September 29, 2017

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 2-581

Re: Project KISS Suggestion - Clearing (RIN 3038-AE55)

Dear Mr. Kirkpatrick,

The Part 190 Subcommittee ("***Committee***") of the Business Law Section of the American Bar Association ("***ABA***") appreciates the opportunity to submit its work product to the Commodity Futures Trading Commission ("***CFTC***" or "***Commission***") for consideration in connection with the Commission's Project KISS initiative.[1] We ask the Commission to consider adopting a new set of Part 190 Rules to govern a commodity broker bankruptcy under subchapter IV of chapter 7 of the Bankruptcy Code, in the form of the attached model rules ("***Model Part 190 Rules***"). The Model Part 190 Rules are the product of a two-year plus initiative undertaken by the Committee to holistically reevaluate the current rules, in light of significant market and regulatory developments since they were first adopted over 30 years ago, and with the benefit of industry experience living through the bankruptcies of several futures commission merchants ("***FCMs***").

The views expressed in this letter, and the proposed Model Part 190 Rules, are presented on behalf of the 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.

The Committee believes that the Model Part 190 Rules are consistent with the goals of Project KISS to simplify and improve how CFTC rules apply in practice, and that our submission is in the spirit of Project KISS.[2] If the Commission is interested in moving forward with a rulemaking proceeding to amend Part 190, as we recommend, but would prefer that we file a rulemaking petition to initiate the process, we are happy to resubmit the Model Part 190 Rules in that manner.

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[1] *Project KISS (Request for Information)*, 82 FR 23765 (May 24, 2017).

[2] We understand that Project KISS is "about taking CFTC's existing rules as they are and applying them in ways that are simpler, less burdensome and less of a drag on the American economy," and is "not about identifying existing rules for repeal or even rewrite." *Id.* at 23766. The press release announcing Project KISS, though, appears to contemplate rule change recommendations. *See* CFTC Press Release No. 7555-17, *CFTC Requests Input on Simplifying Rules* (May 3, 2017).

I. Background on the Committee and the Part 190 Project

The Committee was established in February 2015 as a joint subcommittee of the Derivatives and Futures Law Committee and Business Bankruptcy Committee of the ABA Business Law Section, and its members are drawn primarily from those two committees.[3] The Committee was formed to conduct a careful review of the Part 190 Rules to identify potential areas where they could be improved, with the plan to draft comprehensive revisions in the form of model rules that the CFTC could consider for potential agency rulemaking.

The Part 190 Rules apply to the liquidation of a U.S.-based FCM or a U.S.-based clearing house that is registered with the CFTC as a derivatives clearing organization ("***DCO***"), in a proceeding (a "***subchapter IV proceeding***"[4]) governed by subchapter IV of chapter 7 of the U.S. Bankruptcy Code ("***Code***"). The CFTC first adopted the rules in 1983, pursuant to its authority under Section 20 of the Commodity Exchange Act ("***Act***" or "***CEA***"), and has amended them several times over the years. The rules are of critical importance for managing the liquidation of an FCM or DCO in a subchapter IV proceeding.

The rules have generally served the industry, bankruptcy professionals and customers well. That said, the Committee believes there is a need to update Part 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 FCM that is severely under-segregated.

A. Committee Membership

The Committee initially had around 35 members, but over time expanded to more than 45 members. The Committee comprises attorneys who work extensively in the areas of derivatives law, bankruptcy law or both, including lawyers at:

- Law firms
- FCMs
- Clearing houses and exchanges
- Government agencies
- Industry associations

Committee members participated in the project with the shared goals of developing model rules that work together as an integrated whole, are clear and unambiguous in setting out objectives, and avoid unnecessary complexity that could hinder or delay timely, prudent action by the trustee for the failed commodity broker. The members brought differing views to the many issues that the Committee considered, drawing on their unique and varied experiences, to the benefit of the final work product.

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[3] The Committee is co-chaired by Kathryn Trkla, representing the Derivatives and Futures Law Committee, and Vincent Lazar, representing the Business Bankruptcy Committee.

[4] The term also covers a proceeding initiated under SIPA (defined below) against an FCM that is registered under the federal securities laws as a broker-dealer.

Notably, attorneys for the MF Global trustee, and the trustee for the Peregrine Financial Group bankruptcy, actively participated in the Committee's work, offering their valuable perspective on practical issues they encountered in administering those bankruptcies under the current rules. The DCO representatives provided helpful input based on their experience managing the defaults of clearing member FCMs such as MF Global, and also on appropriate rules for handling the liquidation of a DCO in a subchapter IV proceeding. The Committee also benefitted from the participation of attorneys who were formerly at the CFTC, including one of the drafters of the original rules.

B. Methodology for Developing the Model Part 190 Rules

At the outset, several law firms contributed to a detailed section-by-section analysis of the existing Part 190 Rules, which was shared with all Committee members. The analysis addressed the text of the rules and experience operating under the rules, and identified potential issues for the Committee's attention. Based on that analysis, and with additional input from Committee members, the Committee prepared a master issues list. The Committee then organized into working groups to tackle issues in the following areas:

- Delivery Account Class
- Retail Forex/Custody Arrangements
- Customer Property – FCM Bankruptcy
- Initial Administration – FCM Bankruptcy
- Porting – FCM Bankruptcy
- Account Liquidation – FCM Bankruptcy
- Claims Process
- Dually Registered FCM-BDs
- DCO Bankruptcies
- Cross-Border

The working groups provided recommendations and proposed drafting changes to the existing rules, from which the Committee prepared a first draft of the model rules that was circulated to the full Committee for review and comment on October 4, 2016. Revised drafts were circulated to the Committee on June 1, 2017, August 22, 2017 and September 6, 2017.[5] A number of committee members contributed to the drafting and provided input and comments, resulting in the Model Part 190 Rules.

