INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

FCM

Enforceability upon a Customer's Insolvency or Other Default of the Position Liquidation, Margin Liquidation and Determination of Account Provisions of a Customer Agreement pursuant to which a US Futures Commission Merchant Clears Futures and/or Cleared Swaps for the Customer and the validity, perfection and enforcement of the security interest granted a US Futures Commission Merchant by a Customer under a Customer Agreement

4 February 2026

British Virgin Islands

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Dear Sirs

Enforceability upon a Customer's Insolvency or Other Default of the Position Liquidation, Margin Liquidation and Determination of Account Provisions of a Customer Agreement pursuant to which a US Futures Commission Merchant Clears Futures and/or Cleared Swaps for the Customer and the validity, perfection and enforcement of the security interest granted a US Futures Commission Merchant by a Customer under a Customer Agreement

British Virgin Islands

1 Introduction

1.1 We have been asked to advise the International Swaps and Derivatives Association, Inc. (***ISDA***) and the Futures Industry Association (***FIA***) regarding the enforceability under the laws of the British Virgin Islands of the Position Liquidation, Margin Liquidation and Determination of Account provisions (collectively, ***remedial provisions***) of a customer agreement (the ***Covered Agreement***) pursuant to which a futures commission merchant (the ***FCM***) registered with the Commodity Futures Trading Commission (the ***CFTC***) clears Futures and/or Cleared Swaps for a customer located in the British Virgin Islands (the ***Customer***), as well as the validity, perfection and enforcement of the security interest granted the FCM by the Customer under a Covered Agreement in the Collateral (as defined below).

1.2 If a Customer clears only Futures, the Covered Agreement will consist of a customer account agreement (the ***Base Account Agreement***). If the Customer clears only Cleared Swaps or both Futures and Cleared Swaps, the Covered Agreement will consist of a Base Account Agreement together with a Cleared Derivatives Addendum substantially in the form published by FIA and ISDA in 2012 or 2018 (either, the ***CDA***).

1.3 The types of transactions that may be cleared for the Customer pursuant to the Covered Agreement include US Futures, Foreign Futures and Cleared Swaps (together, ***Covered Transactions*** or ***Covered Contracts***).

1.4 We have been provided with a memorandum dated 17 November 2021 from Sullivan & Cromwell LLP "Regarding Futures and Options Transactions, Cleared Swaps and Foreign Futures Transaction Executed and Carried by Futures Commission Merchants for their Customers" (the ***Sullivan & Cromwell memorandum***). We have also been provided with a high-level overview and summary of the main concepts covered, conclusions reached and certain factual assumptions in the Sullivan & Cromwell memorandum (the ***Summary Annex***) which is included in the annex of the Instructions

from ISDA (as that term is defined below).

1.5 This opinion is given with respect to Customers organised in the British Virgin Islands as any of the customer types described in Appendix A.

1.6 This opinion is subject to the details, definitions, assumptions and fact patterns set out in the instructions from ISDA (the ***Instructions***) set out in full in Annex 2. Additional assumptions are contained in Schedule 1. Schedules 2, 3, 4 and 5 set out certain matters of British Virgin Islands law referred to in the body of the opinion.

1.7 Terms defined in the Summary Annex or the Instructions have the same meanings in this opinion unless otherwise defined.

1.8 This opinion is confined to matters of British Virgin Islands law and nothing herein should be construed to express or imply any opinion with regard to any other system of law. While it is a separate legal jurisdiction the British Virgin Islands follows general principles of English common law. The opinion is limited in scope to the matters expressly commented on.

1.9 This opinion is addressed to the International Swaps and Derivatives Association, Inc. (***ISDA***) and the Futures Industry Association (***FIA***) solely for the benefit of their members in relation to their use of Covered Agreements. No other person may rely on this opinion for any purpose without our prior written consent. This opinion may, however, be shown by ISDA or FIA or an ISDA or FIA member to their advisors, members' advisors or auditors or any competent regulatory or supervisory authority for such members for the purposes of information only, on the basis that we assume no responsibility to such authority or any other person as a result or otherwise.

2 Opinions

PART I Position Liquidation, Margin Liquidation and Determination of Account

1. Would the parties' agreement on governing law and submission to jurisdiction set out in each of the Base Account Agreement and CDA be given effect by a court in your jurisdiction, and what would be the consequences if they were not?

2.1 The parties' agreement as to governing law in each of the Base Account Agreement and CDA would be upheld as a valid choice of law by the courts of the British Virgin Islands and applied by the courts in proceedings in relation to the Base Account Agreement and CDA as the proper law of those agreements.

2.2 The submission to jurisdiction would be upheld assuming it was made in good faith. However if a dispute in relation to the Base Account Agreement or CDA is related to the insolvency of a customer organised in the British Virgin Islands, it is possible that the British Virgin Islands courts would accept jurisdiction notwithstanding the provisions for jurisdiction. The conclusions of this opinion speak to the likely approach taken by a British Virgin Islands court in this situation.

2. Would the Position Liquidation provisions of each of the Base Account Agreement and the CDA be enforceable under the laws of your jurisdiction and each of the Position Liquidation methods described in Section XI of the S&C Memo and paragraph 2.5 of the Summary Annex be recognized and upheld by a court in your jurisdiction? If a particular Position Liquidation method would either not be upheld or could be challenged, please provide further detail and explain the reason for this. Are there any circumstances in your jurisdiction, including any moratorium, stay, freeze or other consequence of the commencement of an insolvency proceeding, that might affect the FCM's ability to exercise Position Liquidation?

2.3 On the basis of the following, the Position Liquidation provisions of each of the Base Account Agreement and the CDA will be enforceable under the laws of the British Virgin Islands and each of the Position Liquidation methods described in Section XI of the S&C Memo and paragraph 2.5 of the

Summary Annex would be upheld in the British Virgin Islands.

2.4 Position Liquidation under the Base Account Agreement includes the FCM closing out or otherwise liquidating the Customer's open positions in its Contracts, and hedging risk incurred by the FCM in connection with an Event of Default, by any reasonable method, including by means of entering into offsetting transactions, risk-reducing transactions or hedging transactions, and by valuing any transactions entered into by the FCM. The CDA prescribes comparable Position Liquidation methods. In the case of either type of agreement, each of the methods seeks to "remove" or "close out" the position from the relevant omnibus customer positions account (whether at a DCO or foreign clearing organisation).

2.5 We have identified some general risks to close-out below, but these are potential challenges to transactions themselves rather than to the methodology of Position Liquidation. Otherwise British Virgin Islands law does not introduce grounds for challenging Position Liquidation as carried out by the FCM as principal under the Covered Agreement using any of the methods above, assuming they have been provided for in the Covered Agreement and are carried out on a basis recognised and commonly used in the derivatives markets.

2.6 There are no circumstances under British Virgin Islands law that might affect the FCM's ability to exercise Position Liquidation, including imposing a moratorium, stay or freeze on the exercise of Position Liquidation in respect of an Account Class or the overall Customer Account on the commencement of an insolvency proceeding.

2.7 We have set out below other potential risks to the exercise of Position Liquidation provisions under British Virgin Islands insolvency laws. We do not believe these are material in the context of a Covered Agreement.

(a) *Avoidance risk*. Avoidance risks are summarised in Schedule 3 and apply to Customers which are British Virgin Islands companies (***BVIBCs***) only. Assuming the Covered Agreement is entered into for bona fide commercial reasons and at arms' length by each of the parties and with no intent to defraud creditors it is unlikely these would pose material risk to the exercise of Position Liquidation, Margin Liquidation or a Determination of Account.

(b) *Disclaimer of onerous contracts*. The effect of disclaiming a contract is to create a claim for loss or damage against the estate of the insolvent party. In effect it would result in the same valuation process. A liquidator cannot disclaim a single transaction.

2.8 The analysis is simplified where Part XVII applies. Part XVII is summarised in Schedule 4 and is likely to apply to all Covered Transactions, in which case any risks associated with Insolvency Proceedings discussed in the previous paragraphs may be disregarded and the risk of a successful challenge to Position Liquidation, Margin Liquidation or a Determination of Account is low.

3. Would the Margin Liquidation provisions of each of the Base Account Agreement and CDA be enforceable under the laws of your jurisdiction and the FCM's Margin Liquidation in respect of each Account Class be recognized and upheld by a court in your jurisdiction? Are there any circumstances in your jurisdiction, including any moratorium, stay, freeze or other consequence of the commencement of an insolvency proceeding, you can foresee that might affect the FCM's ability to exercise Margin Liquidation?

4 Would the Determination of Account provisions of each of the Based Account Agreement and CDA be enforceable under the laws of your jurisdiction and the FCM's Determination of Account in respect of (a) each Account Class and (b) all Account Classes on a combined basis be recognized and upheld by a court in your jurisdiction? Are there any circumstances in your jurisdiction, including any moratorium, stay, freeze or other consequence of the commencement of an insolvency proceeding, you can foresee that might affect the FCM's ability to exercise a Determination of Account in respect of an Account Class or the overall Customer Account (comprising the three Account Classes)?

2.9 *Margin Liquidation*. Our response to question 2 applies equally to Margin Liquidation. We believe the British Virgin Islands courts would uphold Margin Liquidation as carried out by the FCM as principal under the Covered Agreement, assuming it is done in accordance with the Covered Agreement and on a commercially reasonable basis.

2.10 While we do not believe it necessary to rely on Permitted Uses Rights to achieve Margin Liquidation, our view is that the British Virgin Islands courts would treat the validity of rehypothecation rights and other rights of use as governed by New York law[1] and would therefore uphold the right under the applicable Customer Property Rules to withdraw and apply Segregated Funds or Separate Account Funds. The FCM's use of Collateral is therefore a matter of contract between the parties.

2.11 Please refer to our response in paragraphs 2.6 to 2.8 as to whether there are any circumstances under British Virgin Islands law that might affect the FCM's ability to exercise Margin Liquidation, and which sets out other potential risks to the exercise of Margin Liquidation provisions under British Virgin Islands insolvency laws. We do not believe these are material in the context of a Covered Agreement.

2.12 *Determination of Account*. For the reasons which follow and subject to our comments in respect of certain entity types, we believe the Determination of Account provisions of each of the Base Account Agreement and CDA would be enforceable under the laws of the British Virgin Islands and the FCM's Determination of Account in respect of (i) each Account Class and (ii) all Account Classes on a combined basis would be recognised and upheld by a court in the British Virgin Islands. We summarise the analysis using contractual accounting, close-out netting, insolvency set-off and security enforcement below. While the insolvency set-off analysis would not distinguish as separate calculations Determination of Account of each Account Class and Determination of Account of all Account classes on a combined basis, since the effect would be the same as that reached using other methods (and since Part XVII is expressed to prevail over insolvency set-off), we believe the British Virgin Islands courts would not interfere with Determination of Account on a contractual basis.

(a) *Contractual accounting.* The failure to perform under an agreement gives rise to a claim for damages in accordance with general principles of contract law. Parties are free (with certain exceptions) to use a prearranged method of arriving at the amounts payable on termination of a contract. Calculation of damages by reference to a commercially acceptable and reasonable methodology would be acceptable under British Virgin Islands law. Noting our comments below and in our response to question 2 and our comments on the enforceability of Position Liquidation and Margin Liquidation, we believe the courts would uphold Determination of Account based on contractual accounting, notwithstanding close-out as a result of insolvency proceedings in respect of the Customer.

(b) *Netting agreements.* Part XVII (*Netting and Financial Contracts*) of the Insolvency Act (***Part XVII***) (see Schedule 4) provides that notwithstanding anything contained in the Insolvency Act, any rules promulgated under the Insolvency Act or in any rule of law relating to insolvency, provisions relating to the netting of obligations under a netting agreement shall be enforceable against each party to that contract. In our view, a Covered Agreement will constitute a "netting agreement" under Part XVII for US Futures, Foreign Futures and Cleared Swaps. Section 150 of the Insolvency Act, relating to insolvency set-off, is expressly made subject to Part XVII, and so if the insolvency set-off rules under British Virgin Islands law were to produce a different result from the Determination of Account provisions, the

[1] If the Covered Agreement were governed by the laws of the British Virgin Islands there may be arguments as to the FCM's right to use the Collateral as it may be seen as constituting a "clog on the equity of redemption" or otherwise being an "unlawful collateral advantage". There is no British Virgin Islands case law of which we are aware which is determinative of the issue of whether a provision which is valid under its governing law might still be struck down by the British Virgin Islands courts as a clog on the equity of redemption. In principle, a document which is valid under its governing law should be upheld and enforced in the British Virgin Islands unless it is contrary to public policy. In any case our view is that a security interest created over a fungible and shifting pool of collateral creates an entitlement of the collateral provider to receive back identical securities rather than the same securities, in which case a right of rehypothecation could not properly be construed as a clog even under British Virgin Islands law.

Determination of Account provisions would prevail.

(c) *Insolvency set-off.* If Part XVII does not apply, either because the Covered Agreement would not constitute a netting agreement for the purposes of Part XVII or for reasons of fraud or misrepresentation, insolvency set-off would apply to any amounts arising from dealings prior to the commencement of liquidation[2] and prior to the FCM having knowledge of the insolvency of the Customer. Section 150(4) of the Insolvency Act provides that a party may before the commencement of liquidation waive the benefit of set-off, and the effect of insolvency set-off is therefore likely to have a similar effect to contractual netting provisions. Where Part XVII does not apply however, transactions may be subject to avoidance as a preference or undervalue transaction (see Schedule 3 and our response to question 2).

(d) *Security enforcement.* The security provisions are covered in Part II of this opinion and, subject to caveats below, will be enforceable through insolvency proceedings. Where there is any question about the legal analysis of Determination of Account on a netting basis, the enforceability of security provisions provides additional reassurance that the effect of the Determination of Account provisions will be upheld.

2.13 *Segregated portfolio companies.* Part XVII defines a netting agreement as an agreement "between two parties", "party" being "a person constituting one of the parties to an agreement". There has not yet been any judicial consideration of how far "person" should extend. Nevertheless we believe that a portfolio of a segregated portfolio company should be treated as a person for these purposes. Although the portfolio itself does not have separate legal personality, it only engages in transactions through the segregated portfolio company itself (which clearly does have separate legal personality). Although the strictures relating to the treatment of portfolio assets and portfolio liabilities would prevent recognition or enforcement of any netting of assets and liabilities outside the specific portfolio in question, we believe that Part XVII should be effective to ensure primacy be given to the Determination of Account provisions in the event of any Insolvency Proceedings and the conclusions in relation to British Virgin Islands companies above should therefore apply equally to segregated portfolios of SPCs. There is no requirement of British Virgin Islands law that an agreement with an SPC must include contractual terms reflecting the statutory provisions preventing the attribution of liabilities of one portfolio to the assets of a separate portfolio either prior to or after the onset of insolvency. However it is important that the Covered Agreement clearly identifies for the account of which segregated portfolio the SPC is entering into the Covered Agreement.

2.14 *Partnerships*. Subject to our comments below, the conclusions of this opinion in respect of Companies apply to partnerships, and Determination of Account provisions will be enforceable against all forms of partnership. In particular the applicability of Part XVII is not limited to Companies and we believe any form of partnership will still constitute one "party" for the purposes of Part XVII.

(a) *General Partnerships*. Partners of General Partnerships are only liable for the partnership debts which accrue during the time when they are a partner. Mutuality concerns therefore arise where there is a change of a partner. A General Partnership would ordinarily be dissolved on the insolvency of a partner. Otherwise there is no statutory provision for the liquidation of General Partnerships. Although, in the absence of insolvency law, a British Virgin Islands court would not interfere with the operation of netting provisions there is some question as to how the courts would deal with Transactions entered into by different partners. We therefore make the following recommendations.

(1) Parties wishing to enter into Covered Agreements with General Partnerships should (i) always do so with the same partner and (ii) prohibit any change of partner unless all Transactions have been formally novated to a new partner.

[2] Consideration should be given as to whether Insolvency Proceedings in respect of the segregated portfolio company itself as well as the specific portfolio are included as close-out triggers.

(2) Given the likely effect of partner insolvency on the existence of the partnership, consider terminating on the bankruptcy or insolvency of any partner. In any case the bankruptcy or insolvency of the partner with which Transactions are entered into on behalf of the partnership should be treated as a termination event.

(3) As a practical measure the identity of the contracting partner should be included in the description of the Customer in all documentation.

(b) *1996 Limited Partnerships.* General partners of 1996 Limited Partnerships are only liable for the partnership debts which accrue during the time when they are a general partner. Mutuality concerns therefore arise where there is a change of a general partner. A 1996 Limited Partnership would ordinarily be dissolved on the insolvency of a partner. Otherwise there is no statutory provision for the liquidation of 1996 Limited Partnerships. Although, in the absence of insolvency law, a British Virgin Islands court would not interfere with the operation of netting provisions there is some question as to how the courts would deal with Transactions entered into by different general partners. We therefore make the following recommendations.

(1) Parties wishing to enter into Covered Agreements with 1996 Limited Partnerships should (i) always do so with the same general partner and (ii) prohibit any change of general partner unless all Transactions have been formally novated to a new general partner.

(2) Given the likely effect of partner insolvency on the existence of the partnership, consider terminating on the bankruptcy or insolvency of any partner. In any case the bankruptcy or insolvency of the general partner with which Transactions are entered into on behalf of the partnership should be treated as a termination event.

(3) As a practical measure the identity of the contracting general partner should be included in the description of the Customer in all documentation.

(c) *2017 Limited Partnerships without Legal Personality*. A 2017 Limited Partnership without Legal Personality will terminate after 90 days (or such period is as is specified in the partnership agreement or by the court) without at least one solvent general partner and at least one solvent limited partner. There is some friction between the lack of legal personality and the prescribed insolvency proceedings for 2017 Limited Partnerships without Legal Personality. Until this has been resolved we recommend treating them in the same way as 1996 Limited Partnerships including requiring novation of transactions on any change of general partner.

