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By Electronic Mail

July 20, 2020

Mr. Christopher J. Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

Re: Part 190 Bankruptcy Regulations - RIN 3038–AE67
85 Fed. Reg. 36,000 (June 12, 2020)

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**")[1] is pleased to submit this letter in response to the Commodity Futures Trading Commission's ("**Commission**") request for comment on its proposed amendments to Part 190 of its rules governing the bankruptcy of commodity brokers ("**Proposed Amendments**").[2] The Proposed Amendments set out in proposed Subpart A and Subpart B are based in substantial part on a proposal that the Part 190 Subcommittee of the Business Law Section of the American Bar Association submitted to the Commission in 2017 in response to the Commission's Project KISS initiative ("**ABA Proposal**").[3] FIA previously voiced its general

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[1] FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington DC. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's core constituency consists of firms that operate as clearing members in global derivatives markets, including firms registered with the Commodity Futures Trading Commission as futures commission merchants ("**FCMs**").

[2] *Part 190 Bankruptcy Regulations*, 85 Fed. Reg. 36,000 (June 12, 2020). The Proposed Rules would also make technical amendments to certain provisions of Parts 1, 4, and 41 of the Commission's rules.

[3] In May 2017, the Commission announced that it had begun an agency-wide review of its rules, regulations, and practices to make them simpler, less burdensome, and less costly and solicited suggestions from the public. 82 Fed.Reg. 23765 (May 24, 2017).

support for the ABA Proposal,[4] and we are similarly pleased to support the Proposed Amendments with regard to Subpart A and Subpart B, subject to our comments below.

We begin our comments, however, with a discussion of proposed Subpart C, which would establish a more comprehensive regime to govern the bankruptcy of a derivatives clearing organization ("**DCO**"). For the reasons explained below, we urge the Commission to undertake one or more roundtables to allow for a robust discussion of the intended operation of the proposed rules and of any concerns to which the rules give rise. Although we support the portions of Subpart C that reinforce the finality of closeout netting rules and more granularity and transparency of rules that will apply in the event of a DCO bankruptcy, we set forth concerns we have at this time with respect to certain provisions that warrant further study. We anticipate that the recommended roundtables will provide the information we need to comment more meaningfully on these provisions

We are concerned that Proposed Subpart C will unnecessarily complicate what is already likely to be "an extraordinarily complex situation", thereby inadvertently increasing legal uncertainty. Although current Part 190 applies to the bankruptcy of a DCO, the rules provide little detail and focuses, instead, on the bankruptcy of an FCM. As derivatives markets in general, and clearing in particular, have become more complex, we appreciate the Commission's desire to establish the appropriate approach to be taken in the event of a DCO bankruptcy, thereby relieving "the trustee of the burden of developing, in the moment, models to address an extraordinarily complex situation."[5] In this regard, we support, in particular, the provisions of the Proposed Amendments that would direct the trustee to follow a DCO's closeout netting rules that require the closeout of all open positions promptly upon a bankruptcy event.[6]

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4 Letter from Walt L. Lukken, President and Chief Executive Officer, FIA, to Christopher Kirkpatrick, Secretary, CFTC (Sept. 28, 2017), available at: https://www.fia.org/sites/default/files/2019-05/2017-09-28-CFTC-Project-KISS.pdf.

5 85 Fed. Reg. at 36,002 (June 12, 2020)

6 Chicago Mercantile Exchange ("**CME**") Rule 818 is a representative example of a closeout provision on which clearing members rely. In particular, CME Rule 818.A provides:

> **Bankruptcy of the Exchange.** If at any time the Exchange: (i) institutes or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights, or a petition is presented for its winding up or liquidation, and, in the case of any such proceeding or petition presented against it, such proceeding or petition results in a judgment of insolvency or bankruptcy or the entry of an order for relief or the making of an order for the Exchange's winding-up or liquidation, or (ii) approves resolutions authorizing any proceeding or petition described in clause (i) above (collectively, a "**Bankruptcy Event**"), ***all open positions in the Clearing House shall be closed promptly***. [Emphasis supplied.]