The Committee held three in-person meetings – in April 2015, June 2015 and November 2016 – at which members discussed issues in depth. The Committee also held a number of planning and progress update calls. The Committee greatly appreciates the participation by CFTC Division of Clearing and Risk ("***DCR***") staff in two of the in-person meetings. Their willingness to share their knowledge in our "brainstorming" exercises helped inform our understanding of the current rules and how they are intended to operate. DCR 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.

[5] In addition, many interim drafts were circulated with particular working groups or among individuals actively involved in the drafting.

II. Overview of the Model Part 190 Rules

The Model Part 190 Rules represent a comprehensive overhaul of the existing rules. The Committee took care to adhere to the core concepts first laid out when the rules were adopted in 1983. The changes do, though, represent some changes to existing policies, as noted below.

A. General

1. Reorganization

The Model Part 190 Rules are organized into three subparts: Subpart A, which contains general provisions applicable to all proceedings under the rules; Subpart B, which contains provisions specific to a proceeding in which the debtor is an FCM; and Subpart C, which contains provisions specific to a proceeding in which the debtor is a DCO. We believe that reorganizing the rules into three subparts will improve the application of the Part 190 Rules, which currently are not organized into subparts, because that will simplify how and when the rules apply in practice, by identifying the circumstances in which different rules are relevant.

The Model Part 190 Rules are organized as follows.

Subpart A—General Provisions

Rule 190.00 - Statutory authority, organization, core principles, scope, and construction (NEW)

Rule 190.01 - Definitions

Rule 190.02 - General

Subpart B—Debtor is a Futures Commission Merchant

Rule 190.03 - Notices and proofs of claim

Rule 190.04 - Operation of the debtor's estate—customer property

Rule 190.05 - Operation of the debtor's estate—general

Rule 190.06 - Making and taking delivery under commodity contracts

Rule 190.07 - Transfers

Rule 190.08 - Calculation of allowed net equity

Rule 190.09 - Allocation of property and allowance of claims

Rule 190.10 - Provisions generally applicable to futures commission merchants

Subpart C—Clearing Organization as Debtor (NEW)

Rule 190.11 - Scope and purpose

Rule 190.12 - Required reports and records

Rule 190.13 – Prohibitions on the avoidance of transfers

Rule 190.14 - Operation of the estate of the debtor subsequent to the filing date and prior to the primary liquidation date

Rule 190.15 - Wind-down and recovery plan

Rule 190.16 – Delivery

Rule 190.17 - Calculation of net equity

Rule 190.18 - Treatment of property

In addition, the Model Part 190 Rules contain two appendices:

Appendix A – Template Claim Form for Commodity Broker Customers of a Debtor FCM

Appendix B – Special Bankruptcy Distributions When a Debtor FCM Participates in Cross-Margining Programs for Commodity Contracts and Securities

Framework 1—Special Distribution of Customer Funds When the Cross-Margining Account is a Futures Account

Framework 2—Special Distribution of Customer Funds When the Cross-Margining Account is a Cleared Swaps Customer Account [RESERVED]

2. Limiting Part 190 to FCMs and DCOs

The definition of commodity broker in Section 101(6) of the Code covers categories of commodity brokers beyond FCMs and DCOs, specifically, commodity option dealers and leverage transaction merchants. To our knowledge, no person is currently registered or operating as a commodity option dealer or leverage transaction merchant. Indeed, it does not appear that a person may legally act as a commodity option dealer in light of the Commission's decision to rescind its commodity option dealer rules in 2012.[6] The Commission, in fact, already removed commodity option dealers from the scope of Part 190 when it eliminated the commodity option account class formerly recognized under the rules.[7]

Although the CFTC has not revoked its Part 31 Rules governing leverage transaction merchants, we question whether trading of leverage contracts is permissible in light of the restrictions on retail commodity transactions added to the CEA in 2010. With limited exception, Section 2(c)(2)(D) effectively prohibits persons from trading leveraged, margined or financed transactions in commodities with retail customers in bilateral, off-exchange transactions.

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. We further note that this approach aligns the account class distinctions in the Model Part 190 Rules to the

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[6] *Commodity Options*, 77 FR 25320 (April 27, 2012).

[7] *Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions*, 77 FR 6336 (Feb. 7, 2012).

distinctions made by the CFTC in prescribing customer funds segregation protections for different categories of commodity contracts.[8]

If the regulatory framework changes such that it becomes viable for a person to operate as a commodity option dealer or leverage transaction merchant, the Commission could expand the Model Part 190 Rules at that time to add a subpart containing rules specific to a subchapter IV proceeding of such a commodity broker.

3. Context to Aid Administration

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 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.[9]
- 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.

4. Scope

a. Proceedings

As explained above, the Committee recommends limiting Part 190 to commodity brokers that are FCMs or DCOs. Thus, proposed Rule 190.00(d)(1)(i) states that the rules apply to proceedings commenced by or against an FCM or DCO under subchapter IV of chapter 7 of the Code.

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[8] The one exception is the delivery account class; the CFTC does not have rules imposing segregation obligations with respect to property held in a delivery account.

[9] Specifically, we explain the authority granted under Section 20 of the Act. We have also updated the statutory authority citations that precede the Part 190 Rules.

