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ALERT MEMORANDUM

CFTC Proposes Comprehensive Revision of FCM and DCO Insolvency Rules

May 29, 2020

On April 14, 2020, the Commodity Futures Trading Commission (the "**CFTC**") proposed amendments (the "**Proposal**") to its Part 190 regulations ("**Part 190**") that govern the liquidation of a "commodity broker," including a futures commission merchant (an "**FCM**") or a derivatives clearing organization (a "**DCO**").[1]

The Proposal represents the CFTC's first attempt to materially revise Part 190 since its original promulgation in 1983. However, as relates to FCMs, the Proposal would constitute more of an update and modernization than a substantive overhaul. The Proposal's FCM provisions would largely retain the existing Part 190 framework, with adjustments to reduce uncertainty, align procedural and other requirements with regulatory and technological changes over the past four decades, and codify as formal rules many of the CFTC's previously expressed positions. As a result, with limited exceptions discussed below, the Proposal, if implemented, would not materially change how an FCM bankruptcy is conducted.

Nonetheless, with respect to DCOs, the Proposal represents a material substantive change. Although the Proposal would continue Part 190's existing approach of applying to an insolvent DCO many of the rules applicable in an FCM liquidation, it would in many instances allow the DCO's own rules to override those provisions. Specifically, the Proposal would give effect to the DCO's loss allocation, recovery, and wind-down rules, even if those rules are not consistent with the Part 190 framework. As a result, the Proposal would shift to DCOs the responsibility of developing a workable and equitable liquidation framework. It could also mean that different rules govern the liquidation of different DCOs.

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The following Memorandum provides a brief overview of the regulations applicable to FCM and DCO insolvencies and key takeaways from the Proposal.

[1] *Amendments to Part 190 Bankruptcy Regulations* (Apr. 14, 2020), available here.

I. Background

1. Existing Commodity Broker Liquidation Framework

Subchapter IV of Chapter 7 of the U.S. Bankruptcy Code (the "**Code**")[2] sets out special provisions for the liquidation of a "commodity broker," which is defined to include an FCM or a DCO.[3] Rather than a comprehensive framework, however, the provisions of Subchapter IV function more as key principles that require further elaboration.

Congress empowered the CFTC with the authority to promulgate rules defining the details of commodity broker insolvencies. The CFTC first released such rules, which are contained in Part 190,[4] in 1983. Since then, it has only made technical changes to these rules, including to establish a separate account class for cleared swaps following the enactment of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**").

2. Changes in the Cleared Derivatives Market

The cleared derivatives market and the derivatives regulatory framework have substantially changed in many respects since the CFTC promulgated Part 190. Of particular note:

— Multiple FCMs have been liquidated over the past four decades pursuant to Part 190 or the Securities Investor Protection Act ("**SIPA**"), which largely incorporates Part 190. These liquidations have provided important practical lessons, including the need for the commodity broker's bankruptcy trustee (the "**Trustee**") to act quickly with incomplete information.

— Congress enacted the Dodd-Frank Act, which not only established an entirely new regulatory framework for swaps but also created the Orderly Liquidation Authority special resolution regime for systemically important financial companies ("**OLA**").

— Following the implementation of the Dodd-Frank Act's swaps clearing mandate and enactment of OLA, market participants and regulators have increased their focus on the need for a coherent, risk-limiting, and equitable regime to govern the insolvency of a central counterparty, such as a DCO.

— The cleared derivatives market has seen substantial technological innovations, including the shift from paper-based to electronic documentation and trading systems.

— The variety of underliers subject to contracts carried by an FCM and cleared on a DCO has dramatically expanded to include virtual currencies and other intangible assets.

— Parties have challenged certain core concepts set forth in Part 190, including the scope of the "customer property" and "commodity contract" definitions.

— The CFTC and the Securities and Exchange Commission have sought to identify opportunities for portfolio margining of transactions subject to their separate regulatory regimes.

