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M E M O R A N D U M

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TO: Owen Taylor
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RE: Transfer of Cleared Swap and Foreign Futures Positions from a FCM Clearing Member

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This memorandum describes the bankruptcy rules that govern transfers of Positions (as defined herein) and associated margin from a FCM Clearing Member (as defined herein) that has entered (or following the transfers enters) insolvency proceedings under Subchapter IV of Chapter 7 of the U.S. Bankruptcy Code (the "Code") and Part 190 of the Regulations (the "Part 190 Rules") of the Commodity Futures Trading Commission ("CFTC") (such provisions, collectively, the "Commodity Broker Liquidation Provisions") and, if the FCM Clearing Member is also a broker-dealer that is a member of the Securities Investor Protection Corporation ("SIPC"), under the provisions of the Securities Investor Protection Act of 1970 ("SIPA"). This memorandum is not intended as a comprehensive summary of the laws and procedures governing such proceedings, the rights and obligations of customers of a failed FCM Clearing Member or the factors that could affect the amount of losses such customers ultimately may sustain. Rather, this memorandum is intended to provide an overview of the rules relevant to the transfer of Positions and associated margin, known as "porting", from a failing FCM Clearing Member to a solvent FCM Clearing Member in connection with, or prior to, a Code or a SIPA insolvency proceeding with respect to the failing FCM Clearing Member.

Questions Presented

Following the commencement of an insolvency proceeding with respect to a defaulting FCM Clearing Member pursuant to the Commodity Broker Liquidation Provisions:

(a) What are the duties of the trustee for such FCM Clearing Member with regard to transferring Positions and associated margin from the defaulting FCM Clearing Member to a solvent FCM Clearing Member?

(b) May a DCO (as defined below) facilitate and assist the trustee in such transfers?

Brief Answer

Subject to the assumptions, qualifications, discussion and analysis contained herein, we believe that the trustee appointed over the operations of the failing FCM Clearing Member, in the proper carrying out of its duties under the Commodity Broker Liquidation Provisions, would likely seek approvals of the CFTC, SIPC (where the FCM Clearing Member is a member of SIPC) and the bankruptcy court and, assuming such approvals are granted, would likely attempt to transfer eligible Positions carried in eligible accounts of "public customers" and, to the extent within the trustee's control and consistent with the rules discussed herein, associated margin securing such Positions to one or more solvent FCM Clearing Members. We base our views on the legal rights and obligations of the trustee under the Commodity Broker Liquidation Provisions. We note that the attendant factual circumstances, including but not limited to the integrity of the failing FCM Clearing Member's books and records, its compliance with customer property segregation, secured amount and other legal requirements, practical and legal impediments to the trustee's ability to gain control over customer funds, the protections afforded to customer funds under foreign law, other effects of applicable law, regulations and rules, the existence of contractual mechanisms among the relevant parties, the decisions of a derivatives clearing organization with respect to its exercise of liquidation rights and rights to apply customer margin, and the willingness and ability of transferee FCM Clearing Members to accept Positions, will influence the prospects of successful porting.

The assistance of the DCO at which Positions are cleared would appear to be a practical necessity to enable porting by the trustee. While such assistance is not compelled under the Commodity Broker Liquidation Provisions, such provisions are generally compatible with a DCO's facilitation of porting by the trustee, assuming such facilitation is carried out in accordance with the instructions of the trustee, the terms of any court orders and regulatory actions approving the transfers, and otherwise in accordance with the Commodity Broker Liquidation Provisions.[1]

I. Assumptions and Definitions

1. An "FCM Clearing Member" is a clearing member of a CFTC-registered derivatives clearing organization (such clearing organization, a "DCO"), which clearing member is (i) registered as a futures commission merchant ("FCM") pursuant to the Commodity Exchange Act and actually operates a business as such; (ii) a "commodity broker" as defined in Section 101(6) of the Code; (iii) an entity that resides or has a domicile, a place of business or property in the United States; and (iv) not a bank, insurance company or other entity (including any insured depository institution) subject to insolvency procedures other than under the Code or SIPA.