In addition, proposed Rule 190.00(d)(1)(ii) explains that the rules apply to an FCM that is subject to a proceeding under the Securities Investor Protection Act of 1970 ("***SIPA***"). Many FCMs are also registered as broker-dealers ("***BDs***") with the Securities and Exchange Commission under the Securities Exchange Act of 1934. A proceeding against a dually-registered FCM-BD will likely be initiated under SIPA, as was the case with the Lehman and MF Global proceedings. Part 190 is relevant in this scenario because the trustee in a SIPA proceeding has the same duties as a trustee in a subchapter IV proceeding when the debtor is also a commodity broker, to the extent consistent with the provisions of SIPA or as otherwise ordered by the court.[10]

Proposed Rule 190.09(d)(1) also explains that the rules may serve as guidance with respect to distribution of property in a proceeding in which the Federal Deposit Insurance Corporation ("***FDIC***") acts as receiver for an FCM or DCO pursuant to Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("***Dodd-Frank Act***"). Section 5390(m)(1)(B) of Title 12 of the U.S.C. provides that the FDIC must apply the provisions of subchapter IV of chapter 7 of the Code in respect of 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" (as those terms are defined in 12 U.S.C. § 5381(a)).

b. Account Class and Trust Property Limitations

Proposed Rule 190.00(d)(2) provides that the trustee may not recognize any account class that is not enumerated in the definition of account class in Rule 190.01. The account classes are limited to (i) futures accounts; (ii) foreign futures accounts; (iii) cleared swaps accounts; and (iv) delivery accounts, which we further recommend splitting into physical delivery and cash delivery account classes. The Committee believes that adding the account class limitation underscores the Commission's position that an FCM's retail forex customers are not covered as a protected account class under Part 190.[11]

Proposed Rule 190.00(d)(2) includes limitations on the recognition of certain types of trusts. Specifically, it provides that, so long as there is any shortfall in customer property to satisfy customer net equity claims in the enumerated account classes, a creditor is not entitled to distribution of property on the basis that the debtor holds the property in a constructive trust. The provision is intended, *inter alia*, to conserve resources of the bankruptcy estate by mitigating the risk of costly litigation over whether property is covered by a constructive trust. The proposed rule, though, does not restrict a creditor's rights to property not covered by an account class that the debtor holds on an express trust basis pursuant to statute, government rule, regulation or order, or legally binding agreement between the debtor and such person.

c. Commodity Contracts: Explicitly Defining What's In and What's Out

Proposed Rule 190.00(d)(3) limits commodity contracts within the scope of Part 190 to commodity contracts that are cleared by a DCO or by a foreign clearing organization.

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[10] *See* 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 . . . .").

[11] *See* generally *In re Peregrine Financial Group, Inc.*, No. 16-3424 (7th Cir. Aug. 7, 2017). *See also* the Risk Disclosure Statement that an FCM engaged in retail forex is required to provide to its retail forex customers, which is set out in CFTC Rule 5.5.

Proposed Rule 190.00(d)(3) explains that uncleared options on commodities and leverage transactions are excluded from the definition of commodity contract for purposes of Part 190. It also states that commodity contracts do not include security futures products when they are carried in a securities account. For avoidance of doubt, it also states that retail foreign exchange transactions described in CEA Sections 2(c)(2)(B) or (C), and security-based swaps or other securities (other than security futures products carried in an enumerated account class), are not commodity contracts.

In addition, Proposed Rule 190.00(d)3)(iii) makes clear that the term commodity contract does not include retail commodity transactions described in CEA Section 2(c)(2)(D), unless the transactions are executed on or subject to the rules of a designated contract market ("***DCM***") or foreign board of trade ("***FBOT***") as, or as if, they are futures. Because they are exchange-traded, it follows that the transactions will be cleared.

Cleared contracts within the scope of the Model Part 190 Rules include certain commodity contracts that may not fit within the CEA classifications for futures, options on futures or swaps. Commodity contracts for purposes of the Model Part 190 Rules include:

- As part of the cleared swaps account class, swaps as defined in CEA Section 1a(47) and Commission Rule 1.3(xxx) that are cleared, along with non-swap/non-futures contracts that are traded on an over-the-counter ("***OTC***") basis[12] and cleared by a DCO or a foreign clearing organization the same as if they are swaps. *See* the definition of commodity contract in proposed Rule 190.01(k) in conjunction with the definition of swap in proposed Rule 190.01(ss).

- As part of the futures or foreign futures account class, futures or options on futures executed on or subject to the rules of a DCM or FBOT, including retail commodity contracts traded on such markets as or "as if" they are futures, as well as exchange-listed contracts that may be classified as forward contracts under the Act and which are cleared by a DCO or a foreign clearing organization the same as if they are futures. *See* the definition of commodity contract in proposed Rule 190.01(k) in conjunction with the definition of futures contract in proposed Rule 190.01(aa).

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[13] 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.

Code Section 761(4)(F)(ii) provides that the term commodity contract covers, with respect to a commodity broker that is an FCM or a DCO, "any other contract, option, agreement, or transaction, in each case, that is cleared by" a DCO. Thus, such contracts already fall within the scope of subchapter IV, and the Commission therefore has authority to cover non-swap/non-futures OTC transactions cleared by a DCO within the scope of Part 190 Rules applicable to a subchapter IV proceeding. To the extent a foreign

[12] We use the term OTC also to refer to any trading of such cleared non-swap/non-futures instruments that may occur on a swap execution facility.

