most of the changes in proposed § 190.01 would be conforming changes, such as correcting cross-references and deleting definitions of certain terms that are not used in proposed part 190. Other changes would tie the definitions in § 190.01 more closely to the definitions in § 1.3 and other Commission regulations, to reflect changes in Commission regulations. In some cases, the Commission is proposing more substantive changes to the definitions, such as amending or adding definitions to further clarify and provide additional details where the current definitions are silent or unclear, or to reflect concepts that are new to proposed part 190. In particular, the Commission is proposing to separate the delivery account class into two sub-classes, a physical delivery account class and a cash delivery account class; the relevant terms are defined below. The proposed definitions of commodity contract and physical delivery property would codify positions that the Commission has taken in recent commodity broker bankruptcies.<sup>48</sup>

The Commission is also proposing to amend the current § 190.01 to replace the paragraphs currently identified with an alphabetic designation for each defined term (*e.g.*, “§ 190.01(II)”) with a simple alphabetized list, as is recommended by the Office of the

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<sup>48</sup> Respectively, In Re Peregrine Financial Group and In Re MF Global, Inc.

Federal Register, and as recently implemented by the Commission with respect to, *e.g.*, § 1.3.<sup>49</sup>

The Commission is proposing the following definitions in proposed § 190.01:

“*Account Class*”: The current definition of the term account class specifies that it includes certain types of customer accounts, each of which is to be recognized as a separate class of account. The types are “futures account,” “foreign futures accounts,” “leverage accounts,” “delivery accounts,” and “cleared swaps accounts.” The proposed definition of the term “account class” would be expanded to include definitions of each of these account classes. However, as discussed above with respect to proposed § 190.00(d)(1)(i), the “commodity options” and “leverage account” account classes are proposed to be removed, at least temporarily.

The definition of “futures account” would cross-reference the definition of the same term in § 1.3 of the Act, while the definition of “cleared swaps account” cross-references the definition of “cleared swaps customer account” in § 22.1. Each of these definitions applies to both FCMs and DCOs. The definition of “foreign futures account” cross-references the definition of “30.7 account” in § 30.1(g). As that latter definition is limited to FCMs, a corresponding reference to such accounts at a clearing organization would be included, in the event that a clearing organization clears foreign futures transactions for members that are FCMs, where those accounts are maintained on behalf of those FCM members’ 30.7 customers (as that latter term is defined in § 30.1(f)). This would not apply to the case where a foreign clearing organization is clearing foreign futures for clearing members that are not subject to the requirements of § 30.7.

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<sup>49</sup> See generally 83 FR 7979, 7979 & n.6 (Feb. 23, 2018).

Paragraph (1)(iv) of the definition of account class would address the delivery account class. The delivery account class is relevant when an FCM or DCO establishes delivery accounts through which it accounts for the making or taking of physical delivery under commodity contracts whose terms require settlement by delivery of a commodity, in either case in an account designated as a delivery account on the books and records of the entity.

Paragraph (1)(iv)(A)(1) would define delivery accounts for FCMs, and would be based on current § 190.05(a)(2). Paragraph (1)(iv)(A)(2) would incorporate the same concepts for clearing organizations, and also adds in additional concepts. Specifically, a clearing organization may act as a central depository for physical delivery property represented by electronic title documents, or otherwise in electronic (dematerialized) form.

As set forth in paragraph (1)(iv)(B), the delivery account class would be subdivided into separate physical and cash delivery account classes, as provided in proposed § 190.06(b).<sup>50</sup> Customer property held in a delivery account is not subject to Commission segregation requirements. Thus, it may be more challenging and time-consuming to identify customer property for the delivery account class.

As the ABA Committee noted:

Based on lessons learned from the MF Global bankruptcy, those challenges are likely greater for tracing cash. Physical delivery property, in particular when held in the form of electronic documents of title as is prevalent today, is more readily identifiable and less vulnerable to loss,

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<sup>50</sup> It should be noted that under the proposed regulations, “physical delivery property” refers to a commodity that is held in a form that can be delivered, including, *e.g.*, virtual currencies, and (in contrast to current § 190.01(11)(3)), is not limited to physical (*i.e.*, tangible) commodities.

compared to cash delivery property that an FCM may hold in an operating bank account.<sup>51</sup>

(and such cash would thus be commingled with the FCM's own cash intended for operations). Thus, separating (1) cash delivery property and customer claims therefor from (2) physical delivery property and customer claims therefor, would promote the more efficient and prompt distribution of the latter to customers.

For these reasons, the Commission is proposing that the delivery account class be further divided into physical delivery and cash delivery account classes, for purposes of pro rata distributions to customers for their delivery claims.

The claims with respect to these subclasses are fixed on the filing date. Thus, the physical delivery account class includes, in addition to certain physical delivery property, cash delivery property received post-filing date in exchange for physical delivery property held on the filing date that has been delivered under a commodity contract. Conversely, the cash delivery account class includes, in addition to certain cash delivery property, physical delivery property that has been received post-filing date in exchange for cash delivery property held on the filing date.

Paragraph (2) of the definition of account class would address commingling orders and rules. Specifically, there are cases where commodity contracts (and associated collateral) that would be attributable to one account class are held separately from contracts and collateral associated with that first account class, and instead are allocated to a different account class and commingled with contracts and collateral in such account class. This would take place because the contracts in question are risk-offsetting to

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<sup>51</sup> ABA Cover Note at 14. *See also In re MF Global Inc.*, 2012 WL 1424670 (noting how physical delivery property was traceable).

contracts in the latter account class.<sup>52</sup> This commingling may be authorized pursuant to a Commission regulation or order, or pursuant to a clearing organization rule that is approved in accordance with § 39.15(b)(2). Paragraph (2) would confirm that the trustee must treat the commodity contracts in question (and the associated collateral) as being held in an account of the latter account class.

Paragraph (3) of the definition of account class would address cases where the commodity broker establishes internal books and records in which it records a customer's commodity contracts and collateral, and related activity. It would confirm that the commodity broker is considered to maintain such an account for the customer regardless of whether it has kept such books and records current or accurate.

“*Act*” is proposed to be added to the definitions in proposed § 190.01 to refer to the Commodity Exchange Act.

“*Allowed net equity*” is proposed to be revised to update cross-references and to allow for two definitions of the term (as used in subparts B and C of part 190).

“*Bankruptcy code*” is proposed to be revised to update cross-references.

“*Business day*” is proposed to be described further by defining what constitutes a Federal holiday. The definition also would clarify that the end of a business day is one second before the beginning of the next business day.

“*Calendar day*” is proposed to be amended to include a reference to Washington, DC as the location of the Calendar day.

“*Cash delivery account class*” is proposed to be cross-referenced to the new definition in “account class.”

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<sup>52</sup> This could involve portfolio margining within a DCO or cross-margining between a DCO and another central counterparty, which may or may not be a derivatives clearing organization.

“*Cash delivery property*” and “*physical delivery property*” are proposed to be added.

The current definition of “delivery account,” § 190.05(a)(2), refers to an account that contains only property described in three of the nine categories of property in the definition of “specifically identifiable property.” Following the suggestion of the ABA Committee,<sup>53</sup> the Commission is proposing to define directly a delivery account class, taking elements of the definition from the current definition of “specifically identifiable property,” as discussed below with reference to the proposed changes to that definition. The proposed regulation will separate delivery property into subcategories, with separate definitions of “cash delivery property” and “physical delivery property.”

Defining these terms would also be relevant for proposed § 190.06, which would address the process for making or taking physical delivery under commodity contracts, including deliveries that may occur outside a delivery account.

The proposed definition of cash delivery property would carry through the concepts from current § 190.01(II)(4) and (5) that the cash or cash equivalents, or the commodity, must be identified on the books and the records of the debtor as having been received, from or for the account of a particular customer, on or after three calendar days before the relevant (i) first delivery notice date in the case of a futures contract or (ii) exercise date in the case of an option.

The proposed definition of physical delivery property includes, under the four specified sets of circumstances discussed below, a commodity, whether tangible or intangible, held in a form that can be delivered to meet and fulfill delivery obligations

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<sup>53</sup> See ABA Cover Note at 10.

under a commodity contract that settles via delivery if held to a delivery position.<sup>54</sup> The definition would note that this includes warehouse receipts, shipping certificates or other documents of title (including electronic title documents) for the commodity, or the commodity itself.

Some of the changes in the definition address changes in delivery practices since the 1980s. The reference to electronic title documents explicitly would recognize that “title documents for commodities are now commonly held in dematerialized, electronic form, in lieu of paper.” Moreover, the types of commodities that might be physically delivered would extend beyond tangible commodities to those that are intangible, including Treasury securities, foreign currencies, or virtual currencies.<sup>55</sup>

For purposes of analytical clarity, the definition of physical delivery property would be separated into four categories:

First, commodities or documents of title for commodities that the debtor holds for the account of a customer for purposes of making delivery of such property and which, as of the filing date or thereafter, can be identified as held in a delivery account for the benefit of such customer on the books and records of the debtor.<sup>56</sup>

Second, commodities or documents of title for commodities that the debtor holds for the account of the customer, where the customer received or acquired such property by taking delivery under an expired or exercised commodity contract, and which, as of

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<sup>54</sup> The current definition is found in § 190.01(11)(3), and focuses on documents of title and physical commodities.

<sup>55</sup> See ABA Cover Note at 10, 12-13.

<sup>56</sup> These first two categories together correspond to current § 190.01(11)(3), with the first category corresponding to physical delivery property held for the purpose of *making* delivery and the second category corresponding to physical delivery property held as a result of *taking* delivery. The property that is (or should be) within these two categories, as of the filing date, comprises the property that will be distributed as part of the physical delivery account class.

the filing date or thereafter, can be identified as held in a delivery account for the benefit of such customer on the books and records of the debtor.<sup>57</sup>

The third category addresses property that (a) is in fact being used, or has in fact been used, for the purpose of making or taking delivery, but (b) is held in a futures, foreign futures, cleared swaps, or (if the commodity is a security) securities account.<sup>58</sup> This property would be considered physical delivery property *solely* for the purpose of the obligations, pursuant to proposed § 190.06, to make or take delivery of physical delivery property. Property in this category would be *distributed* as part of the account class in which it is held (futures, foreign futures, or cleared swaps, or, in the case of a securities account, as part of a SIPA proceeding).

Fourth, where such commodities or documents of title are not held by the debtor, but are delivered or received by a customer in accordance with proposed § 190.06(a)(2) (either by itself in the case of an FCM bankruptcy or in conjunction with proposed § 190.16(a) in the case of a clearing organization bankruptcy), they will be considered physical delivery property, but, again, *solely* for purposes of obligations to make or take delivery of physical delivery property pursuant to proposed § 190.06.<sup>59</sup> As this property

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<sup>57</sup> The current definition does not prescribe or imply a limit to how long such received property can be held in a delivery account, because there is no principled basis to draw a bright line delineating how long is too long. The proposed definition explicitly would codify that position.

<sup>58</sup> See ABA Cover Note at 13 (“When the FCM has a role in facilitating delivery, deliveries may occur via title transfer in a futures account, foreign futures account, cleared swaps account, delivery account, or, if the commodity is a security ... in a securities account.”).

<sup>59</sup> As noted immediately above, the third and fourth categories of physical delivery property are not part of the physical delivery account class. They are included because the Commission is proposing, consistent with the suggestion in the ABA Submission for § 190.06 and the ABA Cover Note “to provide more specificity than is found in current [§] 190.05 on how to accomplish delivery” where “[o]pen positions ... get caught in delivery position where parties incur bilateral contractual obligations.” *Id.* at 13. This more ramified approach to setting out obligations in connection with delivery requires a correspondingly broader definition of physical delivery property.

is held outside of the debtor’s estate (and there was no obligation to transmit it to the debtor’s customer accounts), it is not subject to pro rata distribution.

“*Cash equivalents*” is proposed to be added to define assets that might be accepted as a substitute for United States dollar cash.

“*Cleared swaps account*” is proposed to be cross-referenced to the new definition in “account class.”

“*Clearing organization*” is proposed to be revised to update cross-references.

“*Commodity broker*” is proposed to be updated to reflect the current definition of commodity broker in the Bankruptcy Code and the relevant cross-references.

“*Commodity contract*” is proposed to be amended to incorporate and extend in context (through references to current Commission regulations) the definition in section 761(4) of the Bankruptcy Code.<sup>60</sup>

“*Commodity contract account*” is proposed to be added to refer to accounts of a customer based on commodity contracts in one of the account classes, as well as, for purposes of identifying customer property for the foreign futures account class, accounts maintained by foreign futures intermediaries or foreign clearing organizations reflecting foreign futures.

“*Court*” is proposed to be clarified to refer to the court having jurisdiction over the debtor’s estate, reflecting that such court may not be a bankruptcy court (*e.g.*, in the event of a withdrawal of the reference.)<sup>61</sup>

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<sup>60</sup> It should be noted that, consistent with proposed § 190.00(d)(3)(iv) and the decision *In re Peregrine Financial Group, Inc.*, 866 F.3d 775, 776 (7th Cir. 2017), *adopting by reference Secure Leverage Group, Inc. v. Bodenstein*, 558 B.R. 226 (N.D. Ill. 2016), retail foreign exchange contracts do not fit within the definition of commodity contracts.

<sup>61</sup> *Cf.* 28 U.S.C. 157(d).

“*Cover*” is proposed to be reworded to improve clarity; no substantive change is intended.

“*Customer*” is proposed to be revised to reflect the revisions to part 190 through this rulemaking, specifically, noting the different meanings of “customer” with respect to an FCM in contrast to with respect to a DCO.

“*Customer claim of record*” is proposed to be reworded to improve clarity; no substantive change is intended.

“*Customer class*” is proposed to be revised to reflect the revisions to part 190 through this rulemaking, specifically emphasizing the difference between public customers and non-public customers.

“*Customer property, customer estate*” is proposed to be updated to clarify cross-references and to note that customer property distribution is also addressed in § 766(i) of the Bankruptcy Code.

“*Dealer option*” is proposed to be eliminated as this term is no longer used.

“*Debtor*” is proposed to be revised to explicitly refer to commodity brokers involved in a bankruptcy proceeding, a proceeding under SIPA, or a proceeding under which the FDIC is appointed as a receiver.

“*Delivery account*” is proposed to be cross-referenced to the new definition in “account class.”

“*Distribution*” is proposed to be defined to include transfer of property on a customer’s behalf, return of property to a customer, as well as distributions to a customer of valuable property that is different than the property posted by that customer.

“*Equity*” is proposed to be amended to update a cross-reference.

“*Exchange Act*” and “*FDIC*” definitions are proposed to be added as the Commission is taking into account both in these proposed rules.

“*Filing Date*” is proposed to be revised to include the commencement date for proceedings under SIPA or Title II of the Dodd-Frank Act.<sup>62</sup>

“*Final net equity determination date*” is proposed to be revised stylistically, to provide updated cross-references, and to further clarify who the parties involved are intended to be.

“*Foreign board of trade*” is proposed to be added, and incorporates by reference the definition in § 1.3 (which is consistent with § 48.2(a)).

“*Foreign clearing organization*” is proposed to be added to refer to a clearing house, clearing association, clearing corporation or similar entity, facility or organization that clears and settles transactions in futures or options on futures executed on or subject to the rules of a foreign board of trade.

“*Foreign future*” and “*Foreign futures commission merchant*” are unchanged.

“*Foreign futures account*” is proposed to be cross-referenced to the new definition in “account class.”

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<sup>62</sup> In SIPA, the term “filing date” is defined to occur earlier than the filing of an application for a protective decree if the debtor is the subject of a proceeding in which a receiver, trustee, or liquidator for the debtor has been appointed and such proceeding is commenced before the date on which the application for a protective decree under SIPA is filed. In such case, the term “filing date” is defined to mean the date on which such proceeding is commenced. By contrast, this proposal does not define the term “filing date” to occur earlier in such a case, although it would (in proposed § 190.02(f), discussed below) authorize such a receiver to themselves file a voluntary petition for bankruptcy of the FCM.

This difference is due to the different uses of the “filing date” in these rules and in SIPA. For purposes of part 190, “filing date” refers to the date on and after which a commodity broker is treated as a debtor in bankruptcy. *See, e.g.*, proposed §§ 190.00(c)(4), 190.06(a)(1), 190.06(b)(1), 190.08(b)(4), 190.09(a)(1)(ii)(A). For purposes of SIPA, by contrast, the “filing date” is the date on which securities are valued. *See, e.g.*, SIPA sections 8(b), 8(c)(1), 8(d), 9(a)(3), 15 U.S.C. 78fff-2(b), (c)(1), (d), 78fff-3(a)(3).

“*Foreign futures intermediary*” is proposed to refer to a foreign futures or options broker, as defined in § 30.1, acting as an intermediary for foreign futures contracts between a foreign futures commission merchant and a foreign clearing organization.

“*Funded balance*” is proposed to be revised to refer to the definition in proposed § 190.08(c). That definition is discussed further below.

“*Futures, futures contract*” is proposed to be added to clarify what these terms mean for purposes of part 190.

“*Futures account*” is proposed to be cross-referenced to the new definition in “account class.”

“*House account*” is proposed to be modified to replace the current definition with one that (a) clarifies the connection between the concept of a “house account” in part 190 and the concept of a proprietary account in § 1.3, and (b) separately defines the term in relation to an FCM, in relation to a foreign futures commission merchant, and in relation to a DCO.

“*In-the-money amount*” is proposed to be deleted as the term will no longer be used. It is proposed to be replaced by “in-the-money,” a term that is Boolean, and is used in proposed § 190.04(c).

“*Joint account*” is proposed to be edited to reflect the fact that a commodity pool must be a legal entity.<sup>63</sup> Thus, the reference to a commodity pool that is not a legal entity is removed.

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<sup>63</sup> See § 4.20(a)(1).

“*Leverage contract*” and “*Leverage transaction merchant*” are proposed to be deleted, consistent with the discussion above with respect to proposed § 190.00(d)(1)(i)(B).

“*Member property*” is proposed to be moved from current § 190.09(a), and clarified to note that member property may be used to pay net equity claims based on claims on behalf of non-public customers of the member.

“*Net equity*” is proposed to be revised to update cross-references, including the difference between bankruptcy of an FCM and of a clearing organization.

“*Non-public customer*” and “*public customer*”: These definitions are complements (*i.e.*, every customer is either a public customer or a non-public customer, but not both). The Commission is proposing to define who is considered a public versus a non-public customer separately for FCMs and for clearing organizations.

In the case of a customer of an FCM, the proposed regulation would explicitly define “public customer.”<sup>64</sup> The definition of public customer would be analyzed separately for each of the relevant account classes (futures, foreign futures, cleared swaps, and delivery) with the relevant cross-references to other Commission regulations. For the futures account class, this would be a futures customer as defined in § 1.3 whose futures account is subject to the segregation requirements of section 4d(a) of the Act and the Commission regulations thereunder; for the foreign futures account class, a § 30.7 customer as defined in § 30.1 whose foreign futures account is subject to the segregation requirements of § 30.7; for the cleared swaps account class, a cleared swaps customer as

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<sup>64</sup> This is in contrast to the current definitions in § 190.01(cc) and (ii), which explicitly define non-public customer, and define public customer as a customer that is not a non-public customer. This proposed change would not be intended to be substantive, but rather would be intended to foster closely tying the account classes to business-as-usual segregation requirements.

defined in § 22.1 whose cleared swaps account is subject to the segregation requirements of part 22; and for the delivery account class, a customer that would be classified as a public customer if the property held in the customer's delivery account had been held in an account described in one of the prior three categories. This would tie the definition of public customer for bankruptcy purposes to the definitions of "customer" (and segregation requirements) that apply during business as usual. An FCM's non-public customers would be defined as customers that are not public customers.

As part of the process for introducing a bespoke regime for the bankruptcy of a clearing organization, the proposed definitions also would differentiate between public and non-public customers for those purposes. Specifically, customers of clearing members (whether such clearing members are FCMs or foreign brokers) acting on behalf of their proprietary (*i.e.*, house) accounts, would be non-public customers, while all other customers of clearing members would be public customers.

In the case of members of a DCO that are foreign brokers, the determination as to whether a customer of such a member is a proprietary member would be based on either the rules of the clearing organization or the jurisdiction of incorporation of such member: if either designates the customer as proprietary member, then the customer would be treated as a proprietary member.

"*Open commodity contract*" is proposed to be reworded to improve clarity; no substantive change is intended.

"*Order for relief*" is proposed to be revised to update cross-references and to be reworded for stylistic purposes.

"*Person*" is proposed to be added as a definition to clarify what this term means.

“*Physical delivery account class*” is proposed to be cross-referenced to the new definition in “account class.”

“*Physical delivery property*” See discussion above under “cash delivery property.”

“*Premium*” is proposed to be deleted as that term is no longer used.

“*Primary liquidation date*” is proposed to be revised to reflect the removal of the concept of accounts being held open for later transfer. As a result of such removal, the Commission would also delete current § 190.03(a), which sets forth provisions regarding the operation of accounts held open for later transfer, since there will no longer be any such accounts.

“*Principal contract*” is proposed to be deleted as that term is no longer used. This term was previously used to refer to contracts that are not traded on designated contract markets, but the definition excluded cleared swaps.

“*Public customer*” is discussed under non-public customer.

“*Securities Account*” and “*SIPA*” are proposed to be added to address the bankruptcy of an FCM that is also subject to the Securities Investor Protection Act. These are based on appropriate cross-references to the Exchange Act and SIPA.

“*Security*” is proposed to be changed to update the cross-reference to the Bankruptcy Code.

“*Short term obligation*” is proposed to be removed as the term is no longer used. It would be removed from the definition of specifically identifiable property, and the concept of a duration or maturity date of 180 days or less would be stated explicitly in the text of that latter definition.

*“Specifically identifiable property”* The Commission is proposing a new definition that updates and streamlines the definition in current § 190.01(II).

The proposal in paragraph (1)(i) would focus on “futures accounts,” “foreign futures accounts,” and “cleared swaps accounts.” Paragraph (1)(i)(A) of the proposed definition corresponds in major part to paragraphs (1) and (6) of the current definition. For securities, paragraph (1)(i)(A)(I) of the proposal substantially copies current paragraph (1)(i), but would clarify that a security is not a short term obligation when it has “a duration or maturity date of more than 180 days.” Paragraph (1)(i)(A)(2) of the proposal simply would reformat current paragraph (6). For warehouse receipts, bills of lading, or other documents of title (paragraph (i)(B), corresponding to current paragraph (ii)), the proposal would restate the corresponding portion of the current definition.

Paragraph (1)(ii) of the definition in the proposal would further the approach of providing discretion to the trustee. It would include as specifically identifiable property commodity contracts that are treated as such in accordance with proposed § 190.03(c)(2). As discussed further below,<sup>65</sup> the latter provision would permit (but does not require) the trustee, following consultation with the Commission, to treat open commodity contracts of public customers as specifically identifiable property if they are held in a futures account, foreign futures account, or cleared swaps account that is designated as a hedging account in the debtor’s books and records, and if the trustee determines that treating the commodity contracts as specifically identifiable property is reasonably practicable under the circumstances of the case. In contrast, paragraph (2) of the current definition is more prescriptive. It refers to open commodity contracts that meet the following criteria: they

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<sup>65</sup> See section II.B.1.

(A) have not been transferred, (B) are identified on the books and records of the debtor FCM as held for the account of a particular customer, and (C) are either bona fide hedging positions or transactions as defined in § 1.3 or are commodity option transactions that have been determined by the registered entity to be appropriate to the reduction of risks in the conduct and management of a commercial enterprise pursuant to rules that have been approved by the Commission pursuant to section 5c(c) of the CEA.

Paragraph (3) of the current definition refers to documents of title, including warehouse receipts or bills of lading, or physical commodities that, as of the filing date, can be identified on the books and records of the debtor as received from or for the account of a particular customer as held specifically for the purpose of delivery or exercise. These types of property, to the extent included in the debtors estate, would be transposed in the proposed regulations to paragraphs (1) through (3) of the definition of physical delivery property, in this proposed § 190.01, above, and discussed in that context.

Paragraph (4) of the current definition refers to cash or other property deposited prior to the entry of the order for relief to pay for the taking of physical delivery on a long commodity contract, or the payment of the strike price upon exercise of a short put or a long call option contract on a physical commodity. Correspondingly, paragraph (5) of the current definition refers to the cash price tendered, for property deposited prior to the entry of the order for relief, where such property (i) has been deposited to make physical delivery on a short commodity contract, or for exercise of a long put or a short call option contract on a physical commodity, and (ii) is identified on the books and records of the debtor as received from or for the account of a particular customer on or after three

calendar days before the first notice date (for delivery) or exercise date (for exercise). In either case, current paragraph (5) requires the customer to make delivery or exercise the option in accordance with the applicable contract market rules. These items both refer to cash, which is fungible, and thus are excluded from the definition of specifically identifiable property, but are instead proposed to be addressed in the definition of cash delivery property, the proper treatment of which is addressed in proposed § 190.06(a)(3)(i)(B), discussed below.

Current paragraph (7), which refers to open commodity contracts that have been transferred, would be deleted, in that open commodity contracts that have been transferred are no longer part of the debtor's estate, and thus no longer subject to liquidation as part of a bankruptcy. While the customer may well have to provide margin to the transferee in order to collateralize the contract, that requirement does not deny the customer the protection applicable to specifically identifiable property.

Current paragraph (8), limiting treatment as specifically identifiable property to the items specified in the definition thereof would be transposed to proposed paragraph (3), while current paragraph (9), which excludes security futures products and related collateral from specifically identifiable property, if they are held in a securities account, would be transposed to proposed paragraph (2).

“*Strike price*” is proposed to be reworded for brevity. No substantive change is intended.

“*Substitute customer property*” The Commission is proposing to add this definition to refer to the property (in the form of cash or cash equivalents) delivered to

the trustee by or on behalf of a customer in order to redeem either specifically identifiable property or a letter of credit.

“*Swap*” is proposed as the term used to refer to what is in the current regulation referred to as a “Cleared swap.”<sup>66</sup> The definition is proposed to be updated to reflect the current definition and meaning of the term “swap” under the Commission’s rules and regulations outside of part 190. The definition also would add as a swap, for purposes of this part, “any other contract, agreement or transaction that is carried in a cleared swaps account pursuant to a rule, regulation or order of the Commission, provided, in each case, that it is cleared by a clearing organization [*i.e.*, a DCO] as, or the same as if it were, a swap.”<sup>67</sup>

“*Trustee*” is proposed to be amended to include the trustee in a SIPA proceeding.

“*Undermargined*” The Commission proposes to define “undermargined” for purposes of part 190 as follows: A futures account, foreign futures account, or cleared swaps account carried by the debtor is considered undermargined if the funded balance for such account is below the minimum amount that the debtor is required to collect and maintain for the open commodity contracts in such account under the rules of the relevant clearing organization, foreign clearing organization, DCM, Swap Execution Facility (“SEF”), or FBOT. If any such rules establish both an initial margin requirement and a lower maintenance margin<sup>68</sup> requirement applicable to any commodity contracts (or to the entire portfolio of commodity contracts or any subset thereof) in a particular

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<sup>66</sup> See Current § 190.01(pp).

<sup>67</sup> Cf. 11 U.S.C. 761(4)(F)(ii) (including as a commodity contract “with respect to a futures commission merchant or clearing organization, any other contract, option, agreement, or transaction, in each case, that is cleared by a clearing organization”).

<sup>68</sup> For further discussion of maintenance margin and its relationship to initial margin, see, e.g., <https://www.cmegroup.com/education/courses/introduction-to-futures/margin-know-what-is-needed.html>.

commodity contract account of the customer, the trustee will use the lower maintenance margin level to determine the customer's minimum margin requirement for such account. An undermargined account may or may not be in deficit.<sup>69</sup>

“*Variation Settlement*” is proposed to be added to define the payments a trustee may make with respect to open commodity contracts. It would include “variation margin” as defined in § 1.3, and, in order to cover all of the potential obligations associated with an open commodity contract, also includes all other daily settlement amounts (such as price alignment payments) that may be owed or owing on the commodity contract.

The Commission requests comment with respect to all aspects of proposed § 190.01. In particular, are the revised definitions useful? Do any appear likely to lead to unintended consequences, and, if so, how may these best be mitigated?

### 3. Regulation 190.02: General

Proposed § 190.02(a)(1) is derived from current § 190.10(b)(1). There is one substantive change: the proposed section would permit a request to the Commission for exemption from any procedural provision (rather than limiting such requests to exemptions from, or extension of, a time limit). Such an exemption may be subject to conditions, and must be consistent with the purposes of this part and of subchapter IV of the Bankruptcy Code. This change would further major theme 7, discussed in section I.B

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<sup>69</sup> An account is in deficit if the balance is negative (*i.e.*, the customer owes the debtor instead of the reverse). An account can be undermargined but not in deficit (if the balance is positive, but less than the required margin). *See* discussion of proposed § 190.04(b)(4). For example, if the margin requirement is \$100 and the account balance is \$20, the account is undermargined by 80, but is not in deficit. If the account loses a further \$35, the balance would be (\$15). The account would be in deficit by \$15, and would be undermargined by \$115.

above, of enhancing trustee discretion. It would allow, *e.g.*, the trustee to request to be permitted to extend a deadline or to amend a form.

Proposed §§ 190.02(a)(2)(i), (a)(2)(ii), and (a)(3), and 190.02(b), are derived from current §§ 190.10(b)(2), (3), and (4), and § 190.10(d), respectively, with minor editorial and conforming changes.

Proposed §§ 190.02(c) (forward contracts), (d) (other), and (e) (rule of construction) would be transposed from current §§ 190.10(e), (g), and (h), respectively.

Proposed § 190.02(f) would be added to enhance customer protection in cases where a receiver has been appointed (pursuant to *e.g.*, section 6c of the CEA) for an FCM due to a violation or imminent violation<sup>70</sup> of the customer property protection requirements of section 4d of the CEA or of the regulations thereunder, or of the Commission's capital rule (§ 1.17 of this chapter). It would explicitly permit such a receiver to file a voluntary petition for bankruptcy of such FCM in appropriate cases. For example, the receiver may determine that, due to a deficiency in property in segregation, bankruptcy is necessary in order to protect customers' interests in customer property.

The Commission requests comment with respect to all aspects of proposed § 190.02. In particular, is it appropriate to permit trustees to request relief from procedural provisions such as requirements as to forms, in addition to requesting relief from deadlines? Is it appropriate to permit receivers for FCMs to file voluntary petitions

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<sup>70</sup> Section 6c of the CEA provides in relevant part that whenever it shall appear to the Commission that any person has engaged, is engaging, or *is about to engage* in any act or practice constituting a violation of any provision of this Act or any rule, regulation, or order thereunder the Commission may bring an action in the proper district court to enjoin such act or practice, or to enforce compliance with this Act. Section 6c also refers to an order appointing a temporary receiver to administer such restraining order and to perform such other duties as the court may consider appropriate. 7 U.S.C. 13a-1.

in bankruptcy? Does any portion of proposed § 190.02 appear likely to lead to unintended consequences, and, if so, how may these be mitigated?

*B. Subpart B—Futures Commission Merchant as Debtor*

The provisions of subpart B (proposed §§ 190.03-190.10) address debtors that are FCMs.

1. Regulation 190.03: Notices and Proofs of Claims

In proposed § 190.03, the Commission is proposing to reorganize and revise much of current § 190.02. Moreover, some portions of current § 190.10 have been reorganized into proposed § 190.03, and have been revised.

a. Regulation 190.03(a): Notices – Means of Providing

Proposed § 190.03(a)(1) is substantially similar to current § 190.10(a). In an effort to modernize part 190, the Commission proposes to delete the current requirement that all mandatory or discretionary notices to be given to the Commission under part 190 be sent to the Commission via overnight mail (*i.e.*, hard copy). Proposed § 190.03(a)(1) would retain the requirement that all such notices be sent to the Commission via electronic mail. Overnight hard copy delivery is unnecessary, and removing the requirement to send notices to the Commission via overnight mail will result in cost savings.

Proposed § 190.03(a)(2) is a new section proposed by the Commission to provide a general means of providing notice to customers under part 190. Proposed § 190.03(a)(2) would replace the specific procedures for providing notice to customers that currently appear in § 190.02(b) and, in light of evolving technology since the original issuance of part 190, implement a more generalized approach for giving notice to

customers, whereby the trustee must establish and follow procedures “reasonably designed” for giving notice to customers under part 190. In addition, in an effort to modernize part 190, the Commission proposes to state that such notice procedures should generally include the use of a website and customers’ electronic addresses. In the Commission’s view, this new approach provides trustees with the necessary flexibility to determine the best way to provide notice to customers under part 190 and is consistent with the manner in which bankruptcy trustees in recent FCM bankruptcy cases have provided notice to customers. The Commission anticipates that adopting the more generalized approach to notifying customers set forth in proposed § 190.03(a)(2), rather than retaining the specific notice requirements in the existing regulations, including newspaper publication, will result in both cost savings for the debtor’s estate, and more efficient and effective notification of customers.

The Commission requests comment as to the proposed approach to notice requirements set forth in proposed § 190.03(a). Are the proposed changes helpful? Do the proposed revisions appear likely to lead to unintended consequences, and, if so, how may such consequences be mitigated?

b. Regulation 190.03(b): Notices to the Commission and Designated Self-Regulatory Organizations.

Proposed § 190.03(b)(1) is derived from current § 190.02(a)(1). The time requirements set forth in proposed § 190.03(b)(1) are meant to ensure that the Commission and the relevant designated SRO (“DSRO”)<sup>71</sup> will be aware of a bankruptcy

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<sup>71</sup> For further detail regarding SROs and DSROs *see generally* § 1.52.

filing or SIPA application as soon as is practicable. These changes to the regulation are designed to codify the practices observed in recent bankruptcy and SIPA cases.

The Commission proposes to revise the time within which a commodity broker must notify the Commission in the event of a voluntary or involuntary bankruptcy filing.<sup>72</sup> First, proposed § 190.03(b)(1) would provide that, in the event of a voluntary bankruptcy filing, the commodity broker must notify the Commission and the appropriate designated SRO (“DSRO”) as soon as practicable before, and in any event no later than, the time of filing.<sup>73</sup>

Second, proposed § 190.03(b)(1) would provide that, in the event of an involuntary bankruptcy filing or an application for a protective decree under SIPA<sup>74</sup>, the commodity broker must notify the Commission and the appropriate DSRO immediately upon the filing of such petition or application.

Moreover, as a practical matter, a decision to file for bankruptcy takes measurable time, as does the preparation of the necessary papers. The Commission notes that, in previous FCM voluntary bankruptcy filings, the commodity broker has provided the Commission and its DSRO with notice ahead of the bankruptcy filing. Proposed § 190.03(b)(1) merely would codify the expectation that such advance notice should, in fact, occur to the extent practicable.

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<sup>72</sup> A voluntary case under a chapter of the Bankruptcy Code is commenced by the debtor by filing a petition under that chapter. Section 301(a) of the Bankruptcy Code, 11 U.S.C. 301(a). (A commodity broker may only be a debtor under chapter 7. *See generally* section 109 of the Bankruptcy Code, 11 U.S.C. 109.) Under certain circumstances, creditors of a person may file an involuntary case against that person pursuant to section 303 of the Bankruptcy Code, 11 U.S.C. 303. In such cases, the order for relief will be granted only if the petition is not timely controverted or if the court makes specific findings. *Id.* There is no historical precedent for an involuntary petition in bankruptcy being filed against a commodity broker.

<sup>73</sup> The historical background of such notice is discussed below in section II.C.1.

<sup>74</sup> A SIPA proceeding is commenced when SIPC files a petition for a protective order. *See generally* SIPA section 5, 15 U.S.C. 78eee.

Proposed § 190.03(b)(1) further would amend current § 190.02(a)(1) by allowing the commodity broker to provide the relevant docket number of the bankruptcy or SIPA proceeding to the Commission and the DSRO “as soon as known,” in order to account for the fact that there may be a time lag between the filing of a proceeding and the assignment of a docket number. It is better that the Commission promptly be notified of the filing, rather than waiting for assignment and communication of the docket number.

Proposed § 190.03(b)(2), concerning intent to transfer customer accounts, is derived from current § 190.02(a)(2). Current § 190.02(a)(2) provides that the trustee, the applicable DSRO, or the commodity broker must notify the Commission of an intent to transfer or to apply to transfer open commodity contracts in accordance with section 764(b) of the Bankruptcy Code and relevant provisions of current part 190 no later than three days after the order for relief. Proposed § 190.03(b)(2) would remove the deadline for such notification because three days is likely in many cases to be too long, but may in some cases be too short.

The Commission expects that the bankruptcy trustee would begin working on transferring any open commodity contracts as soon as the trustee is appointed and that, by the end of three days following entry of the order for relief, any such transfers likely will be either completed, actively in process or determined not to be possible. Indeed, the Commission expects that a DCO would, in most cases, be reluctant to hold a position open for more than three days following entry of the order for relief unless a transfer is actively in process and imminent. Thus, while the Commission recognizes that the “[a]s soon as possible” language is somewhat vague, given past experience, the Commission views the current timeframe of three days after entry of the order for relief as generally

too long, and it is not clear what precise shorter period of time would be generally appropriate, given the uniqueness of each case. Under different circumstances, that is, where transfer arrangements cannot be made within three days after the order for relief, a specified deadline for notification may in fact be harmful, in that it could be interpreted to prohibit notification after the expiration of such deadline (and thus, impliedly prohibit the trustee from forming the intent to transfer after that time).

In the event of an FCM bankruptcy, the Commission anticipates that there will be frequent contact between the trustee, the relevant DSRO, any relevant clearing organization(s), and the Commission; thus, a specified deadline for such notification to occur would not appear to be helpful under such circumstances. The proposal also clarifies that notification should be made with respect to a transfer of customer property.

The Commission requests comment on proposed § 190.03(b). As proposed, would § 190.03 meet the objective of ensuring that the Commission and the relevant DSRO will be aware of a bankruptcy filing or SIPA proceeding as soon as is practicable? Why or why not?

c. Regulation 190.03(c): Notices to Customers; treatment of hedging accounts and specifically identifiable property.

Proposed § 190.03(c) would address notices to customers and treatment of hedging accounts and specifically identifiable property.

Proposed § 190.03(c)(1) would deal with notices to customers concerning specifically identifiable property other than open commodity contracts, and is derived from current § 190.02(b)(1). Proposed § 190.03(c)(1) would require the trustee to use all reasonable efforts to notify promptly any customer whose futures account, foreign futures

account, or cleared swaps account includes specifically identifiable property, that such specifically identifiable property may be liquidated on and after the seventh day after the order for relief if the customer has not instructed the trustee in writing before the deadline specified in the notice to return such property pursuant to the terms for distribution of customer property contained in proposed part 190.

The Commission would remove the requirement that the trustee publish notice to customers regarding specifically identifiable property in a newspaper for two consecutive days prior to liquidating such property. Instead, the new notice requirement to customers under part 190 are contained in proposed § 190.03(a)(2), which would provide that a trustee must establish and follow procedures “reasonably designed for giving adequate notice to customers.” As noted above, this change is meant to provide the trustee with flexibility in notifying customers regarding specifically identifiable property, and to modernize part 190 to allow the trustee to provide notice to customers in a way that will maximize the number of customers reached.

Pursuant to current § 190.02(b)(1), the trustee may commence liquidation of specifically identifiable property on the sixth calendar day following the second publication date of the notice to customers. Because proposed § 190.03(c)(1) would not require newspaper publication of customer notice, the Commission would allow the trustee to commence liquidation of specifically identifiable property on the seventh day after the order for relief (or such other date as specified by the trustee with the approval of the Commission or the court), so long as the trustee has used all reasonable efforts promptly to notify the customer under § 190.03(a)(2) and the customer has not instructed the trustee in writing to return such specifically identifiable property.

With respect to the return of specifically identifiable property, proposed § 190.03(c)(1) would add that the trustee’s notice to customers whose futures accounts, foreign futures accounts, or cleared swaps accounts include specifically identifiable property must specify the terms upon which such property may be returned, “including, if applicable and to the extent practicable, any substitute customer property that must be provided by the customer.” This addition is meant to make clear that the trustee’s notice to customers with specifically identifiable property should include, where applicable, a reference to substitute customer property.<sup>75</sup>

Proposed § 190.03(c)(2) would change how a bankruptcy trustee may treat open commodity contracts carried in hedging accounts to a categorical approach; it would replace the bespoke approach of current § 190.02(b)(2). Part 190 currently treats hedging positions as a type of specifically identifiable property, where the customer is given special rights, namely, to have the trustee endeavor to avoid liquidating its hedging positions.<sup>76</sup> Under current § 190.02(b)(2), the trustee treats customers with specifically identifiable open commodity contracts on a bespoke basis; specifically, to the extent the trustee does not receive transfer instructions regarding a customer’s specifically identifiable open commodity contracts, the trustee is required to liquidate such contracts within a certain time period.

Proposed § 190.03(c)(2) would take a more categorical approach with respect to open commodity contracts. As discussed in major theme 7 in section I.B above, recent commodity broker bankruptcies have involved many thousands of customers, with as

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<sup>75</sup> For an explanation of why proposed 190.03(c)(1) would refer to “substitute customer property” rather than “cash,” please see discussion below, section II.B.7, in connection with proposed § 190.09(d)(1).

<sup>76</sup> See current §§ 190.01(II), 190.02(f)(1)(ii), and 190.04(e)(1).

many as hundreds of thousands of commodity contracts. Trustees must make decisions as to how to handle such customers and contracts within days—in some cases, hours—after being appointed.

In light of the practical difficulties of treating such large numbers of customers with similar open commodity contracts on a bespoke basis, under proposed § 190.03(c)(2), the Commission is proposing instead to give the trustee authority (*i.e.*, an option, but not an obligation), to treat open commodity contracts of public customers held in hedging accounts designated as such in the debtor’s records as specifically identifiable property, after consulting with the Commission and when practical under the circumstances.<sup>77</sup> To the extent the trustee exercises such authority, proposed § 190.03(c)(2) would provide that the trustee must notify each relevant public customer in accordance with proposed § 190.03(a)(2) and request that the customer provide instructions whether to transfer or liquidate the relevant open commodity contracts.<sup>78</sup>

Proposed § 190.03(c)(2) would also require the notice to customers to inform the customer that (i) if the customer does not provide instructions in the prescribed manner

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<sup>77</sup> See also discussion of “Changing the Special Treatment for Hedge Positions” in the ABA Cover Note: Given the policy preference set out in the Model Part 190 Rules that the trustee should attempt to port positions of public customers, which in practice is what typically occurs in actual subpart IV proceedings, we question the need to provide special protection to assure that hedge positions are transferred. We are also concerned that if a trustee is required to identify hedge accounts and provide the hedge account holders the opportunity to keep their positions open, that could interfere with the trustee’s ability to take prudent and timely action to manage the debtor FCM’s estate to protect all customers. We have attempted to strike a balance by allowing the trustee to provide special hedge account treatment when it is practical to do so.

ABA Cover Note at 11-12.

<sup>78</sup> The Commission also would make other changes that are intended to make it simpler for the trustee to identify hedging positions and allow an FCM to designate an account as a hedging account by relying on explicit customer representations that the account contains a hedging position. See proposed § 190.10(b). This would simplify the existing requirement that FCMs provide a hedging instructions form when a customer first opens up a hedging account. For commodity contract accounts opened prior to the effective date of the part 190 revisions, the Commission is proposing that FCMs may rely on written hedging instructions received from the customer in accordance with current § 190.06(d). See proposed § 190.10(b)(3).

and by the prescribed deadline, the customer's open commodity contracts will not be treated as specifically identifiable property; (ii) any transfer of the open commodity contracts is subject to the terms for distribution contained in proposed § 190.09(d)(2); (iii) absent compliance with any terms imposed by the trustee or the court, the trustee may liquidate the open commodity contracts; and (iv) providing instructions may not prevent the open commodity contracts from being liquidated.

To the extent the trustee does not exercise its authority to treat public customer positions carried in a hedging account as specifically identifiable property, the trustee would endeavor to, as the baseline expectation, treat open commodity contracts of public customers carried in hedging accounts the same as other customer property and effect a transfer of such contracts to the extent possible. The Commission is proposing to make these changes to reflect the policy preference to port *all* positions of public customers. Requiring a trustee to identify hedging accounts and provide the hedging account holders the opportunity to keep their positions open may be a resource and time intensive process, which could interfere with the trustee's ability to take prudent and timely action to manage the debtor FCM's estate to protect all of the FCM's customers. By allowing the FCM to rely on representations made by customers during business-as-usual, the trustee will be able to take timely and prudent action to manage the debtor FCM's estate and protect all customers. In cases where it may be practical, the trustee may elect to provide special hedging account treatment.

Proposed § 190.03(c)(3) would address notice of an involuntary bankruptcy proceeding, and is derived from current § 190.02(b)(3). Both sections provide that a trustee appointed in an involuntary proceeding may notify customers of the

commencement of such a proceeding prior to entry of an order for relief, and upon leave of the court, and that a trustee in an involuntary proceeding may request customer instructions with respect to the return, liquidation or transfer of specifically identifiable property. Proposed § 190.03(c)(3) would add a specific reference to proposed § 190.03(a)(2), which would set forth the procedure the trustee must follow in providing notice to customers. This change is intended to make clear that the notice described in proposed § 190.03(c)(3) must be in accordance with the notice provisions set forth in proposed § 190.03(a)(2). In addition, the Commission proposes to change the reference to “the trustee” in current § 190.02(b)(3) to “a trustee” in proposed § 190.03(c)(3) since appointment of a trustee in an involuntary bankruptcy proceeding is not automatic.<sup>79</sup> Lastly, the Commission would delete the specific reference to “open commodity contracts at the end of current § 190.02(b)(3); given that the treatment of open commodity contracts as specifically identifiable property is likely to be less relevant under the proposed regulations, the Commission is proposing that such specific reference is unnecessary.

Proposed § 190.03(c)(4) would require the bankruptcy trustee to notify customers that an order for relief has been entered and instruct customers to file a proof of customer claim and is derived from current § 190.02(b)(4). Proposed § 190.03(c)(4) would add a specific reference to proposed § 190.03(a)(2), which would set forth the procedure the trustee must follow in providing notice to customers. This change would make clear that the notice described in proposed § 190.03(c)(4) must be in accordance with the notice provisions set forth in proposed § 190.03(a)(2).

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<sup>79</sup> See 11 U.S.C. 303(g).

In addition, the Commission would replace the term “customer of record” in current § 190.02(b)(4) with “customer” in proposed § 190.03(c)(4). The term “customer of record” is not a defined term in part 190, and the Commission notes that whether or not a customer qualifies as a “customer of record,” all customers should receive notice that an order for relief has been entered. Specifically, those customers for whom the debtor has contact information in its records should be notified using such contact information. For those customers whose contact information is not available in the debtor’s records, notice is effectively given via the use of a website pursuant to proposed § 190.03(a)(2).

Proposed § 190.03(c)(4) also would provide that the trustee shall cause the proof of customer claim form to set forth the bar date for its filing, a requirement that exists in current § 190.02(d).

The Commission requests comment on proposed § 190.03(c). Are the proposed changes to the notice requirements helpful? Is the grant of discretion to the trustee concerning whether hedging accounts should be treated as specifically identifiable property (based on a policy of facilitating cost effective and prompt administration of the debtor’s estate) appropriately tailored? Do the proposed revisions appear likely to lead to unintended consequences, and, if so, how may such consequences be mitigated?

d. Regulation 190.03(d): Notice of Court Filings

Proposed § 190.03(d) addresses notice of court filings and is derived from current § 190.10(f). The Commission would replace the term “court papers” in current § 190.10(f) to “court filings” in proposed § 190.03(d), as, in the Commission’s view, the term “court filings” is a more accurate description, given that the modernization of court

filings means that many are filed electronically rather than in paper form. In addition, whereas current § 190.10(f) provides that all court papers must be directed to the Washington, DC headquarters of the Commission, in an effort to modernize this section, proposed § 190.03(d) would refer back to proposed § 190.03(a)(1), which requires notices to the Commission to be sent by electronic mail.

The Commission requests comment on proposed § 190.03(d). Do the proposed revisions appear likely to lead to unintended consequences, and, if so, how may such consequences be mitigated?

e. 190.03(e): Proof of Customer Claim

Proposed § 190.03(e) would set forth the requirement for a trustee to request that customers provide information sufficient to determine a customer's claim in accordance with the regulations contained in part 190, and is derived from current § 190.02(d). The proposed regulation would list certain information that customers shall be requested to provide, to the extent reasonably practicable, but would grant the trustee discretion to adapt the request to the facts of the particular case. This discretion would be granted to the trustee in order to enable them to tailor the proof of claim form to the information that, in the considered view of the trustee, is most appropriate in light of the specifics of the types of business that the debtor did (and did not do), the way in which such types of business were organized, and the available records of the debtor (as well as the reliability of those records).

Proposed § 190.03(e) would reorganize and revise certain information items that are listed in current § 190.02(d), though most of the information items listed in proposed

§ 190.03(e) correspond to those listed in current § 190.02(d). The changes to the listed information items are as follows:

- Proposed § 190.03(e)(1) corresponds to current § 190.02(d)(1). Proposed § 190.03(e)(1) would add, for clarity, the four types of commodity contract accounts as defined in proposed § 190.01.
- Proposed § 190.03(e)(2) corresponds to current § 190.02(d)(4). Proposed § 190.03(e)(2) would ask whether the claimant itself is a public or non-public customer, rather than asking whether the account is a public or non-public customer account, as current § 190.02(d)(4) does. In the Commission’s view, such a revision corresponds to the fact that “public customer” and “non-public customer” are the terms that would be defined in proposed part 190, and the information provided by customers should correspond to those defined terms.
- Proposed § 190.03(e)(3) would gather certain information that should be collected with respect to commodity contract accounts held by each claimant with the debtor. Much of the information that would be requested in proposed § 190.03(e)(3) is included in current § 190.02(d), though it would be reorganized and several information items would be revised. Proposed § 190.03(e)(3) would ask for (i) the account number; (ii) the name in which the account is held; (iii) the balance as of the last account statement and any subsequent activity that would affect the balance of the account as stated on the last account statement; (iv) the capacity in which the account is held; (v) whether the account is a joint

account and, if so, the claimant's percentage interest in the account; (vi) whether the account is discretionary; (vii) whether the account is an individual retirement account for which there is a custodian; and (viii) whether the account is a cross-margining account for futures and securities.

- Proposed § 190.03(e)(4) would seek information regarding any accounts held by the claimant with the debtor that are not commodity contract accounts. Proposed § 190.03(e)(4) would be added in order for a claimant to provide a full picture of all accounts it holds with the debtor beyond those classified as commodity contract accounts that are listed in response to paragraph (e)(3) of this section.
- Proposed § 190.03(e)(5) is derived from current § 190.02(d)(6). Proposed § 190.03(e)(5) would seek information regarding all claims against the debtor not based upon a commodity contract account or an account listed in response to paragraph (e)(4) of this section. This provision is meant for a claimant to provide a full picture of all claims it has against the debtor beyond those arising from its commodity accounts with the debtor.
- Proposed § 190.03(e)(6) is the same as current § 190.02(d)(7). Proposed § 190.03(e)(6) would seek information regarding any claims of the debtor against the claimant. Proposed § 190.03(e)(6) would be included in order for a claimant to provide any information about amounts it might owe to the debtor.

- Proposed § 190.03(e)(7) is derived from current § 190.02(d)(8), though the wording would be revised from that in current part 190. While current § 190.02(d)(8) asks about any “deposits of money, securities or property” that the claimant holds with the debtor, proposed § 190.03(e)(7) would seek information regarding “any open positions, unliquidated securities or other unliquidated property” that the claimant may hold with the debtor. This change is meant to correspond to the various forms that specifically identifiable property may take. In addition, proposed § 190.03(e)(7) explicitly would ask for the value of any open positions, unliquidated securities or other unliquidated property. A claimant in an FCM bankruptcy should provide its own view as to the value of such open positions, unliquidated securities or other unliquidated property in order to support its claim against the debtor.
- Proposed § 190.03(e)(8) corresponds to current § 190.02(d)(11). The Commission is proposing slight revisions to the text in the proposed regulation and would ask the claimant to first identify whether it holds positions in security futures products and, only if so, to specify the type of account(s) in which such positions are held.
- Proposed § 190.03(e)(9) corresponds to current § 190.02(d)(12). The Commission would change the word “possible” to “practicable” to clarify that there may be situations where payment in kind is indeed possible but not practicable, and thus to manage expectations.

- Proposed § 190.03(e)(10) is the same as current § 190.02(d)(13). The Commission continues to believe that a claimant in an FCM bankruptcy proceeding should provide copies of any documents that support the information contained in the proof of customer claim.

There is one information item listed in current § 190.02(d) that would not appear in proposed § 190.03(e). Proposed § 190.03(e) would not include current § 190.02(d)(9), which asks whether the claimant is or was an “affiliate,” “insider,” or “relative” of the debtor as those terms are defined by sections 101(2), (25), and (34) of the Bankruptcy Code. This deletion is proposed due to the fact that proposed § 190.03(d)(4) now asks whether the claimant is a public or non-public customer, terms that are defined within proposed part 190. Therefore, a reference to terms as defined in the Bankruptcy Code is no longer necessary.

Finally, the header language to proposed § 190.03(e), unlike that to current § 190.02(d), would not contain a requirement that the proof of customer claim form set forth the bar date for its filing because such requirement would be moved to proposed § 190.03(c)(4), as discussed above.

The Commission requests comment on proposed § 190.03(e). Are the proposed changes helpful? Is the grant of discretion to the trustee concerning the data to be requested appropriately tailored? Do the proposed revisions appear likely to lead to unintended consequences, and, if so, how may such consequences be mitigated?

f. Regulation 190.03(f): Proof of Claim Form

Proposed § 190.03(f) is a new section which would provide that a template proof of claim form is included as appendix A to part 190.<sup>80</sup> The Commission would substantially revise the customer proof of claim form referred to in proposed § 190.03(f), and that is described above in the discussion of proposed § 190.03(e). In revising the customer proof of claim form, the Commission has endeavored to streamline the form, and to better map it to the information listed in proposed § 190.03(e). In that respect, the revised customer proof of claim form now would include, in each section, citations to the location in the text of proposed § 190.03(e) where such information is listed.

Proposed § 190.03(f)(1) would provide that, to the extent there are no open commodity contracts that are being treated as specifically identifiable property, the bankruptcy trustee should modify the proof of claim form to delete any references to open commodity contracts as specifically identifiable property. This would be the case, if, *e.g.*, all open commodity contracts had been transferred or liquidated before the proof of claim form is sent. Proposed § 190.03(f)(2) would make clear that the trustee has discretion whether to use the template proof of claim form, and that the proof of claim form should be modified to reflect the specific facts and circumstances of the case. The provisions of proposed § 190.03(f), taken together, are meant to provide bankruptcy trustees with the appropriate flexibility to determine the best and most efficient way to compose the customer proof of claim form.

The Commission requests comment on proposed § 190.03(f). Are the proposed changes to the treatment of the proof of customer claim form helpful? Do the revisions

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<sup>80</sup> Appendix A is discussed in section II.D below.

appear likely to lead to unintended consequences, and, if so, how may such consequences be mitigated? Is the discretion granted to the trustee appropriately tailored? If not, what changes should be made?

2. Regulation 190.04: Operation of the Debtor’s Estate—Customer Property

Proposed § 190.04 would address the collection of margin and variation settlement, as well as the liquidation and valuation of positions. The Commission is proposing to clarify and update portions of current §§ 190.02, 190.03, and 190.04 in its proposed § 190.04. Changes from the current to the proposed regulation text are discussed below.

The Commission is proposing to revise current § 190.02(e) regarding transfers for customers in a bankruptcy proceeding in proposed § 190.04(a). It would largely retain the current provisions, including the identification of a clear policy preference<sup>81</sup> that the trustee should use its best efforts to transfer open commodity contracts and property held by the failed FCM for or on behalf of its public customers to one or more solvent FCMs.<sup>82</sup> Proposed § 190.04(a)(1) would provide that the trustee “shall promptly” use its best efforts to effect such transfers, while current § 190.02(e)(1) states that the trustee “must immediately” do so. This revision would be a minor change, designed to signal to the trustee to take action to transfer open commodity contracts as soon as practicable, while avoiding the potential pressure of the term “immediately” in light of the challenges presented in an FCM bankruptcy. In addition, in proposed § 190.04(a)(2), the

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<sup>81</sup> The rationale for this policy preference is addressed in the discussion of proposed § 190.00(c)(4) in section II.A.1 above. *See also* ABA Cover Note at 14 (“We recommend explicitly identifying in proposed Rule 190.04(a) a clear policy that the trustee should use best efforts to transfer open commodity contracts and property held by the failed FCM for or on behalf of its public customers to one or more solvent FCMs.”)

<sup>82</sup> Proposed § 190.04(a) also would contain updated cross-references to other provisions within proposed part 190 that discuss transfers of customer property.

Commission is proposing a clarifying change to replace the term “equity” with “property.” In doing so, the Commission would clarify that the trustee should endeavor to transfer all types of property that the commodity broker is holding on behalf of customers; the transfer is not limited to equity. The Commission also would add the word “public” before “customers” to clarify that the transfers discussed in proposed § 190.04(a)(1) relate to the open commodity contracts and property of the debtor’s public customers.<sup>83</sup>

Proposed § 190.04(a)(2) is derived from current § 190.02(e)(2), and would address transfers in the case of involuntary proceedings. In proposed § 190.04(a)(2), the Commission would strike language from current § 190.02(e)(2), addressing involuntary cases, that would limit a commodity broker against which an involuntary petition in bankruptcy is filed to trading for liquidation only unless otherwise directed by the Commission, by any applicable self-regulatory organization or by the court. Limitations on the business of an FCM in bankruptcy would be dealt with more generally in proposed § 190.04(e)(4); there is no need to separately address involuntary cases.<sup>84</sup> Proposed § 190.04(a)(2), like current § 190.02(e)(2), also would provide that if such a commodity broker demonstrates to the Commission within a specified period of time that it is in compliance with the Commission’s segregation and financial requirements on the filing date, the Commission may determine to allow the commodity broker to continue in business. The Commission would retain this provision because, in the Commission’s view, any requirement to transfer customers is properly addressed pursuant to

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<sup>83</sup> The Commission is proposing the same change—addition of the word “public” before “customers”—to proposed § 190.04(a)(2), discussed below.

<sup>84</sup> The reference to “liquidation” further down in current § 190.02(e)(4) accordingly would be deleted, since the limitation to trading for liquidation only would be deleted from the proposed provision.

§ 1.17(a)(4), which deals with FCMs that do not meet minimum financial requirements. The Commission preliminarily is of the view that an FCM that does meet such requirements should not be compelled to cease business and transfer its customers absent an appropriate finding by a court or the Commission. In addition, similarly to proposed § 190.04(a)(1), discussed above, the Commission would replace the term “equity” with “property” to clarify that the transfers discussed in proposed § 190.04(a)(2) are for all types of property that the commodity broker is holding on behalf of customers, rather than limited to only equity. Also, as in proposed § 190.04(a)(1), discussed above, the Commission would add the word “public” before “customers” to clarify that the transfers discussed in proposed § 190.04(a)(1) relate to the open commodity contracts and property of the debtor’s public customers.

In proposed § 190.04(b)(1), the Commission would clarify and update the provisions in current § 190.02(g)(1) allowing a trustee to make “variation and maintenance margin payments” on behalf of the debtor FCM’s customers. While the proposed regulation is intended to be consistent with the current regulation, there are a number of substantive changes to the proposed regulation from the current regulation text.

First, the current regulation limits margin payments to “pending liquidation.” In fact, the approach consistent with the Commission’s longstanding policy is for the trustee to endeavor to *transfer* open commodity contracts. The trustee has *two* paths for the treatment of such contracts: transfer and, if transfer is not possible, liquidation. The regulation would accordingly be revised to permit the trustee to make margin payments pending *transfer or* liquidation, not just pending liquidation.

Second, the current provision could be read to prohibit margin payments for contracts that are being held open. While holding contracts open may or may not be practicable given the particular circumstances of the bankruptcy, a complete prohibition against paying margin on such open contracts would undermine the point of having the possibility to hold those contracts open. Accordingly, the proposed regulation would delete the phrase “required to be liquidated under paragraph (f)(1) of this section” and thus would instead apply more broadly to any open commodity contracts.

The following changes are more technical in nature.

Third, the proposed regulation would replace the phrase “variation and maintenance margin payments” with “payments of initial margin and variation settlement” which, in the Commission’s view, more accurately describes the types of payments being reflected in this provision. Fourth, the proposed regulation would replace the phrase “to a commodity broker” with “to a clearing organization, commodity broker, foreign clearing organization or foreign futures intermediary” to account for the various types of entities to which a margin payment described in this provision may be made. Lastly, the proposed regulation would replace the phrase “specifically identifiable to a particular customer” with “specifically identifiable property of a particular customer” in order to be consistent with the definitions in proposed part 190, which includes as a defined term “specifically identifiable property.”

Proposed § 190.04(b)(1)(i), which is derived from current § 190.02(g)(1)(i), would prevent the trustee from making any payments on behalf of any commodity contract account that is in deficit, to the extent within the trustee’s control. The Commission also would add the phrase “to the extent within the trustee’s control” as

recognition of the fact that certain commodity contract accounts may be held on an omnibus basis (*i.e.*, on behalf of several customers), so to the extent the trustee is making a margin payment on behalf of the omnibus account, it may be out of the trustee's control to identify and only pay on behalf of those underlying customer accounts (within the omnibus account) that are not in deficit. The Commission, lastly, would add a proviso noting that proposed § 190.04(b)(1)(i) shall not be construed to prevent a clearing organization, foreign clearing organization, FCM or foreign futures intermediary from exercising its rights to the extent permitted under applicable law. The Commission is proposing this addition to remove any doubt that the right of these "upstream" entities to use collateral posted by the FCM on an omnibus basis is not affected by the prohibition on making margin payments on behalf of accounts that are in deficit.

Proposed § 190.04(b)(1)(ii) is new and would add a restriction that the trustee cannot make an upstream margin payment with respect to a specific customer account that would exceed the funded balance of that account. This revision would be consistent with the pro rata distribution principle discussed in proposed § 190.00(c)(5), in that any payment in excess of a customer's funded balance would be to the detriment of other customers.

Proposed § 190.04(b)(1)(iii) would make some minor non-substantive clarifications of the language in current § 190.02(g)(1)(ii), but retains the limitation that the trustee may not make payments on behalf of non-public customers of the debtor from funds that are segregated for the benefit of public customers.

Proposed §§ 190.04(b)(1)(iv)-(v) would expand and clarify current § 190.02(g)(1)(iii)<sup>85</sup> to provide that margin must be used consistent with the requirements of section 4d of the CEA.<sup>86</sup> First, proposed § 190.04(b)(1)(iv) would provide that, if the trustee receives payments from a customer in response to a margin call, then to the extent within the trustee's control,<sup>87</sup> the trustee must use such payments to make margin payments for the open commodity contract positions of such customer. Second, proposed § 190.04(b)(1)(v) would provide that the trustee may not use payments received from one public customer to meet the margin (or any other) obligations of any other customer. Given the restriction in paragraph (v), it may be impracticable for a trustee to follow paragraph (iv); in such a situation, the trustee would hold onto the funds received in response to a margin payment and such funds would be credited to the account of the customer that made the payment.<sup>88</sup>

Proposed § 190.04(b)(1)(vi) has its analog in current § 190.02(g)(1)(iv), but would build upon the concept in the current regulation. Current § 190.02(g)(1)(iv) provides that no payments need be made to restore initial margin, thus noting that such payments are not required but implicitly allowing such payments to be made. Proposed § 190.04(b)(1)(vi) would explicate this in more detail and provides more comprehensive guidance to the trustee about when such payments may be made. Specifically, proposed § 190.04(b)(1)(vi) would provide that, in the event that the funds segregated for the benefit of public customers in a particular account class exceed the aggregate net equity

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<sup>85</sup> Current § 190.02(g)(1)(iii) provides that "The trustee must make margin payments if payments of margin are received from customers after bankruptcy in response to margin calls . . . ."

<sup>86</sup> See 7 U.S.C. 6d.

<sup>87</sup> The Commission's proposal to use the phrase "to the extent within the trustee's control" would recognize the reality that certain accounts are held on an omnibus basis. See discussion of proposed § 190.04(b)(1)(i) above.

<sup>88</sup> See proposed § 190.08(c)(1)(ii).

claims for all customers in that account class, the trustee is permitted to use such funds to meet the margin obligations for any public customer in such account class whose account is under-margined, but not in deficit, and sets conditions around such use.

In proposed § 190.04(b)(2), the Commission would update existing § 190.02(g)(2), which concerns margin calls made by a trustee with respect to under-margined accounts of public customers. The Commission would remove the current *requirement* that the trustee issue such margin calls, by replacing the term “must issue margin calls” with “may issue a margin call,” in light of the possibility that the trustee will determine it impracticable or inefficient to do so. Current § 190.02(g)(2), which sets up a retail-level analysis on issuing mandatory margin calls based on the funded balance of the account, is based on a model of the FCM continuing in business. The proposed changes, as reflected in proposed § 190.04(b)(2), would recognize that an FCM in bankruptcy will be operated in crisis mode, and may be pending wholesale transfer or liquidation of open positions.<sup>89</sup> Therefore, the Commission would allow for the *possibility* that the trustee may issue margin calls. The specification of highly prescriptive conditions for issuing such calls is no longer appropriate, given the Commission’s proposal that whether or not to make such a call is now based on the trustee’s discretion.

Proposed § 190.04(b)(3) is largely similar to current § 190.02(g)(3), with updated cross-references. The Commission would retain in proposed § 190.04(b)(3) the important concept that margin payments made by a customer in response to a trustee’s margin call are fully credited to the customer’s funded balance. Since these post-petition

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<sup>89</sup> See generally major theme 7 discussed in section I.B above.

margin payments by the customer are fully counted toward the customer's net allowed equity claims, under proposed § 190.04(b)(3), they would not be subject to pro rata distribution (in contrast to the treatment of the debtor commodity broker's pre-petition obligations to customers).

Proposed § 190.04(b)(4) addresses the trustee's obligation to liquidate certain open commodity contracts, in particular, those in deficit and those where the customer has failed promptly to meet a margin call. It would be a combination of current §§ 190.03(b)(1), 190.03(b)(2) and 190.04(e)(4).

During business as usual, an FCM is required to cover, at all times, any customer accounts in deficit (*i.e.*, those with debit balances) with its own capital.<sup>90</sup> The FCM is also required to cover with its own capital any undermargined amounts in customer accounts each day by no later than the Residual Interest Deadline.<sup>91</sup> These ongoing requirements are intended to protect other customers with positive account balances.

An FCM in bankruptcy will generally not have capital available to protect other customers by covering these obligations; rather, any loss suffered by customers whose accounts are in deficit will be at the risk of those other customers.<sup>92</sup> Proposed § 190.04(b)(4) is intended to mitigate the risk to those other customers by directing the trustee to liquidate such accounts.

In light of the importance of mitigating this fellow-customer risk, proposed § 190.04(b)(4) would, in contrast to many of the other proposed changes to part 190, act

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<sup>90</sup> *See, e.g.*, §§ 1.22(i)(4), 1.23(a)(2).

<sup>91</sup> *See, e.g.*, § 1.22(c)(3).

<sup>92</sup> While the trustee may seek to recover any debit balance from a customer, *see* proposed § 190.09(a)(1)(ii)(E), proposed § 190.04(b)(4) proceeds from the conservative assumption that such efforts will be unsuccessful.

to cabin the trustee's discretion. Specifically, it would first provide that the trustee shall, as soon as practicable, liquidate all open commodity contract accounts in any commodity contract account (i) that is in deficit; (ii) for which any mark-to-market calculation would result in a deficit; or (iii) for which the customer fails to meet a margin call made by the trustee within a reasonable time. This requirement, in part, would reflect current §§ 190.03(b)(1) and (b)(2). Pursuant to current § 190.03(b)(1), a trustee must liquidate open commodity contracts if "any payment of margin would result in a deficit in the account in which they are held."<sup>93</sup> In proposed § 190.04(b)(4), the Commission would add a requirement to liquidate "all open commodity contracts in any commodity contract account that is in deficit." The existing language applies to an account that is on the threshold of deficit; the proposed revised language would clarify that the provision also applies to an account that is already in deficit. Moreover, the change from "payment of margin" to "mark-to-market" calculation addresses the case where the trustee is aware, based on mark-to-market calculations, that the account is in deficit. In order to protect other customers more effectively, the proposed regulation would direct the trustee to begin the liquidation process immediately upon gaining that awareness, rather than delaying until the time when a margin payment is due.

Proposed § 190.04(b)(4) further would provide that, absent exigent circumstances or unless otherwise provided, a reasonable time for meeting margin calls made by a trustee shall be one hour or such greater period not to exceed one business day, as

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<sup>93</sup> An account is in deficit if the balance is negative (*i.e.*, the customer owes the debtor instead of the reverse). An account can be undermargined but not in deficit (if the balance is positive, but less than the amount of required margin). For example, a customer may have a margin requirement of 100 and an equity balance of 80. Such customer is undermargined by 20, but is not in deficit, because the liquidation value of the commodity contracts is positive.

determined by the trustee.<sup>94</sup> This proposed language is largely reflective of current § 190.04(e)(4), though it would add the concept of “exigent circumstances” as a new exception to the general and long-established rule that a minimum of one hour is sufficient notice for a trustee to liquidate an undermargined account. This revision would provide the trustee with the discretion to deem a period of less than one hour as sufficient notice to liquidate an undermargined account if the “exigent circumstances” so require.

The Commission would delete current § 190.03(b)(3), which would permit the trustee to liquidate open commodity contracts where the trustee has received no customer instructions with respect to such contracts by the sixth calendar day following the entry of the order for relief. This change is being proposed as part of a move from a model where the trustee receives and complies with instructions from individual customers to a model—that reflects actual practice in commodity broker bankruptcies in recent decades—where the trustee transfers as many open commodity contracts as possible.<sup>95</sup>

Proposed § 190.04(b)(5) is new, and would provide guidance to the trustee in assigning liquidating positions<sup>96</sup> to the debtor FCM’s customers when only a portion of

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<sup>94</sup> See *Morgan Stanley & Co. Inc. v. Peak Ridge Master SPC Ltd.*, 930 F.Supp.2d 532, 539-540 (S.D.N.Y. 2013)(Morgan Stanley, in its business discretion, determined Peak Ridge's account had assumed overly risky positions, necessitating an increase in the margin requirement and giving Peak Ridge a limited amount of time to bring the account into compliance. “Courts have held that as little as one hour is sufficient notice under similar circumstances.”). See also *Capital Options Invs., Inc. v. Goldberg Bros. Commodities, Inc.*, 958 F.2d 186, 190 (7th Cir. 1992) (“One-hour notice to post additional margin . . . is reasonable where a contract specifically provides for margin calls on options at any time and without notice.”); *Prudential-Bache Sec., Inc. v. Stricklin*, 890 F.2d 704, 706–07 (4th Cir. 1989) (rejecting a claim that 24-hour notice, which the broker normally gave to customers, was necessary before broker could liquidate an undermargined account and upholding notice of one hour as in accordance with the customer agreement); *Modern Settings, Inc. v. Prudential-Bache Sec. Inc.*, 936 F.2d 640, 645 (2d Cir. 1991) (upholding a provision of a customer agreement allowing Defendant-broker to liquidate an undermargined account without notice).