ICE Clear U.S. Rule 806, Insolvency of the Corporation, and ICE Clear Credit Rule 805, ICE Clear Credit Default, are similar.

We further appreciate the Commission's desire to provide guidance to the Federal Deposit Insurance Corporation ("**FDIC**") in the event that the FDIC is appointed a DCO's receiver under the Orderly Liquidation Authority provisions of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**"). As the Commission notes, under the relevant provisions of Title II, the FDIC's liability to a creditor in respect of its claims against the estate of a DCO in a Title II receivership (*e.g.*, an FCM's claims against a DCO in respect of liabilities of the DCO that have not been transferred to a bridge) is the amount that the claimant would have received if the FDIC had not been appointed receiver and, instead, the DCO would have been liquidated under Chapter 7 of the Bankruptcy Code ("**Code**"). Consequently, Part 190 should provide guidance on the amount to which a clearing member would be entitled in the event of the liquidation of a DCO under subchapter IV of Chapter 7 of the Code.

In our view, upon a DCO's bankruptcy, the trustee's primary objective should be to ensure that the DCO's closeout procedures are promptly followed and that netting (and any related loss allocation) provisions in the DCO's rules are effectively applied in furtherance of the timely administration of the estate and the liquidation and distribution of the DCO's assets. We submit that the Commission's proposed Subpart C should be carefully tailored to support this objective. To this end, we further submit that proposed Subpart C should ensure that the rights and obligations of clearing members as set forth in the rules of a bankrupt DCO, including, where applicable, the right to have all open positions promptly closed and clearing members to receive the benefit of netting, are not adversely affected. Such deference is appropriate, as DCOs are regulated under, and their default rules must be consistent with, Part 39 of the Commission's rules.

By seeking to provide a trustee in bankruptcy or an FDIC receiver sufficient flexibility to address circumstances, however unlikely, that may arise, we are concerned that the proposed Subpart C will unnecessarily distract the trustee or receiver from its primary objective, increasing legal uncertainty, to the detriment of clearing members and other market participants. The comments that follow are intended to refocus Subpart C to achieve the objectives identified above.

The Proposed Amendments should not call into question the enforceability of DCO closeout netting provisions. As the Commission is aware, eighteen of the twenty largest FCMs, as determined by customer segregated funds held, are affiliates of US or foreign banking organizations.[7] As such, in addition to the Commission's rules and the rules of the relevant DCOs, these FCMs are subsidiaries of bank holding companies subject to the rules of one or more US or non-US bank regulatory authorities that require the calculation of the FCMs' exposures to DCOs for a myriad of different purposes, including financial and regulatory reporting, risk management, bank regulatory capital, leverage ratio, Global Systemically Important Bank surcharge and legal lending limit. Under these latter rules, a DCO's closeout netting provisions set out in its rules (or its bylaws), and the enforceability of such provisions in the event of the DCO's insolvency, provide the legal basis for netting by a clearing member of its exposures to a DCO. Such netting materially

[7] Financial Data for FCMs as of April 2020, available at: https://www.cftc.gov/sites/default/files/2020-04/01-%20FCM%20Webpage%20Update%20-%20April%202020.pdf

reduces exposures to DCOs and is critical to regulatory capital management, which in turn affects the continued provision of clearing services to clients in a cost-efficient manner.

