Futures Industry Association
2001 Pennsylvania Ave. NW
Suite 600
Washington, DC 20006-1823

202.466.5460
202.296.3184 fax
www.futuresindustry.org

By Electronic Mail

January 15, 2010

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

Re: Operation, in the Ordinary Course of Business, of a Commodity Broker
74 Fed.Reg. 66598 (December 16, 2009)

Dear Mr. Stawick:

The Futures Industry Association ("FIA")[1] welcomes the opportunity to submit this letter in response to the Commodity Futures Trading Commission's ("Commission's) proposal to amend its bankruptcy rules, 17 CFR Part 190 ("Bankruptcy Rules"), to permit a trustee in bankruptcy, with the written permission of the Commission, to operate the business of a commodity broker, in the ordinary course. Specifically, the Commission proposes to amend Rule 190.04(d) to add a new subparagraph (3) to provide:

> *Exception to liquidation only.* Notwithstanding paragraph (d)(2) of this section,[2] the trustee may, with the written permission of the Commission, operate the business of the debtor in the ordinary course, including the purchase or sale of new commodity contracts on behalf of the customers of the debtor under appropriate circumstances, as determined by the Commission.

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[1] FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest futures commission merchants ("FCMs") in the United States. Among FIA's associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets.

[2] Rule 190.04(d)(2) authorizes a trustee to enter into new commodity transactions only for the purposes of (1) offsetting open commodity contracts, (2) transferring a transferable notice applicable to an open commodity contract, or (3) covering, in its discretion and with the Commission's approval, inventory or commodity contracts of the commodity broker that cannot be liquidated immediately because of market conditions.

The purpose of the proposed amendment is "to enable customers to manage their accounts, after their commodity broker enters into bankruptcy *and prior to the transfer of their accounts*, in certain circumstances.[3] [Emphasis supplied.]

FIA appreciates that there may be occasions when it would be appropriate to authorize a trustee to operate the business of an FCM for a limited period of time, in particular, as the Commission notes, when an FCM has sufficient capital to continue operating and has reached an agreement to transfer all customer positions to another, solvent FCM. For example, the trustee for Lehman Brothers, Inc. ("Lehman") was authorized to operate the business of Lehman for a brief period of time pending the Court's approval of the sale of Lehman's business to Barclays Capital Inc. ("Barclays").[4]

Nonetheless, we cannot support adoption of the proposed rule at this time and in this form. For the reasons set forth below, we believe further action on the proposed rule is premature. Moreover, standing alone, the proposed rule is overly broad and fails to give sufficient guidance to either the trustee or the Commission staff charged with implementing its provisions.[5] As such, the proposed rule does not provide an opportunity for meaningful comment on its substance.

The proposed rule should be considered only in connection with a comprehensive review of the relevant provisions of the Bankruptcy Code and the Commission's Rules.

The proposed amendment represents the second revision to the Commission's bankruptcy rules published for comment within a four-month period. In August, the Commission proposed to amend Rule 190.01(a) to (i) codify the Commission's September 2008 *Interpretative Statement Regarding Funds Relating to Cleared-Only Contracts Determined to be Included in a Customer's Net Equity* ("Interpretative Statement"),[6] and (ii) add a sixth and separate account class for a limited group of cleared over-the-counter ("OTC") derivatives.[7]

In our comment letter on the Commission's August proposal, we discussed the degree of legal uncertainty surrounding the treatment of cleared OTC derivatives under the Bankruptcy Code ("Code") and noted that the Commission had recently proposed amendments to the Code that would extend to swap dealers, their counterparties and their customers the special protections that Subchapter IV of Chapter 7 of the Code provides to customers of commodity brokers. While encouraging the Commission to pursue with Congress the adoption of appropriate amendments to the Code, we concluded:

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[3] 74 Fed.Reg. 66598, 66600 (December 16, 2009).

[4] The Court's order appointing the trustee authorized the trustee to operate Lehman's business until 6:00 PM on Friday, September 19, 2008. We understand that Barclays guaranteed all transactions effected by Lehman's customers during this period.

[5] As the Commission notes, in accordance with the provisions of Rule 190.10(d), the Commission has delegated to the Director of the Division of Clearing and Intermediary Oversight ("DCIO"), and such Commission staff acting under the Director's direction, essentially all functions of the Commission under Part 190. Therefore, the DCIO Director would be expected to exercise the authority reserved to the Commission under the proposed rule.

[6] 73 Fed.Reg. 65514 (November 4, 2008).

[7] 74 Fed.Reg. 40794 (August 13, 2009).