(d) *Limited Partnerships with Legal Personality*. A Limited Partnership with Legal Personality will terminate after 90 days (or such period is as is specified in the partnership agreement or by the court) without at least one solvent general partner and at least one solvent limited partner. Given legal personality of the partnership and codified insolvency proceedings, mutuality concerns are assuaged and Limited Partnerships with Legal Personality may be treated in the same way as Companies.

(e) *Trusts and unit trusts*. For the reasons which follow and subject to our comments on mutuality on a change of trustee we are of the view that the Determination of Account provisions will be enforceable against trustees in respect of trust funds.

(f) *Pre-insolvency*. On the assumption that the Transactions are within the powers of the trustees and permitted by the terms of the trust and are properly entered into, and the other party to the Agreement is not aware after due enquiry of any breach by the trustees, we are of the view that the Determination of Account provisions would be enforceable under British Virgin Islands law in accordance with their terms in the absence of a single trustee insolvency,

the insolvency of all trustees or trust fund insolvency.

(g) *Single trustee insolvency*. For the purposes of this opinion, a ***trustee insolvency*** means the trustee's winding-up, administration, administrative receivership or bankruptcy. Where a single trustee becomes insolvent but there are other solvent trustees who are jointly or jointly and severally liable for the obligations under the Agreement, the third party would be entitled to proceed against any of the remaining solvent trustees who would have recourse to the assets of the trust to meet that liability, or if applicable, the third party would have direct recourse to the trust assets pursuant to section 97 of the Trustee Act. Accordingly, a single trustee insolvency would not affect the enforceability of the netting provisions. Where the Agreement is silent on whether the trustees are jointly and severally liable there is a presumption that the trustees who execute such agreement will be jointly liable for the obligations under it. However specific language is required in the Agreement if the trustees are to be jointly and severally liable, which would improve the third party's position in the event of a single trustee becoming insolvent, because the third party's claim against a jointly liable trustee could be potentially lost whereas it would not be lost against jointly and severally liable trustees.

(h) *Insolvency of all trustees*. In practice the insolvency of multiple individual trustees would be a rare occurrence. Where there is a sole corporate trustee which becomes insolvent, the trust instrument would normally provide for the appointment of a new trustee. Following such substitution, the third party, by subrogation to the original trustee's right of indemnity, would be entitled to enforce its subrogated right of indemnity against the trust assets directly, regardless of the fact that the newly appointed trustee would not be liable for the previous trustee's liabilities. Such right of indemnity would of course, be limited to the extent of the original trustee's right of indemnity and the third party will be in a better position in relation to a trust created after 1 March 2004 where the indemnity contained in section 100 of the Trustee Act will apply. Note however our concerns in paragraph (j) below as to issues with mutuality following a change of trustee.

(i) *Trust fund insolvency*. If the trust fund itself (rather than its trustees) were to become insolvent the trust will not be wound up under the British Virgin Islands insolvency legislation as it is not a separate legal entity. On a trust fund insolvency a creditor or other party claiming a beneficial interest under the trust may however apply to the British Virgin Islands court under Part 67 of the Civil Procedure Rules for "an Order for the execution of a Trust to be carried out under the direction of the Court", referred to as an administration order (but not to be confused with an administration order under Part III of the Insolvency Act). The administration procedure is entirely discretionary and the trust fund's assets will be administered by the court as its discretion may direct in accordance with principles of justice and equitability. It is important to note that Part 67 of the Civil Procedure Rules contains no mandatory set-off rules, and that section 150 of the Insolvency Act dealing with insolvency set-off is only applicable in the liquidation of companies and the bankruptcy of individuals and does not apply to trusts. However, as discussed above in respect of partnerships the provisions of Part XVII are not so limited.

(j) *Mutuality and changes of trustees.* For similar reasons to those given for General Partnerships above we have reservations as to whether mutuality will be preserved across a change of trustee and therefore recommend that parties wishing to enter into Covered Agreements with trusts should prohibit changes of trustees.

2.15 Please refer to our response in paragraphs 2.6 to 2.8 as to whether there are any circumstances under British Virgin Islands law that might affect the FCM's ability to exercise a Determination of Account, and which sets out other potential risks to the exercise of Determination of Account provisions under British Virgin Islands insolvency laws. We do not believe these are material in the context of a Covered

Agreement.

6. Assuming the parties have entered into the Covered Agreement, an Event of Default has occurred with respect to the Customer and the FCM has determined a lump-sum cash balance or net termination amount in a currency other than the currency of the jurisdiction in which the insolvent customer is organized:

(a) Outside the context of insolvency proceedings, would a court in your jurisdiction enforce a claim for the cash balance or net termination amount in the currency in which it was determined?

(b) Can a claim for the cash balance or net termination amount be proved (i.e., filed) in insolvency proceedings in your jurisdiction without conversion into the local currency?

If in either case the claim must be converted to local currency for purposes of enforcement or proof in insolvency proceedings, please set out the rules governing the timing and exchange rate for such conversion.

2.16 Since the British Virgin Islands courts have power to grant a monetary judgment expressed otherwise than in the currency of the British Virgin Islands, any monetary judgment[3] of a court in the British Virgin Islands, including outside the context of insolvency proceedings, in respect of a claim for the net termination amount is likely to be expressed in the currency in which such net termination amount is determined, assuming that is the currency in which such claim is made.

2.17 Any claim in the liquidation of a BVIBC or a 2017 Limited Partnership[4] based on a liability incurred or payable in a currency other than US dollars must be converted into US dollars. There are no rules governing the timing and exchange rate for such conversion (as the British Virgin Islands uses only US dollars).

7. Are there any other local law considerations that you would recommend the FCM to consider in connection with the exercise of Position Liquidation, Margin Liquidation or a Determination of Account?

2.18 No.

PART II Validity, Perfection and Enforcement of FCM's Security Interest in Customer's Rights and Interests in Respect of Collateral

Validity and perfection of the security interest

1. Under the laws of your jurisdiction, what law governs the contractual aspects of the security interest in the Customer's rights and interests in respect of the various types of Collateral? Would the courts of your jurisdiction recognize the validity of a security interest created under the Covered Agreement, assuming it is valid under New York law (as the governing law of the Covered Agreement)?

[3] Any final and conclusive monetary judgment for a definite sum obtained in the English High Court may be registered and enforced as a judgment of the British Virgin Islands court under the Reciprocal Enforcement of Judgments Act (Cap 65) (the ***REJA***) provided that (i) application for registration of the judgment is made within twelve months of its date (or such longer period as the British Virgin Islands court may allow), (ii) the relevant party is not appealing and does not have the right and intention to appeal and (iii) the British Virgin Islands court considers it just and convenient that the judgment be so enforced. Judgments of the English County Courts and the New York courts (and the courts of most other jurisdictions) may not be registered under the REJA. However, a judgment obtained in the English County Courts or the New York courts may be treated as a cause of action in itself and sued upon as a debt at common law so no retrial of the issues would be necessary. In this case an appeal is irrelevant unless a stay of execution has been granted. An English High Court judgment may also be enforced in this way, but the applicant may be penalised on costs. Whether registering a judgment under the REJA or suing upon a judgment as a debt at common law, it will be necessary that (i) the relevant court had jurisdiction in the matter and the parties either submitted to such jurisdiction or was resident or carrying on business within such jurisdiction and was duly served with process, (ii) the judgment was not in respect of penalties, fines, taxes or similar fiscal or revenue obligations, (iii) in obtaining judgment there was no fraud on the part of the person in whose favour judgment was given or on the part of the court, (iv) recognition or enforcement in the British Virgin Islands would not be contrary to public policy and (v) the proceedings pursuant to which judgment was obtained were not contrary to the principles of natural justice.

[4] Since there are no statutory insolvency proceedings for trusts or partnerships other than 2017 Limited Partnerships, there is no equivalent provision for claims in their liquidation.

2.19 Contractual aspects of the security interest in the various forms of Collateral, including the creation and validity of the security interest, would be governed by the chosen law of the Covered Agreement.

2.20 The British Virgin Islands courts would recognize the validity of a security interest created under the Covered Agreement, assuming it is valid under New York law (though see our comment in section 2.10 and the relevant footnote regarding the possibility of Collateral as constituting a "clog on the equity of redemption").

2. Under the laws of your jurisdiction, what law governs the proprietary aspects of the security interest in the Customer's rights and interests in respect of the different types of Collateral (i.e., the formalities required to protect the security interest against competing claims) granted by the Customer (for example, the law of the jurisdiction of incorporation or organization of the Customer, the jurisdiction where the Collateral is Located (or deemed Located), the jurisdiction or location of the FCM's intermediary or the jurisdiction of the location of the FCM as the Customer's securities intermediary, in relation to Collateral in the form of intermediated securities)? What factors would be relevant to this question? If the Location (or deemed Location) of the Collateral is the determining factor, please briefly describe the principles governing such determination under the law of your jurisdiction with respect to the different types of Collateral. If relevant, please describe how the laws of your jurisdiction apply to each form in which securities Collateral may be held as described in Additional Assumption II.B.3 in the Instructions.

2.21 Under British Virgin Islands rules, the law governing proprietary aspects of the security interest in the different types of Collateral will be that of the jurisdiction where the Collateral is located (or deemed located) at the time the security interest attaches to the Collateral.

(a) Cash will be located in the place where the relevant account is maintained[5]. This is likely to be the location of Customer's account on the books of the FCM.

(b) British Virgin Islands law would ordinarily consider the location of a directly held, registered certificated security to be the place where the register is located. A directly held physically certificated bearer security will be located in the place where the relevant certificate is located. However in certain circumstances the *situs* of an equity security such as shares or warrants may be the place where the issuing company is incorporated (either generally, or for specific purposes such as validity of transfers). In particular, for the purposes of determining matters relating to title and jurisdiction, the location of the ownership of shares, debt obligations or other securities of a BVIBC is the British Virgin Islands[6].

(c) In relation to securities held indirectly or on a fungible basis with or through a custodian or securities depository, including in a securities account, a British Virgin Islands court is likely to adopt the "place of the relevant intermediary approach" (***PRIMA***)[7].

(d) Debts are usually deemed to be located at the place where the debtor (in this case an FCM which holds cash belonging to the customer) ordinarily resides. The main exceptions are debts arising under a letter of credit (which are normally located at the place of presentation) and debts arising from a specialty contract (which existing case law suggests are located in the place of the specialty instrument, although some commentators suggest that older case

[5] *Arab Bank v Barclays Bank (Dominion, Colonial and Overseas) 1954 AC 495*

[6] Section 245 of the BVIBC Act. There is some friction between this provision and (i) our views on the application of PRIMA and (ii) our comments in the first sentence of paragraph (b) where the register is held outside the British Virgin Islands. Where the register is held outside the British Virgin Islands, the British Virgin Islands courts would be bound by the statutory provision and, while it would clearly be advisable to take any perfection steps required in the jurisdiction where the register is held, the courts would usually determine whether title had been transferred under British Virgin Islands law. Bearer shares have effectively been abolished in the British Virgin Islands so will not be relevant for this analysis. Where securities are held indirectly, our presumption is that the British Virgin Islands courts would only look as far as the depository in applying British Virgin Islands law to determine title. We believe the British Virgin Islands courts would consider the transfer of any indirect or fungible rights to those shares as equitable interests. British Virgin Islands law does not provide for the transfer of equitable rights so there would be no inconsistency in applying PRIMA to determine applicable law.

[7] As set out in the Hague Convention of 5 July 2006 on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary.

law might not be followed by the courts today).

(e) Contract rights are generally located where those rights would be enforced. In the case of contract rights a British Virgin Islands court would, subject to certain restrictions such as public policy issues and any attempt to contract out of statutory provisions regarding title and location of shares debts and securities, look to the governing law of the underlying contract for issues of perfection.

2.22 In practice, the British Virgin Islands is unlikely to be a relevant location for proprietary reasons either because Collateral is not located in the British Virgin Islands or because there will be no perfection requirements in the British Virgin Islands. Note however our comments on registration of security in our response to question 5 below.

3. Would the courts of your jurisdiction recognize a security interest in the Customer's rights and interests in respect of the different types of Collateral? In answering this question, please bear in mind the different forms in which securities Collateral may be held, as described in the Additional Assumption II.B.3 above. Please indicate, in relation to cash Collateral, if your answer depends on the Location (or deemed Location) of the Customer Account or the account in which the relevant deposit obligations are recorded and/or upon the currency of those obligations.

2.23 The British Virgin Islands courts would recognise the validity of a security interest in the different types of Collateral provided the security interest was valid under (a) the governing law of the Covered Agreement and (b) the *lex situs* of the Collateral, provided always that any mandatory perfection requirements in relation to the Collateral arising under the laws of any other jurisdiction had been complied with.

2.24 In relation to cash Collateral, the location (or deemed location) of the place of the account will normally determine the *lex situs*, and so will be relevant. However the currency of any cash Collateral is not relevant under British Virgin Islands law for these purposes.

2.25 The laws of the British Virgin Islands do not impose any additional requirements of form or otherwise for the recognition or validity of a security interest (other than where the assets comprise shares in a BVIBC (see paragraph 2.43).

4. What is the effect, if any, under the laws of your jurisdiction of the fact that the amount secured or the amount of the Collateral subject to the security interest will fluctuate under the Covered Agreement (including as a result of establishing open positions in additional Covered Contracts from time to time)? In particular:

(a) Would the security interest be valid in relation to future obligations of the Customer?

(b) Would the security interest be valid in relation to future Collateral (i.e., cash and securities Collateral not yet delivered to the FCM and open positions not yet established in Covered Contracts at the time of entry into the Covered Agreement)?

(c) Is there any difficulty with the concept of creating the security interest over a fluctuating pool of assets, for example, by reason of the impossibility of identifying in the Covered Agreement the specific assets deposited by the Customer with the FCM?

(d) Is it necessary under the laws of your jurisdiction for the amount secured by the security interest to be a fixed amount or subject to a fixed maximum amount?

(e) Is it permissible under the laws of your jurisdiction for the FCM to hold Collateral in excess of its actual exposure to the Customer under the Covered Agreement?

In relation to (a), it is understood that the security interest in the Customer's rights and interests in respect of any specific Collateral would only be relevant in relation to future obligations, if ever, at the time such

future obligations arise and then only in relation to Collateral held at that time. This question concerns whether it would be necessary for either party to perform any action at such time in order to ensure the effectiveness of the security interest as security for such obligations or whether the security interest would take effect in relation to those future obligations without further action by either party.

In relation to (b), it is understood that the security interest in the Customer's rights and interests in respect of the different types of Collateral to be delivered at some point in the future after the time of entry into the Covered Agreement would not take effect in relation to such Collateral until it had been delivered to the FCM in accordance with the Covered Agreement. This question concerns whether it would be necessary for either party to perform any action at such time in order to ensure the effectiveness of the security interest in the Customer's rights and interests in respect of such Collateral or whether the security interest in relation to the Customer's rights and interests in respect of such Collateral would take effect without further action (other than the delivery) by either party.

In relation to (c), you may assume that each specific delivery to the FCM and return by the FCM of Collateral consisting of cash or securities under the Covered Agreement from time to time would be properly recorded by the FCM, so that, while the pool of Collateral would change from time to time, at any specific time the composition of the pool of Collateral could be clearly identified by the FCM.

2.26 There is no difficulty under the laws of the British Virgin Islands if the amount of any cash or securities Collateral subject to the security interest will fluctuate under the Covered Agreement.

2.27 In answer to the specific questions on this point:

(a) Yes, the security interest would be recognised as valid in relation to relation to future obligations of the Customer provided that the future obligations can be determined with sufficient certainty as and when they arise by reference to the terms of the Covered Agreement.

(a) Yes, the security interest would be valid in relation to future Collateral provided the future Collateral can be ascertained as and when it is provided. Under British Virgin Islands law it is possible to create security interests over future property, and the British Virgin Islands courts would give effect to such a power arising under any foreign legal system.

(b) No, there is no difficulty with a security interest being created over a fluctuating pool of assets provided the fluctuating pool of assets over which the security interest to be created is identified with sufficient certainty in order to identify the collateral at any given time. Note that where assets may be substituted freely by the Customer there is a risk that a British Virgin Islands court might characterise the security interest as floating.

(c) No, it is not necessary under the laws of the British Virgin Islands for the amount secured by the security interest to be a fixed amount or subject to a fixed maximum amount.

(d) Yes, it is permissible under the laws of the British Virgin Islands for the FCM to hold Customer Collateral in excess of its actual exposure to the Customer under the Covered Agreement, provided it has been agreed by the parties that such excess may be held. In the event of any enforcement the FCM would normally need to account for any excess where the proceeds of enforcing the security exceeds the amount of the secured obligations.

5. Assuming that the courts of your jurisdiction would recognize the security interest in the Customer's rights and interests in respect of each type of Collateral, is any action (filing, registration, notification, stamping, notarization or any other action or the obtaining of any governmental, judicial, regulatory or other order, consent or approval) required in your jurisdiction to perfect the security interest? If so, please indicate what actions must be taken and how such actions may differ, if at all, depending upon the type of Collateral in question.

2.28 No action is required under the laws of the British Virgin Islands to perfect the security interest.

However under British Virgin Islands law a security interest created by a BVIBC or a 2017 Limited Partnership over Collateral located in any jurisdiction should be registered in the British Virgin Islands in order to maintain priority in the event of an application to enforce before a British Virgin Islands court. Registration should be made on the Register of Registered Charges by submitting an application in the approved form to the British Virgin Islands Registry of Corporate Affairs (the ***Registry***). A BVIBC or a 2017 Limited Partnership is also required to enter particulars of the security interest on a register of charges and maintain a copy of the register at its registered office, although failure to do so does not affect the security interests but merely gives rise to penalties.

2.29 Failure to register at the Registry will not affect the validity of the security interest as against the BVIBC or the 2017 Limited Partnership or any liquidator on its insolvency but may result in a loss of priority as against subsequent registered secured creditors. An unregistered security interest will rank after registered secured interests but before any subsequent unregistered security interests, by an application of the rule that when the equities are equal the first in time shall prevail, and subject to the priority accorded to a fixed charge over a floating charge which does not contain a negative pledge, perfection by notice, contractual subordination or similar requirements.