The rules of the US bank regulatory authorities effectively provide that, in order to recognize the netting of its exposures to a DCO, a bank-affiliated clearing member must be able to conclude[8] that the closeout netting provisions in the DCO's rules (or bylaws) constitute a "qualifying master netting agreement",[9] as defined under the rules of the US bank regulatory authorities. Specifically, the clearing member must be able to conclude that the DCO's rules (or bylaws or some other written agreement between the DCO and the clearing member) provide that the clearing member's transactions with the DCO:

- would be closed out on a net basis promptly upon an event of default, including an event of receivership, conservatorship, insolvency, liquidation or similar proceeding, with respect to the DCO, and such net closeout will not be stayed under applicable law, other than in a receivership under Title II (which would provide that such closeout netting that is based solely upon the FDIC's appointment as the DCO's receiver may not be exercised (i) until 5:00 pm (Eastern time) on the business day following the date of the FDIC's appointment or (ii) after the member has received notice that its transactions have been transferred to a bridge); and

- would be enforceable, including in the event of the DCO's receivership, conservatorship, insolvency, liquidation or similar proceeding.[10]

Every major DCO now has closeout netting provisions in its rulebook[11] and has obtained legal opinions confirming their enforceability. The registered DCOs in the US that have closeout netting provisions in their rules (or bylaws) include CME, ICE Clear Credit, ICE Clear US, Minneapolis Grain Exchange, Nodal Clear and OCC.[12] There are currently only four registered DCOs that do

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[8] A clearing member typically bases its conclusion on a reasoned legal opinion delivered by external counsel that is refreshed on a periodic basis.

[9] In this regard, we note that CME Rule 818.C provides, in part, that the rule "shall be deemed to be (i) a master netting agreement for Proprietary Netting; (ii) a master netting agreement for Futures Customer Netting and (iii) a master netting agreement for Swap Customer Netting." Similarly, ICE Clear U.S. Rule 806(g)(vii) provides: "The By-Laws and Rules of the Corporation, including this Rule 806, are a "netting contract", as defined in the Federal Deposit Insurance Corporation Improvement Act of 1991, as amended.

[10] *See, e.g.*, 12 CFR §§ 249.3, 249.4. Title II proceedings with respect to a DCO would constitute a receivership of the DCO.

[11] *See,* fn. 6, *supra*. The netting provisions also prescribe the manner by which the closing price of open is determined. For example, each of ICE Clear Credit Rule 810, Termination of Clearing, and ICE Clear U.S. Rule 806, Close-Out Netting, specifies the date and time of termination of all open contracts following a bankruptcy event (which is 5 p.m., New York time, on the second business day following the bankruptcy event). *See*, *also* CME Rule 818.D.

[12] DCOs outside the US that are either registered or have an exemption from registration (ASX Clear (Futures), Eurex Clearing, ICE Clear Europe, ICE NGX Canada, Japan Securities Clearing Corporation, Korea Exchange, LCH

not appear to have closeout netting provisions in their rules: CX Clearinghouse, Eris Clearing, Ledger X and North American Derivatives Exchange.

Closeout netting provisions would prevent continued operation of a bankrupt DCO as contemplated in proposed Rule 190.14(b)(2). We understand that the Commission does not intend that the Proposed Amendments call into question the enforcement of closeout netting provisions set out in DCO rulebooks. Nonetheless, it is essential that the Commission take care to assure that Proposed Amendments do not inadvertently have this effect. In this regard, we are concerned that certain provisions of proposed Rule 190.14(b)(2) and (c)(1), regarding the operation of the estate of the debtor DCO subsequent to the filing date, may create an unacceptable level of legal uncertainty. Consequently, the Commission should not adopt this proposed rule.

Proposed Rule 190.14(b)(1) would provide that a DCO shall cease making calls for variation or initial margin subsequent to the order for relief with respect to the DCO, except as otherwise explicitly provided in subsection (b) of proposed Rule 190.14. Proposed 190.14(b)(2) would authorize a trustee, with the Commission's permission, to continue to operate a DCO for up to six days following the order for relief, if the trustee believes that continued operation would facilitate either (i) the prompt transfer of the clearing operations of the DCO to another DCO; or (ii) resolution of the DCO pursuant to Title II of the Dodd-Frank Act. Importantly, the proposed rule would require the trustee to determine first that continued operation of the DCO is "practicable". As set out in proposed Rule 190.14(b)(2)(ii), continued operation would not be "practicable" if the rules of the DCO "compel the termination of all or substantially all of the outstanding contracts under the circumstances then prevailing (*e.g.*, upon the order for relief)."[13]