2. The "Positions" to be transferred are "commodity contracts" (as defined in the Code) within the "cleared swaps" account class or the "foreign futures" account class established under the Part 190 Rules and are carried, respectively, in cleared swaps accounts or foreign futures accounts of "public customers" of the FCM Clearing Member.

[1] See, e.g., Order Approving the Transfer of Certain Segregated Customer Commodity Positions, MF Global, Inc., Doc. 14, Case No. 11-2790 (MG) SIPA (S.D.N.Y. 2011) (authorizing facilitating DCOs to consummate approved account transfers and take all other actions reasonably necessary in furtherance thereof to complete account transfers directed by the trustee).

3. The FCM Clearing Member becomes subject to a Code proceeding under Subchapter IV of Chapter 7 of the Code, or, where the FCM is a broker-dealer, a SIPA proceeding under which the Commodity Broker Liquidation Provisions are applied to the transfers of Positions and associated margin.

4. Each of the Positions and the associated margin that the trustee seeks to transfer constitute "customer property" (as defined in section 761 of the Code) allocable to the cleared swaps account class or the foreign futures account class, as applicable.

5. Each customer of the FCM Clearing Member constitutes a "customer" (as defined in section 761 of the Code). As used herein, a "public customer" of an FCM Clearing Member is any customer other than a "non-public customer" (as defined in 17 C.F.R. § 190.01(cc)).[2]

6. The FCM Clearing Member does not become subject to a receivership proceeding under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Title II")[3].

7. The FCM Clearing Member does not become subject to a federal or state equity receivership.[4]

II. Discussion

A. Applicable Insolvency Regimes

An FCM is subject to a voluntary or involuntary bankruptcy proceeding under the Code. See 11 U.S.C. § 301 (governing voluntary petitions) and 11 U.S.C. §303 (governing involuntary petitions).[5] Such proceeding would be a liquidation proceeding under subchapter IV of Chapter

[2] A "non-public customer" is a person with certain insider or affiliate relationships with the FCM Clearing Member, including, for example, officers, directors, owners of 10 percent or more of the capital stock of the FCM Clearing Member and employees of the FCM Clearing Member whose duties include managing the business of the FCM Clearing Member, handling Positions or associated collateral, keeping records pertaining to Positions or associated collateral, or signing or co-signing checks on behalf of the FCM Clearing Member. See 17 C.F.R. § 190.01(cc).

[3] Title II establishes a system known as the Orderly Liquidation Authority for the liquidation of systemically important nonbank financial companies in certain circumstances ("OLA"). OLA combines elements of the Federal Deposit Insurance Act ("FDIA") and the Code, as well as elements unique to OLA. A receiver may be appointed for a company under OLA if the Secretary of the Treasury, in consultation with the applicable regulators, were to determine that an FCM is a "financial company" (as defined in Title II) and the other conditions to the invocation of OLA were met (e.g., the company is in default or in danger of default, its failure would adversely affect the financial stability of the United States and no "viable private sector alternative" exists for preventing the default of the company). Section 210(m) of OLA provides that the receiver shall "in the case of any covered financial company … that is a commodity broker, apply the provisions of subchapter IV of chapter VII of the [Code], in respect of the distribution to any customer of all customer property and all member property, as if such covered financial company …were a debtor for purposes of such subchapter." The interplay between OLA and the Commodity Broker Liquidation Provisions is unclear.

[4] A federal or state court may appoint a receiver to protect the rights of parties in response to litigation. Additionally, where there have been violations of securities or commodities laws, a federal court may appoint a receiver for a financial firm at the request of the Securities and Exchange Commission or the CFTC. See, e.g., Peregrine Fin. Group, Inc., Case No. 12-5383 (N.D. Ill. 2012) (appointed receiver relieved of duties with respect to commodity broker after bankruptcy filed).