2.30 Under the Registration and Records Act 1881 (the ***Registration and Records Act***), every document which is executed as a deed must be registered at the Deeds Registry in the British Virgin Islands or it will be void against a subsequent purchaser for value or mortgagee. The definition of deed for these purposes "includes every document in writing affecting or relating to lands, tenements or hereditaments in the [British Virgin Islands]". While it is widely assumed that this definition was intended to be construed in a restrictive fashion to matters relating to land within the British Virgin Islands, this has never been tested judicially and it remains possible that a court would apply the provisions to any document entered into as a deed by a limited partnership or trust or a company organised under foreign law which maintains a registered office in the British Virgin Islands. BVIBCs are specifically exempted from the Registration and Records Act. There is a time limit for registration of three months if the deed is executed within the British Virgin Islands and twelve months if executed outside the British Virgin Islands.

2.31 Otherwise there is no registration regime for security interests created by trusts or partnerships, other than 2017 Limited Partnerships and priority between competing security interests would, subject to our comments above, be determined by common law.

2.32 Where security has been created over shares in a BVIBC, the BVIBC may make a notation of the security interest in its share register. Although the notation has no statutory effect it will give notice to any party reviewing the share register of the security interest. It is also possible for the BVIBC to file a copy of its annotated share register with the Registry to make notice of the security interest publicly available.

6. If there are any other requirements to ensure the validity or perfection of the security interest in the Customer's rights and interests in respect of each type of Collateral, please indicate the nature of such requirements. For example, is it necessary as a matter of formal validity that the Covered Agreement be expressly governed by the law of your jurisdiction or translated into any other language or for the Covered Agreement to include any specific wording? Are there any other documentary formalities that must be observed in order for the security interest in the Customer's rights and interests in respect of any type of Collateral to be recognized as valid and perfected in your jurisdiction?

2.33 There are no documentary or any particular additional requirements or formalities to be carried out in order to ensure the validity or perfection of the security interest, e.g. it is not necessary as a matter of formal validity that the Covered Agreement be expressly governed by the laws of the British Virgin Islands or translated into any other language.

7. Assuming that the FCM has obtained a valid and perfected security interest under the laws of your jurisdiction, to the extent such laws apply, by complying with the requirements set forth in your responses to questions II.C.1 through II.C.6 above, as applicable, will the FCM or the Customer need to take any action

thereafter to ensure that the security interest continues to be and/or remains perfected, particularly with respect to additional cash or securities Collateral transferred from time to time when required pursuant to the Covered Agreement?

2.34 No additional actions need to be taken by the FCM or the Customer in the British Virgin Islands in order to ensure that the security interest continues to be and/or remains perfected.

2.35 Where it is not the British Virgin Islands the laws of the jurisdiction where the Collateral is located may impose perfection requirements in respect of additional Collateral.

8. Assuming that (a) pursuant to the laws of your jurisdiction, the laws of another jurisdiction govern the validity and/or perfection of a security interest in the Customer's rights and interests in respect of any type of Collateral (e.g., because the Collateral is Located or deemed Located outside your jurisdiction) and (b) the FCM has obtained a valid and perfected security interest in the Collateral under the laws of such other jurisdiction, will the FCM have a valid security interest in the Collateral so far as the laws of your jurisdiction are concerned? Is any action (filing, registration, notification, stamping or notarization or any other action or the obtaining or any governmental, judicial, regulatory or other order, consent or approval) required under the laws of your jurisdiction to establish, perfect, continue or enforce the security interest? Are there any other requirements of the type referred to in question II.C.6 above?

2.36 The British Virgin Island courts would recognize the validity of a security interest in the different types of collateral where (a) that security interest is governed by the laws of another jurisdiction, and (b) the security interest is valid under (i) the governing law of the Covered Agreement and (i) the *lex situs* of the Collateral, provided always that any mandatory perfection requirements in relation to the Collateral arising under the laws of any other jurisdiction had been complied with.

2.37 There are no documentary or any particular additional requirements or formalities to be carried out in order to ensure the validity or perfection of the security interest.

2.38 The laws of the British Virgin Islands do not impose any additional requirements of form or otherwise for the recognition or validity of a security interest (other than where the assets comprise shares in a BVIBC (see paragraph 2.43).

9. Are there any particular duties, obligations or limitations imposed on the FCM in relation to the care of the Collateral held by it pursuant to the security interest?

2.39 Under the laws of the British Virgin Islands the FCM is under an obligation established by case law to take reasonable steps to ensure the safe custody of any charged property in its possession.

10. Do the laws of your jurisdiction recognize the right of the FCM to use cash or securities Collateral (as described in Additional Assumptions II.B.2 and II.B.3 in the Instructions) pursuant to an agreement with the Customer? In particular, how does such use of the Collateral affect, if at all, the validity, continuity, perfection or priority of the security interest otherwise validly created and perfected prior to such use? Are there any other obligations, duties or limitations imposed on the FCM with respect to its use of such Collateral under the laws of your jurisdiction?

2.40 As the Covered Agreement is governed by New York law[8], the validity of any right of the FCM to use cash or securities Collateral will be governed by New York law, and we do not believe there is any reason in principle why a British Virgin Islands court would seek to interfere with such an arrangement if it is valid as a matter of New York law. The FCM's use of Collateral is a matter of contract between the parties.

[8] If the Covered Agreement were governed by the laws of the British Virgin Islands there would be a degree of tension between the FCM's right to use the charged property and the customer's "equity of redemption" in the Collateral, as the right of use might be construed as constituting a "clog on the equity of redemption" or otherwise an "unlawful collateral advantage". The position in the British Virgin Islands with regard to this issue is the same as the position under English law.

Enforcement of the security interest in the Customer's rights and interests in the Collateral in the absence of an insolvency proceeding

Note the Additional Assumption II.B.5 in the Instructions which applies to questions II.C.11 to II.C.14 below.

11. Assuming that the FCM has obtained a valid and perfected security interest under the laws of your jurisdiction, to the extent such laws apply, by complying with the requirements set forth in your responses to questions II.C.1 through II.C.6 above, as applicable, what are the formalities (including the necessity to obtain a court order or conduct an auction), notification requirements (to the Customer or any other person) or other procedures, if any, that the FCM must observe or undertake in enforcing its security interest as a secured party under the Covered Agreement? For example, is it free to sell the Collateral (including to itself) and apply the proceeds to satisfy the Customer's outstanding obligations under the Covered Agreement? Do such formalities or procedures differ depending on the type of Collateral involved?

2.41 Subject to the following comments on exercise of a power of sale, it is not necessary for any particular formalities to be observed or undertaken by the FCM in exercising its security interest.

(a) In exercising a power of sale, the FCM is subject to a duty to take reasonable care to obtain the best price reasonably available at the time[9]. This will normally be the current market value of the Collateral comprising securities[10].

(b) A secured party may not sell Collateral to itself, either alone or with others, unless the sale is made by the court and the secured party has obtained leave to bid. This is because such a transaction would amount to foreclosure without the leave of the court. In addition, there is a broader policy basis for the rule, which is that a person should not put himself in a position where his duty (in this case, to obtain the best price reasonably available) and his interest (in this case, to pay as low a price as possible) conflict.

(c) It is established that a secured party may sell mortgaged property to a company in which it has an interest, provided that it can prove that the sale was in good faith and that it had taken reasonable steps to obtain the best price reasonably obtainable at that time[11]. *A fortiori*, a secured party may sell mortgaged property to an affiliated company, subject to the same proviso.

12. Assuming that (a) pursuant to the laws of your jurisdiction, the laws of another jurisdiction govern the validity and/or perfection of a security interest in the Customer's rights and interests in respect of any Collateral (e.g., because such Collateral is Located or deemed Located outside your jurisdiction) and (b) the FCM has obtained a valid and perfected security interests under the laws of such other jurisdiction, are there any formalities, notification requirements or other procedures, if any, that the FCM must observe or undertake in your jurisdiction in exercising its rights as a secured party under the Covered Agreement?

2.42 The laws of the British Virgin Islands do not impose any additional requirements of form or otherwise for the recognition or validity of a security interest, other than where the assets comprise shares in a BVIBC.

2.43 If the Collateral comprises shares in a BVIBC, in order to create a valid mortgage or charge, the BVIBC Act requires that there must be a written instrument which clearly indicates (a) the intention to create a mortgage or charge and (b) the amount secured by the mortgage or charge or how that amount is to be calculated.

13. Are there any laws or regulations in your jurisdiction that would limit or distinguish a creditor's enforcement rights with respect to the security interest in the Customer's rights and interests in respect of

[9] *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1972] Ch 949; 2 All ER 633

[10] *Downsview Nominees Ltd v First City Corporation Ltd* [1993] AC 295

[11] *Farrars v Farrars Ltd* (1888) 40 ChD 395

any type of Collateral depending on (a) the type of transaction underlying the creditor's exposure, (b) the type of Collateral or (c) the nature of the creditor or the debtor? For example, are there any types of "statutory liens" that would be deemed to take precedence over the security interest?

2.44 There are no laws or regulations in the British Virgin Islands that would limit or distinguish a creditor's enforcement rights with respect to the type of security interest.

2.45 There are statutory "preferential claims" in the British Virgin Islands which may have preference over floating charges. These include employees' wages up to US$10,000 each, certain amounts due to the British Virgin Islands Social Security Board up to an unlimited amount, certain amounts due in respect of employee health insurance or pension contributions up to US$5,000 each, amounts due to the British Virgin Islands government up to US$50,000 and sums due to the British Virgin Islands Financial Services Commission in respect of fees or penalties up to US$20,000. In practice such preferential claims are not likely to be significant.

14. How would your response to questions II.C.11 through II.C.13 above change, if at all, assuming that an insolvency proceeding above has occurred with respect to the FCM (notwithstanding that the Covered Agreement may not provide for any events of default in respect of the FCM) rather than or in addition to the Customer (for example, would this affect this ability of the FCM to enforce its security interest in the Customer's rights and interests in the Collateral)?

2.46 The occurrence of insolvency proceedings with respect to the FCM would not change our responses.

Enforcement of the security interest in the Customer's rights and interest in Collateral after the commencement of an insolvency proceeding

2.47 Note the Additional Assumption II.B.6 in the Instructions which applies to questions II.C.15 through II.C.17 below.

15. How are competing priorities between creditors determined in your jurisdiction? What conditions must be satisfied if the FCM's security interest in the Customer's rights and interests in each type of Collateral is to have priority over all other claims (secured or unsecured) of an interest in the Collateral?

2.48 A British Virgin Islands court would apply British Virgin Islands rules[12] as summarised below to questions of priority.

2.49 *BVIBCs and 2017 Limited Partnerships*

(a) A charge entered in the Register of Relevant Charges has priority over any subsequent charge.

(b) Priorities between unregistered security interests are determined by the common law. However where a British Virgin Islands court would apply common law rules (as opposed to the statutory priority rules), they would also look to other principles of substantive law. Therefore in practice, the issues raised by the common law rules would prove academic as a British Virgin Islands court would defer questions of priority to the lex situs through application of conflict of laws rules.

(c) The order of priorities is subject to the express consent of the holder of a prior charge or

[12] We note that there is a possibility that a British Virgin Islands court would not consider itself the appropriate forum for enforcement proceedings in respect of collateral located outside the British Virgin Islands. Therefore, it will be a matter for the conflict of laws rules applicable in the jurisdiction in which enforcement is sought as to whether British Virgin Islands priority rules would be relevant. Further, even if the British Virgin Islands court accepts such jurisdiction, as ultimate enforcement proceedings in respect of the collateral will by necessity take place in the jurisdiction of the location of the asset, it will be a matter for the conflict of laws rules applicable in such jurisdiction as to whether British Virgin Islands priority rules or a British Virgin Islands court judgment based on British Virgin Islands priority rules would be relevant to enforcement.

agreement between creditors.

(d) A registered floating charge is postponed to a subsequently registered fixed charge unless the floating charge contains a prohibition or restriction on the power of the entity to create any future charge ranking in priority to or equally with the charge[13].

2.50 *IBCs*

Charges created by a BVIBC in its previous corporate form as an International Business Company (***IBC***) are subject to the priority rules applicable to IBCs.

(a) Fixed security took priority over floating security save for cases described in (c) below.

(b) Security interests created before 1 January 1991 had priority over all security interests created on or after 1 January 1991 and as between themselves ranked in order of creation.

(c) Where an IBC created a register of mortgages, charges and other encumbrances (an ***IBC Register of Charges***), all security interests recorded in the IBC Register of Charges took priority over all security interests which had not been entered in the IBC Register of Charges (except for security interests created prior to 1 January 1991) and as between themselves ranked in order of their entry into the IBC Register of Charges, whether fixed or floating.

(d) Priorities between unregistered security interests created on or after 1 January 1991 were determined by the common law rules and therefore the comments at paragraph 2.50(b) above apply.

2.51 *Transitional priority rules for a BVIBC that was formerly an IBC*

Priority of charges between those created by a BVIBC and those created by a BVIBC in its previous corporate form as an IBC are a matter for transitional provisions.

(a) Charges registered in the IBC Register of Charges take priority over subsequent charges.

(b) Our view as to the priority between unregistered charges created by a BVIBC in its previous corporate form as an IBC and charges entered in the Register of Registered Charges under the BVIBC regime is that, notwithstanding registration in the Register of Registered Charges, priority is determined in accordance with the common law rules and therefore the comments at paragraph 2.50(b) above apply.

Note that the transitional provisions provide that a charge created by a BVIBC in its previous corporate form as an IBC may be entered in the Register of Registered Charges and take priority in accordance with the BVIBC regime.

2.52 *Other entities*

There is no registration regime under British Virgin Islands statute in respect of trusts or partnerships other than 2017 Limited Partnerships and we believe that a British Virgin Islands court would apply common law principles to questions of priority and therefore the comments at paragraph 2.41(b) above apply.

16. Would the FCM's enforcement of its security interest in the Customer's rights and interests in any type of Collateral be subject to any stay, moratorium or freeze or otherwise be affected by commencement of the insolvency?

[13] Although there is no way of definitively determining the existence of other security interests as a matter of British Virgin Islands law, as a practical matter we do not believe there is any way in which a third party could have a fixed charge over Collateral credited to an account held with the FCM or a DCO without their knowledge or consent.

2.53 The FCM's enforcement of its security interest would not be subject to any stay, moratorium or freeze or otherwise be affected by commencement of the insolvency of the customer.

2.54 Although the position is reinforced if the Covered Agreement constitutes a netting agreement for the purposes of Part XVII, assets subject to a security interest will in any case fall outside the estate available to a liquidator and, subject to the provisions on administration coming into force and the rules on voidable transactions, there is no provision of British Virgin Islands law which would provide grounds for a stay on enforcement.

17. Will the Customer (or its administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official) be able to recover any transfers of Collateral consisting of cash or securities made to the FCM during a certain "suspect period" preceding the date of the insolvency as a result of such a transfer constituting a "preference," fraudulent transfer or transaction at an undervalue (however called and whether or not fraudulent) in favour of the FCM or on any other basis? If so, how long before the insolvency does this suspect period begin? Would the posting of additional margin (which could be required when the Customer Account's net liquidating equity has fallen below the required margin level for the Customer Account due to trading losses in respect of one or more Covered Contracts cleared for the Customer) during the suspect period be subject to avoidance, either because the Collateral was considered to relate to an antecedent or pre-existing obligation or for some other reason?

2.55 British Virgin Islands law has provisions for voidable transactions which are summarised in Schedule 3. However it is highly unlikely that a British Virgin Islands court would hold as void a transaction entered into for *bona fide* commercial reasons and at arms' length by each of the parties and with no intent to defraud creditors.

2.56 The position is reinforced if the Covered Agreement constitutes a netting agreement for the purposes of Part XVII, which provides that, notwithstanding anything contained in the Insolvency Act or in any rule of law relating to insolvency, "the provisions relating to netting, the set off of money provided by way of security, the enforcement of a guarantee and the enforcement of a collateral arrangement and the set off of the proceeds thereof, as contained within a netting agreement or a guarantee provided for in such agreement shall be legally enforceable against a party to the agreement and where applicable, against a guarantor or other person providing security". The Insolvency Act defines netting agreement as an agreement "in relation to present or future financial contracts", the (presumably unintended) consequence being that if financial contracts have been entered into before 16 August 2004 (the effective date of the Insolvency Act) it would take a further financial contract to bring the netting agreement within the scope of the Insolvency Act. Otherwise, the Insolvency Act is clear on its face that a netting agreement is legally enforceable against a party notwithstanding that it constitutes a preference, an undervalue transaction, a voidable floating charge or an extortionate credit transaction.

2.57 The posting of additional margin during the suspect period would not be subject to avoidance assuming it relates to a contractual obligation from before the commencement of the suspect period.

Miscellaneous

18. Are there any other local law considerations that you would recommend the FCM to consider in connection with enforcing its security interest in the Customer's rights and interests in respect of any Collateral?

2.58 No.

19. Are there any other circumstances you can foresee that might affect the FCM's ability to enforce its security interest in the Customer's rights and interests in respect of Collateral in your jurisdiction?

2.59 No.

Yours faithfully

Harney Westwood & Riegels (BVI) LP

Harney Westwood & Riegels

APPENDIX A

CUSTOMER TYPES[16]

CERTAIN COUNTERPARTY TYPES[14]

Description	**Covered by opinion**	**Legal form(s)**
Bank/Credit Institution. A legal entity, which may be organized as a corporation, partnership or in some other form, that conducts commercial banking activities, that is, whose core business typically involves (a) taking deposits from private individuals and/or corporate entities and (b) making loans to private individual and/or corporate borrowers. This type of entity is sometimes referred to as a "commercial bank" or, if its business also includes investment banking and trading activities, a "universal bank". (If the entity only conducts investment banking and trading activities, then it falls within the "Investment Firm/Broker Dealer" category below.) This type of entity is referred to as a "credit institution" in European Community (***EC***) legislation. This category may include specialised types of bank, such as a mortgage savings bank (provided that the relevant entity accepts deposits and makes loans), or such an entity may be considered in the local jurisdiction to constitute a separate category of legal entity (as in the case of a building society in the United Kingdom (***UK***)).	Yes.	BVIBCs[15] regulated by the Banks and Trust Companies Act 1990.
Central Bank. A legal entity that performs the function of a central bank for a Sovereign or for an area of monetary union (as in the case of the European Central Bank in respect of the euro zone).	Not applicable.	
Corporation. A legal entity that is organized as a corporation or company rather than a partnership, is engaged in industrial and/or commercial activities and does not fall within one of the other categories in this Appendix B.	Yes.	BVIBCs (including SPCs[16] and restricted

[14] In these definitions, the term "legal entity" means an entity with legal personality other than a private individual.