As we read proposed Rule 190.14(b)(2)(ii)(A), we believe that closeout netting provisions of the type described above should constitute rules that would "compel the termination of all or substantially all of the outstanding contracts under the circumstances then prevailing" upon the bankruptcy of the DCO. Therefore, continued operation of the DCO would not be "practicable", and the trustee would not be authorized to continue to operate the DCO, regardless of whether it believes such operation subsequent to an order for relief would facilitate either the prompt transfer of the DCO's operations to another DCO or the DCO's resolution under Title II. As noted above, all but four DCOs (and certainly all systemically important DCOs that potentially could become subject to Title II proceedings) have closeout netting provisions.

However, if subsection (2)(ii)(A) of proposed Rule 190.14(b) could be read to provide the trustee some level of discretion to determine whether or when DCO rules may "compel" the termination

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Ltd., LCH SA and OTC Clearing Hong Kong Limited) have closeout netting provisions in their rules (or in other written agreements with members).

[13] In addition, continued operation of the DCO would not be practicable if all or substantially all of the members of the DCO (other than those who are themselves subject to a bankruptcy proceeding) would not be able to, or would in fact not, make variation payments as owed during the temporary timeframe. We find it not "practicable" to believe that non-defaulting clearing members, or their clients, would ever be willing to continue to pay margin to the estate of a bankrupt DCO.

of contracts, such discretion, in turn, may call into question whether the DCO's rules constitute a "qualifying master netting agreement" as described in the rules of the several bank regulatory authorities. Such reading introduces an unacceptable level of legal uncertainty related to the enforceability of closeout netting provisions.

Moreover, we believe that continued operation of a DCO after an order for relief would be ill-advised. This is because we see no circumstance in which a trustee would find it practicable to continue to operate the DCO once it has entered bankruptcy. We submit that it is highly unlikely that a trustee with no familiarity or understanding of central clearing would be in position to manage effectively the operation of a bankrupt DCO, and it is counterproductive for the Commission's rules to suggest that this is the case.

In the case of a systemically important DCO, the prospect of a bankruptcy trustee operating the DCO for even a brief interim period prior to commencement of Title II proceedings could result in a loss of market confidence and a destabilizing rush to exit by clearing members and their clients, which could potentially frustrate the successful resolution of the DCO under Title II. In the case of a non-systemically important DCO, and assuming the DCO's rules do not provide for closeout netting, we believe that the post-filing transfer of its clearing operations to another DCO would be difficult at best. Even if it were possible, clearing members and their clients should not be expected to take the execution risk of being forced to continue clearing through a bankrupt DCO when successful completion of a transfer to a new DCO in bankruptcy is not certain. In any event, as noted earlier, we do not believe that non-defaulting clearing members or their clients would be willing to continue to pay margin to the estate of a bankrupt DCO.[14]

Given the concerns described above, we believe that subsection (b)(2) of proposed Rule 190.14 is fundamentally flawed and should not be adopted. If, following the roundtables that we have recommended, we better understand its purpose, we would be pleased to work with Commission staff to develop appropriate revisions to this subsection.

Implementation of all DCO default rules and procedures and recovery and wind down plans post-bankruptcy is inappropriate. Proposed Rule 190.15(b) directs the trustee, in administering a proceeding under Subpart C, to implement, in consultation with the Commission, the default rules and procedures maintained by the debtor under Rule 39.16[15] and, as applicable, Rule 39.35[16] 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

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14 For the same reasons, we recommend that the Commission decline to adopt proposed Rule 190.14(c).

15 Commission Rule 39.16 requires each DCO to "have 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]".

16 Commission Rule 39.35 imposes similar, but more detailed, obligations on systemically important and Subpart C DCOs.

default rules and procedures is practicable.[17] Proposed Rule 190.15(c) further directs the trustee in consultation with the Commission, to take actions in accordance with any recovery and wind-down plans maintained by the debtor and filed with the Commission pursuant to Rule 39.39,[18] to the extent reasonable and practicable.