To address these developments, and in response to the CFTC's Project KISS, the Business Law Section of the American Bar Association formed a subcommittee (the "**ABA Subcommittee**") to develop and submit a model set of Part 190 rules.[5] The ABA Subcommittee made its submission to the CFTC on September 29, 2017.[6]

3. The Proposed Part 190 Amendments

The CFTC considered the ABA Subcommittee's submission and subsequently released the Proposal, which would comprehensively revise Part 190. As

[2] 11 U.S.C. §§ 761-767.
[3] *See* 11 U.S.C. §§ 101(6), 761.
[4] 17 C.F.R. Part 190.
[5] Cleary Gottlieb lawyers actively participated in the ABA Subcommittee.
[6] The ABA Subcommittee's proposed model rules are available here. Its cover note for those rules is available here.

noted above, however, the Proposal's provisions related to FCMs would more serve to increase the clarity of Part 190 and align it with existing practice and CFTC policy than to materially modify the way FCM liquidations are conducted. In Section II below, we highlight some of the notable ways in which the Proposal seeks to achieve this goal as well as some of the Proposal's provisions that do constitute departures from the existing Part 190 framework.

In furtherance of these efforts, the Proposal would also make some modest changes to certain business-as-usual FCM operations. We discuss these changes in Section III below.

As noted above, the provisions concerning DCOs would set out new substantive rules for the liquidation of a troubled DCO. We discuss some of the notable aspects of these rules in Section IV below.

II. Clarifying and Modernizing Changes

1. A New Core Principles Section

Under the Proposal, Part 190 would be broken into three distinct subparts: a general subpart addressing provisions common to FCMs and DCOs; a subpart specific to FCMs; and a subpart specific to DCOs. Included in the new subpart common to FCMs and DCOs would be a new Section 190.00. That section would set forth some "core concepts" related to Part 190, including:

a. Customer Priority

Section 766(h) of the Code and the existing Part 190 framework provide for two key rules with respect to the priority of claims to "customer property":

— the debtor commodity broker's customers have priority over all of the debtor's other claimants (other than certain administrative claims); and

— the claims of the debtor's public customers must be satisfied in full before the claims of its non-public customers (*i.e.*, an affiliate or insider of the FCM) may be paid.[7]

The Proposal would retain these two rules with certain clarifying changes to note that a public customer is, in the case of an FCM, any customer whose commodity account is subject to the CFTC's segregation requirements, and in the case of a DCO, any person whose account with the member FCM is not classified as an FCM proprietary account.

b. Porting Customer Positions

Consistent with the existing Part 190 framework, the Proposal would express a strong preference for porting customer positions from an insolvent FCM to another FCM. Such porting is meant to minimize the disruption to customers resulting from an FCM insolvency and limit the harm to a customer that can result from liquidating its existing hedges and requiring it to find replacement hedges.

In a bit of a departure from the existing Part 190, however, the proposed language in Section 190.00 would suggest that this preference only applies to the positions of *public* customers. Although existing Section 190.06(e) makes clear that porting is not permissible for the FCM's "house account" (*i.e.*, its own positions), it does not address expressly whether positions of the FCM's affiliates may be transferred.

> Although the language in proposed Section 190.00 would not definitively disallow transfers of non-public customer positions, it does strongly indicate that such transfers would be disfavored, or potentially impermissible. This indication may help to clarify how the transactions of an FCM's affiliates would be treated in the event of the FCM's failure and accordingly allow such affiliates to calculate with greater certainty their exposure to the FCM for regulatory capital or other purposes.

In addition, in furtherance of the CFTC's policy preference in favor of porting, the Proposal would seek to improve the transferability of FCM customer

[7] *See* 17 C.F.R. § 190.08.

positions. Specifically, the Proposal would clarify that:

— transferee FCMs can accept a transfer before completing customer diligence, as long as such diligence is completed within six months of such transfer;[8] and

— any account agreements governing a transferred customer account would be assigned to the transferee by operation of law.

c. *Pro Rata* Distribution

Under Section 766(h) of the Code, the Trustee must distribute customer property ratably based on each customer's claim. Existing Part 190 generally tracks this mandate, but separates customer property by account class (*i.e.*, futures, foreign futures, cleared swaps, and delivery). Under Part 190, customer property attributable to an account class is distributed *pro rata* to claims arising from that account class. Any excess is then distributed to the other public customers, depending on the size of the shortfall in such account class.

The Proposal would retain this framework. However, it would also include certain changes described below to better ensure that customers posting letters of credit as margin receive the same *pro rata* treatment as other customers.

d. Deliveries

Part 190 currently contains special provisions relating to commodity contracts that are settled by delivery and that cannot be liquidated or transferred prior to the time by which delivery must be made. Section 190.00 would make clear the CFTC's preference with respect to such contracts, including:

— that such contracts be liquidated if possible before such time as they would move into a delivery position; and

— when such contracts are in a delivery position, to allow delivery to occur.

In addition, the Proposal would add provisions allowing for delivery of intangible commodities, including virtual currencies.