[15] Companies incorporated, continued or re-registered under the BVI Business Companies Act 2004 (the ***BVIBC Act***) and identified by any of the following in the last part of the name: "Limited", "Corporation" or "Incorporated", "Société Anonyme" or "Sociedad Anonima", "Ltd", "Corp", "Inc" or "S.A.", or in the case of an unlimited company "Unlimited" or "Unltd", or any other word or words, or abbreviations thereof, as may be specified in any regulations promulgated under the BVIBC Act. This includes companies originally incorporated (i) under the International Business Companies Act (Cap 291) and re-registered under the BVI Business Companies Act either voluntarily before 30 November 2006 or automatically on 1 January 2007 or (ii) under the Companies Act (Cap 285) and re-registered under the BVI Business Companies Act either voluntarily before 1 January 2009 or automatically on 1 January 2009.

[16] Segregated portfolio companies identified by inclusion in the name of the designation "Segregated Portfolio Company" or "SPC". The

		purposes companies[17]).
Hedge Fund/Proprietary Trader. A legal entity, which may be organized as a corporation, partnership or in some other legal form, the principal business of which is to deal in and/or manage securities and/or other financial instruments and/or otherwise to carry on an investment business predominantly or exclusively as principal for its own account.	Yes.	BVIBCs (including SPCs) whether regulated by the Securities and Investment Business Act 2010 or not. These entities may also take the form of partnerships or unit trusts[18].
Insurance Company. A legal entity, which may be organised as a corporation, partnership or in some other legal form (for example, a friendly society or industrial & provident society in the UK), that is licensed to carry on insurance business, and is typically subject to a special regulatory regime and a special insolvency regime in order to protect the interests of policyholders.	Qualified[19].	BVIBCs (including SPCs) regulated by the Insurance Act 2008.
International Organization. An organization of Sovereigns established by treaty entered into between the Sovereigns, including the International Bank for Reconstruction and Development (the World Bank), regional development banks and similar organizations established by treaty.	Not applicable.	

assets and liabilities of segregated portfolio companies are compartmentalised and the segregated portfolios, although not separate legal entities, are treated as distinct entities for most (but not all) insolvency related purposes. The conclusions reached in this opinion are generally applicable to segregated portfolio companies except were indicated and provided there is no attempt to attribute the liabilities of one portfolio to the assets of a separate portfolio either prior to or after the onset of insolvency.

[17] Restricted purposes companies identified by the designation "(SPV) Limited" or "(SPV) Ltd". Unlike ordinary BVIBCs, restricted purposes companies have limitations on their powers set out in their memoranda and articles of association and actions taken outside those limitations may be *ultra vires*. Provided the entry into of an Agreement is within the powers of a restricted purposes company, the conclusions reached in this opinion are applicable to restricted purposes companies.

[18] British Virgin Islands trusts settled in the British Virgin Islands are regulated by the Trustee Act (Cap 303) (the ***Trustee Act***) and where relevant the Virgin Islands Special Trusts Act 2003 (the ***VISTA***). Trusts are not legal entities.

[19] The Insurance Act 2008 provides that a British Virgin Islands insurance company "shall not invest or trade in a derivative without the prior written approval of the [Financial Services] Commission". The Regulatory Code 2009 provides that as part of the application for an insurance license, the business plan should include among other things "any plans that the applicant has to purchase or sell derivatives" (a "derivative" being defined in the Regulatory Code as "an option, a future or a contract for differences"). Properly therefore such approval would have been obtained at the time of licensing. If an insurance company were to invest or trade in a derivative without consent, any agreement to that effect would be unenforceable against the counterparty under the Financial Services Commission Act, 2001. Note however that the agreement would still be enforceable against the insurance company by the counterparty, which would also be entitled to recover from the insurance company any money or other property paid or transferred by it under the agreement, as well as compensation for any loss.

Investment Firm/Broker Dealer. A legal entity, which may be organized as a corporation, partnership or in some other form, that does not conduct commercial banking activities but deals in and/or manages securities and/or other financial instruments as an agent for third parties. It may also conduct such activities as principal (but if it does so exclusively as principal, then it most likely falls within the "Hedge Fund/Proprietary Trader" category above.) Its business normally includes holding securities and/or other financial instruments for third parties and operating related cash accounts. This type of entity is referred to as a "broker-dealer" in US legislation and as an "investment firm" in EC legislation.	Yes.	BVIBCs regulated by the Securities and Investment Business Act 2010. These entities may also take the form of partnerships or unit trusts.
Investment Fund. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide investors with a share in profits or income arising from property acquired, held, managed or disposed of by the manager(s) of the legal entity or arrangement or a right to payment determined by reference to such profits or income. This type of entity or arrangement is referred to as a "collective investment scheme" in EC legislation. It may be regulated or unregulated. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by general law and/or, typically in the case of regulated Investment Funds, financial services legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Investment Fund (for example, a trustee of a unit trust) contract on behalf of the Investment Fund, are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.	Yes.	BVIBCs (including SPCs) whether regulated by the Securities and Investment Business Act 2010 or not. These entities may also take the form of partnerships or unit trusts.
Local Authority. A legal entity established to administer the functions of local government in a particular region within a Sovereign or State of a Federal Sovereign, for example, a city, county, borough or similar area.	Qualified[20].	BVIBCs.

[20] Whilst there are instances in which a transaction may be entered into for hedging purposes (which may well be an effective risk management strategy for a government department), there being no British Virgin Islands precedent in such matters we believe that a court in the British Virgin Islands may well take the view of the Law Lords in *Hazel v Hammersmith and Fulham London Borough Council* [1992] 2 AC 1 that a local authority had no power to enter into interest rate swap transactions with the object of making profit because of their speculative nature. We therefore recommend caution in respect of transactions with government entities in the British Virgin Islands as the act of entering into derivatives transactions, if found to be outside the powers of such bodies, may be unlawful.

Partnership. A legal entity or form of arrangement without legal personality that is (a) organised as a general, limited or some other form of partnership and (b) does not fall within one of the other categories in this Appendix B. If it does not have legal personality, it may nonetheless be treated as though it were a legal person for certain purposes (for example, for insolvency purposes) and not for other purposes (for example, tax or personal liability).	Yes.	General Partnerships[21]. 1996 Limited Partnerships[22]. 2017 Limited Partnerships without Legal Personality[23]. Limited Partnerships with Legal Personality[24].
Pension Fund. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide pension benefits to a specific class of beneficiaries, normally sponsored by an employer or group of employers. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by pensions legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Pension Fund (for example, a trustee of a pension scheme in the form of a common law trust) contract on behalf of the Pension Fund and are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.	Yes.	BVIBCs (including SPCs) whether regulated by the Securities and Investment Business Act 2010 or not. These entities may also take the form of partnerships or unit trusts.
Sovereign. A sovereign nation state recognized internationally as such, typically acting through a direct agency or instrumentality of the central government without separate legal personality, for example, the ministry of finance, treasury or national debt office. This category does not include a State of a Federal Sovereign or other political sub-division of a sovereign nation state if the sub-division has separate legal personality (for example, a Local Authority) and it does not include any legal entity owned by a sovereign nation state (see "Sovereign-owned Entity").	Qualified[20].	BVIBCs.

[21] Formed or regulated under the Partnership Act 1996. General Partnerships are not legal entities and the partners do not have limited liability.

[22] Formed or regulated under the Partnership Act 1996. 1996 Limited Partnerships formed under the Partnership Act 1996 may be reregistered voluntarily as 2017 Partnerships without Legal Personality (or as 2017 Limited Partnerships with Legal Personality) under the Limited Partnership Act 2017. Any 1996 Limited Partnerships which have not been reregistered by 11 January 2028 will be automatically reregistered as 2017 Partnerships without Legal Personality under the Limited Partnership Act 2017 on 11 January 2028. 1996 Limited Partnerships are not legal entities.

[23] Formed, registered or reregistered under the Limited Partnership Act 2017. 1996 Limited Partnerships may be reregistered voluntarily as 2017 Limited Partnerships without Legal Personality (or as Limited Partnerships with Legal Personality) under the Limited Partnership Act 2017.

[24] Formed, registered or reregistered under the Limited Partnership Act 2017. 1996 Limited Partnerships formed under the Partnership Act 1996 may be reregistered voluntarily as Limited Partnerships with Legal Personality (or as 2017 Limited Partnerships without Legal Personality) under the Limited Partnership Act 2017.

Sovereign Wealth Fund. A legal entity, often created by a special statute and normally wholly owned by a Sovereign, established to manage assets of or on behalf of the Sovereign, which may or may not hold those assets in its own name. Such an entity is often referred to as an "investment authority". For certain Sovereigns, this function is performed by the Central Bank, however for purposes of this Appendix B the term "Sovereign Wealth Fund" excludes a Central Bank.	Not applicable.	
Sovereign-Owned Entity. A legal entity wholly or majority-owned by a Sovereign, other than a Central Bank, or by a State of a Federal Sovereign, which may or may not benefit from any immunity enjoyed by the Sovereign or State of a Federal Sovereign from legal proceedings or execution against its assets. This category may include entities active entirely in the private sector without any specific public duties or public sector mission as well as statutory bodies with public duties (for example, a statutory body charged with regulatory responsibility over a sector of the domestic economy). This category does not include local governmental authorities (see "Local Authority").	Qualified[20].	BVIBCs.
State of a Federal Sovereign. The principal political sub-division of a federal Sovereign, such as Australia (for example, Queensland), Canada (for example, Ontario), Germany (for example, Nordrhein-Westfalen) or the United States of America (for example, Pennsylvania). This category does not include a Local Authority.	Not applicable.	

SCHEDULE 1

Additional Assumptions

1 The Covered Agreement constitutes valid, binding and enforceable obligations in accordance with their express terms under New York law, and the New York courts would accept the calculation of delivery values upon the happening of an Event of Default as a genuine and *bona fide* pre-estimate of a party's loss, and would not construe those provisions as a penalty.

2 Each party has all requisite capacity and corporate power to execute, deliver and perform its obligations under the Covered Agreement (and we draw your attention to certain limitations on capacity of specific types of entities outlined in Appendix B) and has taken all necessary steps to authorise, execute, deliver and perform the Covered Agreement and all Covered Transactions.

3 Any Base Account Agreement and CDA conform in all respects to the description of them in Annex 1 and have not been extended or modified in any way inconsistent with Annex 1.

4 The Covered Agreement is entered into for *bona fide* commercial reasons and at arms' length by each of the parties and with no intent to defraud creditors.

5 The Covered Agreement and all Covered Transactions are entered into prior to the commencement of Insolvency Proceedings (as defined in Schedule 2) in respect of the Customer[25].

6 At the time at which a Covered Transaction is entered into under the Covered Agreement, neither party has actual notice of the insolvency of the other party.

7 No provision of any law (other than British Virgin Islands law) affects the opinions stated herein.

8 Subject to our comments in respect of partnerships and trusts, all obligations under the Covered Agreement are mutual between the parties in the sense that there are only two parties and each is personally liable as regards obligations owing by it and is beneficial owner of the obligations owed to it.

[25] Any Covered Transactions entered into after Insolvency Proceedings have commenced in relation to a BVIBC are void unless the court otherwise orders, as the BVIBC does not have capacity to contract.

SCHEDULE 2

Insolvency Proceedings

1 **Insolvency**

1.1 The primary legislation governing bankruptcy and insolvency proceedings in the British Virgin Islands is the Insolvency Act 2003 (the ***Insolvency Act***).

1.2 Except where otherwise defined, ***insolvent*** in relation to an insolvent party means:

(a) it fails to comply with a statutory demand for payment served on it in accordance with the provisions of Part V of the Insolvency Act;

(b) execution or process issued on a judgment, decree or order of a British Virgin Islands court in favour of a creditor is returned wholly or partly unsatisfied;

(c) the value of the insolvent party's liabilities exceed its assets (the ***balance sheet test***); or

(d) the insolvent party is unable to pay its debts as they fall due (the ***cash flow test***).

2 **Companies**

2.1 The only bankruptcy, composition, rehabilitation or other insolvency proceedings to which a party incorporated in or with a branch in the British Virgin Islands would be subject in the British Virgin Islands are:

(a) supervised creditors' arrangements under Part II (*Creditors' arrangements*) of the Insolvency Act;

(b) receivership and administrative receivership[26] under Part IV (*Receivership*) of the Insolvency Act[27]; and

(c) liquidation under Part VI (*Liquidation*) of the Insolvency Act

(collectively ***Insolvency Proceedings***).

In addition, Part III (*Administration*) of the Insolvency Act provides for administration. However this part has not been brought into force and administration is not considered an ***Insolvency Proceeding*** for the purposes of this opinion.

2.2 There are a number of additional reorganisational processes under British Virgin Islands law in respect of BVIBCs which are not necessarily related to the insolvency of the party. These are:

(a) solvent voluntary liquidation, insolvent voluntary liquidation (in which case it is subject to the provisions of Part VI of the Insolvency Act) or dissolution under Part XII (*Liquidation, Striking-Off and Dissolution*) of the BVI Business Companies Act 2004 (the ***BVIBC Act***);

(b) a reorganisation under Part IX (Merger, Consolidation, Sale of Assets, Forced Redemptions, Arrangements and Dissenters) of the BVIBC Act; and

(c) continuation under foreign law under Part X (*Continuation*) of the BVIBC Act.

2.3 Other than a requirement to notify the relevant regulatory body, there are no special provisions

[26] An administrative receiver is a receiver of the whole, or substantially the whole, of the business, undertaking and assets of a company.

[27] Which also covers receivership under the Conveyancing and Law of Property Act (Cap 220).

relating to banks, regulated funds or broker dealers. Insolvency proceedings for these entities are generally conducted in the same fashion as for unregulated entities of the same type.

2.4 The BVIBC Act contains certain additional provisions relating to the insolvency of segregated portfolio companies. Notwithstanding any other provision of British Virgin Islands law, a liquidator of a segregated portfolio company is bound to maintain the segregation of the portfolios and, in discharging the claims of creditors, may only apply the company's assets to those entitled to recourse to them under the segregated portfolio provisions of the BVIBC Act. The principles of segregation of portfolios are therefore maintained through insolvency. The BVIBC Act also contains provisions under which certain parties may apply to the court for a portfolio liquidation order in respect of a specific segregated portfolio and where relevant in this opinion the expression ***Insolvency Proceedings*** includes portfolio liquidation orders. The BVIBC Act further contains provision for administration orders in respect of individual segregated portfolios, effectively applying the provisions of Part III (*Administration*) of the Insolvency Act to segregated portfolios (once the relevant provisions have been brought into force).

3 Partnerships

2017 Limited Partnerships without Legal Personality
Limited Partnerships with Legal Personality

3.1 In relation to 2017 Limited Partnerships without Legal Personality and Limited Partnerships with Legal Personality, the Limited Partnership Act 2017 broadly provides that the Insolvency Act shall apply to such partnerships with any necessary changes[28]. Accordingly, paragraph 1.1 above would broadly apply with equal effect to such partnerships.

General Partnerships
1996 Limited Partnerships

3.2 Section 499 of the Insolvency Act provides that the Insolvency Rules (the ***Rules***) will determine which provisions of the Insolvency Act apply to insolvent partnerships. To date only one set of Rules has been promulgated, the Insolvency Rules 2005. However, these do not address the position in relation to insolvent partnerships. Neither a General Partnership nor a 1996 Limited Partnership is a separate legal entity. They cannot be liquidated in the same manner as a Company, but it is possible to pursue claims in respect of the partnership against each person who was a member of the partnership at the relevant time. In the event that any partner is unable to satisfy the claims made against them the partner would be subject to insolvency proceedings under British Virgin Islands law in the usual way[29].

3.3 The courts of the British Virgin Islands do have jurisdiction to wind-up and dissolve such partnerships on various grounds, including:

(a) when the business of the partnership can only be carried on at a loss; and

(b) whenever circumstances have arisen which, in the opinion of the court, render it just and equitable that the partnership be dissolved.

However the court will only hear an application on these grounds from a partner, not a third party. Further there is nothing in British Virgin Islands law at present that would enable the court to wind up a partnership itself (as distinct from any partners) on the basis that the partnership was insolvent on the basis of the cash flow test or the balance sheet test.

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[28] The main relevant difference is that there is a different test for "insolvency" from that which applies to Companies.

[29] The Partnership Act 1996 actually provides that the provisions of the Companies Act relating to winding-up and dissolution … shall apply *mutatis mutandis* to the winding-up of the limited partnership. The provisions of the Companies Act relating to winding-up and dissolution were repealed by the Insolvency Act, and, while the Partnership Act 1996 was not amended, under normal provisions of statutory interpretation it must be assumed that the references would be construed as references to the Insolvency Act.

3.4 If any individual partner of a General Partnership or a 1996 Limited Partnership has been declared bankrupt (for an individual) or has gone into insolvent liquidation (for a company), then the partnership will be dissolved. If upon the dissolution of the partnership it is unable to pay the partnership debts as they fall due, then in the case of a 1996 Limited Partnership the winding up and dissolution of the partnership proceeds as if the partnership was an insolvent company. There is no present guidance under British Virgin Islands law as to how the winding-up and dissolution of an insolvent General Partnership could be conducted. In comparable common law jurisdictions courts have sometimes resorted to the fiction of treating the insolvent partnership as a quasi- person in order to maintain an orderly distribution amongst creditors, but there is no statutory basis upon which such a procedure might be based.