We believe that the use of these rules for any purpose other than to ensure enforcement of a DCO's closeout netting provisions (including any related provisions providing for post-bankruptcy loss allocation) is inappropriate. By their terms, the default rules and procedures required by Commission Rules 39.16 and 39.35 represent contractual arrangements between a DCO and its members whose purpose is to provide resources and tools to the DCO to *prevent* its bankruptcy.[19] A fundamental term (whether express or implied) of such arrangements is that such resources and tools are only available *prior* to bankruptcy. The Commission should not seek to revise these arrangements, and thereby undermine the long-standing and settled expectations of DCOs and their members, through provisions that would instruct the trustee to implement, with discretion, such default rules and procedures in the DCO's bankruptcy. Similarly, a DCO's recovery plan addresses actions to be taken prior to the DCO's bankruptcy and is not relevant post-filing.[20]

Reliance on recovery and wind down plans post-bankruptcy is particularly inappropriate, because some of those plans have been developed with no input or opportunity for comment by clearing members and other market participants. Moreover, we understand that these plans do not prescribe a particular course of action but, rather, present a menu of options that a DCO might consider. As such, these plans would appear to provide no meaningful guidance to a trustee. For all of the above reasons,[21] we do not support the adoption of proposed Rule 190.15(b) and (c).[22] In the alternative, we recommend that the Commission revise proposed Rule 190.15(b) to confirm that, in administering a proceeding under Subpart C, the trustee must implement any termination, close-

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[17] Whether implementation of a bankrupt DCO's default rules and procedures would be conditioned on continued operation of the DCO pursuant to proposed Rule 190.14(b) is unclear.

[18] Commission Rule 39.39 requires systemically important and Subpart C DCOs to maintain viable plans for: (i) recovery or orderly wind-down, necessitated by uncovered credit losses or liquidity shortfalls; and, separately, (ii) recovery or orderly wind-down necessitated by general business risk, operational risk, or any other risk that threatens the derivatives clearing organization's viability as a going concern.

[19] Additionally, the concept of "default rules and procedures" could encompass a number of different tools or actions, some of which would be inappropriate and risky for a bankruptcy trustee to attempt to execute. Moreover, to the extent that the Commission would select some but not other default rules and procedures for a trustee to implement, the adoption of proposed Rule 190.15(b) will increase uncertainty as to possible bankruptcy scenarios.

[20] For the avoidance of doubt, our objection to the use of recovery and wind down plans is limited to a post-bankruptcy environment. It is in the interest of all parties – DCOs, clearing members and market participants – that every effort be made to avoid the bankruptcy of a DCO whenever possible. A DCO's recovery plans may play an essential role in achieving this goal.

[21] We would also note that a literal reading of the proposed provisions would appear to require implementation of rules, procedures and plans that are intended to address ***default*** losses even in a scenario in which a DCO's failure is due to ***non-default*** losses. We believe this would be an inappropriate outcome.

[22] For these same reasons, we do not support the adoption of proposed Rule 190.19(b).

out and liquidation provisions included in the rules (or bylaws) of the debtor (including any provisions that are a part thereof or related thereto that provide for loss allocation).

The calculation of a clearing member's net equity claim should not include the value of assessments that, under the rules of the DCO, may no longer be made or are not required to be paid. Proposed Rule 190.17(b)(1) provides that the calculation of a clearing member's net equity claim must include the full application of the debtor's loss allocation rules and procedures, including 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. The proposed rule misinterprets the purpose of the contractual framework in DCO rules around default funds and, for that reason, we cannot support it.