[5] An involuntary chapter 7 proceeding may be commenced by three or more holders of non-contingent claims not subject to bona fide dispute if such claims aggregate at least $15,775 more than the value of any lien on property of the debtor securing such claims. If the debtor has less than 12 creditors, then an involuntary petition may be filed by one creditor holding at least $15,775 of such claims. 11 U.S.C. § 303(b). The petition will be granted if the

7 of the Code, as an FCM may not commence Chapter 11 reorganization proceedings. See 11 U.S.C. §109(d), 11 U.S.C. §103(d).[6] Upon the order for relief (i.e., the filing of a voluntary petition or the granting by the Court of an involuntary petition), a trustee would be appointed with respect to the assets and operations of the FCM.

It is possible that the relevant FCM is also a broker-dealer. For FCMs that are also broker-dealers that are insured by SIPC, the relevant FCM could become subject to a liquidation proceeding under SIPA. Under SIPA, if a SIPC insured broker-dealer has (i) failed or is in danger of failing to meet its obligations to customers or is insolvent; (ii) is not in compliance with certain financial responsibility or other rules applicable to it; or, (iii) has had a receiver, trustee or liquidator appointed for it, SIPC may file an application with a US District Court (the "District Court") for a protective decree.[7] If the District Court grants the application, a SIPA liquidation proceeding is commenced and a trustee is appointed by SIPC to wind down the affairs of the broker-dealer.[8] Once issued, the protective decree stays any pending bankruptcy case, foreclosure, equity receivership or similar proceedings with respect to the broker dealer or its assets. SIPA provides that a SIPC trustee appointed for a debtor that is a joint broker-dealer and FCM is also subject to the duties of a trustee in a case under subchapter IV of Chapter 7 of the Code, to the extent consistent with SIPA.[9] For FCMs that are broker dealers that are not insured by SIPC (or where SIPC does not seek a protective decree), it is conceivable that the liquidation of securities accounts of the FCM would be effected pursuant to the stockbroker liquidation provisions of subchapter III of Chapter 7 of the Code. However, this memorandum assumes that any FCM that is a broker-dealer is insured by SIPC and would therefore become subject to a SIPA liquidation proceeding that incorporates the Commodity Broker Liquidation Provisions.[10]

B. The Commodity Broker Liquidation Provisions

The Commodity Broker Liquidation provisions establish a framework for the liquidation of insolvent commodity brokers. These provisions mandate the ratable distribution of customer property to customers on the basis of, and to the extent of, such customers' allowed net equity

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petitioners can show that (i) the debtor is generally not paying its debts as they become due (unless the debts are the subject of a bona fide dispute as to liability or amount) or (ii) within 120 days before the petition date, a custodian (subject to certain exceptions) was appointed over, or took possession of, the assets of the debtor. 11 U.S.C. § 303(h).

[6] The Commodity Broker Liquidation Provisions apply to liquidation of a "commodity broker." The term "commodity broker" is defined in the Code to mean a "futures commission merchant, foreign futures commission merchant, clearing organization, leverage transaction merchant, or commodity options dealer, as defined in section 761 of [the Code], with respect to which there is a customer, as defined in section 761 of [the Code]." 11U.S.C. § 101(6).

[7] 15 U.S.C. § 78eee(a)(3).

[8] 15 U.S.C. § 78eee(b)(3).

[9] 15 U.S.C. § 78fff-1(b). The interplay between SIPA and the Commodity Broker Liquidation Provisions is not completely clear as the SEC and CFTC have yet to develop a common framework for dual SIPC insured broker-dealer/FCM proceedings. See Market Transactions Advisory Committee, Report to the U.S. Securities and Exchange Commission Pursuant to Section 17A(f)(4) of the Securities Exchange Act of 1934 (Jan. 13, 1997). Nonetheless, any potential for inconsistencies between SIPA and the Commodity Broker Liquidation Provisions to interfere with porting has not manifested itself in recent large joint broker-dealer/FCM insolvency proceedings.