[13] *Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act*, 77 FR 69694 (Nov. 20, 2012).

clearing organization may clear such transactions for an FCM under the CEA framework, we believe the transactions would be covered by the Code's commodity contract definition in Section 761(4)(F)(i), which covers "any other contract, option, agreement, or transaction that is similar to a contract, option, agreement, or transaction referred to in this paragraph."

It is appropriate to cover exchange-traded and cleared retail commodity transactions within the scope of Part 190, and as part of the futures or foreign futures account class, because they may only be traded on or subject to the rules of an exchange as futures or as if they are futures. If the transactions are futures, they are commodity contracts under Code Section 761(4)(A) or (B). If they are treated "as if" they are futures, it follows that they would be covered by the Commission's segregation rules for futures or foreign futures. They would also be commodity contracts either under Code Sections 761(4)(A) or (B), or under Code Section 761(4)(F)(i) as contracts that are similar to contracts referred to in other parts of the section.

It is also appropriate to treat any exchange-listed contracts that may be covered by the forward contract exclusion as part of the futures or foreign futures account class when they are cleared by a clearing organization or foreign clearing organization the same as futures. Such contract would be commodity contracts under Code Section 761(4)(F)(i) as contracts that are similar to contracts referred to in other parts of the section.

5. Clearing Relationships

The Committee designed the Model Part 190 Rules to recognize different clearing relationships that exist today or could potentially exist in the future, and to explicitly address the different considerations they raise. Thus, we make distinctions in the rules between clearing and non-clearing FCMs (*e.g.*, proposed Rule 190.04(e)(1)), and the rules expressly acknowledge that a debtor FCM could clear commodity interest transactions through a foreign broker or foreign clearing organization (*e.g.*, proposed Rule 190.01(l)).

In addition, the Model Part 190 Rules contemplate that a DCO potentially could have foreign broker clearing members that clear trades for their non-U.S. customers, and that foreign clearing organizations potentially could clear swaps for customers of FCM clearing members pursuant to a CFTC exemption from DCO registration. We understand that the Commission would need to amend its existing rules (or issue appropriate orders) to accommodate such relationships, but we believe it is useful to anticipate those potential changes in the Model Part 190 Rules. In addition, if the Commission were to permit FCMs to clear swaps for customers through a foreign clearing organization that is not registered as a DCO, we understand that it may adopt separate segregation requirements for such "foreign swaps" clearing and, thus, may wish to establish a corresponding account class for such cleared commodity contracts. We believe the flexible design of the Model Part 190 Rules will readily accommodate amendments to add another enumerated account class.

6. Definitions

We have made a number of changes to the definitions used in Part 190. Many of the changes are intended to update and simplify the definitions, or to correct cross-references. Others are more substantive, as explained below:

- **Account Class**. We have expanded the definition of the term account class (set out in proposed Rule 190.01(a)) to include specific definitions for the terms "futures account," "foreign futures

account," "cleared swaps account," and "delivery account." The definitions distinguish between accounts carried on the books of an FCM and on the books of a DCO. The delivery account definition provides that the account class is further divided into separate physical delivery and cash delivery account classes.

- **Commodity Broker**. We propose replacing the definition in current Rule 190.01(g) with a streamlined definition that is consistent with our recommendation to limit Part 190 to FCMs and DCOs. *See* proposed Rule 190.01(j).

- **Commodity Contract; Futures Contract and Swap Contract**. We propose replacing the definition of the term commodity contract in current Rule 190.01(h), which cross-references the Code definition, with a definition that is consistent with the scope we recommend, described above. *See* proposed Rule 190.01(k). We have added definitions for the terms "futures contract" and "swap" that are also consistent with our recommended scope. *See* proposed Rules 190.01(aa) and (ss), respectively. (The swap definition is in lieu of the cleared swap definition in current Rule 190.01(pp).)

- **Foreign Board of Trade**. We recommend adding a definition for the term in proposed Rule 190.01(x) that is consistent with the standard in Section 4(a) of the Act and the definitions in CFTC Rules 1.3(ss) and 48.2(a).

- **Foreign Clearing Organization**. We recommend adding a definition for the term in proposed Rule 190.01(y) that covers a clearing house or similar entity that is located outside the U.S., its possessions or territories, is not registered as a derivatives clearing organization, and clears and settles transactions in futures or options on futures executed on or subject to the rules of a foreign board of trade or transactions in swaps.

- **House Account**. We recommend replacing the current definition with one that separately defines the term in relation to an FCM and in relation to a DCO. *See* proposed Rule 190.01(bb).

- **Physical Delivery Property and Cash Delivery Property**. These are new definitions, which are contained in proposed Rules 190.01(jj) and (g), respectively. They are relevant for dividing the delivery account class into physical delivery and cash delivery account classes. The terms are also relevant for proposed Rule 190.06, which addresses the process for making or taking physical delivery under commodity contracts, including deliveries that may occur outside a delivery account. We have moved elements of the current definition for specifically identifiable property that are relevant for the delivery account class, in updated form, to the physical delivery property definition. The proposed definition specifically recognizes that title documents for commodities are now commonly held in dematerialized, electronic form, in lieu of paper.

- **Public Customer and Non-Public Customer**. We recommend shifting the focus to explain who is considered a public customer of an FCM, with relevant cross-references to other Commission rules, and then defining an FCM's non-public customers as a customer that is not a public customer. The proposed definitions also seek to clarify who is considered a public customer or non-public customer in relation to a clearing member of a DCO, including in the context of a clearing member that is a foreign broker. *See* proposed Rules 190.01(ll) and (ff), respectively.