3.5 Because the position with respect to 1996 Limited Partnerships is much less satisfactory than that for Limited Partnerships with Legal Personality or even 2017 Limited Partnerships without Legal Personality, our recommendation when dealing with Counterparties who are 1996 Limited Partnerships would be to require that they re-register under the Limited Partnership Act.

4 Trusts and unit trusts

4.1 Trusts may be terminated under the terms of the trust, by unanimous agreement of the beneficiaries or on the order of a court.

SCHEDULE 3

Voidable Transactions

1 Under British Virgin Islands law, certain transactions may be set aside or otherwise varied or amended by orders of the British Virgin Islands court upon the application of a liquidator or administrator when an insolvent party goes into liquidation or into administration. Principally these are where the transaction is an unfair preference, an undervalue transaction, a voidable floating charge or an extortionate credit transaction.

2 Unfair preferences, undervalue transactions, voidable floating charges and extortionate credit transactions are all regulated by the Insolvency Act and in each case the transaction must have been entered into within the relevant vulnerability period, being the period prior to the onset of insolvency[30] or the making of the administration order and (except in the case of extortionate credit transactions) the transaction must either (a) have been entered into at a time that the insolvent party was insolvent or (b) have caused the insolvent party to become insolvent, for which purposes insolvent excludes insolvent under the balance sheet test.

3 An unfair preference is a transaction that has the effect of putting a creditor into a position which, in the event of the insolvent party going into insolvent liquidation, would be better than the position in which that creditor would have been vis-à-vis other creditors of the insolvent party if the transaction had not been entered into. A transaction is not an unfair preference if it took place in the ordinary course of the insolvent party's business. The relevant vulnerability period is six months, except if the creditor is a connected person[31], in which case it is two years.

4 An undervalue transaction is a transaction where the insolvent party makes a gift or otherwise receives no consideration for the transaction, or the value of the consideration that it receives in money or money's worth is considerably less than the consideration provided to the insolvent party. A transaction is not an undervalue transaction if the insolvent party enters into the transaction in good faith and for the purposes of its business and if at the time it entered into the transaction there were reasonable grounds for believing that the transaction would benefit the insolvent party. The relevant vulnerability period is six months, except if the creditor is a connected person, in which case it is two years.

5 A floating charge may be set aside if there was no consideration at the same time or subsequent to the creation of the charge. The relevant vulnerability period is six months, except if the creditor is a connected person, in which case it is two years.

6 An extortionate credit transaction is a transaction for or involving the provision of credit and, having regard to the risk accepted by the person giving credit, (a) the terms of such credit extension are such as to require grossly exorbitant payments to be made (either unconditionally or in certain contingencies) or (b) the transaction otherwise grossly contravenes ordinary principles of fair trading. The relevant vulnerability period is five years.

7 In addition, any conveyance made by any person with intent to defraud creditors is voidable at the instance of the person thereby prejudiced under British Virgin Islands law. It is not a requirement

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[30] For which purposes "insolvency" means (a) it fails to comply with the requirements of a statutory demand that has not been set aside, (b) execution or other process issued on a judgment, decree or order of a British Virgin Islands court in favour of a creditor of the company is returned wholly or partly unsatisfied or (c) the company is unable to pay its debts as they fall due.

[31] In relation to a company, "connected person" means any one or more of: (a) a promoter of the company; (b) a director or member of the company or of a related company; (c) a beneficiary under a trust of which the company is or has been a trustee; (d) a related company; (e) another company one of whose directors is also a director of the company; (f) a nominee, relative, spouse or relative of a spouse of a person referred to in (a) to (c); (g) a person in partnership with a person referred to in (a) to (c); and (h) a trustee of a trust having as a beneficiary a person who is, apart from this paragraph, a connected person. A company is related to another company if (a) it is a subsidiary or holding company of that other company; (b) the same person has control of both companies; and (c) the company and that other company are both subsidiaries of the same holding company.

that the relevant transaction was entered into at a time when one party was insolvent or became insolvent as a result of the transaction. It is not a requirement that the transferring party subsequently went into liquidation or administration and the right to challenge is not limited to a liquidation. However, no conveyance entered into for valuable consideration and in good faith to a person who did not have notice of the intention to defraud may be impugned.

SCHEDULE 4

Set-Off and Netting

1 Insolvency set-off is regulated under Part V (*Provisions applicable to the liquidation of companies and the bankruptcy of individuals*) of the Insolvency Act and is applicable to BVIBCs, foreign companies and individuals. Specifically Section 150 provides for automatic set-off of mutual credits and debts incurred prior to the commencement of liquidation.

2 Part XVII (*Netting and Financial Contracts*) of the Insolvency Act (***Part XVII***), based on the ISDA model netting act, provides that notwithstanding anything contained in the Insolvency Act, the insolvency rules promulgated under the Insolvency Act or in any rule of law relating to insolvency, provisions relating to netting and set off, as well as the enforcement of collateral arrangements and the set off of the proceeds thereof, as contained within a netting agreement are enforceable against each party to that contract.

3 Section 150 of the Insolvency Act is expressly made subject to Part XVII, and so if the insolvency set-off rules were to produce a different result from the netting provisions of a "netting agreement" the netting provisions would prevail.

4 A "netting agreement" is defined in Part XVII as an agreement between two parties only in relation to present or future financial contracts between them the provisions of which include the termination of those contracts for the time being in existence, the determination of the termination values of those contracts and the set-off of the termination values so determined so as to arrive at a net amount due.

5 For the purposes of Part XVII of the Insolvency Act, a financial contract is a contract, including any terms and conditions incorporated into any such contract, pursuant to which payment or delivery obligations that have a market or an exchange price are due to be performed at a certain time or within a certain period of time.

6 Without limiting the previous paragraph, the following are financial contracts:

(a) a currency, cross-currency or interest rate swap agreement;

(b) a basis swap agreement;

(c) a spot, future, forward or other foreign exchange agreement;

(d) a cap, collar or floor transaction;

(e) a commodity swap;

(f) a forward rate agreement;

(g) a currency or interest rate future;

(h) a currency or interest rate option;

(i) equity derivatives, such as equity or equity index swaps, equity options and equity index options;

(j) credit derivatives, such as credit default swaps, credit default basket swaps, total return swaps and credit default options;

(k) energy derivatives, such as electricity derivatives, oil derivatives, coal derivatives and gas

derivatives;

(l) weather derivatives, such as weather swaps or weather options;

(m) bandwidth derivatives;

(n) freight derivatives;

(o) carbon emissions derivatives;

(p) a spot, future, forward or other commodity contract;

(q) a repurchase or reverse repurchase agreement;

(r) an agreement to buy, sell, borrow or lend securities, such as a securities lending transaction;

(s) a title transfer collateral arrangement;

(t) an agreement to clear or settle securities transactions or to act as a depository for securities;

(u) any other agreement similar to any agreement or contract referred to in paragraphs (a) to (t) with respect to reference items or indices relating to (without limitation) interest rates, currencies, commodities, energy products, electricity, equities, weather, bonds and other debt instruments and precious metals;

(v) any derivative or option in respect of, or combination of, one or more agreements or contracts referred to in paragraphs (a) to (u); and

(w) any agreement or contract designated as such by the [British Virgin Islands Financial Services] Commission.

SCHEDULE 5

Orders in Aid of Foreign Insolvency Proceedings

1 Under Part XIX of the Insolvency Act, liquidators and representatives of other insolvency proceedings[32] taking place in designated territories[33] may apply to the British Virgin Islands court for assistance.

2 The British Virgin Islands court, when faced with such an application, shall do what will best ensure the economic and expeditious administration of the foreign proceedings to the extent that is consistent with certain guiding principles, specifically the just treatment of all persons claiming in the foreign proceedings, the protection of persons in the British Virgin Islands who have claims against the company against prejudice and inconvenience in the processing of claims in the foreign proceedings, the prevention of preferential or fraudulent disposition of property, the need for distributions to claimants in the foreign proceedings to be substantially in accordance with the order of distributions in a British Virgin Islands insolvency and comity.

3 The orders which the British Virgin Islands court can make in aid of the foreign proceedings are extremely wide and include the restraining of proceedings; orders requiring a person to deliver up the property of the company to the foreign representative, orders to facilitate the co-ordination of insolvency proceedings in the British Virgin Islands with the foreign insolvency proceedings and authorising the foreign representative of any person who could be examined in British Virgin Islands insolvency proceedings.

4 It seems that the provisions are wide enough for the British Virgin Islands court not only to render merely procedural assistance but also to apply substantive principles of British Virgin Islands insolvency law[34]. The British Virgin Islands court has a discretion whether to apply the law of the British Virgin Islands or the law applicable to the foreign proceedings[35]. However, set-off and preferential creditors are protected from this provision in that the court order cannot affect the right of any creditor to benefit from the set-off provisions in Section 150 of the Insolvency Act, or result in a preferential creditor receiving less than he would under a British Virgin Islands insolvency, without the consent of such person.

5 Note that provisions in Part XVIII of the Insolvency Act based on the UNCITRAL Model Law on Cross-Border Insolvency for giving and seeking assistance in insolvency proceedings have not been brought into force.

6 Apart from the statutory provisions, a liquidator appointed under a foreign liquidation may apply to the British Virgin Islands court for relief on behalf of the company in liquidation and the British Virgin Islands court will recognise that liquidator's standing.

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[32] Specifically "collective judicial or administrative proceedings in which the property and affairs of the debtor are subject to control or supervision by a foreign court". It is arguable that administrative receivership is not within the ambit of this definition because it is not a collective proceeding nor is the administrative receiver truly under the control or supervision of the court. See *Mann v Secretary of State for Employment* [1999] ICR 898, House of Lords, holding that receivership was not a collective satisfaction of creditors' claims and therefore not an insolvency proceeding for the purposes of an EC directive.

[33] Australia, Canada, Finland, Hong Kong, Japan, Jersey, New Zealand, United Kingdom and USA.

[34] See *Re BCCI (No. 9)* [1994] 2 BCLC 636 per Rattee J

[35] Section 467(5) of the Insolvency Act.

ANNEX 1

Summary Annex

March 23, 2025

*The following is intended as a high-level overview and summary of the main concepts covered, conclusions reached, and factual assumptions in the Sullivan & Cromwell LLP Memorandum to the Futures Industry Association and the International Swaps And Derivatives Association, Inc. Regarding Futures and Options Transactions, Cleared Swap and Foreign Futures Transactions Executed and Carried by Futures Commission Merchants for Their Customers dated November 17, 2021 (the "**S&C Memo**"). Counsel should not rely on this overview and summary as a substitute for reading the S&C Memo in full, as this overview and summary does not include all the assumptions, nor the qualifications and detailed reasoning, set out in the S&C Memo. Terms used but not defined in this summary annex have the meanings given to those terms in the S&C Memo or the instruction letter to which this summary annex is attached. Unless otherwise indicated, the references to paragraphs and notes in the text below are to paragraphs and notes of this summary annex.*

1 Legal relationships between FCM, customer and DCO (or foreign futures broker) prior to customer default

The customer agreement

1.1 Pursuant to the terms of a customer agreement (the "**customer agreement**") between an FCM and its customer, the FCM maintains one or more accounts on its books and records in the customer's name (individually or collectively, the "**customer account**"), and the customer authorizes the FCM, to execute, carry and clear contracts for the purchase and sale of US futures, foreign futures and/or cleared swaps[1] on behalf of the customer (with respect to the customer, its "**contracts,**" which are referred to in the S&C Memo as "t**ransactions**").[2] The effect of this authorization, and the FCM's acceptance, is to cause the FCM to become the customer's agent for these purposes.[3] If the customer clears only futures, the customer agreement will consist of a customer account agreement (a "**base account agreement**"). If the customer clears only cleared swaps or it clears both futures and cleared swaps, the customer agreement will consist of a base account agreement together with a cleared derivatives addendum ("**CDA**"). In either case, the customer agreement may also include one or more other documents relating to the terms of the relationship between the FCM and the customer. The CDA is intended to serve as an addendum to a base account agreement, and all of these documents together form a single agreement that governs the customer account. The customer agreement typically provides that the customer account and the customer's contracts are subject to "applicable law," which is generally defined to include applicable US legislation, rules, regulations and interpretations of regulatory agencies and self-regulatory organizations ("**SROs**") and the rules of trading venues (including exchanges) and clearing organizations where the customer's contracts are executed and cleared.[4]

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[1] For purposes of this summary, the instruction letter to which it is annexed and the S&C Memo, "**futures**" means US futures and/or foreign futures, as the context may require; "**US futures**" means futures contracts or options on futures contracts cleared by the FCM for a customer through a derivatives clearing organization registered as such (a "**DCO**") with the Commodity Futures Trading Commission (the "**CFTC**") under the Commodity Exchange Act (the "**CEA**"); "**cleared swaps**" means swap contracts cleared by the FCM for a customer through a DCO (including single-name credit default swap contracts carried in accounts established in accordance with Section 4d(f) of the CEA pursuant to exemptive relief orders of the CFTC and the Securities and Exchange Commission); "**foreign futures**" means futures contracts or options on futures contracts made on or subject to the rules of a foreign board of trade and cleared by the FCM for a customer through a foreign futures broker; and "**foreign futures broker**" means a person that is a member of the foreign board of trade and foreign clearing organization ("**FCO**").

[2] As used herein, "**contract**" means, depending on the context, either (i) a term of reference describing a unit of trading in a particular futures or cleared swaps product or (ii) a futures or cleared swap product approved and designated for trading or clearing pursuant to the rules of an exchange or other trading venue or clearing organization.

[3] The customer agreement establishes (i) a debtor-creditor relationship between the FCM and the customer in respect of the customer account, (ii) the scope and terms of the FCM's authority as agent and the responsibilities of the FCM and the customer in relation to the contracts carried by the FCM for the customer and (iii) other contractual rights and obligations of the FCM and its customer relating to their relationship. Some of those other contractual rights and obligations are rights and obligations of the FCM in a principal capacity as the customer's contractual counterparty, rather in its capacity as the customer's agent.

[4] Some customer agreements also explicitly include the customs and practices of the clearing organizations and trading venues relevant to the customer's contracts. In addition, to the extent the customer agreement is governed by New York law, it would generally be interpreted

1.2 Under the customer agreement, and consistent with its role as the customer's agent, the FCM is required to account to the customer for the profits and losses derived from the customer's contracts. To the extent that the contracts carried by the FCM for the customer generate profits, the FCM is required to account for those profits to the customer; to the extent that they generate losses, the customer is required to make the FCM whole for those losses.

1.3 The customer agrees in its customer agreement to (i) deposit and maintain margin with the FCM, (ii) pay the FCM the amount of any trading losses, debit balances or deficiencies (and any applicable interest on those amounts), premiums on options purchased for the customer, brokerage charges and commissions owed to or incurred by the FCM, charges imposed by exchanges or other SROs relating to the customer's contracts or the customer account, and other costs arising in the course of the customer's relationship with the FCM (and the customer agreement authorizes the FCM to debit the customer account for any of these amounts) and (iii) reimburse or indemnify the FCM for any costs or liabilities incurred by the FCM in the course of providing services or exercising remedies under the customer agreement. The customer grants to the FCM a security interest in the customer account as well as the contracts and the cash, securities and other property (collectively, "**funds**") credited to the customer account, as discussed in paragraphs 1.37 through 1.42. Events of default applicable to the customer and related remedial provisions are set out in both the base account agreement and the CDA (if any), as discussed in paragraphs 2.3 and 2.4. A customer agreement has no specified term, but may be terminated by either party by written notice. If either party delivers notice of termination of the customer agreement (other than as a result of a customer default), the customer must promptly close its open contracts or instruct the FCM to transfer them to another FCM; if the customer fails to do so, the FCM is entitled to liquidate the customer's open positions and any other property credited to the customer account. Rule 2-27 of the National Futures Association (the "**NFA**") also requires an FCM, upon receipt of an instruction from a customer to transfer its customer account (or portions thereof) to another FCM, to effect the transfer of balances and positions to the other FCM in accordance with the terms of Rule 2-27 (and such an instruction could be given by the customer without terminating the customer agreement). Additionally, CFTC Rule 39.15(d) mandates that a DCO must have rules providing that the DCO will promptly transfer all or a portion of a customer's positions, and related funds as necessary, from the clearing member of the DCO that carries the customer account to another clearing member, without requiring the close-out and rebooking of the contracts outstanding prior to the requested transfer, subject to certain conditions, including, among other things, that the customer has instructed the carrying clearing member to make the transfer and that the customer is not currently in default to the carrying clearing member.

The customer account

1.4 The FCM records in the customer account all the contracts entered into by the FCM on behalf of the customer, as well as debits and credits reflecting margin deposited by or excess margin released to the customer, realized and unrealized gains and losses on the customer's contracts, interest or other income on margin held in the customer account, net option values, commissions, amounts payable to introducing brokers, costs relating to physical settlement, fees and other amounts due to or from the customer in respect of the customer account and any other amounts that may be credited or debited to the customer account under the customer agreement.

1.5 As discussed in paragraphs 1.12 through 1.24, the CEA and the CFTC's rules with respect to the treatment of funds received by the FCM from, for or on behalf of customers to margin, guarantee or secure customer contracts, or accruing to customers as the result of their contracts (collectively, "**customer funds**"), require the FCM to segregate or set aside those customer funds based on the product classes to which they relate (*i.e.*, US futures, cleared swaps or foreign futures) and, as a general matter, prohibit commingling of customer funds segregated or set aside for one product class with customer funds segregated or set aside in respect of any other product class, or with the FCM's proprietary funds (except to the extent of the FCM's residual interest, as described in paragraphs

in accordance with the customs and practices of the futures industry as a whole, as well as in accordance with other standard rules of contractual interpretation.