2. Amendments that Clarify Netting Rights

a. Partial Transfers

As noted above, Part 190 expresses a strong preference for porting rather than liquidating customer positions. In furtherance of this preference, Part 190 permits the Trustee to partially transfer a customer's positions when a complete transfer is not possible. Although such a partial transfer may provide the customer with some continuity, it could—as a theoretical matter—disrupt a customer's netting set.

For example, a Trustee could, in theory, transfer a customer's out-of-the-money positions to a transferee FCM and "leave behind" at the debtor FCM either the associated margin posted by the customer in respect of such positions or the customer's in-the-money positions. In such an event, the customer could incur greater losses than had its positions been entirely liquidated, as the customer would be required to deliver margin to the transferee FCM in respect of its out-of-the-money positions, and may not recover fully on its claims for its return of margin or in-the-money positions.

Although the practical risk of such "cherry picking" is quite low, the ABA Subcommittee proposed clarifying amendments to Part 190 that would prevent a Trustee from engaging in partial transfers that could either disrupt a customer's netting set or unduly preference one customer over another. Specifically, the ABA Subcommittee proposed that:

— the Trustee only be permitted to effect a partial transfer of a customer's positions if such transfer would not increase a customer's net equity claim; and

[8] Query, however, whether diligence obligations arising from regimes outside the CFTC's jurisdiction would be covered by this clarification.

— the Trustee only transfer a customer's positions and margin if, after taking into account all customer property available for distribution, such transfer would not result in insufficient remaining customer property to make equivalent distributions to other customers.

The Proposal includes these provisions. If adopted, they would provide greater certainty that netting sets cannot be broken through a partial transfer. In addition, they would make clear that a transfer of the positions of some customers but not others should not generally result in the transferred customers receiving more than those left behind.

b. FCM Close-out Rights

The Proposal would also include specific language addressing an FCM's right to exercise close-out netting rights against a debtor that is also an FCM. The Code's safe harbors specifically protect these rights; however, Part 190 does not currently address how those rights interact with the provisions of Part 190. Under the Proposal, Part 190 would include specific language stating that:

— an FCM is permitted to liquidate a debtor FCM's positions, so long as the FCM uses commercially reasonable efforts to achieve competitive pricing; and

— such liquidation would not be voidable, regardless of whether the FCM used commercially reasonable efforts to achieve competitive pricing. Instead, the Trustee's sole remedy with respect to a claim challenging such a liquidation would be monetary damages, calculated as the difference between the liquidation price and the liquidation price that would have resulted from a commercially reasonable effort to achieve competitive pricing.

This language, if adopted, would provide FCMs with greater certainty that Part 190 would not interfere with their ability to exercise the close-out netting rights that Congress specifically safeguarded in the Code's safe harbors.

3. Amendments to Facilitate Portfolio Margining

Currently, Part 190 does not contain an independent definition of "commodity contract," but instead refers back to the definition contained in Section 761 of the Code. That definition encompasses a broad range of transactions, including any transaction cleared by a DCO. However, the language does not expressly reference transactions that are outside the scope of the CFTC's regulatory remit, but are nonetheless carried in an account subject to CFTC regulation, whether through a portfolio margining arrangement or otherwise.

The Proposal seeks to provide greater clarity that such transactions would be treated as commodity contracts by specifying a "commodity contract" definition and noting that the definition includes:

— as a "futures contract," (1) any retail commodity transaction executed on or subject to the rules of a designated contract market ("**DCM**") or foreign board of trade ("**FBOT**") as if it were a futures contract; and (2) a forward contract that is executed on or subject to the rules of a DCM or FBOT and cleared by a DCO (or foreign clearing organization) as if it were a futures contract; and

— as a "swap," any transaction that is carried in a cleared swaps account and is cleared by a DCO as if it were a cleared swap.

The Proposal would also clarify, for portfolio margining purposes, how to treat a commodity contract that would normally be attributable to one account class, but is instead allocated to a second account class (the "home field") and commingled with contracts therein.[9] In such a situation, the "home field" rule would apply—both contracts (and

[9] The CFTC noted that such commingling is potentially authorized by CFTC regulation or order or a DCO's rule because the contracts in question are intended to offset each other. Proposal, at 32-33.

associated collateral) should be treated as contracts held in the second account class.

4. *Clarifications Regarding the Scope of Commodity Contracts and Customer Property*

In recent FCM bankruptcies, claimants have taken positions regarding the scope of Part 190's definitions of "commodity contract" and "customer property" that conflicted with the CFTC's policy positions.