- **Specifically Identifiable Property**. We propose a new definition that updates and streamlines the definition in current Rule 190.01(ll). *See* proposed Rule 190.01(pp).

- **Other**. We recommend adding new definitions for the terms "cash equivalent" (used in the definition of cash delivery property), "Exchange Act," "FDIC," "SIPA" and "variation settlement." *See* proposed Rules 190.01(h), (t), (u), (oo) and (uu), respectively. We recommend deleting definitions for the terms "equity" (not used elsewhere in the Model Part 190 Rules) and "premium" (the term is commonly understood).

B. Proceeding Involving an FCM

1. Claims Process

The Model Part 190 Rules replace the detailed requirements (which are also outdated, *e.g.*, publication of notices in newspapers) for how the trustee must communicate with the customers of a failed FCM. As proposed, the trustee, after consultation with the Commission, may follow their own reasonably designed procedures for providing notice to, and receiving claims from, the FCM's customers. *See* proposed Rule 190.03, in conjunction with proposed Rule 190.02(a).

We also recommend a streamlined template proof of customer form that the trustee may use, to be attached to the rules as Appendix A. The trustee is given flexibility to modify the proof of claim form to take into account the particular facts and circumstances of the case.

2. Changing the Special Treatment for Hedge Positions

We have modified the treatment of hedge accounts and positions. Current Part 190 treats hedge positions as a type of specifically identifiable property, where the customer is given special rights to avoid having its hedge positions liquidated by the trustee. We propose instead to give the trustee the authority, when practical under the circumstances, to treat public customer positions carried in a hedge account as specifically identifiable property, following consultation with the Commission. *See* proposed Rules 190.03(b)(2) and 190.04(d)(1).

We have made other changes that are intended to make the process simpler for the trustee to identify hedge positions and to move away from requiring FCMs to provide the hedge instructions form when a customer first opens a hedge account, and allowing an FCM to designate an account as a hedge account in reliance on a representation from the customer that the account will contain hedge positions.[14] *See* proposed Rule 190.10(b).

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

[14] The proposed rule includes a grandfather provision that allows the FCM to continue to rely on hedge instructions for existing accounts.

to strike a balance by allowing the trustee to provide special hedge account treatment when it is practical to do so.

3. Collection of Margin and Variation Settlement

We propose changes that are intended to streamline, clarify and update the provisions allowing a trustee to collect margin from a debtor FCM's customers. *See* proposed Rule 190.04(b). We have retained 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. Thus, such payments are not subject to pro rata distribution, in that they count dollar-for-dollar towards the customer's allowed net equity claim. *See* proposed Rule 190.04(b)(3).

4. Liquidation and Valuation of Positions

We propose changes to streamline, clarify and update the provisions on liquidation of open positions. We provide more detail relating to liquidation of positions by a person other than the trustee, *i.e.*, by a DCO, a foreign clearing organization, another FCM or a foreign broker. The changes include provisions for the trustee to assign liquidating positions to the debtor FCM's customers when only a portion of the open contracts are liquidated, and for addressing circumstances where an FCM or foreign broker fails to use commercially reasonable efforts to liquidate positions to achieve competitive pricing. *See* proposed Rule 190.04(d) and (e).

We also clarify the manner in which customer positions and other customer property are valued for purposes of determining the amount of a customer's claim. *See* proposed Rule 190. 08(d).

5. Deliveries Under Physical Delivery Commodity Contracts

a. The Delivery Process

We recommend certain changes relating to deliveries under commodity contracts. Delivery issues may not arise in every subchapter IV proceeding, as that will largely depend on the timing of the entry of the order for relief relative to when physical delivery contracts move into a delivery position. Also, many commodity contracts are cash-settled, and for contracts that settle by physical delivery, market participants typically offset the contracts before incurring delivery obligations. Nonetheless, a debtor FCM could be carrying commodity contracts requiring delivery performance. 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.

The delivery provisions in Part 190 have remained largely unchanged since they were adopted in 1983. The existing rules reflect the prevailing delivery practices of the time, when delivery was effected largely by tendering paper warehouse receipts or certificates. Today, though, most deliverable title documents are held in electronic form, typically (but not always) with the clearing organization serving as the central depository for such instruments, and delivery occurs by electronic transfer. Thus, as noted above, we have updated the definition of physical delivery property to recognize electronic as well as other forms of title.

In addition, under the terms of some contracts (such as certain energy futures), the party with the contractual obligation to make delivery will physically transfer the tangible commodity to meet its obligations. The proposed rule is designed to cover that type of delivery as well.

We have retained the policy that the trustee should use their best efforts to liquidate open commodity contracts that settle by physical delivery (and which are not transferred) before they move into a delivery position. *See* proposed Rule 190.04(c). Open positions may nonetheless get caught in a delivery position where parties incur bilateral contractual delivery obligations. We believe it is useful to provide more specificity than is found in current Rule 190.05 on how to accomplish delivery in those circumstances. We provide this specificity in proposed Rule 190.06.

The ways in which delivery of a commodity is effected under a physical delivery contract vary based on the circumstances and relevant market. This variability includes the role that an FCM may have in facilitating deliveries for its customers. 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 (*i.e.*, Treasuries), in a securities account. We recognize that deliveries may be effected in different types of accounts in proposed Rule 190.06. *See* also proposed Rule 190.10(c).[15]

Current Rule 190.05 applies to delivery of a "physical commodity." Proposed Rule 190.06 applies to any type of commodity that is subject to physical delivery, such as Treasury securities or foreign currencies. This is captured in the definition of physical delivery property. 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 customer in a delivery account.