<sup>95</sup> Cf. major theme 7 in section I.B above.

<sup>96</sup> A liquidating position or transaction is one that offsets a position held by the debtor, in whole or in part. Thus, if the debtor has three long March '21 corn contracts, then three (or two, or one) short March '21 corn contracts would be a liquidating transaction.

the open commodity contracts in an omnibus account are liquidated. It is intended to protect the customer account as a whole, in light of the fact that any losses which cause a customer account to go into deficit are, as discussed in connection with proposed § 190.04(b)(4) above, at the risk of other customers. To mitigate the risk of such losses, the provision would establish a preference, subject to the trustee's exercise of reasonable business judgment, for assigning liquidating transactions to individual customer accounts in a risk-reducing manner. Specifically, the trustee should endeavor to assign such liquidating transactions first, in a risk-reducing manner, to commodity contract accounts that *are* in deficit; second, in a risk-reducing manner, to commodity contract accounts that are under-margined;<sup>97</sup> and finally to liquidate any remaining open commodity contracts. Where there are multiple accounts in any of these groups, the trustee would be instructed to, to the extent practicable, allocate such liquidating transactions pro rata. The proposed section would explain that the term "risk-reducing manner" is measured by the margin methodology and parameters followed by the DCO at which such contracts are cleared. Specifically, where allocating a transaction to a particular customer account reduces the margin requirement for that account, such an allocation is "risk-reducing."

Proposed § 190.04(c) directs the trustee to use its best efforts to avoid delivery obligations concerning contracts held through the debtor FCM by transferring or liquidating such contracts before they move into delivery position. It has its analog in current § 190.03(b)(5) and would incorporate a portion of current § 190.02(f)(1)(ii). Current § 190.03(b)(5) instructs the trustee to liquidate promptly and in an orderly manner commodity contracts that are not settled in cash (implicitly, those that settle via

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<sup>97</sup> And thus are next at risk of going into deficit.

physical delivery of a commodity) where the contract would remain open beyond the earlier of (i) the last day of trading or (ii) the first day on which notice of delivery may be tendered—that is, where the contract would move into delivery position. Proposed § 190.04(c) would have the same purpose, but would use more explicit language regarding physical delivery, referring to “any open commodity contract that settles upon expiration or exercise via the making or taking of delivery of a commodity,” and moving into the delivery position. In addition, proposed § 190.04(c) would expand on current § 190.03(b)(5) to include explicit reference to how options on commodities move into delivery position, some of which is taken from current § 190.02(f)(1)(ii).

Proposed § 190.04(d) is derived from current §§ 190.02(f) and 190.04(d). Specifically, proposed § 190.04(d) would set forth the categories of commodity contracts and other property held by or for the account of a debtor that must be liquidated by the trustee in the market or by book entry offset, promptly and in an orderly manner.<sup>98</sup>

Importantly, the Commission would retain the requirement, present in the header language to current § 190.02(f), that the trustee effect such liquidation “in an orderly manner.” This is to recognize that any factor which, in the trustee’s discretion, makes it imprudent to liquidate a position at a particular point in time would contribute to the trustee’s judgment as to what constitutes liquidation “in an orderly manner.”

Proposed § 190.04(d)(1) derives from current § 190.02(f)(1), and would provide that all open commodity contracts must be liquidated, subject to two exceptions:

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<sup>98</sup> The Commission is proposing three non-substantive changes in the header language to proposed § 190.04(d) from that in current § 190.02(f): (1) addition of the phrase “except as otherwise set forth in this paragraph (d)” to account for any exceptions that are included in the subsections under the header language; (2) addition of cross-references to proposed § 190.04(e) when discussing liquidation, as that provision contains instructions on how to effect liquidation; and (3) deletion of the phrase “subject to limit moves and to applicable procedures under the Bankruptcy Code.”

(1) commodity contracts that are specifically identifiable property and are subject to customer instructions to transfer as provided in proposed § 190.03(c)(2); and (2) open commodity contract positions that are in a delivery position.<sup>99</sup> In the former case (specifically identifiable property), proposed § 190.04(d)(1) would revise the language of current § 190.02(f)(1)(ii) to add references to the provisions of proposed § 190.03(c)(2) (concerning the trustee's option to treat hedging accounts as specifically identifiable property) and proposed § 190.09(d)(2) (concerning the payments that customers on whose behalf specifically identifiable commodity contracts will be transferred must make to ensure that they do not receive property in excess of their pro rata share).<sup>100</sup> The latter exception, for open commodity contract positions that are in a delivery position is new, and would provide that such positions should be treated in accordance with proposed § 190.06, which concerns delivery.<sup>101</sup>

Proposed § 190.04(d)(2) would describe when specifically identifiable property, other than open commodity contracts or physical delivery property must be liquidated. This provision derives from current § 190.02(f)(2), but would contain a number of revisions.

First, the proposed provision would apply to specifically identifiable property, other than open commodity contracts *or physical delivery property*, while the current regulation applies only to specifically identifiable property other than open commodity

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<sup>99</sup> Proposed § 190.04(d)(1) would also delete the reference in current § 190.02(f)(1)(i) to dealer option contracts since such term is no longer used.

<sup>100</sup> As noted above in the discussion of proposed § 190.04(c), part of current § 190.02(f)(1)(ii) would be incorporated into proposed § 190.04(c), and therefore would not appear in proposed § 190.04(d)(1).

<sup>101</sup> As noted in section II.A.1 above in the discussion of proposed § 190.00(c)(6), a delivery default could have a disruptive effect on the cash market for the commodity and could adversely impact the parties to the transaction.

contracts. This change is intended to provide the trustee with discretion to avoid interfering with the physical delivery process.

Second, while the current regulation would require liquidation of such property if the fair market value of the property drops below 90% of its value on the date of the entry of the order for relief,<sup>102</sup> the proposed regulation (in paragraph (d)(2)(i)) changes that figure to 75% of the fair market value, in order to provide greater discretion to the trustee to forego or postpone liquidation in appropriate cases.

Third, the proposed regulation (in paragraph (d)(2)(ii)) would add an additional condition that would require liquidation where failure to liquidate the specifically identifiable property may result in a deficit balance in the applicable customer account, which corresponds to the general policy of liquidating any accounts that are in deficit.

Lastly, the proposed regulation (in paragraph (d)(2)(iii)), while similar to current § 190.02(f)(2)(ii), would include updated cross-references to the provisions in proposed part 190 that discuss the return of specifically identifiable property.

Proposed § 190.04(d)(3) is new, and is intended to codify the Commission's longstanding policies of pro rata distribution and equitable treatment of customers in bankruptcy, as described in § 190.00(c)(5) above, as applied to letters of credit posted as margin.<sup>103</sup> Accordingly, customers who post letters of credit as margin would be treated no differently than other customers and thus would suffer the same pro rata loss.

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<sup>102</sup> See current § 190.02(f)(2)(i).

<sup>103</sup> See, e.g., 48 FR 8716, 8718-19 (March 1, 1983) (Commission intends "to assure that customers using a letter of credit to meet original margin obligations would be treated no differently than customers depositing other forms of non-cash margin or customers with excess cash margin deposits. If letters of credit are treated differently than Treasury bills or other non-cash deposits, there would be a substantial incentive to use and accept such letters of credit as margin as they would be a means of avoiding the pro rata distribution of margin funds, contrary to the intent of the [Bankruptcy] Code [11 U.S.C. 766].")

The implementation of this policy in current § 190.08(a)(1)(i)(E) was challenged in an adversary proceeding in the MF Global Bankruptcy,<sup>104</sup> the codifications of this policy in proposed §§ 190.00(c)(5) (clarifying policy), 190.04(d)(3) (treatment in bankruptcy), and 190.10(d) (treatment during business as usual) are intended to effectively implement the policy and to forestall any future challenge.

Proposed paragraph (d)(3) would provide that the trustee may request that such a customer deliver substitute customer property with respect to any letter of credit received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract. This would apply whether the letter of credit is held by the trustee on behalf of the debtor's estate or a DCO or a foreign broker or foreign clearing organization, and whether it is held on a pass-through or other basis. The amount of the substitute customer property to be posted may be less than the full face amount of the letter of credit, in the trustee's discretion, if such lesser amount is sufficient to ensure pro rata treatment consistent with proposed §§ 190.08 and 190.09. If required, the trustee may require the customer to post property equal to the full face amount of the letter of credit to ensure pro rata treatment. Proposed paragraph (d)(3)(i) would provide that, if such a customer fails to provide substitute customer property within a reasonable time specified by the trustee, the trustee may draw upon the full amount of the letter of credit or any portion thereof.

Proposed paragraph (d)(3)(ii) would address cases where a letter of credit received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract is not fully drawn upon. The trustee would be instructed to treat any portion of

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<sup>104</sup> See *ConocoPhillips v. Giddens*, No. 12 Civ. 6014, 2012 WL 4757866 (S.D.N.Y. 2012)

the letter of credit that is not fully drawn upon as having been distributed to the customer. However, the amount treated as having been distributed would be reduced by the value of any substitute customer property delivered by the customer to the trustee. For example, if the face amount of the letter of credit is \$1,000,000, the customer delivers \$250,000 in substitute customer property, and no portion of the letter of credit is drawn upon, then the trustee will treat the customer as having received a distribution of \$750,000. In order to avoid an effective transfer of value, due to an expiration on or after the date of the order for relief, to the customer who posted the letter of credit, this calculation will not be changed due to such an expiration.

Paragraph (d)(3)(iii) would confirm that any proceeds of a letter of credit drawn by the trustee, or substitute customer property posted by a customer, shall be considered customer property in the account class applicable to the original letter of credit.

Proposed § 190.04(d)(4), which would provide for the liquidation of all other property not required to be transferred or returned pursuant to customer instructions and which has not been liquidated, is derived from current § 190.02(f)(3). Proposed § 190.04(d)(4) would except from the liquidation requirement any “physical delivery property held for delivery in accordance with the provision of” proposed § 190.06, in order to avoid interfering with the physical delivery process.

In proposed § 190.04(e), the Commission would provide details regarding the liquidation and valuation of open positions.<sup>105</sup> This paragraph is derived from current § 190.04(d), subject to a number of changes.

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<sup>105</sup> In proposed § 190.08(d), the Commission would also clarify the process by which customer positions and other customer property are valued for purposes of determining the amount of a customer’s claim.

Proposed § 190.04(e)(1)(i), which would describe the process of liquidating open commodity contracts when the debtor is a member of a clearing organization, is derived from current § 190.04(d)(1)(ii). Both the current and the proposed regulations include an emphasis on achieving the goal of competitive pricing “to the extent feasible under market conditions at the time of liquidation.” Treatment under the CEA of clearing organization rules has evolved from a pre-approval regime to a primarily self-certification regime. The Commission is of the view that the various processes set forth in part 40 of the Commission’s regulations (including self-certification under § 40.6, voluntary submission for rule approval under § 40.5, and Commission review of certain rules of systemically important DCOs under § 40.10) are sufficient, and that a separate rule approval process for rules regarding settlement price in the context of a bankruptcy is no longer necessary. The Commission is accordingly proposing in § 190.04(e)(1)(i) to delete the requirement, contained in current § 190.04(d)(1)(i), that a clearing organization obtain approval pursuant to section 5c(c) of the CEA for its rules regarding liquidation of open commodity contracts.

Proposed § 190.04(e)(1)(i) also would add a provision regarding open commodity contracts that are futures or options on futures that were established on or subject to the rules of a foreign board of trade and cleared by the debtor as a member of a foreign clearing organization, providing that such contracts shall be liquidated pursuant to the rules of the foreign clearing organization or foreign board of trade or, in the absence of such rules, in the manner the trustee deems appropriate. This new provision would be analogous to the current one, but would additionally extend to cases where the debtor FCM is a member of a foreign clearing organization.

Proposed § 190.04(e)(1)(ii) is new. It would provide instructions to the trustee regarding the liquidation of open commodity contracts where the debtor is not a member of a DCO or foreign clearing organization, but instead clears through one or more accounts established with an FCM or a foreign futures intermediary. In such a case, the proposed regulation would provide that the trustee shall use commercially reasonable efforts to liquidate the open commodity contracts to achieve competitive pricing, to the extent feasible under market conditions at the time of liquidation. The Commission would add this provision in order to account for those circumstances where the trustee must liquidate open commodity contracts for a debtor that is not a clearing member.

As with proposed § 190.04(e)(1)(i), the Commission would delete the rule approval requirement in proposed § 190.04(e)(2) for the same reasons stated above. Proposed § 190.04(e)(2) is derived from current § 190.04(d)(1)(ii). The proposed regulation would provide for a trustee or clearing organization to apply to the Commission for permission to liquidate open commodity contracts by book entry. In such a case, the settlement price for such commodity contracts shall be determined by the clearing organization in accordance with its rules, which shall be designed to establish, to the extent feasible under market conditions at the time of liquidation, such settlement prices in a competitive manner.

Proposed § 190.04(e)(3) is new. It would recognize that an FCM or foreign futures intermediary through which a debtor FCM carries open commodity contracts will generally have enforceable contractual rights to liquidate such commodity contracts. The proposed rule would confirm that the upstream intermediary may exercise such rights. However, there would be a proviso: the liquidating FCM or foreign futures intermediary

shall use commercially reasonable efforts to liquidate the open commodity contracts to achieve competitive pricing, to the extent feasible under market conditions at the time of liquidation and subject to any rules or orders of the relevant clearing organization, foreign clearing organization, designated contract market, swap execution facility or foreign board of trade governing its liquidation of such open commodity contracts.

If the liquidating FCM or foreign futures intermediary fails to do so, the trustee may seek damages reflecting the difference in price(s) resulting from such failure. However, such damages are the trustee's sole available remedy; the proposed regulation makes clear that "[i]n no event shall any such liquidation be voided."

Proposed §§ 190.04(e)(4)(i) and (ii) derive from current §§ 190.04(d)(2) and (3), respectively, with some minor non-substantive language changes and updated cross-references.

Proposed § 190.04(f) derives from current § 190.04(e)(5). Proposed § 190.04(f) would contain only minor non-substantive changes from the current regulation text, including (1) a cross-reference to the liquidation provisions in proposed §§ 190.04(d) and (e), and (2) a clarification that the provision is referring to commodity contracts that are long option contracts, rather than to long option contracts more generally.

The Commission requests comment with respect to all aspects of proposed § 190.04. Specifically, do the revisions create any unintended conflicts with customer protection regulations set forth in parts 1, 22, and 30? If so, how may such conflicts be resolved? Are any of the proposed clarification changes (here or elsewhere) likely to create unintended consequences? If so, how might those be avoided or mitigated?

The Commission specifically seeks comment on whether the revised approach in proposed § 190.04(b)(4) regarding the required liquidation of certain open commodity contract accounts provides the trustee with an appropriate amount of discretion and is practicable. Given the level of discretion provided, are the trustee's choices likely to be challenged by customers who believe they did not benefit from those decisions? Could such challenges materially slow down the distribution of customer property relative to a context where the trustee was granted less discretion? Also, is the approach set forth in proposed § 190.04(b)(5), regarding the assignment of liquidating positions to debtor FCM customers in a "risk-reducing manner" when only a portion of the open commodity contracts in an omnibus account are liquidated, practicable? The Commission also seeks comment in particular on the treatment of letters of credit in bankruptcy, as set forth in proposed § 190.04(e).

3. Regulation 190.05: Operation of the Debtor's Estate—General

The Commission would revise parts of current § 190.04 in proposed § 190.05, and would add two new provisions to (1) require a trustee to use all reasonable efforts to continue to issue account statements for customer accounts holding open commodity contracts or other property, and (2) clarify the trustee's obligations with respect to residual interest.

Proposed § 190.05(a) is derived from current § 190.04(a). Given that an FCM bankruptcy will likely be a fast-paced situation requiring the trustee to make decisions with little time for consideration, the Commission recognizes that there may be circumstances under which strict compliance with the CEA and the regulations thereunder may not be practicable. Accordingly, while current § 190.04(a) states that the

trustee “shall” comply with all provisions of the CEA and of the regulations thereunder as if it were the debtor, the Commission would amend the language in proposed § 190.05(a) to state that the trustee “shall use reasonable efforts to comply” with all provisions of the CEA and of the regulations thereunder as if it were the debtor. This change is intended to provide the trustee some flexibility in making decisions in an emergency bankruptcy situation, subject, of course, to the requirements of the Bankruptcy Code.

Proposed § 190.05(b) is derived from current § 190.04(b). In revising this provision, the Commission’s objective is to provide the bankruptcy trustee with the latitude to act reasonably given the circumstances they are confronted with, recognizing that information may be more reliable and/or accurate in some insolvency situations than in others and permitting an approach that, to an appropriate extent, favors cost effectiveness and promptness over precision.<sup>106</sup> Whereas current § 190.04(b) provides that a trustee “must” compute a funded balance for each customer account which contains open commodity contracts as of the close of each business day, proposed § 190.05(b) would require that trustee to use “reasonable efforts” to compute a funded balance for each customer account that contains open commodity contracts or other property as of the close of business each business day until such open commodity contracts and other property in such account has been transferred or liquidated. Proposed § 190.05(b) further would provide that such computations “shall be as accurate as reasonably practicable under the circumstances, including the reliability and availability of information.”

In addition, proposed § 190.05(b) would increase the scope of customer accounts for which the bankruptcy trustee is obligated to compute a funded balance to accounts

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<sup>106</sup> See major theme 7.c discussed in section I.B above.

that contain open commodity contracts or other property, as opposed to just accounts that contain open commodity contracts. In the Commission’s view, this broadened scope is appropriate; there is no reason to exclude customer accounts that contain only property (the value of which may change) from the scope of those for which bankruptcy trustees must compute a daily funded balance. Moreover, proposed § 190.05(b) would revise the length of time the trustee has the obligation to compute the funded balance of customer accounts. In current § 190.04(b), the trustee must compute a funded balance for certain customer accounts “until the final liquidation date.” In proposed § 190.05(b), however, the trustee must compute a funded balance only until the open commodity contracts and other property in the account have been transferred or liquidated. This change ties the computation requirement to each specific account, such that a bankruptcy trustee is not required to continue to compute the funded balance of customer accounts that do not contain any open commodity contracts or other property. Lastly, while current § 190.04(b) required the computation to be completed by noon on the next business day, the Commission does not believe that a noon deadline is crucial in a bankruptcy context (as it is with respect to an FCM conducting ongoing daily business<sup>107</sup>); proposed § 190.05(b) therefore would not contain a specific deadline. Of course, such computation would inherently need to be accomplished prior to performing any action where knowledge of funded balances is essential, such as transfer of accounts or property.

Proposed § 190.05(c) is derived from current § 190.04(c).

Proposed § 190.05(c)(1) concerns record retention, and is derived from current § 190.04(c)(1). It is intended to be more comprehensive than the current provision, and

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<sup>107</sup> See, e.g., § 1.32(d).

thus would expand the records referred to from “computations required by this part” to “records required under this chapter to be maintained by the debtor, including records of the computations required by this part.” It is also, on the other hand, intended to enable the trustee to mitigate the expenses of record retention by permitting them to end their record retention responsibilities effectively when they close the bankruptcy case. The proposed provision would thus reduce the time that records are required to be retained from “the greater of the period required by § 1.31 of this chapter or for a period of one year after the close of the bankruptcy proceeding for which they were compiled” to “until such time as the debtor’s case is closed.”

Proposed § 190.05(c)(2) would simplify the corresponding portion of current § 190.04(c)(2) by omitting the requirement that the records required in proposed § 190.05(c)(1) be available to the Court and parties in interest. It would retain the requirement that such records be available to the Commission and the United States Department of Justice. A court will generally not itself look at records, and any parties in interest should have access to records under the discovery provisions of the Federal Rules of Bankruptcy Procedure and the Federal Rules of Civil Procedure, as applicable.

Proposed § 190.05(d) is new. It is intended to facilitate the ability of customers of the bankrupt FCM with open commodity contracts or property to keep track of such open commodity contracts or property even during insolvency, and promptly to make them aware of the specifics of the liquidation or transfer of such contracts or property. It would require the trustee to use all reasonable efforts to continue to issue account statements with respect to any customer for whose account open commodity contracts or other property is held that has not been liquidated or transferred. The provision also would

require the trustee to issue an account statement reflecting any liquidation or transfer that has taken place with respect to a customer account promptly after such liquidation or transfer has occurred.

Proposed § 190.05(e)(1) concerns disbursements to customers. It is derived from current § 190.04(e)(2). The Commission is proposing to change this provision to reflect the policy preference to transfer as many public customer positions as practicable in the event of an FCM insolvency.<sup>108</sup> Proposed § 190.05(e)(1) would provide that a trustee needs court approval to make disbursements to customers, but (in contrast to the current regulation) would specifically carve out disbursements made in connection with a transfer of customer property made in accordance with proposed § 190.07. The Commission notes, however, that specifically carving out transfers made in accordance with proposed § 190.07 from requiring court approval does not detract from the trustee's ability to, in their discretion, nonetheless seek and obtain court approval for certain transfers of customer property. The Commission recognizes that there is an inherent tension between distributing to public customers as much customer property as possible from the debtor's estate, as quickly as possible, and ensuring accuracy in distribution, and believes that proposed § 190.05(e)(1) strikes the right balance between these competing objectives.<sup>109</sup>

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<sup>108</sup> The Commission notes that current § 190.08(d) provides for the return of specifically identifiable property other than commodity contracts under certain circumstances (namely, where the customer makes good any pro rata loss related to that property) without court approval; however, the Commission would delete this provision in favor of allowing transfers without court approval for the reasons stated above.

<sup>109</sup> The concept of prioritizing cost effectiveness and promptness over precision is discussed in detail in major theme 7.c in section I.B above and in overarching concept three in the cost-benefit considerations, section IV.C.3 below.

Proposed § 190.05(e)(2) is derived from current § 190.04(e)(3). It concerns how a bankruptcy trustee may invest the proceeds<sup>110</sup> from the liquidation of open commodity contracts and specifically identifiable property, and other customer property. Proposed § 190.05(e)(2) would retain much of current § 190.04(e)(3), although the Commission would expand the provision in current § 190.04(e)(3) permitting the bankruptcy trustee to “invest any customer equity in accounts which remain open in accordance with § 190.03” to permit the investment of “any other customer property,” albeit continuing to strictly limit the permissible investments to obligations of, or fully guaranteed by, the United States, and limiting the location of permissible depositories to those located in the United States or its territories or possessions.

Proposed § 190.05(f) is new. It would require a bankruptcy trustee to apply the residual interest provisions contained in § 1.11 “in a manner appropriate to the context of their responsibilities as a bankruptcy trustee” and “in light of the existence of a surplus or deficit in customer property available to pay customer claims.” The purpose of the residual interest provisions is to have the FCM maintain a sufficient buffer in segregated funds “to reasonably ensure that the [FCM] . . . remains in compliance with the segregated funds requirements at all times.”<sup>111</sup>

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<sup>110</sup> Proposed § 190.05(e)(2) would use the term “proceeds” rather than the term “equity,” which is used in current § 190.04(e)(3). This would be simply a change in wording and would not be meant to be a substantive difference.

<sup>111</sup> Section 1.11(e)(3)(i)(D).

The ABA Submission would instead have provided:

*Residual interest.* The trustee is not required to transfer cash, securities, or other property of the debtor into a segregated account to maintain the debtor’s ongoing compliance with its targeted residual amount obligations pursuant to § 1.11 of this chapter and the debtor’s residual interest policies adopted thereunder or its related obligations to cover debit balances or under-margined amounts as provided in §§ 1.22, 22.2 or 30.7 of this chapter; provided, however, that any property not segregated under this exception shall nonetheless constitute customer property as provided in § 190.09(a)(1).

In the Commission’s view, the residual interest provisions contained in § 1.11 remain important, even in bankruptcy, in order to facilitate the goal of having each customer of the debtor receive in distributions from the debtor’s estate all that the customer is entitled to, and therefore a trustee should be obligated to continue to apply such provisions, as appropriate, during the course of an FCM bankruptcy proceeding.

The context of the trustee’s responsibilities—to wind down operations, and to transfer or liquidate positions and assets—will have a significant impact on how the trustee should apply the residual interest provisions. The references to a surplus or deficit in customer property in proposed § 190.05(f) are meant to apply the residual interest provisions to the bankruptcy context. Specifically, the Commission expects that, to the extent there is a surplus of segregated customer funds in a particular account class, a trustee would apply the residual interest provisions to minimize the risk that there could be a deficit and, to the extent there is a deficit of segregated customer funds in a particular account class, the trustee would apply the residual interest provisions to minimize such deficit and to promote the fair distribution of customer property consistent with the pro rata principle.

The Commission requests comment with respect to all aspects of proposed § 190.05. Specifically, the Commission seeks comment on the practicability of the proposed requirements in proposed § 190.05(d) regarding the issuance of account statements. The Commission also requests comment on the practicability and

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The ABA Cover Note explains that “It seems impractical to require the trustee to continue to assure that funds of the debtor FCM are transferred into segregation to meet the FCM’s top up obligations after the order for relief.” *Id.* at 15.

For the reasons explained in the text, the Commission is instead proposing to require the trustee to apply the residual interest provisions, but on a modified basis.

appropriateness of § 190.05(f), which proposes to require the application of the residual interest provisions set forth in § 1.11 in order to minimize risks of deficit of customer property during bankruptcy.

4. Regulation 190.06: Making and Taking Delivery under Commodity Contracts

The issues concerning delivery in bankruptcy are discussed in some detail in proposed 190.00(c)(6).

As discussed above,<sup>112</sup> proposed § 190.04(c) directs the trustee to use its best efforts to avoid delivery obligations concerning contracts held through the debtor FCM by transferring or liquidating such contracts before they move into delivery position. Where the trustee is unable to do so, proposed § 190.06(a)(2), discussed below, would direct the trustee to use reasonable efforts to permit the relevant customer to make or take delivery outside the administration of the debtor's estate. Where that is not practicable, proposed § 190.06(a)(3) would address delivery as part of the administration of the debtor's estate. Proposed §§190.06(a)(4) and (5) discuss, respectively, issues relating to deliveries in a securities account and in a house account, while proposed §190.06(b) addresses the issues concerning special account class provisions for delivery accounts.<sup>113</sup>

In proposed § 190.06, the Commission is proposing to make significant changes to current § 190.05 regarding making and taking deliveries on commodity contracts to provide more specificity and to reflect current delivery practices. Generally, open positions may get caught in a delivery position where the parties incur bilateral

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<sup>112</sup> Section II.B.2.

<sup>113</sup> These issues are also addressed in the definitions of account class, delivery account class, cash delivery property and physical delivery property, discussed in section II.A.2 (§ 190.01 (definitions)).

contractual delivery obligations.<sup>114</sup> It is important to address deliveries to avoid disruption to the cash market for the commodity and to avoid adverse consequences to parties that may be relying on delivery taking place in connection with their business operations.

The current delivery provisions largely reflect the delivery practices at the time current part 190 was adopted in 1983. At that time, delivery was effected largely by tendering paper warehouse receipts or certificates. In contrast, most deliverable title documents today are held and transferred in electronic form, typically with the clearing organization serving as the central depository for such instruments. Under the terms of some contracts (such as energy futures) the party with the contractual obligation to make delivery will physically transfer a tangible commodity to meet its obligations.<sup>115</sup> In other cases, intangible commodities may be delivered, including virtual currencies.

As noted previously, in the definitions section (proposed § 190.01), the Commission is proposing to divide the delivery account class into physical delivery and cash delivery account classes to recognize the differing obligations for the different types of delivery.

The Commission is also proposing to recognize that, consistent with current practice, physical deliveries<sup>116</sup> may be effected in different types of accounts in proposed

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<sup>114</sup> The timing of the entry of the order for relief in a subchapter IV proceeding relative to when physical delivery contracts move into a delivery positions will generally determine whether a delivery issue may arise. Additionally, during business as usual, market participants typically offset contracts before incurring delivery obligations.

<sup>115</sup> See ABA Cover Note at 15.

<sup>116</sup> Current § 190.05 applies to delivery of a physical commodity. Proposed § 190.06 would apply to any type of commodity that is subject to physical delivery, whether tangible or intangible. This would be captured in the definition of physical property discussed earlier. Given the different ways in which delivery may take place, physical delivery property is not limited to property that an FCM holds for or on behalf of a

§ 190.06.<sup>117</sup> For example, when an FCM has a role in facilitating delivery, deliveries may occur via title transfer in a futures account, foreign futures account, cleared swaps account, delivery account, or, if the commodity is a security, in a securities account.

Proposed § 190.06(a)(2), which would replace current § 190.05(b), addresses delivery made or taken on behalf of a customer outside of the administration of the debtor's estate, (*i.e.*, directly between the debtor's customer and the delivery counterparty assigned by the clearing organization). Current § 190.05(b) requires a DCO, DCM, or SEF to enact rules that permit parties to make or take delivery under a commodity contract outside the debtor's estate, through substitution of the customer for the commodity broker. The Commission believes that deliveries should occur in this manner only where feasible. Deliveries may not always happen in this manner, as customers largely rely on their FCMs to hold physical delivery property on their behalf in electronic form.<sup>118</sup>

Thus, proposed § 190.06(a)(2)(i) would direct the trustee to use "reasonable efforts" to allow a customer to deliver physical delivery property that is held directly by the customer in settlement of a commodity contract, and to allow payment in exchange for such delivery, to occur outside the debtor's estate, where the rules of the exchange or clearing organization prescribe a process for delivery that allows delivery to be fulfilled either (A) in the ordinary course by the customer, (B) by substitution of the customer for the commodity broker, or (C) through agreement of the buyer and seller to alternative

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customer in a delivery account. For a discussion of those different ways, *see* the third category under the definition of physical delivery property in § 190.01 in section II.A.2 above.

<sup>117</sup> *See also* proposed § 190.10(c).

<sup>118</sup> The proposed regulation again would delete the requirement for registered entity rules to be submitted for approval in accordance with section 5c(c) of the Act for reasons discussed in proposed §§ 190.04(e)(1) and (2).

delivery procedures. In requiring the trustee to use “reasonable efforts,” rather than (as in current § 190.06(a)(1)) “best efforts,” to allow a customer to deliver physical property that is held directly by the customer and not by the debtor to occur outside the administration of the debtor’s estate, the Commission would recognize that in the event that the trustee is unable to transfer or earlier liquidate the positions, delivery involves a significant degree of bespoke administration. Moreover, requiring the trustee’s best efforts for delivery might require the trustee to spend more time focusing on the needs of a few customers and detract from the trustee’s ability to manage the short term challenges of the administration of the estate in the days immediately following the filing date.

Proposed § 190.06(a)(2)(ii) would address the circumstance where, while the customer makes physical delivery in satisfaction of a commodity contract using property that is outside the administration of the estate of the debtor, the customer nonetheless has property held in connection with that contract at the debtor (*i.e.*, collateral posted in connection with that contract pre-petition). Consistent with existing § 190.05(b)(2), the proposed paragraph provides that the property held at the debtor becomes part of the customer’s claim, and can only be distributed pro rata, despite the customer fulfilling the delivery obligation outside the administration of the debtor’s estate.

Proposed § 190.06(a)(3) would apply when it is not practicable to effect delivery outside the estate. The Commission would revise current § 190.05(c)(1)-(2) in proposed § 190.06(a)(3) by providing additional details for when delivery is made or taken within the debtor’s estate. Proposed § 190.06(a)(3) would clarify that which was implied and was not addressed in current § 190.5(c)(1)-(2). It would contain provisions for the trustee to deliver physical or cash delivery property on a customer’s behalf, or return such

property to the customer so that the customer may fulfill its delivery obligation. This regulation would include restrictions designed to assure that a customer does not receive (or otherwise benefit from) a distribution of customer property (or other use of such property that benefits the customer) that exceeds the customer's pro rata share of the relevant customer property pool.

Proposed § 190.06(a)(4) is new and would recognize that delivery may need to be made in a securities account if an open commodity contract held in a futures account, foreign futures account, or cleared swaps account requires the delivery of securities, and property from any of these accounts is transferred to the securities account for the purpose of effecting delivery. Nonetheless, the value of the property transferred to the securities account must be limited to the customer's funded balance for a commodity contract account, and only to the extent that funded balance exceeds (*i.e.*, the surplus over) the customer's minimum margin requirements for that account. Moreover, such transfer may not be made if the customer is under-margined or has a deficit balance in any other commodity contract accounts.

Proposed § 190.06(a)(5) is derived from current § 190.05(c)(3), with some clarifying rewording. No substantive change is intended.

Proposed § 190.06(b) is new, and would create separate account subclasses for physical delivery property held in delivery accounts and the proceeds of such physical delivery property separate from cash delivery property.<sup>119</sup> As noted by the ABA

Committee:

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<sup>119</sup> See reference to discussion of physical delivery property above in proposed § 190.00. In particular, recall that "physical delivery property" can include any deliverable commodity, and is not limited to commodities that are tangible.

Customer property held in a delivery account is not subject to Commission segregation requirements. Thus, it may be more difficult to identify customer property for the delivery account class. Based on lessons learned from the MF Global bankruptcy, it appears that those challenges are greater for tracing cash. Physical delivery property, in particular when held in the form of electronic title documents as is prevalent today, is more readily identifiable and less vulnerable to loss, compared to cash delivery property that an FCM may hold in an operating bank account.<sup>120</sup>

For these reasons, the Commission proposal would divide the delivery account class into separate physical delivery and cash delivery account subclasses, for purposes of pro rata distributions to customers in the delivery account class on their net equity claims. Proposed § 190.06(b)(1)(i) would provide that the physical delivery account class includes physical delivery property held in delivery accounts as of the filing date, and the proceeds of any such physical delivery property received subsequently (*i.e.*, after the filing date), and (ii) the cash delivery account class includes cash delivery property in delivery accounts as of the filing date, along with physical delivery property for which delivery is subsequently taken (*i.e.*, after the filing date) on behalf of a customer in accordance with proposed § 190.06(a)(3).

Proposed § 190.06(b)(2) would provide that customer property in the cash delivery account class includes cash or cash equivalents that are held in an account under a name, or in a manner, that clearly indicates that the account holds property for the purpose of making payment for taking delivery of a commodity under commodity contracts. Customer property in the cash delivery account class would also include any other property that is (x) not segregated for the benefit of customers in the futures, foreign futures, or cleared swaps account classes) and (y) traceable (through, *e.g.*,

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<sup>120</sup> ABA Cover Note at 14. *See generally* discussion of the *delivery account class* in the discussion of the definition of *account class* in § 190.01 in section II.A.2 (definitions) above.

account statements) as having been received after the filing date as part of taking delivery.

Proposed §190.06(b)(2) would also provide, conversely, that customer property in the physical delivery account class includes cash or cash equivalents that are held in an account under a name, or in a manner, that clearly indicates that the account holds property received in payment for making delivery of a commodity under a commodity contract. Customer property in the physical delivery account class would also include any other property that is (x) not segregated for the benefit of customers in the futures, foreign futures, or cleared swaps account classes) and (y) traceable (through, e.g., account statements) as having been held for the purpose of making delivery of a commodity under a commodity contract, or held as of the filing date as a result of taking delivery.

The Commission requests comment with respect to all aspects of proposed § 190.06. In particular, the Commission seeks comment on the implications of the proposal in § 190.06(b) to subdivide the delivery account class into separate physical delivery and cash delivery account subclasses. Are there additional challenges or benefits that the Commission has not considered?

#### 5. Regulation 190.07: Transfers

The policy preference for transferring (or “porting”) public customer commodity contract positions, as well as all or a portion of such customers’ account equity, is discussed in proposed § 190.00(c)(4). In proposed § 190.07, the Commission is proposing to make changes to current § 190.06 governing transfers.

Proposed § 190.07(a) would revise current § 190.06(a), which sets forth general provisions for transfers.

Proposed § 190.07(a)(1) derives from current § 190.06(a)(1), with a few technical changes.

In proposed § 190.07(a)(2), which derives from current § 190.06(a)(2), the Commission would make minor changes to improve readability, although no substantive changes are intended. In addition, in § 190.07(a)(2), the Commission would delete “or persons which are required to be registered as futures commission merchants” because such persons are included within the definition of futures commission merchants in § 1.3.

The changes in proposed § 190.07(a)(3) from current § 190.06(a)(3) focus on the goal of promoting transfers, but only to the extent consistent with good risk management. Specifically, the current regulation provides that no clearing organization or other self-regulatory organization may adopt, maintain in effect, or enforce rules that *prevent* the acceptance by its members of transfers of open commodity contracts and the equity margining or securing of such contracts from FCMs with respect to which a petition in bankruptcy has been filed, if the transfers have been approved by the Commission. It also states that this provision shall not limit the exercise of any contractual right of a clearing organization or other registered entity to liquidate open commodity contracts.

In proposed § 190.07(a)(3), the Commission would change the word “prevent” to “[i]nterfere with” to focus on the goal of promoting transfers consistent with good risk management. Further, the Commission would re-word the current regulation and specifically would clarify that the regulations do not limit a clearing organization or other

registered entity's contractual right adequately to manage risk or to liquidate or transfer open commodity contracts.<sup>121</sup>

Proposed § 190.07(b) would revise current § 190.06(c), regarding requirements for transferees. In proposed § 190.07(b)(1), the Commission would clarify current § 190.06(c)(1) to establish that it is the duty of the transferee – not of anyone else – to assure that the transferee is not in violation of the minimum financial requirements upon accepting a transfer. The Commission would reframe current § 190.06(c)(2) in proposed § 190.07(b)(2)(i), but the changes would not be substantive. Similarly, proposed §§ 190.07(b)(2)(ii)(A) and (B) would transpose current §§ 190.06(c)(3) and (4), respectively, with conforming and non-substantive wording changes.

Proposed §§ 190.07(b)(3) and (4) are new common sense provisions to guide the transfer of open commodity contracts and property.

Proposed § 190.07(b)(3) recognizes that customer diligence processes would have already been required to have been completed by the debtor FCM with respect to each of its customers as part of opening their accounts. It thus would provide that a transferee may accept open commodity contracts and property, and may open accounts on its records prior to completing customer diligence, provided that account opening diligence as required is performed as soon as practicable but no later than six months after transfer, unless the time is extended, by the Commission, for a particular account, transfer, or debtor. The Commission believes that this proposal is entirely consistent with past

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<sup>121</sup> See ABA Cover Note at 14 (“recommend[ing] ... [c]larification that the rule does not limit a DCO’s (or other registered entity’s) contractual right to liquidate *or transfer* open commodity contracts.”) Separately, the Commission would delete current § 190.06(b) regarding notice to the Commission regarding an intention to transfer commodity contracts held by or for a commodity broker from or for the account of a customer to another person registered as an FCM after a bankruptcy petition has been filed. In the Commission’s view, this provision would be duplicative of the notice provision in proposed § 190.03(b)(2) and therefore would be unnecessary.

practice in FCM bankruptcies, and provides the flexibility that is likely to be needed in a bankruptcy situation by allowing transfers to occur before customer due diligence is completed, while still retaining the requirement that due diligence be performed as soon as practicable thereafter.

Proposed § 190.07(b)(4) is intended to further clarify what the governing agreement between the transferred customer and the transferee is at and after the time the transfer becomes effective. It is intended to make clear that any consequences for breaches pre-transfer would be borne by the transferor rather than the transferee. It would provide that any account agreements governing a transferred account shall be deemed assigned to the transferee and shall govern the customer's relationship unless and until a new agreement is reached, and would also provide that a breach of the agreement prior to a transfer does not constitute a breach on the part of the transferee.

Proposed § 190.07(b)(5) carries forward current § 190.02(c), and would provide that customer instructions received by the debtor with respect to open commodity contracts or specifically identifiable property that has been, or will be, transferred in accordance with section 764(b) of the Bankruptcy Code, should be transmitted to any transferee, who shall comply therewith to the extent practicable (if the transferee subsequently enters insolvency).

The Commission would revise current § 190.06(e), eligibility for transfer under section 764(b) of the Bankruptcy Code (accounts eligible for transfer), in proposed § 190.07(c). Sections and references pertaining to dealer option accounts and leverage accounts would be deleted because those account types are no longer being addressed in

this regulation.<sup>122</sup> The proposed revision in § 190.07(c) would change the language “all accounts are eligible for transfer” in current § 190.06(e)(1) to “[a]ll commodity contract accounts (including accounts with no open commodity contract positions) are eligible for transfer. . . .” The new language would focus on the commodities business and recognizes that accounts can be transferred even if the accounts are intended for trading commodities but do not include any open commodity contracts at the time of the order for relief.<sup>123</sup>

Proposed § 190.07(d), special rules for transfers under section 764(b) of the Bankruptcy Code, primarily would revise current § 190.06(f). Current § 190.06(f)(1) concerning dealer options would not be covered in this regulation.

Proposed § 190.07(d)(1) would be relocated from current § 190.02(e)(1).

Proposed § 190.07(d)(2) would be drawn from current § 190.06(f)(3), with revision intended to more generally promote transfers.

Currently § 190.06(f)(3)(i) provides that the Commission will not disapprove such a transfer for the sole reason that it was a partial transfer if it would prefer the transfer of accounts, the liquidation of which could adversely affect the market or the bankrupt estate. The Commission would revise the language in proposed § 190.07(d)(2)(i) to state that the Commission will not disapprove such a transfer for the sole reason that it was a

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<sup>122</sup> This refers to the entirety of current §§ 190.06(e)(1)(ii)-(iii) and (f)(1) and the reference to dealer option contracts in §190.06(f)(3)(i). Accounts for trading commodities are used to purchase or sell a commodity.

<sup>123</sup> Cf. 11 U.S.C. 761(9)(A)(ii)(II) (customer means, with respect to an FCM, an entity that holds a claim against the FCM arising out of “a deposit or payment of cash, security, or other property with such [FCM] for the purpose of making or margining [a] commodity contract”) (emphasis added).

Thus, where a person opens a customer account and deposits collateral on day 1, intending to trade on day 3 (or some subsequent day when the customer determines that it is propitious to trade) and the FCM becomes a debtor on day 2 (or some other day when the customer has no positions open) such person nonetheless qualifies as a customer, and their claim would be a customer claim.

partial transfer.” The proposed revision would be consistent with the policy of promoting the transfer of customer commodity accounts.

In proposed § 190.07(d)(2)(ii), the Commission would clarify that the open commodity contracts and the associated property are to be transferred, thus the term “property” has been inserted throughout the section. The Commission would propose to add to current § 190.06(f)(2)(ii) a requirement that a partial transfer of contracts and property may be made *so long as such transfer would not result in an increase in the amount of any customer’s net equity claim*. The added language would caution against partial transfers that would break netting sets and make the customer worse off. The Commission also would add language that clarifies that one way to accomplish a partial transfer is by liquidating a portion of the open commodity contracts held by a customer such that sufficient value is realized, or margin requirements are reduced to an extent sufficient, to permit the transfer of some or all of the remaining open commodity contracts and property. The revisions are intended to clarify that the liquidation may either crystallize gains or have the effect of reducing the required margin. Finally, with regards to the transfer of part of a spread or a straddle, the Commission would insert language in § 190.07(d)(2)(ii) that states “to the extent practicable under the circumstances,” each side of the spread or straddle must be transferred or none of the open commodity contracts comprising the spread or straddle may be transferred. This language would be added to clarify that the trustee is required to protect customers holding spread or straddle positions from the breaking of netting sets, but only to the extent practicable given the circumstances.

Proposed § 190.07(d)(3) is new. It would provide details regarding the treatment and transfer of letters of credit used as margin, consistent with other proposed provisions related to letters of credit. Generally, this provision states that a letter of credit associated with a commodity contract may be transferred with an eligible commodity contract account if it is held by a DCO on a pass-through basis or if it is transferable by its terms. This transfer cannot be made if it would result in a recovery that exceeds the amount to which the customer is entitled in proposed §§ 190.08 and 190.09 (note that, pursuant to proposed § 190.04(d)(3)(ii), any portion of such a letter of credit that is not drawn upon is treated as having been distributed to the customer, except to the extent that the customer delivers substitute customer property).

If the letter of credit cannot be transferred and the customer does not deliver substitute property, the trustee may draw upon a portion or upon all of the letter of credit, the proceeds of which will be treated as customer property in the applicable account class. The Commission believes a regulation detailing how letters of credit are to be treated in a transfer will provide more certainty, as there is currently no such regulation, and that the proposed treatment is both practical and consistent with the policy of pro rata distribution.<sup>124</sup>

Proposed § 190.07(d)(4) is new and would require a trustee to use reasonable efforts to prevent physical delivery property from being separated from commodity contract positions under which the property is deliverable. The Commission is proposing this regulation to clarify its expectations in such situations, specifically, to promote the delivery process.

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<sup>124</sup> See also discussion of treatment of letters of credit in bankruptcy under proposed § 190.04(d)(3) in section II.B.2.

Proposed § 190.07(d)(5) is intended to prevent prejudice to customers generally by prohibiting the trustee from making a transfer that would result in insufficient customer property being available to make equivalent percentage distributions to all equity claim holders in the applicable account class. It would revise current § 190.06(e)(2), changing the framing of the current regulation and focusing on transfers as a whole. The Commission further would clarify that the trustee should make determinations based on customer claims reflected in the FCM's records, and, for customer claims that are not consistent with those records, should make estimates using reasonable discretion based in each case on available information as of the calendar day immediately preceding transfer.

The Commission would revise current § 190.06(g) in proposed § 190.07(e), regarding the prohibition on avoidance of transfers under section 764(b) of the Bankruptcy Code. Throughout proposed § 190.07(e), the Commission would insert “or customer property” following “the transfer of commodity contract accounts” to clarify that transfers of commodity contract accounts include the associated customer property, and that customer property may be transferred even if the customer has no open commodity contracts (as was done in the MF Global bankruptcy).

In proposed § 190.07(e)(1), concerning transfers that were made pre-relief,<sup>125</sup> the Commission would add language that transfers “are approved” to clarify that the Commission is following the procedure set forth in the Bankruptcy Code and adding

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<sup>125</sup> Proposed § 190.07(e) refers to transfers that were made “pre-relief” rather than “pre-filing date” because section 764(b) is based on the date of relief, not the filing date. The difference is attributable to the fact that, unlike voluntary bankruptcy cases, where the filing of the case constitutes an order for relief, see 11 U.S.C. 301(b), the order for relief in an involuntary bankruptcy will issue only if the petition is not timely controverted, or after trial. *See* 11 U.S.C. 303(h).

specific citations to the Bankruptcy Code. Proposed § 190.07(e)(1)(ii) also would apply to withdrawals or settlements at the request of public customers, in addition to transfers, in order to incorporate current § 190.06(g)(3). In this context, “public customers” would include a lower-level (*i.e.*, downstream) FCM acting on behalf of its own public customers (*e.g.*, cleared at the debtor on an omnibus basis).

Proposed § 190.07(e)(1)(iii) would add a provision to respect the actions of a receiver acting to protect the interests of customers in their property. Specifically, the provision would prohibit the avoidance of a transfer from “a receiver that has been appointed for the FCM that is now a debtor.”<sup>126</sup>

Proposed § 190.07(e)(2) would pertain to post-relief transfers. In proposed § 190.07(e)(2)(i), which is derived from current § 190.06(g)(2)(i), the Commission would modify the term “SRO/commodity broker” to “clearing organization” because the only entities who can perform the transfers that are subject to the provision are the trustee, and, in certain circumstances, clearing organizations. Proposed § 190.07(e)(2)(ii) is derived from current § 190.06(g)(2)(ii). Similarly, proposed § 190.07(e)(3) is derived from current § 190.06(g)(3), dealing with withdrawals (in contrast to the transfers dealt with previously).

Proposed § 190.07(f) is a revision to current § 190.06(h) regarding Commission action. The Commission would clarify that, notwithstanding the other provisions of this section (with exceptions discussed below), it may prohibit the transfer of a particular set or sets of the commodity contract accounts, or permit the transfer of a particular set or sets of commodity contract accounts that do not comply with the requirements of the

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<sup>126</sup> A receiver might be appointed pursuant to, *e.g.*, section 6c(a) of the CEA, 7 U.S.C. 13a-1(a).

section. In addition, the Commission would clarify that the transfers of the commodity contract accounts includes the associated customer property. The exceptions are the policy in favor of avoiding the breaking of netting sets in § 190.07(d)(2)(ii), and the avoidance of prejudice to other customers in § 190.07(d)(5).

The Commission requests comment with respect to all aspects of proposed § 190.07. Specifically, the Commission seeks comment on proposed § 190.07(b)(3), which permits transferees to accept open commodity contracts and property prior to completing customer diligence. Does the proposed provision with a maximum six-month period post-transfer (absent Commission action) for diligence requirements provide FCMs with sufficient flexibility to accept transfers following an FCM bankruptcy? Are there additional constraints on the requirements to perform diligence imposed by other regulators that the Commission should take into account? The Commission also seeks comment on proposed § 190.07(d)(2)(ii). Are there better ways to structure the provisions regarding partial transfers of a customer's commodity contract account? Is the discretion granted to the trustee concerning estimates of other customer claims appropriate?

6. Regulation 190.08: Calculation of Allowed Net Equity

Proposed § 190.08 is derived from current § 190.07, with a significant number of technical changes.

Proposed § 190.08(a) is derived from current § 190.07(a), but changed to reflect the fact that, under the revised definition of the term "primary liquidation date," all commodity contracts will be liquidated or transferred prior to the primary liquidation

date.<sup>127</sup> Since no (relevant) operations will occur subsequent to the liquidation date, current § 190.07(d), a provision that sets forth instructions on how to adjust a customer's funded balance due to operations subsequent to the primary liquidation date, is rendered moot, and the reference to such section would be removed in proposed § 190.08(a).<sup>128</sup>

Proposed § 190.08(b), like current § 190.07(b), would set forth the steps for a trustee to follow when calculating each customer's net equity.<sup>129</sup> This proposed revision is meant to clarify that, when calculating the customer's claim against the debtor, the basis for calculating such claim should be what appears in the debtor's records. Once the customer's claim based on the debtor's records is calculated, the customer will have the opportunity to dispute such claim based on their own records, and the trustee may adjust the debtor's records if it is persuaded by the customer. However, for purposes of the calculations set forth in proposed § 190.08(b), the focus should be on the numbers that appear in the debtor's own records. In the header language to proposed § 190.08(b), the text would accordingly refer to "a customer's total customer claim of record" rather than "the total claim of a customer" against the estate of the debtor."

In addition, the header language to proposed § 190.08(b) would clarify that the calculation of a customer's claim against the debtor is based on all types of customer property, including any commodity contracts, held by the debtor for or on behalf of the

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<sup>127</sup> See definition of "primary liquidation date" in proposed § 190.01.

<sup>128</sup> For the same reason, two other provisions in current § 190.07 also would be deleted. First, current § 190.07(b)(6), which instructs the trustee how to adjust the calculation of net equity of accounts remaining open subsequent to the primary liquidation date, would be deleted from proposed part 190. Second, current § 190.07(c)(2)(v), which provides that the calculation of funded balance must be adjusted by deficits generated by the continued operation of accounts after the primary liquidation date which cannot be fully adjusted under current § 190.07(d), has also would be deleted. Since, under the revised definition of the term "primary liquidation date," no accounts will remain open subsequent to the primary liquidation date, these two provisions would no longer be necessary.

<sup>129</sup> Pursuant to section 20(a)(5) of the CEA, 7 U.S.C. 24(a)(5), the Commission has the power to provide how the net equity of a customer is to be determined.

customer. While this was always the Commission’s intent, the language in current § 190.07(b) could be construed more narrowly to exclude any customer property other than commodity contracts.

Proposed § 190.08(b)(1), which would set forth the steps for a trustee to follow when calculating the equity balance of each commodity contract account of a customer, is derived from current § 190.07(b)(1), with the following changes (to the extent not addressed below, the provisions in proposed § 190.08(b)(1) are the same as those in current § 190.07(b)(1)).

First, in proposed § 190.08(b)(1)(i), which corresponds to current § 190.07(b)(1), the revised text would instruct the trustee to determine the equity balance of “each commodity contract account,” rather than “each customer account.” The term “commodity contract account” would be a defined term and, in the Commission’s view, using such defined term in this context would be more precise because a customer may have other types of accounts (*e.g.*, securities accounts) with the debtor that are not relevant for the purposes of calculating net equity.

Second, in proposed § 190.08(b)(1)(i)(C), which corresponds with current § 190.07(b)(1)(iii), the Commission would replace the term “current realizable market value” with “realizable market value” in order to avoid confusion, since, according to the regulation text, the realizable market value is determined as of the close of the market on the last preceding market day.

Third, proposed § 190.08(b)(1)(ii)(A)(2), which corresponds with current § 190.07(b)(1)(iii)(A)(2), would be simplified to more clearly refer to the cash proceeds

from the liquidation of the customer securities or other property referred to earlier in proposed § 190.08(b)(1)(i)(C).

Fourth, proposed § 190.08(b)(1)(ii)(A)(4) regarding letters of credit is new, and would be added to be consistent with other new provisions regarding how letters of credit are to be treated in the event of an FCM bankruptcy. This provision would treat the face amount of any letter of credit received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract as part of the posting customer's ledger balance.<sup>130</sup>

Lastly, in proposed § 190.08(b)(1)(ii)(B)(2), which corresponds with current § 190.07(b)(1)(iii)(B)(2), the Commission would add a reference to transfers made pursuant to proposed §§ 190.04(a) and 190.07, which the Commission would clarify should be categorized as disbursements for the purposes of this paragraph.

Proposed § 190.08(b)(2) is derived from current § 190.07(b)(2). Proposed § 190.08(b)(2) would provide instructions to the trustee regarding how to aggregate the credit and debit equity balances of all accounts of the same class held by a customer. Specifically, the proposed regulation would set forth how to determine whether accounts are held in the same capacity or in separate capacities. The Commission is proposing three changes in proposed § 190.08(b)(2) from current § 190.07(b)(2). First, in both proposed §§ 190.08(b)(2)(iii) and (iv), the Commission would add language to clarify that, in discussing accounts held in the name of an executor or administrator of an estate, the Commission is referring to accounts held in the name of an executor or administrator

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<sup>130</sup> Separately, in proposed § 190.04(d)(3)(ii), any portion of the letter of credit that is not drawn upon is treated as having been distributed to the customer (with any substitute customer property posted serving as an offset).

*in its capacity as such.* This clarification would reflect what was always intended in current §§ 190.07(b)(2)(iii) and (iv). Second, in proposed § 190.08(b)(2)(viii), the Commission would delete the terms “leverage accounts” and “options accounts,” as those types of accounts are no longer being addressed in proposed part 190.<sup>131</sup> Third, also in proposed § 190.08(b)(2)(viii), the Commission would add a referenced exception to the paragraph, which notes that futures accounts, delivery accounts, and cleared swaps accounts of the same person shall not be deemed to be held in separate capacities, although such accounts may be aggregated in accordance with paragraph (b)(3) of the section. Current § 190.07(b)(2)(viii) is subject to one exception, paragraph (b)(2)(ix) of the section, which sets forth that an omnibus customer account of an FCM shall be deemed to be held in a separate capacity from the house account and any other omnibus customer account of such person. Proposed § 190.08(b)(2)(viii) would also be subject to exception from paragraph (b)(ix) and would add another exception, from paragraph (b)(xiv), which would reflect that accounts held by a customer in separate capacities shall be deemed to be accounts of separate customers. Fourth, in proposed § 190.08(b)(2)(xi), the Commission would expand the scope of retirement or pension plans that are discussed in that paragraph. As written, current § 190.07(b)(2)(xi) refers only to retirement or pension plans under the Employee Retirement Income Security Act of 1974 (“ERISA”); the Commission’s proposal would expand the scope of plans dealt with in proposed § 190.08(b)(2)(xi) to those under ERISA or similar federal,<sup>132</sup> state or foreign laws or regulations applicable to pension and retirement plans since, in the Commission’s view,

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<sup>131</sup> See proposed § 190.00(d)(1)(i).

<sup>132</sup> Including, *e.g.*, a church plan exempt from ERISA pursuant to section 403(b)(9) thereof.

any such retirement or pension plan is a separate entity from its administrators, employers, employees, participants, or beneficiaries.

Proposed § 190.08(b)(3), which sets forth instructions regarding how and when to set off positive and negative equity balances, is derived from current § 190.07(b)(3). The Commission would make several non-substantive edits to the current text for clarification purposes including, in proposed § 190.08(b)(3)(ii), adding letters to illustrate the equation that is described in the text. In addition, the Commission would edit §§ 190.08(b)(3)(ii) and (iii) to clarify that the provisions regarding the offset against a positive equity balance only apply in the event a customer has more than one class of account with a positive equity balance. Lastly, the Commission would make a slight change in proposed § 190.08(b)(3)(v) to clarify that, prior to the entry of an order for relief, the provisions of § 1.22 of the Commission's regulations and section 4d of the CEA govern what setoffs are permitted. As written, current § 190.07(b)(3)(v) refers to both the date of entry of an order for relief and the filing date, but the Commission notes that, in an involuntary bankruptcy, there may be a time gap between those dates. The Commission's proposed change to refer only to the date of entry of an order for relief would account for that inconsistency.

Proposed § 190.08(b)(4), which would provide that the value of property that has been transferred or distributed must be added to the net equity amount calculated for that customer, is substantially similar to current § 190.07(b)(4). In the proviso language, the Commission would replace the term "customer claims" with "allowed customer claims." This change is intended to clarify that the calculation of net equity for any late-filed claims should be based on the amount that the customer is actually entitled to. The

Commission also would correct a typographical error in current § 190.07(b)(4) where the word “data” should be “date.”

Proposed § 190.08(b)(5), which would provide that the calculation of net equity should be adjusted to correct for misestimates or errors, including corrections for the liquidation of claims or specifically identifiable property at a value different from the estimate value previously used in computing net equity, would be substantially similar to current § 190.07(b)(5), with two minor changes. First, the Commission is proposing to revise the term “subsequent events” to “ongoing events” in order to recognize that such events may be “ongoing” during the administration of the estate, accounting for the volatility that may arise with such events. The prior term of “subsequent events” refers to the primary liquidation date. Second, the Commission would add the phrase “or specifically identifiable property” to clarify that one of the ongoing events that should result in an adjustment to the calculation of net equity is the liquidation of unliquidated claims *or specifically identifiable property* at a value different from the estimated value previously used.

Proposed § 190.08(c), concerning the calculation of the funded balance, is derived from current § 190.07(c). In the header language to proposed § 190.08(c), the references to calculation as of the primary liquidation date would be deleted, because the funded balance (*i.e.*, each customer’s pro rata share of the customer estate with respect to an account class) is relevant both (i) before the primary liquidation date (in support of determining how much value may be transferred, if a prompt transfer can be arranged) and (ii) after the primary liquidation date (as the value of property in the estate relative to

claims may change as assets (including claims *by* the estate) are marshalled and liquidated, and claims against the estate are made and resolved).

Proposed § 190.08(c)(1), would set forth instructions for calculating the funded balance of any customer claim, and is derived from current § 190.07(c)(1). The Commission would make several non-substantive edits to the current text for clarification purposes, including (1) in proposed § 190.08(c)(1), clarifying that the funded balance of any customer claim shall be computed separately by account class and customer class; (2) in proposed § 190.08(c)(1)(i), adding letters to illustrate the equation that is described in the text; and (3) in proposed § 190.08(c)(1)(i)(B) and (C), referring to “other property” instead of simply “property.” In addition, the Commission would add § 190.08(c)(1)(i)(A), which would state that the ratio calculated in proposed § 190.08(c)(1)(i) should be multiplied by the sum of, among other items, the value of letters of credit received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract relating to all customer accounts of the same class. This provision would be added to provide consistency with the other new provisions regarding the use of letters of credit.

Proposed § 190.08(c)(1)(i)(B) is derived from current § 190.07(c)(1)(i)(A). Here, the Commission would refer to “all customer accounts of the same class” rather than “all accounts of the same class.” This change is meant to clarify that this provision only applies to customer accounts.

Proposed § 190.08(c)(1)(ii) is derived from current § 190.07(c)(1)(ii), with two proposed changes: First, the Commission would recognize that an FCM may be taken into insolvency involuntarily, and proposes to account for that possibility by starting the

period during which 100% of margin is credited in an involuntary case on the date of the bankruptcy filing. Second, taking into account prior changes made with respect to the use of letters of credit, the Commission would add a proviso at the end of the paragraph to describe how margin posted to substitute for a letter of credit would affect the calculation of funded balance.

Proposed § 190.08(c)(2) is derived from current § 190.07(c)(2), and would require the funded balance to be adjusted to correct for ongoing events including, but not limited to, those events listed in the proposed and current regulation. Current § 190.07(c)(2)(v) would be deleted from the proposed regulation since, under the revised definition of “primary liquidation date,” no account will be continuing to operate after the primary liquidation date, thus rendering current § 190.07(c)(2)(v) moot. In this section the Commission would revise the term “subsequent events” to “ongoing events” for the same reasons discussed in § 190.08(b)(5).

Proposed § 190.08(d) is derived from current § 190.07(e). Both set forth instructions about how to value commodity contracts and other property for purposes of calculating net equity as set forth in the rest of proposed § 190.08. The Commission is proposing to delete current §§ 190.07(e)(2) (valuation of principal contracts) and (e)(3) (valuation of bucketed contracts) in favor of the more generalized approach to valuing property held by or for a commodity broker set forth in proposed § 190.08(d)(5), which allows the trustee a certain degree of flexibility in valuing such property. Proposed § 190.08(d)(5) is discussed in further detail below.

In addition, current § 190.07(e) contains, in the header language, instructions to the trustee about when the trustee may use the weighted average of the liquidation prices

of commodity contracts and other property in computing the net equity of each customer. The Commission would retain the concept of using the weighted average of liquidation prices in certain circumstances, but would move such concept into other sections of proposed § 190.08(d); as such, this concept is discussed in further detail below.

Proposed § 190.08(d)(1) is derived from current § 190.07(e)(1), and would set forth instructions about how to value commodity contracts. The Commission would reorganize proposed § 190.08(d)(1) into two paragraphs: (i) open commodity contracts, and (ii) liquidated commodity contracts.

In proposed § 190.08(d)(1)(i) regarding the valuation of open commodity contracts, the Commission would maintain the requirement that the value of an open commodity contract shall be equal to the settlement price as calculated by the clearing organization pursuant to its rules. The Commission, however, would delete the requirement that the clearing organization's rules must be approved by the Commission. As noted above,<sup>133</sup> the Commission believes that the various processes set forth in part 40 of the Commission's regulations (including self-certification under § 40.6, voluntary submission for rule approval under § 40.5, and Commission review of certain rules of systemically important DCOs under § 40.10) are sufficient, and that a separate rule approval process for rules regarding valuation of open commodity contracts is no longer necessary.

In addition, current § 190.07(e)(1) provides that, if an open commodity contract is transferred, its value shall be determined as of the end of the settlement cycle in which it is transferred. The Commission would change the timing for valuation in proposed

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<sup>133</sup> See discussion of proposed § 190.04(e)(2) in section II.B.2 above.

§ 190.08(d)(1)(i) to the end of the last settlement cycle on the day preceding the transfer. This would allow the value of the open commodity contract to be known prior to the transfer. There would be other non-substantive revisions to the wording of proposed § 190.08(d)(1)(i) as compared to that in current § 190.08(e)(1).

Proposed § 190.08(d)(1)(ii) would be changed to clarify how to value commodity contracts that have been liquidated. Current § 190.07(e)(1) provides that the value of a liquidated commodity contract “shall be equal to the net proceeds of liquidation.” Proposed § 190.08(d)(1)(ii) instead provides that the value of a liquidated commodity contract “shall equal the actual value realized on liquidation of the commodity contract.”

Proposed § 190.08(d)(1)(ii)(A) would allow the trustee to use the weighted average of liquidation prices for identical commodity contracts that are liquidated within a 24-hour period or business day, but not at the same price. This concept derives from text that is currently in § 190.07(e). This provision is important because it recognizes that, in a bankruptcy situation, the trustee may liquidate identical commodity contracts over a short period of time but may not be able to liquidate them all at the same price. In order to provide the trustee with an appropriate mechanism for determining the value of such commodity contracts, the Commission is proposing to allow the trustee to use the weighted average of liquidation prices of identical commodity contracts liquidated within a certain period of time but at different prices. The Commission proposes certain changes to the current text including, for example, the time period within which such contracts must be liquidated in order for the trustee to use the weighted average of the liquidation prices. While current § 190.07(e) applies this concept to commodity contracts liquidated “on the same date,” proposed § 190.08(d)(1)(ii)(A) would apply this concept to

commodity contracts liquidated “within a 24 hour period or business day (or such other period as the bankruptcy court may determine is appropriate).” The Commission notes that settlement days and business days often do not fall within one calendar date. For instance, in accordance with proposed § 190.01, a “business day” begins at 8 a.m. one day and ends at 7:59:59 a.m. the next day that is a business day. On weekends, a “business day” begins at 8 a.m. on Friday morning and ends at 7:59:59 a.m. on Monday morning. Thus, the Commission would revise the time frame in proposed § 190.08(d)(1)(ii)(A) to bring it more in line with how settlement cycles and business days work.

Proposed § 190.08(d)(1)(ii)(B), which would provide instructions on how to value commodity contracts that are liquidated as part of a bulk auction by a clearing organization or similarly outside of the open market, is a new provision. It is important to recognize that commodity contracts are, at times, liquidated as part of a bulk auction or otherwise outside of the open market, and to provide for a mechanism by which to value commodity contracts that are liquidated in such a manner. The proposed regulation would value a commodity contract that is liquidated as part of a bulk auction at the settlement price calculated by the clearing organization as of the end of the settlement cycle during which the commodity contract was liquidated. The Commission is not proposing to set the value of a commodity contract that is liquidated as part of a bulk auction at the auction price, because the auction will not necessarily establish the price for each particular position; rather, the auction might cover an entire portfolio, or a portfolio that is divided into separate “lots” that consist of related (but not necessarily identical) positions.

Proposed § 190.08(d)(2) is derived from current § 190.07(e)(4). Proposed § 190.08(d)(2) would incorporate the same weighted average concept discussed above with respect to proposed § 190.08(d)(1)(ii)(A), allowing a trustee to use the weighted average of the liquidation prices of identical securities that are liquidated within a 24-hour period or business day (or such other period as the bankruptcy court may determine is appropriate), but not at the same price. As discussed above, allowing a trustee to use the weighted average of liquidation prices of identical securities liquidated within a certain period of time but at different prices provides the trustee with an appropriate mechanism for determining the value of such securities. For the same reasons stated above, the Commission would revise the time period within which such securities must be liquidated in order for the trustee to use the weighted average of the liquidation prices. In addition, for clarification purposes, the Commission is proposing that the value of liquidated securities shall equal the actual value realized on liquidation of the securities.

Proposed § 190.08(d)(3) is derived from current § 190.07(e)(5). While current § 190.07(e)(5) determines how to value “cash commodities” held in inventory, the Commission believes that this concept is more appropriately applied to all “commodities” held in inventory. Additionally, recognizing that the fair market value of a commodity held in inventory is not always readily ascertainable, the Commission would provide that, in such an event, the trustee may value such commodity in accordance with proposed § 190.08(d)(5), a catch-all provision providing the trustee with flexibility to value property using such professional assistance as they deem necessary.

Proposed § 190.08(d)(4) is new, and would be added by the Commission to be consistent with other changes regarding the use of letters of credit received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract.

Proposed § 190.08(d)(5) is derived from current § 190.07(e)(5). Proposed § 190.08(d)(5) would provide the trustee with pragmatic flexibility in determining the value of customer property by allowing the trustee, in their discretion, to enlist the use of professional assistance to value customer property. In furtherance of the goal of providing flexibility to the trustee, the Commission would delete the requirement that the trustee seek approval of the court prior to enlisting professional assistance to value customer property.<sup>134</sup> Such a constraint, in the Commission's view, unduly restricts the trustee's actions in a bankruptcy situation and is unnecessary. In addition, for clarification purposes, the Commission is proposing that the value of property that is sold shall equal the actual value realized on sale of such property.

The Commission requests comment with respect to all aspects of proposed § 190.08. Specifically, the Commission seeks comment with regards to the proposed revisions to the calculation of the equity balance of a commodity contract set forth in proposed § 190.08(b)(1). Are there any unintended consequences from the proposed revisions and, if so, how can such consequences be mitigated? The Commission also seeks comment as to the appropriateness of the proposal to determine the value of an open commodity contract at the end of the last settlement cycle on the day preceding the transfer rather than at the end of the day of the transfer, as set forth in § 190.08(d)(1)-(2).

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<sup>134</sup> To be sure, the requirements of 11 U.S.C. 327 concerning the employment of professional persons would still apply. However, the regulation would no longer require the approval of the court to invoke the assistance of such an approved professional in valuing customer property, so long as such assistance falls within the scope of activity approved pursuant to Code section 327.

7. Regulation 190.09: Allocation of Property and Allowance of Claims

Proposed § 190.09 is derived from current § 190.08. Generally, proposed § 190.09 would provide that the property of a debtor's estate must be allocated among account classes and between customer classes as provided in the proposed regulation. This property would constitute a separate estate of the customer class and the account class to which it is allocated and would be designated by reference to such customer class and account class.

There are three substantive changes in proposed 190.09, and a significant number of technical changes. The substantive changes are as follows:

Proposed §§ 190.09(a)(1)(ii)(G) and (L) are two categories of property that are defined to be included in customer property in order better to protect customers from shortfalls in customer property (*i.e.*, cases where customer property is insufficient to cover claims for customer property).