[10] As mentioned above in our assumptions, it is conceivable that an FCM Clearing Member could become subject to a receivership proceeding under Title II or a state or federal receivership. This memorandum does not address such scenarios.

claims, with public customers being afforded priority in such distribution to all other claims (other than certain expenses attributable to the administration of customer property).[11] See 11 U.S.C. § 766(h). Customer property is generally allocated to a particular account class established by the Part 190 Rules[12], and each customer with a claim based on an account within such account class will share pro rata with other customers with claims based on such account class on the basis of, and to the extent of, such customers' allowed net equity claims. See 17 C.F.R. §190.08. In contrast to a conventional Chapter 7 proceeding, where the trustee is directed to reduce to money the property of the estate as expeditiously as is compatible with the best interests of the parties in interest, see 11 U.S.C. § 704(a)(1), the Commodity Broker Liquidation Provisions include provisions to facilitate the distribution of customer property in the form of transfers of open commodity contracts and associated margin equity to other FCMs, to the extent consistent with pro rata distribution. Additional protections applicable to "specifically identifiable" commodity contracts allow customers that hold such contracts to redeem them from the debtor's estate, to the extent they have not been transferred as part of a bulk transfer, by depositing security with the trustee.

The Commodity Broker Liquidation Provisions support porting of Positions and associated margin by imposing a "best efforts" duty on the trustee to effectuate a bulk transfer and by providing safe harbors from avoidance by the trustee for certain transfers of customer property.

1. Trustee's Duty to Transfer Positions

The Part 190 Rules provide that, commencing immediately after the entry of the order for relief, the trustee must use its best efforts to effect a transfer no later than the seventh calendar day after the order for relief of the open commodity contracts and equity held by the debtor for or on behalf of its customers. See 17 C.F.R. § 190.02(e)(1). If an involuntary petition has been filed, the seven calendar day period for transfers commences on the filing date, and the duty to use best efforts to effect a transfer applies to the debtor commodity broker if a trustee has not yet been appointed. However, if the debtor in an involuntary case demonstrates to the CFTC within such period that it is in compliance with segregation and financial requirements on the filing date, and the CFTC determines that such transfer is neither appropriate nor in the public interest, the debtor may continue in business subject to applicable provisions of the Code. See 17 C.F.R. § 190.02(e)(2).

This duty to effect a bulk transfer is, however, subject to limitations under the Part 190 rules and must be balanced against countervailing duties of the trustee to liquidate open commodity contracts as required under such rules. Because a transfer of account equity prior to final claims determination could result in departures from pro rata distribution, a number of safeguards apply.

[11] Although the definitions and computational mechanics for "customer property" and "net equity" could have a material effect on a customer's distributional entitlement, for purposes of our discussion regarding porting, such concepts are relevant primarily for their effect on the determination of the "funded balance", discussed in footnote 15.

[12] The Part 190 Rules establish the following account classes: futures accounts, foreign futures accounts, leverage accounts, delivery accounts (as defined in the Part 190 Rules), and cleared swaps accounts. See 17 C.F.R. §190.01(a)(1). If Positions that would otherwise belong to one account class (and associated margin) are, pursuant to a CFTC rule, regulation or order (or a DCO rule approved by the CFTC pursuant to 17 C.F.R. § 39.15(b)(2)), held separately from other Positions in such account class, and are commingled with Positions (and associated margin) in a different account class, then the former Positions (and associated margin) are treated, for purposes of the Part 190 Rules, as being held in the latter account class. 17 C.F.R. §190.01(a)(2(iii).