> With the state of the law surrounding cleared OTC derivatives in such flux, especially in the event of a default of an FCM carrying such cleared OTC derivatives, we respectfully suggest it may be appropriate that the Commission defer action on the proposed amendments to the Bankruptcy Rules creating a "cleared OTC derivatives" account class, until Congress has an opportunity to decide how to respond to the various recommendations presented.[8]

Since FIA submitted its comment letter in September, the House of Representatives has adopted HR 4173, The Wall Street Reform and Consumer Protection Act of 2009. In this bill, the House instructs the Commission, in coordination with the Securities and Exchange Commission and the several bank regulatory authorities, to recommend, within 180 days of enactment of the bill, legislative changes to the federal insolvency laws (i) to enhance legal certainty with respect to swap participants clearing non-proprietary swap positions with a swap clearinghouse, (ii) to clarify and harmonize the insolvency law applicable to entities that are both FCMs and broker-dealers, and (iii) to facilitate the portfolio margining of securities and commodities positions through entities that are both FCMs and broker-dealers.

FIA supports the comprehensive review of the relevant provisions of the Code and the Commission's bankruptcy rules contemplated by the above provision of HR 4173 and urges the Commission, along with other regulatory authorities, to undertake such a review even if this provision of the bill does not become law.[9] Pending completion of such a review and the development of recommendations for comprehensive reform, we cannot support any amendments designed to address discrete issues that may be identified by the Commission.

The Code and the Commission's bankruptcy rules embody complex legal structures. A change in one section of the Code or rules may very well affect other provisions in ways that are not always obvious. Each proposed amendment to the rules, therefore, requires an analysis of its potential impact on all other sections of the rules. In light of the current uncertainty surrounding the scope of the Commission's jurisdiction over OTC derivatives — cleared and uncleared — any such analysis is time-consuming and, ultimately, uncertain. The process is, at best, inefficient, but may also result in the adoption of amendments that have unintended consequences.

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[8] Letter from John M. Damgard, President, Futures Industry Association, to David A. Stawick, Secretary to the Commission, dated September 14, 2009, page 7.

[9] This provision of HR 4173 is consistent with the recommendations of participants who took part in the hearings on harmonization of regulation held by the Commission and the Securities and Exchange Commission in September. In a Report published in October, the agencies noted that several participants at the joint hearings held in September testified that as more OTC derivatives are traded on exchanges and cleared through clearing organizations, it will be important to develop and implement a more uniform customer account regime that protects both customer assets and the integrity of the market in the event of a default of a major firm. In the absence of amendments to the Code relating to the liquidation of stockbrokers and commodity brokers, the participants encouraged the agencies to develop uniform procedures to guide a trustee, as well as the Bankruptcy Court, when a joint BD/FCM becomes insolvent.

In the absence of legislative changes, the Commission and the Securities and Exchange Commission, in coordination with the Securities Investor Protection Corporation, should first develop uniform procedures to guide a trustee of an insolvent FCM/broker-dealer.

As measured by adjusted net capital, all but seven (7) of the 50 largest FCMs are also registered broker-dealers.[10] Therefore, it is likely that the trustee appointed to oversee an insolvent FCM/broker-dealer will be appointed by the Securities Investor Protection Corporation ("SIPC").[11] The Commission, on the other hand, has no statutory control over the selection of a trustee.[12] Consequently, although a SIPC trustee may be authorized by the court to operate the business of an FCM/broker-dealer,[13] the trustee selected by SIPC may not have sufficient knowledge or experience to operate the FCM-related business of the FCM/broker-dealer.

In these circumstances, if the proposed amendment were adopted, responsibility for operating the FCM-related business of the FCM/broker-dealer would fall by default to DCIO staff. We question whether it is appropriate for Commission staff to undertake this responsibility and whether staff would have the necessary expertise to do so.

We understand that the Commission has suggested an amendment to the Code to grant it a deciding voice in the selection of a commodity broker trustee. Among the legislative recommendations the Commission transmitted to Congress in August was an amendment to section 762 of the Code that would require a court to appoint as trustee for the liquidation of a commodity broker "such person as the Commission, in its sole discretion, specifies."[14] However, Congress has yet to act on this proposal. In either event, it is clear that coordination between the Commission and SIPC, as well as the Securities and Exchange Commission, will be essential in selecting, and providing guidance to, a trustee of an FCM/broker-dealer.[15] Without such written guidance, the proposed amendment, if adopted, would have little value.

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[10] Financial Data for Futures Commission Merchants as of November 30, 2009.

[11] Under the provisions of the Securities Investor Protection Act ("SIPA"), if SIPC determines that a SIPC member has failed or is in danger of failing to meet its obligations to customers, SIPC may apply to the court for a protective order. If the court grants the order, the court is required to appoint as trustee of a bankrupt broker-dealer, and as attorney for the trustee, "such persons as SIPC, in its sole discretion, specifies." 15 USC § 78eee. The trustee has the same duties as a trustee under Chapter 7 of the Code, including the duties specified in Subchapter IV. 78 USC § 78fff-1.

[12] This is true even in the case of a stand-alone FCM. Although the Commission has the right to appear and be heard on any matter involving a commodity broker liquidation, the court is not required to appoint a trustee selected by the Commission. 11 USC § 762. In the ordinary course, a Chapter 7 trustee is randomly selected by the US Trustee from the approved trustee panel.