Paragraph (G) would be a new category of property that constitutes customer property. It would include any cash, securities, or other property which constitutes current assets of the debtor, including the debtor's trading or operating accounts and commodities of the debtor held in inventory, in the greater of (i) the amount of the debtor's targeted residual interest amount pursuant to § 1.11 with respect to each account class, or (ii) the debtor's obligations to cover debit balances or under-margined amounts as provided in §§ 1.20, 1.22, 22.2 and, 30.7.<sup>135</sup> Each of the sets of regulations referred to

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<sup>135</sup> See ABA Cover Note at 15 ("recommend[ing] adding a provision to the customer property definition that deems property in the debtor's estate to be customer property to the extent of the FCM's obligation to maintain a targeted residual amount in segregation pursuant to CFTC Rule 1.11, or its obligation to cover debit balances or under-margined amounts in customer accounts under CFTC Rules 1.22, 22.2 or 30.7 ...

in proposed § 190.09(a)(1)(ii)(G) requires an FCM to put certain funds into segregation on behalf of customers. To the extent the FCM has failed to comply with those regulatory requirements prior to the filing of the bankruptcy, this provision requires the bankruptcy trustee to fulfill that requirement, and allows the trustee to use the current assets of the debtor to do that. The Commission is of the view that proposed § 190.09(a)(1)(ii)(G) would be appropriate since an FCM is already required, under the Commission's regulations, to set aside the funds referred to for the benefit of its customers, and because the provision limits the amount of funds a trustee may take from the debtor's current assets to put into segregation for the FCM's customers. Proposed § 190.09(a)(1)(ii)(G) also fits within the definition of "customer property" in section 761 of the Bankruptcy Code, which refers to "other property of the debtor that any applicable law, rule, or regulation requires to be set aside or held for the benefit of a customer."<sup>136</sup>

Proposed § 190.09(a)(1)(ii)(L) is the analog to current § 190.08(a)(1)(ii)(J) but with updated cross-references (and a new second sentence, discussed in the next paragraph). It would state that customer property includes any cash, securities, or other property in the debtor's estate, but only to the extent that the customer property under the other definitional elements is insufficient to satisfy in full all claims of the FCM's public customers. The Commission notes that in *In re Griffin Trading Co.*,<sup>137</sup> the United States Bankruptcy Court for the Northern District of Illinois ruled that the Commission exceeded its statutory authority by adopting current § 190.08(a)(1)(ii)(J) and held that it was invalid. This decision was vacated on appeal pursuant to a settlement reached by the

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adding a provision that expressly covers an FCM's 'top-up' obligations prescribed under specific CFTC rules provides greater legal certainty.")

<sup>136</sup> 11 U.S.C. 761(10)(A)(ix).

<sup>137</sup> 245 B.R. 291 (Bankr. N.D. Ill. 2000), *vacated*, 270 B.R. 882 (N.D. Ill. 2001).

parties. The property described in proposed § 190.09(a)(1)(ii)(L), like proposed § 190.09(a)(1)(ii)(G) discussed above, would appear to fit within the definition of “customer property” in section 761 of the Bankruptcy Code, which refers to “other property of the debtor that any applicable law, rule, or regulation requires to be set aside or held for the benefit of a customer”<sup>138</sup> because of the Commission’s regulations regarding segregation of customer property. Thus, though current § 190.08(a)(1)(ii)(J) may be subject to challenge, the Commission continues to be of the view that section 20 of the CEA provides it with the authority to include proposed § 190.09(a)(1)(ii)(L) in part 190.

A new second sentence of proposed § 190.09(a)(1)(ii)(L) would note explicitly that customer property for purposes of these regulations includes any “customer property,” as that term is defined in SIPA, that remains after satisfaction of the provisions in SIPA regarding allocation of (securities) customer property. SIPA provides that such remaining customer property would be allocated to the general estate.<sup>139</sup> It would appear that any securities customer property that remains after satisfaction in full of securities claims provided for in that section of SIPA proceeding and would accordingly become property of the general estate should, to the extent otherwise provided in proposed § 190.09(a)(1)(ii)(L), and for the same reasons, become customer property in the FCM bankruptcy proceeding.

Proposed § 190.09(d) would govern the distribution of customer property, and has its analog in current § 190.08(d). While current §§ 190.08(d)(1)(i) and (ii) and (d)(2) require customers to deposit cash in order to obtain the return of specifically identifiable

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<sup>138</sup> 11 U.S.C. 761(10)(A)(ix).

<sup>139</sup> See generally SIPA section 8(c)(1), 15 U.S.C. 78fff-2(c)(1).

property, proposed §§ 190.09(d)(1)(i) and (ii) and (d)(2) would require instead the posting of “substitute customer property,” a term proposed to be defined in proposed § 190.01 to mean (in relevant part) “cash or cash equivalents.” “Cash equivalents” is proposed, in turn, to be defined as “assets, other than United States dollar cash, that are highly liquid such that they may be converted into United States dollar cash within one business day without material discount in value.”<sup>140</sup>

The purpose of requiring customers to, in essence, “buy back” specifically identifiable property is to implement the pro rata distribution principle set forth in section 766(h) of the Bankruptcy Code, and discussed in proposed § 190.00(d)(5). More particularly, section 766(d) provides that if the value of specifically identifiable property exceeds the amount to which the customer is entitled under subsection (h) or (i) of section 766, then the customer may deposit cash with the trustee equal to the difference between the value of such property and the amount to which the customer is entitled, and the trustee then shall return or transfer the property.

Permitting customers to redeem specifically identifiable property with either cash or cash equivalents, rather than requiring cash, may mitigate the difficulty (and costs) such customers face in obtaining redemption, but will in any event fully implement the pro rata distribution principle. In addition, each of proposed §§ 190.09(d)(1)(i) and (ii) and (d)(2) would replace the phrase “in an amount equal to” with “with a value equal to”

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<sup>140</sup> The header language in proposed § 190.09(d)(1) deletes the phrase “other than a commodity contract,” though this deletion does not have a substantive effect, and is meant for clarification purposes only.

to account for the proposal that customers may now use cash equivalents, rather than just cash, to redeem their specifically identifiable property.<sup>141</sup>

The remaining provisions of proposed § 190.09 include only technical changes:

The header language to the proposed regulation would note that property that is connected with certain cross-margining arrangements is subject to the provisions of appendix B, framework 1 of part 190. With the revisions in the header language to proposed § 190.09, the Commission has attempted to clarify that, where certain cross-margining arrangements are involved, allocation of customer property will be subject not just to proposed § 190.09, but also to the provisions in appendix B, framework 1.

Proposed § 190.09(a)(1), like its analog in current § 190.08(a)(1), would define the scope of “customer property” that is available to pay the claims of a debtor FCM’s customers. Customers are entitled to a priority over other creditors of the debtor with respect to distributions of customer property.<sup>142</sup> The claims of public customers are satisfied ahead of those of non-public customers. Proposed § 190.09(a)(1)(i), derived from current § 190.08(a)(1)(i), and would list the categories of property that are included in the term “customer property,” specifically “cash, securities, or other property or the proceeds of such cash, securities, or other property received, acquired, or held by or for the account of the debtor, from or for the account of a customer, including a non-public customer.” Proposed changes to these categories from the current regulation text would

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<sup>141</sup> While section 766(d) would require the customer to deposit cash, section 20(a)(3) of the CEA permits the Commission to “[n]otwithstanding title 11 ... provide ... by rule or regulation ... the method by which the business of [a debtor] commodity broker is to be conducted or liquidated after the date of the filing of the petition” in bankruptcy. It would appear that this power extends to enacting a regulation permitting a customer to post cash equivalents rather than cash in this situation. 7 U.S.C. 24(a)(3).

<sup>142</sup> However, consistent with section 766(h) of the Bankruptcy Code, certain claims involving administrative expenses connected with administering customer property take precedence over customer claims. 11 U.S.C.766(h).

be as follows (to the extent not addressed below, the provisions in proposed § 190.09(a)(1)(i) would be the same as those in current § 190.08(a)(1)(i)):

- While current § 190.08(a)(1)(i)(C) refers to warehouse receipts, bills of lading, or other documents of title or property held or acquired by the debtor to fulfill a commodity contract, proposed § 190.09(a)(1)(i)(C) simply would refer back to the definition of “physical delivery property” set forth in proposed § 190.01.
- Proposed § 190.09(a)(1)(i)(D) is new, and would clarify explicitly that customer property includes cash delivery property, as well as any other property that the debtor received as payment for a commodity to be delivered to fulfill a commodity contract from or for the commodity customer account of a customer.
- Proposed § 190.09(a)(1)(i)(F), which is the analog to current § 190.08(a)(1)(i)(E), would state that letters of credit are included in customer property, including any proceeds of a letter of credit drawn by the trustee pursuant to proposed § 190.04(c)(3). Substitute customer property posted by a customer pursuant to proposed § 190.04(d)(3) also would be included. While current § 190.08(a)(1)(i)(E) also discusses letters of credit, the changes made to proposed § 190.09(a)(1)(i)(F) are meant to be consistent with the new letters of credit provisions added elsewhere in proposed part 190.

- Proposed § 190.09(a)(1)(i)(G), which is the analog to current § 190.08(a)(1)(i)(F), would delete the phrase “To the extent not otherwise included” solely for clarification purposes.

Proposed § 190.09(a)(1)(ii), derived from current § 190.08(a)(1)(ii), would list the categories of “[a]ll cash, securities, or other property” that are included in customer property. Proposed changes to these categories from the current regulation text are as follows (to the extent not addressed below, the provisions in proposed § 190.09(a)(1)(ii) would be the same as those in current § 190.08(a)(1)(ii)):

- Proposed § 190.09(a)(1)(ii)(A), which is the analog to current § 190.08(a)(1)(ii)(A), would clarify that any cash, securities, or other property that is segregated *for customers* on the filing date is considered customer property.
- Proposed § 190.09(a)(1)(ii)(D) would make a number of changes to its analog in current § 190.08(a)(1)(ii)(D). First, proposed § 190.09(a)(1)(ii)(D) would include in customer property any “cash, securities, or other property” that *was* (rather than *is*, as the current regulation text states) property received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract. This change would be made for the sake of logical consistency with respect to time references; the reference is to the prior status of property that is *subsequently* recovered by the trustee. Second, proposed § 190.09(a)(1)(ii)(D) would delete the phrase “which has been withdrawn” as unnecessary. Lastly, proposed § 190.09(a)(1)(ii)(D) would add the

phrase “or is otherwise recovered by the trustee on any other claim or basis,” to account for the fact that the trustee may recover such property by means other than their avoidance powers and that, no matter the means of recovery, such property should be included in customer property.

- Proposed § 190.09(a)(1)(ii)(E), which is the analog to current § 190.08(a)(1)(ii)(E), would change the phrase “against a customer account” to “against a customer.” Such change is made for clarification purposes only.
- Proposed § 190.09(a)(1)(ii)(G) is discussed above as a substantive change.
- Proposed § 190.09(a)(1)(ii)(H), which is the analog to current § 190.08(a)(1)(ii)(G), would delete the phrase “unless including such property in the customer estate would not significantly increase the customer estate.” The Commission views this restriction in the current regulation text as unnecessary and therefore proposes deleting it.
- Proposed § 190.09(a)(1)(ii)(K) is new, and would include in customer property any cash, securities, or other property which is a payment from an insurer to the trustee arising from or related to a claim related to the conversion or misuse of customer property. The Commission is of the view that adding this provision will ensure that any such cash, securities, or other property would become part of the pool of customer property, and is appropriate because the funds recovered pursuant to such insurance payment would, absent the conversion or misuse, have been available to pay customers.

- Proposed § 190.09(a)(1)(ii)(L) is discussed above as a substantive change.

Proposed § 190.09(a)(2), like its analog in current § 190.08(a)(2), would list categories of property that are not included in the “customer property” that is available to pay the claims of a debtor FCM’s customers. Proposed changes to these categories from the current regulation text are as follows (to the extent not addressed below, the provisions in proposed § 190.09(a)(2) are the same as those in current § 190.08(a)(2)):

- Proposed § 190.09(a)(2)(iii), which is the analog to current § 190.08(a)(2)(iii), would state that forward contracts will not be included in customer property, but would add “unless such contracts are cleared by a clearing organization or, in the case of forward contracts treated as foreign futures, a foreign clearing organization.” This addition is meant to clarify that any forward contracts that are cleared by a clearing organization *are* included in customer property, so it is only uncleared forward contracts that will be excluded from the pool of customer property.<sup>143</sup>
- Proposed § 190.09(a)(2)(iv), which is the analog to current § 190.08(a)(2)(iv), would exclude from customer property any physical delivery property that is not held by the debtor and is delivered or received by a customer to fulfill the customer’s delivery obligation under a commodity contract. The definition of the term “physical delivery property” in proposed § 190.01 specifically would note that any

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<sup>143</sup> Cf. 11 U.S.C. 761(4)(F)(ii) (including within the definition of “commodity contract” “with respect to a futures commission merchant or clearing organization, any other contract, option, agreement, or transaction, in each case, that is cleared by a clearing organization.”).

commodities or documents of title that are not held by the debtor, and are delivered or received by a customer to fulfill the customer's delivery obligation under a commodity contract outside the administration of the estate pursuant to proposed § 190.06(a)(2), are not subject to pro rata distribution. Thus, proposed § 190.09(a)(2)(iv) simply would import this concept into proposed § 190.09 by specifying that such physical delivery property is not considered "customer property" for purposes of allocation to customers.

- Proposed § 190.09(a)(2)(v), which is the analog to current § 190.08(a)(2)(v), would delete the word "maintenance" as it appears in the current regulation text, so as to eliminate any distinction between initial and maintenance margin. As proposed, the provision would not include in customer property any property deposited by a customer with the commodity broker, after the entry of an order for relief, that is not necessary to meet the initial *or* maintenance margin requirements applicable to that customer's account(s).
- Proposed § 190.09(a)(2)(viii) is new, and would clarify that any money, securities or other property held in a securities account to fulfill delivery, under a commodity contract, from or for the account of a customer, is excluded from customer property. Proposed § 190.09(a)(2)(viii) would be parallel to proposed § 190.09(a)(2)(vii) (which would be the same as current § 190.08(a)(2)(vii)), which excludes from customer property any money, securities or property held to margin, guarantee or secure security

futures products if held in a securities account. These provisions, together, are meant to focus on securities futures contracts that are held in securities accounts, and that therefore would be protected under SIPA and would not constitute customer property for purposes of part 190.

Proposed § 190.09(a)(3) is new. It would reserve the right of the bankruptcy trustee to assert claims against any person to recover the shortfall of property enumerated in proposed §§ 190.09(a)(1)(i)(F) and 190.0(a)(1)(ii)(A) through (L). The purpose of proposed § 190.09(a)(3) is to clarify, for the avoidance of doubt, that any claims that the trustee may have against a person to recover customer property will not be undermined or reduced by the fact that the trustee may have been, or might be, able to satisfy customer claims by other means.

Proposed § 190.09(b) is analogous to current § 190.08(b).<sup>144</sup> The Commission would add the phrase “or attributable to” when discussing how to treat property segregated on behalf of or attributable to non-public customers. This addition is to clarify that this provision would apply both to property that is in the debtor’s estate as of the time of the bankruptcy filing as well as property that is later recovered by the trustee and becomes part of the debtor’s estate on a later date.

Proposed § 190.09(c) would set forth instructions regarding allocation of customer property, including a few changes from its analog in current § 190.08(c). Specifically, proposed § 190.09(c)(1)(i) would add “or recovered by the trustee on behalf of or for the benefit of an account class” when describing property that must be allocated

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<sup>144</sup> Cf. 11 U.S.C. 766(h) (Notwithstanding any other provision of this subsection, a customer net equity claim based on a proprietary account, as defined by Commission rule, regulation, or order, may not be paid either in whole or in part, directly or indirectly, out of customer property unless all other customer net equity claims have been paid in full.).

to the specific account class. This addition is meant to clarify, similar to the addition discussed above with respect to proposed § 190.09(b), that this provision regarding allocation of customer property would apply both to (1) property that is in the debtor's estate as of the time of the bankruptcy filing as well as (2) property that is later recovered by the trustee and becomes part of the debtor's estate on a later date.

Proposed § 190.09(c)(1)(ii) is new. It would instruct the trustee with respect to the treatment of any property remaining after payment in full is made to allowed customer claims in a particular account class. Specifically, the new text would provide that such remaining property shall be allocated in accordance with proposed § 190.09(c)(2), which would set forth the order of allocation for any customer money, securities and property that cannot be traced to a specific customer account class. This new provision would also be consistent with the requirement, under section 766(h) of the Bankruptcy Code, that customer property must be distributed to customers in priority to all other claimants.

Proposed § 190.09(c)(2) would delete the restrictions that "money, securities, and property received from or for the account of customers" must also be "on behalf of any account class which is received on behalf of the customer estate." The latter restriction is unnecessary: Any "money, securities and property received from or for the account of customers" should be treated as customer property, and needs to be allocated. Moreover, the reference to allocation as of "the primary liquidation date" is removed, because money, securities or property may be recovered or marshalled at a variety of times during the proceedings.

Proposed §§ 190.09(d)(1) and (d)(2) were discussed above as substantive changes. Certain other changes to proposed § 190(d)(2), and changes to the remaining paragraphs of § 190.09(d), governing the distribution of customer property, are technical:

There would be a few additional changes to § 190.09(d)(2) from the text in current § 190.08(d)(2), including (1) replacement of the phrase “[a]ny specifically identifiable commodity contract” with “[a]ny open commodity contract that is specifically identifiable property”; (2) replacement of the term “customer” with “public customer”; and (3) replacement of the phrase “adequate security for the non-recovery of any overpayments” with “to assure the recovery of any overpayments.” These changes are all meant for clarification purposes only.

Proposed § 190.09(d)(3) is derived from current § 190.08(d)(3). Both the proposed and current regulations refer to the distribution, at the request of the customer, of “like-kind securities.” The purpose of this provision is to allow for distribution of securities that are interchangeable with the securities deposited by the customer.<sup>145</sup> However, it would appear that there is no commonly understood definition of “like-kind securities.”

The Commission notes that SIPA addresses an analogous issue. SIPA section 7(b)(1), 15 USC 78fff-1(b)(1), provides that “the trustee shall deliver securities to or on behalf of customers to the maximum extent practicable in satisfaction of customer claims for *securities of the same class and series of an issuer . . .*.” In order to clarify the meaning of like-kind securities, proposed § 190.03(d)(3) would adopt this approach, and

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<sup>145</sup> In the context of dematerialized securities, it is impracticable to identify the exact securities deposited by a customer (e.g., Class A Share #12345 of Acme, Inc.).

would read, in relevant part that: the customer may request that the trustee purchase or otherwise obtain the largest whole number of like-kind securities (*i.e., securities of the same class and series of an issuer*), with a fair market value (inclusive of transaction costs) which does not exceed that portion of such customer's allowed net equity claim that constitutes a claim for securities, if like-kind securities can be purchased in a fair and orderly manner.

Additional changes in proposed § 190.09(d)(3) from the text of current § 190.08(d)(3) are (1) addition of a cross-reference to a portion of the definition of “specifically identifiable property” as set forth in proposed § 190.01; and (2) replacement of the phrase “if that customer had had no open commodity contracts” with “but the customer has no open commodity contracts.”

Proposed § 190.09(d)(4) is substantially similar to current § 190.08(d)(4). The only difference is that proposed § 190.09(d)(4) would contain updated cross-references to proposed §§ 190.03(e) and (f), which discuss the customer proof of claim form.

Proposed § 190.09(d)(5) is derived from current § 190.08(d)(5). The proposed regulation would contain a few changes to the text of current § 190.08(d)(5) that are meant solely for clarification, including (1) the addition of the phrase “with respect to a particular account class”; (2) the addition of the phrase “in such account class”; and (3) updated cross-references.

Lastly, current § 190.08(d)(6) would be moved to proposed § 190.04(b)(1)(ii).

The Commission requests comment with respect to all aspects of proposed § 190.09. Specifically, the Commission seeks comment as to whether the proposed revisions to § 190.09(a)(1) would appropriately preserve customer property for the

benefit of customers. In particular, the Commission seeks comment on whether proposed §§ 190.09(a)(1)(ii)(G), concerning property that other regulations require to be placed into segregation, and (L), concerning remaining shortfalls, are appropriately crafted. Moreover, is it advisable to permit customers to post “substitute customer property” rather than “cash” in proposed § 190.09(d)? Is it appropriate to clarify the term “like-kind securities” by reference to the concept, derived from SIPA, of “securities of the same class and series of an issuer?”

8. Regulation 190.10: Provisions Applicable to Futures Commission Merchants During Business as Usual

The Commission is proposing to revise current § 190.10, which sets forth the provisions generally applicable to FCMs. Certain provisions in current § 190.10 would be moved to proposed §§ 190.02 and 190.03, as described above. Proposed § 190.10 would contain new and moved provisions that set forth an FCM’s obligations during business as usual.

The most substantive change in proposed § 190.10 concerns subsection (d). This provision is new, and would address letters of credit. It would prohibit an FCM from accepting a letter of credit unless certain conditions (1) are met at the time of acceptance and (2) remain true through its date of expiration.

First, the trustee must be able to draw upon the letter of credit, in full or in part, in the event of a bankruptcy proceeding, the entry of a protective decree under SIPA, or the appointment of FDIC as receiver pursuant to Title II of the Dodd-Frank Act. Second, if the letter of credit is permitted to be and is passed through to a clearing organization, the bankruptcy trustee for such clearing organization or (if applicable) FDIC must be able to

draw upon the letter of credit, in full or in part, in the event of a bankruptcy proceeding, or where the FDIC is appointed as receiver pursuant to Title II.

As noted in § 190.00(c)(5), the concept of pro rata distribution would apply to all customers, including those posting letters of credit. Proposed § 190.04(d)(3) would describe how the trustee must treat letters of credit in bankruptcy. The trustee would be required to treat the letter of credit in a manner consistent with pro rata distribution and be permitted to draw upon the full amount of unexpired letters of credit or any portion thereof or treat the letter of credit as having been distributed to the customer for purposes of calculating entitlements to distribution or transfer. Regulation 190.10(d) is intended to ensure that an FCM's treatment and acceptance of letters of credit during business as usual is consistent with and does not preclude the trustee's treatment of letters of credit in accordance with proposed §§ 190.00(c)(5) and 190.04(d)(3).<sup>146</sup>

The Commission has considered the impact that the implementation of this regulation would have on FCMs and their customers, since letters of credit are currently in use by the industry.<sup>147</sup> Accordingly, upon the effective date of the regulation, proposed § 190.10(d) would apply only to *new* letters of credit and customer agreements.

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<sup>146</sup> The Commission notes that, unlike the case in *ConocoPhillips*, 2012 WL 4757866 at \*5-\*6, it is entirely clear that this regulation does not constitute an "exercise of regulatory authority" with respect to an "identified banking product." Assuming for the sake of analysis that letters of credit constitute identified banking products, the Commission would not exercise any regulatory authority over them, and would not specify what should be done with any letter of credit. Rather, the Commission simply is proposing to exercise regulatory authority over FCMs, and prohibit them from accepting certain letters of credit (*i.e.*, those which do not meet the criteria specified in proposed § 190.10(d)) as collateral for CFTC-regulated futures, options, and swaps.

<sup>147</sup> The Commission notes that the Joint Audit Committee ("JAC") forms for an Irrevocable Standby Letter of Credit (both Pass-Through and Non Pass-Through) would appear to be consistent with the requirements of proposed § 190.10(d).

See [https://www.cmegroup.com/clearing/audit/files/rm\\_FU\\_Irrevocable\\_Standby\\_LOC920.pdf](https://www.cmegroup.com/clearing/audit/files/rm_FU_Irrevocable_Standby_LOC920.pdf); [https://www.cmegroup.com/clearing/audit/files/S\\_irrstandbynonpassthroughloc.pdf](https://www.cmegroup.com/clearing/audit/files/S_irrstandbynonpassthroughloc.pdf). Based on staff discussions with industry participants, the Commission understands that most letters of credit currently in use by the industry follow the JAC forms.

In order to mitigate the impact of implementing this regulation with respect to existing letters of credit and customer agreements, the Commission proposes to include a reasonable transition period of one year from the effective date until § 190.10(d) would apply to existing letters of credit and customer agreements.

Proposed § 190.10(a) is also new. It would note that an FCM would be required to maintain current records relating to its customer accounts, pursuant to §§ 1.31, 1.35, 1.36, and 1.37 of this chapter, and in a manner that would permit them to be provided to another FCM in connection with the transfer of open customer contracts of other customer property. This provision would recognize that current and accurate records are imperative in arranging for the transfer of customer contracts and other property, both for the trustee of the estate of the defaulter and for an FCM that is accepting the transfer.<sup>148</sup>

Proposed § 190.10(b) would concern the designation of hedging accounts. It would incorporate concepts contained in current §§ 190.04(e), 190.06(d), and the current Bankruptcy appendix form 3 instructions. As noted below, for purposes of this regulation, a customer would not need to provide, and an FCM would not be required to judge, evidence of hedging intent for purposes of bankruptcy treatment. Rather, proposed § 190.10(b) would permit the FCM to treat the account as a hedging account for such purposes based solely upon the written record of the customer's representation.

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<sup>148</sup> As the ABA Cover Note observes:

Paragraph (a) requires an FCM to maintain current records relating to its customer accounts, and provides that those records may be provided to another FCM to facilitate transfer of open customer positions. The provision is not intended to expand an FCM's recordkeeping obligations under other Commission rules. It is intended to emphasize the importance of current and accurate records for an FCM that is accepting the transfer of customer positions and property from the debtor FCM.

ABA Cover Note at 15.

Hedging treatment for these bankruptcy purposes would not be determinative for any other purpose.

Proposed § 190.10(b)(1) would require an FCM to provide a customer an opportunity to designate an account as a hedging account when the customer first opens the account, rather than when the customer undertakes its first hedging contract, as specified in current § 190.06(d)(1). Giving this opportunity to each customer at the outset would provide the opportunity to allow for clear instruction at a point when both customer and FCM are focused on the specifics of the relationship between them, and would enhance the ability of the FCM properly to account for the customer property. The proposed regulation would also require, consistent with current § 190.06(d)(2), that the FCM indicate prominently in its accounting records for each customer account whether the account is designated as a hedging account.

Proposed § 190.10(b)(2) would set forth the requirements for an FCM to treat an account as a hedging account: if, but only if, the FCM obtains the customer's written representation that the customer's trading in the account will constitute hedging as defined under any relevant Commission rule or rule of a DCO, DCM, SEF, or FBOT. This is in lieu of obtaining written hedging instructions as required under current § 190.06(d).<sup>149</sup>

In order to avoid the significant burden that would be associated with requiring FCMs to re-obtain hedging instructions for existing accounts, proposed § 190.10(b)(3) would provide that the requirements of (b)(1) and (b)(2) do not apply to commodity contract accounts opened prior to the effective date of these revisions to part 190. Rather,

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<sup>149</sup> See ABA Cover Note at 16.

the regulation would recognize expressly that an FCM may continue to designate existing accounts as hedging accounts based on written hedging instructions obtained under former § 190.06(d).

Finally, proposed § 190.10(b)(4) would permit an FCM to designate an existing futures, foreign futures or cleared swaps account of a particular customer as a hedging account, provided that the FCM obtains the representation required under proposed paragraph (b)(2) from such customer. As noted above with respect to § 190.10(b)(2), this treatment only would be relevant for purposes of hedging account treatment in bankruptcy.

Proposed § 190.10(c) is new. It would address the establishment of delivery accounts during business as usual.<sup>150</sup> As recognized in current § 190.05 (and, in particular, current § 190.05(a)(2)) and the definition in current § 190.01(II)(3,4, and 5), when a commodity contract is in the delivery phase, or when a customer has taken delivery of commodities that are physically delivered, associated property may be held in a “delivery account” rather than in the segregated accounts pursuant to, e.g., § 1.20 or § 22.2.<sup>151</sup> The Commission is proposing to recognize that when an FCM facilitates delivery under a customer’s physical delivery contract, and such delivery is effected outside of a futures account, foreign futures account, or cleared swaps account, it must be effected through (and the associated property held in) a delivery account. If, however, the commodity that is subject to delivery is a security, the FCM may effect delivery

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<sup>150</sup> See proposed § 190.06 regarding the making and taking of deliveries during bankruptcy.

<sup>151</sup> See 48 FR at 8731 (Property segregated on behalf of a delivery account, under the allocation provisions, will be allocated only to that account class. This means that although this property will not be distributed to the extent its value exceeds a claimant’s net equity claim and will be distributed pro rata among claimants with delivery claims which are of the same class, it will not be diluted by other types of customer claims. This solution reduces the dilution effect of proration without offending the basic principle of proration of equivalent claims.)

through (and the property may be held in) a securities account. The regulation would clarify that the property must be held in one of these types of accounts. The Commission is proposing to address the establishment of delivery accounts during business as usual because of their importance during bankruptcy, as addressed in proposed § 190.06.

Proposed 190.10(d) was addressed above as a substantive change.

Proposed § 190.10(e) would concern the disclosure statement for non-cash margin. It is derived from current § 190.10(c), with corresponding changes to cross-references. The reference in the required disclosure statement to notice (in the event of bankruptcy) by publication would be deleted, consistent with the changes to notice provisions in proposed § 190.03(a)(2).

The Commission notes, however, that the ABA Committee proposed to delete entirely the requirement that FCMs provide this disclosure statement, on the basis that the requirement was originally imposed in order to address a concern that customers might otherwise challenge pro rata distribution of non-cash collateral on the basis that they did not consent to such treatment. The ABA Committee stated that it “does not believe that such a risk exists today under prevailing bankruptcy law.”

Do commenters believe that requiring this disclosure is helpful, either legally (with respect to pro rata distribution) or practically (with respect to enhancing customer understanding)? Should the form of disclosure be changed in some manner? Or do commenters believe that this requirement should be deleted?

The Commission also requests comment with respect to all other aspects of proposed § 190.10. Specifically, the Commission seeks comment with respect to the impact of proposed § 190.10(b) regarding the designation of hedging accounts and

proposed § 190.10(c) regarding the establishment of delivery accounts during business as usual.

The Commission also specifically seeks comment on proposed § 190.10(d), regarding changes to the business as usual requirements for acceptance of letters of credit, and in particular seeks comment as to (a) whether its understanding is correct that most letters of credit currently in use by the industry follow the JAC forms, (b) the impact of additional requirements concerning letters of credit (as well as any alternative methods of achieving the goal of treating customers posting letters of credit consistent with the treatment of other customers), and (c) whether the proposed one year transition period is reasonable.

*C. Subpart C—Clearing Organization as Debtor*

The Commission is proposing to promulgate a new subpart C of part 190 (proposed §§ 190.11-190.19), addressing the currently unprecedented context of a clearing organization as debtor.

1. Regulation 190.11: Scope and Purpose of Subpart C

When originally proposing part 190 in 1981, the Commission proposed to (and ultimately did) forego providing generally applicable rules for the bankruptcy of a clearing organization.<sup>152</sup> The Commission explained that, beyond

proposing that all open commodity contracts, even those in a deliverable position, be liquidated in the event of a clearing organization bankruptcy because it would be highly unlikely that an exchange could maintain a properly functioning futures market in the event of the collapse of its clearing organization[, t]he Commission has proposed no other rules with respect to the operation of clearing organization debtors. Under [s]ection

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<sup>152</sup> At the time, the definition of clearing organization in section 761(2) of the Bankruptcy Code was an “organization that clears commodity contracts on, or subject to the rules of, a contract market or board of trade. See PL 95-598 (1978), 92 Stat 2549.

764(b)(2) of the Code, the Commission has the power to permit a distribution of the proceeds of a clearing organization liquidation free from the avoidance powers of the trustee. Because the bankruptcy of a clearing organization would be unique, the Commission is not proposing a general rule in this regard. The potential for disruption of the Markets, and of the nation's economy as a whole, in the case of a clearing organization bankruptcy, together with the desirability of the Commission's active participation in developing a means of meeting such an emergency, has disposed the Commission to take a case-by-case approach with respect to clearing organizations.<sup>153</sup>

Much has changed in the intervening 38 years. Markets move much more quickly, and thus the importance of quick action in respect to the bankruptcy of a clearing organization has increased. The Commodity Futures Modernization Act established DCOs as a separate registration category.<sup>154</sup> The bankruptcy of a clearing organization would remain unique—it remains the case that no clearing organization registered with the Commission has ever entered bankruptcy—and thus the need for significant flexibility remains, but the balance has shifted towards establishing ex ante the approach that would be taken.

Two clearing organizations for which the Commission has been designated the agency with primary jurisdiction have been designated as systemically important to the United States financial system pursuant to title VIII of Dodd-Frank.<sup>155</sup> If any clearing organization were to approach insolvency, it is possible, though not certain, that such an entity would be resolved pursuant to Title II of Dodd-Frank.<sup>156</sup>

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<sup>153</sup> 46 FR 57535, 57545 (Nov. 24, 1981).

<sup>154</sup> Commodity Futures Modernization Act of 2000 Pub.L.No. 106-554 section 1(a)(5); Appendix E, section 112(f).

<sup>155</sup> See Dodd-Frank section 804 (designation of systemic importance), section 803(8) (definition of “supervisory agency”), 12 U.S.C. 5463, 5462(8). These are CME and ICE Clear Credit. A third clearing organization (Options Clearing Corporation) has also been so designated, but the SEC is the supervisory agency in that case.

<sup>156</sup> Resolution under Title II would require a recommendation concerning factors specified in section 203(a)(2) of Dodd-Frank, 12 U.S.C. 5383(a)(2), by a 2/3 majority of the members then serving of

Administration of a resolution under Title II of Dodd-Frank depends, in part, on clarity as to entitlements under chapter 7 of the Bankruptcy Code. Specifically, section 210(a)(7)(B) of Dodd-Frank<sup>157</sup> provides with respect to claims against the covered financial agency in resolution, that “a creditor shall, in no event, receive less than the amount that the creditor is entitled to under paragraphs (2) and (3) of subsection (d), as applicable.” Tracing to the cross-referenced subsection, section 210(d)(2)<sup>158</sup> provides that the maximum liability of the FDIC to a claimant is the amount that the claimant would have received if the FDIC had not been appointed receiver, and (instead), the covered financial company had been liquidated under chapter 7 of the Bankruptcy Code.<sup>159</sup> Thus, it is important to have a clear “counterfactual” that establishes what creditors would be entitled to in the case of the liquidation of a clearing organization under chapter 7 (subchapter IV) of the Bankruptcy Code.

Accordingly, proposed § 190.11 would establish that this subpart C to part 190 applies to proceedings under subchapter IV to chapter 7 of the Bankruptcy Code where the debtor is a clearing organization.

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each of the Board of Governors of the Federal Reserve System and of the FDIC, followed by a determination concerning a related set of factors specified in section 203(b), 12 U.S.C. 5383(b), by the Secretary of the Treasury in consultation with the President. Thus, the choice of resolution versus bankruptcy for a DCO that is, in the terminology of Dodd-Frank, “in default or in danger of default,” *see* Dodd-Frank section 203(c)(4), 12 U.S.C. 5383(c)(4), cannot be considered certain.

It is, however, clear that Title II applies to clearing organizations. *See, e.g.*, Dodd-Frank section 210(m), 12 U.S.C. 5390(m) (applying “the provisions of subchapter IV of chapter 7 of the bankruptcy code” to “member property” of “commodity brokers”). Pursuant to section 761(16) of the Bankruptcy Code, “member property” applies only to a debtor that is a “clearing organization.” 11 U.S.C. 761(16).

<sup>157</sup> 12 U.S.C. 5390(a)(7)(B).

<sup>158</sup> 12 U.S.C. 5390(d)(2).

<sup>159</sup> For the sake of completeness, it should be noted that section 210(d)(2), 12 U.S.C. 5390(d)(2), provides, as an additional comparator, “any similar provision of State insolvency law applicable to the covered financial company.” Given federal regulation of DCOs, it would appear that this phrase is inapplicable. Similarly, section 210(d)(3), 12 U.S.C. 5390(d)(3), which refers to covered financial companies that are brokers or dealers resolved by SIPC, is also inapplicable here, given the inconsistency in being both a DCO and a broker-dealer.

The Commission requests comment regarding the proposed scope of subpart C of part 190 as set forth in proposed § 190.11. Do commenters support or oppose the decision to establish an explicit, bespoke set of regulations for the bankruptcy of a clearing organization?

2. Regulation 190.12: Required Reports and Records

The operations of a clearing organization are extremely time-sensitive. For example, § 39.14 requires that a clearing organization complete settlement with each clearing member at least once every business day. It is thus critical that the Commission receive notice of a DCO bankruptcy in an extraordinarily rapid manner, and that the trustee that is appointed (and the Commission) are rapidly provided with critical documents, as discussed further below.

Proposed § 190.12(a)(1) would be analogous to proposed § 190.03(a), in that it would provide instructions regarding how to give notice to the Commission and to a clearing organization's members, where such notice would be required under subpart C of proposed part 190.<sup>160</sup> For a discussion of how these notice provisions differ from those in current part 190, please refer to the discussion of proposed § 190.03(a).<sup>161</sup>

Proposed § 190.12(a)(2) would require the clearing organization to notify the Commission either in advance of, or at the time of, filing a petition in bankruptcy (or within three hours of receiving notice of a filing of an involuntary petition against it).<sup>162</sup>

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<sup>160</sup> While proposed § 190.03(a)(2) would apply to notice to an FCM's customers, and proposed § 190.12(a)(1)(ii) would apply to notice to a clearing organization's members, the means of giving notice are identical.

<sup>161</sup> See section II.B.1 above.

<sup>162</sup> Commodity broker bankruptcies are rare, and outside the experience of most chapter 7 trustees, who are chosen from a panel of private trustees eligible to serve as such for all chapter 7 cases. See generally 11 U.S.C. 701(a)(1), 28 U.S.C. 586(a)(1). Historically, Commission staff, on being notified of an impending commodity broker bankruptcy, have worked with the office of the relevant regional United States Trustee,

Notice would need to include the filing date and the court in which the proceeding has been or will be filed. While the clearing organization would also need to provide notice of the docket number, if the docket number is not immediately assigned, that information would be provided separately as soon as available.

It is also important to permit the trustee to begin to understand the business of the clearing organization as soon as practicable, and within hours. Accordingly, proposed § 190.12(b)(1) would require the clearing organization to provide to the trustee copies of each of the most recent reports filed with the Commission under § 39.19(c), which includes § 39.19(c)(1) (daily reports, including initial margin required and on deposit by clearing member, daily variation and end-of-day positions (by member, by house and customer origin), and other daily cash flows), § 39.19(c)(2) (quarterly reports, including of financial resources), § 39.19(c)(3) (annual reporting, including audited financial statements and a report of the chief compliance officer), § 39.14(c)(4) (event-specific reporting, which would include the most up-to-date version of any recovery and wind-down plans the debtor maintained pursuant to § 39.39(b),<sup>163</sup> and which may well include events that contributed to the clearing organization's bankruptcy), and § 39.19(c)(5) (reporting specially requested by the Commission or, by delegated authority, staff). In order to provide the trustee with an initial overview of the business and status of the clearing organization, with respect to quarterly, annual, or event-specific reports, the clearing organization would be required to provide any such reports filed during the preceding 12 months. These reports would need to be provided to the trustee as soon as

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*see generally* 28 U.S.C. 581 *et. seq.*, to identify, and have then briefed, the chapter 7 trustee that would then be appointed. This would be even more important in the context of a clearing organization bankruptcy.

<sup>163</sup> *See* § 39.19(c)(4)(xxiv),

practicable, but in any event no later than three hours following the later of the commencement of the proceeding or the appointment of the trustee. It is the Commission's expectation that in the event of an impending bankruptcy event, staff at the DCO would, as soon as practicable, be preparing these materials for transmission to the trustee.

Similarly, proposed § 190.12(b)(2) would require the debtor clearing organization, in the same time-frame, to provide the trustee and the Commission with copies of the default management plan and default rules and procedures maintained by the debtor pursuant to § 39.16 and, as applicable, § 39.35. While some of this information may have previously been filed with the Commission pursuant to § 39.19, it is important that the Commission have readily available what the clearing organization believes are the most up-to-date versions of these documents. Moreover, given that these documents must be provided to the trustee, providing copies to the Commission should impose minimal additional burden (particularly if the documents are provided in electronic form).

Current § 39.20(a) requires a DCO to maintain records of all activities related to its business as such, and sets forth a non-exclusive list of the records that are included in that term. To enable the trustee and the Commission further to understand the business of the clearing organization, proposed § 190.12(c) would require the clearing organization to make copies of such records available to the trustee and to the Commission no later than the business day after the commencement of the proceeding. In order to inform the trustee and the Commission better concerning the enforceability in bankruptcy of the clearing organization's rules and procedures, the clearing organization is similarly

required to make available any opinions of counsel or other legal memoranda provided to the debtor, by inside or outside counsel, in the five years preceding the commencement of the proceeding, relating to the enforceability of those arrangements in the event of an insolvency proceeding involving the debtor.<sup>164</sup>

The Commission requests comment with respect to all aspects of proposed § 190.12. In particular, are the reports and records identified in proposed § 190.12 to be provided to the Commission useful and appropriate? Are the proposed time deadlines appropriate? Are there additional reports and records that should be included in the regulation?

3. Regulation 190.13: Prohibition on Avoidance of Transfers

Proposed § 190.13 would implement section 764(b) of the Bankruptcy Code, protecting certain transfers from avoidance (sometimes referred to as “claw-back”), with respect to a debtor clearing organization. It is analogous to proposed § 190.07(e) (and current § 190.06(g)), with certain changes. Specifically, while proposed § 190.07(e) approves FCM transfers unless they are explicitly disapproved, proposed § 190.13 requires explicit Commission approval for DCO transfers. While an FCM can transfer only a portion of its customer positions, a DCO must maintain a balanced book, and thus

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<sup>164</sup> The trustee of a corporation in bankruptcy controls the corporation’s attorney-client privilege for pre-bankruptcy communications. *Commodity Futures Trading Comm’n v. Weintraub*, 471 U.S. 343 (1985). Production to the Commission pursuant to the proposed regulation would not waive that privilege (although voluntary production would). *See, e.g., U.S. v. de la Jara*, 973 F.2d 746, 749 (9<sup>th</sup> Cir. 1992) (“a party does not waive the attorney-client privilege for documents which he is *compelled* to produce”) (emphasis in original); Office of Comptroller of the Currency Interpretative Letter, 1991 WL 338409 (With respect to “internal Bank documents” that are “subject to the attorney-client privilege” and are “requested by OCC examiners for their use during examinations of the Bank,” OCC “has the power to request and receive materials from national banks in carrying out its supervisory duties. It follows that national banks must comply with such requests. That being the case, it is our position that when national banks furnish documents to us at our request they are not acting voluntarily and do not waive any attorney-client privilege that may attach to such documents.”)

must transfer all of its customer positions (or at least all positions in a given product set). Given the importance of transferring open commodity contracts and the property margining such contracts in the event of a DCO bankruptcy, the Commission is proposing that any such transfer should require explicit Commission approval.

Thus, whereas current § 190.06(g)(1)(iii) provides that a pre-relief transfer by a clearing organization cannot be avoided as long as it is *not disapproved* by the Commission, proposed § 190.13(a) would instead provide that a pre-relief transfer of open commodity contracts and the property margining or securing such contracts cannot be avoided as long as it was *approved* by the Commission, either before or after such transfer. Similarly, while current § 190.06(g)(2)(i) provides (for all commodity brokers, including clearing organizations) that a post-relief transfer of a customer account cannot be avoided as long as it is *not disapproved* by the Commission, proposed § 190.13(b) would instead provide that a post-relief transfer of open commodity contracts and the property margining or securing such contracts made to another clearing organization cannot be avoided as long as it was *approved* by the Commission, either before or after such transfer.

The Commission requests comment with respect to all aspects of proposed § 190.13. In particular, do commenters agree with the approach of requiring explicit approval of transfers by clearing organization debtors?

4. Regulation 190.14: Operation of the Estate of the Debtor Subsequent to the Filing Date

Proposed § 190.14(a) would provide discretion to the trustee to design the proof of claim form and to specify the information that is required. Broad discretion would appear to be appropriate, given the bespoke nature of a clearing organization bankruptcy.

Proposed § 190.14(b) addresses continued operation of a DCO. Proposed § 190.14(b)(1) would provide that, after the order for relief, the debtor clearing organization would cease making calls for either variation or initial margin, except as otherwise provided in § 190.14(b).

Proposed § 190.14(b)(2) would allow for the possibility that the trustee believes that continued operation of the debtor clearing organization would be both useful and practicable, in which event the trustee may request permission of the Commission to operate the clearing organization for up to six calendar days after the order for relief, to the extent practicable, in accordance with the rules and procedures of the debtor, and with respect to open commodity contracts of the debtor.

In this context, usefulness would be addressed in paragraph (b)(2)(i), namely that such continued operation would facilitate accomplishing promptly (the outer limit of which would be no more than six calendar days) either (A) transfer of the clearing operations to another DCO or (B) resolution of the DCO pursuant to Title II of Dodd-Frank. (*i.e.*, that such transfer or entry into a Title II resolution proceeding was not practicable to accomplish before the order for relief, but could be accomplished within a brief period thereafter).

Practicability would be addressed in paragraph (b)(2)(ii). If the rules of the debtor clearing organization compel the termination of all or substantially all outstanding contracts under the relevant circumstances (*e.g.*, upon an order for relief), then continued operation would not be practicable. Moreover, cooperation by the members of the clearing organization would be required for practicability. Thus, it would be necessary that all (or substantially all) of the members of the clearing organization (other than those which are themselves subject to a bankruptcy proceeding) are both able and willing to make variation payments as owed during the temporary timeframe.

The reason for the six calendar day outer limit is that six calendar days is one less than seven calendar days, the maximum under section 764(b) of the Bankruptcy Code.

Proposed § 190.14(b)(3) would require the Commission, upon receiving such a request, to consider it promptly (as a practical matter, a failure to grant such a request within a relatively small number of hours during business days would likely make continued operation impracticable). Where the Commission is persuaded that the trustee's conclusions with respect to usefulness and practicability are well grounded (a standard that is intended to grant the Commission wide discretion in making a decision, which discretion appears necessary in light of the unprecedented and exigent circumstances), the Commission may grant the request. The proposed regulation would also permit the Commission to grant the request for fewer calendar days than the trustee has requested, but then to renew permission to continue operations, so long as the total calendar days of continued operation total no more than six.

Proposed § 190.14(c)(1) would require the trustee to liquidate, no later than seven calendar days after the order for relief, all open commodity contracts that had not earlier

been terminated, liquidated or transferred. However, such liquidation would not be required if the Commission (whether at the request of the trustee or sua sponte) determines that such liquidation would be inconsistent with the avoidance of systemic risk<sup>165</sup> or, in the expert judgment of the Commission, would not be in the best interests of the debtor clearing organization's estate.<sup>166</sup> The trustee would be directed to carry out such liquidation in accordance with the rules and procedures of the debtor clearing organization, to the extent applicable and practicable.

Proposed § 190.14(c)(2) would, analogously to existing § 190.08(d)(3) and proposed § 190.09(d)(3), permit the trustee to, rather than liquidating securities and making distributions in the form of cash, instead make distributions to members in the form of securities that are equivalent (*i.e.*, securities of the same class and series of an issuer) to those that were originally delivered to the debtor by the clearing member or such member's customer.

Proposed § 190.14(d) would require the trustee to use reasonable efforts to compute the funded balance of each customer account immediately prior to the distribution of any property in the account, "which shall be as accurate as reasonably practicable under the circumstances, including the reliability and availability of information." Proposed § 190.14(d) is analogous to proposed § 190.05(b), modified for the context of a DCO bankruptcy. Similarly to proposed § 190.05(b), the Commission's objective in proposed § 190.14(d) would be to provide the bankruptcy trustee with the

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<sup>165</sup> See section 3(b) of the CEA, 7 U.S.C. 5(b) (It is the purpose of the CEA to ensure the avoidance of systemic risk.).

<sup>166</sup> See section 20(a)(3) of the CEA, 7 U.S.C. 24(a)(3) (Notwithstanding title 11, the Commission may provide with respect to a commodity broker that is a debtor the method by which the business of such commodity broker is to be conducted or liquidated after the date of the filing of the petition.).

latitude to act reasonably given the circumstances they are confronted with, recognizing that information may be more reliable and/or accurate in some insolvency situations than in others. However, at a minimum, the trustee would be required to calculate each customer's funded balance prior to distributing property, to achieve an appropriate allocation of property between customers.

The Commission requests comment with respect to all aspects of proposed § 190.14. In particular, the Commission seeks comment on the framing of the concepts of usefulness and practicability in the context of permitting the trustee to continue to operate a DCO in insolvency, in accordance with proposed § 190.14(b)(2), in order to, facilitate the transfer of clearing operations to another DCO or placing the debtor DCO into resolution pursuant to Title II of Dodd-Frank. Is there a better way to frame either of these terms? Moreover, is it appropriate to provide for the possibility that the trustee may be permitted to delay liquidating contracts?

5. Regulation 190.15: Recovery and Wind-down Plans; Default Rules and Procedures

Proposed § 190.15 would favor implementation of the debtor's default rules and procedures maintained pursuant to § 39.16 and, as applicable, § 39.35, and any recovery and wind-down plans maintained by the debtor and filed with the Commission, pursuant to §§ 39.39 and 39.19, respectively. Section 39.16 requires each DCO to, among other things, "adopt rules and procedures designed to allow for the efficient, fair, and safe management of events during which clearing members become insolvent or default on the obligations of such clearing members to the" DCO. In adopting § 39.35, the Commission explained that it "was designed to protect SIDCOs, Subpart C DCOs, their

clearing members, customers of clearing members, and the financial system more broadly by requiring SIDCOs and Subpart C DCOs to have plans and procedures to address credit losses and liquidity shortfalls beyond their prefunded resources.”<sup>167</sup> Similarly, in adopting § 39.39, the Commission explained that it is “designed to protect the members of such DCOs and their customers, as well as the financial system more broadly, from the consequences of a disorderly failure of such a DCO.”<sup>168</sup>

Proposed § 190.15(a) would provide that the trustee shall not avoid or prohibit any action taken by the DCO debtor that was reasonably within the scope of, and was provided for, in any recovery and wind-down plans maintained by the debtor and filed with the Commission, subject to section 766 of the Code. This is intended to provide finality and legal certainty to actions taken by a DCO to implement its recovery and wind-down plans, which are developed subject to Commission regulations.

Proposed § 190.15(b) would instruct the trustee to implement, in consultation with the Commission, the debtor DCO’s default rules and procedures maintained pursuant to § 39.16, and, as applicable, § 39.35, as well as any termination, close-out and liquidation provisions included in the rules of the debtor, subject to the trustee’s reasonable discretion and to the extent that implementation of such default rules and procedures is practicable.

Similarly, proposed § 190.15(c) would instruct the trustee to, in consultation with the Commission, take actions in accordance with any recovery and wind-down plans maintained by the debtor and filed with the Commission, to the extent reasonable and practicable. These proposed regulations are intended to provide the trustee, who will

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<sup>167</sup> 78 FR 72476, 72492 (December 2, 2013).

<sup>168</sup> *Id.* at 72494.

need quickly to take action to manage the DCO (and any member default), with a roadmap to manage such action, which roadmap is based on the rules, procedures, and plans the DCO has developed in advance, and subject to the requirements of the Commission's regulations.

The Commission requests comment with respect to all aspects of proposed § 190.15. In particular, is it appropriate to steer the trustee towards implementation of the debtor DCO's default rules and procedures and recovery and wind-down plans in proposed §§ 190.15(b) and (c)? Are the qualifiers concerning discretion, reasonability and practicability appropriate and sufficient?

6. Regulation 190.16: Delivery

Proposed § 190.16(a) would instruct the trustee to use reasonable efforts to facilitate and cooperate with completion of delivery in a manner consistent with proposed § 190.06(a) (which would instruct trustees of FCMs in bankruptcy to foster delivery where a contract has entered delivery phase before the filing date or where it is not practicable for the trustee to liquidate a contract moving into delivery position after the filing date) and the pro rata distribution principle addressed in proposed § 190.00(c)(5). As noted in discussing proposed § 190.06(a), it is important to address deliveries to avoid disruption to the cash market for the commodity and to avoid adverse consequences to parties that may be relying on delivery taking place in connection with their business operations. However, given the potential for competing demands on the trustee's resources, including time, this instruction would be limited to requiring "reasonable efforts."

Proposed § 190.16(b) would carry forward, to the context of a DCO in bankruptcy, the delineation between the physical delivery property account class and the cash delivery property account class that would be set forth in proposed § 190.06(b). Specifically, physical delivery property that is held in delivery accounts for the purpose of making delivery would be treated as physical delivery property, as are the proceeds from any sale of such property. By contrast, cash delivery property that is held in delivery accounts for the purpose of paying for delivery would be treated as cash delivery property, as would any physical delivery property for which delivery is subsequently taken.

The Commission requests comment with respect to all aspects of proposed § 190.16. Specifically, the Commission seeks comment as to whether it is appropriate, in the context of a clearing organization bankruptcy, to separate the physical delivery account class from the cash delivery account class. If so, should the physical delivery account class for a clearing organization be further divided into separate sub-classes for each type of physical delivery property? If so, what should be the definition of a “type of physical delivery property”? Alternatively, might it be more prudent in the context of a clearing organization to treat the delivery account class as a single, undivided account class?

7. Regulation 190.17: Calculation of Net Equity

Proposed § 190.17(a) with respect to net equity is parallel to proposed § 190.18(a) with respect to customer property. Proposed § 190.17(a)(1) would confirm that a member of a clearing organization may have claims in separate capacities, that is, claims on behalf of its public customers (customer account) and claims on behalf of itself and its

non-public customers (affiliates) (house account), and, within those separate customer classes, further separated by account class. The member would be treated as part of the public customer class with respect to claims based on commodity customer accounts carried as “customer accounts” by the clearing organization for the benefit of the member’s public customers, and as part of the non-public customer class with respect to claims based on its house account. Proposed § 190.17(a)(2) would direct that net equity shall be calculated separately with respect to each customer capacity and, within such customer capacity, by account class.

Proposed § 190.17(b)(1) would confirm that the calculation of members’ net equity claims—and, thus, the allocation of losses among members and their accounts—is based on the full application of the debtors’ loss allocation rules and procedures, including the default rules and procedures referred to in §§ 39.16 and 39.35. These pre-existing loss allocation rules and procedures are the contract between and among the members and the DCO, and thus the Commission preliminarily believes it is appropriate to give them effect regardless of the bankruptcy of the DCO—and regardless of the timing of any such bankruptcy (*i.e.*, regardless of whether such loss allocation rules and procedures have been applied fully prior to the order for relief). While certain DCOs may have discretion, consistent with governance procedures, as to precisely when they call for members to meet assessment obligations, the Commission believes that allocation of losses should not depend on the happenstance of when default management or recovery tools were used—*e.g.*, when assessments were called for, or when such assessments were met.

DCOs also often have rules to “reverse the waterfall”—that is, to allocate to members’ accounts recoveries on claims against defaulting members<sup>169</sup> in reverse order of the allocation of the losses.<sup>170</sup> Proposed § 190.17(b)(2) would implement such rules in bankruptcy, that is, to adjust members’ net equity claims (and the basis for distributing any such recoveries) in light of such recoveries. This regulation would similarly implement DCO loss allocation rules in other contexts, for example, (i) rights to portions of mutualized default resources that are either prefunded or assessed and collected, and, in either event, not used, as well as (ii) rules that would allocate to members recoveries against third parties for non-default losses that are, under the DCO’s rules, originally borne by members.

Proposed § 190.17(c) would incorporate by reference the equity calculations set forth in proposed § 190.08, to the extent applicable.<sup>171</sup>

Section 766(i) of the Bankruptcy Code (1) allocates a debtor DCO’s customer property (other than member property) to the DCO’s customers (*i.e.*, clearing members) ratably based on the clearing members’ net equity claims based on their (public) customer accounts, and (2) allocates a debtor DCO’s member property to the DCO’s clearing members ratably based on the clearing members’ net equity claims based on

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<sup>169</sup> These recoveries might be based on prosecution of such claims in an insolvency or receivership proceeding, or, in the reasonable commercial judgment of the DCO, the settlement or sale of such claims.

<sup>170</sup> For example, if the DCO rules allocate losses in excess of the defaulters’ available resources first to the DCO’s own contributions, second to the mutualized default fund contributions of members other than the defaulter, third to assessments, and fourth to gains-based haircutting (*pro rata*), all of which tools were in fact used in a particular case, then recoveries on claims against the defaulting members would be allocated (to the extent available) first to those member accounts for which gains were haircut, *pro rata* based on the aggregate amount of such haircuts per member account, until all such haircuts have been reversed, second to those members who paid assessments, *pro rata* based on the amount of such assessments paid, until all such assessments have been repaid, third to members whose mutualized default-fund contributions were consumed, *pro rata* based on such default-fund contributions, until all such contributions have been repaid, and fourth to the DCO to the extent of its own contribution.

<sup>171</sup> For a discussion of the proposed changes between current § 190.07 and proposed § 190.08, which both set forth the methodology for calculating net equity, please see sections II.B.5 and II.B. 6 above.

their proprietary (*i.e.*, house) accounts. Proposed § 190.17(d) would implement this provision by defining funded balance as a clearing member's pro rata share of member property (for a clearing member's house accounts) or customer property other than member property (for accounts for a clearing member's public customers). The pro rata amount is calculated with respect to each account class available for distribution to customers of the same customer class. Moreover, given that calculation of funded balance for FCMs is an analogous exercise, calculations would be made in the manner provided in the relevant regulation, proposed § 190.08(c), to the extent applicable.<sup>172</sup>

The Commission requests comment with respect to all aspects of proposed § 190.17. Is it appropriate to base these calculations on the full application of the debtors' loss allocation rules and procedures, including the default rules and procedures referred to in §§ 39.16 and 39.35?

8. Regulation 190.18: Treatment of property

Proposed § 190.18(a), with respect to customer property, is parallel to proposed § 190.17(a) with respect to net equity. It would provide that property of the debtor clearing organization's estate is allocated between member property, and customer property other than member property, as provided in proposed § 190.18, in order to satisfy claims of clearing members, as customers of the debtor. The property so allocated would constitute a separate estate of the customer class (*i.e.* member property, and customer property other than member property) and the account class to which it is allocated, and would be designated by reference to such customer class and account class.

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<sup>172</sup> For a discussion of the proposed changes between current § 190.07(c) and proposed § 190.08(c), which both set forth the methodology for calculating funded balance, please see sections II.B.5 and II.B.6 above.

Proposed § 190.18(b) would set out the scope of customer property for a clearing organization.<sup>173</sup> It is based in large part on proposed § 190.09(a) (scope of customer property for FCMs). Specifically, proposed §§ 190.18(b)(1)(i)(A through G) are based on proposed §§ 190.09(a)(1)(i)(A through G). Proposed § 190.09(a)(1)(H) would not be mapped over because loans of margin are not applicable to DCOs.<sup>174</sup>

Proposed §§ 190.18(b)(1)(ii) (A through D) are based on proposed §§ 190.09(a)(1)(ii)(A, D, E and F) respectively, while proposed § 190.18(b)(1)(ii)(E) would incorporate by reference §§ 190.09(a)(1)(ii)(H through K), as if the term debtor used therein refers to a clearing organization as debtor. Proposed §§ 190.09(a)(1)(ii)(B, C, G, and L) would not be mapped over because they would not be applicable based on the differences in business models, structures, and activities between FCMs and of DCOs.

Proposed § 190.18(b)(1)(iii) would be unique to a clearing organization. It would include as customer property any guarantee fund deposit, assessment, or similar payment or deposit made by a member, to the extent any remains following administration of the debtor's default rules and procedures. It also would include any other property of a member that, pursuant to the debtor's rules and procedures, is available to satisfy claims made by or on behalf of public customers of a member.

Proposed § 190.18(b)(2), which would identify property that is not included in customer property, would incorporate by reference proposed § 190.09(a)(2), as if the

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<sup>173</sup> This is another provision prescribed pursuant to the Commission's authority under section 20(a)(1) of the CEA, 7 U.S.C. 24(a)(1).

<sup>174</sup> For a discussion of the proposed changes between current § 190.08(a) (on which proposed § 190.09(a) is based) and proposed § 190.09(a), please see section II.B.7 above.

term debtor used therein refers to a clearing organization as debtor and to the extent relevant to a clearing organization.<sup>175</sup>

Proposed § 190.18(c) would allocate customer property between customer classes. It would operate in the following order of preference: Allocation to customer property other than member property is favored over allocation to member property so long as the funded balance in any account class for members' public customers is less than one hundred percent of net equity claims. Once all account classes for customer property other than member property are fully funded (*i.e.*, at one hundred percent of net equity claims), any excess could be allocated to member property.

Thus, proposed § 190.18(c)(1) would allocate any property referred to in proposed § 190.18(b)(1)(iii) (guarantee deposits, assessments, etc.) first to customer property other than member property (*i.e.*, to benefit public customers) to the extent any account class therein is not fully funded, and then to member property. This is a change from the proviso in current § 190.09(b), which would allocate such property to member property. This change is intended to favor public customers, consistent with the policy embodied in section 766(h) of the Bankruptcy Code.

Similarly, proposed § 190.18(c)(2) would allocate any excess funds in any account class for members' house accounts first to customer property other than member property to the extent that any account class therein is not fully funded, and then any remaining excess to house accounts, to the extent that any account class therein is not fully funded. Finally, proposed § 190.18(c)(3) would allocate any excess funds in any account for members' customer accounts first to customer property other than member

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<sup>175</sup> For a discussion of the proposed changes between current § 190.08(a)(2) (on which proposed § 190.09(a)(2) is based) and proposed § 190.09(a)(2), see section II.B.7 above.

property to the extent that any account class therein is not fully funded, and then any remaining excess to house accounts, to the extent that any account class therein is not fully funded.

Proposed § 190.18(d) would allocate customer property among account classes within customer classes. Proposed § 190.18(d)(1) would confirm that, where customer property is tied to a specific account class—that is, where it is segregated on behalf of, readily traceable on the filing date to, or recovered by the trustee on behalf of or for the benefit of an account class within a customer class—the property must be allocated to the customer estate of that account class (that is, the account class for which it is segregated, to which it is readily traceable, or for which it is recovered).

Pursuant to proposed § 190.18(d)(2), customer property which cannot be allocated in accordance with the previous paragraph would be allocated in a manner that promotes equality of percentage distribution among account classes within a customer class. Thus, such property would be allocated first to the account class for which funded balance—that is, the percentage that each member’s net equity claim is funded—is the lowest. This would continue until the funded balance percentage of that account class equals the funded balance percentage of the account class with the next lowest percentage of funded claims. The remaining customer property would be allocated to those two account classes so that the funded balance for each such account class remains equal. This would continue until the funded balance percentage of those two account classes is equal to the funded balance of the account class with the next lowest percentage of funded claims, and so forth, until all account classes within the customer class are fully funded.

Proposed § 190.18(e) would confirm, however, that where the debtor has, prior to the order for relief, kept initial margin for house accounts in accounts without separation by account class, then member property will be considered to be in a single account class.

Proposed § 190.18(f) would be the analog in the DCO context to proposed § 190.09(a)(3) in the context of FCMs. It would reserve the right of the trustee to assert claims against any person to recover the shortfall of property enumerated in proposed §§ 190.18(b)(1)(i)(E), (b)(1)(ii) and (b)(1)(iii). The purpose of proposed § 190.18(f), as with proposed § 190.09(a)(3), would be to clarify that any claims that the trustee may have against a person to recover customer property will not be undermined or reduced by the fact that the trustee may have been able to satisfy customer claims by other means.

The Commission requests comment with respect to all aspects of proposed § 190.18. In particular, the Commission seeks comment on the comprehensiveness of the scope of customer property for a clearing organization in proposed § 190.18(b). The Commission also requests comment on the appropriateness of the proposed allocation of customer property between customer classes in proposed § 190.18(c) and within customer classes in proposed § 190.18(d).

#### 9. Regulation 190.19: Support of Daily Settlement

As the Commission noted in proposing § 39.14(b), “[t]he daily settlement of financial obligations arising from the addition of new positions and price changes with respect to all open positions is an essential element of the clearing process at a DCO.”<sup>176</sup>

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<sup>176</sup> 76 FR 3608, 3708 (Jan. 11, 2011).

Indeed, Congress confirmed this by requiring that each DCO complete money settlements not less frequently than once each business day.<sup>177</sup>

In the ordinary course of business, variation settlement payments are, at a set time or times each day,<sup>178</sup> sent to the DCO from the customer and proprietary accounts of each clearing member with net losses in such accounts (since the last point of computation of settlement obligations for that member) and then sent from the DCO to the customer and proprietary accounts of each clearing member with net gains in such accounts over that time period.

There is no necessary relationship between the aggregate amount of payments to the DCO from all clearing member customer accounts with net losses and the aggregate amount of payments from the DCO to clearing members' customer accounts with net gains. On the other hand, it is the case that, for each business day, the sum of variation settlement payments to the clearinghouse from clearing members' customer and house accounts with net losses will equal the sum of variation settlement payments from the clearinghouse to clearing members' customer and house accounts with net gains.<sup>179</sup>

Those variation settlement payments will be received into the DCO's accounts at one or more settlement banks from the accounts of the clearing members with net losses and subsequently be disbursed from the DCO's accounts at settlement banks to the accounts

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<sup>177</sup> See Core Principle E(i), 7 U.S.C. 7a-1(c)(2)(E)(i).

<sup>178</sup> DCOs are required to effect settlement with each clearing member at least once each business day. They are additionally required to have the capability to effect a settlement with each clearing member on an intraday basis. See § 39.14(b).

<sup>179</sup> Thus, while (for each settlement cycle), customer account losses ( $x$ ) plus house account losses ( $y$ ) will equal customer account gains ( $p$ ) plus house account gains ( $q$ ) (that is,  $x + y = p + q$ ),  $x$  would only equal  $p$  by random chance.

of the clearing members with net gains.<sup>180</sup> Depending on the settlement bank and operational arrangements of the particular DCO, the variation settlement funds will remain in the DCO's accounts between receipt and disbursement for a time period of between several minutes and several hours.

It is crucial to the settlement process that the variation settlement payments that flow into the DCO from accounts with net losses are available promptly to flow out of the DCO as variation settlement to accounts with net gains. Accordingly, the Commission is proposing § 190.19(a), pursuant to section 20(a)(1) of the CEA,<sup>181</sup> to provide that, upon and after an Order for Relief, such funds<sup>182</sup> are to be included in the customer property of the DCO, that they will be considered traceable to, and shall promptly be distributed to, member and customer accounts entitled to payment with respect to the same daily settlement. This customer property would be allocated to (i) member property and (ii) customer property other than member property, in proportion to the ratio of total gains in member accounts with net gains, and total gains in customer accounts with net gains, respectively.

Regulation 190.19(b) would deal with cases where there is a shortfall in funds received pursuant to paragraph (a) (*i.e.*, settlement payments received by the DCO). This

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<sup>180</sup> In some cases, the DCO will use one settlement bank, and all settlement funds will flow into and out of that bank. In other cases, the DCO may use a system of settlement banks, and the DCO may, after receiving payments from members with payment obligations, move funds between and among the settlement banks (possibly through a "concentration bank") to match the settlement funds at each bank to the DCO's settlement obligations to members who are entitled to settlement payments.

<sup>181</sup> 7 U.S.C. 24(a)(1) (Notwithstanding title 11 of the United States Code, the Commission may provide, with respect to a commodity broker that is a debtor under chapter 7 of title 11, by rule or regulation (1) that certain cash, securities, other property, or commodity contracts are to be included or excluded from customer property or member property.)

<sup>182</sup> Because deposits of initial margin described in § 39.14(a)(iii) are separate from the variation settlement process, they are treated separately in proposed § 190.19(a). Such funds would be member property to the extent that they are deposited on behalf of members' house accounts, and customer property other than member property to the extent that they are deposited on behalf of members' customer accounts.

generally would occur in case of a member default. Proposed paragraph (b)(1), to the extent of such shortfall, would supplement the available settlement funds in accordance with the DCO's default rules and procedures (adopted pursuant to § 39.16 for all DCOs and, for DCOs subject to subpart C of part 39, § 39.35) and any recovery plans and wind-down plans maintained pursuant to § 39.39 and submitted to the Commission pursuant to § 39.19.<sup>183</sup> These funds would be allocated in the same proportion as referred to in paragraph (a).

Four types of property would be included as customer property: (i) Initial margin held for the account of a member that has defaulted on a daily settlement, including initial margin segregated for the customers of such member. This would be restricted to the extent that such margin may only be used to the extent that such use is permitted pursuant to parts 1, 22 and 30 (which include provisions restricting the use of customer margin); (ii) Assets of the debtor to the extent dedicated to such use as part of the debtor's default rules and procedures, or as part of any recovery and wind-down plans described in the previous paragraph, (such assets are sometimes referred to as "skin in the game"); (iii) Prefunded guarantee or default funds maintained pursuant to the DCO debtor's default rules and procedures; and (iv) Payments made by members pursuant to assessment powers maintained pursuant to the DCO debtor's default rules and procedures.

Paragraph (b)(2) would provide that, to the extent that the funds that are included as customer property pursuant to paragraph (a), supplemented as described in paragraph (b)(1), such funds would be allocated between (i) member property and (ii) customer

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<sup>183</sup> See 39.19(c)(4)(xxiv).

property other than member property, in proportion to the ratio of total gains in member accounts with net gains, and total gains in customer accounts with net gains, respectively.

The Commission requests comment with respect to all aspects of proposed § 190.19.

*D. Appendix A Forms*

The Commission is proposing to delete forms 1 through 3 contained in appendix A and would replace form 4 with a streamlined proof of claim form. Current forms 1 through 3 include (i) a schedule of the trustee's duties in operating the debtor FCM's estate, (ii) a form for requesting customer instructions regarding non-cash property; and (iii) a form for requesting instructions from a customer concerning transfer of hedging positions. The forms contain outdated provisions that require unnecessary information to be collected. The Commission believes these changes provide a trustee with flexibility to act based on the specific circumstance of the case, while still acting consistently with the rules.

As noted in proposed § 190.03(f), the trustee would be permitted, but not required, to use the revised template proof of claim form proposed as new appendix A. That template is intended to implement proposed § 190.03(e), and includes cross-references to the detailed paragraphs of that section. Similarly, the proposed instructions would also be designed to aid customers in providing information and documentation to the trustee that will enable the trustee to decide whether, and in what amount, to allow each customer's claim consistent with part 190.

The Commission requests comment with respect to all aspects of proposed revisions to the appendix A template proof of claim form. Is the information called for

by the template fit for the goal of providing the trustee with the information they will need to determine whether and in what amount to allow a claim? Is any of the information called for unnecessary, unhelpful, or disproportionately burdensome? Does the form fail to request any information that is necessary to accomplish that goal? Are the proposed instructions clear and correct?

*E. Appendix B Forms*

Appendix B to the current part 190 regulations contains special bankruptcy distribution rules. These rules are broken into two frameworks. Framework 1 provides special rules for distributing customer funds when the debtor FCM participated in a futures-securities cross-margining program that refers to that framework. Framework 2 provides special rules for allocating as shortfall in customer funds to customers when the shortfall is incurred with respect to funds held in a depository outside the U.S. or in a foreign currency.

Framework 1 is applicable to specific cross-margining programs that explicitly refer to that distributional framework. The framework establishes separate pools of cross-margining and non-cross-margining funds and subordinates customer claims for cross-margining wherever that would be to the benefit of customer claims for non-cross-margining.