1.16, 1.18 and 1.20). To ensure that the FCM maintains books-and-records segregation consistent with these rules, if a customer clears contracts in multiple product classes, it is treated as having a separate account or sub-account for each product within the customer account. Accordingly, as used in this summary annex, with respect to the customer, (i) "**US futures account**," "**cleared swaps account**" and "**foreign futures account**" mean the entries on the FCM's books and records pertaining to the US futures customer funds, cleared swaps customer funds or foreign futures customer funds, respectively, of the customer, (ii) "**futures account**" means the customer's US futures account and/or its foreign futures account, as the context may require, (iii) "**account class**" means the customer's US futures account, cleared swaps account or foreign futures account and (iv) "**customer account**" may refer, as the context requires, to any account class or all account classes on a combined basis maintained by the FCM for a customer under a customer agreement.

1.6 The customer agreement establishes the customer account as a mutual, open and running account between the customer and the FCM.[5] A mutual open account is an account in which, by agreement of the parties, a connected series of debit and credit entries of reciprocal[6] charges and allowances is to be recorded, and the parties intend that the individual items of the account, once applied to the account, will not be considered independently, but as a continuation of a related series, such that the account balance will increase and decrease as additional related debits and credits are entered and change the account balance until either party wishes to settle and close the account. In other words, as funds are credited to a customer account (whether as margin deposited by, or as gains accruing to, the customer), and funds are debited from the customer account (whether as charges payable by the customer or withdrawals to return funds to the customer or deliver them to another party), the balance of the customer account increases or decreases. Moreover, consistent with the common-law view that an account constitutes a claim or demand by one person against another creating a debtor-creditor relationship, the parties intend that the customer account represent one single indivisible liability, represented by the customer account's balance, owed by one party, as debtor, to the other, as creditor, arising from the series of related and reciprocal debits and credits.[7] Like other types of account agreements, the customer agreement generally provides no details as to the operation of the customer account or the method by which balances are determined, either pre- or post-default, but such matters may be inferred from both the customs and practices of the industry, the nature of the relationship between the customer and the FCM and the customer margining standards discussed under "**Margining and operation of the customer account**" in paragraphs 1.25 through 1.31, to which the customer account is subject.[8] This balance – the customer account's "**net liquidating equity**" – determines, among other things, when the FCM must call for initial and maintenance margin, when the FCM may disburse excess margin upon the customer's request and how much the FCM must segregate or set aside pursuant to the Customer Property Rules discussed in paragraphs 1.132 through 1.234. It also serves as the basis for calculating the FCM's claim against the customer in the event of the customer's default, and the customer's claim in the FCM's bankruptcy, as described under "**Treatment of customer property in the FCM's bankruptcy**" in paragraphs 1.32 through 1.36.

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5 The terms "open" and "running" indicate that the business relationship reflected in the account is ongoing. *See* 1 C.J.S. Account, Action on § 1 ("More specifically, an open account involves ongoing charges by one party and payments by another party, where the parties have not settled the charges, or where there are running or current dealings between them and the account is kept open in expectation of future dealings.").

6 In other words, the entries must reflect obligations that are mutual – between the same two parties.

7 This intention applies both within a single account class, as discussed below, and across account classes, because there is a single business relationship between the FCM and customer with respect to all account classes, and a single account maintained for the customer under the customer agreement, of which all account classes form a part.

8 The customer account is subject to these requirements both by law and regulation, which mandate these aspects of the manner in which customer accounts are managed, and by the customer agreement, which (as noted above) is expressly made subject to "applicable law" and frequently contains an express acknowledgement of the margin requirements specifically.

1.7 Under CFTC rules, for purposes of determining the amount that the FCM must segregate or set aside,[9] the customer's net liquidating equity is equal to the market value of any customer funds that the FCM receives from the customer, as adjusted by (i) any permitted uses as described in paragraphs 1.19 and 1.20, (ii) any accruals on permitted investments of such customer funds that, pursuant to the customer agreement, are creditable to the customer, (iii) any unrealized gains and losses with respect to the customer's contracts,[10] (iv) any charges lawfully accruing to the customer, including any commission, brokerage fee, interest, tax or storage fee and (v) any appropriately authorized distribution or transfer of such customer funds. In practice, prior to default, the net liquidating equity reflected in a customer account is determined in accordance with customer margining standards (the "**margining standards**") established by the "Joint Audit Committee," a representative committee of SROs, including the NFA and US futures exchanges, that participate in a joint audit and financial surveillance program with respect to FCMs that has been approved and is overseen by the CFTC. The margining standards (which address, among other things, when the FCM must call for margin, how excess margin is calculated, when it may be disbursed to the customer and how to compute net liquidating equity for margining purposes) represent "applicable law" to which the customer account and contracts are subject, as described in note 9, and operate together with the provisions of customer agreements relating to customer margin, payment, reimbursement and indemnification obligations to establish the customer's contractual rights to amounts payable to it under its customer agreement. *See* paragraphs 1.285 through 1.31 for further information as to how the net liquidating equity of a customer account is calculated for margining purposes.

Customer contracts

Assumed clearing relationships and account structures

1.8 The S&C Memo addresses the circumstance in which the FCM clears US futures and cleared swaps for the customer through a DCO as a direct member of the DCO, such that the FCM is interposed between the DCO and customer in the clearing chain. *See* the S&C Memo, Section VI. In the case of foreign futures, it is assumed that the FCM utilizes a foreign futures broker (which may be an affiliate of the FCM) to execute the foreign futures of the customer (which may be either a US or non-US person) on a foreign futures exchange and to clear them through an FCO (as a direct member of the FCO). *See* the S&C Memo, Section VII.

1.9 When the FCM clears US futures or cleared swaps for the customer, the FCM clears the contracts directly with the DCO, which credits the contracts to an omnibus customer positions account[11] of the FCM at the DCO maintained in the name of the FCM for the benefit of its customers in the relevant account class.[12] The FCM, in turn, credits the contracts to the customer account of the relevant customer on the FCM's books. Similarly, in the case of the customer's foreign futures, the foreign futures broker clears the contracts with the relevant FCO, which

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[9] As discussed in note 28, a different formulation of "net liquidating equity" is used for purposes of determining the amount of margin that the customer must deposit at any time. However, the result of both definitions is to ensure that the FCM receives sufficient margin from the customer to satisfy the customer's obligations in respect of the positions cleared and carried for it by the FCM and that the FCM segregates or sets aside and maintains sufficient funds to satisfy the net liquidating equity of all its customers.

[10] *See* the discussion of unrealized gains and losses in paragraph 1.30.

[11] A "**position**" is "an interest in the market, either long or short, in the form of one or more open contracts." https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/CFTCGlossary/index.htm#P.

[12] In the case of cleared swaps, the structure of the omnibus customer positions account is the same as in the case of futures. However, the FCM is required to provide the DCO, no less frequently than once each business day, information sufficient to identify, for each cleared swaps customer, the portfolio of rights and obligations arising from the cleared swaps that such FCM intermediates for the customer. 12 C.F.R. § 22.11(c)(2). In addition, the DCO must maintain records, updated no less frequently than once each business day, of (1) the amount of margin required at such DCO for each cleared swaps customer of the relevant FCM; and (2) the sum of all such amounts for all customers of such FCM. 12 C.F.R. § 22.12(c). The DCO is obligated to treat the value of the customer funds received from each cleared swaps customer as belonging to that cleared swaps customer, except that this treatment does not limit the DCO's right to liquidate any or all positions in the omnibus customer positions account upon the default of the FCM. *Id.* § 22.15. As a result, although the customer funds of the various customers are commingled in a single omnibus account, they are "legally segregated" by the maintenance of records and rules that allow the DCO and the FCM to track the value of customer funds allocable to each customer and ensure that the funds of one customer are not used to satisfy the obligations arising out of cleared swaps allocable to another customer.

credits the contracts to an omnibus account with the FCO maintained in the name of the foreign futures broker for its customers, and the foreign futures broker, in turn, credits the contracts to an omnibus customer positions account of the FCM with the foreign futures broker maintained in the name of the FCM for the benefit of its foreign futures customers. The FCM, in turn, credits the contracts to the customer accounts of the relevant customer on the FCM's books. Accordingly, for every contract, there are at least two relevant accounts: (i) the customer account on the FCM's books in the name of the customer to which the FCM credits all contracts cleared for that customer by the FCM across all DCOs or FCOs, and (ii) an omnibus customer positions account of the FCM at the applicable DCO, or foreign futures broker, to which the FCM's customer contracts for all its customers in the relevant account class at that DCO, or foreign futures broker, are credited.

FCM as agent-trustee with respect to the customer's contracts

1.10 Although in all cases the FCM enters into the customer's contracts as the customer's agent and upon the instruction and for the risk and benefit of the customer, the FCM's relationship with the DCO or the FCM's foreign futures broker with respect to the customer's contracts is treated by the DCO or foreign futures broker as a principal-to-principal relationship. This principal-to-principal relationship is governed by the terms of the DCO's rules and procedures, or by a contractual arrangement between the FCM and the foreign futures broker (which is likely governed by non-US law). In neither case is the FCM's customer a party to the contracts. The customer is not in privity of contract with the DCO or foreign futures broker with respect to the customer's contracts, neither the DCO nor the foreign futures broker has any liability to the customer under the contracts and the customer has no rights or claims against the DCO or foreign futures broker under the contracts. Moreover, from a US law perspective, the FCM is not in privity of contract with the FCO. The FCM is fully liable as principal for all amounts owing to the DCO or foreign futures broker in connection with the FCM's customer contracts. *See* the S&C Memo, Sections VI and VII.

1.11 Under these arrangements, the FCM acts as an "**agent-trustee**" of the customer with respect to the contracts cleared by the FCM on behalf of the customer. This reflects the fact that, as the sole counterparty and principal obligor to the DCO or foreign futures broker under the contracts cleared by the FCM on the customer's behalf with the DCO or foreign futures broker,[13] the FCM holds legal title to (*i.e.*, it is the legal owner of) the contracts credited to the omnibus customer positions account maintained with the DCO or foreign futures broker — but the customer is the beneficial owner (*i.e.*, the owner in equity) of the contracts cleared by the FCM on the customer's behalf and credited to the omnibus customer positions account at the relevant DCO or foreign futures broker, entitled to their benefit and subject to the burdens of and obligations arising from the contracts. In other words, these contracts are held in trust[14] for the customer by the FCM.[15] Because contracts that have the same terms (*e.g.*, futures contracts for the same commodity and delivery month traded on the same exchange) are fungible and are held by the FCM for all its customers for which it clears and maintains open positions in such fungible contracts, the customer does

[13] The precise nature of what the FCM holds for the customer when it clears contracts through a foreign futures broker will depend on the structure of those contracts and the laws governing those contracts and the relationship with the foreign futures broker. If the FCM is a party to the contracts, it would be an agent-trustee for the customer in respect of the contracts.

[14] Under US common-law principles, (i) an agent undertakes to act on behalf of the principal and subject to its control, but an agent, as such, does not acquire title to the property of its principal (although an agent may have possession of, and be authorized to deal with, its principal's property); (ii) a trustee has title to property that it holds subject to equitable duties to deal with it for the benefit of another, but is not subject to the control of the trust settlor or beneficiaries except to the extent the terms of the trust reserve or confer some such power over the trustee; and (iii) an agent-trustee is an agent that has title to property that it agrees to hold for the benefit and subject to the control of its principal, resulting in a technical trust relationship, but one that is generally subject to rules of agency, not trust, law.

[15] Notably, however, as mentioned in paragraph 2.1, notwithstanding this agent-trustee relationship with respect to the customer's contracts, the FCM retains a contractual right under the customer agreement, under the circumstances specified in the customer agreement (including certain non-default scenarios), to close out the contracts in its capacity as the contractual counterparty to the DCO, for its own account as principal and without regard to the directions or interest of the customer.

not have an interest in or any claim to any specific contract, but rather maintains a *pro rata* beneficial interest in such fungible contracts as a whole.[16] *See* Section VI of the S&C Memo.

Customer funds

1.12 As noted above, an FCM is required to segregate customer funds. Customer funds relating to each account class must be segregated separately and in accordance with the respective rules for each account class. The segregation rules are set out in (i) section 4d(a)(2) of the CEA and CFTC rules 1.20 through 1.30 and 1.32, in the case of customer funds of US futures customers, and (ii) section 4d(f) of the CEA and the CFTC's Part 22 rules, in the case of customer funds of cleared swaps customers. Similarly, the FCM is required to hold customer funds of foreign futures customers in "separate accounts" in accordance with the CFTC's Part 30 rules. The separate account rules applicable to foreign futures and the segregation rules applicable to US futures and cleared swaps are similar, but are based on different statutory provisions and reflect the different clearing relationships (and risks) involved in foreign futures. The CEA statutory provisions and the segregation or separate account rules (collectively, the "**Customer Property Rules**") applicable to each account class provide that the FCM may not commingle customer funds of customers maintained in such account class with funds that are deposited by customers and maintained in accounts pursuant to the rules applicable to the other account classes or with the FCM's proprietary funds, unless such commingling is expressly permitted by CFTC rule or order (or by any DCO rule approved by the CFTC).

US futures and cleared swaps

1.13 The respective Customer Property Rules for US futures and cleared swaps require the FCM to treat and deal with the customer funds of each of its customers with contracts in each account class as belonging to the customer, separately account for and segregate the customer funds from its own assets (other than certain proprietary funds of the FCM contributed by the FCM to the segregated assets, which may be commingled with such customer funds, as described in paragraph 1.16) and not use such customer funds to margin the contracts or secure or extend the credit of any customer or person other than the customer for whom such customer funds are held. The Customer Property Rules for each of these account classes specify the amount of property that must be held under the rules, the manner in which the property must be held and the purposes for which the FCM may use the property.

1.14 The FCM may deposit segregated funds (as defined in paragraph 1.15) only with permitted depositories, which are banks or trust companies (in an omnibus account established by the FCM with its bank for the benefit of its customers of the relevant account class), DCOs (in the FCM's omnibus customer margin accounts on the books of the DCOs for customers of the relevant account class),[17] and other registered FCMs (each, a "**depository**"), in

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[16] There do not appear to be any cases that evaluate the precise scope of the customer's interest in the contracts carried by the FCM, if only because the nature of the customer's interest in the underlying contracts would not determine the outcome in the context of the FCM's insolvency pursuant to the CFTC's Part 190 rules." S*ee* paragraphs 1.32 – 1.36. Additionally, the nature and scope of the customer's interest in futures contracts cleared for it are entirely irrelevant in determining how the FCM may perfect its security interest in such contracts under the UCC. As discussed in note 452, the customer's futures contracts are, by definition, "commodity contracts" carried in a "commodity account" by the FCM as the customer's "commodity intermediary." As a result, under UCC Article 9, the FCM's security interest may be perfected by the FCM's control of the customer account, which the FCM has automatically by virtue of its status as a commodity intermediary, and there is no need to consider the nature and scope of the customer's interests in such contracts. In contrast, if the FCM and customer elect to treat the customer's cleared swaps as "financial assets" credited to a "securities account" maintained for the customer by the FCM as the customer's "securities intermediary" for purposes of UCC Article 8, the rights and interests of the customer in respect of its cleared swaps under the indirect holding provisions of Article 8 parallel the rights and interests of the customer against the FCM as agent-trustee described above. However, even in the case of cleared swaps that are subject to a financial asset election, the nature and scope of a customer's rights and interests in such cleared swaps do not determine their treatment under the CFTC's Part 190 rules in the FCM's insolvency. *See* the discussion in note 43.

In any event, the customer's interest should not extend beyond the contracts that are for the same commodity and delivery month and traded on the same exchange, if only because the FCM cannot be said to have executed any other contract on behalf of that customer.

[17] The DCO holds the funds of customers of multiple FCMs in a single account with its bank or custodian, but allocates those funds to the respective FCMs on the books of the DCO, in a manner similar to the way in which the FCM commingles funds of multiple customers in the accounts that it maintains with its banks and custodians but credits individual customers with their respective shares of such funds.

each case with account names that clearly identify the funds therein as belonging to the FCM's customers in the applicable account class and show that the funds are segregated as required by the Customer Property Rules for the account class. As used in this summary annex, "**segregated account**" means, with respect to either US futures or cleared swaps, an account maintained by the FCM with an individual depository to hold segregated funds for the benefit of customers in the applicable account class, and "**segregated funds account**" means, with respect to each account class, all segregated accounts (on a combined basis) maintained by the FCM with all depositories that hold segregated funds in respect of the account class.

1.15 The respective Customer Property Rules for US futures and cleared swaps result in what US federal courts (both district and appellate) and the CFTC have described as a "technical trust" or "specific statutory trust" over all the customer funds held by the FCM for the benefit of its customers in the applicable account class, as well as any proprietary funds contributed by the FCM to the segregated funds with respect to the account class (such customer funds and proprietary funds for each account class, collectively, the "**segregated funds**" for such account class). *See* the S&C Memo, Section VI. The respective statutory trusts for US futures and cleared swaps are established by the CEA and related regulations; they are distinct from the common-law agent-trustee relationship described above, under which the FCM carries customer contracts. Moreover, the statutory trusts are not common-law trusts, and not subject to common-law fiduciary legal principles. Although similar to a common-law "resulting trust,"[18] the scope of the statutory trusts, and the duties of the FCM with respect to the customer funds, are determined by the Customer Property Rules for the applicable account class.

1.16 The distinction between the nature of the specific statutory trusts and a common law trust is exemplified by several actions that the FCM may take under the respective Customer Property Rules for US futures and cleared swaps, but that generally would not be permitted in relation to a classic common-law trust. Several examples demonstrate these differences. First, the Customer Property Rules for each account class permit the FCM to invest customer funds in certain types of permitted investments specified by the CFTC ("**permitted investments**") and retain as its own any resulting income – something that would not be permitted to a common-law trustee.[19] Second, as noted above, the FCM is permitted to commingle customer funds of different customers held in the same account class on an omnibus basis in its segregated funds account for the account class. Third, the FCM, in accordance with the Customer Property Rules for each account class, may deposit and maintain its own funds as a "**residual interest**" in its segregated funds account for the account class as a cushion or buffer to protect against becoming "undersegregated" (*i.e.*, failing at any time to hold funds in such accounts sufficient to meet the CFTC's "**segregation requirement**" for the account class), as discussed in paragraph 1.18. Fourth, and most fundamentally, the FCM is permitted to use the segregated funds that are subject to the statutory trust to satisfy its own obligations to DCOs and other parties in relation to customer contracts – whether for the same or for a different customer – as discussed in paragraph 1.19. *See* the S&C Memo, Section VI.B.