A trustee is not permitted to make disbursements to customers prior to final distribution except with approval of the court or in accordance with 190.08(d), a provision governing the return or transfer of specifically identifiable property. See 17 C.F.R. § 190.04(e)(2). Notice of the bulk transfer to the CFTC and its approval or non-objection are also necessary as conditions to the availability of certain protections from avoidance actions by the trustee, as discussed below. The amount of collateral that may be transferred along with such open commodity contracts generally will be determined as part of such CFTC and court approval process. Lack of reliable records on which to base a determination of the amount of equity to be transferred,[13] or insufficiencies in the amount of customer funds in segregation (or, in the case of foreign futures, separately maintained in accessible "30.7 accounts")[14] may preclude approval or limit the amount of margin that may be transferred.

The amount of money, securities or property that may be transferred in respect of any eligible account may not exceed the "funded balance" of such account based on available information as of the calendar day immediately preceding transfer less the value on the date of return or transfer of any property previously returned or transferred with respect to the account. 17 C.F.R. § 190.06(e)(2).[15]

The following accounts are not eligible for transfer: (i) house accounts[16] or the accounts of general partners of the debtor if the debtor is a partnership; (ii) leverage accounts, if the debtor is the leverage transaction merchant with respect to such accounts; (iii) dealer option accounts, if the debtor is the dealer option grantor with respect to such accounts; and (iv) accounts which are in deficit. 17 C.F.R. §190.06(e)(1). Prior to amendments that became effective in April 2012,[17] 17 C.F.R. § 190.06(e)(1) provided that accounts without open contracts were ineligible for transfer. The CFTC's analysis of this amendment appears to rest on a reading of the protections from avoidance afforded by 11 U.S.C. § 764(b)(2) as applying "presumably [to] claims attendant" to the liquidation of a commodity contract.[18] We express no view on this analysis.

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[13] See, e.g., Response/Statement of the Commodity Futures Trading Commission regarding the Trustee's Motion for an Order Approving Transfers and Interim Distributions to Certain Commodity Customers of the Debtor, Peregrine Financial Group, Inc. , Doc. 163, Case No. 12-5383 (N.D. Ill. 2012) (urging that validity testing of debtor's books and records was necessary in order to "avoid a mis-distribution of customer funds").

[14] The obligations of a FCM to segregate cleared swaps customer collateral are detailed in 17 C.F.R. Part 22, while obligations to maintain the "foreign futures or foreign options secured amount" in separate accounts are set out in 17 C.F.R. §30.7. References in this memorandum to the segregation of customer funds or collateral should be understood to refer also to the maintenance of the foreign futures or foreign options secured amount.

[15] The "funded balance" is defined as "a customer's pro rata share of the customer estate with respect to each account class available as of the primary liquidation date for distributions to customers of the same class." 17 C.F.R. § 190.07(c). Because the computation of the funded balance depends, among other factors, on the positions carried by the FCM Clearing Member for its customers at all clearing organizations, the amount of collateral segregated on behalf of its customers maintained at each clearing organization, and the amount of segregated customer collateral maintained by the FCM Clearing Member outside of any clearing organization, a reliable estimate of the funded balance generally will require knowledge of the overall circumstances of the FCM Clearing Member with regard to customer positions and segregated assets.

[16] A "house account" is defined as any commodity account owned by the debtor. 17 C.F.R. § 190.01(x).

[17] See Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 Fed. Reg. 6336 (February 7, 2012).

[18] 76 Fed. Reg. 33818, 33842 (June 9, 2011).

Although certain proprietary accounts are eligible for transfer, the requirement that the amount of collateral transferred not exceed the funded balance, together with the lower distributional priority afforded to "nonpublic customers", may preclude their transfer in many cases.

Partial transfers (i.e., of some eligible customer accounts but not others, or of less than all of the open commodity contracts in an account) may be permissible:

- 17 C.F.R. § 190.06(f)(3)(i) states: "If all eligible customer accounts held by a debtor cannot be transferred under Rule 190.06, a partial transfer may nonetheless be made. The [CFTC] will not disapprove such a partial transfer for the sole reason that it was a partial transfer if it would prefer the transfer of accounts, the liquidation of which could adversely affect the market or the bankrupt estate." In the adopting release for the Part 190 Rules, the CFTC notes, however, that "if the records of the debtor are in poor order, … the trustee may deem it advisable not to make anything less than a bulk transfer," subject to certain exceptions for dealer option contracts. 48 Fed. Reg. 8716, 8726 (March 1, 1983).