— During the bankruptcy of Peregrine Financial Group, certain of Peregrine's retail customers asserted that their claims against Peregrine arising from off-exchange foreign exchange ("**FX**") and metals contracts were entitled to priority because: (1) their contracts were similar enough to futures contracts to be considered commodity contracts; or (2) their transactions (and associated collateral) were held in a constructive or resulting trust by Peregrine, such that they were not part of Peregrine's "customer property" or general estate. The United States Bankruptcy Court for the Northern District of Illinois rejected both claims.[10]

— In the context of Griffin Trading's bankruptcy, Griffin's creditors challenged the authority of the CFTC to treat any property of the debtor FCM's estate as "customer property" (upon a customer property shortfall).[11] Although the United States Bankruptcy Court for the Northern District of Illinois held that this rule exceeded the CFTC's rulemaking authority, this decision was vacated on appeal after the parties settled.

In order to limit the opportunity for challenge and bolster the CFTC's policy positions, the Proposal would include the following clarifications:

— FX and certain other transactions that are not cleared or carried by an FCM in a CFTC-regulated account are not commodity contracts, and thus are not entitled to Part 190's protections;

— no property that falls within the definition of customer property will be excluded from this definition because it is considered to be held in a constructive or resulting trust; and

— customer property includes certain funds the FCM is already required to set aside for the benefit of its customers.[12]

The last clarification may serve as a fallback to protect customers in the event another court follows the approach of the *Griffin* court in holding that the CFTC does not have authority to extend the "customer property" definition to any other property of the debtor FCM's estate. This is because the clarification would significantly expand the scope of customer property to assets that are not segregated without implicating some of the considerations that informed the *Griffin* decision. In particular, the clarification is in alignment with Section 761 of the Bankruptcy Code, which defines customer property to include "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."[13] In addition, the clarification would still technically leave available other property within the debtor FCM's estate to which customers would not have priority claims.[14]

The Proposal's reaffirmation and codification of the CFTC's policy positions comes in the wake of *Kisor v. Wilkie*,[15] in which the Supreme Court curtailed deference to an agency's

[10] *Secure Leverage Grp., Inc. v. Bodenstein*, 558 B.R. 226, 231 (N.D. Ill. 2016), *aff'd sub nom. In re Peregrine Fin. Grp., Inc.*, 866 F.3d 775 (7th Cir. 2017), *as amended* (Aug. 8, 2017).

[11] *In re Griffin Trading Co.*, 245 B.R. 291 (Bankr. N.D. Ill. 2000), *vacated as mooted sub. nom. Inskeep v. MeesPierson N.V. (In re Griffin Trading Co.)*, 270 B.R. 882 (Bankr. N.D. Ill. 2001).

[12] Specifically, customer property would include the greater of: (1) the amount of the FCM's targeted residual interest amount for each account class; or (2) the amount of funds the FCM set aside to cover debit balances or under-margined accounts.

[13] *See* 11 U.S.C. § 761(10)(A)(ix).

[14] This issue was a concern of the *Griffin* court. *See In re Griffin Trading Co.*, 245 B.R. at 310-11.

[15] 139 S. Ct. 2400 (2019). For additional context on this case, please see our alert memorandum.

interpretation of its ambiguous regulations. In particular, the Court held that such an interpretation should be afforded deference only if the regulation is "genuinely ambiguous"—one that is still ambiguous after exhausting the "traditional tools" of construction, such as analyzing the text, structure, history, and purpose of a regulation.[16] Moreover, even where the regulation is genuinely ambiguous, certain agency interpretations may not warrant deference, including those that are not "authoritative" or the "official position" of the agency.[17]

By including Section 190.00 to lay out the purpose of and general policy preferences embedded in Part 190, as well amending Part 190 to reflect the CFTC's positions expressed in previous FCM bankruptcies, the CFTC appears to be fortifying its interpretations of Part 190 in the event that a court applied *Kisor* to one of its regulations. In addition, the Proposal's clarifying amendments could prevent a court from needing to apply *Kisor* in the first place.