1.17 The primary purpose of the statutory trust, and the Customer Property Rules as a whole, is to ensure that the FCM has sufficient assets, in liquid form, available at all times to satisfy its obligations in respect of its customers' accounts. The segregation requirement was adopted to curb abuses in the handling of customer funds that were common practices by futures commission merchants before the enactment of the CEA. Some commission merchants in the futures markets used customer funds belonging to one customer to extend credit to more favored

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[18] A "**resulting trust**" is a type of trust that arises by operation of law when the actions of the parties indicate that money is transferred to a party with the intention that the money is to be kept or used as a separate fund for the benefit of the payor or a third person. The trust carries out and enforces the inferred intent of the parties. The trustee of such a trust "has no duties to perform, no trust to administer and no purpose to carry out except the single task of holding onto or conveying the property to the beneficiary." *In re Downey Financial Corp*., 499 B.R. 439, 468 (Bkrtcy. D. Del. 2013).

[19] Examples of permitted investments include (i) investments (including by means of reverse repo transactions) of customer funds in the form of cash in various types of highly liquid securities and (ii) sales of customer funds in the form of securities by means of repo transactions. In all cases, the FCM must also segregate the permitted investments that it makes with segregated funds and must bear any losses arising from the investments. This segregation requirement serves to ensure that sufficient value is maintained in segregation or set aside so that it is available at all times to satisfy customer claims, including in the FCM's bankruptcy.

customers or used customer funds for their own proprietary trading. These practices often left FCMs without sufficient resources to satisfy their obligations to their customers in respect of their accounts. Today, segregation is also recognized as a key measure protecting the markets, by ensuring the availability of funds to the FCM when required to comply with its obligations to a DCO in respect of the customer's contracts.

1.18 Under the Customer Property Rules, the FCM must maintain funds in segregation in an aggregate amount at least sufficient to cover the FCM's "total obligations" to all customers in the relevant account class. This amount is equal to the aggregate positive net liquidating equity for every customer in the same account class (without reduction for any customer net liquidating equities that are negative). The funds held in segregation may be the actual funds received from customers or for the customers' account, or may be other funds derived by the FCM from other sources.[20] In addition, to prevent the use of one customer's funds to margin or settle another customer's positions, the FCM must have, for each customer account whose net liquidating equity is insufficient on any business day to cover the margin required for the customer's open positions, a residual interest in its segregated funds account on the following business day in an amount at least equal to the sum of the undermargined amounts of customer accounts in the same account class. Furthermore, the FCM maintains additional funds in segregation (as part of its residual interest) in excess of its total obligations to all customers to protect against becoming undersegregated at any time.[21] If the FCM discovers at any time that it holds insufficient funds in its segregated funds account for an account class to satisfy the segregation requirement or the undermargined amounts requirement for the account class, it must immediately deposit sufficient funds into its segregated funds account to bring the account back into compliance. The FCM may make withdrawals from its segregated accounts for an account class that are made to or for the benefit of customers, as described in paragraph 1.19, but may also make withdrawals for its own proprietary uses to the extent of its residual interest, subject to certain limitations and conditions (including the general limitation that any withdrawal of funds not made to or for the benefit of customers must not result in one customer's funds being used to margin or carry the contracts, or extend the credit, of any other customer or person).

1.19 The Customer Property Rules for US futures and cleared swaps expressly permit the FCM to apply segregated funds maintained in each account class as necessary in the normal course of business to margin, guarantee, secure, transfer, adjust or settle the customer's contracts in such account class with a DCO or another FCM, including to pay commissions, brokerage, interest, taxes, storage and other charges incurred in connection with the customer's contracts ("**permitted uses**"). Other costs and expenses that are chargeable to the customer under the customer agreement but not necessary to the execution or maintenance of its contracts may not be paid directly from segregated funds (because that would reduce the segregated funds available for distribution to other customers whose funds are maintained in the same account class), but they may be charged to the customer account by debiting the cash balance in the customer account ("**chargeable costs**"). By debiting the cash balance, the FCM offsets the customer's obligation to reimburse the FCM for the chargeable costs against the FCM's obligation to repay the cash balance and thereby reduces the customer's net liquidating equity, and with it the customer's interest in the funds held in segregation. This reduction in the customer's interest increases the FCM's residual interest in the segregated funds, thereby permitting the FCM (if it is otherwise fully compliant with segregation requirements) to withdraw the corresponding amount of funds from segregation to reimburse itself the amount of the chargeable costs (provided that the FCM satisfies the conditions and restrictions for withdrawal of residual interest funds). In practice, the FCM may utilize this method in connection with payment of the FCM's commissions and fees payable by the customer to the FCM, as well as reimbursement of amounts paid by the FCM to third parties in respect of the customer's contracts. *See* the S&C Memo, Section VI.B.

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[20] Although cash margin is fungible, such that it would be impossible to determine whether the cash held in segregation is or is not the same cash that the FCM received from, or for the account of, the customer, the same rule applies to non-fungible margin, such as margin in the form of securities. The FCM may hold the actual securities received from the customer in segregation, or may segregate cash with a value equal to that of the securities, in lieu of the securities themselves. *See* note 19.

[21] The FCM is required to establish and maintain a target residual interest that is in an amount that reasonably ensures that the FCM always remains in compliance with the segregation requirement.

Foreign futures

1.20 The Customer Property Rules for foreign futures are parallel to, but are separate from, the Customer Property Rules for customer funds maintained in the other two account classes. They require the FCM to set aside and maintain in one or more "**separate accounts**" funds in an amount, which is denominated as the "foreign futures or foreign options secured amount" (the "**secured amount**"), at least sufficient to cover or satisfy all its obligations to foreign futures customers, which are defined as the full net liquidating equities owed to them by the FCM. The FCM must deposit the secured amount under an account name that clearly identifies the funds as belonging to foreign futures customers and shows that the secured amount is set aside as required by Part 30. The FCM may deposit funds set aside as the secured amount only with permitted depositories, which include banks or trust companies located in the US, banks or trust companies outside the US that have in excess of $1 billion of regulatory capital, registered FCMs or DCOs, FCOs of any foreign board of trade, members of any foreign board of trade, or any such member's or clearing organization's designated depositories. The FCM may hold the secured amount in separate accounts maintained in non-US depositories outside the US only in an amount sufficient to meet margin requirements established by foreign boards of trade or FCOs, or to meet margin calls issued by foreign futures brokers carrying foreign futures of the FCM's customers, together with an additional "prefunding" amount to mitigate operational demands. The FCM is prohibited from using the funds of one foreign futures customer to purchase, margin or settle the contracts of, or to secure or extend credit to, any person other than such customer. As with US futures and cleared swaps, the foreign futures Customer Property Rules have a "permitted uses" provision (set out in CFTC rule 30.7) that expressly permits the FCM to "withdraw funds from [separate accounts] in an amount necessary in the normal course of business to margin, guarantee, secure, transfer or settle [customers' foreign futures positions] with a foreign broker or clearing organization." The Customer Property Rules for foreign futures also require the FCM to maintain a residual interest in its separate account(s)[22] and permit investment of the amounts held in the separate account(s), subject to the FCM accepting liability for losses in a manner similar to the requirements and limitations on the FCM's investment of the funds in a segregated account for US futures or cleared swaps. The FCM may not commingle foreign futures customer funds with its own property, except in accordance with the rules relating to its residual interest in those funds, or with segregated funds maintained in the other two account classes.

1.21 Prior to amendments to the CFTC's Part 30 rules made in 2013, requirements regarding the margin provided by foreign futures customers were substantially less robust than the segregation requirements established by the Customer Property Rules for US futures and cleared swaps, and those established by the 2013 amendments. Among other things, the FCM was required to set aside in separate accounts a secured amount sufficient to cover only the margin required on open positions, plus or minus any unrealized gains or losses on such positions. The FCM was not required to set aside a secured amount sufficient to cover all the FCM's obligations to foreign futures customers (*i.e.*, the positive net liquidating equities of all foreign futures customers). Any customer funds deposited by customers in excess of such amount could be held by the FCM in operating cash accounts and used by the FCM as if they were its capital. Moreover, the FCM was permitted, but was not required, to set aside funds for foreign futures customers if they were not US persons.

1.22 The CFTC did not view the pre-2013 Customer Property Rules for foreign futures as operating to impose a statutory trust over foreign futures customer funds. Instead, the CFTC believed the secured amount under the pre-2013 rules represented a security deposit made by the FCM to secure its obligations to its foreign futures customers and, unlike US futures segregated funds, did not constitute a trust of funds explicitly denominated as belonging to customers.

1.23 However, the 2013 amendments significantly enhanced the protections afforded foreign futures customer funds and extended to foreign futures customers treatment substantially equivalent to the treatment already provided

[22] As used herein, "**separate account funds**" means the funds credited to a separate account, including in respect of the FCM's residual interest.

to US futures customers. The amendments effectively replicated for foreign futures the segregation regimes applicable to US futures (including rights of the FCM, such as the right of permitted uses), thereby contributing to the CFTC's stated goal of having customer protections that are substantially similar across the three account classes. Like the futures and cleared swaps segregation regimes, the new foreign futures customer funds rules required the funds received by or for the account of foreign futures customers to be held in a separate account for the specific purpose of carrying out the customers' business. Based on the current substantial similarities of the three customer property regimes resulting from the 2013 amendments and applying reasoning of courts in cases in which they have found statutory trusts in other regulatory frameworks, the S&C Memo concludes that there is a strong argument that the foreign futures Customer Property Rules operate to establish a separate specific statutory trust over foreign futures customer funds, although no court or regulator has yet specifically confirmed this view. *See* the S&C Memo, Section VII.D.

Implications of Customer Property Rules in respect of customer entitlements

1.24 Under the Customer Property Rules for each account class, the claims of customers for their customer funds, together with the FCM's residual interest, constitute the entirety of the entitlements to the segregated funds or separate account funds of such account class. The FCM's residual interest, as its name implies, is the remainder of the segregated funds or separate account funds of the applicable account class after accounting for the aggregate claims of customers to their customer funds and is subordinated to the interests of the customers. For purposes of the Customer Property Rules for each account class, the extent of each customer's entitlement to the segregated funds or separate account funds is limited to a monetary value equal to its net liquidating equity, which the CFTC views as representing the FCM's total obligations to the customer in respect of such account class.

Margining and operation of the customer account

Example of margining between the FCM and DCOs in respect of US futures and cleared swaps

1.25 When the FCM establishes an open position for the customer in a US future or cleared swap cleared by a DCO, the FCM will be required to satisfy the DCO's initial margin requirement for the position by delivering funds to the DCO to be held in the DCO's account with its depositary.[23] The DCO will credit the funds received from the FCM to the omnibus customer margin accounts for customers of the relevant account class on the books of the DCO. If the open position is closed, the FCM is no longer required to maintain initial margin for it, and unless the funds are needed to margin other positions of any customer in the same account class cleared by the FCM with the DCO, the DCO will return any initial margin it holds with respect to that position to the FCM's segregated account at the settlement bank that it uses in connection with that DCO.[24] Furthermore, the amount of initial margin required with respect to a contract may change over the term of the contract; if that occurs, the FCM will be required to deliver additional funds to the DCO, or will be entitled to receive the return of the now-excess funds from the DCO, on the same basis.

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[23] *See* note 17.

[24] A DCO will calculate initial margin in respect of an FCM's omnibus customer positions account on a "gross" basis equal to the sum of the initial margin amounts that would be required by the DCO for each individual customer within that account as if each customer were a clearing member. However, the DCO and FCM will settle *US futures* initial margin amounts due on the same day on a net basis, such that initial margin amounts due from customers will be netted against initial margin amounts being released by the DCO to other customers. In contrast, *cleared swaps* initial margin amounts are settled on a gross basis. The FCM's customers are divided into those whose initial margin requirements have increased and those whose initial margin requirements have decreased since the prior day, and the FCM must deposit with the DCO the aggregate of the increased initial margin amounts before it is permitted to withdraw the aggregate of the released initial margin amounts.

1.26 In addition, for each open position of the customer in a contract in respect of which the DCO and FCM exchange variation margin amounts,[25] the DCO will (i) at the end of each trading day, mark to market the position and determine a variation margin amount payable by the DCO to the FCM (or by the FCM to the DCO) equal to any trading gains (or losses) in respect of the position for that trading day,[26] (ii) net that variation margin amount with all other variation margin amounts for all other open positions of the customer and all other customers in the same account class cleared by the FCM at the DCO and (iii) at or before the opening of the next trading day, deposit to or withdraw from the FCM's segregated account at its settlement bank the resulting aggregate net variation margin amount. DCOs are authorized to credit or debit variation margin payments from the FCM's segregated account without further action or authorization by the FCM; accordingly, this process occurs without any action by the FCM. Any other DCO clearing open positions of the same customer in the same account class will conduct a similar variation margin settlement process. Because all these debits and credits are made by each DCO to the FCM's segregated funds account,[27] the variation margin amounts credited by one DCO to the FCM's segregated account in respect of the net gains on the customer's open positions with the DCO may be used to satisfy variation margin amounts for which another DCO debits the segregated account in respect of net losses on open positions it clears. The netting of variation margin amounts due to a DCO (in respect of trading losses) and from the same DCO (in respect of trading gains) in respect of the customer's open positions in contracts cleared by the DCO, and the use of variation margin amounts received from one DCO (in respect of net trading gains) and to satisfy variation margin requirements payable to another DCO (in respect of net trading losses) in respect of the customer's open positions in contracts cleared by each DCO constitute permitted uses of customer funds to satisfy the customer's obligations.

1.27 If, at any time at or following the establishment of an open position, the FCM holds insufficient funds of the customer to fully cover the DCO's initial or variation margin requirements, the FCM will be required to use its own funds, whether or not it is then able to obtain additional margin in the requisite amount from the customer.

Example of margining between the FCM and customer in respect of US futures and cleared swaps

1.28 If the customer's net liquidating equity is less than the applicable margin requirement for its customer account, the customer account is undermargined, and the FCM will call for the customer to deposit with the FCM additional funds so that the customer's net liquidating equity at least equals the customer account's initial margin

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[25] The DCO and FCM exchange variation margin amounts with respect to all cleared swaps and US futures contracts, other than options on futures with "equity-style" margining. No variation margin amounts are paid in respect of options with "equity-style" margining prior to the exercise of the options. An upfront premium on an equity-style option is paid from the buyer to the seller (via the DCO) when the option is traded, and the buyer receives a credit net liquidating value ("**NLV**"), equal to the current replacement value of the option, which the buyer can use as collateral to satisfy its initial margin requirements or offset any debit NLV on other equity-style options. Upon receipt of the upfront premium, the seller receives a debit NLV that must be covered by collateral, being either any credit NLV on other equity-style options or cash, securities or other collateral. The value of the NLV – both debit and credit – varies each day with the current fair value of the option. If the option is exercised, the buyer receives the underlying future, and the final NLV becomes the variation margin amount on the resulting futures position. In contrast, for an option on a future with "futures-style" margining, a premium is paid only upon exercise/expiry, not upfront on the trade date, there is no NLV, and variation margin amounts are paid on a daily basis during the life of the option.

[26] Variation margin amounts exchanged by a DCO and FCM in respect of US futures and cleared swaps constitute settlement payments that extinguish mark-to-market exposures as between the DCO and the FCM, rather than transfers of collateral that secure such exposures. As a result, if the FCM pays variation margin to the DCO, the DCO is not obligated to hold the variation margin for the benefit of that FCM in the omnibus customer margin account maintained on its books. However, daily settlement by the FCM and DCO of the variation margin amounts in respect of open positions does not result in the positions being considered settled or closed.

[27] As noted above, the FCM may maintain more than one segregated account; all the segregated accounts (on a combined basis) maintained by the FCM with all depositories that hold segregated funds in respect of the account class are treated as a single fund relating to the relevant account class in which all customers within that account class have an interest. Generally, a DCO will designate a limited number of banks or trust companies that they themselves use as settlement banks and the FCM will pick one on the DCO's list as the FCM's settlement bank for that DCO. To the extent possible, the FCM will typically select a settlement bank that it can use across DCOs in respect of the same account class and currency. For example, the FCM may select the New York branch of a bank for USD and the London Branch of the bank for currencies other than USD.

requirement.[28] When the customer meets the margin call, the funds will be deposited in one of the FCM's segregated accounts for the applicable account class at one of the FCM's settlement banks (or credited to one of the FCM's segregated securities custody accounts, in the case of non-cash funds), and the FCM will credit the customer's deposit to the cash balance (and/or the non-cash margin balance) of the customer account (which will increase the liability of the FCM to the customer and the customer's net liquidating equity claim against the FCM's segregated funds for such account class). The FCM must continue to hold the funds with permitted depositories, as described in paragraph 1.14, which may include the FCM's omnibus customer margin accounts for customers of the relevant account class on the books of one or more DCOs (which may or may not be DCOs through which the FMC has cleared positions for that customer).[29] Each of the cash and non-cash balances in the customer account on the FCM's books represents funds deposited by the customer with the FCM or derived from the customer's contracts, and those balances are not adjusted when the FCM deposits initial margin with a DCO in respect of the customer's contracts as a result of establishing positions in the customer's contracts cleared through the DCO, or when the DCO releases initial margin to the FCM as a result of closing those positions.

1.29 The FCM may call for initial margin from the customer in respect of a position in an amount greater than the amount of initial margin that the relevant DCO requires from the FCM in respect of the position. The FCM will generally maintain the excess margin in its segregated account(s) at the FCM's settlement bank(s), but may also deposit the excess margin with other permitted depositories, including a DCO.