- If all of a customer's open commodity contracts cannot be transferred under Rule 190.06, a partial transfer of contracts may be made. A partial transfer may be effected by liquidating that portion of the open commodity contracts held by a customer which represents sufficient equity to permit the transfer of the remainder. If any commodity contracts to be transferred in a partial transfer are part of a spread or straddle, both sides of such spread or straddle must be transferred or neither side may be transferred. 17 C.F.R. § 190.06(f)(3)(ii).

The Part 190 Rules reserve to the CFTC the power to permit account transfers that do not comply with requirements ordinarily applicable to such transfers, "in appropriate cases and to protect the public interest." See 17 C.F.R. § 190.06(h)(2). SIPA also authorizes the court presiding over the liquidation of an FCM that is also a SIPC-insured broker-dealer to modify the application of these regulations. See SIPA § 78fff-1(b).

Even if a bulk transfer is achieved, the customer may be required to post margin in order to maintain the transferred Positions,[19] and access to the transferred account may be impeded by rule or regulation or temporary measures to permit adjustments to the amount of equity transferred.[20]

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[19] 17 C.F.R. § 190.06(c)(3) provides that the transferee of a "commodity contract for which notice is given under §190.06(b)(2) [*sic*] must keep that contract open one business day after its receipt, unless the customer for whom the transfer is made fails to respond within a reasonable time to a margin call for the difference between the margin transferred with such contract and the margin which such transferee would require with respect to a similar commodity contract held for the account of a customer in the ordinary course of business."

[20] See, e.g., 17 C.F.R. § 39.13(g)(8)(iii) (requiring derivatives clearing organizations to require their clearing members to ensure that their customers do not withdraw funds from their accounts with such clearing members unless the net liquidating value plus the margin deposits remaining in a customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products and swap portfolios held in such customer's account which are cleared by the derivatives clearing organization). See, generally, Joint Audit Committee Margins Handbook (available at http://www.nfa.futures.org/NFA-compliance/publication-library/margins-handbook.pdf) for restrictions applicable to under-margined accounts. See also CME Notice of "Hold" for any Accounts Transferred from MF Global, Inc. (available at http://www.cmegroup.com/tools-information/lookups/advisories/clearing/files/Chadv11-402.pdf).

2. Trustee's Duty to Liquidate Commodity Contracts

Subject to the duties of the trustee to attempt to make the transfers described above, the Part 190 Rules instruct the trustee to liquidate or offset commodity contracts and other property held by or for the account of the debtor promptly and in an orderly manner, subject to exceptions for certain contracts held in bona fide hedging accounts. 17 U.S.C. § 190.02(f)(1). An appendix to the Part 190 Rules provides a schedule of the trustee's duties and certain "practical suggestions." Instructions in the appendix relating to the date of the order for relief caution that the trustee should "recognize that if there is a substantial shortfall [of customer funds], a transfer … is highly unlikely." However, if there is a small shortfall, then the trustee should negotiate with the clearing organization to effect a transfer. See 17 C.F.R. § 190, Bankruptcy Appendix A: Form 1 – Operation of the Debtor's Estate -- Schedule of Trustee's Duties. Although the seventh calendar day after the order of relief (coinciding with the period for avoidance protections under section 764(b) of the Code, discussed in the following section) is generally the last possible date for such bulk transfers,[21] the trustee need not wait for such period to lapse before liquidating open contracts. If the trustee determines that "no transfer is possible, as in a case of severe undersegregation, then contracts may be liquidated as soon as such a determination is made." 48 Fed. Reg. 8726.[22]