A DCO's default fund represents a multilateral indemnification arrangement between the DCO and its members pursuant to which members' contributions are used to cover the DCO's losses resulting from member default(s) and thereby prevent the DCO's bankruptcy. A DCO has no authority under its rules to request or to apply these funds for any other purpose, nor do we believe that a trustee would have any authority under the Code to do so. In this regard, we note, in particular, that the rules of certain DCOs expressly provide that the authority of a DCO to make new assessments or require a clearing member to cure a deficiency in its guaranty fund deposit terminates with the DCO's bankruptcy.[23] In these circumstances, we believe it is inappropriate to require a clearing member to reduce the value of its net equity claim by the amount of an assessment that, under the rules of the relevant DCO, either may no longer be made or are not required to be paid.

As important, the purpose of DCO guarantee funds is solely to permit a DCO to meet its obligations to non-defaulting clearing members with respect to losses arising from the default of another clearing member. Guaranty funds are not intended to be applied to any other losses incurred by a DCO. However, by requiring that a clearing member's net equity claim must include the full application of the DCO's loss allocation rules and procedures, proposed Rule 190.17(b)(1) appears to have the effect of reducing a clearing member's potential recovery, even when the full application of the DCO's loss allocation rules is not necessary to meet the DCO's obligations to non-defaulting clearing members. Such a result would impermissibly benefit the DCO's general creditors and shareholders to the detriment of clearing members.

Customer property should not include guaranty fund deposits. Proposed Rule 190.18(b)(1)(iii) provides that customer property will include "[a]ny guaranty fund deposit,

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[23] *See, e.g.*, CME Rule 818.C.2, which states: "After a Bankruptcy Event takes place, the authority of the Clearing House, pursuant to Rule 802, to make new assessments and/or require a Clearing Member to cure a deficiency in its guaranty fund deposit arising after the Bankruptcy Event, shall terminate." Similarly, ICE Clear U.S. Rule 806(e) provides, in relevant part: "As of the Termination Time for a Clearing Member's positions, the authority of the Corporation, pursuant to Rule 302, to make new assessments and/or require a Clearing Member to cure a deficiency in its Guaranty Fund deposit shall terminate, but without limiting the obligations of Clearing Members to make such contributions or assessments for which the obligation arose prior to the Termination Time."

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." As discussed above a DCO's default fund represents a multilateral indemnification arrangement between the DCO and its members pursuant to which members' contributions are used to cover the DCO's losses resulting from member default(s) and thereby prevent the DCO's bankruptcy. A DCO has no authority under its rules to request or to apply these funds for any other purpose, nor do we believe that a trustee would have any authority under the Code to do so. For this reason, we recommend that the Commission modify proposed Rule 190.18 to remove this provision.

We appreciate that the above comments with regard to Subpart C are significant. Nonetheless, we wish to make clear that we support the adoption of rules that would set out an appropriate, more carefully tailored, approach to be taken in the event of a DCO bankruptcy. In this regard, we would welcome the opportunity to meet with the Commission or its staff to discuss our concerns in greater detail. In particular, it would be helpful to consider how the Proposed Amendments might be applied in certain circumstances.

We turn now to Subpart A and Subpart B of the Proposed Amendments. Our comments on each subpart are limited, and we otherwise generally support their adoption.

The Proposed Amendments should require the Commission's consent before a receiver is permitted to file a voluntary petition in bankruptcy on behalf of an FCM. Proposed Rule 190.02(f) provides that, in the event that a receiver for an FCM is appointed due to the violation or imminent violation (i) of the customer property protection requirements under the Commodity Exchange Act ("**Act**") or the Commission's rules, or (ii) of the FCM's minimum capital requirements, the receiver may, in an appropriate case, file a petition for bankruptcy of such FCM pursuant to section 301 of the Code. We assume that any receiver that may be appointed by a court would be in response to a proceeding initiated by the Commission pursuant to section 6c of the Act, which authorizes the Commission to file an action in the appropriate US District Court when it appears that a 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". We appreciate that there may be circumstances in which a receiver may determine that a voluntary petition under the Code is warranted. However, in light of the fact that such a petition would effectively close the FCM, we believe that the rule should provide that the receiver may file a voluntary petition only with the prior consent of the Commission.