Current Rule 190.05(b) requires a DCO, DCM or swap execution facility ("***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 Committee believes that deliveries should occur in that manner, where feasible. Current Rule 190.05(b) may be of limited value in that regard, though, given that customers, to a large extent, rely on their FCMs to hold physical delivery property on their behalf in electronic form. We also do not think it is necessary to require a clearing house or market to adopt such a rule, because they have their own self-interest in protecting against delivery interruptions.

Thus, we have not included the provisions of Rule 190.05(b) in proposed Rule 190.06. Instead, proposed Rule 190.06(a) directs the trustee to use reasonable efforts to allow a customer to fulfil its delivery obligation directly, outside administration of the estate, when the rules of the relevant clearing house or market allow delivery to be fulfilled (i) in the normal course directly by the customer; (ii) by substitution of the customer for the commodity broker; or (iii) through agreement of the buyer and seller to alternative delivery procedures.

For deliveries that occur as part of the administration of the debtor's estate, proposed Rule 190.06 contains 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. The rule includes restrictions designed to assure that a customer does not receive a distribution of customer property that exceeds the customer's pro rata share of the relevant customer property pool.

b. Delivery Account Class

The delivery account class is relevant when an FCM establishes delivery accounts through which it effects physical delivery under commodity contracts, or in which it holds physical delivery property, on

[15] We believe this is implicit in current Rule 190.05.

behalf of a customer. Customer property held in a delivery account is not subject to CFTC 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, those challenges are likely 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. For these reasons, the Committee recommends that the delivery account class be divided into separate physical delivery and cash delivery account classes, for purposes of pro rata distributions to customers in the delivery account class on their net equity claims.

6. Transfers

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.

We also recommend certain changes to the separate rule governing transfers. Specifically, proposed Rule 190.07 includes:

- Clarification that the rule does not limit a DCO's (or other registered entity's[16]) contractual right to liquidate ***or transfer*** open commodity contracts. *See* proposed Rule 190.07(a)(3).

- Provisions relating to assignment of customer agreements to a receiving FCM, and the FCM's reliance on such records prior to conducting its own customer due diligence. *See* Proposed Rule 190.07(b)(3) and (4).

- A provision relating to the treatment and transfer of customer letters of credit. *See* Proposed Rule 190.07(d)(3).

- A provision that requires the trustee to use reasonable efforts to prevent physical delivery property from being separated from commodity contract positions under which the property is deliverable. *See* proposed Rule 190.07(d)(4).

- A "no prejudice to other customers" provision that prohibits the trustee from making a transfer that would result in insufficient customer property being available to make equivalent percentage distributions to all net equity claim holders in the applicable account class. *See* proposed Rule 190.07(d)(5).

7. Customer Property: The Griffin Trading Issue and Residual Interest

Current Rule 190.08(a) defines the scope of "customer property" that is available (by account class) to pay the claims of the debtor FCM's futures customers, foreign futures customers or cleared swaps customers. Customers are entitled to receive distributions of customer property over other creditors of the debtor (other than certain claims in administering the bankruptcy estate), with claims of public customers satisfied ahead of those of non-public customers. The current definition includes a provision that deems any cash, securities or other property in the debtor's estate to be customer property to the extent that

[16] Another registered entity would include a DCM or a SEF.

customer property under the other definitional elements is insufficient to satisfy in full all claims of the FCM's public customers. *See* current CFTC Rule 190.08(a)(1)(ii)(J).

As the Commission knows, in 2000 the Bankruptcy Court in *In re Griffin Trading Co.*[17] ruled that the CFTC exceeded its statutory authority by adopting this provision of the rule, and thus it held that the provision was invalid. Although the decision was vacated on appeal, and thus is of no precedential value, that action was taken pursuant to a stipulation reached by the parties, not based on a ruling on the merits. Thus, the issue is widely understood to be unsettled.

The Committee recommends retaining the provision. Given the risk of potential legal challenge, though, we also recommend 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. *See* proposed Rule 190.09(a)(1)(ii)(G).

Those obligations were not expressly set out in the Commission's rules when Part 190 was promulgated; thus, the provision updates the customer property definition to reflect the Commission's current segregation rules. The provision is defensible because it is linked specifically to property that an FCM is required to set aside pursuant to Commission rule for the benefit of its customers. Thus, it should be covered by the definition of customer property in Section 761(10)(A)(ix) of the Code, which covers "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." We understand the Commission's position that such property should be covered by current Rule 190.08(a)(1)(ii)(G), but we believe adding a provision that expressly covers an FCM's "top up" obligations prescribed under specific CFTC rules provides greater legal certainty.

As a related change, we recommend including a provision in proposed Rule 190.05 clarifying the trustee's obligations with respect to residual interest. Under the current rules and the Model Part 190 Rules, the trustee is required to comply with provisions of the CEA and CFTC rules "as if it were the debtor," "except as specifically provided otherwise" in the rules. 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. Thus, we include a provision that states that the trustee is not required to transfer cash or other property into a segregated account to maintain a debtor FCM's compliance with its targeted residual amount obligations under CFTC Rule 1.11 or its other top-up obligations under CFTC Rules 1.22, 22.2 or 30.7. Importantly, the provision also confirms that such amounts still constitute customer property as provided in proposed Rule 190.09(a)(1).