5. *Modifications to the Treatment of Letters of Credit to Facilitate Pro Rata Distribution*

Since 1983, the CFTC has taken the position that customers who post letters of credit as margin should be treated no differently in an FCM bankruptcy than customers who post cash or securities as margin. In furtherance of this mandate, Part 190 currently includes the "full proceeds" of a letter of credit posted as margin within the definition of customer property, such that those proceeds are subject to *pro rata* distribution.[18]

However, the Proposal noted, some customers "sought to escape *pro rata* treatment" to which other customers are subject.[19] Specifically, in the MF Global bankruptcy, customers challenged the Trustee's decision to treat the full face value of letters of credit as customer property that had already been distributed to the customer. As a result of the Trustee's decision, the customers' net equity claims against MF Global's estate were reduced by the full face value of the letters of credit. In addition, if their respective *pro rata* share of customer property was less than the full face value of the letters of credit, the customers could have been required to pay the difference to the estate.

The United States District Court for the Southern District of New York concluded that the customers' arguments raised issues that required "substantial and material consideration."[20] However, each customer ultimately settled its dispute with the Trustee.

In response to the uncertainty left in the wake of these settlements, the Proposal would more clearly define how the Trustee should treat a letter of credit posted as margin. Specifically:

— drawn portions from such a letter of credit would be treated as customer property within the FCM's estate; and

— any undrawn portions of such a letter of credit would be treated as customer property already distributed to the customer.

  - The customer's claim against the FCM's estate would be reduced by this amount; to the extent that such amount exceeded the *pro rata* share of customer property to which the customer was entitled, then the customer would owe the FCM's estate that excess amount.

In addition, the Proposal would also establish the following requirements with respect to letters of credit:

— as a business-as-usual matter, a customer may only post a letter of credit as margin if its terms permit the letter to be drawn in Part 190 proceedings (or

[16] *Id.* at 2415.
[17] *Id.* at 2416.
[18] 17 C.F.R. § 190.08(a)(1)(i)(E).
[19] Proposal, at 22 n.33, 80-82.
[20] *See In re MF Glob. Inc.*, 484 B.R. 18, 22 (S.D.N.Y. 2012); *In re MF Glob., Inc.*, No. 12 CIV. 6014, 2012 WL 4757866, at *2 (S.D.N.Y. Oct. 4, 2012). The CFTC intervened in both cases and took the same position as the Trustee.

SIPA or OLA proceedings) in respect of the FCM, even if the customer has not defaulted; and

— the Trustee may request that a customer who posted a letter of credit deliver substitute property; if the customer does not, the Trustee could then draw on the full amount of the letter of credit.

6. *Greater Discretion/Flexibility for an FCM's Trustee*

There are some parts of the Proposal which would limit a Trustee's discretion, such as the proposed prohibition on a Trustee transferring customer accounts in deficit. However, the Proposal would generally expand a Trustee's discretion by subjecting the Trustee's operations to fewer process and timing restrictions. These changes would include giving the Trustee the option to:

— request an exemption from any procedural requirement of Part 190;

— treat open commodity contracts in hedging accounts as specifically identifiable property,[21] instead of requiring the Trustee do so; and

— follow current mandatory provisions of Part 190, such as the existing requirement that the Trustee keep each side of a spread and straddle together, only "to the extent practicable."

Similarly, certain timing and other constraints that Part 190 currently imposes on a Trustee (*e.g.*, how soon to transfer open commodity contracts) would be changed to "as soon as practicable." The CFTC explained this proposed change by noting that, in previous in FCM bankruptcies, these timing constraints were satisfied well in advance and unnecessary (*e.g.*, when providing the CFTC notice of a voluntary bankruptcy filing) or resulted in unnecessary pressure in challenging circumstances (*e.g.*, when attempting to transfer customer positions).

The Proposal also addresses the extent to which a Trustee would be required to follow the CFTC's existing rules applicable to an FCM. In particular, the Proposal would:

— require the Trustee to use "reasonable efforts" to comply with all provisions of the Commodity Exchange Act and CFTC regulations as if it were the FCM and to compute balances for customer accounts with open contracts or property as of the close of each business day. Under the existing Part 190 framework, the Trustee is required to comply with these requirements; and

— explicitly require that the Trustee apply the CFTC's residual interest provisions, although "in a manner appropriate to the context" of debtor's estate.

7. *Modernization Changes*

To bring Part 190 in line with technological changes in the cleared derivatives market, the Proposal would add provisions related to delivery that reflect modern forms of holding and transferring property. For example, these provisions would accommodate the use of electronic documents of title.

In addition, the Proposal would also modernize notice provisions, including by permitting the Trustee to use electronic messages to provide notices and removing the existing newspaper customer notice requirements.