The Proposed Amendments should not restrict cash delivery property to cash received no earlier than three calendar days before the relevant first notice day or exercise date. The definition of cash delivery property in proposed Rule 190.01 provides, in part, that the cash or cash equivalents held in the cash delivery account "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***". The Federal Register release does not explain

why it has proposed to restrict cash delivery property to cash and cash equivalents received no earlier than three calendar days before the relevant first notice day or exercise date, and we see no reason why cash or cash equivalents that may be received by a debtor FCM and properly deposited in a cash delivery account prior to this period should not be accorded the same protections under Part 190 as cash and cash equivalents received within the three calendar day time frame.

The Commission should revise proposed Rule 190.04(d)(3) to confirm that authority of the trustee to require a customer that posts a letter of credit to deliver substitute customer property does not extend to letters of credit posted to a delivery account. Proposed Rule 190.04(d)(3) provides, in part, that a 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." A "commodity contract", in turn, is defined to mean (i) a futures or options on futures contract executed on or subject to the rules of a designated contract market, (ii) a futures or option on futures contract executed on or subject to the rules of a foreign board of trade, or (iii) a cleared swap. Based on the foregoing, we believe the authority granted the trustee in proposed Rule 190.04(d)(3) would not extend to letters of credit held in the delivery account.

We believe this is the correct result. A purchaser that takes delivery under a commodity contract frequently is not required to take delivery for a significant period of time after the purchaser and seller have been matched. In these circumstances, the purchaser may be required to post a letter of credit as security for full payment when delivery is made. If the trustee were to require a purchaser to substitute cash or cash equivalents or risk having the letter of credit drawn down prior to the time that delivery is made, the purchaser's liquidity could be impaired.

Notwithstanding the foregoing, we are concerned that because the parties' obligations under the delivery account arise from a commodity account, a trustee's authority under proposed Rule 190.04(d)(3) could be interpreted to apply to letters of credit held in a delivery account. For the avoidance of doubt, therefore, we request that the Commission revise proposed Rule 190.01(d)(3) to make clear that a trustee's authority would not apply to letters of credit held in a delivery account.

The Proposed Amendments should provide transferee FCMs more specific relief from applicable law relating to "customer diligence". In order to facilitate the transfer, or porting, of customer accounts to one or more transferee FCMs, proposed Rule 190.07(b)(3) provides:

> 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.

We strongly support the policy underlying this position.[24] As the proposed rule recognizes, the transfer, rather than liquidation, of positions would likely not occur if transferee FCMs were required to conduct customer diligence before accepting any transferred account. Relief from the customer diligence requirements, therefore, is essential if the Commission's policy of favoring porting over the liquidation of customer accounts is to be realized.[25]

We are concerned, however that proposed Rule 190.07(b)(3) does not provide sufficient relief from applicable law governing customer diligence. "Customer diligence" is not a defined term either in the Proposed Amendments or elsewhere in the Commission's rules. This creates a level of legal uncertainty that exposes transferee FCMs to unacceptable regulatory risk. To cure this uncertainty, we encourage the Commission to specify the customer diligence rules from which transferee FCMs will have temporary relief. Such rules may include, but not be limited to: (i) rules relating to anti-money laundering requirements (including rules requiring FCMs to implement customer identification programs and know your customer requirements and all corresponding self-regulatory organization ("**SRO**") requirements);[26] (ii) rules relating to risk and other disclosures (Rules 1.55, 30.6, 33.7 and similar SRO disclosure requirements); (iii) rules relating to capital and residual interest requirements (Rules 1.11, 1.17, 1.22, 1.23, 22.2, 22.17, 30.7 and 41.48 and related SRO requirements);[27] (iv) rules relating to account statements required under Rule 1.33 in the event positions transfer with inadequate contact information (Rule 1.33 and related SRO requirements); and rules relating to margin in the event accounts transfer without adequate margin (Rules 1.17, 39.13, 41.42-41.49 and related SRO requirements).