8. Provisions Generally Applicable to FCMs

We recommend setting out certain obligations that apply generally to an FCM in a single, standalone rule. To that end, the Committee recommends proposed Rule 190.10, which addresses the following:

- **Current Customer Records**. 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

[17] 245 B.R. 291 (N.D. Ill. 2000), *vacated*, 270 B.R. 882 (2001).

importance of current and accurate records for an FCM that is accepting the transfer of customer positions and property from the debtor FCM.

- **Designation of Hedge Accounts**. Paragraph (b) requires an FCM to provide a customer an opportunity to designate an account as a hedge account when the customer first opens the account. It provides that the FCM may rely upon the customer's written representation that positions in the account are hedge positions, in lieu of obtaining written hedge instructions as required under current Rule 190.06(d). The proposed rule also allows an FCM to re-designate an existing account as a hedge account if it obtains an appropriate representation from the customer that the account contains hedge positions. The proposed rule expressly recognizes that an FCM may continue to designate existing accounts as hedge accounts based on the hedge instructions.

  The proposed rule expressly clarifies that an account may be designated as a hedge account if positions in the account constitute hedging as defined under any relevant Commission rule or rule of a DCO, foreign clearing organization, DCM, SEF or FBOT.

- **Deliveries**. Paragraph (c) recognizes that delivery under a customer's physical delivery contract, when facilitated by the FCM, could be effected in a futures account, foreign futures account or cleared swaps account (or a securities account if the commodity being delivered is a security). It also provides that if the delivery does not occur in one of those accounts, the FCM must (when facilitating the delivery) effect the delivery through a delivery account. It is the Committee's understanding that the provision is consistent with the manner in which deliveries occur in practice.

The Committee recommends deleting the requirement in current Rule 190.10 that an FCM must (except as provided in other CFTC rules) provide its customers with a special disclosure statement regarding treatment of non-cash collateral they may post, in the event of the FCM's bankruptcy. It is our understanding that the Commission originally imposed this requirement out of concern that a customer could challenge pro rata distribution of non-cash collateral if the customer has not specifically consented to such treatment. The Committee does not believe that such a risk exists today under prevailing bankruptcy law.

9. Appendix A Forms

The Committee recommends deleting Forms 1 through 3 contained in Appendix A and replacing Form 4 with a streamlined proof of claim form. The forms that would be deleted 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 hedge positions. The forms contain outdated provisions and are highly prescriptive. The Committee believes it is preferable for the trustee to have flexibility to act based on the specific circumstances of the case, in a manner consistent with the rules.

10. Appendix B Special Distribution Rules

Appendix B to the current Part 190 Rules contains special bankruptcy distribution rules, as follows: (i) Framework 1, which provides special rules for distributing customer funds when the debtor FCM participated in a futures-securities cross-margining program; and (ii) Framework 2, which provides

special rules for allocating a 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.

We recommend retaining Framework 1, with some clarifying changes. We do not recommend, and have not made, changes to the examples illustrating how the distribution rules apply to different segregation/under-segregation scenarios. We propose deleting the specific limitation that customers must be market professionals, to provide flexibility should the Commission decide to expand the scope of customers that may participate in futures-securities cross-margining programs. The Commission will still control who may participate under the terms of the cross-margining orders it issues.

We recommend including a place holder for distribution rules relating to customer cross-margining programs for swaps and securities (*e.g.*, security-based swaps). The CFTC and SEC have not, to date, approved such programs, and thus we have not attempted to define appropriate distribution rules for securities held in cross-margining accounts that are considered cleared swaps customer accounts.

We recommend deleting the separate distributional framework addressing shortfalls relating to customer funds held outside the U.S. or in the form of a foreign currency. The existing provisions are complicated, raising concerns that they could interfere with quick porting of positions in the event there are losses due to extraordinary foreign events. Also, the CFTC has significantly enhanced customer protections since the existing Framework 2 was adopted,[18] which we believe mitigates the concerns underlying the current provisions.

C. Separate Rules to Govern a DCO Subchapter IV Proceeding

The current Part 190 Rules apply generally to a commodity broker liquidation proceeding administered under subchapter IV of chapter 7 of the Code, including to a proceeding that may involve a DCO. The rules, although general in application, are largely tailored to a subchapter IV proceeding involving an FCM, and contain only one provision, Rule 190.09 Member Property, that is specific to a DCO proceeding. Because a DCO insolvency raises unique considerations, the FCM focus of the existing rules could create significant confusion if tested in a DCO subchapter IV proceeding.

Accordingly, the Committee has included Subpart C in the Model Part 190 Rules, which contains rules that are specific to a DCO proceeding. We were careful to avoid overly prescriptive rules, to preserve flexibility for the trustee to act as appropriate for the *sui generis* circumstances at hand. Proposed Subpart C provides some deference to a DCO's wind-down and recovery plan, recognizing that the DCO's plan and related rules will likely take into account any unique considerations and issues that the DCO faces. We believe this approach allows the DCOs and Commission the flexibility to continually evaluate the issues around a DCO insolvency and the appropriate manner for responding.

We also provide a new definition for the term "member property" in proposed Rule 190.18, which we believe is consistent with the current definition.

Although the Committee recognizes that the likelihood of liquidating a DCO in a subchapter IV proceeding may be remote, so long as that is a possibility, we believe it is important for Part 190 to set out the basic rules that would apply. In the event that a DCO is instead subject to an orderly liquidation

[18] *Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations*, 78 FR 68506 (Nov. 14, 2013).

proceeding by the FDIC pursuant to Title II of the Dodd-Frank Act, the proposed Subpart C rules could provide useful guidance on distribution of customer and member property in accordance with subchapter IV of chapter 7 of the Code, and consistent with no-creditor worse off standards.