The ABA Committee proposed clarifying changes to framework 1, and one substantive change:<sup>184</sup> The ABA Committee “propose[s] deleting the specific limitation that customers must be market professionals, should the Commission decide to expand

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<sup>184</sup> See ABA Submission at 58-59.

the scope of customers that may participate in futures-securities cross-margining programs.”<sup>185</sup>

More recent cross-margining programs established in Commission Orders pursuant to section 4d of the CEA treat all customer claims (whether involving cross-margining or not, whether involving securities or not) equally, and do not refer to Framework 1. Accordingly, it is already possible for customers who are not market professionals to participate in cross-margining programs, including those that involve securities. There thus appears no need substantively to change framework 1. On the other hand, framework 1 will continue to apply to the programs established pursuant to Orders that refer to that framework, and so it would appear helpful to make clarifying changes.

The Commission is accordingly proposing the clarifying changes suggested in the ABA Submission, but is not proposing the substantive change incorporated in the ABA Submission. It would retain the current instructions and examples following the first three paragraphs in appendix B, framework 1 entirely unchanged.

The Commission is proposing to retain framework 2 with some clarifying changes to the opening paragraph; no substantive change is intended. It would retain the current instructions and examples following the first paragraph in appendix B, framework 2 entirely unchanged.

The Commission requests comment with respect to all aspects of the proposed revisions to the opening paragraph of appendix B, framework 2.

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<sup>185</sup> See ABA Cover Note at 17.

*F. Technical Corrections to Other Parts*

1. Part 1

The Commission is proposing several technical corrections and updates to part 1 in order to update cross-references. These are as follows:

- In § 1.25(a)(2)(ii)(B) the Commission would revise the cross-reference to specifically identifiable property, since the definition would be updated in proposed § 190.01.
- In §§ 1.55(d), (d)(1), and (d)(2), references to current § 190.06 would be removed consistent with the revisions to proposed § 190.10(b).
- In § 1.55(f), 1.65(a)(3) and 1.65(a)(3)(iii) the Commission would update references to the customer acknowledgment in proposed § 190.10(e).

2. Part 4

In part 4, the Commission is proposing minor technical corrections: In §§ 4.5(c)(2)(iii)(A), 4.12(b)(1)(i)(C) and 4.13(a)(3)(ii)(A) the Commission would change the cross-references to the proposed defined term for “in-the-money-amount.”

3. Part 41

In part 41, the Commission would be proposing one technical correction. In § 41.41(d), the Commission would delete the cross-reference to the recordkeeping obligations in current § 190.06, pursuant to the revisions to proposed § 190.10(b).

### **III. Revisions proposed by the ABA Committee that have not been proposed by the Commission.**

As noted in section I.A above, today's NPRM has benefited greatly from the ABA Submission. In this section, the Commission will address those points where this proposal departs most significantly from the ABA Submission and ABA Cover Note.

First, as discussed in section II.A.1 above, the Commission has, in proposed § 190.00(d)(2)(ii), proposed a more direct approach to addressing the issue of constructive and other trusts than the approach suggested in the ABA Submission.

Second, as discussed in section II.B.3 above, the Commission would propose in § 190.05(f) to modify the application to the trustee of the residual interest provisions in § 1.11 rather than to exempt the trustee from those provisions completely as suggested in the ABA Submission.

Third, sections III A-E of the ABA Cover Note recommend that the Commission make changes to Commission Rules outside part 190, including (A) the definition of Foreign Option in § 30.1(d), (B) the definition of Proprietary Account in § 1.3, (C) the definition of Variation Margin in § 1.3, (D) part 22 regulations concerning non-swap and non-futures OTC transactions cleared by a DCO, and (E) part 31 regulations for Leverage Transaction Merchants. The ABA Committee "emphasize[s], though, that [these proposed changes] are not prerequisites for the Model Part 190 Rules to work as drafted. The Proposed Model Part 190 Rules stand on their own."<sup>186</sup>

While these proposals merit due consideration, the Commission has determined, in light of practical limits to staff time and resources, to address these proposals at a later

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<sup>186</sup> ABA Cover Note at 18-19.

time and separately from these proposed revisions to part 190. By contrast, the “Technical Housekeeping Changes” proposed in section III F of the ABA Cover Note are more simple, and have been addressed in today’s proposal, as discussed in section II.F above.

The ABA Submission also included proposed revisions to appendix B, framework 1 (Special Distribution of Customer Funds When FCM Participated in Cross-Margining). As discussed in section II.E above, the Commission is proposing the clarifying changes included in the ABA Submission, but is declining to “delet[e] the specific limitation that customers must be market professionals.”<sup>187</sup>

Finally, the ABA Cover Note suggests that the Commission delete framework 2 (Special Allocation of Shortfall To Customer Claims When Customer Funds For Futures Contracts and Cleared Swaps Customer Collateral are Held In A Depository Outside Of The United States Or In A Foreign Currency) on the grounds that the framework is complicated and unnecessary.<sup>188</sup> While the operation of framework 2 is undeniably complicated, it appears still to be necessary in order to protect those customers who post collateral in the form of U.S. dollars required to be held in the United States.<sup>189</sup> Indeed, staff recently issued a no-action letter to Eurex Clearing conditioned upon FCMs providing customers with a written disclosure statement describing “the operation of Framework 2 of Part 190 of the Commission’s regulations in the event of an FCM

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<sup>187</sup> *Id.* at 17.

<sup>188</sup> ABA Cover Note at 17.

<sup>189</sup> *Cf.* § 1.49(e).

bankruptcy.”<sup>190</sup> Accordingly, while the Commission would welcome proposals to simplify framework 2, it does not intend to delete or amend that framework at this time.

#### **IV. Cost-Benefit Considerations**

##### *A. Introduction*

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.<sup>191</sup> Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors (collectively referred to herein as “Section 15(a) Factors”).

The Commission recognizes that the proposed changes to part 190 could create benefits, but also could impose costs. The Commission has endeavored to assess the expected costs and benefits of the proposed rulemaking in quantitative terms, including costs related to matters addressed in the Paperwork Reduction Act<sup>192</sup> (“PRA-related costs”), where possible. In situations where the Commission is unable to quantify the costs and benefits, the Commission identifies and considers the costs and benefits of the applicable proposed rules in qualitative terms. The lack of data and information to estimate those costs is attributable in part to the nature of the proposed rules.

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<sup>190</sup> See CFTC Staff Letter 18-31 at 7.

<sup>191</sup> Section 15(a) of the CEA, 7 U.S.C. 19(a).

<sup>192</sup> 44 U.S.C. 3501 *et. seq.*

The Commission generally requests comment on all aspects of its cost-benefit considerations, including the identification and assessment of any costs and benefits not discussed herein; the potential costs and benefits of the alternatives discussed herein; data and any other information to assist or otherwise inform the Commission's ability to quantify or qualitatively describe the costs and benefits of the proposed rules; and substantiating data, statistics, and any other information to support positions posited by commenters with respect to the Commission's discussion. The Commission welcomes comment on such costs from all members of the public, but particularly from FCMs, DCOs, and persons with experience as bankruptcy and SIPA trustees (or professionals who have provided support to such trustees), who can provide quantitative cost data or other learning based on their respective experiences. Commenters may also suggest other alternatives to the proposed approaches.

*B. Baseline*

The baselines for the Commission's consideration of the costs and benefits of this proposed rulemaking are: (1) the Commission's current regulations in part 190, which establish bankruptcy rules in the event of an FCM bankruptcy; (2) current appendix A to part 190, which contains four bankruptcy forms (form 1—Operation of the Debtor's Estate—Schedule of Trustee's Duties; form 2—Request for Instructions Concerning Non-Cash property Deposited with (Commodity Broker); form 3—Request for Instructions Concerning Transfer of Your Hedging Contracts Held by (Commodity Broker); and form 4—Proof of Claim); and (3) current appendix B to part 190, which contains two frameworks setting forth rules concerning distribution of customer funds or

allocation of shortfall to customer claims in specific circumstances. The Commission seeks comment on all aspects of the baseline laid out above.

*C. Overarching Concepts*

1. Changes to Structure of Industry

The Commission is proposing several revisions in proposed part 190 in order to take into account the changes to the structure of the industry since part 190 was originally published in 1983. In particular, the Commission would recognize that FCMs and DCOs now operate in a different world where matters such as market moves, transactions, and movements of funds tend to happen much more quickly. These changes result from a number of factors, in particular advances in technology and the global nature of underlying markets. While trading through FCMs in the 1980's took place predominantly through open-outcry during what were then considered business hours in the United States, in the 21<sup>st</sup> Century, FCMs and DCOs are responsible for trades that take place continuously from Sunday afternoon through Friday afternoon (U.S. Eastern time), due to overnight electronic trading, as well as trading in time zones that are up to 16 hours ahead of U.S. Eastern time (Sydney, Australia, from approximately October through March).

As a result, several of the changes the Commission is proposing to part 190 would address these changed circumstances. For instance, proposed § 190.03(b)(2) would remove the current deadline of three days following the entry of an order for relief for the trustee or DSRO to notify the Commission its intent to transfer open commodity contracts. Instead, proposed § 190.03(b)(2) would provide that the trustee or DSRO must notify the Commission of an intent to transfer “[a]s soon as possible.” As discussed

further below, this change would be in recognition of the fact that a DCO or upstream FCM is unlikely to hold a position open for three days following entry of the order for relief, and that the trustee would be expected to be working on transferring any open positions immediately upon appointment.<sup>193</sup> The Commission believes that the revisions in proposed part 190 that would address the computerized and fast-paced nature of the industry would benefit all parties involved in a bankruptcy proceeding, since the rules would reflect how the industry actually works today and would not unnecessarily delay the administration of a bankruptcy proceeding.

## 2. Trustee Discretion

In several places in proposed part 190, the Commission would attempt to provide additional flexibility and discretion to the bankruptcy trustee in taking certain actions.<sup>194</sup> For instance, proposed § 190.03(e) and (f) permit the trustee flexibility to modify the proof of claim form to take into account the particular facts and circumstances of the case. Proposed § 190.03(a)(2) would provide that the trustee the discretion to “establish and follow procedures reasonably designed for giving adequate notice to customers under this part.” This discretionary approach would be in contrast to the customer notice

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<sup>193</sup> Another example appears in proposed § 190.04(b)(4), which provides that a trustee shall liquidate all open commodity contracts in any commodity contract account that is in deficit or for which the customer fails to meet a margin call made by the trustee within a reasonable time. The provision further provides that, “absent exigent circumstances, a reasonable time for meeting margin calls made by the trustee shall be deemed to be one hour, or such greater period not to exceed one business day.” Proposed § 190.04(b)(4) thus allows for the possibility that, in the event of exigent circumstances, a “reasonable time” could be deemed by the trustee to be less than one hour, a possibility that accounts for the fast-paced nature of the industry.

Other revisions that reflect changes to the structure of the industry are reflected in proposed § 190.00(c)(6)(iv), which makes clear that the delivery provisions contained in the proposed regulations apply to any commodity that is subject to delivery under a commodity contract, whether the commodity itself is tangible or intangible, including virtual currencies, and in the definition of “physical delivery property” contained in proposed § 190.01, which reflects the fact that a document of title for a commodity can be electronic.

<sup>194</sup> The alternative, to forego providing such flexibility or discretion, would invert the benefits and costs discussed below.

procedures in current part 190, which are more prescribed and depend on the type of notice being given.<sup>195</sup>

The Commission is of the view that, in general, affording more discretion to the bankruptcy trustee in appropriate circumstances is beneficial, and indeed necessary, where matters are unique and fast-paced, as they often are in commodity broker bankruptcy proceedings. Moreover, each formal approval the trustee is required to obtain takes significant time and involves significant administrative costs, to the detriment of customers. In many areas, it is unlikely that a prescriptive approach can be designed that will reliably be “fit for purpose” in all plausible future circumstances.

Therefore, increased discretion of the trustee would benefit the estate by allowing the trustee to make decisions that are uniquely tailored to the particular case, rather than being compelled to follow a procrustean framework, or being required to request formal approval from the Commission or other parties before implementing those decisions. This approach leads to approaches that are better tailored to the specifics of the circumstances, reductions in administrative costs (to the benefit of customers and/or other creditors) and faster distributions of customer property (to the benefit of customers). It is also intended to mitigate the negative externalities arising from the distressed circumstances that tend to result in further reduction in the value of customer assets

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<sup>195</sup> Other examples include proposed § 190.04(d)(3), providing the trustee with discretion to request that a customer deliver substitute customer property with respect to a letter of credit, which “may equal the full face amount of the letter of credit or any portion thereof, to the extent required or may be required in the trustee’s discretion to ensure pro rata treatment among customer claims within each account class;” proposed § 190.08(d)(5), providing that a trustee shall value certain property “using such professional assistance as the trustee deems necessary in its sole discretion under the circumstances;” and proposed § 190.14(a), providing that a trustee in a clearing organization bankruptcy may, in their discretion based upon the facts and circumstances of the case, instruct each customer to file a proof of claim containing such information as is deemed appropriate by the trustee.

The Commission recognizes, however, that with increased discretion comes a risk of trustee mistake or misfeasance; in other words, a trustee making decisions that turn out not to be in the best interests of the customers or other creditors. While this is certainly a potential cost in situations where the trustee is given increased discretion or flexibility, the Commission believes that this potential cost would be mitigated by (1) the high degree of informal (and, where necessary, formal) involvement of Commission staff in FCM and DCO bankruptcy matters,<sup>196</sup> and (2) the fact that such discretion would not be unbounded and would apply only in particular circumstances, as discussed below. Therefore, the Commission's judgment in granting discretion to the trustee would apply these principles.

An additional risk related to increased discretion is the possibility that parties that are dissatisfied with the trustee's exercise of discretion may challenge it in court, potentially leading to increased litigation costs. The Commission believes that this risk is mitigated by (1) the fact that certain of these decisions would be made in contexts where the trustee would be seeking an order of the bankruptcy court approving the trustee's approach (and thus the trustee's discretion would be subject to judicial review within a proceeding in which interested parties have an opportunity to object) and (2) the likelihood that bankruptcy courts would respect the Commission's rules granting the trustee discretion, thereby mitigating the cost of such litigation.

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<sup>196</sup> As a formal matter, the Commission has the right to appear and be heard on any issue in any such case. *See* 11 U.S.C. 762(b). As a practical matter, trustees and their counsel have, in previous commodity broker bankruptcies, consulted with Commission staff frequently and on an ongoing basis, particularly in making and implementing important decisions.

Instances where the revisions to proposed part 190 would afford more flexibility or discretion to the bankruptcy trustee are discussed in further detail where they appear in each provision below.

### 3. Cost Effectiveness and Promptness versus Precision

In its proposed revisions to part 190, the Commission is endeavoring to effect a proper balance between cost effectiveness and promptness, on the one hand, and precision, on the other hand. Current part 190 favors cost effectiveness and promptness over precision in certain respects, particularly with respect to the concept of pro rata treatment, where, following the policy choice made by Congress in section 766(h) of the Bankruptcy Code, the Commission is proposing that it is more important to be cost effective and prompt in the distribution of customer property (*i.e.*, in terms of being able to treat customers as part of a class) than it is to value each customer's entitlements on an individual basis. The proposed revisions to part 190 would take this concept further, recognizing that there are additional circumstances where cost effectiveness and promptness in the administration of a bankruptcy proceeding should have higher priority than precision. For instance, proposed § 190.05 would provide that the bankruptcy trustee shall use reasonable efforts to compute a funded balance for each customer account that contains open commodity contracts and other property as of the close of each business day, "which shall be as accurate as reasonably practicable under the circumstances, including the reliability and availability of information." The quoted language would allow the trustee to avoid more precise calculations where such precision would not be cost effective or could not reasonably be accomplished on a prompt basis (for example, in a situation where price information for particular assets or contracts was

not readily available).<sup>197</sup> The Commission believes that these revisions emphasizing cost effectiveness and promptness over precision would further the policy embodied in section 766(h) of the bankruptcy code and benefit parties involved in a bankruptcy proceeding overall, as they would lead to (1) in general, a faster administration of the proceeding, (2) customers receiving their share of the debtor's customer property more quickly, and (3) a decrease in administrative costs. There could, however, be corresponding costs to this approach for some customers in that they may lose out on being treated precisely in terms of their individual circumstances (and may receive a smaller distribution of customer property than otherwise).

#### 4. Unique Nature of Bankruptcy Events

The Commission would recognize in proposed part 190 that there is no one-size-fits-all approach to the administration of the bankruptcy of an FCM or a DCO, and that it would be important that the rules allow the trustee, in conducting that administration, to take into account the unique nature of each of these events. The revisions to proposed part 190, therefore, would address the uniqueness of these bankruptcy events and would allow for the bankruptcy trustee to tailor their approach in the way that most makes sense given the individual circumstances of the case at hand.<sup>198</sup> History has shown that FCM

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<sup>197</sup> Another example of advancing the overarching concept of favoring cost effectiveness over precision is in proposed § 190.08(d)(5), which would provide that, in computing net equity, a trustee may value all customer property not otherwise listed in proposed § 190.05(d) using such professional assistance as the trustee deems necessary. This provision, which would replace more specific valuation instructions that currently appear in part 190, would recognize that it is more cost effective for the trustee to enlist whatever professional help they need to value certain types of customer property rather than prescribe certain valuation methods for every type of customer property they may encounter in the course of a bankruptcy proceeding, and thereby would emphasize cost effectiveness over precision.

<sup>198</sup> Circumstances that may vary include the accuracy of the commodity broker's records at the time of bankruptcy, whether the bulk of an FCM's customer accounts were transferred in the days after the filing date (or otherwise migrated in the days before), the number of customer accounts, the existence and extent of a shortfall in customer funds, and the complexity of the positions carried by the commodity broker.

bankruptcies play out in very different ways, and several of the Commission's proposed revisions to part 190 would address that reality. For instance, proposed §§ 190.03(e) and (f), addressing the customer proof of claim form in an FCM bankruptcy, would allow the trustee, in their discretion, to modify the proof of claim form to take into account the particular facts and circumstances of the particular bankruptcy case rather than using, unmodified, a standardized proof of claim form that may not be appropriate for those circumstances. Similarly, proposed § 190.14(a) would allow the trustee in a DCO bankruptcy, "in its discretion based upon the facts and circumstances of the case," to instruct each customer to file a proof of claim form containing such information as is deemed appropriate by the trustee. These provisions would reflect the fact that each FCM and DCO bankruptcy would present individual circumstances, and that the proof of claim form would likely have to be modified to take into account the unique facts and circumstances of each case. The Commission believes that the revisions of this type would benefit all parties involved in a bankruptcy proceeding by better tailoring such a proceeding to the unique needs of the particular case.

5. Administrative Costs are Costs to the Estate, and Often to the Customers

In many instances in this proposal, the Commission has noted that a certain provision would impose or reduce administrative costs. The Commission notes that, in each of these cases, administrative costs would be a cost to the estate of the debtor, since administrative expenses that the bankruptcy trustee would incur in administering the estate (including for the time of the trustee, accountants, counsel, consultants, etc.) would be passed onto the estate itself, which means that, in the event of a shortfall, such costs would be ultimately borne by the customers of the debtor, who would receive smaller

dividends on their claims as the value of the debtor's estate decreases.<sup>199</sup> By a parity of reasoning, reducing such administrative costs would reduce the shortfall, and increase recoveries by customers.

6. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to the overarching concepts described above. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the overarching concepts discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

*D. Subpart A—General Provisions*

1. Regulation 190.00: Statutory Authority, Organization, Core Concepts, Scope, and Construction

a. Consideration of Costs and Benefits

Proposed § 190.00 would contain general provisions applicable to all of proposed part 190 that would set forth the concepts that guide the Commission's bankruptcy regulations. While all of proposed § 190.00 is new, in that current part 190 does not contain an analogous regulation, there would be cost-benefit implications only for certain provisions within proposed § 190.00, since the bulk of proposed § 190.00 is designed to explain concepts that would be either (1) not different from those contained in current part 190, but would be simply made explicit in the proposed rules, or (2) new, in that they

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<sup>199</sup> While such costs could in certain cases be borne instead by general creditors, section 766(h) permits customer property to be used to meet "claims of a kind specified in section 507(a)(2)" of the Bankruptcy Code (which in turn include claims for the expenses of administering the estate) "that are attributable to the administration of customer property."

would not be contained in current part 190, but simply would be concepts that are meant to clarify how revised substantive provisions operate. In the latter case, cost and benefit considerations are addressed with respect to the substantive provisions.

The Commission believes that there would be no cost-benefit implications to the following provisions within proposed § 190.00:

- Proposed § 190.00(a), which would set forth the statutory authority pursuant to which the Commission is proposing to adopt proposed part 190.
- Proposed § 190.00(b), which would describe how the proposed rules are organized into three subparts. The Commission notes that, while the addition of DCO-specific rules in this proposal would be new, the cost-benefit implications of the DCO-specific provisions (proposed §§ 190.11 through 190.18) are discussed separately below.
- Proposed § 190.00(c)(2), which would provide that proposed part 190 establishes four separate account classes, each of which would be treated differently under the proposed rules. In the Commission’s view, this provision would be a mere clarification, as current part 190 also establishes different account classes for different types of cleared commodity contracts, and would treat each account class differently.
- Proposed § 190.00(c)(3), which would explain the distinction between “public customers” and “non-public customers,” and the priority that both public and non-public customers enjoy with respect to distributions of customer property. Both of these concepts exist in current part 190 and

would be merely clarified and explained further in proposed § 190.00(c)(3).

- Proposed § 190.00(c)(4), which would clarify that the policy preference behind the rules in subpart B of part 190 is to transfer a debtor FCM's customers' open commodity contract positions to another FCM (frequently referred to as "porting" customer positions) rather than liquidating those customer positions.
- Proposed § 190.00(c)(5), which would explain that proposed part 190 applies the concept of pro rata distribution when it comes to shortfalls of property in a particular account class. In the Commission's view, this provision would not add anything new to part 190 and would be merely explanatory, as current part 190, consistent with section 766(h) of the Bankruptcy Code, also rests on the concept of pro rata distribution.
- Proposed § 190.00(d)(1)(i)(A), which would provide that the definition of "commodity broker" in proposed part 190 covers both "futures commission merchants" and "foreign futures commission merchants" because both are required to register as a FCMs under the CEA and Commission regulations.
- Proposed § 190.00(d)(1)(ii), which would provide that proposed part 190 applies to a proceeding commenced under SIPA with respect to a debtor that is registered as a broker or dealer under the CEA when the debtor also is an FCM. In the Commission's view, this provision would be merely explanatory.

- Proposed § 190.00(d)(2)(i), which would state that the bankruptcy trustee may not recognize any account class that is not one of the account classes enumerated in proposed § 190.01. This provision, again, would be a mere clarification that is not meant to add anything new to proposed part 190.
- Proposed § 190.00(d)(3), which would set forth the transactions that are excluded from the definition of “commodity contract.” This provision, in the Commission’s view, merely would explain and carry over concepts that are already embedded in current part 190.
- Proposed § 190.00(e), which would set forth rules of construction concerning amendments to statutes and regulations referred to in proposed part 190, and defining the relationship between proposed part 190 and statutes and other regulations. In the Commission’s view, these rules of construction would have no cost-benefit implications, as they merely would make explicit the Commission’s expectations with respect to a very narrow set of issues involved in reading and interpreting the provisions in proposed part 190.

The Commission believes that there would be cost-benefit implications to the following provisions within proposed § 190.00:

- Proposed § 190.00(c)(1) would state that proposed part 190 is limited to a commodity broker that is (1) an FCM as defined by the CEA and Commission regulations, or (2) a DCO under the CEA and Commission regulations. Current part 190 applies to a broader set of “commodity brokers,” including FCMs, clearing organizations, commodity options

dealers, and leverage transaction merchants. This proposed narrowing of the application of part 190 (by excluding the empty categories of commodity options dealers and leverage transaction merchants) would benefit the Commission, the bankruptcy estate, and customers by allowing the Commission to propose regulations that are better tailored to the new, narrower, set of commodity brokers that are covered by the proposed regulations (and thus, less complex).<sup>200</sup> There would be a corresponding cost, in that the Commission would need to develop such regulations, if and when a commodity options dealer or leverage transaction merchant registers as such.

- Proposed § 190.00(c)(6) would discuss the treatment of commodity contracts that require delivery performance. As in current part 190, proposed part 190 would reflect a policy preference for a bankruptcy trustee to liquidate commodity contracts that settle via delivery before they move into a delivery position. When that cannot be done, however, and when parties to a commodity contract incur delivery obligations, the regulations in proposed part 190 would direct the trustee to use reasonable efforts to allow a customer to fulfill its delivery obligation directly, outside administration of the debtor's estate, when the rules of the relevant market or clearinghouse allow delivery to be fulfilled (1) in the normal course directly by the customer, (2) by substitution of the customer for the

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<sup>200</sup> Moreover, prescribing regulations that are intended to be applicable to entities that, at some unknown point in the future, enter these empty categories risks poor tailoring due to lack of data concerning the characteristics of those unknown future entrants.

commodity broker, or (3) through agreement of the buyer and seller to alternative delivery procedures. This is contrast to current § 190.05(b), which requires a DCO, DCM, or SEF to enact rules that permit parties to make or take delivery under a commodity contract outside the debtor's estate, through substitution of the customer for the commodity broker.

The proposed regulations, in allowing for more flexibility in how a customer could effect delivery outside of the debtor's estate, would benefit customers by allowing for a more bespoke approach to effecting delivery when customers incur delivery obligations under their open commodity contracts. There, however, would be costs in acting in such a bespoke fashion in contrast to following standards established during business as usual.

- Proposed § 190.00(d)(1)(i)(B) would note that there are currently no registered leverage transaction merchants or commodity options dealers, and that the Commission would adopt rules with respect to leverage transaction merchants or commodity options dealers at such time as an entity registers as one of those categories of commodity brokers. This change would benefit the Commission in terms of cost effectiveness by allowing the Commission to propose bankruptcy rules specifically tailored to leverage transaction merchants or commodity options dealers only in the event an entity registers as such. In the event that happens, there would be costs involved in doing so. It is possible that the cost of such a

separate rulemaking or rulemakings would be greater than the marginal costs of proposing and finalizing such rules as part of this rulemaking.

- Proposed § 190.00(d)(1)(iii), would provide that proposed part 190 shall serve as guidance as to the distribution of customer property and member property in a proceeding in which the FDIC is acting as receiver pursuant to title II of Dodd-Frank. Section 210(m)(1)(B) of title II,<sup>201</sup> requires the FDIC, where the covered financial company or bridge financial company is a commodity broker, to apply the provisions of subchapter IV as if the financial company were a debtor for purposes of such subchapter. This provision would have the benefits associated with transparently providing to FDIC during business-as-usual the guidance of the agency with regulatory and supervisory responsibility for supervising commodity brokers (*i.e.*, FCMs and DCOs).<sup>202</sup>
- Proposed § 190.00(d)(2)(ii) would provide that no property that would otherwise be included in customer property shall be excluded from customer property because it is considered to be held in a constructive, resulting, or other trust that is implied in equity. This provision would have the benefit of supporting the statutory policy of pro rata distribution for the pool of customers, by ensuring that all property that properly

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<sup>201</sup> 12 U.S.C. 5390(m)(1)(B).

<sup>202</sup> DCOs operate nearly 24-hours a day, between Sunday afternoon and Friday evening. Moreover, the risks that a DCO is required to manage are based on market movements and events (including in OTC markets) that may occur whether or not the DCO is able to operate. Accordingly, FDIC staff (in cooperation with Commission staff) engage in significant efforts to plan for the unlikely event that resolution under Title II would be necessary for a DCO.

Thus, there is a public benefit to facilitating FDIC's efforts in resolution planning for DCOs by setting forth clearly guidance as to the distribution of customer property and member property in a DCO resolution proceeding.

belongs in the category of “customer property” would be considered such customer property. It would mitigate the friction costs of particular customers structuring their relationships with their FCMs in order to establish such a trust for the purpose of thwarting their exposure to pro rata distribution, as well as the friction costs of litigation within the bankruptcy proceeding over the effectiveness of such structures in achieving that goal.

- However, this approach would impose costs on those customers, if any there be, who would otherwise endeavor to rely on the trust concept to shield certain of their property from entering the pool of customer property. Such customers might (despite opposition from the Commission and the trustee) otherwise be successful in litigation over the effectiveness of such arrangements, or may obtain settlements that would benefit their individual claims (albeit to the detriment of other customers, and to the policy of pro rata distribution).

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.00. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

2. Regulation 190.01: Definitions
  - a. Consideration of Costs and Benefits

Proposed § 190.01 would set forth definitions as they are used for purposes of proposed part 190. In the Commission’s view, only certain of the definitions in proposed § 190.01 would have any cost-benefit implications, and these are discussed in more detail below. The rest of the definitions would set forth in proposed § 190.01, in the Commission’s view, would not impose any costs or benefits, as the changes to the definitions would be minor (in the vein of, for example, updating cross-references or updating language to reflect the changes in the rest of proposed part 190) or merely would clarify the current definition.

Where, in the Commission’s view, a definition in proposed § 190.01 would have cost-benefit implications, those implications are discussed in more detail below:

- “*Account class*,” “*cash delivery property*,” and “*physical delivery property*.” The definition of the term “account class” would be expanded to include definitions of each type of account class set forth in proposed part 190: futures account, foreign futures account, cleared swaps account, and delivery account. Including a specific definition of each type of account class would benefit all parties involved in a bankruptcy proceeding by ensuring that all parties would have a common understanding of how these various types of accounts would be defined for purposes of part 190.
- The proposed definition of “account class” also would remove the category in current part 190 of “leverage account” because, as noted

above, there are currently no registered leverage transaction merchants. Rather, the Commission would adopt rules with respect to leverage transaction merchants (and, accordingly, with respect to leverage accounts) at such time as an entity registers as such. Removal of the category of “leverage account” from the “account class” definition would benefit market participants by allowing the Commission to propose bankruptcy rules specifically tailored to leverage transaction merchants (and, accordingly, to leverage accounts) in the event an entity registers as such. As noted above with respect to § 190.00(d)(1)(i)(B), in the event of the registration of a leverage transaction merchant, there would be costs involved in proposing and finalizing such tailored rules. It is possible that the cost of such a separate rulemaking or rulemakings would be greater than the marginal costs of proposing and finalizing such rules as part of this rulemaking.

The proposed definition of “account class” also would split “delivery accounts” into separate physical and cash delivery account classes. Because cash delivery property is, in some cases, more difficult to trace to specific customers and more vulnerable to loss,<sup>203</sup> this separate treatment of physical delivery property and cash delivery property would benefit customers with physical delivery property by allowing for more prompt distribution of such physical delivery property. This separation would also benefit the estate, because the trustee would not have to wait to

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<sup>203</sup> These reasons for this difficulty and vulnerability are discussed above in section II.B.4 in the explanation of the changes to proposed § 190.06(b)

distribute physical delivery property to customers while attempting to trace cash delivery property, which could result in a more prompt resolution of the bankruptcy as a whole. However, there would be potential added costs in the form of complications, in that the trustee will have to deal with two delivery account subclasses rather than one delivery account class. Moreover, in the event of a shortfall, some customers could ultimately obtain larger recoveries, while others could obtain smaller recoveries.

Pursuant to section 4d of the CEA, certain contracts and associated collateral that would be associated with one account class may instead (pursuant to, *e.g.*, Commission regulation<sup>204</sup> or order) be commingled with a different account class.<sup>205</sup> The purpose of such arrangements is to associate such contracts with an account class in which they are risk-reducing related to other contracts in that latter account class.

Paragraph 2 of the definition of account class confirms that such arrangements will be respected in bankruptcy, that is, such contracts and associated collateral will be treated as being part of the account class into which they are commingled. The benefit of this treatment in bankruptcy would be to foster such risk-reducing (and margin-efficient) arrangements during business as usual; there would be no associated costs in bankruptcy.

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<sup>204</sup> See § 39.15(b)(2), which provides a mechanism for these arrangements to be implemented pursuant to clearing organization rules.

<sup>205</sup> Securities positions may also be commingled in an account class subject to section 4d of the CEA, 7 U.S.C. 6d.

Finally, paragraph 3 of the definition addresses cases where a commodity broker's account for a customer is non-current, or otherwise inaccurate, a matter over which the customer has, at best, limited control. Paragraph 3 would confirm that a commodity broker is considered to maintain an account for a customer where it establishes internal books and records for the customer's contracts and collateral and related activity, regardless of whether the commodity broker has kept those internal books or records current or accurate. The benefit of this treatment would be to treat customers in accordance with their entitlements, regardless of whether the commodity broker has maintained its books and records current or accurate.

- “*Customer*,” “*Customer class*,” “*public customer*,” and “*non-public customer*.” The definition of the terms “public customer” and “non-public customer” would be revised to include separate definitions of those terms for FCMs and DCOs. This change would reflect the new organization of proposed part 190, which would include separate provisions for when the debtor is (1) an FCM (subpart B), and (2) a DCO (subpart C). The “public customer” definition for FCMs also would be revised to define that term with respect to each of the relevant account classes.

These changes likely would result in the benefit of clarifying and making more transparent who qualifies as a “public” versus a “non-public” customer, a categorization which would have an effect on the distribution of property to which each customer is entitled. This clarity

and transparency would, in turn, tend to reduce the administrative costs (to the estate and to claimants) involved in the claims allowance process, as well as the likelihood (and cost) of litigation by dissatisfied claimants. These changes could, however, impose costs on any customers (if they exist) for whom, under current part 190, it would not be clear which category they fall into. Given that the pool of customer property would be different for public and non-public customers, a hypothetical customer who could have been considered “public” under current part 190 but would be categorized as “non-public” under proposed part 190 could receive less in the distribution of customer property (with other customers receiving more).

- “*Futures, futures contract:*” The Commission is proposing to add a definition for the terms “futures” and “futures contract” to clarify what those terms mean for purposes of proposed part 190. This clarification would serve the goals of clarity and transparency (and, consequently, reducing administrative costs) by making it more explicit, and transparent, which types of transactions are considered “futures” and therefore form part of the futures account or foreign futures account.
- “*House account:*” The definition of the term “house account” would be revised to include separate definitions of that term for FCMs, foreign FCMs and DCOs, in a manner that clarifies the connection between the concept of a “house account” in part 190 and the concept of a proprietary account in § 1.3. This change would reflect the new organization of

proposed part 190, which now includes separate provisions for when the debtor is (1) an FCM (subpart B), or (2) a DCO (subpart C). This change would serve the goals of clarity and transparency (and, consequently, reducing administrative costs) by clarifying what precisely constitutes a house account for purposes of each type of proceeding.

- “*Primary liquidation date:*” The definition of the term “primary liquidation date” would be revised to remove the reference to accounts being held open for later transfer, as currently reflected in § 190.03(a). The concept of holding certain commodity contracts open for later transfer would be removed from proposed part 190 in favor of a policy of transferring as many open commodity contracts as possible within a particular timeframe after entry of an order for relief<sup>206</sup> or, if that is not possible, liquidating such commodity contracts. The proposed definition of “primary liquidation date” would reflect this preferred policy. This change in policy would benefit some customers, who would be able to avoid having their open commodity contracts liquidated in favor of transferring such contracts to another commodity broker. It could, however, impose costs on any customers, if they exist,<sup>207</sup> who might have benefited from having their open commodity contracts held open for transfer after the primary liquidation date (by, for instance, being able to transfer such contracts to a preferred commodity broker). In the

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<sup>206</sup> See proposed § 190.04(a)(1).

<sup>207</sup> Given that the clearing organization for such contracts may not be willing to permit such contracts to be held open for an extended period of time, the existence of such customers is indeed hypothetical.

hypothetical event that a larger number of contracts is liquidated rather than transferred, that additional quantum of liquidation may result in additional (downward) pressure on prices. This policy shift could also impose administrative costs, since the bankruptcy trustee may expend time and effort to carry out its obligation to use its “best efforts” to transfer all open commodity contracts prior to the primary liquidation date.

- “*Specifically identifiable property*:” The Commission is proposing to revise the definition of the term “specifically identifiable property” to update, clarify and streamline the current definition of that term. These updates, clarifications and streamlining edits would serve the goals of clarity and transparency (and, consequently, reducing administrative costs). Of course, increasing clarity and transparency may be to the detriment of those customers (if any there be) for whom such clarity results in assignment to a less favorable category.
- “*Substitute customer property*:” The definition of the term “substitute customer property” would be added to refer to cash or cash equivalents delivered to the trustee by or on behalf of a customer in order to redeem specifically identifiable property or a letter of credit. This provision would benefit customers who, in a bankruptcy event, would like to redeem their specifically identifiable property or letters of credit and, under the current rules, have no way to do so.<sup>208</sup> Introducing the concept of substitute customer property could impose administrative costs, however,

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<sup>208</sup> Benefits and costs associated with the use of substitute customer property are addressed further below in connection with proposed § 190.04(d)(3) in section IV.E.2.

because the trustee would have to expend time and resources on accounting for the substitute customer property and ensure that such property ends up in the proper pool of customer property once received.

- “*Swap*:” The Commission would amend the definition of “cleared swap” that appears in the current rules in order to clarify what this term means for purposes of proposed part 190. This clarification would serve the goals of clarity and transparency (and, consequently, reducing administrative costs),

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.01. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits to the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

3. Regulation 190.02: General

a. Consideration of Costs and Benefits

Proposed § 190.02(a)(1) would provide that the bankruptcy trustee may, for good cause shown, request from the Commission an exemption from the requirements of any procedural provision in proposed part 190. This is in contrast to current § 190.10(b)(1), which provides only that a bankruptcy trustee may request an exemption from, or extension of, any time limit prescribed in current part 190. This change could benefit the estate, the Commission, and customers by allowing the trustee to request an exemption

from a requirement in proposed part 190 that would lower administrative costs and increase timeliness. This change could, however, impose administrative costs if the trustee's request is ill-founded and the Commission were nonetheless to grant the request.

The Commission does not believe that there would be any cost-benefit implications to proposed §§ 190.02(a)(2), (a)(3), (b), (c), (d), and (e), as those sections largely align with the provisions in current part 190 from which they would be derived.

Proposed § 190.02(f) is a new section which would explicitly allow a receiver appointed due to a violation or imminent violation of the customer property protection requirements of section 4d of the CEA or of the regulations thereunder, or of the FCM's minimum capital requirements in § 1.17 of this chapter, to file a petition for bankruptcy of such FCM in appropriate cases. This provision may benefit customers, in that a bankruptcy proceeding may be necessary to protect customers' interests in customer property. However, this provision could also impose costs on the customers, who may not receive as much as they otherwise would have under the receivership. In addition, there could be additional administrative costs that result from this provision, as the bankruptcy trustee would have to spend time and resources overseeing a bankruptcy proceeding that might not be entered into under the current rules; these costs could possibly be greater than the costs of continuing to administer the FCM under receivership.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.02. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide

preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

4. Section 15(a) Factors—Subpart A

a. Protection of Market Participants and the Public

Subpart A of the proposed rules would increase the protection of market participants and the public by clearly setting forth how customers of FCMs and DCOs will be classified and treated, and how their accounts will be categorized and treated, in the event of an FCM or DCO insolvency. The goal of subpart A of the proposed rules would be to promote clarity in terms of how the insolvency of an FCM or DCO would proceed, and to increase transparency to the customers of FCMs and DCOs as to how their property would be treated in the event of such an insolvency.

b. Efficiency, Competitiveness, and Financial Integrity

Subpart A of the proposed rules would promote efficiency (in the sense of both cost effectiveness and timeliness) in the administration of insolvency proceedings of FCMs and DCOs and the financial integrity of derivatives transactions carried by FCMs and/or cleared by DCOs by clearly communicating the goals and core concepts involved in such insolvencies, and by setting forth clear definitions that have been updated to account for current market practices. These effects would, in turn, enhance the competitiveness and financial integrity of U.S. FCMs and DCOs, by enhancing market confidence in the protection of customer funds and positions entrusted to U.S. FCMs and DCOs, even in the case of insolvency.

c. Price Discovery

Price discovery is the process of determining the price level for an asset through the interaction of buyers and sellers and based on supply and demand conditions. To the extent that the proposed regulations would mitigate the need for liquidations in conditions of distress, they would avoid negative impacts on price discovery.

d. Sound Risk Management Practices

Subpart A of the proposed rules would generally promote sound risk management practices by setting forth the core concepts to which the bankruptcy trustee must adhere in administering an FCM or DCO bankruptcy.

e. Other Public Interest Considerations

Some of the FCMs or DCOs that might enter bankruptcy are very large financial institutions, and some are (or are part of larger groups that are) considered to be systematically important. An effective bankruptcy process that efficiently facilitates the proceedings is likely to benefit the financial system (and thus the public interest), as that process would help to attenuate the detrimental effects of the bankruptcy on the financial network.

*E. Subpart B—Futures Commission Merchant as Debtor*

1. Regulation 190.03: Notices and Proofs of Claims

a. Consideration of Costs and Benefits

Proposed § 190.03(a)(1) would replace the requirement in current § 190.10(a) that all mandatory or discretionary notices be sent to the Commission via overnight mail with

the requirement of sending the notices by electronic mail.<sup>209</sup> This change would result in a benefit to all parties required to provide notices to the Commission because they would be able to avoid the costs of sending such notice in hardcopy form via overnight mail. These revisions would also allow the Commission to receive such notices – and thus, to act – much more expeditiously.

Proposed § 190.03(a)(2), which is new, would replace the more specific procedures for providing notice to customers that appear in current § 190.02(b), allowing the trustee to establish and follow procedures “reasonably designed” for giving adequate notice to customers.<sup>210</sup> Proposed § 190.02(a)(2) also would provide that the trustee’s procedures for providing notice to customers should include “the use of a prominent website as well as communication to customers’ electronic addresses that are available in the debtor’s books and records.” Such a generalized and more modernized approach to notifying customers would benefit the debtor’s estate by leading to administrative cost savings, as the trustee would be able to choose cost effective means of providing notice to customers within the more flexible bounds of the proposed regulation. Similarly, it would benefit parties interested in the proceedings, by permitting the trustee flexibly to choose methods of notification that are more prompt and effective. On the other hand, affording the trustee increased discretion in how to provide notice to customers would

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<sup>209</sup> See also proposed § 190.03(d), which is proposing to adopt this new method of providing notice to the Commission for any court filings filed in a bankruptcy.

<sup>210</sup> Proposed § 190.03(a)(2) would be referenced throughout proposed § 190.03 as the proper procedure for providing notice to customers in various circumstances. As an example, proposed § 190.03(c)(1) deletes the requirement in current § 190.02(b)(1) that the trustee publish notice to customers regarding specifically identifiable property in a newspaper for two consecutive days prior to liquidating such property, in favor of the more flexible approach for notice set forth in proposed § 190.03(a)(2). Similarly, see proposed § 190.03(c)(3), which requires a trustee appointed in an involuntary proceeding to notify customers of the commencement of such a proceeding, and § 190.03(c)(4), which requires the trustee to notify customers that an order for relief has been entered, both of which require that such notice be made in accordance with the flexible notice provisions set forth in proposed § 190.03(a)(2).

carry the potential cost of trustee misfeasance and abuse of such discretion, as discussed above.

Proposed § 190.03(b)(1) would revise the time in which a commodity broker must notify the Commission of a bankruptcy filing. In particular: (1) in the event of a voluntary bankruptcy filing, the commodity broker would be required to notify the Commission and the appropriate DSRO as soon as practicable before, and in any event no later than, the time of filing, and (2) in the event of an involuntary bankruptcy filing or an application for a protective decree under SIPA, the commodity broker would be required to notify the Commission and the appropriate DSRO immediately upon the filing of such petition or application. These revisions would codify expectations that (1) in a voluntary bankruptcy proceeding, the commodity broker will provide advance notice to the Commission ahead of the filing to the extent practicable, and (2) in an involuntary bankruptcy proceeding, the commodity broker notify the Commission immediately upon the filing. With respect to a voluntary bankruptcy filing, the Commission expects that both the Commission and the relevant DSRO would be aware of any financial circumstances in the lead-up to a bankruptcy filing in accordance with the mandatory reporting requirements in § 1.12; the revision in proposed § 190.03(b)(1) merely would codify the expectation that the FCM would notify the Commission of the actual bankruptcy filing as soon as practicable before, and in no event later than, the time of the filing. In addition, proposed § 190.03(b)(1) also would allow a commodity broker to provide the relevant docket number of the bankruptcy proceeding to the Commission “as soon as known,” while not waiting on notifying the Commission of the filing itself, to account for the potential time lag between the filing of a proceeding and the assignment

of a docket number. These revisions would foster the ability of the Commission and its staff to perform their duties by providing the Commission with notice of any bankruptcy proceeding as soon as possible.

Proposed § 190.03(b)(2) would remove the current deadline of three days after the order for relief by which the trustee, the relevant DSRO or a clearing organization must notify the Commission of an intent to transfer or to apply to transfer open commodity contracts in accordance with section 764(b) of the Bankruptcy Code, instead instructing such parties to give such notice “[a]s soon as possible” of an intent to transfer. The Commission expects that the bankruptcy trustee would begin working on transferring any open commodity contracts as soon as the trustee is appointed and that, by the end of three days following entry of the order for relief, any such transfers likely will be either completed, actively in process or determined not to be possible. Indeed, the Commission does not expect that a DCO would be likely to hold a position open for more than three days following entry of the order for relief unless a transfer is actively in process and imminent. Thus, while the Commission recognizes that the “[a]s soon as possible” language is somewhat vague, given past experience, the Commission views the current timeframe of three days after entry of the order for relief as generally too long, and it is not clear what precise shorter period of time would be generally appropriate, given the unique circumstances of each case. Under different circumstances, that is, where transfer arrangements cannot be made within three days after the order for relief, this revision would benefit the estate and some customers by removing time constraints that could be construed to prohibit notification after expiration of the deadline (and thus, prohibit the trustee from forming the intent to transfer after that time).

The revision would also enhance the Commission's ability to fulfil its responsibilities to customers and the markets by facilitating prompt notice of an intent to transfer. On the other hand, by giving the trustee, DSRO, or clearing organization more latitude for providing notice of an intent to transfer, there would be the potential cost of misfeasance in waiting an unreasonable amount of time to provide such notice (or to form such intent), which could ultimately impose additional costs on customers who would have benefited from an earlier transfer.

Proposed § 190.03(c)(1) would no longer require the trustee to publish notice to customers with specifically identifiable property in a newspaper of general circulation serving the location of each branch office of the debtor prior to liquidating such property, instead requiring notification to customers with specifically identifiable property in accordance with proposed § 190.03(a)(2). Administrative costs would decrease, as the trustee would thus be relieved of the cost of identifying, and publishing notice in, such newspapers. Moreover, under the proposed regulation, the trustee would no longer have to wait seven days after the second publication date to commence liquidation of specifically identifiable property. Rather, under proposed § 190.03(c)(1), the trustee would be free to commence liquidation of specifically identifiable property starting on the seventh day after entry of the order for relief, which would benefit the estate, and potentially the affected customers, by allowing the trustee more freedom (from the time constraints set forth in the current regulations) in liquidating the specifically identifiable property, which could ultimately result in a better price. Moreover, by using the notice provisions that would be set forth in proposed § 190.03(a)(2) to notify customers with specifically identifiable property, such customers would benefit from receiving notice on

a “prominent website” and, more specifically, at their electronic addresses to the extent such addresses are in the debtor’s books and records, thereby increasing the chances that a customer who would like their specifically identifiable property returned could request such a return within the specified timeframe.

Proposed § 190.03(c)(2) would provide the bankruptcy trustee with authority to treat open commodity contracts of public customers held in hedging accounts designated as such in the debtor’s records as specifically identifiable property.<sup>211</sup> This would be a change from the current framework, under which the trustee treats customers with specifically identifiable property on a bespoke basis; specifically, to the extent the trustee does not receive transfer instructions regarding a customer’s specifically identifiable open commodity contracts, the trustee would be required to liquidate such contracts within a certain time period. To the extent the trustee would exercise the authority derived from proposed § 190.03(c)(2), they would be required to notify each relevant customer and request instructions whether to transfer or liquidate the open commodity contracts. To the extent the trustee would not exercise such authority, the trustee would treat these open commodity contracts the same as other customer property and effect a transfer of such contracts. This new framework would reduce administrative costs and benefit the bankruptcy estate by allowing the trustee to rely on hedging designations made during business as usual, thereby allowing the trustee to make swift and cost effective decisions regarding the treatment of open commodity contracts during a bankruptcy situation. However, it is possible that some customers would have been in a better position if treated on a bespoke basis.

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<sup>211</sup> See proposed § 190.10(b)(2) for the process of designating an account as a “hedging account.”

The Commission does not believe that there would be any cost-benefit implications to proposed §§ 190.03(c)(3) or (c)(4), other than those discussed above with respect to the new notice provision referenced in each, or to proposed § 190.03(d).

Proposed § 190.03(e), like its analog in current § 190.02(d), would set forth the information required from customers regarding their claims against the debtor. As revised, proposed § 190.03(e), would reorganize and add certain information items to those listed in the current regulation including, for example, account numbers for accounts held by the claimant with the debtor,<sup>212</sup> whether the account is an individual retirement account for which there is a custodian,<sup>213</sup> and information regarding any accounts held by the claimant with the debtor that are not commodity contract accounts.<sup>214</sup> The Commission anticipates that, while customers are likely to have this information at their disposal, there could be costs associated with gathering it all in one place. However, this additional and more detailed information would benefit the estate, the bankruptcy court and customers alike by allowing all parties to have a fuller, more detailed and more transparent picture of the customer claims against the debtor. It would foster the reduction of administrative costs and the prompt administration of the estate. Moreover, the Commission is of the view that clarifying several of the information items listed in proposed § 190.03(e) and revising the proof of claim form to match more closely the text of the proposed regulation would result in benefits to all parties involved in an FCM bankruptcy—the estate, the bankruptcy court, and the customers—by making the bankruptcy claims process more prompt and cost effective.

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<sup>212</sup> Proposed § 190.03(e)(3)(i).

<sup>213</sup> Proposed § 190.03(e)(3)(vii).

<sup>214</sup> Proposed § 190.03(e)(4).

This proposed regulation also would provide that the specific items referred to would be included “in the discretion of the trustee.” This discretion would permit the trustee to tailor the information requested to the specifics of the debtor’s prior business, as well as the already-available records. This would permit the trustee to limit or to increase the information requested, in appropriate cases, with a corresponding increase in cost effectiveness. To be sure, there could be corresponding costs (both in administrative expense and time) if the set of information requested by the trustee in the exercise of their discretion turns out, in retrospect, to be overly narrow (or broad).

Proposed § 190.03(f) is a new section which would provide the trustee with flexibility to modify the customer proof of claim form set forth in appendix A to proposed part 190. Specifically, proposed § 190.03(f) would allow the trustee to modify the proof of claim form to take into account the particular facts and circumstances of the case. This provision would benefit the estate because the trustee would be able to modify the proof of claim form in a way that gathers the information necessary in a manner that is both effective and cost effective based on the specific facts of the case, and the trustee would no longer be required to get an order from the bankruptcy court to make such modifications, thereby saving time and resources. This new proposed section would also benefit customers, who would be able to take advantage of the more streamlined and tailored proof of claim forms developed by the trustee, and would therefore spend less time filling out such forms, and the estate, which would bear less administrative cost in evaluating such forms. Again, there could be corresponding administrative costs if the set of information in a modified proof of claim form turns out, in retrospect, to be overly narrow (or broad).

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.03. Are there additional costs or benefits that the Commission should consider? Is the information called for in proposed § 190.03(e) and the template proof of claim form in fact readily available to customers? If not, what changes should be made?

Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? In particular, what desirable results may be sacrificed by deleting existing requirements for newspaper publication? What are the costs associated with newspaper publication? Do the cost savings from deleting the requirement outweigh the associated loss?

Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

2. Regulation 190.04: Operation of the Debtor's Estate—Customer Property

a. Consideration of Costs and Benefits

In proposed § 190.04(a), the Commission would revise current § 190.02(e). The revisions would identify explicitly a policy by which the trustee should use best efforts to transfer open commodity contracts and property held by the failed FCM for or on behalf of its public customers, while largely retaining the current provisions. The proposed changes would set forth a clear policy for trustees to follow, which would benefit customers of the failed FCM in a more streamlined description of the transfer process that is consistent with the core concepts set forth in this part. Thus, the Commission estimates that there would be very little to no cost to the changes.

In addition in proposed § 190.04(a)(1), the Commission is proposing to replace the term “equity” with “property,” in order to clarify that the transfer is for all types of property that the commodity broker is holding on behalf of customers, rather than limited to equity. The Commission is also proposing to add the word “public” before “customer” to clarify that the transfers discussed in the regulation related to the open commodity contracts and property of the debtor’s public customers. In each case, the Commission believes that the changes would clarify the existing regulation to conform to how it has been interpreted in the past, as demonstrated by industry practice. Thus, the type of property transferred would be unlikely to change. Nevertheless, the clarification would benefit customers of the failed FCM by minimizing the likelihood of future disputes concerning qualification of property for transfer. As compared to the text of the current regulation, the revision would be intended to reduce costs for customers and would be designed to increase the amount of property transferred following a default. Based on how the existing regulation has been interpreted in the past, as demonstrated by industry practice in prior bankruptcy proceedings, no additional costs would be anticipated.<sup>215</sup>

Proposed § 190.04(a)(2) is derived from current § 190.02(e)(2) and concerns transfers by a commodity broker against which an involuntary petition in bankruptcy has been filed. As discussed in more detail in section II.B.2 above, both the current and the proposed regulations require such a commodity broker to use best efforts to effect a transfer within seven calendar days. The current regulation also limits such a commodity broker to trading for liquidations only unless otherwise directed by the Commission, by

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<sup>215</sup> The Commission is proposing the same change—the addition of the word “public” before “customers” to proposed § 190.04(a)(2). The anticipated cost and benefit analysis of the change would be the same as in proposed § 190.04(a)(1).

any applicable self-regulatory organization or by the court. Proposed § 190.04(a)(2) deletes this limitation. Rather, proposed § 190.04(e)(4) more generally would cover limitations on the business of an FCM in bankruptcy. Similarly any requirement to transfer customers would be more properly addressed by § 1.17(a)(4).<sup>216</sup> Accordingly, the benefit would be the removal of redundant regulation (and corresponding mitigation of administrative costs). The Commission does not anticipate any resulting increase in cost.

In proposed § 190.04(b)(1), the Commission is clarifying and updating conditions under which the trustee may make variation and maintenance margin payments on behalf of the FCM debtor's customers via five changes to the current regulation, § 190.02(g)(1). First, the proposed regulations would replace the phrase "variation and maintenance margin payments" with "payments of initial margin and variation settlement" which, in the Commission's view, more accurately would describe the types of payments being reflected in this provision. Second, the proposed regulation would replace the phrase "to a commodity broker" with "to a clearing organization, commodity broker, foreign clearing organization or foreign futures intermediary" to account for the various types of entities to which a margin payment described in this provision may be made. Third, the proposed revisions would permit the trustee to make margin payments pending transfer or liquidation rather than just pending liquidation. Fourth, the proposal would delete the phrase "required to be liquidated under current paragraph (f)(1) of this section" and

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<sup>216</sup> Reg. § 1.17(a)(4) provides that an FCM that is not in compliance with the minimum financial requirements established by § 1.17, or is unable to demonstrate such compliance as required by § 1.17(a)(3), or cannot demonstrate that it has sufficient access to liquidity to operate as a going concern, must transfer all customer accounts and immediately cease doing business as an FCM until such time as it is able to demonstrate compliance. The FCM is nonetheless authorized to trade for liquidation purposes only unless otherwise directed by the Commission or the DSRO, or may be allowed by the Commission or the DSRO up to 10 business days in which to achieve compliance without having to transfer accounts.

instead applies more broadly to any open commodity contracts. In sum, the revisions would clarify that payments can be made prior to pending transfers or liquidation, not just pending liquidation. The revision would benefit the customers of the FCM debtor in clarifying that the trustee has two paths in treating open commodity contracts—transfer, and if transfer is not possible, liquidation. This change would clarify powers the trustee already had available under the Bankruptcy Code and would have no associated costs. More specifically, the changes would describe more accurately the types of payments that the trustee would be able to make and to account specifically for the types of entities to which the trustee would be able to make the types of payments referred to in this section. Finally, the deletion in the last portion of the section is being proposed in order to prevent a misreading of the current provision, which could be read to prohibit margin payments for contracts that are being held open, which would undermine the trustee’s ability to hold the contracts open. The revisions to proposed § 190.04(b)(1) would clarify the current regulatory text, which should benefit stakeholders. The Commission does not anticipate any increased cost from the changes.

Proposed § 190.04(b)(1)(i) is derived from current § 190.02(g)(1)(i), which would prevent the trustee from making any payments of behalf of any commodity contract account that is in deficit, to the extent within the trustee’s control. The proposal would add the explicit phrase “to the extent within the trustee’s control” and would add a proviso noting that the regulation shall not be construed to prevent a clearing organization, foreign clearing organization, FCM or foreign futures intermediary carrying an account of the debtor from exercising its rights to the extent permitted under applicable law. The proposal would recognize that certain accounts may be held on an

omnibus basis on behalf of many customers. To the extent the trustee is making a margin payment with respect to such an omnibus account, it may be out of the trustee's control to only make payment with respect to those customer accounts that are not in deficit. Thus, this change would reflect the nature of the omnibus accounts that are part of the regulatory and statutory framework. The proviso similarly would clarify that this prohibition on making margin payments on behalf of accounts in deficit is not intended to prohibit entities from exercising legal rights to margin under applicable law. Due to the structure of the accounts and the explicit requirement of lack of trustee control, any payments that would be made under the new provision would have been made pursuant to Commission authorization under the current regulation. Thus, neither provision would add any new regulatory burden and the Commission does not estimate that there would be any additional cost associated with the proposed changes.

Proposed § 190.04(b)(1)(ii) is a new regulation that would add an explicit restriction that the trustee cannot make a margin payment with respect to a specific customer account that would exceed the funded balance of that account. This restriction would support the pro rata distribution principle discussed in proposed § 190.00(c)(5), and would benefit the other customers of the FCM debtor – any payment of customer property in excess of a particular customer's funded balance would be to the detriment of other customers. This change would be a clarification of the statutory requirements applicable to the customer account.<sup>217</sup>

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<sup>217</sup> While there would be a corresponding detriment to the customers who may have benefited from such excess payments, those customers would only be losing something that runs counter to the statutory goal of pro rata distribution. Moreover, there are no likely incentive effects because, on this issue, customers stand behind the “veil of ignorance” – it is difficult to identify, *ex ante*, which customers would be in the group of gaining customers (or in the group of losing customers).

Proposed § 190.04(b)(1)(iii) would be a minor, non-substantive clarification of current § 190.02(g)(1)(ii), that would not create any changes from the status quo with regards to costs and benefits.

In proposed § 190.04(b)(1)(iv)-(v), the Commission is expanding current § 190.02(g)(1)(iii) to clarify that margin must only be used (*i.e.*, paid to a clearing organization or upstream intermediary) consistent with section 4d of the CEA. Proposed § 190.04(b)(1)(vi) would revise the language in current § 190.02(g)(1)(iv), which states that “no payments need be made to restore initial margin.” The current regulation implies that the trustee *may* make such upstream payments, but does not specify the circumstances in which the trustee may do so. As discussed in detail in section II.B.2 above, proposed § 190.04(b)(1)(vi) would state explicitly the conditions under which the trustee may make payments to meet margin obligations. Together, these changes protect customers who make payments after the order for relief by ensuring that they fully benefit from those payments (and thus encourage customers to make such payments in appropriate circumstances). Moreover, more clearly permitting the trustee, for the purpose of curing customer margin deficiencies, to use funds in an account class that exceed the sum of all of the net equity claims for that account class, would facilitate the orderly transfer of positions and contracts following the default, lessening the potential for further roiling markets. Finally, these changes taken together also benefit the broader group of customers of the FCM debtor by clarifying the treatment of funds in segregated accounts, and thus mitigating administrative costs.

These changes would be a clarification of the statutory requirements applicable to funds in the customer account. While there would be accounting requirements associated

with funds in segregated accounts, substantially all of the costs of such accounting are already incurred pursuant to the segregation rules. Thus, the Commission does not anticipate that there would be any material additional costs associated with this change.

Proposed § 190.04(b)(2) would clarify and update existing § 190.02(g)(2). The current regulation requires retail-level analysis for determining whether to issue margin calls based on the funded balance of the account, and does not grant the trustee discretion as to whether to do so. It is based on a model of the FCM continuing in business.

The Commission is proposing to revise this provision to delete the highly prescriptive conditions, and instead to allow the trustee discretion as to whether to issue margin calls to customers who are undermargined. The revision would benefit public customers of the FCM debtor by giving the trustee the flexibility to recognize that there may be situations in which issuing a margin call is impracticable because the trustee is operating the FCM in “crisis mode” and may be pending wholesale transfer of liquidation of open positions.

It is, however, possible that the trustee would exercise their discretion poorly, or in a manner that, in retrospect, would be seen to be to the detriment of the estate, and that the trustee would have failed to issue a margin call in a situation in which a public customer would have paid the call (and in which the balance of administrative cost and amount recovered would mean that, in retrospect, it would have profited the estate if the call was made). Such failure could result in a cost to the estate of the FCM debtor to the extent that such funds are not available. The balance of the revisions would cause no change to the related costs and benefits.

Proposed § 190.04(b)(3) would retain the concept in current § 190.02(g)(3) with updated cross-references. The Commission does not anticipate that there would be any costs or benefits to the proposed minor revisions.

Proposed § 190.04(b)(4) would combine parts of current §§ 190.03(b)(1), 190.03(b)(2) and 190.04(e)(4). The proposal would make two changes. First, while the current provision would require the trustee to liquidate open commodity contracts if the account is on the threshold of deficit, the proposed revision also would apply to an account that is already in deficit. The revision would clarify the applicability of current authority to a situation that is already implicit in the current rule. The benefit would be a less ambiguous rule that clearly sets forth the applicability of the trustee's authority (and thus results in reduced administrative costs). The Commission does not anticipate any increased cost associated with the change. Relatedly, the proposed rule would change "payment of margin" to "mark-to-market calculation." This change would not require the trustee to make additional calculations but, if a calculation made by the trustee would reveal that the mark-to-market value of the account is a deficit, the trustee would be instructed to liquidate the account as soon as practicable rather than to wait for the time that payment would be due. The benefit of this change would be to liquidate accounts in deficit more promptly (thus mitigating potential further losses), the cost would be the cost of engaging in such liquidation, as well as the possibility that, absent prompt liquidation, the deficit would have been mitigated due to favorable intervening changes in market value (or, potentially, an intervening deposit of additional collateral by the customer).

Second, the Commission is also proposing to add the concept of "exigent circumstances" as a new exception to the general and long-established rule that a

minimum of one hour is sufficient notice for a trustee to liquidate an undermargined account. The revision would benefit other customers of the debtor FCM by giving the trustee flexibility to respond to market conditions following an FCM default, and by recognizing that in stressed markets or in situations where communication protocols cannot practicably be followed, liquidation with one hour notice may be insufficiently prompt. This may mitigate losses to the estate. However, customers who are required to make payments more promptly would bear associated costs, from making such payments in a reduced time frame, or from having contracts liquidated that would otherwise not have been liquidated if the customer had more time to make payment.

The Commission is proposing to delete current § 190.03(b)(3), which permits the trustee to liquidate open commodity contracts where the trustee has received no customer instructions with respect to such contracts by the sixth calendar day following the entry of the order for relief. Under the proposed model, the trustee would liquidate as many open commodity contracts as possible. The Commission is of the view that this change would reflect actual practice in commodity broker bankruptcies in recent decades. The estate would benefit from such a model in that they would be permitted to deal with the customers as a group, requiring less tailored analysis of individual customer positions. The trustee would have more flexibility and could be more cost effective. Many customers would benefit from the trustee being able to act with such flexibility and cost effectiveness. However, some others could fare less well due to losing the tailored treatment under the current model.

The Commission is proposing to add § 190.04(b)(5) to guide the trustee in assigning liquidating positions to the FCM debtor's customers when only a portion of the

open contracts are liquidated. Under the status quo, the trustee must allocate liquidating positions. The benefit of this new provision would be that it presents a clear and transparent mechanism by which the trustee is to allocate the positions. This mechanism would protect the customer account as a whole, by establishing a preference for assigning liquidating transactions to individual customer accounts in a risk-reducing manner: first to commodity contract accounts that are in deficit, next, to commodity contract accounts that are under-margined, and finally to liquidate any remaining open commodity contracts. Consistent with the pro rata distribution principle in § 190.00(c)(5), to the extent that there are multiple accounts in any of these groups, the trustee would be instructed to allocate the transactions on a pro rata basis, thereby minimizing the risk of further losses on the positions and reducing the risk of creating any additional debts for the debtor estate. The allocation mechanism would be, however, subject to the trustee's exercise of reasonable business judgment. It is possible that such judgment could be exercised in a poor manner (or in a manner that, in retrospect, turns out to be regrettable), with resultant cost to the FCM debtor estate.

Proposed § 190.04(c) would incorporate and clarify current § 190.03(b)(5) regarding the liquidation of contracts moving into the delivery position. Current § 190.03(b)(5) requires the liquidation of open commodity contracts that are not settled in cash (*i.e.*, those that settle via physical delivery of a commodity) where the contract would move into delivery position.

The proposed revision would amend this provision using more explicit language regarding physical delivery and includes an explicit reference addressing how options move into the delivery position (portions of this provision are moved from current

§ 190.02(f)(1)(ii)). These clarifications are likely to reduce administrative costs, to the benefit of the estate (and, ultimately, customers). There would be no cost associated with the revision.

Proposed § 190.04(d) would clarify and update portions of current §§ 190.02(f) and 190.04(d) regarding the liquidation and valuation of open positions. The proposal would make three changes to the header text in § 190.04(d) from the text in current § 190.02(f): adding the phrase “except as otherwise set forth in this paragraph (d)” to account for any exceptions that are included in the paragraphs under the header language; adding cross-references to proposed § 190.04(e) when discussing liquidation in the market and book entry via offset (as that provision contains instructions on how to effect such liquidation); and deleting the phrase “subject to limit moves and to applicable procedures under the Bankruptcy Code.” These changes would be non-substantive and would not have associated costs or benefits.

In proposed § 190.04(d)(1), the Commission is proposing to make two changes to current § 190.02(f)(1). The proposal would delete the reference in current § 190.02(f)(1)(i) to dealer option contracts since such term no longer would be used in the proposal. Additionally, the proposal would revise the language of current § 190.02(f)(1)(ii) to add references to the provisions of proposed § 190.03(c)(2) (concerning the trustee’s option to treat hedging accounts as specifically identifiable property) and proposed § 190.09(d)(2) (concerning the payments that customers on whose behalf specifically identifiable commodity contracts would be transferred must make to ensure that they do not receive property in excess of their pro rata share). These revisions would be non-substantive and would not have associated costs.

Proposed § 190.04(d)(2) would clarify and update current § 190.02(f)(2) and would contain a number of proposed revisions. The current regulation applies only to specifically identifiable property other than open commodity contracts, while the proposal would apply to specifically identifiable property, other than open commodity contracts *or physical delivery property*. While the current regulation requires liquidation of such property if the fair market value of the property drops below 90% of its value on the date of the entry of the order for relief, the proposal would (in paragraph (d)(2)(i)) change that figure to 75% of the fair market value. The proposed regulation (in paragraph (d)(2)(ii)) would add an additional new condition that would require liquidation where failure to liquidate the specifically identifiable property may result in a deficit balance in the applicable customer account, which corresponds to the general policy of liquidating any accounts that are in deficit. Finally, the proposal (in paragraph (d)(2)(iii)), while similar to current § 190.02(f)(2)(ii), would include updated cross-references that would discuss the return of specifically identifiable property. The proposal would benefit customers (including those customers with specifically identifiable property in a delivery account) by giving the trustee greater discretion to forego or postpone liquidation of specifically identifiable property in appropriate cases. It is, however, possible that the trustee would exercise their discretion poorly, or in a manner that in retrospect is regrettable, and postpone liquidation of specifically identifiable property or fail to liquidate specifically identifiable property when the estate would have realized more from a prompt liquidation of the property. Such failure could result in a cost to the estate of the FCM debtor to the extent that such funds are not available.

Proposed § 190.04(d)(3) is new and would codify the Commission’s longstanding policies of pro rata distribution and equitable treatment of customers in bankruptcy, as described in proposed § 190.00(c)(5) above, as applied to letters of credit posted as margin. Under the new provision, the trustee could request that a customer deliver substitute customer property with respect to any letter of credit received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract. The amount of the substitute customer property to be posted could, in the trustee’s discretion, be less than the full face amount of the letter of the credit, if such lesser amount is sufficient to ensure pro rata treatment consistent with proposed §§ 190.08 and 190.09. If necessary, the trustee could require the customer to post property equal to the full face amount of the letter of credit to ensure pro rata treatment. Pursuant to paragraph (d)(3)(i), if such a customer fails to provide substitute customer property within a reasonable time specified by the trustee, the trustee could draw upon the full amount of the letter of credit or any portion thereof (if the letter of credit has not expired). Under paragraph (d)(3)(ii), the trustee would be instructed to treat any portion of the letter of credit that is not fully drawn upon as having been distributed to the customer. However, the amount treated as having been distributed would be reduced by the value of any substitute customer property delivered by the customer to the trustee. Any expiration of the letter of credit after the date of the order for relief would not affect this calculation. Pursuant to paragraph (d)(3)(iii), letters of credit drawn by the trustee, or substitute customer property posted by a customer, would be considered customer property in the account class applicable to the original letter of credit.

These proposed new provisions could impose costs on customers that use letters of credit as collateral for their positions in that such customers could be considered to have received distributions up to the full amount of the letter of credit or the trustee may draw upon the full amount of the letter of credit. Under the status quo, the Commission has intended to ensure the customers using letters of credit to meet margin obligations are treated in an economically equivalent manner to those who have posted other types of collateral, so that there is no incentive to use such letters of credit to circumvent the pro rata distribution of margin funds as set forth in section 766(h) of the Bankruptcy Code.<sup>218</sup> However, the treatment was not explicitly codified previously in the Commission's regulations. The proposal would support the policy of pro rata treatment of customers embodied section 766(h) of the Bankruptcy Code by clarifying that letters of credit cannot be used to avoid pro rata distribution of margin funds. It would also avoid concentrating losses on those customers (who are likely to be smaller customers) that cannot qualify for, or cannot afford the cost of, letters of credit, or otherwise do not use letters of credit as collateral.

In the proposal, § 190.04(e)(1)(i) would strike the requirement in current § 190.04(d)(1)(i) that a clearing organization must obtain approval pursuant to section 5c(c) of the CEA for its rules regarding liquidation of open commodity contracts. The current regulation is superfluous in light of the regulatory framework set forth in part 40 of the Commission's regulations. In addition, proposed § 190.04(e)(1)(i) would add language that would apply the current provision to cases where the debtor FCM is a member of a foreign clearing organization, a new defined term added to § 190.01.

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<sup>218</sup> See, e.g., 48 FR at 8718-19.