III. New FCM Business-as-Usual Requirements

In addition to revising the rules applicable in an FCM insolvency, the Proposal would amend a few of the rules that currently apply to the ordinary course operations of an FCM.

Most significantly, as noted above, the Proposal would prohibit an FCM from accepting a letter of credit as margin unless its terms permit the letter to be drawn in Part 190 proceedings (or SIPA or OLA

[21] Part 190 provides greater limits on a Trustee's ability to liquidate specifically identifiable property compared to other types of customer property.

proceedings) in respect of the FCM, even if the customer has not defaulted.

In addition, the Proposal would modestly adjust the requirements related to hedging account designations. Part 190 currently requires an FCM to obtain and record a customer's written instruction stating whether to designate its account as a "hedging account" when the customer undertakes its first hedging contract. The Proposal would shift this timing to the time at which the customer first opens its account—the time when the FCM and customer generally establish the rules governing the account. However, the requirement would not apply to customer accounts established before the effective date of the proposed rule. In addition, consistent with existing practice, in order to establish a hedging account, a customer would need to provide a written representation that its trading will constitute hedging under any relevant CFTC rule or rule of any DCO, DCM, SEF, or FBOT.

Lastly, the Proposal would include a requirement that, if an FCM facilitates or effects delivery of a physical commodity under a commodity contract and does so outside of one of the accounts subject to CFTC regulation, it must do so in a "delivery account," or if the relevant property is a security, in a securities account.

IV. New Rules for DCO Liquidations

Under the existing Part 190 framework, the rules governing the liquidation of a DCO are not well-defined, as the CFTC previously stated that any such liquidation "would be *sui generis*."[22] However, following the introduction of the swaps clearing mandate and the attendant additional concentration of risk, there has been a greater desire to flesh out what would actually happen if a DCO were to become insolvent or unable to satisfy its obligations. The advent of OLA has further increased the need for clarity, as OLA defers to Part 190's distribution provisions with respect to customer property.

In view of these considerations, the Proposal would adopt a separate subpart to govern the liquidation of a DCO. Although this subpart—consistent with existing Part 190—would generally incorporate the provisions applicable to an FCM, it would allow various provisions of the DCO's rules to override or modify these provisions. In particular, the Proposal would:

— prohibit the Trustee from avoiding or prohibiting any action taken by the DCO that was reasonably within the scope of the DCO's recovery and wind-down plans;

— require the Trustee to implement and follow the DCO's default rules and procedures, as well as any termination, close-out, and liquidation provisions included in the DCO's rules, where reasonable and practicable;

— take actions in accordance with the DCO's recovery and wind-down plans, where reasonable and practicable;

— calculate DCO members' net equity claims (and thus determine how to spread losses among DCO members and accounts) using the DCO's loss allocation rules and procedures;

— implement DCO rules granting customers additional property, such as "reverse waterfall" rules;[23]

— include as customer property any guarantee fund deposit (and similar payments or deposits) paid by a member FCM as well as any other property of such an FCM that the DCO's rules and procedures make available to satisfy claims of public customers of a member FCM; and

— follow DCO default rules and procedures and recovery and wind-down plans applicable to making up shortfalls in settlement funds received by the DCO.

[22] *See* CFTC, Account Class, 75 Fed. Reg. 17297, 17299 (Apr. 6, 2010).

[23] Reverse waterfall rules allocate members' recoveries on claims against defaulting members in reverse order of the allocation of the losses.

The Proposal also contemplates permitting an insolvent DCO to operate where doing so would be useful and practicable, such as operating in order to transfer the insolvent DCO's operations or to finish resolving the DCO under OLA. Under the Proposal, the DCO Trustee would be able to request permission from the CFTC to continue operating the DCO. If the CFTC finds that such operation would be useful and practicable, it may permit the Trustee to operate the DCO for up to six calendar days.

As support for these changes, the Proposal argues that DCO rules are developed subject to the CFTC's regulations and are, in the case of loss allocation rules, contractual terms between the FCM and the DCO. Thus, the CFTC would prefer that a DCO Trustee use vetted, pre-existing rules as a "roadmap" instead of "developing, in the moment, models to address an extraordinarily complex situation."

The Proposal would otherwise generally retain the current DCO liquidation framework set forth in Part 190. In particular, the rules applicable to a DCO liquidation would:

— generally prohibit transfers of positions from the DCO, absent the CFTC's express consent; and

— distinguish between member property and customer property, with the latter reserved for claims of the FCM's public customers and former available for the FCM's proprietary claims as well as those of its affiliates.

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