Separately, we note that proposed Rule 190.07(b)(4) provides that 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." We appreciate the need for legal certainty. However, FCMs carefully draft their account agreements in line with their risk management tolerances, and subjecting FCMs to account agreements that are potentially inconsistent with those tolerances in times of market stress would

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[24] We also agree that six months is a reasonable amount of time by which a transferee FCM should be able to complete the customer diligence process, subject to the Commission's authority to grant additional time in particular circumstances.

[25] Notwithstanding this policy preference, we note that the Proposed Amendments further provide that nothing in proposed Rule 190.07 will (i) limit the exercise of any contractual right of a DCO or other registered entity to liquidate or transfer open commodity contracts; or (ii) be interpreted to limit a DCO's ability adequately to manage risk. Proposed Rule 190.07(a)(3). We support this proposed rule.

[26] In this regard, we ask the Commission to confirm that the relief extended herein extends to those rules adopted by the Financial Crimes Enforcement Network, Department of the Treasury, *i.e.*, 12 CFR §§ 1026.100-1026.670.

[27] Relief from Commission Rule 1.17 would not extend to the requirement in proposed Rule 190.07(b)(1) that a transferee FCM must assure that it will not accept a transfer that would cause the transferee to be in violation of the Commission's minimum financial requirements.

appear inadvisable and, in some cases, could put FCMs in positions whereby they are breaching their internal risk management policies and procedures.[28]

We further note that many large customers, in particular, may maintain accounts at more than one FCM. In these circumstances, a customer may already have an agreement in place with the transferee FCM. We do not read the proposed rule to require that the transferee FCM must nonetheless manage the customer's ported account in accordance with the agreement entered into with the defaulting FCM, and we ask the Commission to confirm our view. Where the customer does not already have an agreement in place with the transferee FCM, we suggest that the account agreement of the defaulting FCM should stay in place for a short defined interim period during which the parties may renegotiate terms that are inconsistent with the FCM's risk management practices.

Separately, we observe that a customer's account agreement may not always be able to be physically transferred from the debtor FCM to the transferee FCM. For example, different account classes of the same customer may be transferred to different transferee FCMs; the accounts of multiple customers, whose accounts are transferred to several transferee FCMs, may be governed by a single master account; or it may simply take time for the trustee to locate certain account agreements. For this reason, we ask the Commission to confirm that the customer agreement entered into between the debtor FCM and its customer will be deemed assigned to the transferee FCM, even if the physical agreement is not transferred.[29]

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[28] In this regard, it was noted that questionable risk management may well have led to a defaulting FCM's failure. In these circumstance, it makes little sense for a transferee FCM to be bound, for however brief a period of time, by the terms and conditions of customer account agreements that may have been a contributing cause of the FCM's bankruptcy.

[29] As the Commission may be aware, representatives of FIA member firms have discussed with Commission staff from time-to-time amending Rule 1.49 to expand the definition of "money center currency" therein to include the currencies of a select number of jurisdictions in addition to the historical "money center countries", *i.e.*, Canada, France, Italy, Germany, Japan, and the United Kingdom. FIA member firms believe that the risk of loss from holding these currencies, including loss from sovereign action, is no greater than the risk of loss from holding the current money center currencies. We appreciate that Rule 1.49 is outside the scope of this rulemaking. Nonetheless, we ask the Commission to confirm that, in the event the Commission decides to consider revisions to Rule 1.49 at a later date, nothing in the Proposed Amendments or in Appendix B, Framework 2, would prohibit the Commission from doing so.

Thank you for your consideration of these comments. If the Commission or the staff have any questions regarding the matters discussed herein, please contact Allison Lurton, FIA's Chief Legal Officer and General Counsel, at 202.466.5460 or alurton@fia.org.

Respectfully submitted,

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Honorable Brian Quintenz, Commissioner
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