The first change simply would remove a superfluous regulatory requirement. It would have the benefit of enabling clearing organizations to avoid the cost of seeking rule approval. There would be potential costs, in that an ill-conceived rule could be more readily identified, and addressed, in a rule approval process. The second change would provide a benefit by recognizing that there are circumstances in which the trustee must liquidate the open commodity contracts where the debtor is a member of a foreign clearing organization. Since the current regulation is silent as to the trustee's handling of the debtor's contracts where it is a member of a foreign clearing organization, the trustee arguably could have some discretion as to the handling of these contracts. However, where there are applicable rules of the foreign clearing organization, it is likely that the trustee would handle such contracts as specified in the proposed rule—and would liquidate such contracts pursuant to those rules. Accordingly, benefits and costs arising from the rule change likely would be minimal.

Proposed § 190.04(e)(2) is derived from current § 190.04(d)(1)(ii) with one change: the Commission is proposing to delete the rule approval requirement. As with § 190.04(e)(1)(i), the proposed deletion would remove a redundant regulatory requirement in light of the part 40 rule filing framework, and would enable clearing organizations to avoid the cost of seeking rule approval. As discussed immediately above, there would be both potential benefits and costs to foregoing the rule approval process.

The proposal would add a new, clarifying provision in § 190.04(e)(3), confirming that an FCM or foreign futures intermediary through which a debtor FCM carries open commodity contracts may exercise any enforceable contractual rights the FCM or foreign

futures intermediary has to liquidate such commodity contracts. In addition, proposed § 190.04(e)(3) would add a provision that the liquidating FCM or foreign futures intermediary must use “commercially reasonable efforts” in the liquidation and provides the trustee a damages remedy if the FCM or foreign futures intermediary fails to do so. Damages would be the only remedy; under no circumstance could the liquidation be voided.

The proposed change would benefit carrying FCMs by confirming explicitly that carrying FCMs are allowed to exercise enforceable contractual rights to liquidate contracts. This will reduce administrative costs by reducing ambiguity. At the same time, clarification of the damages remedy protects creditors of the debtor FCM’s estate in the event that the carrying FCM does not use commercially reasonable efforts in liquidating the open contracts. Thus, the regulation itself would provide the estate with a potential mitigant for the costs in the form of a damages remedy.

The remainder of the proposed changes to §§ 190.04(e)(4) and (f) would be non-substantive language changes and clarifications and updated cross-references and would not have associated costs or benefits.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.04. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

3. Regulation 190.05: Operation of the Debtor’s Estate—General

a. Consideration of Costs and Benefits

In proposed § 190.05, the Commission is revising parts of current § 190.04 and adding certain provisions. Current § 190.04 provides that the trustee “shall comply with all of the provisions of the [CEA] and of the regulations thereunder as if it were the debtor” and “*must* compute a funded balance for each customer account which contains open commodity contracts as of the close of business day subsequent to the order for relief until the final liquidation date” (emphasis added).

In both proposed §§ 190.05(a) and 190.05(b), the Commission would make revisions providing the trustee with more flexibility to act in a bankruptcy situation. Proposed § 190.05(a), for example, would provide that the trustee “shall use reasonable efforts” to comply with the CEA and the Commission’s regulations. Proposed § 190.05(b) would require the trustee to “use reasonable efforts” to compute a funded balance for each customer account that contains open commodity contracts or other property as of the close of business each business day until such open commodity contracts and other property in such account have been transferred or liquidated, “which shall be as accurate as reasonably practicable under the circumstances, including the reliability and availability of information.” These two revisions would benefit the estate by recognizing that a bankruptcy could be an emergency event, that perfectly reliable information could be unavailable or inordinately expensive to obtain, and that therefore the trustee should be allowed some measure of flexibility to act reasonably given the particular circumstances of the case. On the other hand, affording the trustee increased discretion in complying with the CEA and the Commission’s regulations, and in

computing a funded balance for each customer account, could carry the potential cost of trustee mistake, misfeasance, or abuse of such discretion, as discussed above. The Commission also notes that, in proposing to add the phrase “which shall be as accurate as reasonably practicable under the circumstances” with respect to the trustee’s computation of funded balance, the Commission would be incorporating the principle of prioritizing cost effectiveness over precision, as discussed in more detail in the overarching concepts above.

Whereas current § 190.04(b) would require a trustee to compute a funded balance only for those customer accounts with open commodity contracts, proposed § 190.05(b) would expand the scope of customer accounts for which a trustee would be required to compute a funded balance to those accounts with open commodity contracts or other property (including, but not limited to, specifically identifiable property). This expansion of the trustee’s duties would represent an administrative cost, as the trustee would have to expend time and resources at the close of business each business day to compute the funded balance of all customer accounts. However, this revision would also result in a benefit to those customers whose accounts hold property but no open commodity contracts, in the form of enhanced information about their financial position (including with regard to collateral, the value of which may change on a daily basis, and with regard to the percentage distribution currently available). These customers would, under the proposed revision, receive daily computations of the funded balance of their accounts with the debtor.

In addition, as noted above, proposed § 190.05(b) only would require the trustee to compute the daily funded balance of customer accounts until the open commodity

contracts and other property in such account has been transferred or liquidated, rather than until the final liquidation date, as current § 190.04(b) provides. This would benefit both the estate, because the trustee would no longer be required to compute the funded balance of customer accounts that do not contain any property, and would also result in some benefit to the customers, who would no longer continue to receive daily account funded balance computations once their accounts do not contain any property.

Proposed § 190.05(c)(1) would impose certain administrative costs because it would expand the scope of records required to be maintained by the debtor from “records of the computations required by this part” in current § 190.04(c)(1) to “records required under this chapter to be maintained by the debtor, including records of the computations required by this part” in proposed § 190.05(c)(1). The proposed paragraph would revise downward the amount of time that such records are required to be kept, from “the greater of the period required by § 1.31 of this chapter or for a period of one year after the close of the bankruptcy proceeding for which they were compiled” in current § 190.04(c)(1) to “until such time as the debtor’s case is closed” in proposed § 190.05(c)(1). This revision would benefit the estate because it would limit the amount of time the trustee would have to maintain the relevant records, thereby mitigating the administrative costs associated with maintaining them.

While current § 190.04(c)(2) requires the records referred to in the previous paragraph to be available during business hours to the Court, parties in interest, the Commission and the Department of Justice, proposed § 190.05(c)(2) no longer would require that such records be available to the Court or to parties in interest. This revision would be unlikely to impact either costs or benefits, as the Court itself would not be

reviewing these records, and parties in interest should already have access to these records under the discovery rules in the Bankruptcy Code.

Proposed § 190.05(d) is a new provision. It would require the bankruptcy trustee to use all reasonable efforts to continue to issue account statements for customer accounts that contain open commodity contracts or other property, and to issue account statements reflecting any liquidation or transfer of open commodity contracts or other property promptly after such liquidation or transfer. This provision would result in administrative costs, as the trustee would have to expend time and resources issuing account statements to customers, but would benefit customers because it would allow them to keep track of their commodity contracts (and the continued availability of hedges) and the property in their accounts, including in particular when such contracts and property are liquidated or transferred, even during a bankruptcy.

Proposed § 190.05(e)(1) would allow a bankruptcy trustee to effect transfers of customer property in accordance with proposed § 190.07, but would require the trustee to obtain court approval prior to making any other disbursements to customers. This provision would benefit the estate and customers by allowing the trustee, without court approval, to port customers' positions and associated property to a solvent FCM as quickly as possible in a bankruptcy situation. In the event that too much customer property (that is, an amount in excess of the ultimate pro rata share) is transferred for those customers whose positions are being ported, and cannot be offset or clawed back, it could result in costs to other customers, for whom less than their pro rata share would be available.

Proposed § 190.05(e)(2) would allow the bankruptcy trustee to invest the proceeds from the liquidation of commodity contracts or specifically identifiable property, and any other customer property, in obligations of or guaranteed by the United States, so long as the obligations are maintained in depositories located in the United States or its territories or possessions. The proposed regulation would expand the scope of customer property that the trustee is permitted to invest in such a manner to include “any other customer property.” This change would benefit customers, in that additional customer property could be invested (in this limited manner)..

Proposed § 190.05(f) is a new provision that does not appear in current part 190. It would, for the first time, require the trustee to apply the residual interest provisions contained in § 1.11 “in a manner appropriate to the context of their responsibilities as a bankruptcy trustee pursuant to” the Bankruptcy Code and “in light of the existence of a surplus or deficit in customer property available to pay customer claims.” This explicit requirement to continue to apply the residual interest requirements set forth in § 1.11 could result in administrative costs, since the trustee would require resources to do so. However, this provision would benefit customers by making it more likely that they would receive what they are entitled to receive from the debtor’s estate.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.05. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed

amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

4. Regulation 190.06: Making and Taking Delivery Under Commodity Contracts

a. Consideration of Costs and Benefits

Proposed § 190.06 would revise current § 190.05 regarding the making and taking of deliveries under commodity contracts.

Specifically, proposed § 190.06(a)(2) would replace current § 190.05(b), which requires a DCO, DCM, or SEF to enact rules that permit parties to make or take delivery under a commodity contract outside the debtor's estate, through substitution of the customer for the commodity broker. Under the proposed revision, the trustee would use "reasonable efforts" (rather than "best efforts" under current § 190.06(a)(1)) to allow a customer to deliver physical delivery property that is held directly by the customer in settlement of a commodity contract, and to allow payment in exchange for such delivery, and for both of these to occur outside the debtor's estate, where the rules of the exchange or clearing organization prescribe a process for delivery that allows delivery to be fulfilled either (A) in the ordinary course by the customer, (B) by substitution of the customer for the commodity broker, or (C) through agreement of the buyer and seller to alternative delivery procedures. Management of contracts in the delivery positions involves a significant degree of tailored administration. Under the best efforts standard, the trustee could spend more time focusing on the needs of a few customers, which could detract from the trustee's ability to manage the estate more broadly. Accordingly, the change from "best efforts" to "reasonable efforts" would benefit creditors of the estate as the trustee would not need to provide a disproportionate amount of individualized

treatment to such contracts. However, particular customers that would otherwise have received the trustee's focused treatment under the "best efforts" standard could suffer a cost from the change.

Proposed § 190.06(a)(3) would revise current § 190.05(c)(1)-(2) by providing additional guidance to address situations when the trustee determines that it is not practicable to effect delivery outside the estate and therefore, delivery is made or taken within the debtor's estate. The revisions would clarify the current regulation. They also would provide the trustee with the flexibility to act "as it deems reasonable under the circumstances of the case," but would set an outer bound to that discretion in requiring the trustee to act "consistent with the pro rata distribution of customer property by account class." This provision again would have the benefits and costs of enhanced discretion discussed above, but would include an outer bound to that discretion.

In proposed § 190.06(a)(4) the Commission would add a new provision to reflect that delivery may need to be made in a securities account.<sup>219</sup> Transfers would be subject to limits based on the customer's funded balance for a commodity contract account and exceeding the minimum margin requirements for that account. Further, customers would be required not to be undermargined or have a deficit balance in any other commodity contract accounts. The new provision would benefit customers who require the delivery of securities, and the trustee, by permitting those securities to be delivered to the proper type of account. By setting limits, the provision would mitigate the risk of transferring too much value out of the commodity contract account (and creating a risk of an undermargin or deficit balance).

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<sup>219</sup> This would only be relevant for debtor FCMs that are also broker-dealers.

Proposed § 190.06(b) is also new and would create an account class for physical delivery property held in delivery accounts and the proceeds of such physical delivery property. This account class would further be sub-divided into separate physical delivery and cash delivery account subclasses. In general, creating the delivery account class would help protect customers with property in delivery accounts following a default, because delivery accounts are not subject to the Commission's segregation requirements. The further sub-division into sub-classes would recognize that cash is more vulnerable to loss, and more difficult to trace, as compared to physical delivery property and would be likely to benefit those with physical delivery claims. Since cash is more vulnerable to loss and more difficult to trace, then under the proposal, customers in the cash delivery sub-class would be more likely to get a pro rata distribution that is less than that in the physical delivery property sub-class. The benefits and costs of creating these sub-classes were discussed more fully above in reference to the definition of account class in proposed § 190.01.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.06. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

5. Regulation 190.07: Transfers
  - a. Consideration of Costs and Benefits

Proposed § 190.07 would revise current § 190.06 regarding transfers. First, in proposed § 190.07(a)(3) the Commission would revise current § 190.06(a)(3). The current regulation would provide that no clearing organization or other self-regulatory organization may adopt, maintain in effect, or enforce rules that prevent the acceptance by its members of transfers of open commodity contracts and the equity margining or securing of such contracts from FCMs with respect to which a petition in bankruptcy has been filed, if the transfers have been approved by the Commission. The revised regulation would change “prevent” to the more general term “[i]nterfere with,” thus proscribing a potentially broader range of conduct in order to promote transfers. However, the revised regulation would include the proviso that it (1) does not limit the exercise of any contractual right of a clearing organization or other registered entity to liquidate or transfer open commodity contracts, and (2) should not be interpreted to limit a DCO’s ability adequately to manage risk. The revision would modify, in a balanced fashion, the standard for clearing organization and SRO rules that are adopted, maintained, in effect, and enforced and where transfers are approved by the Commission. While clearing organizations and SROs will need to comply with the revised standard, the compliance cost should not be different than under the prior standard. Accordingly, there would not be any material cost associated with the change. The clarification that the regulations do not limit contractual risk management rights would provide a benefit to clearing organizations and their members in clarifying that the regulation would not nullify the contracts in this regard, and would not have an associated cost.

In proposed § 190.07(b)(1), the Commission would clarify current § 190.06(c)(1) to set forth that it is the transferee FCM itself who has the responsibility to determine whether it would be in violation of regulatory minimum financial requirements upon accepting a transfer, it is not the trustee's duty. Under current Commission regulations, FCMs are responsible for meeting the requirements under such regulations for customer accounts. The proposed revision would recognize these obligations under already existing regulations and would clarify that such obligations apply when an FCM is a transferee. Accordingly, the Commission does not anticipate any material cost from this proposed revision. Under one interpretation of the current regulation, the trustee would need to do further diligence in order to make the determination whether the transferee would continue to meet minimum financial requirements. Where time is of the essence in making a transfer, and given the transferee's superior knowledge as to its own financial status, it would be more appropriate to leave this responsibility with the transferee,<sup>220</sup> and not to impose any such responsibility on the trustee. The trustee's resources could be better spent on other tasks for the debtor estate. Accordingly, the proposed clarification would reduce administrative burden as well.

Proposed § 190.07(b)(3) is a new provision. It would permit a transferee to accept open commodity contracts and associated property prior to completing customer diligence requirements, provided that such diligence is completed as soon as practicable thereafter, and no later than six months after transfer. It recognizes that customer diligence processes would have already been required to have been completed by the

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<sup>220</sup> The focus here is on the responsibilities of the transferee in contrast to those of the trustee. This is without prejudice to any review of the transferee's status by any DCOs or SROs of which the transferee is a member, or of any regulators (including the Commission) with jurisdiction over the transferee.

debtor FCM with respect to each of its customers as part of opening their accounts. The proposal would provide a benefit to customers and transferee clearing members and trustees, by facilitating the transfer process.<sup>221</sup> If such flexibility were not provided, under the current regulations, transfer might not be accomplished, or may not be accomplished promptly, and liquidation might be the only available option. As discussed in proposed § 190.00(c)(4), it is preferable to avoid liquidation, as liquidation is much more disruptive to markets and to the customers of the defaulted FCM. The proposal would recognize the importance of the account opening diligence requirements and would mitigate the risk from delay by requiring the diligence to be performed as soon as practicable and setting an outer limit at six months, unless that time is extended by the Commission.

Proposed § 190.07(b)(4) is also new. It would clarify that account agreements governing a transferred account are deemed assigned to the transferee until and unless a new agreement is reached. The provision would also explain that consequences for breaches pre-transfer are borne by the transferor rather than the transferee. Proposed § 190.07(b)(4) would codify the industry understanding regarding the legal implications for transfer agreements and thus the primary benefit is to provide transparency to the industry. The Commission does not anticipate that there would be material costs associated with the change.

Proposed § 190.07(b)(5) would carry forward current § 190.02(c), and would provide that in the event of transfer, customer instructions that are received by the debtor

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<sup>221</sup> The corresponding costs would arise from the possibility that the transferee's diligence would reveal problems that had been missed by the debtor FCM's customer diligence process, or arose subsequent to the time that the original process was conducted, and that conducting the revised diligence more promptly would sooner reveal the concerns, thus permitting them to be addressed more expeditiously.

with respect to any open commodity contracts or specifically identifiable property should be transmitted to the transferee, who should comply with such instructions to the extent practicable. The slight revisions to current § 190.02(c) would be merely clarifications, and there would be no costs or benefits associated with such revisions.

Proposed § 190.07(c) would revise current § 190.06(e). The proposed revision would change the language “all accounts are eligible for transfer” in current § 190.06(e)(1) to “all commodity contract accounts (including accounts with no open commodity contract positions) are eligible for transfer. . .” This change would recognize explicitly that accounts can be transferred if the accounts are intended for trading commodities, but do not include any open commodity contracts at the time of the order for relief. The revision would clarify the current language and would not change the types of accounts that can be transferred. Accordingly, the Commission does not anticipate that there would be material added cost associated with the revision.

Proposed § 190.07(d) would revise special rules for transfers under section 764(b) of the Bankruptcy Code, set forth in primarily in current § 190.06(f). Proposed § 190.07(d)(2)(i) would state that the Commission will not disapprove such a transfer for the sole reason that it was a partial transfer.” Current § 190.06(f)(3)(i) sets forth that the Commission will not disapprove such a transfer for the sole reason that it was a partial transfer if it would prefer the transfer of accounts, the liquidation of which could adversely affect the market or the bankrupt estate. The revision would be made to promote transfer. Cost and benefit considerations related to transfer are as discussed above.<sup>222</sup>

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<sup>222</sup> See section II.B.5 above.

Several changes would be proposed in § 190.07(d)(2)(ii). First, the Commission would clarify that associated property (*i.e.*, collateral) would be transferred along with open commodity contracts, and thus would insert the term “property” throughout the section. This change would clarify the current regulation and would not have an associated cost. Second, the Commission would create a limitation on partial transfers where netting sets would be broken and customers’ net equity claims would increase. Trustees would therefore not permit partial transfers where individual customers would be in a worse position (with respect to margin) if the partial transfer were completed. While this provision would require the trustee to consider the impact of partial transfer, under current regulations, the trustee is already required to consider the extent to which a partial transfer would impact customer net equity claims against the FCM debtor’s estate. The revised regulation would provide a benefit to customers by codifying this limitation. Third, § 190.07(d)(2)(ii) would be revised to add language that clarifies that liquidation could either crystallize gains or have the effect of reducing the required margin. This change would have a similar impact to the limitation on partial transfers just considered. It would codify a consideration the trustee should already be addressing, and as such, would not create an additional cost. Finally, the Commission would insert language in § 190.07(d)(2)(ii) that would clarify that the trustee is required to protect customers holding spread or straddle positions from the breaking of netting sets, but only to the extent practicable, given the circumstances. The inserted language would steer the trustee toward respecting spreads and straddles, but would give the trustee more flexibility than the current regulation, so that the trustee can respond to the stressed market conditions and provide the best outcome for the FCM debtor estate and customers

generally. The proposed insertion would recognize that there may be circumstances where partial transfer is not practicable and implies that the trustee makes that decision. It is therefore possible that certain customers holding spread or straddle positions could have positions liquidated or not transferred under the revised provision, or could have spreads or straddles broken because of the trustee's exercise of discretion.<sup>223</sup>

Proposed § 190.07(d)(3) is new and would permit a letter of credit associated with a commodity contract to be transferred with an eligible commodity contract account. If the letter of credit cannot be transferred (either because of its terms or because the transfer would result in a greater recovery of value for the customer than the customer is entitled to) and the customer does not deliver substitute property, the provision would permit the trustee to draw upon all or a portion of the letter of credit and treat the proceeds as customer property in the applicable account class. The proposed regulation would codify the Commission's current intention with regards to letters of credit<sup>224</sup> and the current practice trustees have used. It would ensure that letters of credit are treated in an economically similar fashion to other types of collateral and that customers using letters of credit would not be given any differential economic benefit, thus serving the goal of pro rata distribution. There could be administrative costs incurred by the estate associated with drawing upon a letter of credit, as well as costs to the customer that posted the letter of credit as collateral. Such costs may be mitigated if the customer delivers substitute property, as set forth in the proposed regulation.

Proposed § 190.07(d)(4) is also new and would require a trustee to use reasonable efforts to prevent physical delivery property from being separated from commodity

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<sup>223</sup> See trustee discretion discussion in section IV.C.2 above.

<sup>224</sup> See *ConocoPhillips*, 2012 WL 4757866, and related discussion in section II.B.2 above.

contract positions under which the property is deliverable. While this provision would impose an administrative cost on the estate, it is already a best practice for trustees; keeping delivery property with the underlying contract positions is necessary for (and thus would benefit) the delivery process. Therefore, the additional administrative cost from the revised regulation would be minimal. There would be no cost to customers, who would benefit from the codification of a standard for the trustee.

Proposed § 190.07(d)(5) would revise current § 190.06(e)(2) by making several clarifications. The revised provision would prevent prejudice to customers and prohibit the trustee from making transfers that would result in insufficient customer property being available to make equivalent percentage distributions to all equity claim holders in the applicable account class. This change would be a clarification of the current requirements. It would support achieving the statutory policy of pro rata distribution, but would work to the detriment of any customer who, absent the provision, would otherwise benefit from a larger distribution. The Commission is further proposing to clarify that the trustee should make determinations based on customer claims reflected in the FCM's records, and, for customer claims that are not consistent with those records, should make estimates using reasonable discretion based in each case on available information as of the calendar day immediately preceding transfer. The benefit here would be that the trustee is given discretion to make decisions based on the overarching principle set forth above, valuing cost effectiveness over precise values of entitlement. However, the same potential costs would apply—risk of mistake or misfeasance.

Proposed § 190.07(e) would revise current § 190.06(g). The proposal would add language to clarify that transfers are approved by the Commission pursuant to the

procedure set forth in the Bankruptcy Code and adding specific citations to the Code. Throughout proposed § 190.07(e), the Commission would insert “or customer property” following “the transfer of commodity contract accounts” to clarify that transfers of commodity contract accounts include the associated customer property. These revisions would be clarifications or reorganizations, and there would be no costs or benefits associated with the revisions.

Proposed § 190.07(e)(1)(iii) would add a provision that would prohibit the trustee from avoiding a transfer from “a receiver that has been appointed for the FCM that is now a debtor.” The new provision would be added in order to respect the actions of a receiver that is acting to protect the property of the FCM that has become the debtor in bankruptcy. It would provide certainty to the actions of such a receiver, whose duties, among others, include protecting the customer property of the FCM. However, to the extent that the receiver takes actions that are, considered in retrospect, mistaken or ill-advised, a possibility which cannot be foreclosed given the exigencies of an FCM receivership, the proposal would prevent the correction of such actions.

In proposed § 190.07(e)(2)(i), the Commission would revise current § 190.06(g)(2)(i) to modify the term “SRO/commodity broker” to “clearing organization” because the only entities who can perform the transfers that are subject to the provision are the trustee, and, in certain circumstances, clearing organizations. This revision would be a clarification and would not have any associated cost.

Proposed § 190.07(f) would revise § 190.06(h) regarding Commission action. The provision would clarify that the Commission may prohibit the transfer of a particular set or sets of the commodity contract accounts, or permit the transfer of a particular set or

sets of commodity contract accounts that do not comply with the requirements of the section. In addition, the Commission would clarify that the transfers of the commodity contract accounts includes the associated customer property. These revisions would be clarifications and would not have any associated costs.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.07. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

6. Regulation 190.08: Calculation of Allowed Net Equity

a. Consideration of Costs and Benefits

In proposed § 190.08, the Commission would incorporate much of current § 190.07, though with certain revisions, but also would delete parts of current § 190.07.

The Commission is proposing to delete current §§ 190.07(b)(6), 190.07(c)(2)(v), and 190.07(d)<sup>225</sup> from the proposed rule text, all of which involve how to adjust the calculation of allowed net equity with respect to accounts remaining open after the primary liquidation date. The reason for these proposed deletions is that under the revised definition of the term “primary liquidation date,” all commodity contracts would be liquidated or transferred prior to the primary liquidation date—none would be held

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<sup>225</sup> In addition, as noted above, because the Commission is proposing to delete current § 190.07(d) from the proposed rule text, the Commission is also proposing to delete the reference to such provision in proposed § 190.08(a).

open for transfer thereafter. Therefore, since no accounts would remain open subsequent to the primary liquidation date, these sections would be rendered moot. Accordingly, the Commission does not anticipate any associated costs or benefits.

Proposed § 190.08(b) would set forth the steps for a trustee to follow when calculating each customer's net equity. While proposed § 190.08(b) would contain several revisions from its analog in current § 190.07(b), most of the revisions would be non-substantive and would clarify, not change, the meaning of the provisions in current § 190.07(b). The cost and benefit considerations of the substantive changes to proposed § 190.08(b) are discussed below.

First, proposed § 190.08(b)(1) would set forth instructions for determining the equity balance of each commodity contract account of a customer. Proposed § 190.08(b)(1)(ii) would provide instructions on how to calculate a customer's ledger balance, which goes into determining that customer's equity balance. Proposed § 190.08(b)(1)(ii)(A)(4) is new, and would provide that a customer's ledger balance includes "the face amount of any letter of credit received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract." This treatment would balance the fact that any portion of a posted letter of credit that is not drawn upon would be treated as distributed to the customer. This new provision could result in administrative costs, since the trustee could, if a particular customer has posted a letter of credit as margin for a commodity contract, be required to take the extra step of determining the value of such letter of credit in calculating that customer's equity balance. However, this provision could benefit customers posting letters of credit: Absent this addition to the

rule text, such customers were not explicitly guaranteed that their letters of credit would be taken into account in calculations of their equity balance.<sup>226</sup>

Second, proposed § 190.08(b)(2) would provide instructions to the trustee regarding how to determine whether accounts are held in the same capacity or in separate capacities, for purposes of aggregating the credit and debit equity balances of all accounts of the same class held by a customer in the same capacity. Proposed § 190.08(b)(2)(viii), similar to current § 190.07(b)(2)(viii), would note that futures accounts, delivery accounts, and cleared swaps accounts of the same person shall not be deemed to be held in separate capacities, although such accounts may be aggregated in accordance with paragraph (b)(3) of the section. Current § 190.07(b)(2)(viii) is subject to one exception, paragraph (b)(2)(ix) of the section, which sets forth that an omnibus customer account of an FCM shall be deemed to be held in a separate capacity from the house account and any other omnibus customer account of such person. Proposed § 190.08(b)(2)(viii) would also be subject to exception from paragraph (b)(ix) and would add another exception, from paragraph (b)(xiv), which would reflect that accounts held by a customer in separate capacities shall be deemed to be accounts of separate customers. This change

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<sup>226</sup> The Commission considered similar costs and benefits when it proposed adding other references to letters of credit in proposed § 190.08. For instance, proposed § 190.08(c), which would set forth instructions for calculating the funded balance, includes in the computation “the value of letters of credit received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract related to all customer accounts of the same class.” In addition, proposed § 190.08(d)(4) would set the value of a letter of credit “received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract” as its face amount less the amount, if any, drawn and outstanding. These new provisions regarding letters of credit could result in administrative costs, in that they could involve certain additional steps being taken by the trustee with respect to calculating the allowed net equity of each customer when certain customers have posted letters of credit to margin their commodity contracts, but they would also benefit customers posting letters of credit, who would have explicit assurance that any such letters of credit would be taken into account in such calculations.

provides additional cross-references and clarifies the existing regulations, but does not change any obligations. Accordingly, there is no cost from the revisions.

Proposed § 190.08(b)(2)(xi), like its analog in current § 190.07(b)(2)(xi), would state that certain retirement or pension accounts maintained with the debtor FCM shall be deemed to be held in a separate capacity from an account held in an individual capacity by the retirement or pension plan administrator, or by any employer, employee, participant, or beneficiary with respect to such plan. While current § 190.07(b)(2)(xi) would refer only to retirement or pension plans under ERISA, proposed § 190.08(b)(2)(xi) would expand the scope of retirement and pension plans that would be described in this provision to include such plans under similar federal, state or foreign laws or regulations. This provision could result in administrative costs, because the trustee would need to ensure that all accounts in the name of a retirement or pension plan as described in proposed § 190.08(b)(2)(xi) would be properly categorized as being held in a separate capacity from accounts held in an individual capacity by the plan administrator, or by any employer, employee, participant, or beneficiary with respect to such plan. The benefit of this change would be to foster the achievement of the statutory policies favoring retirement accounts and pension plans.

While the Commission would make certain revisions in proposed §§ 190.08(b)(3), (b)(4) and (b)(5), as described above, the Commission views such revisions as non-substantive and would merely clarify the text in the current analogous provisions. Thus, the Commission would not expect these changes to result in any costs or benefits.

Proposed § 190.08(c) would set forth instructions for calculating each customer's funded balance. As noted above in section II.B.6, the references to calculation as of the

primary liquidation date would be deleted, because the funded balance (*i.e.*, each customer's pro rata share of the customer estate with respect to an account class) is relevant both before the primary liquidation date as well as after.

In addition, proposed § 190.08(c)(1)(ii) would provide that, in calculating each customer's funded balance, the trustee should add any margin payment made between (i) the entry of the order for relief or, in an involuntary case, the date on which the petition for bankruptcy is filed, and (ii) the primary liquidation date. In the analogous current provision, the text did not account for the possibility of an involuntary proceeding, so the Commission is proposing to add text to account for such possibility. This revision would promote the goal of fair distribution. It would likely benefit those customers of a debtor in an involuntary bankruptcy proceeding who make margin payments between the date on which the petition for bankruptcy is filed and the primary liquidation date, in that those payments would be taken into account when the trustee is calculating their funded balance under the proposed rules; it would correspondingly act to the detriment of other customers.

In proposed § 190.08(d), the Commission is proposing in general to implement changes to provide more flexibility to the trustee in valuing commodity contracts and other property held by or for a commodity broker. For instance, the Commission is proposing to delete current §§ 190.07(e)(2) and (e)(3), regarding the valuation of principal contracts and bucketed contracts, respectively, in favor of the more generalized approach to valuing property set forth in proposed § 190.08(d)(5). Moreover, in proposed § 190.08(d)(5), which is based on current § 190.07(e)(5), the Commission is proposing to delete the requirement that the trustee seek approval of the court prior to

enlisting professional assistance to value customer property. These changes would benefit the estate by providing the trustee with more flexibility to determine how to value certain customer property, including whether or not to enlist professional assistance in doing so. Likewise, these revisions would serve the goal of a pro rata distribution to customers, as the accurate valuation of customer property can benefit from the input of a professional. On the other hand, affording the trustee increased discretion in how to value commodity contracts and other property held by a debtor could carry the potential cost of mistake, misfeasance or abuse of discretion by the trustee, as discussed above, or possibly by the professional whose service is retained.

With respect to some of the specific provisions within proposed § 190.08(d), the Commission is proposing substantial changes with respect to the valuation of commodity contracts. First, the Commission is proposing to separate more explicitly the instructions concerning the valuation of (1) open commodity contracts, and (2) liquidated commodity contracts. With respect to open commodity contracts, the Commission would retain the provision that the value of an open commodity contract shall be equal to the settlement price as calculated by the clearing organization pursuant to its rules. However, the Commission is proposing that such clearing organization rules no longer need to be approved by the Commission in order to be used in valuing such contracts for purposes of computing net equity. The benefits and costs of that change in approach are discussed above with respect to proposed § 190.04(e).

With respect to commodity contracts that have been transferred, proposed § 190.08(d)(1)(i) would provide that such contracts be valued at the end of the last settlement cycle on the day preceding such transfer, rather than at the end of the

settlement cycle in which it is transferred. Again, this revision would benefit both the estate and customers by making it practical to calculate the value of the transferred commodity contracts prior to the transfer.

With respect to liquidated commodity contracts, the Commission is proposing that the value of such contracts shall equal the value realized on liquidation of the contract. However, in certain circumstances, proposed § 190.08(d)(1)(ii) also would allow the trustee to either (1) use the weighted average of commodity contracts liquidated within a 24-hour period or business day, or (2) use the settlement price calculated by a clearing organization for commodity contract liquidated as part of a bulk auction by a clearing organization. With respect to the weighted average provision, the Commission is proposing to change the time period within which such contracts must be liquidated in order for the trustee to use the weighted average, from “on the same date” (as provided in current § 190.07(e)) to “within a 24 hour period or business day.” This change would benefit the estate and the goal of pro rata distribution, since it has been proposed in order to bring the time frame more in line with how settlement cycles and business days work.<sup>227</sup> In addition, the Commission is proposing to add the provision regarding valuation in the case of a bulk auction by a clearing organization. In the Commission’s view, such an addition would benefit the estate by providing the trustee with another option for determining appropriately the value of commodity contracts that were liquidated as part of a bulk auction.

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<sup>227</sup> The trading day is generally not the same as the calendar day, but instead may run from *e.g.* 5 p.m. on one business day until 4:59 p.m. on the next. Closing prices for contracts would thus be set at the end of the trading day, not at the end of the calendar day. This consideration of costs and benefits also applies to proposed § 190.08(d)(2), which would incorporate the same weighted average concept as in proposed § 190.08(d)(1)(ii)(A).

In proposed § 190.08(d)(4), which would set forth the valuation method for commodities held in inventory, the Commission is proposing to allow the trustee, in circumstances where the fair market value of the commodity held in inventory is not readily ascertainable, to value the commodity in accordance with proposed § 190.08(d)(5), discussed above. This change would benefit both the estate, since the trustee would have the flexibility to value a commodity held in inventory using such professional assistance as they deem necessary, as well as the customers, who would benefit from a more appropriate valuation due to the trustee's increased flexibility in determining such valuation. It would again, however, involve the costs of possible mistake, misfeasance or abuse of discretion discussed above.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.08. Are there additional costs or benefits that the Commission should consider? Are there any alternatives (*e.g.*, approaches that will more likely lead to accurate valuation) that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? In particular, do the proposed rules strike an appropriate balance of discretion and prescription? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

7. Regulation 190.09: Allocation of Property and Allowance of Claims

a. Consideration of Costs and Benefits

In proposed § 190.09, the Commission would incorporate much of current § 190.08, though with certain revisions and additions. Proposed § 190.09(a)(1) would

define the scope of “customer property” that is available to pay the claims of a debtor FCM’s customers, and proposed § 190.09(a)(1)(i) would set forth the categories of “cash, securities, or other property or the proceeds of such cash, securities, or other property received, acquired, or held by or for the account of the debtor, from or for the account of a customer” that are included in customer property. The Commission is proposing certain substantive changes to the categories listed in proposed § 190.09(a)(1)(i), as discussed below:

- First, proposed § 190.09(a)(1)(i)(D) is a new section that would provide that customer property includes any property “received by the debtor as payment for a commodity to be delivered to fulfill a commodity contract from or for the commodity customer account of a customer.” While the Commission’s intention was always to include such property within the definition of “customer property,” clarifying this explicitly would benefit both the estate and customers by avoiding confusion or potential litigation.
- Second, proposed § 190.09(a)(1)(i)(F) would provide that letters of credit, including proceeds of letters of credit drawn by the trustee, or substitute customer property, constitute “customer property.” This section would be revised to be consistent with the other letters of credit provisions that would be added throughout the proposed part 190. The Commission does not anticipate that this provision would result in any material costs or

benefits, as current § 190.08(a)(1)(i) already includes a provision regarding letters of credit.<sup>228</sup>

Proposed § 190.09(a)(1)(ii) would set forth the categories of “[a]ll cash, securities, or other property” that would be included in customer property. The Commission is proposing certain substantive changes to the categories listed in § 190.09(a)(1)(ii), as discussed below:

- First, proposed § 190.09(a)(1)(ii)(D) would provide that any cash, securities, or other property that was property received, acquired or held to margin, guarantee, secure, purchase, or sell a commodity contract and that is subsequently recovered by the avoidance powers of the trustee or is otherwise recovered by the trustee on any other claim or basis constitutes customer property. The current version of this provision refers only to the trustee’s avoidance powers (leaving out the possibility for recovery other than through avoidance powers). The Commission’s proposed revisions to this section would benefit the estate, by assuring that any property they recover would be included in the pool of customer property, no matter the method of recovery, rather than going to some other creditor (to be sure, those other creditors would receive correspondingly less).
- Second, proposed § 190.09(a)(1)(ii)(G) is new, and would provide that any current assets of the debtor in the greater of (i) the amount that the debtor would be obligated to be set aside as its targeted residual interest

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<sup>228</sup> The costs and benefits of the underlying policy decision to take steps to ensure that customers posting letters of credit are treated (with respect to pro rata allocation of losses) in a manner consistent with the manner in which customers posting other forms of collateral are treated are discussed in connection with proposed § 190.04(d)(3) in section IV.E.2 above.

amount, or (ii) the debtor's obligations to cover debit balances or undermargined amounts, constitutes customer property. This new provision would result in administrative costs, because the trustee would need to take the extra step of determining whether any current assets of the debtor need to be set aside as customer property and, if so, how much. This provision would benefit customers (and serve the policy of protecting customer collateral), however, because it would mitigate the risk of a shortfall in customer funds by ensuring that the trustee would fulfill the Commission's regulations that require an FCM to put certain funds into segregation on behalf of customers. This would result in such funds being included in the pool of customer property, rather than going to some other creditor. It would, to the same extent, operate to the detriment of general creditors.

- Third, proposed § 190.09(a)(1)(ii)(K) is also new, and would provide that any cash, securities, or other property that is payment from an insurer to the trustee arising from or related to a claim related to the conversion or misuse of customer property constitutes customer property. This provision would benefit customers (and, again, the policy of protecting customer collateral), since any insurance payment as described in this proposed section would enlarge the pool of customer property, rather than going to some other creditor.<sup>229</sup> It could result in administrative costs, however, as the trustee would need to spend time and resources in order to

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<sup>229</sup> It would, again, to the same extent, act to the detriment of general creditors.

determine whether any such insurance payments exist, and in prosecuting such insurance claims.

- Fourth, the second sentence of proposed § 190.09(a)(1)(ii)(L) is new, and would provide customer property for purposes of these regulations includes any “customer property,” as that term is defined in SIPA, that remains after satisfaction of the provisions in SIPA regarding allocation of customer property constitutes customer property. This provision would benefit commodity customers (and act to the detriment of general creditors) because any securities customer property remaining after full allocation to securities customers would enlarge the pool of commodity customer property. It could result in administrative costs, however, since the trustee could need to spend time and resources determining the extent to which such property is left over after allocation to customers in a SIPA proceeding.<sup>230</sup>

Proposed § 190.09(a)(2) sets forth the categories of property that are not included in customer property. The Commission has proposed certain substantive changes to the categories listed in proposed § 190.09(a)(2), as discussed below:

- First, in proposed § 190.09(a)(2)(iii), the Commission would add explicit language to state that only those forward contracts that are not cleared by a clearing organization are excluded from the pool of customer property.

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<sup>230</sup> The Commission further notes that the first sentence of proposed § 190.09(a)(1)(ii)(L), which would provide that customer property would include any cash, securities, or other property in the debtor’s estate, but only to the extent that the customer property under the other definitional elements is insufficient to satisfy in full all claims of the debtor’s public customers, would impose no costs and benefits because such provision already appears in current § 190.08, and the only changes to the provision would be non-substantive updates to cross-references.

This revision would benefit customers (and act to the detriment of general creditors), since the pool of customer property would increase by explicitly including any cleared forward contracts.

- Second, proposed § 190.09(a)(2)(v) would provide that any property deposited by a customer with a commodity broker after the entry of an order for relief that is not necessary to meet the margin requirements of such customer is not customer property. The deletion of the word “maintenance” before “margin” would eliminate any distinction between initial and variation margin; this deletion would benefit the estate by ensuring that any amount deposited by a customer after the entry of an order for relief that is necessary to meet that customer’s margin requirements would be included in the pool of customer property. It also would benefit customers who post excess margin, who could be assured that any such excess margin they deposit after the entry of an order for relief will remain their property and will not be included in the pool of customer property. This provision would correspondingly act to the detriment of general creditors.
- Third, proposed § 190.09(a)(2)(viii), which is new, would provide that any money, securities, or other property held in a securities account to fulfill delivery, under a commodity contract that is a security futures product, from or for the account of a customer, is excluded from customer property. This provision avoids conflict with the resolution, under SIPA, of claims for securities and related collateral.

Proposed § 190.09(a)(3), which is new, would give the trustee the authority to assert claims against any person to recover the shortfall of customer property enumerated in certain paragraphs elsewhere in proposed § 190.09(a). This provision could impose administrative costs, since the trustee could have to expend time and resources to assert and prosecute such claims to make up for any shortfall in customer property. The provision would, however, benefit customers, since it would ensure that the trustee would be in a position to recover any such shortfalls and would give the trustee authority to take action to do so. Moreover, since this provision would make explicit what is implicit in current part 190, an additional benefit of this provision would be reduced litigation costs over a trustee's authority to engage in attempts to recover shortfalls in customer property.<sup>231</sup>

Proposed § 190.09(b) would add the phrase "or attributable to" when describing how to treat property segregated on behalf of or attributable to non-public customers ("house accounts"); the addition of this phrase, as described above, would clarify that proposed § 190.09(b)(1) would apply both to property that is in the debtor's estate at the time of the bankruptcy filing, as well as property that is later recovered by the trustee and becomes part of the debtor's estate at the time of recovery. This additional phrase would benefit public customers and the statutory policy in favor of them (and correspondingly act to the detriment of non-public customers), since it could increase the amount of property that is treated as part of the public customer estate. It could impose

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<sup>231</sup> While the persons against whom such claims are successfully asserted may perceive a subjective cost, the Commission does not find these costs relevant to the analysis, as those persons would simply be forced to pay what they rightfully owe the debtor FCM's estate.

administrative costs because it could take time and resources to properly allocate any property that is recovered after the time the bankruptcy is filed.<sup>232</sup>

Proposed § 190.09(c)(1)(ii) is a new provision that would instruct the trustee, in the event there is property remaining allocated to a particular account class after payment in full of all allowed customer claims in that account class, to allocate the excess in accordance with proposed § 190.09(c)(2), which in turn would set forth the order of allocation for any customer property that could not be traced to a specific customer account class. These provisions would benefit public customers who would otherwise face shortfalls (and then, non-public customers who would otherwise face shortfalls). Since these provisions would make explicit what is implicit in current part 190, an additional benefit of these provisions would result from the increased clarity over what to do with any excess customer property. However, the provisions would act to the detriment of general creditors who, under the current regime, could have been more likely to receive any excess customer property in the absence of an explicit provision providing what to do with any such excess customer property.

Proposed § 190.09(d) would govern the distribution of customer property. The only substantive change in proposed § 190.09(d) from its analog in current § 190.08(d) would be in proposed §§ 190.09(d)(1)(i) and (ii), which would import the concept of “substitute customer property.” Whereas current §§ 190.08(d)(1)(i) and (ii) require customers to deposit cash in order to obtain the return of specifically identifiable

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<sup>232</sup> Proposed § 190.09(c)(1) would have a similar change in the addition of the phrase “or recovered by the trustee on behalf of or for the benefit of an account class,” which is meant to clarify that any property recovered by the trustee on behalf of or for the benefit of a particular account class after the bankruptcy filing must be allocated to the customer estate of that account class. This revision would present similar costs and benefits to those discussed above.

property, proposed §§ 190.09(d)(1)(i) and (ii) would allow the posting of “substitute customer property.” This term, which would be defined in proposed § 190.01, would mean cash or cash equivalents. This revision would benefit customers because it would make it easier for customers to redeem their specifically identifiable property by no longer limiting customers to only using cash to do so. It could, however, impose administrative costs in the form of time and resources of the trustee, who, in the event a customer chooses to post cash equivalents to redeem their specifically identifiable property, would be required to value (and potentially to liquidate) such cash equivalents.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.09. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

8. Regulation 190.10: Provisions Applicable to Futures Commission Merchants during Business as Usual

a. Consideration of Costs and Benefits

Proposed § 190.10 addresses provisions applicable to FCMs during business as usual.

In § 190.10(a), the Commission would note that an FCM is required to maintain current records related to its customer accounts, consistent with current Commission regulations, and in a manner that would permit them to be provided to another FCM in

connection with the transfer of open customer contracts and other customer property. The proposed regulation would not impose new obligations, but rather would inform the trustee regarding their duties by incorporating references to the Commission's existing regulations.

Proposed § 190.10(b) would incorporate concepts in current §§ 190.04(e), 190.06(d), and the current Bankruptcy appendix form 3 instructions. Under this new provision, an FCM would be permitted to rely solely upon written record of the customer's representation of hedging intent regarding the designation of a hedging account, thus mitigating administrative costs.

Proposed § 190.10(b)(1) would require an FCM to provide a customer an opportunity to designate an account as a hedging account when the customer first opens the account, allowing for clearing instruction to FCMs at the outset of the relationship. This provision is new, with regards to the timing of the opportunity. Clear instruction at the outset would facilitate the ability properly to account for customer property. There would be some disclosure and accounting costs associated with this provision. The proposed regulation would require FCMs to give customers the opportunity to provide instructions as to whether an account is a hedging account at opening, including those who will never enter into hedging accounts. For those customers that do engage in hedging, it would be more cost effective to designate the account at opening, when both customer and FCM are focused on the specifics of the relationship between them, than to monitor the transactions for the first qualifying transaction to provide the opportunity to make the designation, as applicable under the current regulation. Thus, the proposed

regulation would reduce the probability that the opportunity to designate the account as a hedging account will be missed.

Proposed § 190.10(b)(2) would set forth the conditions for treating an account as a hedging account. The current § 190.06(d) requires written hedging instructions for such treatment to be given. By contrast, proposed § 190.10(b)(2) would permit such treatment upon the customer's written representation that their trading would constitute hedging as defined under any relevant Commission rule or the rule of a DCO, DCM, SEF, or FBOT. This provision is new and would follow from the designation of the accounts. There would be accounting burdens for FCMs and customers associated with the provision.

In proposed § 190.10(b)(3), the Commission would provide that the requirements in §§ 190.10(b)(1)-(2) would not apply to commodity contract accounts opened prior to the effective date of the revisions to part 190 and that an FCM could continue to designate existing accounts as hedging accounts based on written hedging instructions obtained under current regulations. This provision would mitigate the impact of the changes to current requirements in proposed §§ 190.10(b)(1)-(2) by not applying those provisions to already opened hedging accounts and would give FCMs the ability to continue to designate already-open hedging accounts based upon the information collected and maintained during the current regulatory framework.

Proposed § 190.10(b)(4) would permit an FCM to designate an existing customer account as a hedging account for purposes of bankruptcy treatment, provided that the FCM obtains the necessary customer representation. This provision would give FCMs and customers flexibility to apply the proposed regulations to existing accounts where the impact would not be overly burdensome.

In proposed § 190.10(c), the Commission would address the establishment of delivery accounts during business as usual. The Commission would recognize that when an FCM facilitates delivery under a customer's physical delivery contract and such delivery is effected outside of a futures account, foreign futures account, or cleared swaps account, it must be effected through (and the associated property held in) a delivery account.<sup>233</sup> Delivery accounts are of particular importance during bankruptcy although there are costs associated with the opening and maintenance of such accounts. The use of such accounts is considered to be cost effective in facilitating delivery.<sup>234</sup> The benefit of using such accounts would be twofold: to protect customer assets during the delivery process, and to foster the integrity of the delivery process itself.

Proposed § 190.10(d) is new. It would address letters of credit and would prohibit and FCM from accepting a letter of credit during business as usual unless certain conditions are met at the time of acceptance and remain true through the date of expiration. First, the trustee would be required to be able to draw upon the letter of credit in full or in part in the event of a bankruptcy proceeding, the entry of a protective decree under SIPA, or the appointment of FDIC as receiver pursuant to Title II of the Dodd-Frank Act. Second, if the letter of credit would be permitted to be and would in fact be passed through to a clearing organization, the trustee for such clearing organization (or the FDIC) would be required to be able to draw upon the letter of credit in full or in part in the event of a bankruptcy proceeding (or where the FDIC is appointed as receiver). In

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<sup>233</sup> As noted above in the discussion of proposed § 190.10(c) in section II.B.8, if the commodity that is subject to delivery is a security, the FCM may instead effect delivery through (and the property may be held in) a securities account.

<sup>234</sup> The Commission further understands that it is already industry practice to use such accounts, therefore, as a practical matter, the cost associated with mandating the use of such accounts would be mitigated.

addition, proposed § 190.00(c)(5) would clarify that the trustee is required to treat letters of credit in a manner consistent with pro rata distribution and is permitted to draw upon the full amount of unexpired letters of credit or any portion thereof or treat the letter of credit as having been distributed to the customer for purposes of calculating entitlements to distribution or transfer.

Proposed § 190.10(d) would ensure that an FCM's treatment and acceptance of letters of credit during business as usual is consistent with and does not preclude the trustee's treatment of letters of credit in accordance with proposed §§ 190.00(c)(5) and 190.04(d)(3). Letters of credit are currently widely used in the industry. The Commission understands that under industry practice, most existing letter of credit arrangements are consistent with the Joint Audit Committee Forms of Irrevocable Standby Letter of Credit, both Pass-Through and Non Pass-Through,<sup>235</sup> and that these forms are consistent with the proposed new requirements. Nevertheless, FCMs would need to review the existing letters of credit for consistency with the regulation, and it is plausible that some could need to be re-negotiated to be consistent therewith. The Commission has considered the extent of the use of letters of credit in the industry and is proposing that upon the effective date of the regulation, proposed § 190.10(d) would apply only to new letters of credit and customer agreements. The Commission further is proposing to include a transition period of one year from the effective date until proposed § 190.10(d) would apply to existing letters of credit and customer agreements. The transition period would give FCMs an opportunity to conduct the necessary review of existing letters of credit and customer agreements, and to make any necessary changes.

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<sup>235</sup> See section II.B.8 above.

It is possible that some letters of credit could become more expensive if the proposed regulation is adopted as there would be an increased likelihood that the letter of credit will be drawn upon. (As discussed above, this would appear to not apply to the majority of existing arrangements). As noted in the discussion of proposed § 190.04(d)(3), the benefit of the proposed regulation would be ensuring consistent economic treatment of letters of credit with other types of collateral to ensure that all forms of collateral are treated similarly, thus promoting the goal of pro rata distribution.

Proposed § 190.10(e) would largely aligns with the provisions in current part 190 from which it was derived. The statement concerning publication of notice in a newspaper of general circulation would be deleted to correspond to changes discussed in connection with proposed § 190.03(c)(1); there would be no additional cost or benefit implications.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.10. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

9. Section 15(a) Factors—Subpart B

a. Protection of Market Participants and the Public

Subpart B of the proposed rules would increase the protection of market participants and the public by clearly setting forth how the bankruptcy trustee is expected

to treat the property of customers of FCMs in the event of an FCM insolvency, thereby promoting ex ante transparency for such customers.

b. Efficiency, Competitiveness, and Financial Integrity

Subpart B of the proposed rules would promote efficiency (in the sense of both cost effectiveness and timeliness) in the administration of insolvency proceedings of FCMs and the financial integrity of derivatives transactions carried by FCMs by setting forth clear instructions for a bankruptcy trustee to follow in the event of an FCM insolvency, and by updating these instructions to account for current market practices. Moreover, subpart B would provide the bankruptcy trustee with discretion, in certain circumstances, to react flexibly to the particulars of the insolvency proceeding, thereby promoting efficiency of the administration of the proceeding. These effects would, in turn, enhance the competitiveness of U.S. FCMs, by enhancing market confidence in the protection of customer funds and positions entrusted to U.S. FCMs, even in the case of insolvency.

c. Price Discovery

Price discovery is the process of determining the price level for an asset through the interaction of buyers and sellers and based on supply and demand conditions. To the extent that the proposed regulations would mitigate the need for liquidations in conditions of distress, they would avoid negative impacts on price discovery.

d. Sound Risk Management Practices

Subpart B of the proposed rules would promote sound risk management practices by encouraging the bankruptcy trustee effectively to manage the risk of the debtor FCM. Subpart B would accomplish this by revising the bankruptcy rules for an FCM insolvency

that reflect current market practices and effectively protect customer property in the event of such an insolvency.

e. Other Public Interest Considerations

Subpart B of the proposed rules supports the implementation of statutory policy such as promoting protection of public customers and ensuring pro rata distribution of customer funds. Moreover, some of the FCMs that might enter bankruptcy are very large financial institutions, and some are (or are part of larger groups that are) considered to be systematically important. An effective bankruptcy process that efficiently facilitates the proceedings is likely to benefit the financial system (and thus the public interest), as that process would help to attenuate the detrimental effects of the bankruptcy on the financial system and reduce the likelihood that uncertainty as to the outcome of the insolvency could cause disruption to financial markets.

F. Subpart C—Clearing Organization as Debtor

Proposed subpart C to part 190 is intended to create a tailored set of regulations to govern a proceeding under subchapter IV of chapter 7 of the Bankruptcy Code in which the debtor is a clearing organization. While the Commission, in promulgating part 190 in the 1980s, determined to “take a case-by-case approach with respect to [the bankruptcy of] clearing organizations,”<sup>236</sup> the Commission is now proposing to provide a more detailed set of instructions.

The overarching benefits of this approach include the following: (1) uncertainty would be reduced both during business-as-usual (thus enhancing the ability of both clearing members and their customers better to understand their exposures to the possible

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<sup>236</sup> 46 FR at 57545.

insolvency of a clearing organization) and in the unlikely event of the actual bankruptcy (or resolution) of a clearing organization (thus enhancing the cost effectiveness of either process). (2) The resolution regime established under Title II of Dodd-Frank provides that the maximum liability of FDIC as receiver of a covered financial company to a claimant is the amount the claimant would have received if the FDIC had not been appointed receiver and the covered financial company had been liquidated under chapter 7 of the Bankruptcy Code. By establishing a clearer counterfactual, proposed subpart C would (a) enhance the ability of FDIC to plan for and to execute its responsibilities as receiver, (b) enhance the ability of market participants to predict in advance their exposures in the unlikely event of the resolution as a DCO, and (c) mitigate the cost of litigation over the value of such claims. The Commission notes that there could, to a certain extent, be costs imposed by proposed subpart C, in that there could be a corresponding reduction in flexibility with the addition of rules specifically tailored to address a DCO bankruptcy, but the Commission has attempted to draft these proposed rules with the intent of maintaining significant flexibility, where warranted.

1. Regulation 190.11: Scope and Purpose of Subpart C
  - a. Consideration of Costs and Benefits

Proposed § 190.11 simply would state that the new subpart C of part 190 would apply to a proceeding commenced under subchapter IV of chapter 7 of the Bankruptcy Code in which the debtor is a clearing organization. Therefore, the costs and benefits of proposed § 190.11 would be the overarching costs and benefits stated above.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.11. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

2. Regulation 190.12: Required Reports and Records

a. Consideration of Costs and Benefits

Proposed § 190.12(a)(1) would be analogous to proposed § 190.03(a), in that it would provide instructions regarding how to give notice to the Commission and to a clearing organization's members, where such notice would be required under subpart C. For a discussion of the costs and benefits of this section, please refer to the discussion of the cost and benefit implications of proposed § 190.03(a).

Proposed § 190.12(a)(2) would revise the time in which a debtor clearing organization must notify the Commission of a bankruptcy filing. In particular: (1) in the event of a voluntary bankruptcy filing, the debtor would be required to notify the Commission at or before the time of filing, and (2) in the event of an involuntary bankruptcy filing, the debtor must notify the Commission as soon as possible, but in any event no later than three hours after the receipt of the notice of such filing. These revisions would codify expectations that (1) in a voluntary bankruptcy proceeding, the debtor clearing organization will provide advance notice to the Commission ahead of the filing to the extent practicable, and (2) in an involuntary bankruptcy proceeding, the

debtor clearing organization will notify the Commission immediately upon the filing, or within at the most three hours thereafter. With respect to a voluntary bankruptcy filing, the Commission expects that the DCO would have made it aware of its financial distress in the lead-up to a bankruptcy filing in accordance with the mandatory reporting requirements in part 39; the revision in proposed § 190.12(a) merely would codify the expectation that the clearing organization would notify the Commission of an intent to file for bankruptcy protection as soon as practicable before, and in no event later than, the time of the filing. In addition, proposed § 190.12(a) also would allow a debtor clearing organization to provide the relevant docket number of the bankruptcy proceeding to the Commission “as soon as available,” while not waiting on notifying the Commission of the filing itself, to account for the potential time lag between the filing of a proceeding and the assignment by the relevant court of a docket number. These revisions would enhance the ability of the Commission to perform its responsibilities to support the interests of clearing members, customers of clearing members, markets, and the broader financial system, by providing the Commission with prompt notice of any DCO bankruptcy proceeding.

Proposed §§ 190.12(b) and(c) would involve the provision of certain reports and records to the trustee and/or the Commission by the debtor clearing organization. In particular: proposed § 190.12(b) would set forth the reports and records that the clearing organization would be required to provide to the Commission and to the trustee within three hours following the later of the commencement of the proceeding or the appointment of the trustee, and proposed § 190.12(c) would set forth the records to be provided to the Commission and to the trustee no later than the next business day

following commencement of a bankruptcy proceeding. These provisions would impose administrative costs on the debtor clearing organization and/or the trustee, which would be obligated to spend time and resources transmitting copies of the required reports and records to the trustee and/or Commission. However, these provisions would both benefit the estate, and enhance the Commission's ability to fulfil its responsibilities, by providing them with the most current information about the clearing organization, and by allowing the trustee to begin to understand the business of the clearing organization as soon as possible following a bankruptcy filing, which is critically necessary to the administration of the debtor clearing organization's estate. This would in turn promote confidence in the clearing system in particular, and financial markets more broadly.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.12. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

3. Regulation 190.13: Prohibitions on Avoidance of Transfers

a. Consideration of Costs and Benefits

Proposed § 190.13 would implement section 764(b) of the Bankruptcy Code with respect to DCOs, and prohibits the avoidance of certain transfers made either before or after entry of the order for relief. This provision is derived from current § 190.06(g), with certain changes. While the prohibition of avoidance of pre- and post-relief transfers

in current § 190.06(g) would apply so long as the transfer is not disapproved by Commission, the same prohibition on avoidance of pre- and post-relief transfers in proposed §§ 190.13(a) and (b) would require the affirmative approval of the Commission (though such approval can be given either before or after the transfer is made). This change would impose administrative costs on the clearing organization or the trustee, who would have to expend time and resources to seek affirmative approval from the Commission for such a transfer in the context of administering a DCO, respectively, either before or after bankruptcy. As noted above,<sup>237</sup> a clearing organization must maintain a “balanced book,” and thus must transfer all of its customer positions (or at least all positions in a given product set). Any such transfer would have significant effects on the markets cleared, and possibly on the broader financial system. There thus would seem to be important benefits from requiring the Commission’s approval of such a significant transaction, and thus permitting the exercise of discretion by the administrative agency responsible for oversight of the derivatives markets.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.13. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

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<sup>237</sup> See section II.C.3 above.

4. Regulation 190.14: Operation of the Estate of the Debtor Subsequent to the Filing Date

a. Consideration of Costs and Benefits

Proposed § 190.14(a) would provide that the trustee may, in their discretion based upon the facts and circumstances of the case, instruct each customer to file a proof of claim containing such information as is deemed appropriate by the trustee. Allowing the bankruptcy trustee to use their discretion in tailoring the proof of claim form to the specific facts and circumstances of the case would benefit both the trustee and customers by limiting the information requested to only that which is necessary for purposes of administering the debtor's estate and thereby increasing cost effectiveness, particularly given the bespoke nature of a clearing organization bankruptcy. Thus, the Commission has not proposed a prescribed proof of claim form. There could, however, be corresponding administrative costs to both the estate and the customers if the set of information requested by the trustee in the exercise of their discretion turns out in retrospect to be overly narrow or broad.

Proposed § 190.14(b) would provide that a debtor clearing organization will cease making calls for variation or initial margin, except in the limited case where the debtor clearing organization continues operation for a limited time. Specifically, under proposed § 190.14(b)(2), the trustee could request permission of the Commission to continue to operate the clearing organization for up to six calendar days after the order for the relief if the trustee believes that continued operation would (1) facilitate either prompt transfer of the clearing operations of the clearing organization to another DCO or resolution of the DCO under Title II of Dodd-Frank, and (2) be practicable, in the sense

that the rules of the DCO do not compel termination of all outstanding contracts under the circumstances then prevailing and all or substantially all of the DCO's members would be able to, and would, make variation margin payments as owed during the period of continued operations. Under current regulations, it would not be possible to continue the operations of a debtor clearing organization for any amount of time after entry of the order for relief, as there is no clear and coherent mechanism to do so. Providing such a mechanism to enable the trustee to continue the operations of the debtor clearing organization for a set amount of time could, in certain circumstances, benefit clearing members and their customers as well as markets and the broader financial system by allowing time to accomplish an impending transfer of the debtor's clearing operations to another clearing organization, or to allow for the possibility of resolving the debtor clearing organization under Title II. Continuing operations of the debtor clearing organization could, however, impose administrative costs, as the trustee would have to essentially operate the clearing organization according to its rules and procedures, using the estate's already limited resources. Moreover, the attempt to continue operations could fail, despite the predictions of the trustee and of the Commission, and such failure could damage the interests of clearing members and their customers as well as markets and the broader financial system.

The Commission notes that it considered alternatives to proposed § 190.14(b)(2). Specifically, the Commission could have left out the possibility of the debtor clearing organization continuing operations for any period of time after entry of the order for relief. As another alternative, the Commission could have allowed for continued operations with fewer requirements than those in proposed § 190.14(b)(2). The

Commission decided that the framework set out in proposed § 190.14(b) for continuing operations of a debtor clearing organization would strike the proper balance between allowing for continuing operations where it is appropriate to do so while only allowing for continuing operations where such continued operations would be expected to be both useful and practical.

Proposed § 190.14(c)(1) would provide that the trustee shall liquidate all open commodity contracts that have not been terminated, liquidated or transferred no later than seven calendar days after the entry of the order for relief, unless the Commission determines that liquidation would be inconsistent with the avoidance of systemic risk or would not be in the best interests of the debtor's estate. This provision would impose administrative costs in that the trustee would have a hard deadline for terminating, liquidating or transferring any open commodity contracts within a certain timeframe, whereas under current part 190 there was no specified timeframe for such termination, liquidation or transfer. It could, however, benefit clearing members and customers, who would have certainty that their open commodity contracts would be liquidated within a particular timeframe rather than being held open for an undetermined amount of time. A deadline for liquidation or transfer of open contracts could benefit the broader financial markets by mitigating uncertainty.

Proposed § 190.14(c)(2), which is derived from current § 190.08(d)(3), would provide that the trustee may, at their discretion, make distributions in the form of securities that are equivalent to the securities originally delivered to the debtor by a clearing member or such clearing member's customer, rather than liquidating the securities and making distributions in cash. Unlike current § 190.08(d)(3), proposed

§ 190.14(c)(2) would not allow the customer to request that the trustee purchase like-kind securities and distribute those instead of cash, instead would leave it up to the discretion of the trustee whether to do so. This change could impose costs on customers who would prefer to have a distribution of equivalent securities rather than cash since it would take away their right to request such a distribution. However, it could benefit the estate by allowing the trustee to use their discretion as to whether to purchase and distribute equivalent securities, rather than being obligated to do so at the request of a customer.

Proposed § 190.14(d) would require the trustee to use reasonable efforts to compute the funded balance of each customer account immediately prior to the distribution of any property in the account, “which shall be as accurate as reasonably practicable under the circumstances, including the reliability and availability of information.” Setting forth an explicit requirement on the bankruptcy trustee to calculate the funded balance of customer accounts in certain circumstances would impose administrative costs due to the time and effort involved in making such calculations. However, this calculation would be necessary to achieve the goal of making distributions that would be consistent with each customer’s proportionate share.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.14. Are there additional costs or benefits that the Commission should consider? Is it plausible that there would be circumstances under which allowing the trustee to continue DCO operations for a limited period of time would be the best approach to resolving the DCO? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed

amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

5. Regulation 190.15: Recovery and Wind-down Plans; Default Rules and Procedures

a. Consideration of Costs and Benefits

Proposed § 190.15, which is not derived from any provision in current part 190, would provide that (1) the trustee shall not avoid or prohibit any action taken by a debtor that was within the scope of and was provided for in the debtor's recovery and wind-down plans; (2) in administering a DCO bankruptcy, the trustee shall, subject to the reasonable discretion of the trustee and to the extent practicable, implement the default rules and procedures maintained by the debtor; and (3) in administering a DCO bankruptcy, the trustee shall, to the extent reasonable and practicable, take actions in accordance with the debtor's recovery and wind-down plans.

The Commission considered two alternatives to directing the trustee to implement the debtor's own default rules and procedures and recovery and wind-down plans: first, continuing to allow a bankruptcy trustee to develop, in the moment, a plan for liquidating the debtor clearing organization, and second, prescribing an across-the-board method for liquidating a debtor clearing organization. With respect to the first alternative, the Commission is of the view that, given the complexity of the operations of a DCO, and the need for extremely prompt action, having the trustee develop an entire plan in the moment would be likely to turn out to be impracticable. This would be in contrast to the trustee's power under the proposed rule to act differently to a limited extent, in cases

where aspects of the plan would be impracticable. As for the second alternative, given the differences between DCOs, a one-size-fits-all approach likely would be less effective.

The Commission is accordingly of the view that, relative to these alternatives, directing a trustee to implement the DCO's own default rules and procedures, and recovery and wind-down plans, would benefit the estate by providing the trustee with purpose-built rules, procedures and plans to liquidate a DCO, which rules, procedures and plans the DCO has developed subject to the requirements of the Commission's regulations and supervision of the Commission. However, adding concepts of reasonability and practicability would give the trustee the discretion to modify those rules, procedures, and plans where and to the extent necessary. Hence, the Commission believes that an approach whereby the trustee would follow the DCO's own purpose-built default rules and procedures and recovery and wind-down plans would be the most cost effective.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.15. Are there additional costs or benefits that the Commission should consider? Are there any other alternatives that could provide preferable costs or benefits to the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

6. Regulation 190.16: Delivery

a. Consideration of Costs and Benefits

Proposed § 190.16 would address delivery in the context of a clearing organization bankruptcy. Current part 190 does not contain any regulations specific to delivery in the context of a clearing organization bankruptcy.

Proposed § 190.16(a) would provide that a bankruptcy trustee is be required to use “reasonable efforts” to facilitate and cooperate with the completion of the delivery on behalf of the clearing organization’s clearing member or the clearing member’s customer. This would have the benefits of mitigating disruption to the cash market for the commodity and mitigating adverse consequences to parties that could be relying on delivery taking place in connection with their business operations. While the exertion of such reasonable efforts would necessarily involve administrative costs (predominantly, time of the trustee or their agents), the Commission is of the view that this approach would have important benefits relative to the two alternatives. Given the importance of reliable delivery to physical markets, it would be inappropriate to relieve the trustee of the obligation to endeavor to facilitate and cooperate with the members’ or members’ customers’ efforts to accomplish delivery. On the other hand, mandating that the trustee go beyond reasonable efforts would risk compelling the trustee to expend unwarranted amounts of resources in this endeavor.

Proposed § 190.16(b) would clarify which property would be part of the physical delivery account class and which would be part of the cash delivery account class. It is analogous to proposed § 190.06(b) in the FCM context, and would carry forward the concepts in that section but would be modified for the context of a DCO bankruptcy.

Clearly delineating between the physical delivery account class and the cash delivery account class would benefit customers because it would increase transparency in terms of which account class their property belongs in. Proposed § 190.16(b) could, however, impose administrative costs, since accounting separately for physical delivery property and cash delivery property would take the trustee's time and resources. As noted above,<sup>238</sup> the sub-division of the delivery account class into the physical and cash delivery account classes would recognize that cash is more vulnerable to loss, and more difficult to trace, as compared to physical delivery property. Therefore, such sub-division would be likely to benefit those with physical delivery claims. Since cash is more vulnerable to loss and more difficult to trace, then under the proposal, clearing members and customers in the cash delivery sub-class would be more likely to get a pro rata distribution that would be less than that in the physical delivery property sub-class.<sup>239</sup>

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.16. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

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<sup>238</sup> See discussion of § 190.06(b) in section II.B.4 above.

<sup>239</sup> Costs and benefits of the separation of the delivery account class into physical delivery and cash delivery subclasses were also addressed in respect to the costs and benefits section addressing the definition of "account class" in proposed § 190.01, section II.A.2 above.

7. Regulation 190.17: Calculation of Net Equity

a. Consideration of Costs and Benefits

Proposed § 190.17(a) would clarify that a member of a debtor clearing organization may have claims against the clearing organization in separate capacities: on behalf of its public customers (customer accounts) and on behalf of its non-public customers (house accounts). It further would state that net equity shall be calculated separately for each customer capacity in which the clearing member has a claim against the debtor. In the Commission's view, the provisions in proposed § 190.17(a) would be mere clarifications and would not impose any costs or benefits on any parties.

Proposed § 190.17(b) would provide that the calculation of a clearing member's net equity claim in the bankruptcy of a clearing organization shall include the full application of the debtor's loss allocation rules and procedures, as well as full application of any recoveries made by the estate of the debtor in accordance with the debtor's rules and procedures. These provisions would benefit the estate, as the trustee would (a) have a clear roadmap in calculating net equity in the bankruptcy of a clearing organization and would not be obligated to come up with an ad hoc methodology of doing so, and (b) face reduced likelihood and expected amount of litigation costs arising from challenges to the trustee's choice of methodology. They would also benefit clearing members (and, therefore, their customers) by providing transparency as to how their net equity will be calculated. And in certain cases, where the debtor recovers any funds, application of the debtor's "reverse waterfall" rules would benefit clearing members (and, in certain cases, their customers) by increasing the net equity claims of the entitled clearing members. These provisions could, however, impose costs on clearing members whose net equity

claims may have been greater absent the application of the clearing organization’s loss allocation rules and procedures.

Proposed § 190.17(c) would incorporate by reference the net equity calculations set forth in proposed § 190.08, to the extent applicable.<sup>240</sup>

Proposed § 190.17(d) would set forth a definition of the term “funded balance,” which is taken directly from Bankruptcy Code provisions. Clarifying the meaning of the term “funded balance” in the context of a clearing organization bankruptcy would benefit clearing members, in that they would know ex ante what is and is not included in their funded balance and how such amount is calculated. In addition, proposed § 190.17(d) would incorporate by reference the methodology for calculating funded balance that would be set forth in proposed § 190.08(c).<sup>241</sup>

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.17. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

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<sup>240</sup> For a discussion of the cost and benefit considerations for proposed § 190.08, please see section IV.E.6 above.

<sup>241</sup> For a discussion of the cost and benefit considerations for proposed § 190.08(c), please see section IV.E.6 above.

8. Regulation 190.18: Treatment of Property

a. Consideration of Costs and Benefits

Proposed § 190.18(a) is analogous to proposed § 190.17(a), in that it would provide that property of the debtor clearing organization's estate would be allocated between member property and customer property other than member property in order to satisfy the proprietary and customer claims of clearing members. In the Commission's view, the provisions in proposed § 190.18(a) would be mere clarifications and do not impose any costs or benefits on any parties.