[13] 11 USC § 721. We understand that an order authorizing the trustee to operate the business of the broker-dealer usually extends only until the end of the day on which the order is issued in order to close out the day's trading. For example, the order appointing the Lehman trustee authorized the trustee to operate the business until 6:00 PM on that Friday. Even if the Commission adopts the proposed amendment, it is likely that a trustee will want the court's blessing before undertaking to operate a firm's FCM-related business. In this regard, the Commission may want to consider simply amending its rules to authorize the trustee to apply for an order under section 721 to operate the business of an FCM.

[14] Letter from Gary Gensler, Commission Chairman, to the Chairmen and Ranking Members of the relevant Congressional Committees, dated August 17, 2009, and attached legislative recommendations.

[15] We understand that this recommendation is not a new idea. When the Commission adopted Part 190 in 1983, it noted that "the Commission intends to instruct its staff to initiate discussions with SIPC with a view towards

We urge the Commission and SIPC, therefore, to act expeditiously to develop appropriate uniform procedures to guide a trustee. Following an opportunity for public comment, we recommend that these procedures then be adopted as an appendix to Part 190.

The proposed amendment is overly broad and does not provide sufficient guidance to a trustee and Commission staff charged with implementing the rule.

Adoption of the procedures as an appendix to Part 190 would also address the amendment's failure to provide proper guidance to prospective trustees and Commission staff. We recognize that the Commission cannot anticipate every circumstance in which the exercise of this authority may be in the best interests of an FCM's customers. Nonetheless, we also understand that the primary purpose of the proposed amendment is to authorize a trustee to operate the business of an FCM for a discrete period of time pending the transfer of the customer positions of an FCM experiencing financial difficulties to a solvent FCM.

However, in the *Federal Register* release accompanying the proposed amendment, the Commission states only that (1) whether the FCM has entered into an agreement providing for the imminent transfer of customer accounts to another FCM, and (2) whether the FCM has sufficient capital to continue operating its business in the ordinary course until all customer accounts have been transferred are among factors it *may* consider in authorizing a trustee to operate the business of an FCM.[16]

We believe these factors should be viewed as necessary conditions precedent to the exercise of such authority.[17] If the Commission believes there are other circumstances in which it may be appropriate to authorize a trustee to operate the business of the FCM, the public should have an opportunity to comment on those circumstances.

Among other issues, we recommend that the procedures:

- Confirm that the authority of the trustee to operate the business of the FCM will not interfere with the authority of the relevant designated contract markets and derivatives clearing organizations to order the liquidation of positions or otherwise restrict the ability of the FCM to execute and clear transactions.

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developing a common proposal or understanding as to the appropriate treatment of the joint commodity broker-securities dealer in bankruptcy. In this regard, the Commission is aware that the number of such joint firms is increasing and as a result the need for a satisfactory resolution of this matter may become even more apparent in the future." 48 Fed.Reg. 8716 (March 1, 1983). Further, as mentioned earlier, several participants in the joint hearings on harmonization of regulation made a similar recommendation.

[16] 74 Fed.Reg. 66598, 66600 (December 16, 2009).

[17] As noted above, in connection with the transfer of customer accounts from Lehman to Barclays, Barclays guaranteed all transactions effected on behalf of Lehman customers pending the transfer. In these circumstances, there would appear to be no reason not to authorize a trustee to operate the business of the FCM.

- Provide guidance on the type of customers that will be permitted to enter into new transactions. (An FCM may have thousands of customers, and it may not be possible to permit all customers to execute transactions.)[18]

- Offer guidance regarding any special margin requirements that might apply to new positions.

- Confirm the degree of control that the trustee and Commission staff, respectively, will be authorized to exercise. The proposed amendment provides that the trustee will act with the "written permission" of the Commission. The procedures should address whether the decision to operate the business of the FCM will rest in the first instance with the trustee, or whether there are circumstances in which the staff might seek to instruct the trustee to operate the business. The procedures should also explain the extent to which the trustee will be required to have decisions approved by the staff before they are implemented.

- Confirm whether the trustee will have the authority to permit a customer to transfer its account to another FCM or to liquidate its account and withdraw its funds.

Conclusion

FIA appreciates the opportunity to submit these comment on the proposed amendment to Commission Rule 190.04. If the Commission has any questions concerning the matters discussed in this letter, please contact Tammy Botsford, FIA's Vice President and Assistant General Counsel, at (202) 466-5460.

Sincerely,

John M. Damgard
President

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner

Division of Clearing and Intermediary Oversight
Ananda Radhakrishnan, Director
Robert B. Wasserman, Associate Director
Nancy Schnabel, Attorney Advisor

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[18] If the ability to enter into new transactions is to be limited to a particular type of customer, the Commission may want to consider whether this issue might be addressed more easily by expanding the definition of specifically identifiable property in Commission Rule 190.01(kk).