Notwithstanding the duty to attempt a transfer, the trustee must liquidate contracts which cannot be settled in cash and which would otherwise remain open beyond the last day of trading (if applicable), or the first day on which notice of intent to deliver may be tendered, whichever occurs first, as well as certain physical commodity options that cannot be settled in cash. 17 C.F.R. § 190.02(f)(1). A trustee must issue margin calls with respect to any account in which the funded balance less the value on the date of return or transfer of any property previously returned or transferred does not equal or exceed certain thresholds, but the trustee need not make margin calls to restore initial margin. The trustee is authorized, but not obligated, to liquidate any account for which such margin call is not met within a "reasonable time,"[23] provided that the trustee must immediately liquidate any account which is in deficit. 17 C.F.R. § 190.02(g)(2)

3. Avoidance Protections

The Code contains provisions allowing for the avoidance of certain pre- and post-bankruptcy transfers. However, the Commodity Broker Liquidation Provisions contain certain protections from avoidance, which could, under certain circumstances, protect transfers made in connection with the porting process.

[21] The trustee may for good cause request from the CFTC an exemption from, or extension of, any time limit prescribed by the Part 190 Rules, other than any time period established by the Code. 17 C.F.R. § 190.10(b). The CFTC indicated that this provision is "primarily aimed at providing relief in extraordinary cases where unique hardship would otherwise occur." 48 Fed. Reg. 8737.

[22] The CFTC stated in the adopting release of the Part 190 Rules that bulk transfers are generally expected to occur well before expiration of the statutory period, at that time four business days, during which anti-avoidance protection is available pursuant to Section 764(b) of the Code. 48 Fed. Reg. 8726.

[23] A "reasonable time" for meeting margin calls made by the trustee is generally deemed to be one hour, or such greater period not to exceed one business day, as the trustee may determine its sole discretion. 17 C.F.R. § 190.04(e)(4).

The bankruptcy trustee may avoid transfers by the debtor of property that, but for such transfer, would have been "customer property." 11 U.S.C. § 764(a). Sections 544, 545, 547, 548, 549, and 724(a) of the Code confer on the trustee the power to avoid certain preferential, fraudulent and other types of transfers. Section 764(a) of the Code provides that for purposes of such sections, the property transferred is deemed to have been property of the debtor, and, if the transfer was made to a customer or for a customer's benefit, such customer is deemed, for the purposes of section 764, to have been a creditor. Property recovered by the trustee pursuant to such sections is treated as customer property. 11 U.S.C. § 764(a).

Certain transfers of customer property, however, are protected from the avoidance powers under section 764(a). Section 764(b) of the Code provides that, notwithstanding sections 544, 545, 547, 548, 549, and 724(a) of the Code, the trustee may not avoid a transfer made before seven days after the order for relief, if such transfer is approved by the CFTC by rule or order, either before or after such transfer, and if such transfer is—

> (1) a transfer of a commodity contract entered into or carried by or through the debtor on behalf of a customer, and of any cash, securities, or other property margining or securing such commodity contract; or
>
> (2) the liquidation of a commodity contract entered into or carried by or through the debtor on behalf of a customer.

The Part 190 Rules define certain categories of pre-relief and post-relief transfers that are protected from avoidance pursuant to section 764(b) unless the transfers are disapproved by the CFTC:[24]

Post-relief Transfers

The trustee may not avoid a transfer made on or after the entry of the order for relief but not later than the seventh calendar day following the order for relief that is –

> (1) the transfer of a customer account eligible to be transferred under Rule 190.06(e) or (f) made by the trustee or by any self-regulatory organization[25] of the commodity broker, provided that the CFTC is notified in accordance with Rule 190.02(a)(2)[26] prior to the transfer and does not disapprove the transfer; or

[24] See 17 C.F.R. § 190.06(g).