Proposed §§ 190.18(b)(1)(i) and (ii) would set out the scope of customer property for a clearing organization, and would be largely based on proposed § 190.09(a).<sup>242</sup>

Proposed § 190.18(b)(1)(iii) would provide that customer property would include any guaranty fund deposit, assessment or similar payment or deposit made by a clearing member or recovered by a trustee, to the extent any remains following administration of the debtor's default rules and procedures, and any other property of a member available under the debtor's rules and procedures to satisfy claims made by or on behalf of public customers of a member. This provision would support the goal of making customers whole. Specifically, it would benefit clearing members of the debtor, since it clarifies that any property described in this section will be included in the scope of customer property, rather than ultimately going to some other creditor of the debtor. It would result in corresponding costs to non-customer creditors, and could result in administrative costs, however, since the trustee could need to spend time and resources in order to

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<sup>242</sup> For a discussion of the cost and benefit considerations for proposed § 190.09(a), please see section IV.E.7 above.

determine whether any such property exists in order to properly allocate such property to customers.

Proposed § 190.18(b)(2) would incorporate by reference proposed § 190.09(a)(2), as if the term debtor used therein would refer to a clearing organization as debtor and to the extent relevant to a clearing organization.<sup>243</sup>

Proposed § 190.18(c) would set forth the allocation of customer property among customer classes (*i.e.*, allocation between (1) customer property other than member property, and (2) member property). This provision, in general, would set forth the principle, consistent with the statutory preference for public customers over non-public customers embodied in Bankruptcy Code section 766(h), that allocation to customer property other than member property is favored over allocation to member property, so long as the funded balance in any account class for members' public customers is less than one hundred percent of net equity claims. This provision would benefit the public customers of the debtor's clearing members, since it would make clear that allocation to such customers would be preferred over allocation to the clearing members' house accounts. It could impose corresponding costs on the debtor's clearing members and affiliates to the extent that, under the current regime, there would be a possibility that more customer property would be allocated to their house accounts. Overall, this provision would provide the benefit of ex ante transparency to the estate, the debtor's clearing members, and their customers, who would know during business as usual how customer property would be allocated in the event of a bankruptcy.

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<sup>243</sup> For a discussion of the cost and benefit considerations for proposed § 190.09(a)(2), please see section IV.E.7 above.

Proposed § 190.18(d) would set forth the allocation of customer property among account classes. This provision would be similar in concept to proposed § 190.09(c) (and current § 190.08(c)). The Commission is proposing to take an additional step that applies specifically in the context of a clearing organization bankruptcy. Specifically, the Commission is proposing to include a provision that would set forth the allocation of customer property among account classes. This provision would benefit clearing members and their customers, who would have increased transparency, ex ante, into how customer property would be allocated. Prescribing such allocation would, however, impose administrative costs, because the trustee would lose some amount of flexibility in terms of how to allocate customer property between account classes.

Proposed § 190.18(e) would provide that, where the debtor has, prior to the order for relief, kept initial margin for house accounts in accounts without separation by account class, then member property would be considered to be in a single account class. This provision would benefit the estate, because the trustee would not be put to the considerable task of separating in bankruptcy that which was treated as a single account during business-as-usual. The proposed section would also benefit debtor's clearing members, who would have increased transparency as to how their member property would be treated.

Proposed § 190.18(f), which would be the analog to proposed § 190.03(a)(3), would give the trustee the authority to assert claims against any person to recover the shortfall of customer property enumerated in certain paragraphs elsewhere in proposed § 190.18. This provision could impose administrative costs, since the trustee could expend time and resources to assert claims to make up for any shortfall in customer

property. The provision would, however, benefit customers, since it would support the trustee's efforts to recover any such shortfalls and by giving the trustee authority to take action to do so. Moreover, since this provision would make explicit what is implicit in current part 190, an additional benefit of this provision would be reduced litigation costs over a trustee's attempts to recover shortfalls in customer property.<sup>244</sup>

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.18. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

9. Regulation 190.19: Support of Daily Settlement

a. Consideration of Costs and Benefits

Proposed § 190.19, which is new, would deal with the treatment of variation settlement in a clearing organization bankruptcy, and would set forth what to do when there is a shortfall in variation settlement owed to a debtor clearing organization's clearing members and customers. Specifically, proposed § 190.19(a) would provide that any variation settlement payments received by the clearing organization after entry of an order for relief shall be included in customer property, and shall promptly be distributed to the member and customer accounts entitled to such payments. Proposed § 190.19(b) would deal with a situation where there is a shortfall in variation settlement received by

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<sup>244</sup> As discussed above in section IV.E.7, while the persons against whom claims are successfully asserted may perceive a subjective cost, the Commission does not find these costs relevant to the analysis.

the clearing organization, and provides that such funds shall be supplemented in accordance with the clearing organization's default rules and procedures and any recovery and wind-down plans maintained by the clearing organization.

Proposed § 190.19 would benefit clearing members and their customers because it would ensure that any variation settlement received by the clearing organization would be sent to those member and customer accounts that would be entitled to payment of variation settlement, and that the trustee would be able to supplement any shortfall in variation settlement amounts with the property listed in proposed § 190.19(b). There could be corresponding costs to general creditors of the clearing organization since, under current part 190, it would be conceivable that variation settlement received by the clearing organization could be diverted to the pool of general creditors rather than becoming customer property (even though such diversion would be contrary to the expectations of both the Commission and the industry). In clarifying how variation settlement received by the clearing organization is to be treated by the bankruptcy trustee, proposed § 190.19 would also benefit clearing members and their customers by providing enhanced transparency. There could be administrative costs, however, to the extent the trustee would lose some amount of flexibility in terms of how to treat variation settlement received by the clearing organization, and in terms of the time and resources they could need to spend to determine how to make up a shortfall in such settlement funds.

b. Request for Comment

The Commission requests comment on all aspects of its cost and benefit considerations with respect to proposed § 190.19. Are there additional costs or benefits that the Commission should consider? Are there any alternatives that could provide

preferable costs or benefits than the costs and benefits related to the proposed amendments discussed above? Commenters are encouraged to include both qualitative and quantitative assessments of any costs and benefits.

10. Section 15(a) Factors—Subpart C

a. Protection of Market Participants and the Public

Subpart C of the proposed rules would increase the protection of market participants and the public by clearly setting forth how the bankruptcy trustee is expected to treat the property of DCO clearing members and their customers in the event of a DCO insolvency, thereby promoting ex ante transparency for such clearing members and customers. Moreover, the addition in part 190 of bespoke bankruptcy rules for a DCO bankruptcy would provide better protections to market participants by accounting for the unique position of clearing members (and the customers of such clearing member) of a DCO that is going through an insolvency proceeding.

b. Efficiency, Competitiveness, and Financial Integrity

Subpart C of the proposed rules would promote efficiency (in the sense of both cost effectiveness and timeliness) in the administration of insolvency proceedings of DCOs, and the financial integrity of transactions cleared by DCOs by setting forth clear instructions for a bankruptcy trustee to follow in the event of a DCO insolvency. Moreover, subpart C would provide the bankruptcy trustee with discretion, in certain circumstances, to react flexibly to the particulars of the insolvency proceeding, thereby promoting efficiency of the administration of the proceeding. These effects would, in turn, enhance the competitiveness of U.S. DCOs and their FCM clearing members, by

enhancing market confidence in the protection of customer funds and positions entrusted to U.S. DCOs through their clearing members, even in the case of insolvency.

c. Price Discovery

Price discovery is the process of determining the price level for an asset through the interaction of buyers and sellers and based on supply and demand conditions. To the extent that the proposed regulations would mitigate the need for liquidations in conditions of distress, they would avoid the resultant negative impacts on price discovery.

d. Sound Risk Management Practices

Subpart C of the proposed rules would promote sound risk management practices by encouraging the bankruptcy trustee to effectively manage the risk of the debtor DCO. Subpart C would accomplish this by adding bankruptcy rules to part 190 for a DCO insolvency that reflect current market practices and effectively would protect customer property in the event of such an insolvency. Moreover, subpart C would promote sound risk management practices by instructing a bankruptcy trustee to implement the debtor DCO's default rules and procedures and to take actions in accordance with the debtor DCO's recovery and wind-down plans, which rules, procedures and plans are developed and overseen by the Commission.

e. Other Public Interest Considerations

By favoring the implementation of the clearing organization's default rules, recovery plans, and procedures established *ex ante* under the supervision of the Commission, and by supporting daily settlement, the proposed rules would support financial stability. Moreover, some of the DCOs that might enter bankruptcy are very large financial institutions, and some are considered to be systematically important. An

effective bankruptcy process that efficiently facilitates the proceedings is likely to benefit the financial system (and thus the public interest), as that process would help to attenuate the detrimental effects of the bankruptcy on the financial network.

*G. Technical Corrections to Parts 1, 4, and 41*

The Commission is proposing technical corrections to parts 1, 4, and 41 to update cross-references. These corrections and clarifying and do not have any impact on the substantive obligations related to these sections. Thus, there are no costs associated with these minor technical updates.

*H. Antitrust Considerations*

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA in issuing any order or adopting any Commission rule or regulation.<sup>245</sup>

The Commission believes that the public interest to be protected by the antitrust laws is the promotion of competition. The Commission requests comment on whether the proposed rulemaking implicates any other specific public interest to be protected by the antitrust laws. The Commission has considered the proposed rulemaking to determine whether it might have anticompetitive effects. The Commission has not identified any effect on competition of the proposed rulemaking, which would apply only in the rare instance of an FCM or DCO bankruptcy. Accordingly, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA. The Commission requests comment on whether there are less anticompetitive means of

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<sup>245</sup> Section 15(b) of the CEA, 7 U.S.C. 19(b).

achieving the relevant purposes of the CEA that would otherwise be served by adopting the proposed rules.

## **V. Related Matters**

### *A. Regulatory Flexibility Act*

The Regulatory Flexibility Act (“RFA”) requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis on the impact.<sup>246</sup> The regulations proposed by the Commission would affect clearing organizations, FCMs, bankruptcy trustees, and customers. The Commission has previously established certain definitions of “small entities” to be used in evaluating the impact of its regulations in accordance with the RFA.<sup>247</sup>

The Commission has previously determined that clearing organizations and FCMs are not small entities for purposes of the RFA.<sup>248</sup> In the event of a bankruptcy, a trustee is appointed as receiver to manage the estate of the insolvent FCM or clearing organization. Accordingly, since the trustee is representing the estate of either an FCM or clearing organization, the trustee is not a small entity for purposes of the RFA. The Commission recognizes that many customers of an FCM or DCO in bankruptcy could be considered to be small entities for purposes of the RFA. The Commission believes, however, that the amendments to part 190 are designed so that they can be implemented without imposing a significant economic burden on a substantial number of small

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<sup>246</sup> 5 U.S.C. 601 *et seq.*

<sup>247</sup> 47 FR 18618 (Apr. 30, 1982).

<sup>248</sup> *See* 66 FR 45604, 45609 (Aug. 29, 2001); 67 FR 53146, 53171 (Aug. 14, 2002).

entities. The proposed regulations take into account existing trading practices and the logistical considerations of implementing the regulations.

Accordingly, the Commission Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b), that the proposed amendments would not have a significant economic impact on a substantial number of small entities. The Commission invites public comments on this determination.

*B. Paperwork Reduction Act*

The Paperwork Reduction Act (“PRA”) provides that Federal agencies, including the Commission, may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number from the Office of Management and Budget (“OMB”).<sup>249</sup> This proposed rulemaking contains reporting requirements that are collections of information within the meaning of the PRA and for which the Commission has previously received a control number from OMB: OMB Control Number 3038-0021 (Regulations Governing Bankruptcies of Commodity Brokers).

Information Collection 3038-0021<sup>250</sup> contains the reporting, recordkeeping and third-party disclosure requirements in the Commission’s bankruptcy regulations for

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<sup>249</sup> 44 U.S.C. 3501 *et seq.*

<sup>250</sup> There are two information collections associated with OMB Control No. 3038-0021. The first includes the reporting, recordkeeping, and third-party disclosure requirements applicable to a single respondent in a commodity broker liquidation (*e.g.*, a single FCM, DCO, or trustee) within the relevant time period. This includes both (1) proposed requirements on a single FCM or a single trustee in an FCM bankruptcy which correspond to current requirements on a single FCM or a single trustee in an FCM bankruptcy, as provided for in proposed §§ 190.03(b)(1), 190.03(b)(2), 190.03(c)(1), 190.03(c)(2), 190.03(c)(4), 190.05(b), 190.05(d), and 190.07(b)(5); and (2) new requirements on a single DCO or a single trustee in a DCO bankruptcy as provided for in proposed §§ 190.12(a)(2), 190.12(b)(1), 190.12(b)(2), 190.12(c)(1), 190.12(c)(2), 190.14(a), and 190.14(d). The second information collection includes the third-party disclosure requirements that are applicable during business as usual to multiple respondents (*e.g.*, multiple FCMs), as provided for in proposed §§ 190.10(b) and 190.10(e) (which are analogs to current §§ 190.06(d)

commodity broker liquidations (17 C.F.R. part 190). These regulations apply to liquidations under chapter 7, subchapter IV of the Bankruptcy Code.<sup>251</sup> The Commission promulgated part 190 pursuant to the authority of 7 U.S.C. 24. The Commission is proposing to amend Information Collection 3038-0021 to (1) accommodate new information collection requirements for FCMs and DCOs as a result of this proposal, and (2) revise the existing information collection requirements for FCMs and DCOs as a result of this proposal.

The Commission therefore is submitting this proposal to the OMB for its review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. Responses to this collection of information would be mandatory. The Commission will protect proprietary information according to the FOIA and 17 CFR 145, “Commission Records and Information.” In addition, section 8(a)(1) of the CEA strictly prohibits the Commission, unless specifically authorized by the CEA, from making public data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers.<sup>252</sup> The Commission is also required to protect certain information contained in a government system of records according to the Privacy Act of 1974.<sup>253</sup>

The information collection requirements of proposed part 190 are necessary and will be used to facilitate the effective, efficient and fair conduct of liquidation proceedings for FCMs and DCOs and to protect the interests of customers in these

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and 190.10(c)), as well as new a third-party disclosure requirement provided for in proposed § 190.10(d) (regarding letters of credit).

<sup>251</sup> 11 U.S.C. 761 *et seq.*

<sup>252</sup> 7 U.S.C. 12(a)(1).

<sup>253</sup> 5 U.S.C. 552a.

proceedings both directly and by facilitating the participation of the Commission in such proceedings. The estimates below reflect estimated burden hours per information collection requirement; the Commission has not identified any start-up, operational or maintenance costs associated with the information collection requirements set forth below. The Commission requests comment on all aspects of its PRA analysis.

1. Reporting Requirements in an FCM Bankruptcy

Proposed § 190.03(b)(1) would require FCMs that file a petition in bankruptcy to notify the Commission and the relevant DSRO, as soon as practicable before and in any event no later than the time of such filing, of the anticipated or actual filing date, the court in which the proceeding will be or has been filed and, as soon as known, the docket number assigned to that proceeding. It would further require an FCM against which an involuntary bankruptcy petition or application for a protective decree under SIPA is filed to notify the Commission and the relevant DSRO immediately upon the filing of such petition or application.

Proposed § 190.03(b)(2) would require the trustee, the relevant DSRO, or an applicable clearing organization to notify the Commission if such person intends to transfer or apply to transfer open commodity contracts or customer property on behalf of the public customers of the debtor.

Based on its experience, the Commission anticipates that an FCM bankruptcy would occur once every three years.<sup>254</sup> The Commission has estimated the burden hours for the reporting requirements in an FCM bankruptcy as follows:

*Estimated number of respondents: 1.*

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<sup>254</sup> These estimates express the burdens in terms of those that would be imposed on one respondent during the three-year period.

*Estimated annual number of responses per respondent: 1.*<sup>255</sup>

*Estimated total annual number of responses for all respondents: 1.*

*Estimated annual number of burden hours per respondent: 1.*<sup>256</sup>

*Estimated total annual burden hours for all respondents: 1.*

## 2. Recordkeeping Requirements in an FCM Bankruptcy

Proposed § 190.05(b) would require the trustee to use reasonable efforts to compute a funded balance for each customer account that contains open commodity contracts or other property as of the close of business each business day subsequent to the order for relief until the date all open commodity contracts and other property in such account has been transferred or liquidated.

Proposed § 190.05(d) would require the trustee to use reasonable efforts to continue to issue account statements with respect to any customer for whose account open commodity contracts or other property is held that has not been liquidated or transferred.

Based on its experience, the Commission anticipates that an FCM bankruptcy would occur once every three years.<sup>257</sup> The Commission has estimated the burden hours for the recordkeeping requirements in an FCM bankruptcy as follows:

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<sup>255</sup> The Commission estimates that (1) under proposed § 190.03(b)(1), an FCM would make two notifications per bankruptcy (one to the Commission and one to its DSRO), and (2) under proposed § 190.03(b)(2), an FCM would make one notification per bankruptcy. Dividing those numbers by three (since the Commission anticipates an FCM bankruptcy occurring once every three years) results in 0.67 notifications annually pursuant to proposed § 190.03(b)(1), and 0.33 notifications annually pursuant to proposed § 190.03(b)(2), for a total of one notification annually per respondent.

<sup>256</sup> The Commission estimates that (1) the notifications required under proposed § 190.03(b)(1) would take 0.5 hours to make, and (2) the notification required under proposed § 190.03(b)(2) would take 2 hours to make. In terms of burden hours, this amounts to (0.5\*0.67 under proposed § 190.03(b)(1)) plus (2\*0.33 under proposed § 190.03(b)(2)), or a total of one burden hour annually per respondent.

<sup>257</sup> These estimates express the burdens in terms of those that would be imposed on *one* respondent during the three-year period.

*Estimated number of respondents: 1.*

*Estimated annual number of responses per respondent: 26,666.67.<sup>258</sup>*

*Estimated total annual number of responses for all respondents: 26,666.67.*

*Estimated annual number of burden hours per respondent: 266.67.<sup>259</sup>*

*Estimated total annual burden hours for all respondents: 266.67.*

### 3. Third-Party Disclosure Requirements Applicable to a Single Respondent in an FCM Bankruptcy

Proposed § 190.03(c)(1) would require the trustee to use all reasonable efforts to promptly notify any customer whose futures account, foreign futures account, or cleared swaps account includes specifically identifiable property, and that such specifically identifiable property may be liquidated on and after the seventh day after the order for relief if the customer has not instructed the trustee in writing before the deadline specified in the notice to return such property pursuant to the terms for distribution of customer property contained in proposed part 190.

Proposed § 190.03(c)(2) would allow the trustee to treat open commodity contracts of public customers identified on the books and records of the debtor has held

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<sup>258</sup> The Commission estimates that (1) under proposed § 190.05(b), a trustee would compute a funded balance for customer accounts 40,000 times; and (2) under proposed § 190.05(d), a trustee would issue 40,000 account statements for customer accounts. Dividing those numbers by three (since the Commission anticipates an FCM bankruptcy occurring once every three years) results in 13,333.33 records annually pursuant to proposed § 190.05(b), and 13,333.33 records annually pursuant to proposed § 190.05(d), for a total of 26,666.67 records annually per respondent.

<sup>259</sup> The Commission estimates that the each record required under proposed §§ 190.05(b) and 190.05(d) would take 0.01 hours to prepare. In terms of burden hours, this amounts to (0.01\*13,333.33 under proposed § 190.05(b)) plus (0.01\*13,333.33 under proposed § 190.05(d)), or a total of 266.67 burden hours annually per respondent.

in an account designated as a hedging account as specifically identifiable property of such customer.<sup>260</sup>

Proposed § 190.03(c)(4) would require the trustee to promptly notify each customer that an order for relief has been entered and instruct each customer to file a proof of customer claim containing the information specified in proposed § 190.03(e).

Proposed § 190.07(b)(5) would, in the event that specifically identifiable property has been or will be transferred, require the trustee to transmit any customer instructions previously received by the trustee with respect to such specifically identifiable property to the transferee of such property.

Based on its experience, the Commission anticipates that an FCM bankruptcy would occur once every three years.<sup>261</sup> The Commission has estimated the burden hours for the third-party disclosure requirements applicable to a single respondent in an FCM bankruptcy as follows:

*Estimated number of respondents:* 1.

*Estimated annual number of responses per respondent:* 10,003.32.<sup>262</sup>

*Estimated total annual number of responses for all respondents:* 10,003.32.

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<sup>260</sup> The Commission no longer assigns burden hours to the discretionary notice that a trustee may provide to customers in an involuntary FCM bankruptcy proceeding pursuant to proposed § 190.03(c)(3). There have been no involuntary FCM liquidations and none are anticipated. Accordingly, continuing to assign burden hours to this voluntary requirement would inappropriately inflate the burden hours of this information collection.

<sup>261</sup> These estimates express the burdens in terms of those that would be imposed on *one* respondent during the three-year period.

<sup>262</sup> The Commission estimates that a trustee would make the required disclosures under each of proposed §§ 190.03(c)(1), 190.03(c)(2) and 190.03(c)(4) 10,000 times per bankruptcy. Dividing those numbers by three (since the Commission anticipates an FCM bankruptcy occurring once every three years) results in 3,333.33 disclosures annually pursuant to each of proposed §§ 190.03(c)(1), 190.03(c)(2), and 190.03(c)(4). The Commission further estimates that a trustee would make the required disclosure under proposed § 190.07(b)(5) 10 times per bankruptcy. Dividing this number by three results in 3.33 disclosures annually pursuant to proposed § 190.07(b)(5). This amounts to a total of 10,003.32 disclosures annually per respondent.

*Estimated annual number of burden hours per respondent: 1,336.67.<sup>263</sup>*

*Estimated total annual burden hours for all respondents: 1,336.67.*

#### 4. Reporting Requirements in a DCO Bankruptcy

Proposed § 190.12(a)(2) would require a clearing organization that files a petition in bankruptcy to notify the Commission, at or before the time of such filing, of the filing date, the court in which the proceeding will be or has been filed and, as soon as known, the docket number assigned to that proceeding. It further would require clearing organization against which an involuntary bankruptcy petition is filed to similarly notify the Commission within three hours after the receipt of notice of such filing.

Proposed § 190.12(b)(1) would require the debtor clearing organization to provide to the trustee, no later than three hours following the later of the commencement of a bankruptcy proceeding or the appointment of the trustee, copies of each of the most recent reports that the debtor was required to file with the Commission under § 39.19(c).

Proposed § 190.12(b)(2) would require the debtor clearing organization to provide to the trustee and the Commission, no later than three hours following the commencement of a bankruptcy proceeding, copies of (1) the most recent recovery or wind-down plans of the debtor maintained pursuant to § 39.39(b) and (2) the most recent version of the debtor's default management plan and default rules and procedures maintained pursuant to § 39.16 and, as applicable, § 39.35.

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<sup>263</sup> The Commission estimates that (1) each disclosure required under proposed §§ 190.03(c)(1) and 190.03(c)(2) (b) would take 0.1 hours to prepare; (2) each disclosure required under proposed § 190.03(c)(4) would take 0.2 hours to prepare; and (3) each disclosure required under proposed § 190.07(b)(5) would take 1 hour to prepare. In terms of burden hours, this amounts to (0.1\*3,333.33 under proposed § 190.03(c)(1)) plus (0.1\*3,333.33 under proposed § 190.03(c)(2)) plus (0.2\*3,333.33 under proposed § 190.03(c)(4)) plus (1\*3.33 under proposed § 190.07(b)(5)), or a total of 1336.67 burden hours annually per respondent.

Proposed §§ 190.12(c)(1) and (c)(2) would require the debtor clearing organization to make available to the trustee and the Commission, no later than the next business day following commencement of a bankruptcy proceeding, copies of (1) all records maintained by the debtor pursuant to § 39.20(a), and (2) any opinions of counsel or other legal memoranda provided to the debtor in the five years preceding the bankruptcy proceeding relating to the enforceability of the rules and procedures of the debtor in the event of an insolvency proceeding involving the debtor.

Based on its experience, the Commission anticipates that a clearing organization bankruptcy would occur once every fifty years.<sup>264</sup> The Commission has estimated the burden hours for the reporting requirements in a DCO bankruptcy as follows:

*Estimated number of respondents: 1.*

*Estimated annual number of responses per respondent: 2.98.<sup>265</sup>*

*Estimated total annual number of responses for all respondents: 2.98.*

*Estimated annual number of burden hours per respondent: 0.61.<sup>266</sup>*

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<sup>264</sup> No U.S. clearing organization has ever been the subject of a bankruptcy proceeding, and none has come anywhere near insolvency. While there have been less than a handful of central counterparties worldwide that became functionally insolvent during the twentieth century, none of those were subject to modern resiliency requirements. Accordingly, the Commission believes that an estimate of one DCO bankruptcy every fifty years is an appropriate estimate. These burden estimates express the burdens in terms of those that would be imposed on *one* respondent during the fifty-year period.

<sup>265</sup> The Commission estimates that (1) under proposed § 190.12(a)(2), a clearing organization would make two notifications per bankruptcy; (2) under proposed § 190.12(b)(1), a clearing organization would provide 40 reports to the trustee; (3) under proposed § 190.12(b)(2), a clearing organization would provide 5 reports to the trustee and the Commission; (4) under proposed § 190.12(c)(1), a clearing organization would provide 100 records to the trustee and the Commission; and (5) under proposed § 190.12(c)(2), a clearing organization would provide 2 records to the trustee and the Commission. Dividing those numbers by 50 (since the Commission anticipates a clearing organization bankruptcy occurring once every 50 years) results in (1) 0.04 reports annually pursuant to proposed § 190.12(a)(2); (2) 0.8 reports annually pursuant to proposed § 190.12(b)(1); (3) 0.1 reports annually pursuant to proposed § 190.12(b)(2); (4) 2 reports annually pursuant to proposed § 190.12(c)(1); and (5) 0.04 reports annually pursuant to proposed § 190.12(c)(2). This amounts to a total of 2.98 reports annually per respondent.

<sup>266</sup> The Commission estimates that (1) each notification required under proposed § 190.12(a)(2) would take 0.5 hours to make; (2) gathering the reports required under proposed § 190.12(b)(1) would take 0.2 hours; (3) gathering the reports required under proposed § 190.12(b)(2) would take 0.2 hours; (4) gathering the

*Estimated total annual burden hours for all respondents: 0.61.*

5. Recordkeeping Requirements in a DCO Bankruptcy

Proposed § 190.14(d) would require the trustee to use reasonable efforts to compute a funded balance for each customer account that contains open commodity contracts or other property as of the close of business each business day subsequent to the order for relief on which liquidation of property within the account has been completed or immediately prior to any distribution of property within the account.

Based on its experience, the Commission anticipates that a clearing organization bankruptcy would occur once every fifty years.<sup>267</sup> The Commission has estimated the burden hours for the recordkeeping requirements in a DCO bankruptcy as follows:

*Estimated number of respondents: 1.*

*Estimated annual number of responses per respondent: 9.<sup>268</sup>*

*Estimated total annual number of responses for all respondents: 9.*

*Estimated annual number of burden hours per respondent: 0.9.<sup>269</sup>*

*Estimated total annual burden hours for all respondents: 0.9.*

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reports required under proposed § 190.12(c)(1) would take 0.2 hours; and (5) gathering the reports required under proposed § 190.12(c)(2) would take 0.2 hours. In terms of burden hours, this amounts to  $(0.5 \times 0.04)$  under proposed § 190.12(a)(2)) plus  $(0.2 \times 0.8)$  under proposed § 190.12(b)(1)) plus  $(0.2 \times 0.1)$  under proposed § 190.12(b)(2)) plus  $(0.2 \times 2)$  under proposed § 190.12(c)(1)) plus  $(0.2 \times 0.04)$  under proposed § 190.12(c)(2)), or a total of 0.61 burden hours annually per respondent.

<sup>267</sup> These estimates express the burdens in terms of those that would be imposed on *one* respondent during the fifty-year period.

<sup>268</sup> The Commission estimates that, under proposed § 190.14(d), a clearing organization would compute a funded balance for customer accounts 450 times during a bankruptcy. This number is based on an average of 45 clearing members, each with two accounts (house and customer). Dividing that number by 50 (since the Commission anticipates a clearing organization bankruptcy occurring once every 50 years) results in 9 records annually per respondent.

<sup>269</sup> The Commission estimates that computing the funded balance of customer accounts pursuant to proposed § 190.14(d) would take 0.1 hours per computation. In terms of burden hours, this amounts to  $(0.1 \times 9)$ , or 0.9 burden hours annually per respondent.

6. Third-Party Disclosure Requirements Applicable to a Single Respondent in a DCO Bankruptcy

Proposed § 190.14(a) would allow the trustee, in their discretion based upon the facts and circumstances of the case, to instruct each customer to file a proof of claim containing such information as is deemed appropriate by the trustee, and seek a court order establishing a bar date for the filing of such proofs of claim.

Based on its experience, the Commission anticipates that a clearing organization bankruptcy would occur once every fifty years.<sup>270</sup> The Commission has estimated the burden hours for the third-party disclosure requirements applicable to a single respondent in a DCO bankruptcy as follows:

*Estimated number of respondents: 1.*

*Estimated annual number of responses per respondent: 0.9.<sup>271</sup>*

*Estimated total annual number of responses for all respondents: 0.9.*

*Estimated annual number of burden hours per respondent: 0.18.<sup>272</sup>*

*Estimated total annual burden hours for all respondents: 0.18.*

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<sup>270</sup> These estimates express the burdens in terms of those that would be imposed on *one* respondent during the fifty-year period.

<sup>271</sup> The Commission estimates that, under proposed § 190.14(a), a trustee would make the disclosure 45 times during a bankruptcy. This number is based on an average of 45 clearing members. Dividing that number by 50 (since the Commission anticipates a clearing organization bankruptcy occurring once every 50 years) results in 0.9 records annually per respondent.

<sup>272</sup> The Commission estimates that instructing customers to file a proof of claim pursuant to proposed § 190.14(a) would take 0.2 hours. In terms of burden hours, this amounts to (0.2\*0.9), or 0.18 burden hours annually per respondent.

7. Third-Party Disclosure Requirements Applicable to Multiple Respondents During Business as Usual

Proposed § 190.10(b) would require an FCM to provide an opportunity to each of its customers, upon first opening a futures account or cleared swaps account with such FCM, to designate such account as a hedging account.

Proposed § 190.10(d) would prohibit an FCM from accepting a letter of credit as collateral unless such letter of credit may be exercised under certain conditions specified in the proposed regulation.

Proposed § 190.10(e) would require an FCM to provide any customer with the disclosure statement set forth in proposed § 190.10(e) prior to accepting property other than cash from or for the account of a customer to margin, guarantee, or secure a commodity contract.

The requirements described above are applicable on a regular basis (i.e., during business as usual) to multiple respondents. The Commission has estimated the burden hours for the third-party disclosure requirements applicable to multiple respondents during business as usual as follows:

*Estimated number of respondents: 125.*

*Estimated annual number of responses per respondent: 3,000.<sup>273</sup>*

*Estimated total annual number of responses for all respondents: 375,000.*

*Estimated annual number of burden hours per respondent: 60.<sup>274</sup>*

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<sup>273</sup> The Commission estimates that under proposed §§ 190.10(b), 190.10(d) and 190.10(e), an FCM would make the required disclosures 1,000 times per year. This amounts to a total of 3,000 responses annually per respondent.

<sup>274</sup> The Commission estimates that each disclosure required under §§ 190.10(b), 190.10(d) and 190.10(e) would take 0.02 hours to make. In terms of burden hours, this amounts to (0.02\*1,000) under proposed

*Estimated total annual burden hours for all respondents: 7,500.*

8. Request for Comment

The Commission invites the public and other Federal agencies to comment on any aspect of the proposed information collection requirements discussed above. The Commission will consider public comments on this proposed collection of information regarding:

- evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;
- evaluating the accuracy of the estimated burden of the proposed collection of information, including the degree to which the methodology and the assumptions that the Commission employed were valid;
- enhancing the quality, utility, and clarity of the information proposed to be collected; and
- reducing the burden of the proposed information collection requirements on registered entities, including through the use of appropriate automated, electronic, mechanical, or other technological information collection techniques, e.g., permitting electronic submission of responses.

Copies of the submission from the Commission to OMB are available from the CFTC Clearance Officer, 1155 21st Street, NW, Washington, DC 20581, (202) 418-5160 or from <http://RegInfo.gov>. Organizations and individuals desiring to submit comments on the proposed information collection requirements should send those comments to:

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§ 190.10(b)) plus (0.02\*1,000 under proposed § 190.10(d)) plus (0.02\*1,000 under proposed § 190.10(e)), or a60 burden hours annually per respondent.

- The Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, Attn:

Desk Officer for the Commodity Futures Trading Commission;

- (202) 395–6566 (fax); or
- *OIRAsubmissions@omb.eop.gov* (email).

## **List of Subjects**

### **17 CFR Part 1**

Brokers, Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

### **17 CFR Part 4**

Brokers, Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

### **17 CFR Part 41**

Brokers, Reporting and recordkeeping requirements, Securities.

### **17 CFR Part 190**

Bankruptcy, Brokers, Reporting and recordkeeping requirements.

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR chapter I as follows:

## **PART 1 – GENERAL REGULATIONS UNDER THE COMMODITY**

### **EXCHANGE ACT**

1. The authority citation for part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a-1, 7a-2, 7b, 7b-3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24 (2012).

2. In § 1.25, revise paragraph (a)(2)(ii)(B) to read as follows:

**§ 1.25 Investment of customer funds.**

(a) \* \* \*

(2) \* \* \*

(ii) \* \* \*

(B) Securities subject to such repurchase agreements must not be “specifically identifiable property” as defined in § 190.01 of this chapter.

\* \* \* \* \*

3. In § 1.55, revise paragraphs (d) and (f) to read as follows:

**§ 1.55 Public disclosures by futures commission merchants.**

\* \* \* \* \*

(d) Any futures commission merchant, or (in the case of an introduced account) any introducing broker, may open a commodity futures account for a customer without obtaining the separate acknowledgments of disclosure and elections required by this section and by § 1.33(g) and § 33.7 of this chapter, provided that:

(1) Prior to the opening of such account, the futures commission merchant or introducing broker obtains an acknowledgement from the customer, which may consist of a single signature at the end of the futures commission merchant’s or introducing broker’s customer account agreement, or on a separate page, of the disclosure statements, consents and elections specified in this section and § 1.33(g), and in §§ 33.7, 155.3(b)(2), and 155.4(b)(2) of this chapter, and which may include authorization for the transfer of funds from a segregated customer account to another account of such customer, as listed directly above the signature line, provided the customer has acknowledged by check or

other indication next to a description of each specified disclosure statement, consent or election that the customer has received and understood such disclosure statement or made such consent or election; and

(2) The acknowledgment referred to in paragraph (d)(1) of this section is accompanied by and executed contemporaneously with delivery of the disclosures and elective provisions required by this section and § 1.33(g), and by § 33.7 of this chapter.

\* \* \* \* \*

(f) A futures commission merchant or, in the case of an introduced account, an introducing broker, may open a commodity futures account for an “institutional customer” as defined in § 1.3 without furnishing such institutional customer the disclosure statements or obtaining the acknowledgments required under paragraph (a) of this section, or §§ 1.33(g) and 1.65(a)(3), and §§ 30.6(a), 33.7(a), 155.3(b)(2), 155.4(b)(2), and 190.10(e) of this chapter.

\* \* \* \* \*

4. In § 1.65, revise paragraphs (a)(3) introductory text and (a)(3)(iii) to read as follows:

**§ 1.65 Notice of bulk transfers and disclosure obligations to customers.**

(a) \* \* \*

(3) Where customer accounts are transferred to a futures commission merchant or introducing broker, other than at the customer’s request, the transferee introducing broker or futures commission merchant must provide each customer whose account is transferred with the risk disclosure statements and acknowledgments required by § 1.55 (domestic futures and foreign futures and options trading), and §§ 33.7 (domestic

exchange-traded commodity options) and 190.10(e) (non-cash margin—to be furnished by futures commission merchants only) of this chapter and receive the required acknowledgments within sixty days of the transfer of accounts. This requirement shall not apply:

\* \* \* \* \*

(iii) If the transfer of accounts is made from one introducing broker to another introducing broker guaranteed by the same futures commission merchant pursuant to a guarantee agreement in accordance with the requirements of § 1.10(j) and such futures commission merchant maintains the relevant acknowledgments required by § 1.55(a)(1)(ii) and § 33.7(a)(1)(ii) of this chapter and can establish compliance with § 190.10(e) of this chapter.

\* \* \* \* \*

**PART 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS**

5. The authority citation for part 4 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6(c), 6b, 6c, 6l, 6m, 6n, 6o, 12a, and 23.

6. In § 4.5, revise paragraph (c)(2)(iii)(A) to read as follows:

**§ 4.5 Exclusion for certain otherwise regulated persons from the definition of the term “commodity pool operator.”**

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(iii) \* \* \*

(A) Will use commodity futures or commodity options contracts, or swaps solely for bona fide hedging purposes within the meaning and intent of the definition of bona fide hedging transactions and positions for excluded commodities in §§ 1.3 and 151.5 of this chapter; Provided however, That, in addition, with respect to positions in commodity futures or commodity options contracts, or swaps which do not come within the meaning and intent of the definition of bona fide hedging transactions and positions for excluded commodities in §§ 1.3 and 151.5 of this chapter, a qualifying entity may represent that the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; and, Provided further, That in the case of an option that is in-the-money at the time of the purchase, the in-the-money amount as defined in § 190.01 of this chapter may be excluded in computing such five percent; or

\* \* \* \* \*

7. In § 4.12, revise paragraph (b)(1)(i)(C) to read as follows:

**§ 4.12 Exemption from provisions of part 4.**

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(i) \* \* \*

(C) Will not enter into commodity interest transactions for which the aggregate initial margin and premiums, and required minimum security deposit for retail forex transactions (as defined in § 5.1(m) of this chapter) exceed 10 percent of the fair market

value of the pool's assets, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; *Provided, however,* That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01 of this chapter may be excluded in computing such 10 percent; and

\* \* \* \* \*

8. In § 4.13, revise paragraph (a)(3)(ii)(A) to read as follows:

**§ 4.13 Exemption from registration as a commodity pool operator.**

\* \* \* \* \*

(a) \* \* \*

(3) \* \* \*

(ii) \* \* \*

(A) The aggregate initial margin, premiums, and required minimum security deposit for retail forex transactions (as defined in § 5.1(m) of this chapter) required to establish such positions, determined at the time the most recent position was established, will not exceed 5 percent of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into; *Provided,* That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01 of this chapter may be excluded in computing such 5 percent; or

\* \* \* \* \*

**PART 41 – SECURITY FUTURES PRODUCTS**

9. The authority citation for part 41 continues to read as follows:

Authority: Sections 206, 251 and 252, Pub. L. 106-554, 114 Stat. 2763, 7 U.S.C. 1a, 2, 6f, 6j, 7a-2, 12a; 15 U.S.C. 78g(c)(2).

10. In § 41.41, revise paragraph (d) to read as follows:

**§ 41.41 Security futures products accounts.**

\* \* \* \* \*

(d) *Recordkeeping requirements.* The Commission's recordkeeping rules set forth in §§ 1.31, 1.32, 1.35, 1.36, 1.37, 4.23, 4.33, and 18.05 of this chapter shall apply to security futures product transactions and positions in a futures account (as that term is defined in § 1.3 of this chapter). These rules shall not apply to security futures product transactions and positions in a securities account (as that term is defined in § 1.3 of this chapter); provided, that the SEC's recordkeeping rules apply to those transactions and positions.

\* \* \* \* \*

11. Revise part 190 to read as follows:

**PART 190 – BANKRUPTCY RULES**

**Subpart A – General Provisions**

Sec.

- 190.00 Statutory authority, organization, core concepts, scope, and construction.
- 190.01 Definitions.
- 190.02 General.

**Subpart B – Futures Commission Merchant as Debtor**

Sec.

- 190.03 Notices and proofs of claims.
- 190.04 Operation of the debtor's estate—customer property.
- 190.05 Operation of the debtor's estate—general.
- 190.06 Making and taking delivery under commodity contracts.
- 190.07 Transfers.
- 190.08 Calculation of allowed net equity.
- 190.09 Allocation of property and allowance of claims.
- 190.10 Provisions applicable to futures commission merchants during business as usual.

## **Subpart C – Clearing Organization as Debtor**

Sec.

190.11 Scope and purpose of subpart C.

190.12 Required reports and records.

190.13 Prohibition on avoidance of transfers.

190.14 Operation of the estate of the debtor subsequent to the filing date.

190.15 Recovery and wind-down plans; default rules and procedures.

190.16 Delivery.

190.17 Calculation of net equity.

190.18 Treatment of property.

190.19 Support of daily settlement.

Appendix A to Part 190 – Customer Proof of Claim Form

Appendix B to Part 190 – Special Bankruptcy Distributions

Authority: 7 U.S.C. 1a, 2, 6c, 6d, 6g, 7a-1, 12, 12a, 19, and 24; 11 U.S.C. 362, 546, 548, 556, and 761-767, unless otherwise noted.

## **Subpart A – General Provisions**

### **§ 190.00 Statutory authority, organization, core concepts, scope, and construction.**

(a) *Statutory authority.* The Commission has adopted the regulations in this part pursuant to its authority under sections 8a(5) and 20 of the Act. Section 8a(5) provides general rulemaking authority to effectuate the provisions and accomplish the purposes of the Act. Section 20 provides that the Commission may, notwithstanding title 11 of the United States Code, adopt certain rules or regulations governing a proceeding involving a commodity broker that is a debtor under subchapter IV of chapter 7 of the Bankruptcy Code. Specifically, the Commission is authorized to adopt rules or regulations specifying—

(1) That certain cash, securities or other property, or commodity contracts, are to be included in or excluded from customer property or member property;

(2) That certain cash, securities or other property, or commodity contracts, are to be specifically identifiable to a particular customer in a particular capacity;

(3) The method by which the business of the commodity broker is to be conducted or liquidated after the date of the filing of the petition under chapter 7 of the Bankruptcy Code, including the payment and allocation of margin with respect to commodity contracts not specifically identifiable to a particular customer pending their orderly liquidation;

(4) Any persons to which customer property and commodity contracts may be transferred under section 766 of the Bankruptcy Code; and

(5) How a customer's net equity is to be determined.

(b) *Organization.* This part is organized into three subparts. Subpart A contains general provisions applicable in all cases. Subpart B contains provisions that apply when the debtor is a futures commission merchant (as that term is defined in the Act or Commission regulations). This includes acting as a foreign futures commission merchant, as defined in section 761(12) of the Bankruptcy Code, but excludes a person that is "notice-registered" as a futures commission merchant pursuant to section 4f(a)(2) of the Act. Subpart C contains provisions that apply when the debtor is registered as a derivatives clearing organization under the Act.

(c) *Core concepts.* The regulations in this part reflect several core concepts. The following descriptions of core concepts in this paragraph are subject to the further specific requirements set forth in this part, and the specific requirements in this part should be interpreted and applied consistently with these core concepts.

(1) *Commodity brokers.* Subchapter IV of chapter 7 of the Bankruptcy Code applies to a debtor that is a commodity broker, against which a customer holds a "net

equity” claim relating to a commodity contract. This part is limited to a commodity broker that is—

(i) A futures commission merchant, or

(ii) A derivatives clearing organization registered under the Act and Commission regulation promulgated thereunder.

(2) *Account classes.* The Act and Commission regulations provide differing treatment and protections for different types of cleared commodity contracts. This part establishes three account classes that correspond to the different types of accounts that futures commission merchants and clearing organizations are required to maintain under Commission regulations, specifically, the futures account class (including options on futures), the foreign futures account class (including options on foreign futures) and the cleared swaps account class (including cleared options other than options on futures or foreign futures). This part also establishes a fourth account class, the delivery account class (which may be further subdivided as provided in this part), for property held in an account designated within the books and records of the debtor as a delivery account, for effecting delivery under commodity contracts whose terms require settlement via delivery when the commodity contract is held to expiration or, in the case of a cleared option, is exercised.

(3) *Public customers and non-public customers; Commission segregation requirements; member property—(i) Public customers and non-public customers.* This part prescribes separate treatment of “public customers” and “non-public customers” (as these terms are defined in § 190.01) within each account class in the event of a proceeding under this part in which the debtor is a futures commission merchant. Public

customers of a debtor futures commission merchant are entitled to a priority in the distribution of cash, securities or other customer property over non-public customers, and both have priority over all other claimants (except for claims relating to the administration of customer property) pursuant to section 766(h) of the Bankruptcy code.

(A) The cash, securities or other property held on behalf of the public customers of a futures commission merchant in the futures, foreign futures or cleared swaps account classes are subject to special segregation requirements imposed under Commission regulations for each account class. Although such segregation requirements generally are not applicable to cash, securities or other property received from or reflected in the futures, foreign futures or cleared swaps accounts of non-public customers of a futures commission merchant, such transactions and property are customer property within the scope of this part.

(B) While Commission regulations do not impose special segregation requirements with respect to treatment of cash, securities or other property of public customers carried in a delivery account, such property does constitute customer property. Thus, the distinction between public and non-public customers is, given the priority for public customers in section 766(h) of the Bankruptcy code, relevant for the purpose of making distributions to delivery account class customers pursuant to this part.

(ii) *Clearing organization bankruptcies: member property and customer property other than member property.* In the event of a proceeding under this part in which the debtor is a clearing organization, the classification of customers as public customers or non-public customers also is relevant, in that each member of the clearing organization

will have separate claims against the clearing organization (by account class) with respect to—

(A) Commodity contract transactions cleared for its own account or on behalf of any of its non-public customers (which are cleared in a “house account” at the clearing organization), and

(B) Commodity contract transactions cleared on behalf of any public customers of the clearing member (which are cleared in accounts at the clearing organization that is separate and distinct from house accounts). Thus, for a clearing organization, “customer property” is divided into “member property” and “customer property other than member property.” The term member property is used to identify the cash, securities or property available to pay the net equity claims of clearing members based on their house account at the clearing organization.

(iii) *Preferential assignment among customer classes and account classes for clearing organization bankruptcies.* Section 190.18 is designed to support the interests of public customers of members of a debtor that is a clearing organization.

(A) Certain customer property is preferentially assigned to “customer property other than member property” instead of “member property” to the extent that there is a shortfall in funded balances for members’ public customer claims. Moreover, to the extent that there are excess funded balances for members’ claims in any customer class/account class combination, that excess is also preferentially assigned to “customer property other than member property” to the extent of any shortfall in funded balances for members’ public customer claims.

(B) Where property is assigned to a particular customer class with more than one account class, it is assigned to the account class for which the funded balance percentage is the lowest until there are two account classes with equal funded balance percentages, then to both such account classes, keeping the funded balance percentage the same, and so forth following the analogous approach if the debtor has more than two account classes within the relevant customer class.

(4) *Porting of public customer commodity contract positions.* In a proceeding in which the debtor is a futures commission merchant, this part sets out a policy preference for transferring to another futures commission merchant, or “porting,” open commodity contract positions of the debtor’s public customers along with all or a portion of such customers’ account equity. Porting mitigates risks to both the customers of the debtor futures commission merchant and to the markets. To facilitate porting, this part addresses the manner in which the debtor’s business is to be conducted on and after the filing date, with specific provisions addressing the collection and payment of margin for open commodity contract positions prior to porting.

(5) *Pro rata distribution.* (i) The commodity broker provisions of the Bankruptcy Code, subchapter IV of Chapter 7, in particular section 766(h), have long revolved around the principle of pro rata distribution. If there is a shortfall in the cash, securities or other property in a particular account class needed to satisfy the net equity claims of public customers in that account class, the customer property in that account class will be distributed pro rata to those public customers (subject to appendix B of this part). Any customer property not attributable to a specific account class, or that exceeds the amount needed to pay allowed customer net equity claims in a particular account class, will be

distributed to public customers in other account classes so long as there is a shortfall in those other classes. Non-public customers will not receive any distribution of customer property so long as there is any shortfall, in any account class, of customer property needed to satisfy public customer net equity claims.

(ii) The pro rata distribution principle means that, if there is a shortfall of customer property in an account class, all customers within that account class will suffer the same proportional loss relative to their allowed net equity claims. This principle applies to all customers, including those who post as collateral specifically identifiable property or letters of credit. The pro rata distribution principle is subject to the special distribution provisions set forth in Framework 1 of appendix B to this part for cross-margin accounts and Framework 2 of appendix B to this part for funds held outside of the U.S. or held in non-U.S. currency.

(6) *Deliveries.* (i) Commodity contracts may have terms that require a customer owning the contract—

(A) To make or take delivery of the underlying commodity if the customer holds the contract to a delivery position or,

(B) In the case of an option on a commodity,

(1) To make delivery upon exercise (as the buyer of a put option or seller of a call option) or

(2) To take delivery upon exercise (as seller of a put option or buyer of a call option). Depending upon the circumstances and relevant market, delivery may be effected via a delivery account, a futures account, a foreign futures account or a cleared swaps account, or, when the commodity subject to delivery is a security, in a securities

account (in which case property associated with the delivery held in a securities account is not part of any customer account class for purposes of this part).

(ii) Although commodity contracts with delivery obligations are typically offset before reaching the delivery stage (*i.e.*, prior to triggering bilateral delivery obligations), when delivery obligations do arise, a delivery default could have a disruptive effect on the cash market for the commodity and adversely impact the parties to the transaction. This part therefore sets out special provisions to address open commodity contracts that are settled by delivery, when those positions are nearing or have entered into a delivery position at the time of or after the filing date. The delivery provisions in this part are intended to allow deliveries to be completed in accordance with the rules and established practices for the relevant commodity contract market or clearing organization, as applicable and to the extent permitted under this part.

(iii) In a proceeding in which the debtor is a futures commission merchant, the delivery provisions in this part reflect policy preferences to—

(A) Liquidate commodity contracts that settle via delivery before they move into a delivery position, and

(B) When such contracts are in a delivery position, to allow delivery to occur, where practicable, outside administration of the debtor's estate.

(iv) The delivery provisions in this part apply to any commodity that is subject to delivery under a commodity contract, as the term commodity is defined in section of 1a(9) of the Act, whether the commodity itself is tangible or intangible, including agricultural commodities as defined in § 1.3 of this chapter, other non-financial commodities (such as metals or energy commodities) covered by the definition of exempt

commodity in section 1a(20) of the Act, and commodities that are financial in nature (such as foreign currencies) covered by the definition of excluded commodity in section 1a(19) of the Act. The delivery provisions also apply to virtual currencies that are subject to delivery under a commodity contract.

(d) *Scope—(1) Proceedings—(i) Certain commodity broker proceedings under subchapter IV of chapter 7 of the Bankruptcy Code.* (A) Section 101(6) of the Bankruptcy Code recognizes “futures commission merchants” and “foreign futures commission merchants,” as those terms are defined in section 761(12) of the Bankruptcy Code, as separate categories of commodity broker. The definition of commodity broker in § 190.01, as it applies to a commodity broker that is a futures commission merchant under the Act, also covers foreign futures commission merchants because a foreign futures commission merchant is required to register as a futures commission merchant under the Act.

(B) Section 101(6) of the Bankruptcy Code recognizes “commodity options dealers,” and “leverage transaction merchants” as defined in sections 761(6) and (13) of the Bankruptcy Code, as separate categories of commodity brokers. There are no commodity options dealers or leverage transaction merchants as of the date of the adoption of these regulations. The Commission intends to adopt rules with respect to commodity options dealers or leverage transaction merchants, respectively, at such time as an entity registers as such.

(ii) *Futures commission merchants subject to a SIPA proceeding.* Pursuant to section 7(b) of SIPA, 15 U.S.C. 78fff-1(b), the trustee in a SIPA proceeding, where the debtor also is a commodity broker, has the same duties as a trustee in a proceeding under

subchapter IV of chapter 7 of the Bankruptcy Code, to the extent consistent with the provisions of SIPA or as otherwise ordered by the court. This part therefore also applies to a proceeding commenced under SIPA with respect to a debtor that is registered as a broker or dealer under section 15 of the Securities Exchange Act of 1934 when the debtor also is a futures commission merchant.

(iii) *Commodity brokers subject to an FDIC proceeding.* Section 5390(m)(1)(B) of title 12 of the United States Code provides that the FDIC must apply the provisions of subchapter IV of chapter 7 of the Bankruptcy Code in respect of the distribution of customer property and member property in connection with the liquidation of a covered financial company or a bridge financial company (as those terms are defined in section 5381(a) of title 12) that is a commodity broker as if such person were a debtor for purposes of subchapter IV, except as specifically provided in section 5390 of title 12. This part therefore shall serve as guidance as to such distribution of property in a proceeding in which the FDIC is acting as a receiver pursuant to title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act with respect to a covered financial company or bridge financial company that is a commodity broker whose liquidation otherwise would be administered by a trustee under subchapter IV of chapter 7 of the Bankruptcy Code.

(2) *Account class and implied trust limitations.* (i) The trustee may not recognize any account class that is not one of the account classes enumerated in § 190.01.

(ii) No property that would otherwise be included in customer property, as defined in § 190.01 of this part, shall be excluded from customer property because such

property is considered to be held in a constructive, resulting, or other trust that is implied in equity.

(3) *Commodity contract exclusions.* For purposes of this part, the following are excluded from the term “commodity contract”:

(i) Options on commodities (including swaps subject to regulation under part 32 of this chapter) that are not centrally cleared by a clearing organization or foreign clearing organization;

(ii) Transactions, contracts or agreements that are classified as “forward contracts” under the Act pursuant to the exclusion from the term “future delivery” set out in section 1a(27) of the Act or the exclusion from the definition of a “swap” under section 1a(47)(B)(ii) of the Act, in each case that are not centrally cleared by a clearing organization or foreign clearing organization;

(iii) Security futures products as defined in section 1a(45) of the Act when such products are held in a securities account.

(iv) Any off-exchange retail foreign currency transaction, contract or agreement described in sections 2(c)(2)(B) or (C) of the Act.

(v) Any security-based swap or other security (as defined in section 3 of the Exchange Act), but a security futures product that is carried in an account for which there is a corresponding account class under this part is not so excluded.

(vi) Any off-exchange retail commodity transaction, contract or agreement described in section 2(c)(2)(D) of the Act, unless such transaction, contract or agreement is traded on or subject to the rules of a designated contract market or foreign board of trade as, or as if, such transaction, contract or agreement is a futures contract.

(e) *Construction.* (1) A reference in this part to a specific section of a federal statute or specific regulation refers to such section or regulation as the same may be amended, superseded or renumbered.

(2) Where they differ, the definitions set forth in § 190.01 shall be used instead of defined terms set forth in section 761 of the Bankruptcy Code. In many cases, these definitions are based on definitions in parts 1, 22, and 30 of this chapter.

Notwithstanding the use of different defined terms, the regulations in this part are intended to be consistent with the provisions and objectives of subchapter IV of chapter 7 of the Bankruptcy Code.

(3) In the context of portfolio margining and cross margining programs, commodity contracts and associated collateral will be treated as part of the account class in which, consistent with Commission regulations, they are held.

(i) Thus, as noted in paragraph (2) of the definition of account class in § 190.01, where open commodity contracts (and associated collateral) that would be attributable to one account class are, instead, commingled with the commodity contracts (and associated collateral) in a second account class (the “home field”), then the trustee must treat all such commodity contracts and collateral as part of, and consistent with the regulations applicable to, the second account class.

(ii) This concept, that the rules of the “home field” will apply, also pertains to securities positions that are, pursuant to an approved cross margining program, held in a commodities account class (in which case the rules of that commodities account class will apply) and to commodities positions that are, pursuant to an approved cross-

margin program, held in a securities account (in which case, the rules of the securities account will apply, consistent with section 16(2)(b)(ii) of SIPA, 15 U.S.C. 78ll(2)(b)(ii)).

**§ 190.01 Definitions.**

For purposes of this part:

*Account class* (1) means one or more of each of the following types of accounts maintained by a futures commission merchant or clearing organization (as applicable), each type of which must be recognized as a separate account class by the trustee:

(i) *Futures account* has the same definition as set forth in § 1.3 of this chapter.

(ii) *Foreign futures account* means:

(A) A 30.7 account, as such term is defined in § 30.1(g) of this chapter; and

(B) An account maintained on the books and records of a clearing organization for the purpose of accounting for transactions in futures or options on futures contracts executed on or subject to the rules of a foreign board of trade, cleared or settled by the clearing organization for a member that is a futures commission merchant (and related cash, securities or other property), on behalf of that member's 30.7 customers (as that latter term is defined in § 30.1(f) of this chapter).

(iii) *Cleared swaps account* means a cleared swaps customer account, as such term is defined in § 22.1 of this chapter.

(iv)(A) *Delivery account* means:

(I) An account maintained on the books and records of a futures commission merchant for the purpose of accounting for the making or taking of delivery under commodity contracts whose terms require settlement by delivery of a commodity, and

which is designated as a delivery account on the books and records of the futures commission merchant; and

(2) An account maintained on the books and records of a clearing organization for a clearing member (or a customer of a clearing member) for the purpose of accounting for the making or taking of delivery under commodity contracts whose terms require settlement by delivery of a commodity, as well as any account in which the clearing organization holds physical delivery property represented by electronic title documents or otherwise existing in an electronic (dematerialized) form in its capacity as a central depository, in each case where the account is designated as a delivery account on the books and the records of the clearing organization.

(B) The delivery account class is further divided into a “physical delivery account class” and a “cash delivery account class,” as provided in § 190.06(b), each of which shall be recognized as a separate class of account by the trustee.

(2) (i) If open commodity contracts that would otherwise be attributable to one account class (and any property margining, guaranteeing, securing or accruing in respect of such commodity contracts) are, pursuant to a Commission rule, regulation, or order, or a clearing organization rule approved in accordance with § 39.15(b)(2) of this chapter, held separately from other commodity contracts and property in that account class and are commingled with the commodity contracts and property of another account class, then the trustee must treat the former commodity contracts (and any property margining, guaranteeing, securing or accruing in respect of such commodity contracts), for purposes of this part, as being held in an account of the latter account class.

(ii) The principle in paragraph 2(i) will be applied to securities positions and associated collateral held in a commodity account class pursuant to a cross margining program approved by the Commission (and thus treated as part of that commodity account class) and to commodity positions and associated collateral held in a securities account pursuant to a cross margining program approved by the Commission (and thus treated as part of the securities account).

(3) For the purpose of this definition, a commodity broker is considered to maintain an account for another person by establishing internal books and records in which it records the person's commodity contracts and cash, securities or other property received from or on behalf of such person or accruing to the credit of such person's account, and related activity (such as liquidation of commodity contract positions or adjustments to reflect mark-to-market gains or losses on commodity contract positions), regardless whether the commodity broker has kept such books and records current or accurate.

*Act* means the Commodity Exchange Act.

*Allowed net equity* means, for purposes of subpart B of this part, the amount calculated as allowed net equity in accordance with § 190.08(a), and for purposes of subpart C of this part, the amount calculated as allowed net equity in accordance with § 190.17(c).

*Bankruptcy Code* means, except as the context of the regulations in this part otherwise requires, those provisions of title 11 of the United States Code relating to ordinary bankruptcies (chapters 1 through 5) and liquidations (chapter 7 with the

exception of subchapters III and V), together with the federal rules of bankruptcy procedure relating thereto.

*Business day* means weekdays, not including federal holidays as established annually by 5 U.S.C. 6103. A business day begins at 8:00 a.m. in Washington, DC, and ends at 7:59:59 a.m. on the next day that is a business day.

*Calendar day* means the time from midnight to midnight in Washington, DC.

*Cash delivery account class.* See definition under *account class* in this section.

*Cash delivery property* means any cash or cash equivalents recorded in a delivery account that is, as of the filing date,

(1) Credited to such account to pay for receipt of delivery of a commodity under a commodity contract,

(2) Credited to such account to collateralize or guarantee an obligation to make or take delivery of a commodity under a commodity contract, or

(3) Has been credited to such account as payment received in exchange for making delivery of a commodity under a commodity contract. It also includes property in the form of commodities that have been delivered after the filing date in exchange for cash or cash equivalents held in a delivery account as of the filing date. The cash or cash equivalents must be identified on the books and the records of the debtor as having been received, from or for the account of a particular customer, on or after three calendar days before the relevant—

(i) First notice date in the case of a futures contract or

(ii) Exercise date in the case of a (cleared) option.

*Cash equivalents* means assets, other than United States dollar cash, that are highly liquid such that they may be converted into United States dollar cash within one business day without material discount in value.

*Cleared swaps account.* See definition under *account class* in this section.

*Clearing organization* means a derivatives clearing organization that is registered with the Commission as such under the Act.

*Commodity broker* means any person that is—

(1) A futures commission merchant under the Act, but excludes a person that is “notice-registered” as a futures commission merchant under section 4f(a)(2) of the Act, or

(2) A clearing organization, in each case with respect to which there is a “customer” as that term is defined in this section.

*Commodity contract* means—

(1) A futures or options on futures contract executed on or subject to the rules of a designated contract market,

(2) A futures or option on futures contract executed on or subject to the rules of a foreign board of trade,

(3) A swap as defined in section 1a(47) of the Act and § 1.3 of this chapter, that is directly or indirectly submitted to and cleared by a clearing organization and which is thus a cleared swap as that term is defined in section 1a(7) of the Act and § 22.1 of this chapter, or

(4) Any other contract that is a swap for purposes of this part under the definition in this section and is submitted to and cleared by a clearing organization.

Notwithstanding the foregoing, a security futures product as defined in section 1a(45) of the Act is not a commodity contract for purposes of this part when such contract is held in a securities account. Moreover, a contract, agreement, or transaction described in § 190.00(d)(3) as excluded from the term “commodity contract” is excluded from this definition.

*Commodity contract account* means—

(1) A futures account, foreign futures account, cleared swaps account, or delivery account, or

(2) If the debtor is a futures commission merchant, for purposes of identifying customer property for the foreign futures account class (subject to § 190.09(a)(1)), an account maintained for the debtor by a foreign clearing organization or a foreign futures intermediary reflecting futures or options on futures executed on or subject to the rules of a foreign board of trade, including any account maintained on behalf of the debtor’s public customers.

*Court* means the court having jurisdiction over the debtor’s estate.

*Cover* has the meaning set forth in § 1.17(j) of this chapter.

*Customer* means:

(1)(i) With respect to a futures commission merchant as debtor (including a foreign futures commission merchant as that term is defined in section 761(12) of the Bankruptcy Code), the meaning set forth in sections 761(9)(A) and (B) of the Bankruptcy Code.

(ii) With respect to a clearing organization as debtor, the meaning set forth in section 761(9)(D) of the Bankruptcy Code.

(2) The term customer includes the owner of a portfolio cross-margining account covering commodity contracts and related positions in securities (as defined in section 3 of the Exchange Act) that is carried as a futures account or cleared swaps customer account pursuant to an appropriate rule, regulation, or order of the Commission.

*Customer claim of record* means a customer claim that is determinable solely by reference to the records of the debtor.

*Customer class* means each of the following two classes of customers, which must be recognized as separate classes by the trustee: public customers and non-public customers; provided, however, that when the debtor is a clearing organization the references to public customers and non-public customers are based on the classification of customers of, and in relation to, the members of the clearing organization.

*Customer property, customer estate* are used interchangeably to mean the property subject to pro rata distribution in a commodity broker bankruptcy in the priority set forth in sections 766(h) or (i), as applicable, of the Bankruptcy Code, and includes cash, securities, and other property as set forth in § 190.09(a).

*Debtor* means a person with respect to which a proceeding is commenced under subchapter IV of chapter 7 of the Bankruptcy Code or under SIPA, or for which the Federal Deposit Insurance Corporation is appointed as a receiver pursuant to 12 U.S.C. 5382, provided, however, that this part applies only to such a proceeding if the debtor is a commodity broker as defined in this section.

*Delivery account.* See definition under *account class* in this section.

*Distribution* of property to a customer includes transfer of property on the customer's behalf, return of property to a customer, as well as distributions to a customer of valuable property that is different than the property posted by that customer.

*Equity* means the amount calculated as equity in accordance with § 190.08(b)(1).

*Exchange Act* means the Securities Exchange Act of 1934, as amended, 15 U.S.C. 78a *et seq.*

*FDIC* means the Federal Deposit Insurance Corporation.

*Filing date* means the date a petition under the Bankruptcy Code or application under SIPA commencing a proceeding is filed or on which the FDIC is appointed as a receiver pursuant to 12 U.S.C. 5382(a).

*Final net equity determination date* means the latest of:

(1) The day immediately following the day on which all commodity contracts held by or for the account of customers of the debtor have been transferred, liquidated or satisfied by exercise or delivery,

(2) The day immediately following the day on which all property other than commodity contracts held for the account of customers has been transferred, returned or liquidated,

(3) The bar date for filing customer proofs of claim as determined by rule 3002(c) of the Federal Rules of Bankruptcy Procedure, the expiration of the six-month period imposed pursuant to section 8(a)(3) of SIPA, or such other date (whether earlier or later) set by the court (or, in the case of the FDIC acting as a receiver pursuant to 12 U.S.C. 5382(a), the deadline set by the FDIC pursuant to 12 U.S.C. 5390(a)(2)(B) or

(4) The day following the allowance (by the trustee or by the bankruptcy court) or disallowance (by the bankruptcy court) of all disputed customer net equity claims.

*Foreign board of trade* has the same meaning as set forth in § 1.3 of this chapter.

*Foreign clearing organization* means a clearing house, clearing association, clearing corporation or similar entity, facility or organization clears and settles transactions in futures or options on futures executed on or subject to the rules of a foreign board of trade.

*Foreign future* shall have the same meaning as that set forth in section 761(11) of the Bankruptcy Code.

*Foreign futures account.* See definition under *account class* in this section.

*Foreign futures commission merchant* shall have the same meaning as that set forth in section 761(12) of the Bankruptcy Code

*Foreign futures intermediary* refers to a foreign futures and options broker, as such term is defined in § 30.1(e) of this title, acting as an intermediary for foreign futures contracts between a foreign futures commission merchant and a foreign clearing organization.

*Funded balance* means, for purposes of this part, the amount calculated as funded balance in accordance with § 190.08(c) and, as applicable, § 190.17(d).

*Futures, futures contract* are used interchangeably to mean any contract for the purchase or sale of a commodity (as defined in section 1a(9) of the Act) for future delivery that is executed on or subject to the rules of a designated contract market or on or subject to the rules of a foreign board of trade. The term also covers, for purposes of this part,

(1) Any transaction, contract or agreement described in section 2(c)(2)(D) of the Act and traded on or subject to the rules of a designated contract market or foreign board of trade, to the extent not covered by the foregoing definition, and

(2) Any transaction, contract or agreement that is classified as a “forward contract” under the Act pursuant to the exclusion from the term “future delivery” set out in section 1a(27) of the Act or the exclusion from the definition of a “swap” under section 1a(47)(B)(ii) of the Act, provided that such transaction, contract or agreement is traded on or subject to the rules of a designated contract market or foreign board of trade and is cleared by, respectively, a clearing organization or foreign clearing organization the same as if it were a futures contract.

*Futures account.* See definition under *account class* in this section.

*House account* means,

(1) In the case of a futures commission merchant, any proprietary account, as defined in § 1.3 of this chapter, with respect to futures contracts or swaps,

(2) In the case of a foreign futures commission merchant, any proprietary account, as defined in § 1.3 of this chapter, with respect to foreign futures contracts and

(3) In the case of a clearing organization, any commodity contract account of a member at such clearing organization maintained to reflect trades for the member’s own account or for any non-public customer of such member.

*In-the-money* means:

(1) With respect to a call option, when the value of the underlying interest (such as a commodity or futures contract) which is the subject of the option exceeds the strike price of the option; and

(2) With respect to a put option, when the value of the underlying interest (such as a commodity or futures contract) which is the subject of the option is exceeded by the strike price of the option.

*Joint account* means any commodity contract account held by more than one person.

*Member property* means, in connection with a clearing organization bankruptcy, the property which may be used to pay that portion of the net equity claim of a member which is based on the member's house account at the clearing organization, including any claims on behalf of non-public customers of the member.

*Net equity* means, for purposes of subpart B of this part, the amount calculated as net equity in accordance with § 190.08(b), and for purposes of subpart C of this part, the amount calculated as net equity in accordance with § 190.17(b).

*Non-public customer* means:

(1) With respect to a futures commission merchant, any customer that is not a public customer, and

(2) With respect to a clearing organization, any person whose account carried on the books and records of—

(i) A member of the clearing organization that is a futures commission merchant, is classified as a proprietary account under § 1.3 of this chapter (in the case of the futures or foreign futures account class) or as a cleared swaps proprietary account under § 22.1 of this chapter (in the case of the cleared swaps account class), or

(ii) A member of the clearing organization that is a foreign broker, is classified or treated as proprietary under and for purposes of—

- (A) The rules of the clearing organization or
- (B) The jurisdiction of incorporation of such member.

*Open commodity contract* means a commodity contract which has been established in fact and which has not expired, been redeemed, been fulfilled by delivery or exercise, or been offset (*i.e.*, liquidated) by another commodity contract.

*Order for relief* has the same meaning set forth in section 301 of the Bankruptcy Code, in the case of the filing of a voluntary bankruptcy petition, and means the entry of an order granting relief under section 303 of the Bankruptcy Code in an involuntary case. It also means, where applicable, the issuance of a protective decree under section 5(b)(1) of SIPA or the appointment of the FDIC as receiver pursuant to 12 U.S.C. 5382(a)(1)(A).

*Person* means any individual, association, partnership, corporation, trust or other form of legal entity.

*Physical delivery account class.* See definition under *account class* in this section.

*Physical delivery property* means a commodity, whether tangible or intangible, held in a form that can be delivered to meet and fulfill delivery obligations under a commodity contract that settles via delivery if held to a delivery position (as described in § 190.06(a)(1)), including warehouse receipts, shipping certificates or other documents of title (including electronic title documents) for the commodity, or the commodity itself:

(1) That the debtor holds for the account of a customer for the purpose of making delivery of such commodity on the customer's behalf, which as of the filing date or thereafter, can be identified on the books and records of the debtor as held in a delivery account for the benefit of such customer. Cash or cash equivalents received after the

filing date in exchange for delivery of such physical delivery property shall also constitute physical delivery property;

(2) That the debtor holds for the account of a customer and that the customer received or acquired by taking delivery under an expired or exercised commodity contract and which, as of the filing date or thereafter, can be identified on the books and records of the debtor as held in a delivery account for the benefit of such customer, regardless how long such property has been held in such account;

(3) Where property that the debtor holds in a futures account, foreign futures account or cleared swaps account, or, if the commodity is a security, in a securities account, would meet the criteria listed in paragraph (1) or (2) of this definition, but for the fact of being held in such account rather than a delivery account, such property will be considered physical delivery property solely for purposes of the obligations to make or take delivery of physical delivery property pursuant to § 190.06.