III. Recommended Changes to Other Commission Rules

As the Committee progressed with our comprehensive review of the current Part 190 Rules, we identified a small number of other related or cross-referencing CFTC Rules that we believe the Commission should consider amending. We emphasize, though, that the changes proposed below are not perquisites for the Model Part 190 Rules to work as drafted. The proposed Model Part 190 Rules stand on their own.

A. Definition of Foreign Option In Rule 30.1(d)

We recommend that the Commission revise the definition of "foreign option" in Rule 30.1(d) to state explicitly that the definition covers options on futures. This is implicit in the history and context of Part 30, but the clarification would avoid any confusion or misunderstanding that the Part 30 framework applies to options that are covered by the swap definition in CEA § 1a(47) or that are regulated as trade options under Commission Regulation 32.3.

B. Definition of Proprietary Account in Rule 1.3(y)

We recommend that the Commission consider adopting a new definition of proprietary account in Rule 1.3(y) to narrow the scope of persons denied public customer protections when clearing their futures or swaps trades through an FCM with which they are affiliated.[19] The current definition is out of sync with the global consensus to treat affiliates of professional clearing intermediaries as public customers.

At a minimum, we recommend that the Commission consider excluding commodity pools from the current definition. It appears that a commodity pool could be classified as a proprietary account of an FCM if any person identified in paragraphs (2)(i) – (viii) of Rule 1.3(y) owns 10% or more of the pool. We do not see any policy reason to deny passive investors in such a pool the benefits of public customer protections or of having the pool's claim receive the priority of a public customer claim.

C. Definition of Variation Margin in Rule 1.3(fff)

We ask the Commission to consider amending the definition of variation margin in Rule 1.3(fff) to conform to the definition we propose in proposed Rule 190.01(uu). That definition covers:

> "any amount paid or collected (or to be paid or collected) on an open commodity contract relating to changes in the market value of the commodity contract since the trade was executed or the previous time the commodity contract was marked to market along with all other daily settlement amounts (such as price alignment payments) that may be owed or owing on the commodity contract."

[19] The Commission, though, should retain the current definition for the limited purpose of the Rule 3.10(c)(1) exemption from FCM registration.

D. Part 22 Rules

We recommend that the Commission revise its Part 22 Rules to explicitly provide that the segregation framework for cleared swaps applies to non-swap (and non-futures) OTC transactions, such as foreign exchange forwards or foreign exchange swaps, if they are cleared by a DCO.[20] The definition of "commodity contract" in Section 761 of the Bankruptcy Code explicitly covers "any other contract, option, agreement, or transaction, in each case that is cleared by a clearing organization [*i.e.*, by a registered DCO]." As explained above, the Model Part 190 Rules treat such contracts as part of the cleared swaps account class, which we believe is consistent with the approach taken by the DCOs that clear such "other" contracts.

E. Part 31 Rules for Leverage Transaction Merchants

As explained above, we question if a person may act as a leverage transaction merchant under the current CEA framework, as amended in 2010 by the Dodd-Frank Act. In any event, we believe that CEA Section 19 gives the Commission the authority to decide whether to adopt or maintain rules that permit leverage contract trading. Moreover, to our knowledge, there are no registered leverage transaction merchants. Thus, we recommend that the Commission consider repealing the Part 31 Rules as outdated and of no current relevance.

F. Technical Housekeeping Changes

We recommend the following housekeeping changes, if the Commission decides to initiate a rulemaking proceeding to revise the Part 190 Rules:

- Rules 1.55(d), (d)(1) and (d)(2): Delete the cross-references to Rule 190.06 (customer acknowledgement).
- Rules 1.55(f), 1.65(a)(3) and 1.65(a)(3)(iii): Delete the cross-references to 190.10(c) (customer acknowledgement).
- Rule 1.25(a)(2)(ii)(C): Change the cross-reference from 190.01(kk) (definition of specifically identifiable property) to 190.01(pp).
- Rule 4.5(c)(2)(iii)(A): Change the cross-reference and defined term for "in the money amount": … the in-the-money amount as defined in Rule 190.01(cc)(x) (17 CFR 190.01(cc)(x)).
- Rules 4.12(b)(1)(i)(C) and 4.13(a)(3)(ii)(A): Change the cross-reference and defined term for "in the money amount": … the in-the-money amount as defined in Rule 190.01(cc)(x).
- Rule 41.41(d): Delete the cross-reference to Rule 190.06 recordkeeping obligations.

IV. Conclusion

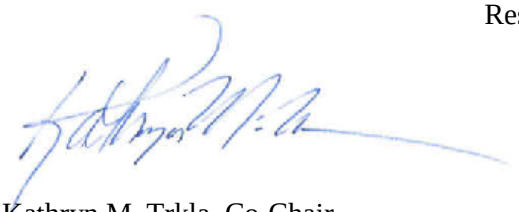
The Committee appreciates the opportunity to provide this letter and the Model Part 190 Rules for the Commission's consideration in connection with Project KISS. We look forward to a dialogue with the

[20] Retail commodity transactions that are exchange-listed and centrally cleared would be covered by the Commission's segregation rules for futures and options on futures.

Commissioners and Commission staff to discuss the Model Part 190 Rules and our related suggestions for revising other CFTC Rules.

Please contact Kathryn Trkla (312-832-5179) or Vincent Lazar (312-923-2989) if you have any questions about this letter, the Model Part 190 Rules or the Committee's process for developing the proposed rules.

Respectfully Submitted,



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