[25] Neither the Part 190 Rules nor the Code defines the term "self-regulatory organization". In the general definitions of terms used in CFTC regulations, 17 C.F.R. § 1.3(ee) defines "self-regulatory organization" to mean a contract market (as defined in §1.3(h)), a swap execution facility (as defined in §1.3(rrrr)), or a registered futures association under section 17 of the Commodity Exchange Act. Prior to amendments to the Part 190 Rules that became effective in April 2012, this provision regarding post-relief transfers referred to transfers made by "any self-regulatory organization or clearing organization of the commodity broker." The CFTC adopting release for the amendments offered no explanation for the deletion of "clearing organization." See 77 Fed. Reg. 6336, 6361 (February 7, 2012).

[26] Rule190.02(a)(2) requires that this notice be given to the CFTC no later than the close of business on the third calendar day after the order for relief. The CFTC has described the purpose of the notification pursuant to Rule 190.02(a)(2) as providing a means for it "to assure in advance that the transfer to be effected meets the pro rata requirements" of the Part 190 Rules. 48 Fed. Reg. 8724.

(2) the transfer of a customer account at the direction of the CFTC upon such terms and conditions as the CFTC may deem appropriate and in the public interest.

Pre-relief transfers

The following transfers prior to the entry of the order for relief may not be avoided by a trustee, unless the transfer is disapproved by the CFTC:

(i) The transfer of commodity contract accounts in compliance with 17 C.F.R. § 1.17(a)(4);[27] or

(ii) The transfer by a public customer, including a transfer by a public customer which is a commodity broker, of commodity contract accounts held from or for the account of such customer by or on behalf of the debtor unless the customer acted in collusion with the debtor or its principals to obtain a greater share of the bankrupt estate than that to which it would be entitled in a bankruptcy distribution; or

(iii) The transfer by a clearing organization[28] of one or more accounts held for or on behalf of customers of the debtor, provided that the money, securities, or other property accompanying such transfer did not exceed the funded balance of each account based on available information as of the close of business on the business day immediately preceding such transfer less the value on the date of return or transfer of any property previously returned or transferred thereto.

III. Qualifications and Reliance

We note that legal analysis with regard to bankruptcy or insolvency law matters, unavoidably, has inherent limitations that generally do not exist in respect of other legal issues. These inherent limitations exist primarily because of (1) the pervasive equity powers of courts presiding over a proceeding under the Code or SIPA, which may be exercised to advance goals of the Commodity Broker Liquidation Provisions, the Code and/or SIPA in preference to other legal rights and policies; (2) the potential relevance to the exercise of judicial discretion of future-arising facts and circumstances, including without limitation the actions and views of the CFTC and SIPC; and (3) the nature of the bankruptcy and trial process.

This memorandum of law is based solely on the Federal laws of the United States as at the date hereof and does not express any view with respect to the laws or regulation of any other jurisdiction. We undertake no duty to update this memorandum of law and disclaim any obligation to revise or supplement this memorandum of law, or to otherwise notify you, should such laws or regulations be changed by legislative or regulatory actions, judicial decisions or otherwise. This memorandum of law is for the exclusive benefit of the addressee and it may not be relied on by others without our prior written consent. We understand that you may permit the Bank of England, the CFTC, the Securities and Exchange Commission and one or more Federal

[27] 17 C.F.R. § 1.17(a)(4) requires an FCM that does not meet certain minimum financial requirements to transfer all customer accounts and immediately cease doing business.

[28] The term "clearing organization" means a derivatives clearing organization registered under the Commodity Exchange Act. 17 C.F.R. § 190.01(f); 11 U.S.C. § 761(2).

Reserve Banks and/or Board of Governors of the Federal Reserve System to review this memorandum in the course of their review and supervision of your activities, and that you may make this memorandum publicly available on your website for informational purposes only, but none of the persons to whom you provide this memorandum of law are authorized to rely on it in any respect.

Sincerely,

MAYER BROWN LLP

CD/JC