(4) Commodities or documents of title that are not held by the debtor and are delivered or received by a customer in accordance with § 190.06(a)(2) (or in accordance with § 190.06(a)(2) in conjunction with § 190.16(a) if the debtor is a clearing organization) to fulfill a customer's delivery obligation under a commodity contract will be considered physical delivery property solely for purposes of the obligations to make or take delivery of physical delivery property pursuant to § 190.06. As this property is held outside of the debtor's estate, it is not subject to pro rata distribution.

*Primary liquidation date* means the first business day immediately following the day on which all commodity contracts (including any commodity contracts that are specifically identifiable property) have been liquidated or transferred.

*Public customer* means:

(1) With respect to a futures commission merchant and in relation to:

(i) The futures account class, a futures customer as defined in § 1.3 of this chapter whose futures account is subject to the segregation requirements of section 4d(a) of the Act and Commission regulations thereunder, including as applicable §§ 1.20 through 1.30 of this chapter;

(ii) The foreign futures account class, a § 30.7 customer as defined in § 30.1 of this chapter whose foreign futures accounts is subject to the segregation requirements of § 30.7 of this chapter;

(iii) The cleared swaps account class, a Cleared Swaps Customer as defined in § 22.1 of this chapter whose cleared swaps account is subject to the segregation requirements of part 22 of this chapter;

(iv) The delivery account class, a customer that is or would be classified as a public customer if the property reflected in the customer's delivery account had been held in an account described in paragraphs (1)(i), (ii) or (iii) of this definition.

(2) With respect to a clearing organization, any customer of that clearing organization that is not a non-public customer.

*Securities account* means, in relation to a futures commission merchant that is registered as a broker or dealer under the Exchange Act, an account maintained by such futures commission merchant in accordance with the requirements of section 15(c)(3) of the Exchange Act and § 240.15c3-3 of this title.

*Security* has the meaning set forth in section 101(49) of the Bankruptcy Code.

*SIPA* means the Securities Investor Protection Act of 1970, 15 U.S.C 78aaa *et seq.*

*Specifically identifiable property:* (1) This term means:

(i) The following property received, acquired, or held by or for the account of the debtor from or for the futures account, foreign futures account or cleared swaps account of a customer:

(A) Any security which as of the filing date is:

(1)(i) Held for the account of a customer;

(ii) Registered in such customer's name;

(iii) Not transferable by delivery; and

(iv) Has a duration or maturity date of more than 180 days; or

(2)(i) Fully paid;

(ii) Non-exempt; and

(iii) Identified on the books and records of the debtor as held by the debtor for or on behalf of the commodity contract account of a particular customer for which, according to such books and records as of the filing date, no open commodity contracts were held in the same capacity

(B) Any warehouse receipt, bill of lading or other document of title which as of the filing date:

(1) Can be identified on the books and records of the debtor as held for the account of a particular customer; and

(2) Is not in bearer form and is not otherwise transferable by delivery;

(ii) Any open commodity contracts treated as specifically identifiable property in accordance with § 190.03(c)(2); and

(iii) Any physical delivery property described in paragraphs (1) through (3) of the definition of physical delivery property in this section.

(2) Notwithstanding any other provision of this definition of specifically identifiable property, security futures products, and any money, securities or property held to margin, guarantee or secure such products, or accruing as a result of such products, shall not be considered specifically identifiable property for the purposes of subchapter IV of the Bankruptcy Code or this part, if held in a securities account.

(3) No property that is not explicitly included in this definition may be treated as specifically identifiable property.

*Strike price* means the price per unit multiplied by the total number of units at which a person may purchase or sell a futures contract or a commodity or other interest underlying an option that is a commodity contract.

*Substitute customer property* means cash or cash equivalents delivered to the trustee by or on behalf of a customer in connection with—

(1) The return of specifically identifiable property by the trustee, or

(2) The return of, or an agreement not to draw upon, a letter of credit received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract.

*Swap* has the meaning set forth in section 1a(47) of the Act and § 1.3 of this chapter, and, in addition, for purposes of this part, also means any other contract, agreement or transaction that is carried in a cleared swaps account pursuant to a rule,

regulation or order of the Commission, provided, in each case, that it is cleared by a clearing organization as, or the same as if it were, a swap.

*Trustee* means, as appropriate, the trustee in bankruptcy or in a SIPA proceeding, appointed to administer the debtor's estate and any interim or successor trustee, or the FDIC, where it has been appointed as a receiver pursuant to 12 U.S.C. 5382.

*Undermargined.* A futures account, foreign futures account or cleared swaps account carried by the debtor is considered undermargined if the funded balance for such account is below the minimum amount that the debtor is required to collect and maintain for the open commodity contracts in such account under the rules of the relevant clearing organization, foreign clearing organization, designated contract market, swap execution facility or foreign board of trade. If any such rules establish both an initial margin requirement and a lower maintenance margin requirement applicable to any commodity contracts (or to the entire portfolio of commodity contracts or any subset thereof) in a particular commodity contract account of the customer, the trustee will use the lower maintenance margin level to determine the customer's minimum margin requirement for such account.

*Variation settlement* means variation margin as defined in § 1.3 of this chapter plus all other daily settlement amounts (such as price alignment payments) that may be owed or owing on the commodity contract.

#### **§ 190.02 General.**

(a) *Request for exemption.* (1) The trustee (or, in the case of an involuntary petition pursuant to section 303 of the Bankruptcy Code, any other person charged with the management of a commodity broker) may, for good cause shown, request from the

Commission an exemption from the requirements of any procedural provision in this part, including an extension of any time limit prescribed by this part or an exemption subject to conditions, provided that the Commission shall not grant an extension for any time period established by the Bankruptcy Code.

(2) A request pursuant to paragraph (a)(1) of this section

(i) May be made ex parte and by any means of communication, written or oral, provided that the trustee must confirm an oral request in writing within one business day and such confirmation must contain all the information required by paragraph (b)(3) of this section. The request or confirmation of an oral request must be given to the Commission as provided in paragraph (a) of this section.

(ii) Must state the particular provision of this part with respect to which the exemption or extension is sought, the reason for the requested exemption or extension, the amount of time sought if the request is for an extension, and the reason why such exemption or extension would not be contrary to the purposes of the Bankruptcy Code and this part.

(3) The Director of the Division of Clearing and Risk, or members of the Commission staff designated by the Director, shall grant, deny or otherwise respond to a request, on the basis of the information provided in any such request and after consultation with the Director of the Division of Swap Dealer and Intermediary Oversight or members of the Commission staff designated by the Director, unless exigent circumstances require immediate action precluding such prior consultation, and shall communicate that determination by the most appropriate means to the person making the request.

(b) *Delegation of authority to the Director of the Division of Clearing and Risk.*

(1) Until such time as the Commission orders otherwise, the Commission hereby delegates to the Director of the Division of Clearing and Risk, and to such members of the Commission's staff acting under the Director's direction as they may designate, after consultation with the Director of the Division of Swap Dealer and Intermediary Oversight, or such member of the Commission's staff under the Director's direction as they may designate, unless exigent circumstances require immediate action, all the functions of the Commission set forth in this part, except the authority to disapprove a pre-relief transfer of a public customer commodity contract account or customer property pursuant to § 190.07(e)(1).

(2) The Director of the Division of Clearing and Risk may submit to the Commission for its consideration any matter which has been delegated to the Director pursuant to paragraph (b)(1) of this section.

(3) Nothing in this section shall prohibit the Commission, at its election, from exercising its authority delegated to the Director of the Division of Clearing and Risk under paragraph (b)(1) of this section.

(c) *Forward contracts.* For purposes of this part, an entity for or with whom the debtor deals who holds a claim against the debtor solely on account of a forward contract, that is not cleared by a clearing organization, will not be deemed to be a customer.

(d) *Other.* The Bankruptcy Code will not be construed by the Commission to prohibit a commodity broker from doing business as any combination of the following: futures commission merchant, commodity options dealer, foreign futures commission merchant or leverage transaction merchant, nor will the Commission construe the

Bankruptcy Code to permit any operation, trade or business, or any combination of the foregoing, otherwise prohibited by the Act or by any rule, regulation or order of the Commission thereunder.

(e) *Rule of construction.* Contracts in security futures products held in a securities account shall not be considered to be “from or for the commodity futures account” or “from or for the commodity options account” of such customers, as such terms are used in section 761(9) of the Bankruptcy Code.

(f) *Receivers.* In the event that a receiver for an FCM is appointed due to the violation or imminent violation of the customer property protection requirements of section 4d of the Act, or of the regulations thereunder, or of the FCM’s minimum capital requirements in § 1.17 of this chapter, such receiver may, in an appropriate case, file a petition for bankruptcy of such FCM pursuant to Section 301 of the Bankruptcy Code.

## **Subpart B – Futures Commission Merchant as Debtor**

### **§ 190.03 Notices and proofs of claims.**

(a) *Notices – means of providing—(1) To the Commission.* Unless instructed otherwise by the Commission, all mandatory or discretionary notices to be given to the Commission under this subpart B shall be directed by electronic mail to *bankruptcyfilings@cftc.gov*. For purposes of this subpart B, notice to the Commission shall be deemed to be given only upon actual receipt.

(2) *To customers.* The trustee, after consultation with the Commission, and unless otherwise instructed by the Commission, will establish and follow procedures reasonably designed for giving adequate notice to customers under this subpart B and for receiving claims or other notices from customers. Such procedures should include, absent good

cause otherwise, the use of a prominent website as well as communication to customers' electronic addresses that are available in the debtor's books and records.

(b) *Notices to the Commission and designated self-regulatory organizations*—(1) *Of commencement of a proceeding.* Each commodity broker that is a futures commission merchant and files a petition in bankruptcy shall as soon as practicable before, and in any event no later than, the time of such filing, notify the Commission and such commodity broker's designated self-regulatory organization of the anticipated or actual filing date, the court in which the proceeding will be or has been filed and, as soon as known, the docket number assigned to that proceeding. Each commodity broker that is a futures commission merchant and against which a bankruptcy petition is filed or with respect to which an application for a protective decree under SIPA is filed shall immediately upon the filing of such petition or application notify the Commission and such commodity broker's designated self-regulatory organization of the filing date, the court in which the proceeding has been filed, and, as soon as known, the docket number assigned to that proceeding.

(2) *Of transfers under section 764(b) of the Bankruptcy Code.* As soon as possible, the trustee of a commodity broker that is a futures commissions merchant, the relevant designated self-regulatory organization, or the applicable clearing organization must notify the Commission, and in the case of a futures commission merchant, the trustee shall also notify its designated self-regulatory organization and clearing organization(s), if such person intends to transfer or to apply to transfer open commodity contracts or customer property on behalf of the public customers of the debtor in accordance with section 764(b) of the Bankruptcy Code and § 190.07(c) or (d).

(c) *Notices to customers*—(1) *Specifically identifiable property other than open commodity contracts.* In any case in which an order for relief has been entered, the trustee must use all reasonable efforts to promptly notify, in accordance with § 190.03(a)(2), any customer whose futures account, foreign futures account or cleared swaps account includes specifically identifiable property, other than open commodity contracts, which has not been liquidated, that such specifically identifiable property may be liquidated commencing on and after the seventh day after the order for relief (or such other date as is specified by the trustee in the notice with the approval of the Commission or court) if the customer has not instructed the trustee in writing before the deadline specified in the notice to return such property pursuant to the terms for distribution of specifically identifiable property contained in § 190.09(d)(1). Such notice must describe the specifically identifiable property and specify the terms upon which that property may be returned, including if applicable and to the extent practicable any substitute customer property that must be provided by the customer.

(2) *Open commodity contracts carried in hedging accounts.* To the extent reasonably practicable under the circumstances of the case, and following consultation with the Commission, the trustee may treat open commodity contracts of public customers identified on the books and records of the debtor as held in a futures account, foreign futures account or cleared swaps account designated as a hedging account in the debtor's records, as specifically identifiable property of such customer. If the trustee does not exercise such authority, such open commodity contracts do not constitute specifically identifiable property. If the trustee exercises such authority, the trustee shall use reasonable efforts to promptly notify, in accordance with § 190.03(a)(2), each

relevant public customer of such determination and request the customer to provide written instructions whether to transfer or liquidate such open commodity contracts. Such notice must specify the manner for providing such instructions and the deadline by which the customer must provide instructions. Such notice must also inform the customer that—

(i) If the customer does not provide instructions in the prescribed manner and by the prescribed deadline, the customer's open commodity contracts will not be treated as specifically identifiable property under this part,

(ii) Any transfer of the open commodity contracts is subject to the terms for distribution contained in § 190.09(d)(2),

(iii) Absent compliance with any terms imposed by the trustee or the court, the trustee may liquidate the open commodity contracts, and

(iv) Providing instructions may not prevent the open commodity contracts from being liquidated.

(3) *Involuntary cases.* Prior to entry of an order for relief, and upon leave of the court, a trustee appointed in an involuntary proceeding pursuant to section 303 of the Bankruptcy Code may notify customers, in accordance with § 190.03(a)(2), of the commencement of such proceeding and may request customer instructions with respect to the return, liquidation or transfer of specifically identifiable property.

(4) *Notice of bankruptcy and request for proof of customer claim.* The trustee shall promptly notify, in accordance with § 190.03(a)(2), each customer that an order for relief has been entered and instruct each customer to file a proof of customer claim containing the information specified in paragraph (e) of this section. Such notice may be

given separately from any notice provided in accordance with paragraph (c) of this section. The trustee shall cause the proof of customer claim form referred to in paragraph (e) of this section to set forth the bar date for its filing.

(d) *Notice of court filings.* The trustee shall promptly provide the Commission with copies of any complaint, motion, or petition filed in a commodity broker bankruptcy which concerns the disposition of customer property. Court filings shall be directed to the Commission addressed as provided in paragraph (a)(1) of this section.

(e) *Proof of customer claim.* The trustee shall request that customers provide, to the extent reasonably practicable, information sufficient to determine a customer's claim in accordance with the regulations contained in this part, including in the discretion of the trustee:

(1) The class of commodity contract account upon which each claim is based (*i.e.*, futures account, foreign futures account, cleared swaps account, or delivery account (and, in the case of a delivery account, how much is based on cash delivery property and how much is based on the value of physical delivery property));

(2) Whether the claimant is a public customer or a non-public customer;

(3) The number of commodity contract accounts held by each claimant, and, for each such account:

(i) The account number;

(ii) The name in which the account is held;

(iii) The balance as of the last account statement for the account, and information regarding any activity in the account from the date of the last account statement up to and including the filing date that affected the balance of the account;

(iv) The capacity in which the account is held;

(v) Whether the account is a joint account and, if so, the amount of the claimant's percentage interest in that account and whether participants in the joint account are claiming jointly or separately;

(vi) Whether the account is a discretionary account;

(vii) Whether the account is an individual retirement account for which there is a custodian; and

(viii) Whether the account is a cross-margining account for futures and securities.

(4) A description of any accounts held by the claimant with the debtor that are not commodity contract accounts;

(5) A description of all claims against the debtor not based upon a commodity contract account of the claimant or an account listed in response to paragraph (e)(4) of this section;

(6) A description of all claims of the debtor against the claimant not included in the balance of a commodity contract account of the claimant;

(7) A description of and the value of any open positions, unliquidated securities or other unliquidated property held by the debtor on behalf of the claimant, indicating the portion of such property, if any, which was included in the information provided in paragraph (e)(3) of this section, and identifying any such property which would be specifically identifiable property as defined in § 190.01;

(8) Whether the claimant holds positions in security futures products, and, if so, whether those positions are held in a futures account, a foreign futures account or a securities account;

(9) Whether the claimant wishes to receive payment in kind, to the extent practicable, for any claim for unliquidated securities or other unliquidated property; and

(10) Copies of any documents which support the information contained in the proof of customer claim, including without limitation, customer confirmations, account statements, and statements of purchase or sale.

(f) *Proof of claim form.* A template customer proof of claim form which may (but is not required to) be used by the trustee is set forth in appendix A to this part.

(1) If there are no open commodity contracts that are being treated as specifically identifiable property (*e.g.*, if the customer proof of claim form was distributed after the primary liquidation date), the trustee should modify the customer proof of claim form to delete references to open commodity contracts as specifically identifiable property.

(2) In the event the trustee determines that the debtor's books and records reflecting customer transactions are not reasonably reliable, or account statements are not available from which account balances as of the date of transfer or liquidation of customer property may be determined, the proof of claim form used by the trustee should be modified to take into account the particular facts and circumstances of the case.

**§ 190.04 Operation of the debtor's estate—customer property.**

(a) *Transfers*—(1) *All cases.* The trustee for a commodity broker shall promptly use its best efforts to effect a transfer in accordance with § 190.07(c) and (d) no later than the seventh calendar day after the order for relief of the open commodity contracts and property held by the commodity broker for or on behalf of its public customers.

(2) *Involuntary cases.* A commodity broker against which an involuntary petition in bankruptcy is filed, or the trustee if a trustee has been appointed in such case, shall use

its best efforts to effect a transfer in accordance with § 190.07(c) and (d) of all open commodity contracts and property held by the commodity broker for or on behalf of its public customers and such other property as the Commission in its discretion may authorize, on or before the seventh calendar day after the filing date, and immediately cease doing business; provided, however, that if the commodity broker demonstrates to the Commission within such period that it was in compliance with the segregation and financial requirements of this chapter on the filing date, and the Commission determines, in its sole discretion, that such transfer is neither appropriate nor in the public interest, the commodity broker may continue in business subject to applicable provisions of the Bankruptcy Code and of this chapter.

(b) *Treatment of open commodity contracts—(1) Payments by the trustee.* Prior to the primary liquidation date, the trustee may make payments of initial margin and variation settlement to a clearing organization, commodity broker, foreign clearing organization or foreign futures intermediary, carrying the account of the debtor, pending the transfer or liquidation of any open commodity contracts, whether or not such contracts are specifically identifiable property of a particular customer, provided, that:

(i) To the extent within the trustee's control, the trustee shall not make any payments on behalf of any commodity contract account on the books and records of the debtor that is in deficit; provided, however, that this provision shall not be construed to prevent a clearing organization, foreign clearing organization, futures commission merchant or foreign futures intermediary carrying an account of the debtor from exercising its rights to the extent permitted under applicable law;

(ii) Any margin payments made by the trustee with respect to a specific customer account shall not exceed the funded balance for that account;

(iii) The trustee shall not make any payments on behalf of non-public customers of the debtor from funds that are segregated for the benefit of public customers;

(iv) If the trustee receives payments from a customer in response to a margin call, then to the extent within the trustee's control, the trustee must use such payments to make margin payments for the open commodity contract positions of such customer;

(v) The trustee may not use payments received from one public customer to meet the margin (or any other) obligations of any other customer; and

(vi) If funds segregated for the benefit of public customers in a particular account class exceed the aggregate net equity claims for all public customers in such account class, the trustee may use such excess funds to meet the margin obligations for any public customer in such account class whose account is under-margined (as described in § 190.04(b)(4)) but not in deficit, provided that the trustee issues a margin call to such customer and provided further that the trustee shall liquidate such customer's open commodity contracts if the customer fails to make the margin payment within a reasonable time as provided in § 190.04(b)(4).

(2) *Margin calls.* The trustee (or, prior to appointment of the trustee, the debtor against which an involuntary petition was filed) may issue a margin call to any public customer whose commodity contract account contains open commodity contracts if such account is under-margined.

(3) *Margin payments by the customer.* The full amount of any margin payment by a customer in response to a margin call under paragraph (b)(2) of this section must be credited to the funded balance of the particular account for which it was made.

(4) *Trustee obligation to liquidate certain open commodity contracts.* The trustee shall, as soon as practicable under the circumstances, liquidate all open commodity contracts in any commodity contract account that is in deficit, or for which any mark-to-market calculation would result in a deficit, or for which the customer fails to meet a margin call made by the trustee within a reasonable time. Except as otherwise provided in this part, absent exigent circumstances, a reasonable time for meeting margin calls made by the trustee shall be deemed to be one hour, or such greater period not to exceed one business day, as the trustee may determine in its sole discretion.

(5) *Partial liquidation of open commodity contracts by others.* In the event that a clearing organization, foreign clearing organization, futures commission merchant, foreign futures intermediary or other person carrying a commodity customer account for the debtor in the nature of an omnibus account has liquidated only a portion of open commodity contracts in such account, the trustee will exercise reasonable business judgment in assigning the liquidating transactions to the underlying commodity customer accounts carried by the debtor. Specifically, the trustee should endeavor to assign the contracts as follows: first, to liquidate open commodity contracts in a risk-reducing manner in any accounts that are in deficit; second, to liquidate open commodity contracts in a risk-reducing manner in any accounts that are undermargined; third, to liquidate open commodity contracts in a risk-reducing manner in any other accounts, and finally to liquidate any remaining open commodity contracts in any accounts. If more than one

commodity contract account reflects open commodity contracts in a particular account class for which liquidating transactions have been executed, the trustee shall to the extent practicable allocate the liquidating transactions to such commodity contract accounts pro rata based on the number of open commodity contracts of such commodity contract accounts. For purposes of this section, the term “a risk-reducing manner” is measured by margin requirements set using the margin methodology and parameters followed by the derivatives clearing organization at which such contracts are cleared.

(c) *Contracts moving to into delivery position.* After entry of the order for relief and subject to paragraph (a) of this section, which requires the trustee to attempt to make transfers to other commodity brokers permitted by § 190.07 and section 764(b) of the Bankruptcy Code, the trustee shall use its best efforts to liquidate any open commodity contract that settles upon expiration or exercise via the making or taking of delivery of a commodity:

(i) If such contract is a futures contract or a cleared swaps contract, before the earlier of the last trading day or the first day on which notice of intent to deliver may be tendered with respect thereto, or otherwise before the debtor or its customer incurs an obligation to make or take delivery of the commodity under such contract;

(ii) If such contract is a long option on a commodity and has value, before the first date on which the contract could be automatically exercised or the last date on which the contract could be exercised if not subject to automatic exercise; or

(iii) If such contract is a short option on a commodity that is in-the-money in favor of the long position holder, before the first date on which the long option position could be exercised.

(d) *Liquidation or offset.* After entry of the order for relief and subject to paragraph (a) of this section, which requires the trustee to attempt to make transfers to other commodity brokers permitted by § 190.07 and section 764(b) of the Bankruptcy Code, and except as otherwise set forth in this paragraph (d), the following commodity contracts and other property held by or for the account of a debtor must be liquidated in the market in accordance with § 190.04(e)(1) or liquidated via book entry in accordance with § 190.04(e)(2) by the trustee promptly and in an orderly manner:

(1) *Open commodity contracts.* All open commodity contracts, except for—

(i) Commodity contracts that are specifically identifiable property (if applicable) and are subject to customer instructions to transfer (in lieu of liquidating) as provided in § 190.03(c)(2), provided that the customer is in compliance with the terms of § 190.09(d)(2), and

(ii) Open commodity contract positions that are in a delivery position, which shall be treated in accordance with the provisions of § 190.06.

(2) *Specifically identifiable property, other than open commodity contracts or physical delivery property.* Specifically identifiable property, other than open commodity contracts or physical delivery property, to the extent that:

(i) The fair market value of such property is less than 75% of its fair market value on the date of entry of the order for relief;

(ii) Failure to liquidate the specifically identifiable property may result in a deficit balance in the applicable customer account; or

(iii) The trustee has not received instructions to return pursuant to § 190.03(c)(1), or has not returned such property upon the terms contained in § 190.09(d)(1).

(3) *Letters of credit.* The trustee may request that a customer deliver substitute customer property with respect to any letter of credit received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract, whether the letter of credit is held by the trustee on behalf of the debtor's estate or a derivatives clearing organization or a foreign intermediary or foreign clearing organization on a pass-through or other basis, including in cases where the letter of credit has expired since the date of the order for relief. The amount of the request may equal the full face amount of the letter of the credit or any portion thereof, to the extent required or may be required in the trustee's discretion to ensure pro rata treatment among customer claims within each account class, consistent with §§ 190.08 and 190.09.

(i) If a customer fails to provide substitute customer property within a reasonable time specified by the trustee, the trustee may, if the letter of credit has not expired, draw upon the full amount of the letter of credit or any portion thereof.

(ii) For any letter of credit referred to in this subsection, the trustee shall treat any portion that is not drawn upon (less the value of any substitute customer property delivered by the customer) as having been distributed to the customer for purposes of calculating entitlements to distribution or transfer. The expiration of the letter of credit on or at any time after the date of the order for relief shall not affect such calculation.

(iii) Any proceeds of a letter of credit drawn by the trustee, or substitute customer property posted by a customer, shall be considered customer property in the account class applicable to the original letter of credit.

(4) *All other property.* All other property, other than physical delivery property held for delivery in accordance with the provisions of § 190.06, which is not required to

be transferred or returned pursuant to customer instructions and which has not been liquidated in accordance with paragraphs (d)(1) through (3) of this section.

(e) *Liquidation of open commodity contracts*—(1) *By the trustee or a clearing organization in the market*—(i) *Debtor as a clearing member*. For open commodity contracts cleared by the debtor as a member of a clearing organization, the trustee or clearing organization, as applicable, shall liquidate such open commodity contracts pursuant to the rules of the clearing organization, a designated contract market, or a swap execution facility, if and as applicable. Any such rules providing for liquidation other than on the open market shall be designed to achieve, to the extent feasible under market conditions at the time of liquidation, a process for liquidating open commodity contracts that results in competitive pricing. For open commodity contracts that are futures or options on futures that were established on or subject to the rules of a foreign board of trade and cleared by the debtor as a member of a foreign clearing organization, the trustee shall liquidate such open commodity contracts pursuant to the rules of the foreign clearing organization or foreign board of trade or, in the absence of such rules, in the manner the trustee determines appropriate.

(ii) *Debtor not a clearing member*. For open commodity contracts submitted by the debtor for clearing through one or more accounts established with a futures commission merchant (as defined in § 1.3 of this chapter) or foreign futures intermediary, the trustee shall use commercially reasonable efforts to liquidate the open commodity contracts to achieve competitive pricing, to the extent feasible under market conditions at the time of liquidation and subject to any rules or orders of the relevant clearing

organization, foreign clearing organization, designated contract market, swap execution facility or foreign board of trade governing the liquidation of open commodity contracts.

(2) *By the trustee or a clearing organization via book entry offset.* Upon application by the trustee or clearing organization, the Commission may permit open commodity contracts to be liquidated, or settlement on such contracts to be made, by book entry. Such book entry shall offset open commodity contracts, whether matched or not matched on the books of the commodity broker, using the settlement price for such commodity contracts as determined by the clearing organization in accordance with its rules. Such rules shall be designed to establish, to the extent feasible under market conditions at the time of liquidation, such settlement prices in a competitive manner.

(3) *By a futures commission merchant or foreign futures intermediary.* For open commodity contracts cleared by the debtor through one or more accounts established with a futures commission merchant or a foreign futures intermediary, such futures commission merchant or foreign futures intermediary may exercise any enforceable contractual rights it has to liquidate such commodity contracts, provided, that it shall use commercially reasonable efforts to liquidate the open commodity contracts to achieve competitive pricing, to the extent feasible under market conditions at the time of liquidation and subject to any rules or orders of the relevant clearing organization, foreign clearing organization, designated contract market, swap execution facility or foreign board of trade governing its liquidation of such open commodity contracts. If a futures commission merchant or foreign futures intermediary fails to use commercially reasonable efforts to liquidate open commodity contracts to achieve competitive pricing in accordance with this § 190.04(e)(3), the trustee may seek damages reflecting the

difference between the price (or prices) at which the relevant commodity contracts would have been liquidated using commercially reasonable efforts to achieve competitive pricing and the price (or prices) at which the commodity contracts were liquidated, which shall be the sole remedy available to the trustee. In no event shall any such liquidation be voided.

(4) *Liquidation only.* (i) Nothing in this part shall be interpreted to permit the trustee to purchase or sell new commodity contracts for the debtor or its customers except to offset open commodity contracts or to transfer any transferable notice received by the debtor or the trustee under any commodity contract; provided, however, that the trustee may, in its discretion and with approval of the Commission, cover uncovered inventory or commodity contracts of the debtor which cannot be liquidated immediately because of price limits or other market conditions, or may take an offsetting position in a new month or at a strike price for which limits have not been reached.

(ii) Notwithstanding paragraph (e)(4)(i) of this section, the trustee may, with the written permission of the Commission, operate the business of the debtor in the ordinary course, including the purchase or sale of new commodity contracts on behalf of the customers of the debtor under appropriate circumstances, as determined by the Commission.

(f) *Long option contracts.* Subject to paragraphs (d) and (e) of this section, the trustee shall use its best efforts to assure that a commodity contract that is a long option contract with value does not expire worthless.

**§ 190.05 Operation of the debtor's estate—general.**

(a) *Compliance with the Act and regulations.* Except as specifically provided otherwise in this part, the trustee shall use reasonable efforts to comply with all of the provisions of the Act and of the regulations thereunder as if it were the debtor.

(b) *Computation of funded balance.* The trustee shall use reasonable efforts to compute a funded balance for each customer account that contains open commodity contracts or other property as of the close of business each business day subsequent to the order for relief until the date all open commodity contracts and other property in such account have been transferred or liquidated, which shall be as accurate as reasonably practicable under the circumstances, including the reliability and availability of information.

(c) *Records—(1) Maintenance.* Except as otherwise ordered by the court or as permitted by the Commission, records required under this chapter to be maintained by the debtor, including records of the computations required by this part, shall be maintained by the trustee until such time as the debtor's case is closed.

(2) *Accessibility.* The records required to be maintained by paragraph (c)(1) of this section shall be available during business hours to the Commission and the U.S. Department of Justice. The trustee shall give the Commission and the U.S. Department of Justice access to all records of the debtor, including records required to be retained in accordance with § 1.31 of this chapter and all other records of the commodity broker, whether or not the Act or this chapter would require such records to be maintained by the commodity broker.

(d) *Customer statements.* The trustee shall use all reasonable efforts to continue to issue account statements with respect to any customer for whose account open commodity contracts or other property is held that has not been liquidated or transferred. With respect to such accounts, the trustee must also issue an account statement reflecting any liquidation or transfer of open commodity contracts or other property promptly after such liquidation or transfer.

(e) *Other matters—(1) Disbursements.* With the exception of transfers of customer property made in accordance with § 190.07, the trustee shall make no disbursements to customers except with approval of the court.

(2) *Investment.* The trustee shall promptly invest the proceeds from the liquidation of commodity contracts or specifically identifiable property, and may invest any other customer property, in obligations of the United States and obligations fully guaranteed as to principal and interest by the United States, provided that such obligations are maintained in a depository located in the United States, its territories or possessions.

(f) *Residual interest.* The trustee shall apply the residual interest provisions of § 1.11 of this chapter in a manner appropriate to the context of their responsibilities as a bankruptcy trustee pursuant subchapter IV of chapter 7 of the Bankruptcy Code and this part, and in light of the existence of a surplus or deficit in customer property available to pay customer claims.

**§ 190.06 Making and taking delivery under commodity contracts.**

(a) *Deliveries—(1) General.* The provisions of this paragraph (a) apply to commodity contracts that settle upon expiration or exercise by making or taking delivery

of physical delivery property, if such commodity contracts are in a delivery position on the filing date, or the trustee is unable to liquidate such commodity contracts in accordance with § 190.04(c) to prevent them from moving into a delivery position, *i.e.*, before the debtor or its customer incurs bilateral contractual obligations to make or take delivery under such commodity contracts.

(2) *Delivery made or taken on behalf of a customer outside of the administration of the debtor's estate.* (i) The trustee shall use reasonable efforts to allow a customer to deliver physical delivery property that is held directly by the customer and not by the debtor (and thus not recorded in any commodity contract account of the customer) in settlement of a commodity contract, and to allow payment in exchange for such delivery, to occur outside the administration of the debtor's estate, when the rules of the exchange or other market listing the commodity contract, or the clearing organization or the foreign clearing organization clearing the commodity contract, as applicable, prescribe a process for delivery that allows the delivery to be fulfilled—

(A) In the normal course directly by the customer,

(B) By substitution of the customer for the commodity broker, or

(C) Through agreement of the buyer and seller to alternative delivery procedures.

(ii) Where a customer delivers physical delivery property in settlement of a commodity contract outside of the administration of the debtors' estate in accordance with paragraph (a)(2)(i) of this section, any property of such customer held at the debtor in connection with such contract must nonetheless be included in the net equity claim of that customer, and, as such, can only be distributed pro rata at the time of, and as part of, any distributions to customers made by the trustee.

(3) *Delivery as part of administration of the debtor's estate.* When the trustee determines that it is not practicable to effect delivery as provided in § 190.06(a)(2):

(i) To facilitate the making or taking of delivery directly by a customer, the trustee may, as it determines reasonable under the circumstances of the case and consistent with the pro rata distribution of customer property by account class:

(A) When a customer is obligated to make delivery, return any physical delivery property to the customer that is held by the debtor for or on behalf of the customer under the terms set forth in § 190.09(d)(1)(ii), to allow the customer to deliver such property to fulfill its delivery obligation under the commodity contract, or

(B) When a customer is obligated to take delivery:

(1) Return any cash delivery property to the customer that is reflected in the customer's delivery account, provided that cash delivery property returned under this subsection shall not exceed the lesser of—

(i) The amount the customer is required to pay for delivery of the commodity, or

(ii) The customer's net funded balance for all of the customer's commodity contract accounts;

(2) Return cash, securities or other property held in the customer's non-delivery commodity contract accounts, provided that property returned under this section shall not exceed the lesser of—

(i) The amount the customer is required to pay for delivery of the commodity, or

(ii) The net funded balance for all of the customer's commodity contract accounts reduced by any amount returned to the customer pursuant to § 190.06(a)(3)(i)(B)(1), and provided further, however, that the trustee may distribute such property only to the extent

that the customer's funded balance for each such account exceeds the minimum margin obligations for such account (as described in § 190.04(b)(2)); and

(C) Impose such conditions on the customer as it considers appropriate to assure that property returned to the customer is used to fulfill the customer's delivery obligations.

(ii) If the trustee does not return physical delivery property, cash delivery property or other property in the form of cash or cash equivalents to the customer as provided in § 190.06(a)(3)(i), subject to § 190.06(a)(4):

(A) To the extent practical, the trustee shall make or take delivery of physical delivery property in the same manner as if no bankruptcy had occurred, and when making delivery, the party to which delivery is made must pay the full price required for taking such delivery; or

(B) When taking delivery of physical delivery property:

(1) The trustee shall pay for the delivery first using the customer's cash delivery property or other property, limited to the amounts set forth in § 190.06(a)(3)(i)(B), along with any cash transferred by the customer to the trustee on or after the filing date for the purpose of paying for delivery.

(2) If the value of the cash or cash equivalents that may be used to pay for deliveries as described in § 190.06(a)(3)(i)(B) is less than the amount required to be paid for taking delivery, the trustee shall issue a payment call to the customer. The full amount of any payment made by the customer in response to a payment call must be credited to the funded balance of the particular account for which such payment is made.

(3) If the customer fails to meet a call for payment under § 190.06(a)(3)(ii)(B)(2) before payment is made for delivery, the trustee must convert any physical delivery property received on behalf of the customer to cash as promptly as possible.

(4) *Deliveries in a securities account.* If an open commodity contract held in a futures account, foreign futures account or cleared swaps account requires delivery of a security upon expiration or exercise of such commodity contract, and delivery is not completed pursuant to §§ 190.06(a)(2) or 190.06(a)(3)(i), the trustee may make or take delivery in a securities account in a manner consistent with § 190.06(a)(3)(ii), provided, however, that the trustee may transfer property from the customer's commodity contract accounts to the securities account to fulfill the delivery obligation only to the extent that the customer's funded balance for such commodity contract account exceeds the customer's minimum margin obligations for such accounts (as described in § 190.04(b)(2)) and provided further that the customer is not under-margined or does not have a deficit balance in any other commodity contract accounts.

(5) *Delivery made or taken on behalf of house account.* If delivery of physical delivery property is to be made or taken on behalf of a house account of the debtor, the trustee shall make or take delivery, as the case may be, on behalf of the debtor's estate, provided that if the trustee takes delivery of physical delivery property it must convert such property to cash as promptly as possible.

(b) *Special account class provisions for delivery accounts.* (1) Within the delivery account class, the trustee shall treat—

(i) Physical delivery property held in delivery accounts as of the filing date, and the proceeds of any such physical delivery property subsequently received, as part of the physical delivery account class, and

(ii) Cash delivery property in delivery accounts as of the filing date, along with any physical delivery property for which delivery is subsequently taken on behalf of a customer in accordance with § 190.06(a)(3), as part of a separate cash delivery account class.

(2) (i) If the debtor holds any cash or cash equivalents in an account maintained at a bank, clearing organization, foreign clearing organization or other person, under a name or in a manner that clearly indicates that the account holds property for the purpose of making payment for taking delivery, or receiving payment for making delivery, of a commodity under commodity contracts, such property shall (subject to § 190.09) be considered customer property—

(A) In the cash delivery account class if held for making payment for taking delivery,

(B) In the physical delivery account class, if held as a result of receiving such payment for a making delivery after the filing date.

(ii) Any other property (excluding property segregated for the benefit of customer in the futures, foreign futures or cleared swaps account class) that is traceable as having been held or received for the purpose of making delivery, or as having been held or received as a result of taking delivery, of a commodity under commodity contracts, shall (subject to § 190.09) be considered customer property—

(A) In the cash delivery account class if received after the filing date in exchange for taking delivery,

(B) Otherwise shall be considered customer property in the physical delivery account class.

**§ 190.07 Transfers.**

(a) *Transfer rules.* No clearing organization, or self-regulatory organization may adopt, maintain in effect, or enforce rules that:

(1) Are inconsistent with the provisions of this part;

(2) Interfere with the acceptance by its members of transfers of commodity contracts, and the property margining or securing such contracts, from futures commission merchants that are required to transfer accounts pursuant to § 1.17(a)(4) of this chapter; or

(3) Interfere with the acceptance by its members of transfers of commodity contracts, and the property margining or securing such contracts, from a futures commission merchant that is a debtor as defined in §190.01, if such transfers have been approved by the Commission, *provided, however*, that this paragraph shall not—

(i) Limit the exercise of any contractual right of a clearing organization or other registered entity to liquidate or transfer open commodity contracts, or

(ii) Be interpreted to limit a clearing organization's ability adequately to manage risk.

(b) *Requirements for transferees.* (1) It is the duty of each transferee to assure that it will not accept a transfer that would cause the transferee to be in violation of the minimum financial requirements set forth in this chapter.

(2) Any transferee that accepts a transfer of open commodity contracts from the estate of the debtor

(i) Accepts the transfer subject to any loss that may arise in the event the transferee cannot recover from the customer any deficit balance that may arise related to the transferred open commodity contracts.

(ii) If the commodity contracts were held for the account of a customer,

(A) Must keep such commodity contracts open at least one business day after their receipt, unless the customer for whom the transfer is made fails to respond within a reasonable time to a margin call for the difference between the margin transferred with such commodity contracts and the margin which such transferee would require with respect to a similar set of commodity contracts held for the account of a customer in the ordinary course of business, and

(B) May not collect commissions with respect to the transfer of such commodity contracts.

(3) A transferee may accept open commodity contracts and property, and open accounts on its records, for customers whose commodity contracts and property are transferred pursuant to this part prior to completing customer diligence, provided that account opening diligence as required by law is performed, and records and information required by law are obtained, as soon as practicable, but in any event within six months of the transfer, unless this time is extended for a particular account, transferee, or debtor by the Commission.

(4) Any account agreements governing a transferred account (including an account that has been partially transferred) shall be deemed assigned to the transferee by

operation of law and shall govern the transferee and customer's relationship until such time as the transferee and customer enter into a new agreement; provided, however, that any breach of such agreement by the debtor existing at or before the time of the transfer (including but not limited to any failure to segregate sufficient customer property) shall not constitute a default or breach of the agreement on the part of the transferee, or constitute a defense to the enforcement of the agreement by the transferee.

(5) If open commodity contracts or any specifically identifiable property has been, or is to be, transferred in accordance with section 764(b) of the Bankruptcy Code and this section, customer instructions previously received by the trustee with respect to open commodity contracts or with respect to specifically identifiable property, shall be transmitted to the transferee of property, which shall comply therewith to the extent practicable.

(c) *Eligibility for transfer under section 764(b) of the Bankruptcy Code—accounts eligible for transfer.* All commodity contract accounts (including accounts with no open commodity contract positions) are eligible for transfer after the order for relief pursuant to section 764(b) of the Bankruptcy Code, except:

(1) House accounts or the accounts of general partners of the debtor if the debtor is a partnership; and

(2) Accounts that are in deficit.

(d) *Special rules for transfers under section 764(b) of the Bankruptcy Code.* (1) The trustee for a commodity broker shall use its best efforts to effect a transfer to one or more other commodity brokers of all eligible commodity contract accounts, open commodity contracts and property held by the debtor for or on behalf of its customers,

based on customer claims or record, no later than the seventh calendar day after the order for relief.

(2) *Partial transfers; multiple transferees*—(i) *Of the customer estate.* If all eligible commodity contract accounts held by a debtor cannot be transferred under this section, a partial transfer may nonetheless be made. The Commission will not disapprove such a transfer for the sole reason that it was a partial transfer. Commodity contract accounts may be transferred to one or more transferees, and, subject to § 190.07(d)(4), may be transferred to different transferees by account class.

(ii) *Of a customer's commodity contract account.* If all of a customer's open commodity contracts and property cannot be transferred under this section, a partial transfer of contracts and property may be made so long as such transfer would not result in an increase in the amount of any customer's net equity claim. One, but not the only, means to effectuate a partial transfer is by liquidating a portion of the open commodity contracts held by a customer such that sufficient value is realized, or margin requirements are reduced to an extent sufficient, to permit the transfer of some or all of the remaining open commodity contracts and property. If any open commodity contract to be transferred in a partial transfer is part of a spread or straddle, to the extent practicable under the circumstances, each side of such spread or straddle must be transferred or none of the open commodity contracts comprising the spread or straddle may be transferred.

(3) *Letters of credit.* A letter of credit received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract may be transferred with an eligible commodity contract account if it is held by a derivatives clearing organization on a pass-through or other basis or is transferable by its terms, so long as the transfer will not

result in a recovery which exceeds the amount to which the customer would be entitled under §§ 190.08 and 190.09. If the letter of credit cannot be transferred as provided for in the foregoing sentence, and the customer does not deliver substitute customer property to the trustee in accordance with § 190.04(d)(3), the trustee may draw upon a portion or all of the letter of credit, the proceeds of which shall be treated as customer property in the applicable account class.

(4) *Physical delivery property.* The trustee shall use reasonable efforts to prevent physical delivery property held for the purpose of making delivery on a commodity contract from being transferred separate and apart from the related commodity contract, or to a different transferee.

(5) *No prejudice to other customers.* No transfer shall be made under this part by the trustee if, after taking into account all customer property available for distribution to customers in the applicable account class at the time of the transfer, such transfer would result in insufficient remaining customer property to make an equivalent percentage distribution (including all previous transfers and distributions) to all customers in the applicable account class, based on—

(i) Customer claims of record and

(ii) Estimates of other customer claims made in the trustee's reasonable discretion based on available information, in each case as of the calendar day immediately preceding transfer.

(e) *Prohibition on avoidance of transfers under section 764(b) of the Bankruptcy Code—(1) Pre-relief transfers.* Notwithstanding the provisions of paragraphs (c) and (d)

of this section, the following transfers are approved and may not be avoided under sections 544, 546, 547, 548, 549 or 724(a) of the Bankruptcy Code:

(i) The transfer of commodity contract accounts or customer property prior to the entry of the order for relief in compliance with § 1.17(a)(4) of this chapter unless such transfer is disapproved by the Commission;

(ii) The transfer, withdrawal, or settlement, prior to the order for relief at the request of a public customer, including a transfer, withdrawal, or settlement at the request of a public customer that is a commodity broker, of commodity contract accounts or customer property held from or for the account of such customer by or on behalf of the debtor unless:

(A) The customer acted in collusion with the debtor or its principals to obtain a greater share of customer property or the bankruptcy estate than that to which it would be entitled under this part; or

(B) The transfer is disapproved by the Commission; or

(iii) The transfer prior to the order for relief by a clearing organization, or by a receiver that has been appointed for the FCM that is now a debtor, of one or more accounts held for or on behalf of customers of the debtor, or of commodity contracts and other customer property held for or on behalf of customers of the debtor, provided that the transfer is not disapproved by the Commission.

(2) *Post-relief transfers.* Notwithstanding the provisions of paragraphs (c) and (d) of this section, the following transfers are approved and may not be avoided under sections 544, 546, 547, 548, 549 or 724(a) of the Bankruptcy Code:

(i) The transfer of a commodity contract account or customer property eligible to be transferred under paragraphs (c) and (d) of this section made by the trustee or by any clearing organization on or before the seventh calendar day after the entry of the order for relief, as to which the Commission has not disapproved the transfer; or

(ii) The transfer of a commodity contract account or customer property at the direction of the Commission on or before the seventh calendar day after the order for relief, upon such terms and conditions as the Commission may deem appropriate and in the public interest.

(f) *Commission action.* Notwithstanding any other provision of this section (other than § 190.07(d)(2)(ii) and (d)(5)), in appropriate cases and to protect the public interest, the Commission may:

(1) Prohibit the transfer of a particular set or sets of commodity contract accounts and customer property; or

(2) Permit transfers of a particular set or sets of commodity contract accounts and customer property that do not comply with the requirements of this section.

**§ 190.08 Calculation of allowed net equity.**

For purposes of this subpart, allowed net equity shall be computed as follows:

(a) *Allowed claim.* The allowed net equity claim of a customer shall be equal to the aggregate of the funded balances of such customer's net equity claim for each account class.

(b) *Net equity.* Net equity means a customer's total customer claim of record against the estate of the debtor based on the customer property, including any commodity

contracts, held by the debtor for or on behalf of such customer less any indebtedness of the customer to the debtor. Net equity shall be calculated as follows:

(1) *Step 1-Equity determination.* (i) Determine the equity balance of each commodity contract account of a customer by computing, with respect to such account, the sum of:

(A) The ledger balance;

(B) The open trade balance; and

(C) The realizable market value, determined as of the close of the market on the last preceding market day, of any securities or other property held by or for the debtor from or for such account, plus accrued interest, if any.

(ii) For the purposes of this paragraph (b)(1), the ledger balance of a customer account shall be calculated by

(A) Adding:

(1) Cash deposited to purchase, margin, guarantee, secure, or settle a commodity contract;

(2) Cash proceeds of liquidations of any securities or other property referred to in paragraph (b)(1)(i)(C) of this section;

(3) Gains realized on trades; and

(4) The face amount of any letter of credit received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract; and

(B) Subtracting from the result:

(1) Losses realized on trades;

(2) Disbursements to or on behalf of the customer (including, for these purposes, transfers made pursuant to §§ 190.04(a) and 190.07); and

(3) The normal costs attributable to the payment of commissions, brokerage, interest, taxes, storage, transaction fees, insurance and other costs and charges lawfully incurred in connection with the purchase, sale, exercise, or liquidation of any commodity contract in such account.

(iii) For purposes of this paragraph (b)(1), the open trade balance of a customer's account shall be computed by subtracting the unrealized loss in value of the open commodity contracts held by or for such account from the unrealized gain in value of the open commodity contracts held by or for such account.

(iv) For purposes of this paragraph (b)(1), in calculating the ledger balance or open trade balance of any customer, exclude any security futures products, any gains or losses realized on trades in such products, any property received to margin, guarantee or secure such products (including interest thereon or the proceeds thereof), to the extent any of the foregoing are held in a securities account, and any disbursements to or on behalf of such customer in connection with such products or such property held in a securities account.

(2) *Step 2-Customer determination (aggregation)*. Aggregate the credit and debit equity balances of all accounts of the same class held by a customer in the same capacity. Paragraphs (b)(2)(i) through (b)(2)(xii) of this section prescribe which accounts must be treated as being held in the same capacity and which accounts must be treated as being held in a separate capacity.

(i) Except as otherwise provided in this paragraph (b)(2), all accounts that are maintained with a debtor in a person's name and that, under this paragraph (b)(2), are deemed to be held by that person in its individual capacity shall be deemed to be held in the same capacity.

(ii) An account maintained with a debtor by a guardian, custodian, or conservator for the benefit of a ward, or for the benefit of a minor under the Uniform Gift to Minors Act, shall be deemed to be held in a separate capacity from accounts held by such guardian, custodian or conservator in its individual capacity.

(iii) An account maintained with a debtor in the name of an executor or administrator of an estate in its capacity as such shall be deemed to be held in a separate capacity from accounts held by such executor or administrator in its individual capacity.

(iv) An account maintained with a debtor in the name of a decedent, in the name of the decedent's estate, or in the name of the executor or administrator of such estate in its capacity as such shall be deemed to be accounts held in the same capacity.

(v) An account maintained with a debtor by a trustee shall be deemed to be held in the individual capacity of the grantor of the trust unless the trust is created by a valid written instrument for a purpose other than avoidance of an offset under the regulations contained in this part. A trust account which is not deemed to be held in the individual capacity of its grantor under this paragraph (b)(2)(v) shall be deemed to be held in a separate capacity from accounts held in an individual capacity by the trustee, by the grantor or any successor in interest of the grantor, or by any trust beneficiary, and from accounts held by any other trust.

(vi) An account maintained with a debtor by a corporation, partnership, or unincorporated association shall be deemed to be held in a separate capacity from accounts held by the shareholders, partners or members of such corporation, partnership or unincorporated association, if such entity was created for purposes other than avoidance of an offset under the regulations contained in this part.

(vii) A hedging account of a person shall be deemed to be held in the same capacity as a speculative account of such person.

(viii) Subject to paragraphs (b)(2)(ix) and (xiv) of this section, the futures accounts, foreign futures accounts, delivery accounts, and cleared swaps accounts of the same person shall not be deemed to be held in separate capacities: *provided, however,* that such accounts may be aggregated only in accordance with paragraph (b)(3) of this section.

(ix) An omnibus customer account of a futures commission merchant maintained with a debtor shall be deemed to be held in a separate capacity from the house account and any other omnibus customer account of such futures commission merchant.

(x) A joint account maintained with the debtor shall be deemed to be held in a separate capacity from any account held in an individual capacity by the participants in such account, from any account held in an individual capacity by a commodity pool operator or commodity trading advisor for such account, and from any other joint account; provided, however, that if such account is not transferred in accordance with §§ 190.04(a) and 190.07, it shall be deemed to be held in the same capacity as any other joint account held by identical participants and a participant's percentage interest therein

shall be deemed to be held in the same capacity as any account held in an individual capacity by such participant.

(xi) An account maintained with a debtor in the name of a plan that is subject to the terms of the Employee Retirement Income Security Act of 1974 and the regulations thereunder, or similar state, federal or foreign laws or regulations applicable to retirement or pension plans, shall be deemed to be held in a separate capacity from an account held in an individual capacity by the plan administrator, any employer, employee, participant, or beneficiary with respect to such plan.

(xii) Except as otherwise provided in this section, an account maintained with a debtor by an agent or nominee for a principal or a beneficial owner shall be deemed to be an account held in the individual capacity of such principal or beneficial owner.

(xiii) With respect to the cleared swaps account class, each individual cleared swaps customer account within each cleared swap omnibus customer account referred to in paragraph (b)(2)(viii) of this section shall be deemed to be held in a separate capacity from each other such individual cleared swaps customer account, subject to the provisions of paragraphs (b)(2)(i) through (xi) of this paragraph (b)(2).

(xiv) Accounts held by a customer in separate capacities shall be deemed to be accounts of different customers. The burden of proving that an account is held in a separate capacity shall be upon the customer.

(3) *Step 3-Setoffs.* (i) The net equity of one customer account may not be offset against the net equity of any other customer account.

(ii) Any (x) obligation to the debtor owed by a customer which is not required to be included in computing the equity of that customer under paragraph (b)(1) of this

section, must be deducted from (y) any obligation to the customer owed by the debtor which is not required to be included in computing the equity of that customer. If the former amount (x) exceeds the latter (y), the excess (x-y) must be deducted from the equity balance of the customer obtained after performing the preceding calculations required by paragraph (b) of this section, provided, that if the customer owns more than one class of accounts with a positive equity balance, the excess (again, x-y) must be allocated and offset against each positive equity balance in the same proportion as that positive equity balance bears to the total of all positive equity balances of accounts of different classes held by such customer.

(iii) A negative equity balance obtained with respect to one customer account class must be set off against a positive equity balance in any other account class of such customer held in the same capacity, provided, that if a customer owns more than one class of accounts with a positive equity balance, such negative equity balance must be offset against each positive equity balance in the same proportion as that positive equity balance bears to the total of all positive equity balances in accounts of different classes held by such customer.

(iv) To the extent any indebtedness of the debtor to the customer which is not required to be included in computing the equity of such customer under paragraph (b)(1) of this section exceeds such indebtedness of the customer to the debtor, the customer claim therefor will constitute a general creditor claim rather than a customer property claim, and the net equity therefor shall be separately calculated.

(v) The rules pertaining to separate capacities and permitted setoffs contained in this section shall only be applied subsequent to the entry of an order for relief; prior to

that date, the provisions of § 1.22 of this chapter and of sections 4d(a)(2) and 4d(f) of the Act (and, in each case, the regulations promulgated thereunder) shall govern what setoffs are permitted.

(4) *Step 4-Correction for distributions.* The value on the date of transfer or distribution of any property transferred or distributed subsequent to the filing date and prior to the primary liquidation date with respect to each class of account held by a customer must be added to the equity obtained for that customer for accounts of that class after performing the steps contained in paragraphs (b)(1) through (3) of this section: *provided, however,* that if all accounts for which there are customer claims of record and 100% of the equity pertaining thereto is transferred in accordance with § 190.07 and section 764(b) of the Bankruptcy Code, net equity shall be computed based solely upon those allowed customer claims, if any, filed subsequent to the order for relief which are not claims of record on the filing date.

(5) *Step 5-Correction for ongoing events.* Compute any adjustments to Steps 1 through 4 of this paragraph (b) required to correct misestimates or errors including, without limitation, corrections for ongoing events such as the liquidation of unliquidated claims or specifically identifiable property at a value different from the estimated value previously used in computing net equity.

(c) *Calculation of funded balance.* *Funded balance* means a customer's pro rata share of the customer estate with respect to each account class available for distribution to customers of the same customer class.

(1) The funded balance of any customer claim shall be computed (separately by account class and customer class) by:

(i) Multiplying the ratio of (x) the amount of the net equity claim of such customer less (y) the amounts referred to in paragraph (c)(1)(ii) of this section of such customer for any account class divided by (p) the sum of the net equity claims of all customers for accounts of that class less (q) the amounts referred to in paragraph (c)(1)(ii) of this section of all customers for accounts of that class (thus,  $((x-y)/(p-q))$ ) by the sum of:

(A) The value of letters of credit received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract relating to all customer accounts of the same class;

(B) The value of the money, securities, or other property segregated on behalf of all customer accounts of the same class less the amounts referred to in paragraph (c)(1)(ii) of this section;

(C) The value of any money, securities or other property which must be allocated under § 190.09 to all customer accounts of the same class; and

(D) The amount of any add-back required under paragraph (b)(4) of this section; and

(ii) Then adding 100% of any margin payment made between the entry of the order for relief (or, in an involuntary case, the date on which the petition for bankruptcy is filed) and the primary liquidation date; *provided, however*, that if margin is posted to substitute for a letter of credit, such margin does not increase the funded balance.

(2) *Corrections to funded balance.* The funded balance must be adjusted to correct for ongoing events including, without limitation:

(i) Added claimants;

(ii) Disallowed claims;

(iii) Liquidation of unliquidated claims at a value other than their estimated value;

and

(iv) Recovery of property.

(d) *Valuation.* In computing net equity, commodity contracts and other property held by or for a commodity broker must be valued as provided in this paragraph (d).

(1) *Commodity contracts*—(i) *Open contracts.* Unless otherwise specified in this paragraph (d), the value of an open commodity contract shall be equal to the settlement price as calculated by the clearing organization pursuant to its rules; provided, however, that if an open commodity contract is transferred to another commodity broker, its value on the debtor's books and records shall be determined as of the end of the last settlement cycle on the day preceding such transfer.

(ii) *Liquidated contracts.* Except as specified below, the value of a commodity contract liquidated on the open market shall equal the actual value realized on liquidation of the commodity contract.

(A) *Weighted average.* If identical commodity contracts are liquidated within a 24-hour period or business day (or such other period as the bankruptcy court may determine is appropriate) as part of a general liquidation of commodity contracts, but cannot be liquidated at the same price, the trustee may use the weighted average of the liquidation prices in computing the net equity of each customer for which the debtor held such commodity contracts.

(B) *Bulk liquidation.* The value of a commodity contract liquidated as part of a bulk auction, taken into inventory or under management by a clearing organization, or

similarly liquidated outside of the open market shall be equal to the settlement price calculated by the clearing organization as of the end of the settlement cycle during which the commodity contract was liquidated.

(2) *Securities.* The value of a listed security shall be equal to the closing price for such security on the exchange upon which it is traded. The value of all securities not traded on an exchange shall be equal in the case of a long position, to the average of the bid prices for long positions, and in the case of a short position, to the average of the asking prices for the short positions. If liquidated, the value of such security shall be equal to the actual value realized on liquidation of the security; provided, however, that if identical securities are liquidated within a 24-hour period or business day (or such other period as the bankruptcy court may determine is appropriate) as part of a general liquidation of securities, but cannot be liquidated at the same price, the trustee may use the weighted average of the liquidation prices in computing the net equity of each customer for which the debtor held such securities. Securities which are not publicly traded shall be valued by the trustee pursuant to paragraph (d)(5) of this section.

(3) *Commodities held in inventory.* Commodities held in inventory, as collateral or otherwise, shall be valued at their fair market value. If such fair market value is not readily ascertainable based upon public sources of prices, the trustee shall value such commodities pursuant to paragraph (d)(5) of this section.

(4) *Letters of Credit.* The value of any letter of credit received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract shall be its face amount, less the amount, if any, drawn and outstanding, provided that, if the trustee makes a determination in good faith that a draw on a letter of credit is unlikely to be

honored on either temporary or permanent basis, the trustee shall value the letter of credit pursuant to paragraph (d)(5) of this section.

(5) *All other property.* Subject to the other provisions of this paragraph (d), all other property shall be valued by the trustee using such professional assistance as the trustee deems necessary in its sole discretion under the circumstances; provided, however, that if such property is sold, its value for purposes of the calculations required by this part shall be equal to the actual value realized on the sale of such property; and, provided further, that the sale shall be made in compliance with all applicable statutes, rules and orders of any court or governmental entity with jurisdiction there over.

**§ 190.09 Allocation of property and allowance of claims.**

The property of the debtor's estate must be allocated among account classes and between customer classes as provided in this section. (Property connected with certain cross-margining arrangements is subject to the provisions of framework 1 in appendix B to this part.) The property so allocated will constitute a separate estate of the customer class and the account class to which it is allocated, and will be designated by reference to such customer class and account class.

(a) *Scope of customer property.* (1) Customer property includes the following:

(i) All cash, securities, or other property or the proceeds of such cash, securities or other property received, acquired, or held by or for the account of the debtor, from or for the account of a customer, including a non-public customer, which is:

(A) Property received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract;

(B) Open commodity contracts;

(C) Physical delivery property as that term is defined in paragraphs (1) through (3) in the definition of that term in § 190.01;

(D) Cash delivery property, or other cash, securities or other property received by the debtor as payment for a commodity to be delivered to fulfill a commodity contract from or for the commodity customer account of a customer;

(E) Profits or contractual rights accruing to a customer as the result of a commodity contract;

(F) Letters of credit, including any proceeds of a letter of credit drawn by the trustee, or substitute customer property posted by the customer, pursuant to § 190.04(d)(3);

(G) Securities held in a portfolio margining account carried as a futures account or a cleared swaps customer account;

(H) Property hypothecated under § 1.30 of this chapter to the extent that the value of such property exceeds the proceeds of any loan of margin made with respect thereto, and

(ii) All cash, securities, or other property which:

(A) Is segregated for customers on the filing date;

(B) Is a security owned by the debtor to the extent there are customer claims for securities of the same class and series of an issuer;

(C) Is specifically identifiable to a customer;

(D) Was property of a type described in paragraph (a)(1)(i)(A) of this section that is subsequently recovered by the avoidance powers of the trustee or is otherwise recovered by the trustee on any other claim or basis;

(E) Represents recovery of any debit balance, margin deficit, or other claim of the debtor against a customer;

(F) Was unlawfully converted but is part of the debtor's estate;

(G) Constitutes current assets of the debtor (as of the date of the order for relief) within the meaning of § 1.17(c)(2) of this chapter, including the debtor's trading or operating accounts and commodities of the debtor held in inventory, in the greater of—

(I) The amount that the debtor is obligated to set aside as its targeted residual interest amount pursuant to § 1.11 of this chapter and the debtor's residual interest policies adopted thereunder, with respect to each of the futures account class, the foreign futures account class, and the cleared swaps account class, or

(2) The debtor's obligations to cover debit balances or under-margined amounts as provided in §§ 1.20, 1.22, 22.2 and 30.7 of this chapter.

(H) Is other property of the debtor that any applicable law, rule, regulation, or order requires to be set aside for the benefit of customers;

(I) Is property of the debtor's estate recovered by the Commission in any proceeding brought against the principals, agents, or employees of the debtor;

(J) Is proceeds from the investment of customer property by the trustee pending final distribution;

(K) Is a payment from an insurer to the trustee arising from or related to a claim related to the conversion or misuse of customer property; or

(L) Is cash, securities or other property of the debtor's estate, including the debtor's trading or operating accounts and commodities of the debtor held in inventory, but only to the extent that the property enumerated in paragraphs (a)(1)(i)(F) and

(a)(1)(ii)(A) through (K) of this section is insufficient to satisfy in full all claims of public customers. Such property includes “customer property,” as defined in section 16(4) of SIPA, 15 U.S.C. 78lll(4), that remains after allocation in accordance with section 8(c)(1)(A) through (D) of SIPA, 15 U.S.C. 78fff-2(c)(1)(A) through (D) and that is allocated to the debtor’s general estate in accordance with section 8(c)(1) of SIPA, 15 U.S.C. 78fff-2(c)(1).

(2) Customer property will not include:

(i) Claims against the debtor for damages for any wrongdoing of the debtor, including claims for misrepresentation or fraud, or for any violation of the Act or of the regulations thereunder;

(ii) Other claims for property which are not based upon property received, acquired or held by or for the account of the debtor, from or for the account of the customer;

(iii) Forward contracts (unless such contracts are cleared by a clearing organization or, in the case of forward contracts treated as foreign futures, a foreign clearing organization);

(iv) Physical delivery property that is not held by the debtor, and is delivered or received by a customer in accordance with §§ 190.06(a)(2) or 190.16(a) to fulfill the customer’s delivery obligation under a commodity contract;

(v) Property deposited by a customer with a commodity broker after the entry of an order for relief which is not necessary to meet the margin requirements applicable to the accounts of such customer;

(vi) Property hypothecated pursuant to § 1.30 of this chapter to the extent of the loan of margin with respect thereto;

(vii) Money, securities or property held to margin, guarantee or secure security futures products, or accruing as a result of such products, if held in a securities account; and

(viii) Money, securities or property held in a securities account to fulfill delivery, under a commodity contract from or for the account of a customer, as described in § 190.06(b)(2).

(3) Nothing contained in this section, including, but not limited to, the satisfaction of customer claims by operation of this section, shall prevent a trustee from asserting claims against any person to recover the shortfall of property enumerated in paragraphs (a)(1)(i)(F) and (a)(1)(ii)(A) through (L) of this section.

(b) *Allocation of customer property between customer classes.* No customer property may be allocated to pay non-public customer claims until all public customer claims have been satisfied in full. Any property segregated on behalf of or attributable to non-public customers must be treated initially as part of the public customer estate and allocated in accordance with paragraph (c)(2) of this section.

(c) *Allocation of customer property among account classes—(1) Property identified to an account class—(i) Segregated property.* Subject to paragraph (b) of this section, property held by or for the account of a customer, which is segregated on behalf of a specific account class, or readily traceable on the filing date to customers of such account class, or recovered by the trustee on behalf of or for the benefit of an account

class, must be allocated to the customer estate of the account class for which it is segregated, to which it is readily traceable, or for which it is recovered.

(ii) *Excess property.* If, after payment in full of all allowed customer claims in a particular account class, any property remains allocated to that account class, such excess shall be allocated in accordance with paragraph (c)(2) of this section.

(2) *All other property.* Money, securities and property received from or for the account of customers which cannot be allocated in accordance with paragraph (c)(1)(i) of this section, must be allocated in the following order:

(i) To the estate of the account class for which, after the allocation required in paragraph (c)(1) of this section, the percentage of each public customer net equity claim which is funded is the lowest, until the funded percentage of net equity claims of such class equals the percentage of each public customer's net equity claim which is funded for the account class with the next lowest percentage of the funded claims; and then

(ii) To the estate of the two account classes referred to in paragraph (c)(2)(i) of this section so that the percentage of the net equity claims which are funded for each class remains equal until the percentage of each public customer net equity claim which is funded equals the percentage of each public customer net equity claim which is funded for the account class with the next lowest percentage of funded claims, and so forth, until the percentage of each public customer net equity claim which is funded is equal for all classes of accounts; and then,

(iii) Among account classes in the same proportion as the public customer net equity claims for each such account class bears to the total of public customer net equity

claims of all account classes until the public customer claims of each account class are paid in full; and, thereafter,

(iv) To the non-public customer estate for each account class in the same order as is prescribed in paragraphs (c)(2)(i) through (iii) of this section for the allocation of the customer estate among account classes.

(d) *Distribution of customer property—(1) Return or transfer of specifically identifiable property.* Specifically identifiable property not required to be liquidated under § 190.04(d)(2) may be returned or transferred on behalf of the customer to which it is identified:

(i) If it is margining an open commodity contract, only if substitute customer property is first deposited with the trustee with a value equal to the greater of the full fair market value of such property on the return date or the balance due on the return date on any loan by the debtor to the customer for which such property constitutes security; or

(ii) If it is not margining an open commodity contract, at the option of the customer, either pursuant to the terms of paragraph (d)(1)(i) of this section, or pursuant to the following terms: such customer first deposits substitute customer property with the trustee with a value equal to the amount by which the greater of the value of the specifically identifiable property to be transferred or returned on the date of such transfer or return or the balance due on the return date on any loan by the debtor to the customer for which such property constitutes security, together with any other disbursements made, or to be made, to such customer, plus a reasonable reserve in the trustee's sole discretion, exceeds the estimated aggregate of the funded balances for each class of account of such customer less the value on the date of its transfer or return of any property transferred or

returned prior to the primary liquidation date with respect to the customer's net equity claim for such account; provided, however, that adequate security to assure the recovery of any overpayments by the trustee is provided to the debtor's estate by the customer.

(2) *Transfers of specifically identifiable commodity contracts under section 766 of the Bankruptcy Code.* Any open commodity contract that is specifically identifiable property and which is not required to be liquidated under § 190.04(d), and which is not otherwise liquidated, may be transferred on behalf of a public customer, provided, however, that such customer must first deposit substitute customer property with the trustee with a value equal to the amount by which the equity to be transferred to margin such contract together with any other transfers or returns of specifically identifiable property or disbursements made, or to be made, to such customer, plus a reasonable reserve in the trustee's sole discretion, exceeds the estimated aggregate of the funded balances for each class of account of such customer less the value on the date of its transfer or return of any property transferred or returned prior to the primary liquidation date with respect to the customer's net equity claim for such account; and, provided further, that adequate security to assure the recovery of any overpayments by the trustee is provided to the debtor's estate by the customer.

(3) *Distribution in kind of specifically identifiable securities.* If any securities of a customer are specifically identifiable property as defined in paragraph (1)(i)(A) of the definition of that term in § 190.01, but the customer has no open commodity contracts, the customer may request that the trustee purchase or otherwise obtain the largest whole number of like-kind securities (*i.e.*, securities of the same class and series of an issuer), with a fair market value (inclusive of transaction costs) which does not exceed that

portion of such customer's allowed net equity claim that constitutes a claim for securities, if like-kind securities can be purchased in a fair and orderly manner.

(4) *Proof of customer claim.* No distribution shall be made pursuant to paragraphs (d)(1) and (d)(3) of this section prior to receipt of a completed proof of customer claim as described in § 190.03(e) or (f).

(5) *No differential distributions.* No further disbursements may be made to customers with respect to a particular account class for whom transfers have been made pursuant to § 190.07 and paragraph (d)(2) of this section, until a percentage of each net equity claim equivalent to the percentage distributed to such customers is distributed to all public customers in such account class. Partial distributions, other than the transfers referred to in § 190.07 and paragraph (d)(2) of this section, with respect to a particular account class made prior to the final net equity determination date must be made pursuant to a preliminary plan of distribution approved by the court, upon notice to the parties and to all customers, which plan requires adequate security to the debtor's estate to assure the recovery of any overpayments by the trustee and distributes an equal percentage of net equity to all public customers in such account class.

**§ 190.10 Provisions applicable to futures commission merchants during business as usual.**

(a) *Current records.* A person that is a futures commission merchant is required to maintain current records relating to its customers' accounts, including copies of all account agreements and related account documentation, and "know your customer" materials, pursuant to §§ 1.31, 1.35, 1.36, and 1.37 of this chapter, which may be provided to another futures commission merchant to facilitate the transfer of open

commodity contracts or other customer property held by such person for or on behalf of its customers to the other futures commission merchant, in the event an order for relief is entered with respect to such person.

(b) *Designation of hedging accounts.* (1) A futures commission merchant must provide an opportunity to each customer, when it first opens a futures account, foreign futures account or cleared swaps account with such futures commission merchant, to designate such account as a hedging account. The futures commission merchant must indicate prominently in the accounting records in which it maintains open trade balances whether, for each customer account, the account is designated as a hedging account.

(2) A futures commission merchant may permit the customer to open an account as a hedging account only if it obtains the customer's written representation that the customer's trading of futures or options on futures, foreign futures or options on foreign futures, or cleared swaps (as applicable) in the account constitutes hedging as such term may be defined under any relevant Commission regulation or rule of any clearing organization, designated contract market, swap execution facility or foreign board of trade.

(3) The requirements set forth in paragraphs (b)(1) and (2) of this section do not apply to a futures commission merchant with respect to any commodity contract account that the futures commission merchant opened prior to [insert Effective Date]. The futures commission merchant may continue to designate as a hedging account any account with respect to which the futures commission merchant received written hedging instructions from the customer in accordance with former § 190.06(d).

(4) A futures commission merchant may designate an existing futures account, foreign futures account or cleared swaps account of a particular customer as a hedging account, provided that it has obtained the representation set out in paragraph (b)(2) of this section from such customer.

(c) *Delivery accounts.* In connection with the making or taking of delivery of a commodity under a commodity contract whose terms require settlement via physical delivery, if a futures commission merchant facilitates or effects the transfer of the physical delivery property and payment therefor on behalf of the customer, and does so outside the futures account, foreign futures account or cleared swaps account in which the commodity contract was held, the futures commission merchant must do so in a delivery account, provided, however, that when the commodity subject to delivery is a security, a futures commission merchant may, consistent with any applicable regulatory requirements, do so in a securities account.

(d) *Letters of credit.* A futures commission merchant shall not accept a letter of credit as collateral unless such letter of credit may be exercised, through its stated date of expiry, under the following conditions, regardless of whether the customer posting that letter of credit is in default in any obligation:

(1) In the event that an order for relief under Chapter 7 of the Bankruptcy Code or a protective decree pursuant to section 5(b)(1) of SIPA is entered with respect to the futures commission merchant, or if the FDIC is appointed as receiver for the futures commission merchant pursuant to 12 U.S.C. 5382(a), the trustee for that futures commission merchant (or, as applicable, FDIC) may draw upon such letter of credit, in full or in part, in accordance with § 190.04(d)(3).

(2) If the letter of credit is passed through to a clearing organization, then in the event that an order for relief under chapter 7 of the Bankruptcy Code is entered with respect to the clearing organization, or if the FDIC is appointed as receiver for the clearing organization pursuant to 12 U.S.C. 5382(a), the trustee for that clearing organization (or, as applicable, FDIC) may draw upon such letter of credit, in full or in part, in accordance with § 190.04(d)(3). A futures commission merchant shall not accept a letter of credit from a customer as collateral if it has any agreement with the customer that is inconsistent with the foregoing.

*(e) Disclosure statement for non-cash margin.* (1) Except as provided in § 1.65 of this chapter, no commodity broker (other than a clearing organization) may accept property other than cash from or for the account of a customer, other than a customer specified in § 1.55(f) of this chapter, to margin, guarantee, or secure a commodity contract unless the commodity broker first furnishes the customer with the disclosure statement set forth in paragraph (e)(2) of this section in boldface print in at least 10 point type which may be provided as either a separate, written document or incorporated into the customer agreement, or with another statement approved under § 1.55(c) of this chapter and set forth in appendix A to § 1.55 which the Commission finds satisfies this requirement.

(2) The disclosure statement required by paragraph (e)(1) of this section is as follows:

**THIS STATEMENT IS FURNISHED TO YOU BECAUSE § 190.10(e) OF THE COMMODITY FUTURES TRADING COMMISSION REQUIRES IT FOR REASONS OF FAIR NOTICE UNRELATED TO THIS COMPANY'S CURRENT FINANCIAL CONDITION.**

1. YOU SHOULD KNOW THAT IN THE UNLIKELY EVENT OF THIS COMPANY'S BANKRUPTCY, PROPERTY, INCLUDING PROPERTY SPECIFICALLY TRACEABLE TO YOU, WILL BE RETURNED, TRANSFERRED OR DISTRIBUTED TO YOU, OR ON YOUR BEHALF, ONLY TO THE EXTENT OF YOUR PRO RATA SHARE OF ALL PROPERTY AVAILABLE FOR DISTRIBUTION TO CUSTOMERS.

2. THE COMMISSION'S REGULATIONS CONCERNING BANKRUPTCIES OF COMMODITY BROKERS CAN BE FOUND AT 17 CODE OF FEDERAL REGULATIONS PART 190.

(3) The statement contained in paragraph (e)(2) of this section need be furnished only once to each customer to whom it is required to be furnished by this section.

### **Subpart C – Clearing Organization as Debtor**

#### **§ 190.11 Scope and purpose of subpart C.**

This subpart C applies to a proceeding commenced under subchapter IV of chapter 7 of the Bankruptcy Code in which the debtor is a clearing organization.

#### **§ 190.12 Required reports and records.**

(a) *Notices*—(1) *Notices – means of providing*—(i) *To the Commission*. Unless instructed otherwise by the Commission, all mandatory or discretionary notices to be given to the Commission under this subpart C shall be directed by electronic mail to *bankruptcyfilings@cftc.gov*. For purposes of this subpart C, notice to the Commission shall be deemed to be given only upon actual receipt.

(ii) *To members*. The trustee, after consultation with the Commission, and unless otherwise instructed by the Commission, will establish and follow procedures reasonably designed for giving adequate notice to members under this subpart C and for receiving claims or other notices from members. Such procedures should include, absent good cause otherwise, the use of a prominent website as well as communication to members' electronic addresses that are available in the debtor's books and records.

(2) *Of commencement of a proceeding.* A debtor that files a petition in bankruptcy that is subject to this subpart shall, at or before the time of such filing, and a debtor against which such a petition is filed shall, as soon as possible, but in any event no later than three hours after the receipt of notice of such filing, notify the Commission of the filing date, the court in which the proceeding has been or will be filed, and, as soon as available, the docket number assigned to that proceeding by the court.

(b) *Reports and records to be provided to the trustee and the Commission within three hours.* (1) As soon as practicable following the commencement of a proceeding that is subject to this subpart and in any event no later than three hours following the later of the commencement of such proceeding or the appointment of the trustee, the debtor shall provide to the trustee copies of each of the most recent reports that the debtor was required to file with the Commission under § 39.19(c) of this chapter, including copies of any reports required under § 39.19(c)(2), (c)(3) and (c)(4) of this chapter (including the most up-to-date version of any recovery and wind-down plans of the debtor maintained pursuant to § 39.39(b) of this chapter) that the debtor filed with the Commission during the preceding 12 months.

(2) As soon as practicable following the commencement of a proceeding that is subject to this subpart and in any event no later than three hours following the commencement of such proceeding (or, with respect to the trustee, the appointment of the trustee), the debtor shall provide to the trustee and the Commission copies of the most up-to-date versions of the default management plan and default rules and procedures maintained by the debtor pursuant to § 39.16 and, as applicable, § 39.35 of this chapter.

(c) *Records to be provided to the trustee and the Commission by the next business day.* As soon as practicable following commencement of a proceeding that is subject to this subpart and in any event no later than the next business day, the debtor shall make available to the trustee and the Commission copies of the following records:

(1) All records maintained by the debtor described in § 39.20(a) of this chapter;

(2) Any opinions of counsel or other legal memoranda provided to the debtor (whether by external or internal counsel) in the five years preceding the commencement of such proceeding relating to the enforceability of the rules and procedures of the debtor in the event of an insolvency proceeding involving the debtor.

**§ 190.13 Prohibition on avoidance of transfers.**

The following transfers are approved and may not be avoided under sections 544, 546, 547, 548, 549, or 724(a) of the Bankruptcy Code:

(a) *Pre-relief transfers.* Any transfer of open commodity contracts and the property margining or securing such contracts made to another clearing organization that was approved by the Commission, either before or after such transfer, and was made prior to entry of the order for relief; and

(b) *Post-relief transfers.* Any transfers of open commodity contracts and the property margining or securing such contracts made to another clearing organization on or before the seventh calendar day after the entry of the order for relief, that was made with the approval of the Commission, either before or after such transfer.

**§ 190.14 Operation of the estate of the debtor subsequent to the filing date.**

(a) *Proofs of Claim.* The trustee may, in its discretion based upon the facts and circumstances of the case, instruct each customer to file a proof of claim containing such

information as is deemed appropriate by the trustee, and seek a court order establishing a bar date for the filing of such proofs of claim.

(b) *Continued operation of the derivatives clearing organization.* (1) Subsequent to the order for relief, the derivatives clearing organization shall cease making calls for variation or initial margin, except as otherwise explicitly provided in this subsection.

(2) If the trustee believes that continued operation of the derivatives clearing organization on a temporary basis would

(i) Facilitate either—

(A) Prompt transfer of the clearing operations of the derivatives clearing organization to another derivatives clearing organization or

(B) Resolution of the derivatives clearing organization pursuant to title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and

(ii) Be practicable, in the sense that—

(A) The rules of the derivatives clearing organization do not compel the termination of all or substantially all of the outstanding contracts under the circumstances then prevailing (*e.g.*, upon the order for relief), and

(B) All or substantially all of the members of the derivatives clearing organization (other than those who are themselves subject to a bankruptcy proceeding) would be able to, and would in fact, make variation payments as owed during the temporary timeframe, then the trustee may request permission of the Commission to continue to operate the derivatives clearing organization for up to six calendar days after the order for relief to the extent practicable and in accordance with the rules and procedures of the debtor, with respect to open commodity contracts of the debtor.

(3) Upon receiving a request pursuant to paragraph (b)(2) of this section, the Commission shall proceed promptly to consider the request and, if it is persuaded that the trustee's conclusions with respect to paragraphs (b)(2)(i) and (ii) of this section are well grounded, may grant the trustee's request. Such grant may be for fewer calendar days than the trustee has requested, but then may be renewed at the Commission's discretion so long as the calendar days of continued operation total no more than six.

(c) *Liquidation.* (1) The trustee shall liquidate all open commodity contracts that have not been terminated, liquidated or transferred no later than seven calendar days after entry of the order for relief, unless the Commission determines that liquidation would be inconsistent with the avoidance of systemic risk or would not be in the best interests of the debtor's estate. Such liquidation of open commodity contracts shall be conducted in accordance with the rules and procedures of the debtor, to the extent applicable and practicable.

(2) In lieu of liquidating securities held by the debtor and making distributions in the form of cash, the trustee may, in its reasonable discretion, make distributions in the form of securities that are equivalent (*i.e.*, securities of the same class and series of an issuer) to the securities originally delivered to the debtor by a clearing member or such clearing member's customer.

(d) *Computation of funded balance.* The trustee shall use reasonable efforts to compute a funded balance for each customer account immediately prior to any distribution of property within the account, which shall be as accurate as reasonably practicable under the circumstances, including the reliability and availability of information.

**§ 190.15 Recovery and wind-down plans; default rules and procedures.**

(a) *Prohibition on avoidance of actions taken pursuant to recovery and wind-down plans.* Subject to the provisions of section 766 of the Bankruptcy Code and §§ 190.13 and 190.18, the trustee shall not avoid or prohibit any action taken by a debtor subject to this subpart that was reasonably within the scope of and was provided for in any recovery and wind-down plans maintained by the debtor and filed with the Commission pursuant to § 39.39 of this chapter.

(b) *Implementation of debtor's default rules and procedures.* In administering a proceeding under this subpart, the trustee shall implement, in consultation with the Commission, the default rules and procedures maintained by the debtor under § 39.16 and, as applicable, § 39.35 of this chapter and any termination, close-out and liquidation provisions included in the rules of the debtor, subject to the reasonable discretion of the trustee and to the extent that implementation of such default rules and procedures is practicable.

(c) *Implementation of recovery and wind-down plans.* In administering a proceeding under this subpart, the trustee shall, in consultation with the Commission, take actions in accordance with any recovery and wind-down plans maintained by the debtor and filed with the Commission pursuant to § 39.39 of this chapter, to the extent reasonable and practicable.

**§ 190.16 Delivery.**

(a) *General.* In the event that a commodity contract, cleared by the DCO, that settles upon expiration or exercise by making or taking delivery of physical delivery property, has moved into delivery position prior to the date and time of the order for

relief, the trustee must use reasonable efforts to facilitate and cooperate with the completion of delivery on behalf of the clearing member or the clearing member's customer in a manner consistent with § 190.06(a) and the pro rata distribution principle addressed in § 190.00(c)(5).

(b) *Special provisions for delivery accounts.* (1) Consistent with the separation of the physical delivery property account class and the cash delivery account class set forth in § 190.06(b), the trustee shall treat—

(i) Physical delivery property held in delivery accounts as of the filing date, along with the proceeds from any subsequent sale of such physical delivery property in accordance with § 190.06(a)(3) to fulfill a clearing member's or its customer's delivery obligation or any other subsequent sale of such property, as part of the physical delivery account class, and

(ii) Cash delivery property in delivery accounts as of the filing date, along with any physical delivery property for which delivery is subsequently taken on behalf of a clearing member or its customer in accordance with § 190.06(a)(3), as part of the separate cash delivery account class.

(2) If the debtor holds any cash or property in the form of cash equivalents in an account with a bank or other person under a name or in a manner that clearly indicates that the account holds property for the purpose of making payment for taking physical delivery, or receiving payment for making physical delivery, of a commodity under any commodity contracts, such property shall (subject to § 190.19) be considered customer property in the cash delivery account class if held for making payment for taking

delivery, or in the physical delivery account class, if held for the purpose of receiving such payment.

**§ 190.17 Calculation of net equity.**

(a) *Net equity – separate capacities and calculations.* (1) If a member of the clearing organization clears trades in commodity contracts through a commodity contract account carried by the debtor as a customer account for the benefit of the clearing member's public customers and separately through a house account, the clearing member shall be treated as having customer claims against the debtor in separate capacities with respect to the customer account and house account at the clearing organization, and by account class. A member shall be treated as part of the public customer class with respect to claims based on any commodity customer accounts carried as "customer accounts" by the clearing organization for the benefit of the member's public customers, and as part of the non-public customer class with respect to claims based on its house account.

(2) Net equity shall be calculated separately for each separate customer capacity in which the clearing member has a claim against the debtor, *i.e.*, separately by the member's customer account and house account and by account class.

(b) *Net equity – application of debtor's loss allocation rules and procedures.* (1) The calculation of a clearing member's net equity claim shall include the full application of the debtor's loss allocation rules and procedures, including the default rules and procedures referred to in § 39.16 and, if applicable, § 39.35 of this chapter. This includes, with respect to the clearing member's house account, any assessments or similar

loss allocation arrangements provided for under those rules and procedures that were not called for before the filing date, or, if called for, have not been paid.

(2) Where the debtor's loss allocation rules and procedures would entitle clearing members to additional payments of cash or other property due to—

(i) Portions of mutualized default resources that are prefunded, or assessed and collected, but in either event not used, or to

(ii) The debtor's recoveries on claims against others (including, but not limited to, recoveries on claims against clearing members who have defaulted on their obligations to the debtor), appropriate adjustments shall be made to the net equity claims of the clearing members that are so entitled.

(c) *Net equity – general.* Subject to paragraph (b) of this section, net equity shall be calculated in the manner provided in § 190.08, to the extent applicable.

(d) *Calculation of funded balance.* *Funded balance* means a clearing member's pro rata share of customer property other than member property (for accounts for a clearing member's customer accounts) or member property (for a clearing member's house accounts) with respect to each account class available for distribution to customers of the same customer class, calculated in the manner provided in § 190.08(c) to the extent applicable.

### **§ 190.18 Treatment of property.**

(a) *General.* The property of the debtor's estate must be allocated between member property and customer property other than member property as provided in this section to satisfy claims of clearing members, as customers of the debtor. The property so allocated will constitute a separate estate of the customer class (*i.e.*, member property,

and customer property other than member property) and the account class to which it is allocated, and will be designated by reference to such customer class and account class.

(b) *Scope of customer property.* Customer property is the property available for distribution within the relevant account class in respect of claims by clearing members, as customers of the clearing organization, based on customer accounts carried by the debtor for the benefit of (x) such members' public customers or (y) such members' house accounts.

(1) Customer property includes the following:

(i) All cash, securities, or other property, or the proceeds of such cash, securities or other property, received, acquired or held by or for the account of the debtor, from or for any commodity contract account of a clearing member carried by the debtor, which is:

(A) Property received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract;

(B) Open commodity contracts;

(C) Physical delivery property as that term is defined in paragraphs (1) through (3) of the definition of that term in § 190.01;

(D) Cash, securities or other property received by the debtor as payment for a commodity to be delivered to fulfill a commodity contract from or for the commodity customer account of a clearing member or a customer of a clearing member;

(E) Profits or contractual rights accruing as a result of a commodity contract;

(F) Letters of credit, including any proceeds of a letter of credit drawn upon by the trustee, or substitute customer property posted by a clearing member or a customer of a clearing member, pursuant to § 190.04(d)(3);

(G) Securities held in a portfolio margining account carried as a futures account or a cleared swaps customer account;

(ii) All cash, securities, or other property which:

(A) Is segregated by the debtor on the filing date for the benefit of clearing members' house accounts or clearing members' public customer accounts;

(B) Which was of a type described in paragraph (b)(1)(i)(A) of this section that is subsequently recovered by the avoidance powers of the trustee or is otherwise recovered by the trustee on any other claim or basis;

(C) Represents a recovery of any debit balance, margin deficit or other claim of the debtor against any commodity contract account carried for the benefit of a member's house accounts or a member's public customer accounts;

(D) Was unlawfully converted but is part of the debtor's estate;

(E) Of a type described in paragraphs (a)(1)(ii)(H) through (K) of § 190.09 (as if the term debtor used therein refers to a clearing organization as debtor); and

(iii) Any guaranty fund deposit, assessment, or similar payment or deposit made by a clearing member, or recovered by the trustee, to the extent any remains following administration of the debtor's default rules and procedures, and any other property of a member available under the debtor's rules and procedures to satisfy claims made by or on behalf of public customers of a member.

(2) Customer property will not include property of the type described in § 190.09(a)(2), as if the term debtor used therein refers to a clearing organization and to the extent relevant to a clearing organization.

*(c) Allocation of customer property between customer classes.* (1) Property referred to in paragraph (b)(1)(iii) of this section should be allocated

(i) To customer property other than member property to the extent that the funded balance is less than one hundred percent of net equity claims for members' public customers in any account class.

(ii) Any remaining excess after the application of paragraph (c)(1)(i) of this section should be allocated to member property.

(2) Where the funded balance for members' house accounts is greater than one hundred percent with respect to any account class,

(i) Any excess should be allocated to customer property other than member property to the extent that the funded balance is less than one hundred percent of net equity claims for members' public customers in any account class.

(ii) Any remaining excess after the application of paragraph (c)(2)(i) of this section should be allocated to member property to the extent that the funded balance is less than one hundred percent of net equity claims for members' house accounts in any other account class.

(3) Where the funded balance for members' public customers in any account class is greater than one hundred percent,

(i) Any excess should be allocated to customer property other than member property to the extent that the funded balance is less than one hundred percent of net equity claims for members' public customers in any other account class.

(ii) Any remaining excess after the application of paragraph (c)(3)(i) should be allocated to member property to the extent that the funded balance is less than one hundred percent of net equity claims for members' house accounts in any account class.

(d) *Allocation of customer property among account classes*—(1) *Segregated property.* Subject to paragraph (b) of this section, property held by or for the account of a customer, which is segregated on behalf of a specific account class within a customer class, or readily traceable on the filing date to customers of such account class within a customer class, or recovered by the trustee on behalf of or for the benefit of an account class within a customer class, must be allocated to the customer estate of the account class for which it is segregated, to which it is readily traceable, or for which it is recovered.

(2) *All other property.* Customer property which cannot be allocated in accordance with paragraph (d)(1) of this section, shall be allocated within customer classes, but between account classes, in the following order:

(i) To the estate of the account class for which the percentage of each members' net equity claim which is funded is the lowest, until the funded percentage of net equity claims of such account class equals the percentage of each members' net equity claim which is funded for the account class with the next lowest percentage of the funded claims; and then

(ii) To the estate of the two account classes so that the percentage of the net equity claims which are funded for each such account class remains equal until the percentage of each net equity claim which is funded equals the percentage of each net equity claim

which is funded for the account class with the next lowest percentage of funded claims, and so forth, until all account classes within the customer class are fully funded.

(e) Where the debtor has, prior to the order for relief, kept initial margin for house accounts in accounts without separation by account class, then member property will be considered to be in a single account class.

(f) Nothing in this section, including but not limited to the satisfaction of customer claims by operation of this section, shall prevent a trustee from asserting claims against any person to recover the shortfall of property enumerated in paragraphs (b)(1)(i)(E), (b)(1)(ii), and (b)(1)(iii) of this section.

**§ 190.19 Support of daily settlement.**

(a) Notwithstanding any other provision of this part, funds received (whether from clearing members' house or customer accounts) by a debtor clearing organization as part of the daily settlement required pursuant to § 39.14 of this chapter shall, upon and after an order for relief, be included as customer property that is reserved for and traceable to, and promptly shall be distributed to, members entitled to payments of such funds with respect to such members' house and customer accounts as part of that same daily settlement. Such funds when received, other than deposits of initial margin described in § 39.14(a)(iii) of this chapter, shall be considered Member property and Customer property other than member property, in proportion to the ratio of total gains in member accounts with net gains, and total gains in customer accounts with net gains, respectively. Deposits of initial margin described in § 39.14(a)(iii) of this chapter shall be considered Member property and Customer property other than member property, to the extent

deposited on behalf of, respectively, clearing members' house accounts and customer accounts.

(b) To the extent there is a shortfall in funds received pursuant to paragraph (a) of this section:

(1) Such funds shall be supplemented in accordance with the derivatives clearing organization's default rules and procedures adopted pursuant to § 39.16 and, as applicable, § 39.35 of this chapter, and any recovery and wind-down plans maintained pursuant to § 39.39 of this chapter and submitted pursuant to § 39.19 of this chapter, including the following property, as applicable, to the extent necessary to meet the shortfall. Such funds shall be included as member property and customer property other than member property in the proportion described in paragraph (a) of this section, and shall be distributed promptly to members' house accounts and members' customer accounts which accounts are entitled to payment of such funds as part of that daily settlement:

(i) Initial margin held for the account of a member, including initial margin segregated for the customers of such member, that has defaulted on payments required pursuant to a daily settlement, but only to the extent that such margin is permitted to be used pursuant to parts 1, 22 and 30 of this chapter.

(ii) Assets of the debtor, to the extent dedicated to such use as part of the debtor's default rules and procedures, and any recovery and wind-down plans, described in this paragraph.

(iii) Prefunded guarantee or default funds maintained pursuant to the debtor's default rules and procedures.

(iv) Payments made by members pursuant to assessment powers maintained pursuant to the debtor's default rules and procedures.

(2) If the funds that are included as customer property pursuant to paragraph (a) of this section, supplemented as described in paragraph (b)(1) of this section, are insufficient to pay in full members entitled to payment of such funds as part of daily settlement, then such funds shall be distributed pro rata to such members' house accounts and customer accounts in proportion to the ratio of total gains in member accounts with net gains, and total gains in customer accounts with net gains, respectively.

12. Revise appendix A to part 190 to read as follows:

**Appendix A to Part 190 – Customer Proof of Claim Form**

[CASE CAPTION]

**CLAIM FORM FOR COMMODITY BROKER CUSTOMERS OF [DEBTOR]**

Debtor: [INSERT]	
Customer Name:	
Account Number(s):	<input type="checkbox"/> Check this box if this claim amends a previously filed claim.
Daytime Telephone number:	<b>Court Claim Number:</b> _____ (If known)
Email:	Filed on: _____
Name and address where payment should be sent (if different from above):	<input type="checkbox"/> Check this box if you are aware that anyone else has filed a proof of claim relating to this claim. Attach copy of statement giving particulars.
Telephone number:	
Email:	

**THIS CLAIM FORM SHOULD BE USED ONLY IF YOU ARE A CUSTOMER HOLDING A CLAIM BASED ON A COMMODITY CONTRACT ACCOUNT (A FUTURES, FOREIGN FUTURES, CLEARED SWAPS OR DELIVERY ACCOUNT) AT THE DEBTOR. A DIFFERENT CLAIM FORM MUST BE USED TO ASSERT OTHER TYPES OF CLAIMS AGAINST THE DEBTOR.**

**THE DEADLINE FOR FILING ALL CUSTOMER CLAIMS BASED ON COMMODITY CONTRACT ACCOUNTS IS [BAR DATE]. NO CUSTOMER CLAIM WILL BE ALLOWED IF IT IS RECEIVED AFTER THIS DATE. CLAIMS MUST BE RECEIVED BY 11:59 P.M. ([TIME ZONE]) ON \_\_\_\_\_ TO BE CONSIDERED TIMELY.**

[Include case-specific instructions for how to file a claim]

If you require additional space to answer any question, please attach separate pieces of paper and label the answers to the corresponding questions.

**I. CLAIM AMOUNT**

For each type of commodity contract account that is applicable, state the amount of your claim against the Debtor.

- (1) Futures account claim: \$ \_\_\_\_\_ [§ 190.03(e)(1)]<sup>1</sup>
- (2) Foreign futures account claim: \$ \_\_\_\_\_ [§ 190.03(e)(1)]
- (3) Cleared swaps account claim: \$ \_\_\_\_\_ [§ 190.03(e)(1)]
- (4) Delivery account claim: \$ \_\_\_\_\_ [§ 190.03(e)(1)]

[Of the amount in (4), please note how much is in the form of cash or cash equivalents (\$ \_\_\_\_\_) and how much is the value of commodities that have been or were/are to be delivered (\$ \_\_\_\_\_)]

- (5) Total claim: \$ \_\_\_\_\_
- (6) Date on which your claim is valued (*see instructions*): \_\_\_\_\_

**II. ACCOUNT INFORMATION**

For each commodity contract account with the Debtor, please provide the following information. To the extent you have multiple commodity contract accounts with the Debtor, please provide the following information for each account separately in an attachment.

- (1) Account number: \_\_\_\_\_ [§ 190.03(e)(3)(i)]
- (2) Name in which the account is held:  
\_\_\_\_\_ [§ 190.03(e)(3)(ii)]
- (3) Please specify all capacities in which you hold the account (check all that are applicable) [§ 190.03(e)(3)(iv)]:
  - a. Individual capacity

<sup>1</sup> Bracketed references are to the corresponding provision in § 190.03(e) where the relevant information item is listed.

- b. Guardian, custodian, or conservator for the benefit of a ward or a minor under the Uniform Gift to Minors Act
- c. Executor or administrator of an estate
- d. Trustee for a trust beneficiary
- e. Corporation, partnership, or unincorporated association
- f. Omnibus customer account of a futures commission merchant
- g. Part owner of a joint account
- h. Individual retirement account
- i. Agent or nominee for a principal or beneficial owner (and not described in Items (a)-(h))
- j. In any other capacity not described above in Items (a)-(i) (please specify the capacity): \_\_\_\_\_

*If you selected more than one box, please attach an explanation.*

- (4) Please specify whether the account is a joint account [§ 190.03(e)(3)(v)]:

**Check one:**     YES                       NO

*If you selected "YES," please specify your percentage interest in the account, and whether all participants in the joint account are claiming jointly. In addition, please see the instructions for additional information required for joint accounts.*

- a. My percentage interest in the joint account is: \_\_\_\_\_%
- b. Participants in the joint account are claiming:

**Check one:**     SEPARATELY     JOINTLY

- (5) Please specify whether the account is a discretionary account (*i.e.*, does another person have trading authority over the account) [§ 190.03(e)(3)(vi)]:

**Check one:**     YES                       NO

*If you selected "YES," please see the instructions for additional information required for discretionary accounts.*

- (6) Please specify whether the account is an individual retirement account for which there is a custodian [§ 190.03(e)(3)(vii)]:

**Check one:**     YES                       NO

1. If you selected "YES," please see the instructions for additional information required for individual retirement accounts for which there is a custodian.

- (7) Please specify whether the account is a cross-margining account for futures and securities [§ 190.03(e)(3)(viii)]:

**Check one:**  YES  NO

If you selected "YES," please see the instructions for additional information required for cross-margining accounts for futures and securities.

**III. ACCOUNT STATEMENT: OPEN POSITIONS, UNLIQUIDATED SECURITIES AND OTHER UNLIQUIDATED PROPERTY**

- (1) Account balance per most recent account statement:  
\$ \_\_\_\_\_ [§ 190.03(e)(3)(iii)]

a. Date of the most recent account statement:  
\_\_\_\_\_

***PLEASE ATTACH A COPY OF THIS STATEMENT (NOT THE ORIGINAL)***

- b. Do you agree with the account balance(s) on your most recent account statement(s), as set forth above?

**Check one:**  YES  NO

If you selected "NO," please explain in an attachment the reasons why you disagree with the account balance reflected on your most recent statement.

- c. Has there been activity in the account since the date of the last account statement up to and including the filing date that has affected the balance of the account ("subsequent activity")?

**Check one:**  YES  NO

If you selected "YES," please provide full information regarding any such subsequent activity in an attachment.

- (2) On the date on which your claim is valued, did you have any open positions, unliquidated securities and/or other unliquidated property in or associated with any of your commodity contract accounts? [§ 190.03(e)(7)]

2. **Check one:**  YES  NO

If you selected "YES," please state below the value of your open positions, unliquidated securities and/or other unliquidated property. In addition, please

*see the instructions for additional information required regarding open positions, unliquidated securities and other unliquidated property.*

Value of all open positions, unliquidated securities and/or other unliquidated property: \$ \_\_\_\_\_

- (3) To the extent you are claiming unliquidated securities or other unliquidated property held in your account, do you wish to receive payment in kind, if possible? [§ 190.03(e)(9)]

**Check one:**     YES                       NO

*If you selected "YES," please see the instructions for additional required information.*

**IV.      CONNECTIONS WITH THE DEBTOR [§ 190.03(e)(2)]**

- (1) Is the customer making this claim one of the following persons (check all that are applicable):

- a.      Officer, director, general partner or owner of ten percent or more of the capital stock of the Debtor.
- b.      An employee, limited partner or special partner of the Debtor whose duties include (1) the management of the business of the Debtor or any part thereof; (2) the handling of the trades or customer funds; (3) the keeping of records pertaining to the trades or funds of customers; or (4) the signing or cosigning of checks or drafts on behalf of Debtor.
- c.      A spouse or minor dependent living in the same household as any person listed in this section.
- d.      A business affiliate that directly or indirectly controls the Debtor, or is directly or indirectly controlled by or is under common control with the Debtor.

- (2) Is the customer making the claim on behalf of any account that is owned 10% or more by the Debtor or by any of the persons, alone or jointly, identified in IV.(1)?

**Check one:**     YES                       NO

*If you selected "YES," please identify such person(s) and the category identified in IV.(1) under which they fit.*

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V. **SECURITY FUTURES PRODUCTS** [§ 190.03(e)(8)]<sup>2</sup>

Is any portion of your claim based on security futures products (i.e. futures whose underlying instrument is either a single security or a narrow-based security index) held in a securities account with the Debtor?

Check one:  YES  NO

*If you selected "YES," you will need to file a separate claim in accordance with the procedures established for claims based on securities accounts at the Debtor.*

VI. **OTHER ACCOUNTS WITH DEBTOR** [§ 190.03(e)(4)]

Do you have any accounts with the Debtor that are not commodity contract accounts listed in response to Section III above?

Check one:  YES  NO

*If you selected "YES," specify the other account number(s) and the type of each such account.*

Account Number	Type of Account
1. _____	_____
2. _____	_____

*(Attach additional page(s) if necessary)*

VII. **OTHER CLAIMS AGAINST DEBTOR** [§ 190.03(e)(5)]

Do you have any other claims against the Debtor not already taken into account in the claim and account information provided in response to Sections I, II, III and VI above?

Check one:  YES  NO

*If you selected "YES," please provide a detailed description in an attachment of any such claim or claims, and attach any supporting documentation you have.*

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<sup>2</sup> This section is for use only in cases where the debtor is jointly registered as a futures commission merchant and securities broker-dealer.

**VIII. AMOUNTS OWED TO DEBTOR [§ 190.03(e)(6)]**

Do you owe any amounts to the Debtor not already taken into account in the claim and account balance information provided in response to the questions in sections I and II above?

**Check one:** YES  NO

*If you selected "YES," please provide a detailed description in an attachment of any such claim or claims, and attach any supporting documentation you have.*

**IX. VERIFICATION**

**CHECK THE APPROPRIATE BOX:**

- I am the customer  I am the customer's authorized agent.  
 I am a guarantor, surety, indorser  
or other (See Bankruptcy Rule 3005.)

***I declare under penalty of perjury that the information provided in this claim is true and correct to the best of my knowledge, information, and reasonable belief.***

Print Name: \_\_\_\_\_

Title: \_\_\_\_\_

Company: \_\_\_\_\_

Address and telephone number (if different from notice address above):

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Telephone number: \_\_\_\_\_

Email: \_\_\_\_\_

\_\_\_\_\_  
Signature (Date)

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***Penalty for presenting fraudulent claim: Fine of up to \$500,000 or imprisonment for up to 5 years, or both. 18 U.S.C. §§ 152 and 3571.***

**INSTRUCTIONS FOR CUSTOMER PROOF OF CLAIM FORM**

<p><b>Customer’s Name and Address:</b> Fill in the name of the person or entity asserting the claim, and the name and address of the person who should receive notices issued during the bankruptcy case. A separate space is provided for the payment address if it differs from the notice address. The customer has a continuing obligation to keep the court informed of its current address. See Federal Rule of Bankruptcy Procedure (FRBP) 2002(g).</p>	<p><b>Date on Which Claim is Valued:</b> Your claim should be valued as of [the last date on which any contracts or property not liquidated to cash balances remained in your account. Do not include the value of any contracts, funds or other property transferred to another commodity broker] [^, the date established by the Court as the date on which customer accounts should be valued].</p>
<ul style="list-style-type: none"> <li>• <b>Types of Customer Accounts:</b></li> <li>• A “futures account” is an account opened for the purpose of trading futures or options on futures on a U.S. futures exchange . Your account statement for a “futures account” would typically include the term “SEG” in the title or description of the account.</li> <li>• A “foreign futures account” is an account opened for the purpose of trading futures or options on futures on an exchange located outside the U.S. Your account statement for a “foreign futures account” would typically include the term “30.7” in the title or description of the account.</li> <li>• A “cleared swaps account” is an account opened for the purpose of holding swaps traded bilaterally or in off-exchange markets that are submitted to a CFTC-registered derivatives clearing organization for settlement and clearing. A “cleared swaps account” also is an account opened for the purpose of trading swaps or options on swaps on a designated contract market or swap execution facility and cleared by a CFTC-registered derivatives clearing organization. Your account statement for a “cleared swaps account” would typically include the term “swap” in the title or description of the account.</li> <li>• A “delivery account” is an account denominated as such and through which deliveries of commodities, whether tangible or</li> </ul>	<p><b>Estimated Claim Amount:</b> If you cannot compute the amount of your claim, you <b>must</b> file an estimated claim. In that case, please be sure to indicate that your claim is an estimated claim.</p> <p><b>Joint Accounts:</b> If any commodity contract account for which you are making a claim is a joint account, please include an attachment listing the account number and the name, address and contact information for each joint account holder other than yourself.</p> <p>If you are making a claim with respect to multiple joint accounts, and those joint accounts are not owned by the same holders in the same legal capacities and in identical ownership percentages, please complete a separate claim form for each joint account.</p> <p><b>Discretionary Accounts:</b> If any commodity contract account for which you are making a claim is a discretionary account, please include an attachment listing the account number and the name, address, and contact information for all persons with trading authority over any of those accounts. If different persons have trading authority over different accounts, please provide this information for each such account, listing applicable account numbers.</p> <p><b>Individual Retirement Accounts for which there is a Custodian:</b> If any commodity contract account for which you are making a claim is an individual retirement account for which there is a custodian, please include an attachment listing the account number and the name, address, and contact information for both the custodian and the account owner.</p>

<p>intangible, occur or have occurred under expiring futures contracts. A delivery account also may hold cash balances, title documents for commodities such as metals warehouse receipts, or other commodities, whether tangible or intangible, that are deliverable under an exchange's futures contract.</p> <ul style="list-style-type: none"> <li>Your account statement may include multiple types of customer accounts in a single account statement.</li> </ul> <p>Other types of derivatives trading accounts that you may have with the debtor, such as accounts holding off-exchange retail forex positions subject to part 5 of the regulations of the CFTC and funds to margin such positions, are not customer accounts entitled to special protection under the Bankruptcy Code.</p> <p><b>Claim in foreign currencies:</b> If some or all of your claim is based on a currency other than U.S. dollars, please file you claim in U.S. dollars based on the exchange rate in effect as of the petition date ([INSERT]), and identify the exchange rate used in calculating your claim in a separate attachment.</p>	<p><b>Cross-Margining Accounts for Futures and Securities:</b> If any commodity contract account for which you are making a claim is a cross-margining account for futures and securities, please include an attachment listing the account number and whether the securities positions are held in an account with the debtor or in an account with an affiliate of the debtor. If such positions are held in an account with an affiliate of the debtor, please identify and include contact information for such affiliate.</p>
<p><b>Open positions, Unliquidated Securities and Other Unliquidated Property:</b> To the extent you have any open positions, unliquidated securities and/or other unliquidated property in a commodity contract account, please include an attachment (i) describing each such open position, unliquidated security and/or other item of unliquidated property (e.g., for positions, by contract, delivery date, long/short, quantity, and strike price for options; for securities, by CUSIP and quantity); (ii) identifying whether such open position, unliquidated security and/or other unliquidated property is specifically identifiable property; and (iii) identifying whether you would prefer, if practicable, payment in kind for each unliquidated security or other item of unliquidated property or to have it liquidated.</p> <p>If the position, unliquidated security or other item of unliquidated property is already reflected in the account statement that you attached in response to Section III of this form, and you agree with the quantity and any value set forth therein, please say so. Otherwise, please (i) state the quantity and value you claim with respect to such open position, unliquidated security and/or other unliquidated property, and explain the basis for that quantity and value; and (ii) attach any documentary evidence supporting such value.</p>	<ul style="list-style-type: none"> <li><b>Documentation:</b></li> <li>Please attach a copy (not the original) of the most recent account statement for each account on which this claim is based.</li> <li>Please enclose copies (not originals) of any documentation or correspondence you believe will be of assistance in processing your claim, including, but not limited to, customer confirmations, account statements, and statements of purchase or sale.</li> </ul> <p>If, at any time, you complained in writing about the handling of your account to any person or entity or regulatory authority, and the complaint relates to the claim that you are asserting in this claim form, please provide copies of the complaint and all related correspondence, as well as any replies that you received.</p>

<p><b>Verification:</b> The individual completing this proof of claim must sign and date it. If the claim is filed electronically, the Bankruptcy Code authorizes courts to establish local rules specifying what constitutes a signature. If you sign this form, you declare under penalty of perjury that the information provided is true and correct to the best of your knowledge, information, and reasonable belief. Your signature is also a certification that the claim meets the requirements of FRBP 9011(b). Whether the claim is filed electronically or in person, if your name is on the signature line, you are responsible for the declaration.</p> <ul style="list-style-type: none"> <li>• Print the name and title, if any, of the customer or other person authorized to file this claim. State the filer's address and telephone number if it differs from the address given on the top of the form for purposes of receiving notices. If the claim is filed by an authorized agent, provide both the name of the individual filing the claim and the name of the agent. Criminal penalties apply for making a false statement on a proof of claim.</li> </ul>	<p><b>Credits:</b> An authorized signature on this proof of claim serves as an acknowledgment that when calculating the amount of the claim, the customer gave the Debtor credit for any obligations of the customer to the Debtor.</p>
<p><b>ADDITIONAL INFORMATION</b></p>	
<p><b>Acknowledgment of Receipt of Claim</b></p> <p>[Instructions for acknowledgment of filing]</p>	<p><b>Offers to Purchase a Claim</b> Certain entities are in the business of purchasing claims for an amount less than the face value of the claims. One or more of these entities may contact you and offer to purchase the claim. Some of the written communications from these entities may easily be confused with official court documentation or communications from the Debtor. These entities do not represent the Bankruptcy Court or the Debtor. A customer has no obligation to sell its claim. However, if a customer decides to sell its claim, any transfer of such claim is subject to FRBP 3001(e), any applicable provisions of the Bankruptcy Code (11 U.S.C. 101 <i>et seq.</i>), and any applicable orders of the Bankruptcy Court.</p>

13. Amend appendix B to part 190 by:

a. Revising the Framework 1 heading and the three introductory paragraphs of Framework 1; and

b. Revising the Framework 2 heading and the introductory paragraph of Framework 2.

The revisions read as follows:

**Appendix B to Part 190 – Special Bankruptcy Distributions**

**Framework 1—Special Distribution Of Customer Funds When The Cross-Margining Account Is A Futures Account**

(a) This distributional rule applies when a debtor futures commission merchant has participated in a cross-margining (“XM”) program for futures and securities under which the cross-margined positions of its futures customers (as defined in § 1.3 of this chapter) and the property received to margin, secure or guarantee such positions are held in one or more accounts pursuant to a Commission order that requires such positions and property to be segregated, pursuant to section 4d(a) of the Act, from the positions and property of—

(1) The futures commission merchant,

(2) If applicable, any affiliate carrying the securities positions as a participant in the XM program (“Affiliate”), and

(3) Other futures customers of the futures commission merchant (such segregated accounts, the “XM accounts”).

(b) The futures commission merchant may, and any Affiliate that holds the securities positions in an XM account that it directly carries will, be registered as a

broker-dealer under the Exchange Act. The Commission order approving the XM program may limit participating customers to market professionals and will require a participating customer to sign an agreement, in a form approved by the Commission, that refers to this distributional rule.

(c) A futures commission merchant is deemed to receive securities held in an XM account, including securities and other property held by an Affiliate in an XM account, as “futures customer funds” (as defined in § 1.3 of this chapter) that margin, guarantee or secure commodity contracts in the XM account (or paired XM accounts at the futures commission merchant and an Affiliate). Under the agreement signed by the customer, in the event that the futures commission merchant (or Affiliate) is the subject of a SIPA proceeding, the customer agrees that securities in an XM account are excluded from the securities estate for purposes of SIPA, and that its claim for return of the securities will not be treated as a customer claim under SIPA. These restrictions apply to the customer only, and should not be read to limit any action that the trustee may take to seek recovery of property in an XM account carried by an Affiliate as part of the customer estate of the futures commission merchant.

(d) XM accounts, and other futures accounts that are subject to segregation under section 4d(a) of the Act (pursuant to the Commission’s regulations thereunder) (“non-XM accounts”), are treated as two subclasses of futures account with two separate pools of segregated futures customer property, an XM pool and a non-XM pool, each of which constitutes a segregated pool under section 4d(a) of the Act. If the futures commission merchant has participated in multiple XM programs, the XM accounts in the different

programs are combined and treated as part of the same XM subclass of futures accounts. A futures customer could hold both non-XM and XM accounts.

(e) Customer claims under Part 190 arising out of the XM subclass of accounts are subordinated to customer claims arising out of the non-XM subclass of accounts in certain circumstances in which the futures commission merchant does not meet its segregation requirements. The segregation requirement is the amount of futures customer funds that the futures commission merchant is required by the Act and Commission regulations or orders to hold on deposit in segregated accounts on behalf of its futures customers (exclusive of its targeted residual amount obligations pursuant to § 1.3 of this chapter).

(f) If there is a shortfall in the non-XM pool and no shortfall in the XM pool, all customer net equity claims, whether or not they arise out of the XM subclass of accounts, will be combined and paid pro rata out of the combined XM and non-XM pools of futures customer property. If there is a shortfall in the XM pool and no shortfall in the non-XM pool, customer net equity claims arising from the XM subclass of accounts must be satisfied first from the XM pool, and customer net equity claims arising from the non-XM subclass of accounts must be satisfied first from the non-XM pool. If there is a shortfall in both the non-XM and XM pools:

(1) If the non-XM shortfall as a percentage of the segregation requirement for the non-XM pool is greater than or equal to the XM shortfall as a percentage of the segregation requirement for the XM pool, all customer net equity claims will be paid pro rata out of the combined XM and non-XM pools of futures customer property; and

(2) If the XM shortfall as a percentage of the segregation requirement for the XM pool is greater than the non-XM shortfall as a percentage of the segregation requirement for the non-XM pool, non-XM customer net equity claims will be paid pro rata out of the available non-XM pool, and XM customer net equity claims will be paid pro rata out of the available XM pool. In this way, non-XM customers will never be adversely affected by an XM shortfall.

(g) The following examples illustrate the operation of this rule. The examples assume that the FCM has two futures customers, one with exclusively XM accounts and one with exclusively non-XM accounts.

\* \* \* \* \*

**Framework 2 Special Allocation of Shortfall To Customer Claims When Customer Funds For Futures Contracts And Cleared Swaps Customer Collateral Are Held In A Depository Outside Of The United States Or In A Foreign Currency**

The Commission has established the following allocation convention with respect to futures customer funds (as § 1.3 of this chapter defines such term) and Cleared Swaps Customer Collateral (as § 22.1 of this chapter defines such term) (both of which are customer funds (as § 1.3 of this chapter defines such term) that are segregated pursuant to the Act and Commission rules thereunder), which applies in certain circumstances when futures customer funds or Cleared Swaps Customer Collateral are held by a futures commission merchant in a depository outside the United States (“U.S.”) or in a foreign currency. If a futures commission merchant enters into bankruptcy and maintains futures customer funds or Cleared Swaps Customer Collateral in a depository outside the U.S. or in a depository located in the U.S. in a currency other than U.S. dollars, the trustee shall

use the following allocation procedures to calculate the claim of each public customer in the futures account class or each public customer in the cleared swaps account class, as applicable, when sovereign action of a foreign government or court has occurred that results in losses to the futures customer funds or Cleared Swaps Customer Collateral. Applying the allocation convention will result in reduction of certain customer claims for such futures customer funds or Cleared Swaps Collateral. For purposes of this bankruptcy convention, sovereign action of a foreign government or court would include, but not be limited to, the application or enforcement of statutes, rules, regulations, interpretations, advisories, decisions, or orders, formal or informal, by a federal, state, or provincial executive, legislature, judiciary, or government agency. The trustee should perform the allocation procedures separately with respect to each public customer in the futures account class or cleared swaps account class.

\* \* \* \* \*

Issued in Washington, DC, on April 16, 2020, by the Commission.

Christopher Kirkpatrick,

*Secretary of the Commission.*

NOTE: The following appendices will not appear in the Code of Federal Regulations.

**Appendices to Bankruptcy Regulations – Commission Voting Summary,**

**Chairman’s Statement, and Commissioners’ Statements**

**Appendix 1 – Commission Voting Summary**

On this matter, Chairman Tarbert and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

## **Appendix 2 – Statement of Support of Chairman Heath P. Tarbert**

In his 1926 novel *The Sun Also Rises*, Ernest Hemingway offers what is perhaps the best chronicle of the anatomy of a typical bankruptcy. In the novel, the character Mike Campbell is asked how he went bankrupt. He answers: “two ways . . . gradually and then suddenly.”

As Hemingway’s dialogue succinctly describes, bankruptcies often come on unexpectedly. A business’s relatively minor financial or operational troubles may be exacerbated by a sudden crisis—whether a firm-level issue, or a national or even global event. Many catalysts for insolvency are entirely unpredictable, and we must be prepared with a bankruptcy regime that fosters a swift and equitable resolution.

### **Background on the CFTC’s Bankruptcy Regime**

Part 190 of the CFTC’s rules, addressing commodity broker<sup>1</sup> bankruptcies, was enacted in 1983. Since that time, the commodity broker bankruptcy process and the state of the industry have gradually changed. Yet in the nearly four decades since, Part 190 has never been revised to keep up. This regime is intended to protect customer funds, but having antiquated rules does not help achieve that goal.

CFTC staff has therefore embarked on a process of updating Part 190 over the last several years, while a healthy economy made bankruptcies relatively unlikely. Today’s proposal is a product of that hard work and engagement with external stakeholders and subject matter experts, including the American Bar Association.

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<sup>1</sup> The term “commodity broker” may refer either to a futures commission merchant (“FCM”) or a derivatives clearing organization (“DCO”). 11 U.S.C. 101(6).

To be clear, U.S. derivatives markets have weathered the recent volatility associated with the coronavirus pandemic admirably. The decision to issue this proposal was made long before COVID-19 emerged as a concern, and I hope and anticipate that it will not be necessary to use this updated bankruptcy regime to address fallout from current market conditions. But as I just noted, we cannot know for certain what the future holds—for bankruptcy often comes “gradually and then suddenly.” We must therefore be prepared for all contingencies.

Accordingly, I am pleased to support today’s proposal to update Part 190 for the 21st century. The proposal promotes the CFTC’s core values in a number of ways, particularly the values of *clarity* and *forward thinking*. The proposal also furthers the agency’s strategic goal of regulating our derivatives markets to promote the interests of all Americans.<sup>2</sup>

### **Clarity for Customers and Creditors**

The proposed rule serves our core value of clarity by incorporating key principles and actual practice as they have evolved in commodity broker bankruptcies and related judicial decisions in the years since 1983.

A new introductory section of the rule would enumerate certain “core concepts” of commodity broker bankruptcies. This section is intended to offer a readily understandable primer on relevant law, policy, and practical considerations in this area, thereby providing a common mental framework for brokers, customers, bankruptcy trustees, courts, and the public. Among other things, this section provides an overview of

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<sup>2</sup> See Remarks of CFTC Chairman Heath P. Tarbert to the 35th Annual FIA Expo 2019 (Oct. 30, 2019), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opatarbert2> (outlining the CFTC’s strategic goals).

the various classes of customer segregated accounts held by a commodity broker; the priority of public customers over non-public customers; the requirement of *pro rata* distribution; and the preference to transfer rather than liquidate open positions.

The proposal would further codify a number of approaches and practices that have proven necessary or desirable in commodity broker bankruptcies in the intervening years since 1983. For example, the proposed rule would authorize a bankruptcy trustee to treat a broker's customers in the aggregate for certain purposes, rather than handling each customer's account on a bespoke basis. This aggregate treatment has in practice proven unavoidable in more recent commodity broker bankruptcies, which have required disposition of hundreds of thousands of derivatives contracts—on behalf of thousands or tens of thousands of customers—within days or even hours. By making clear that such aggregate disposition of accounts is permissible and may even be likely to occur than the alternative, the proposal would provide greater clarity on potential outcomes for trustees, brokers, and customers.

Thus, for example, the proposed rule would expressly permit the trustee, following consultation with CFTC staff, to determine whether to treat open positions of public customers in a designated hedging account as specifically identifiable property (requiring the trustee to solicit and comply with individual customer instructions), or instead transfer or “port” all such positions to a solvent commodity broker where possible. This provision recognizes that requiring the trustee to identify hedging accounts and provide account holders the opportunity to give individual instructions is

often a resource-intensive endeavor, which could interfere with the trustee’s ability to act in a timely and effective manner to protect all the broker’s customers.<sup>3</sup>

The proposal also includes explicit rules governing the bankruptcy of a clearinghouse, otherwise known as a derivatives clearing organization or DCO. Since its inception, Part 190 has contemplated only a “case-by-case” approach with no corresponding rules to spell out what would happen. While a DCO bankruptcy is extremely unlikely, it is important to provide *ex ante* clarity to DCO members and customers as to how a resolution would be handled. The proposed rule would favor following the DCO’s existing default management and recovery and wind-down rules and procedures. This would allow the bankruptcy trustee to take advantage of an established “playbook,” rather than being forced to form a resolution plan in a matter of hours during the onset of a crisis. The proposed rule would also give legal certainty to DCO actions taken in accordance with a recovery and wind-down plan filed with the CFTC by precluding the trustee from voiding any such action.

I support codifying these and other practices within our rules in order to provide greater transparency and predictability to brokers, customers, and other key stakeholders regarding permissible and expected procedures in a bankruptcy scenario.

### **Forward Thinking on Future Insolvencies**

The proposed rule would update a number of provisions to reflect changes in financial technology since Part 190 was enacted 37 years ago. The enhanced discretion discussed above would in many cases help the trustee to account for the many-fold

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<sup>3</sup> The proposal would also grant the trustee needed discretion in other respects—for example, by allowing the trustee to modify the customer proof of claim form as appropriate for a particular bankruptcy.

increase in transaction execution and processing speed, as well as the potential for large and unpredictable market moves given the rise of global trading and the 24-hour news cycle. In addition, the proposal would acknowledge digital assets as a physically deliverable asset class, in light of the listing of a number of physically delivered “virtual currency” derivatives contracts.

The proposed changes also reflect advances in communications technology. For example, under the proposed rule, notice of a bankruptcy filing and related filed documents would be provided to the CFTC by electronic rather than paper means. Furthermore, required customer notice procedures would no longer include publication in a “newspaper of general circulation” in light of the downward trend in newspaper readership. The proposal would similarly recognize changes from paper-based to electronic recording of documents of title.

### **Promoting the Interests of All Americans**

Protection of customer funds is the lynchpin of the commodity broker bankruptcy regime of Part 190. The proposed rule includes a number of measures to enhance those protections, including by buttressing provisions already in place under existing law and regulation. In doing so, the proposal seeks to ensure that the CFTC’s bankruptcy regime works for the derivatives market participants it was meant to serve—particularly public brokerage customers, with a special emphasis on customers using derivatives to hedge their commercial risks.

For example, the proposal reinforces the bankruptcy priority of public broker customers over “non-public” customers (*e.g.*, the broker’s proprietary and affiliate accounts). It also strengthens the CFTC’s longstanding position that shortfalls in

segregated customer assets should be made up from the broker's general estate. As a result, our proposal makes clear that the CFTC's bankruptcy regime is complementary to relatively recently-enacted customer protection rules for day-to-day broker operations.<sup>4</sup>

The proposal would also further the preference—consistent with Subchapter IV of the Bankruptcy Code<sup>5</sup>—for transferring or “porting” customer positions to a solvent broker, rather than liquidating those positions. Porting of positions protects the utility of customer hedges by avoiding the risk of market moves between liquidation and re-establishment of the customer's hedging position. It also mitigates the risk that liquidation itself will cause such market moves. Among other measures, the grant of trustee discretion as to whether to treat hedging positions as specifically identifiable property will serve these objectives by facilitating porting of such positions *en masse*, promptly and efficiently, along with other customer property.

## **Conclusion**

While updates to the CFTC's bankruptcy rules have been years in the making, I believe today's proposal was well worth the wait. The commodity broker resolution regime of Part 190 is respected throughout the world for its effectiveness and efficiency. In addition, Part 190 is important to the continued global competitiveness of American exchanges, clearinghouses, and market intermediaries. The proposed rule further enhances these features of our regime. Through its focus on promoting customer protection, clarity, and forward thinking, I believe the proposed rule would, if finalized, position us well for this decade and beyond.

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<sup>4</sup> 17 CFR 1.23 (enacted in 2013 and revised in 2014) (requiring an FCM to contribute its own funds as “residual interest” to top up shortfalls in customer segregated accounts in the ordinary course of business).

<sup>5</sup> Statutory authority for part 190 includes Subchapter IV of Chapter 7 of the Bankruptcy Code.

### **Appendix 3 – Statement of Support of Commissioner Brian D. Quintenz**

I am pleased to support today’s proposal to amend the Commission’s regulations governing the bankruptcy proceedings of commodity brokers.<sup>1</sup> This proposal makes the first comprehensive change to these regulations since they were first issued in 1983. It marks another important step in Chairman Tarbert’s agenda to update and make more efficient several critical areas of the Commission’s regulations. I note that today’s proposal was not hastily prepared in response to the market events surrounding the COVID-19 pandemic. Commission staff has been considering these amendments since 2017, when a subcommittee of the American Bar Association (ABA) requested that the Commission update the part 190 bankruptcy regulations.<sup>2</sup> The ABA provided its proposal in response to the CFTC’s Project KISS initiative, which generally requested input from the public on how the Commission’s regulations could be simplified to reduce compliance burdens.<sup>3</sup> I commend former Chairman Giancarlo for launching Project KISS because it is important for agencies periodically to review their regulations, some of which may not have been amended for many years, to ensure they are as targeted, rational, and transparent as possible, in light of new developments in the markets they affect. I am pleased that the Commission’s rulemaking work continues despite the new challenges the agency is facing in light of the pandemic.

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<sup>1</sup> Part 190 of the Commission’s regulations (17 CFR 190).

<sup>2</sup> Proposal by the Part 190 Subcommittee of the Business Law Section of the Amer. Bar Assoc., dated Sept. 29, 2017, available at:  
<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61330&SearchText>  
and  
<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61331&SearchText>.

<sup>3</sup> CFTC Requests Public Input on Simplifying Rules,  
<https://www.cftc.gov/PressRoom/PressReleases/pr7555-17>.

I would like to highlight a few aspects of today’s proposal. First of all, the proposal reaffirms the special treatment the U.S. Bankruptcy Code affords to the customer account of an insolvent commodity broker, so that customers’ positions can promptly be transferred.<sup>4</sup> The Commission is proposing new rules for an insolvent DCO, which are similar to the rules applicable to an FCM. These rules take into account Title II of the Dodd-Frank Act, and I am pleased that the FDIC was consulted. Next, taking advantage of the Commission’s experience with a few insolvent FCMs over the past decades, the proposal would provide increased deference to the trustee that a U.S. Bankruptcy Court appoints to oversee the proceedings of an insolvent commodity broker. This increased deference is intended to expedite the transfer of customer funds. In light of the Commission’s experience from the bankruptcy of MF Global in 2011, proposed amendments would treat letters of credit equivalently to other collateral posted by customers, so that the *pro rata* distribution of customer property in the event of a shortfall in the customer account would apply equally to all collateral. The proposal also reflects experience from MF Global by dividing the delivery account into “physical delivery” and “cash delivery” account classes. Property other than cash is generally easier to trace, so it should have the benefit of a separate account class. Finally, the proposal’s revised treatment of the “delivery account,” applicable in the context of physically-settled futures and cleared swaps, would apply not only to tangible commodities, as is currently the case, but also to digital assets. This amendment will provide important legal certainty to the growing exchange-traded market for cleared, physically-settled, digital asset derivatives.

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<sup>4</sup> 11 U.S.C. 761 *et seq.*

I look forward to reviewing the comments to this proposal, not only from FCMs and DCOs, but also from their diverse customer base, including asset managers, the agricultural community, energy firms, and other derivatives end-users.

#### **Appendix 4 – Concurring Statement of Commissioner Rostin Behnam**

I respectfully support the Commodity Futures Trading Commission’s (the “Commission” or “CFTC”) issuance of a proposed rule (the “Proposal”) to amend Part 190 of its regulations, which govern bankruptcy proceedings of commodity brokers. First and foremost, I want to thank Commission staff for all of their hard work on this Proposal. If finalized, it will be the first major update of the CFTC’s existing Part 190 since 1983, when it was originally implemented by the Commission.<sup>1</sup>

The Proposal is not a response to current market conditions, nor is it a proposal that has only recently been considered; it is the product of years of staff analysis and engagement with market participants, including the Part 190 Subcommittee of the Business Law Section of the American Bar Association, which submitted detailed suggested model Part 190 rules in response to a prior Commission request for information.<sup>2</sup> Several agency Chairs going back many years deserve recognition and thanks for pushing to update Part 190 and starting this process. Customer protections are at the heart of the Commodity Exchange Act, and it is imperative that the Commission have clear rules that direct how proceedings occur during a commodity broker

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<sup>1</sup> *Bankruptcy*, 48 FR 8716 (March 1, 1983).

<sup>2</sup> 82 FR 23765 (May 3, 2017). The ABA Submission can be found at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61331&SearchText>; the accompanying cover note (“ABA Cover Note”) can be found at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61330&SearchText>.

bankruptcy. The Commission, market participants, customers, and the public will benefit greatly from this Proposal, and I am proud to have contributed to this effort.

The revision is designed to recognize the many changes in our industry over the past 37 years. The Commission finalized the existing part 190 the same year that the movie *Trading Places* debuted – when futures trading, so distinctly depicted in the film, occurred exclusively in oval trading pits, and markets were less global, less complex, and less sophisticated. To paraphrase former CFTC Chairman Giancarlo, Part 190 is an analog regulation applying to what has since become a digital world.<sup>3</sup>

More personally, I was a lead advisor during the U.S. Senate’s investigation of the 2011 MF Global bankruptcy, the eighth largest corporate bankruptcy in American history.<sup>4</sup> During the Senate investigation, I learned the intricate contours of Part 190, its relationship to the Bankruptcy Code, and how the larger puzzle of creditors, customers, and equity holders, among others, fits together. It was during those frenzied days that I truly appreciated the regulatory principle that *customer margin is sacrosanct property*. As a Commissioner since 2017, I have made customer protections an absolute priority in part because of my experience during those few months. Having spoken with many market participants throughout the bankruptcy proceedings, including those whose money disappeared in the days immediately following, customer protection is my most pressing responsibility.

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<sup>3</sup> See Address of CFTC Commissioner J. Christopher Giancarlo to the American Enterprise Institute: 21st Century Markets Need 21st Century Regulation (Sep. 21, 2016), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-17>.

<sup>4</sup> John Gapper and Isabella Kaminska, *Downfall of MF Global*, Financial Times, Nov. 4, 2011, available at <https://www.ft.com/content/2882d766-06fb-11e1-90de-00144feabdc0>.

The strengths and weaknesses of the Commission’s bankruptcy regime were further laid bare just a few months later in early 2012 following the bankruptcy of Peregrine Financial Group (“PFG”) – a second blow in short order. Important lessons have been learned, both in terms of what works and what does not, and I believe today’s Proposal is a positive step to addressing both.

There are a number of changes in today’s proposal that are intended to further support provisions of Part 190 that have worked in prior bankruptcies. One of the themes of this refresh is clarity. The goal is to be as clear as possible about the Commission’s intentions regarding Part 190 in order to enhance the understanding of Designated Clearing Organizations (“DCOs”), Futures Commission Merchants (“FCMs”), their customers, trustees, and the public at large. Changes in this proposal would foster the longstanding and continuing policy preference for transferring (as opposed to liquidating) the positions of public customers – an important customer protection. Other changes further support existing requirements including that short falls in segregated property should be shored up from the FCM’s general assets, and that *public customers are favored over non-public customers*. The proposal also grants trustees enhanced discretion based upon prior positive experience, and codifies practice adopted in past bankruptcies by requiring FCMs to notify the Commission of their intent to file for voluntary bankruptcy.

Other changes address what has not worked or become outdated. In light of lessons learned from MF Global, the Commission is proposing changes to the treatment of letters of credit as collateral, both during business as usual and during bankruptcy, in

order to ensure that customers who post letters of credit as collateral have the same proportional loss as customers who post other types of collateral.

The Proposal also addresses a number of changes that have naturally occurred in our markets since the original Part 190 finalization in 1983. The Commission is proposing a new subpart C to part 190, specifically governing the bankruptcy of a clearing organization. As DCOs have grown in importance over time, including being deemed systemically important by the Financial Stability Oversight Council following the financial crisis<sup>5</sup>, the Commission believes that it is imperative to have a clear plan in place for exactly how a DCO bankruptcy would be resolved. The Proposal also addresses changes in technology over the past 37 years, and the movement from paper-based to electronic-based means of communication – a stark reminder from the PFG bankruptcy.

I am hopeful that the 90 day comment period will allow sufficient time for the public to digest this extensive Proposal and provide fulsome comments. There can be no higher demand of market participants and the general public than to assist and guide the Commission in its duty, especially for one as important as this Proposal; it is absolutely critical.

If needed, I encourage market participants to request an extension of the comment period. As we all continue to endure the challenges of new realities at home and in the workplace as a result of the Covid-19 pandemic, I firmly believe the Commission needs to be as flexible as necessary to accommodate market participants and the general public in their efforts to provide us with the best comments to rulemakings. I have made my

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<sup>5</sup> [https://www.federalreserve.gov/paymentsystems/designated\\_fmnu\\_about.htm](https://www.federalreserve.gov/paymentsystems/designated_fmnu_about.htm).

position clear on what and how the Commission should be allocating its resources during these unprecedented times.<sup>6</sup>

As we propose bankruptcy rules that would provide important customer protections, I note with approval that today we are also finalizing another rule related to customer protection. Rule 160.30 re-establishes longstanding detailed requirements for Commission registrants to adopt policies and procedures to address administrative, technical and physical safeguards for the protection of customer records and information.

I would like to close by again thanking staff for all of their hard work in producing this refresh of the Commission's part 190 rules to provide important customer protections, and look forward to considering comments from the public as the Commission considers this critically important rule.

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<sup>6</sup> Statement of Commissioner Rostin Behnam Regarding COVID-19 and CFTC Digital Assets Rulemaking (March 24, 2020), <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement032420>; Statement of Commissioner Rostin Behnam Regarding CFTC's Extension of Currently Open Comment Periods in Response to the COVID-19 Epidemic (April 10, 2020), <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement041020>.

## **Appendix 5 – Statement of Commissioner Dan M. Berkovitz**

### *Introduction*

I support the proposed comprehensive amendments to the Commission’s bankruptcy regulations. These regulations specifically address the disposition of assets, particularly customer property, of a bankrupt futures commission merchant (FCM) or derivatives clearing organization (DCO). The amendments provide a needed update to regulations that the Commission originally adopted in 1983 to account for significant changes in the size, complexity, and structure of our derivatives markets and market participants over the past 37 years. They also incorporate “lessons learned” from FCM bankruptcies during that period. FCM bankruptcies are rare, and a registered DCO has never gone bankrupt in the history of the CFTC. It is nonetheless important to make the bankruptcy process as effective and efficient as possible to protect, preserve, and return customer assets quickly.

The overarching purposes of the provisions in the U.S. Bankruptcy Code relating to the liquidation of commodity brokers are to protect the customers of such brokers and to mitigate systemic risks that could arise from a commodity broker bankruptcy.<sup>1</sup> The Bankruptcy Code provides certain special protections for positions and property of customers of an FCM debtor so that the customers and current or future counterparties (and the clearing house) can be assured that those positions and property will not be treated as part of the FCM debtor’s property and can be transferred to another FCM. In

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<sup>1</sup> See 11 U.S.C., Chapter 7, Subchapter IV—Commodity Broker Liquidation. “Commodity Broker” is defined to mean a futures commission merchant, foreign futures commission merchant, clearing organization, leverage transaction merchant, or commodity options dealer, for which there is a “customer,” as defined in the bankruptcy code. See 11 U.S.C. 101(6).

this way, a single FCM's bankruptcy will not cascade through derivatives markets by impacting customer positions and the counterparties to those positions.<sup>2</sup>

In section 20(a) of the Commodity Exchange Act ("CEA") Congress gave the Commission broad authority to establish regulations regarding commodity broker debtors, including identifying which property shall be considered customer property (or commodity broker member property), the method for conducting the business of a commodity broker after the filing of a bankruptcy petition, and how net equity of customers is determined.<sup>3</sup> Pursuant to CEA section 20, the Commission first adopted regulations to address these issues in 1983.

#### *Need for Comprehensive Amendments*

Since 1983, trading volumes and speeds have increased significantly. There are fewer FCMs, and much of the FCM business is concentrated in a few large firms, particularly with respect to swaps. Swap trading and clearing were added to the CFTC's jurisdiction following the 2008 financial crisis, and FCMs and clearing organizations trade and clear large volumes of swaps that were not considered when the Commission first adopted its bankruptcy regulations. The volume of cleared derivatives trades has also grown, and the amount of customer property held by FCMs and clearing organizations has correspondingly increased to tens of billions of dollars. This increase in the amount of customer property holdings and concentration of activity in fewer

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<sup>2</sup> The bankruptcy trustee is directed to "return promptly to a customer any specifically identifiable security, property, or commodity contract to which such customer is entitled, or shall transfer, on such customer's behalf, such security, property, or commodity contract to a commodity broker that is not a debtor" subject to CFTC regulations. 11 U.S.C. 766(c). Section 764(a) of the Bankruptcy Code provides that "any transfer by the debtor of property that, but for such transfer, would have been customer property, may be avoided by the [bankruptcy] trustee . . ." 11 U.S.C. 764(a).

<sup>3</sup> See CEA section 20(a), 7 U.S.C. 24(a).

commodity brokers increases the complexity and risks posed by a commodity broker bankruptcy.

These changes in the derivatives industry since the Commission originally adopted its bankruptcy regulations warrant updating those regulations. In addition, the several FCM bankruptcies that have occurred during this period have provided valuable lessons regarding how the current regulations have operated in practice. It is appropriate to incorporate into the Commission's regulations these lessons to improve the timely and equitable distribution of customer assets. The preamble to the Proposal provides a good summary of the foundational principles underlying the Proposal and describes the large number of rule amendments to implement those principles. I will mention here a few aspects of the Proposal that I encourage commenters to address.

The Proposal is consistent with the bankruptcy code generally, while also recognizing the particular nature and uses of derivatives and their unique status under the code. The Proposal incorporates pro rata distribution among "public customers"<sup>4</sup> as a class, with public customers having a priority interest in property held by a debtor FCM. This approach is appropriate because public customers are not participants in the business decisions of the FCM debtor, and pro rata distribution among public customers would put smaller customers on an equal footing with larger customers. The Proposal also grants greater discretion to the trustee that manages the bankruptcy process, in recognition of the complexity of modern commodity brokers, the speed of trading and price discovery, and the stated goal of prompt distribution of customer property.

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<sup>4</sup> Generally, public customers are customers whose accounts must be segregated from the proprietary accounts of an FCM or of the members of a clearing organization. *See* Definition of "public customer" in regulation 190.01.

Emphasizing *prompt* distribution of customer property over exacting *precision* in certain aspects of the bankruptcy proceedings is also a guiding concept in the Proposal. One of the lessons the Commission has learned from prior FCM bankruptcies is that many public customers rely on expected cash flows from commercial activities, including associated hedges, to fund ongoing operations. A failure to promptly distribute funds in a bankruptcy proceeding could therefore not only disrupt the cash flow and normal business operations of the debtor's customers, but also set in motion a chain of payment delays or failures in commercial markets.

While I believe the Proposal largely achieves an appropriate balance of equitable and prompt resolution of a bankrupt commodity broker, I look forward to receiving comments from stakeholders on these issues. In particular, I look forward to hearing from smaller commercial market participants who may not have the resources to actively defend their own interests in an FCM bankruptcy proceeding. Does the Proposal provide sufficient protections? Are the likely outcomes from the customer property distribution choices made in the Proposal expected to provide an equitable and timely result? I look forward to comments.

#### *Comment Period*

Speaking of comments, in light of the coronavirus emergency this country and the world are currently dealing with, 90 days is not sufficient time to review and comment on this nearly 400-page document. The Proposal amends almost every section in the existing bankruptcy regulations and adds several new provisions. A 90-day comment period would barely be long enough in normal times. Many stakeholders with an interest in these regulations are struggling day-by-day, hour-by-hour, just to maintain operations,

generate cash flow, and pay employees. It is incongruous to ask the public to digest in 90 days a lengthy and complex rulemaking that took the Commission three years to develop. There is no statutory deadline or commercial imperative that compels a comment period of 90 days. There is no need to rush commenters or the rulemaking process in the midst of a pandemic in an area as complex and as important as bankruptcy.

*Conclusion*

I commend the hard work of the Commission staff who have spent years working on this Proposal. The Proposal's deliberative, pragmatic choices reflect time spent learning from past bankruptcies and engaging with a number of interested parties (particularly the American Bar Association) on these issues. My office received a number of briefings on the Proposal and staff worked diligently to incorporate our comments throughout the process.

The Proposal is a comprehensive and complex effort to modernize the Commission's existing bankruptcy regulations. While FCM bankruptcies are rare and clearing organization bankruptcies have not occurred to date, such events can be highly disruptive to market participants. In some cases, they could impact the continued operation of markets altogether. It is critical for the Commission to update its bankruptcy rules to reduce the probability and extent of potential disruptions should an unfortunate event of bankruptcy occur.

I look forward to comments on the Proposal and working to finalize this rule in a thoughtful and deliberative manner.