1.30 From the time the FCM establishes an open position for the customer in a contract in respect of which variation margin amounts are exchanged between the FCM and DCO[30] until the position is closed, daily trading gains or losses will increase or decrease the position's open trade equity reflected in the customer account, which will represent the net cumulative (*i.e.*, life-to-date) "unrealized" gain or loss in respect of the position. Unrealized gains and losses will not change the customer's cash balance (notwithstanding the cash payments made between the FCM and the DCO, as described in paragraph 1.25), but will increase or decrease open trade equity (and the customer account's net liquidating equity); increases in open trade equity resulting from unrealized gains in a customer's account represent "settled cash" that can support new trading by that customer.[31] When the position is

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[28] As noted above, a different definition of "net liquidating equity" is used for determining the customer's margining requirement (as opposed to determining the FCM's segregation requirement and the other purposes described above). For purposes of determining when the customer must provide additional margin, the customer's net liquidating equity is equal to the sum of (i) the customer account's "**open trade equity**" with respect to open positions in contracts in respect of which the FCM and DCO exchange variation margin amounts (which include cleared swaps and US futures, other than options on futures with "equity-style" margining (see note 25)), (ii) the customer account's cash balance, (iii) the collateral value of non-cash margin and (iv) if the FCM does not use the "total equity" method for margining, net option value ("**NOV**") of options in respect of which no daily variation margin amounts are exchanged. A "total equity" method FCM, for margining purposes, does not include NOV in net liquidating equity, and changes in NOV instead result in adjustments to the customer's initial margin requirement. Open trade equity represents the net cumulative "unrealized" gains and losses in respect of the customer's positions while they are open (*i.e.*, the open trade equity of an open position as of any date reflects the net cumulative gain or loss in respect of the position for the period from the establishment of the position to such date, as discussed in paragraph 1.30). When the position is closed, the net cumulative gain or loss represented by open trade equity is "realized" by the customer and the position's open trade equity (which may be less than zero) either increases or decreases the cash balance of the customer account (and thereafter is no longer reflected in the account's open trade equity). The cash balance is increased by, among other things, (1) cash deposited by the customer as margin with the FCM, (2) the net cumulative gains realized in respect of the customer's positions with open trade equity when they are closed (which equals the positions' net positive open trade equity immediately prior to their closure) and (3) any other amounts payable to the customer under the customer agreement; and is decreased by, among other things, (A) the net cumulative losses realized in respect of the customer's positions with open trade equity when they are closed (which equals the positions' net negative open trade equity immediately prior to their closure), (B) any permitted withdrawals of excess cash margin from the customer account by the customer and (C) commissions, brokerage fees, taxes, interest and other charges to the account.

[29] *See* paragraph 1.36.

[30] See note 25.

[31] As discussed in paragraph 1.26, the daily settlements of variation margin amounts between the DCO and the FCM acting on behalf of its customers in respect of open positions constitute final settlement of the gains and losses as between the DCO and the FCM. However, because the FCM does not credit the customer account with corresponding cash credits or debits, they do not result in adjustments of the customers' cash balances for purposes of margining or segregation; rather, as between the customer and the FCM, the value to the customer

closed, the cumulative net trading gain or loss reflected in the position's open trade equity will be "realized" and the FCM will credit or debit the cash balance of the customer account by the amount of the position's open trade equity (and thereafter no open trade equity will be reflected in respect of the closed position). In addition, when the position is closed, the aggregate initial margin requirement applicable to the customer account will be reduced by the amount of initial margin the customer was required by the FCM to maintain in respect of the position.

Implications of margining practices and regulations in respect of customer entitlements

1.31 To the extent the customer account's net liquidating equity exceeds the initial margin requirement for the account, taking into account all open positions, such excess margin amount constitutes "**free funds**" available for withdrawal by the customer upon its request. When free funds are disbursed to the customer, the amount of the disbursement is debited from the customer account's cash balance (if cash is disbursed) or the non-cash margin balance (if non-cash margin is returned). Because the customer's entitlement to free funds is determined by reference to its net liquidating equity, the customer never has a claim against the FCM for payment of trading gains in respect of the customer's contracts on a contract-by-contract or gross basis.[32]

Treatment of customer property in the FCM's bankruptcy

1.32 In the event of an FCM's bankruptcy, the "**customer property**" of the FCM would be subject to the special distribution rules established in the commodity broker liquidation provisions of Subchapter IV of Chapter 7 of the US Bankruptcy Code (the "**Code**"), 11 U.S.C. §§ 761-767 ("**Subchapter IV**"), and the CFTC's Part 190 bankruptcy rules, 17 C.F.R. §§ 190.00 *et seq.* ("**Part 190**").[33] Section 761 of Subchapter IV defines "customer property" to mean "cash, a security, or other property, or proceeds of such cash, security, or property, received, acquired, or held by or for the account of the [FCM], from or for the account of a customer," including, among other things, (i) an open commodity contract; (ii) property received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract; (iii) profits or contractual or other rights accruing to a customer as a result of a commodity contract; (iii) specifically identifiable property (as defined below); (iv) a security held as property of the FCM to the extent such security is necessary to meet a net equity claim based on a security of the same class and series of an issuer; (v) property that was unlawfully converted from and that is the lawful property of the estate; and (vi) "other property of the [FCM] that any applicable law, rule, or regulation requires to be set aside or held for the benefit of a customer, unless including such property as customer property would not significantly increase customer property . . . ." Additionally, the CFTC is given very broad statutory authority in Section 20 of the CEA to specify "by rule or regulation . . . that certain cash, securities, other property or commodity contracts are to be included in or excluded from customer property." The CFTC has exercised this authority to further specify in Part 190 that customer property includes, among other things, property that: (1) is segregated for customers on the "**filing**

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of its open positions (including the net value of all historic variation margin amounts between the DCO and FCM) is accounted for as open trade equity. However, because the unrealized gains represent "settled cash" of the customer, the payments of variation margin between the FCM and the DCO result in increases or decreases in the customer's net liquidating equity claim against the FCM, increasing or decreasing the FCM's segregated funds requirement for the applicable account class and the customer's claim against those segregated funds.

[32] Additionally, the CFTC's Rule 1.56 prohibits the FCM from representing in any way that it will, with respect to any commodity interest carried by the FCM for or on behalf of any person: (1) guarantee such person against loss; (2) limit the loss of such person; or (3) not call for or attempt to collect initial and maintenance margin as established by the rules of the applicable exchange. To the extent a provision in a Customer Agreement entitled the customer to gross trading gains and such provision was inconsistent with the prohibitions in Rule 1.56, it would be void.

[33] Enacted by Congress as part of the Bankruptcy Reform Act of 1978, Subchapter IV lays out a high-level framework for bankruptcy liquidations of FCMs (and DCOs) that was based largely on recommendations of the CFTC to address concerns it had with respect to the treatment of customer property in an FCM's bankruptcy. *See Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary*, 94th Cong., 2d Sess. 2377-2420 (1977) (testimony of William T. Bagley, former CFTC Chairman) [hereinafter "***Bagley***"]. Subchapter IV's high-level framework is supplemented by the Part 190 rules, which were promulgated by the CFTC in 1982 to provide more detailed procedures to guide bankruptcy trustees and assist courts in conducting Subchapter IV proceedings in a manner consistent with the Customer Property Rules. *See* A. Corcoran and S. Erwin, *Maintenance of Market Strategies in Futures Broker Insolvencies: Futures Position Transfers from Troubled Firms*, 44 Wash. & Lee L. Rev. 849, 871 (Summer, 1987) [hereinafter "***Corcoran-Erwin***"].

date" (which is the date on which (x) a petition under the Code, or an application under the Securities Investor Protection Act ("**SIPA**"), is filed commencing a proceeding with respect to an FCM, or the Federal Deposit Insurance Corporation ("**FDIC**") is appointed as receiver of the FCM under the Orderly Liquidation Authority); (2) was "received, acquired, or held to margin, guarantee, secure, purchase or sell a commodity contract" that is subsequently recovered by the avoidance powers of the trustee; (3) constitutes current assets of the FCM, including its trading or operating accounts and commodities held in inventory, in the greater of (a) the amount that the FCM is obligated to set aside as its targeted residual interest with respect to each account class and (b) the FCM's obligations to cover debit balances or undermargined amounts as provided in the Customer Property Rules; and (4) is property of the FCM's estate, including its trading or operating accounts and commodities held in inventory, to the extent that the other listed categories of customer property are insufficient to satisfy in full all claims of its "**public customers**," which are all its customers other than its "**non-public customers**," which are its affiliates and insiders who clear through the FCM in its proprietary accounts.

Priority of customer claims to, and the pro rata distribution of, customer property

1.33 Subchapter IV provides for the administration of customer property in an FCM's bankruptcy as property of the FCM's estate and treats the FCM's customers as creditors of the estate, but it also requires the FCM's bankruptcy trustee to distribute the FCM's customer property ratably to the FCM's customers on the basis and to the extent of such customers' allowed net equity claims, and in priority to claims of all other creditors of the FCM, except for certain administrative expenses related to customer property (the "**statutory preference**").[34] Part 190 further specifies the manner in which property of the FCM's estate must be allocated among account classes (including the US futures account class, the cleared swaps account class and the foreign futures account class) and between the

[34] The statutory preference, Subchapter IV's definition of customer property and the CFTC's statutory authority to determine by rule or regulation which property will be included in or excluded from customer property largely track CFTC recommendations intended to address concerns that it had as to whether an FCM's bankruptcy trustee would trace or identify, and grant the FCM's customers a preference to, funds deposited by them to secure or margin their contracts. Prior to Subchapter IV's enactment, the segregation requirements of the Customer Property Rules had no counterpart in US bankruptcy laws and, as a result, the special treatment of customer funds in an FCM's bankruptcy was "open to speculation." *Bagley* at 2378. In the absence of an express statutory preference, the CFTC had argued that a bankrupt FCM should be treated as a trustee of its customer funds and that to the extent such funds could be traced and identified, they could be reclaimed by the FCM's customers. Although bankruptcy trustees did award preferences to customers with respect to customer funds actually held by FCMs in segregation at the time of bankruptcy, the theory under which they did so was unclear, with the preferences based on differing *ad hoc* adaptations of traditional trust law to FCMs or the application of pre-1938 law governing securities broker-dealer bankruptcies (for a description of the treatment of customers of bankrupt broker-dealers prior to 1938, *see* K. Kettering, *Repledge Deconstructed*, 61 U. Pitt. L. Rev. 45, 70 (Fall, 1999) [hereinafter, "***Kettering***"]. Moreover, there was no clear statement of the law. The cases in the area had resulted in vague decisions that did not clearly explain why preferences had been awarded or disallowed and those decisions had not been tested at an appellate level. In the case of customer funds not in actual segregation at the time of the bankruptcy (because, for example, they had been wrongfully diverted from segregation), customer claims to such funds were generally rejected outright, even when such funds were easily traceable, leaving customers without a priority claim and relegated to the status of general creditors. The CFTC also worried more generally that the commingling (permissible under the Customer Property Rules) of customer funds and an FCM's own funds (in the form of its residual interest) could make it much more difficult for a trustee to trace and identify customer funds and that such commingling, together with the FCM's right to invest customer funds and retain the profits therefrom, could result in a trustee finding that the FCM did not hold customer funds in trust for its customers and that they should not be given a preference to customer funds with which the FCM's own funds had been commingled.

Addressing these concerns, the customer property definition "provides a basis for assuring that commodity customers receive priority claims that are coextensive with their ownership interests in funds and property held by the bankrupt FCM as defined by Section 4d(2) of the CEA." Corcoran-Erwin, *supra* note 33, at 874. The definition establishes that "an FCM's improper commingling of commodity customer funds, whether with its own trading accounts or other funds, does not deprive customers of priority claims to such funds wherever they can be found . . . [and] provides a basis for reaching other assets of the FCM to restore customer funds missing from an estate through diversion or other abuse." *Id.* at 875. Moreover, Subchapter IV provides that customer property includes assets of the FCM to the extent that available segregated funds are insufficient to satisfy public customer claims without regard to whether such assets were diverted from segregation, and this result is confirmed by Part 190's specification that customer property includes property of the FCM's estate, including its trading or operating accounts and commodities inventory, to the extent that other enumerated categories of customer property are insufficient to fully satisfy public customer claims. *Id.* As Corcoran and Erwin explain, the customer property framework assures "that difficulties in tracing customer funds will not unfairly disadvantage customers to the benefit of the [debtor FCM's] general creditors, establishing by rule a variation on the presumption drawn from English trust law that 'where a wrongdoer commingles his own funds in a bank account with those of another person and thereafter makes withdrawals from that account, the wrongdoer withdrew his own funds first.'" *Id.*

FCM's public customer class and its non-public customer class (each, a "**customer class**"). Each allocated amount is then treated as a separate estate of the account class and customer class to which it is allocated. Property segregated for a specific account class may be distributed only to customers in that account class (including by means of a transfer of property to a third party on a customer's behalf, return of property to a customer or distribution to a customer of valuable property that is different than the property posted by the customer), and if the customer property for an account class is insufficient to satisfy all the net equity claims of public customers in the account class, such customer property is distributed *pro rata* to the public customers in respect of those claims. Any customer property not attributable to a specific account class, or that exceeds the amount needed to pay allowed customer net equity claims in a particular account class, is distributed to public customers in other account classes so long as there is a shortfall in those other account classes. Non-public customers do not receive any distribution of customer property so long as there is any shortfall, in any account class, of customer property needed to satisfy public customer net equity claims. The *pro rata* distribution principle means that, if there is a shortfall of customer property in an account class, all customers in the account class suffer the same proportional loss relative to their allowed net equity claims. The principle applies to all customers, including those who post as collateral specifically identifiable property.[35]

Bulk transfers of customer contracts and funds that are not specifically identifiable property

1.34 Subchapter IV and Part 190 also contemplate prompt efforts by an FCM's bankruptcy trustee to effect transfers of all or a portion of the FCM's customer property to other FCMs. Although Subchapter IV does not expressly mandate the trustee attempt to effect transfers of customer positions (except, as described below, in the case of contracts that the trustee designates as specifically identifiable property, so long as the value of the contracts does not exceed the customer's *pro rata* share of customer property), Part 190 articulates a policy preference for porting open contracts of the debtor FCM's public customers, along with all or a portion of the customers' account equity. Part 190 requires the trustee to promptly use its best efforts to effect a bulk transfer to one or more transferee FCMs of all eligible customer accounts and customer property held by the debtor FCM for or on behalf of its customers, based on customer claims of record, no later than the seventh calendar day after the "**order for relief**," which is (i) the commencement of a voluntary case under the Code (*i.e.*, the filing of a petition), (ii) the entry of an order for relief in an involuntary case under the Code, (iii) the issuance of a protective decree with respect to the FCM under SIPA or (iv) the appointment of the FDIC as receiver of the FCM under the Orderly Liquidation Authority. To facilitate such transfers, Part 190 authorizes the trustee to conduct the FCM's business on a limited basis, with specific provisions authorizing the trustee's collection of margin from customers and payment of margin to DCOs, foreign futures brokers and other clearing intermediaries for open positions to better assure they remain open prior to transfer. As a general matter, all customer accounts (including accounts with no open contract positions) are eligible for transfer after the order for relief, other than the FCM's own account and customer accounts that are in deficit (*i.e.*, accounts with negative balances). However, Part 190 prohibits any transfer by the trustee if, after taking into account all customer property available for distribution to customers in the applicable account class at the time of transfer, the transfer would result in insufficient remaining customer property to make an equivalent percentage distribution (including all previous transfers and distributions) to all customers in the same account class. Customers whose customer accounts, contracts and funds are included in a bulk transfer have no consent rights with respect to the transferee FCM.[36] Part 190 requires the trustee to liquidate "as soon as practicable under the circumstances" all open contracts in any customer account that is in deficit, or for which any mark-to-market calculation would result in a deficit, or for which a customer fails to meet a margin call made by the trustee within a reasonable time. The trustee must also promptly liquidate any open contracts that have not been transferred by

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[35] As Corcoran and Erwin explain, the *pro rata* distribution requirement "establishes a principle of equal treatment for all customers and effects a proportionate allocation of any shortfall in customer property available for distribution, a standard that accords with established law under the CEA, common law trust precepts, and the bankruptcy principle that 'equality is equity.'" Corcoran-Erwin, *supra* note 33, at 876-877.

[36] Any customer that objects to the selection of the transferee FCM can elect to move its account to another FCM of its own choosing following the bulk transfer away from the bankrupt FCM, as described in paragraph 1.3.

the seventh day following the order for relief (other than open contracts that are specifically identifiable property and are subject to customer instructions to transfer rather than liquidate, as discussed below).

Specifically identifiable property

Return or transfer of specifically identifiable property other than customer contracts

1.34.1 The provisions of Subchapter IV and Part 190 relating to the disposition of a customer's "**specifically identifiable property**" (as described below) establish a method for transferring such property (even if a bulk transfer of the FCM's customer accounts cannot be achieved) that give a customer some control over the disposition of the property, subject to satisfaction of conditions that are intended to ensure that the disposition does not undermine the equity of the ratable distribution of customer property. Subchapter IV refers to, but does not define, "specifically identifiable property." Rather, the CFTC is granted broad authority by CEA Section 20 to provide, by rule or regulation, that "certain cash, securities, other property, or commodity contracts are to be specifically identifiable to a particular customer in a specific capacity . . ." The CFTC has exercised this authority to define specifically identifiable property quite narrowly in Part 190 to mean the following property: (A) any security that as of the filing date is (1) is held for the account of a customer, registered in such customer's name and not transferable by delivery and has a duration or maturity date of more than 180 days or (2) is fully paid, non-exempt and identified on the FCM's books and records as held for or on behalf of the account of a customer for which no open contracts were held in the same capacity; (B) any warehouse receipt, bill of lading or other document of title that as of the filing date can be identified on the FCM's books and records as held for the account of a particular customer and is not in bearer form and is not otherwise transferable by delivery; (C) certain physical delivery property; and (D) certain open contracts in hedging accounts that the trustee elects to treat as specifically identifiable property (as described below in paragraph 1.34.2). If an order for relief has been entered, Section 190.03(c)(1) of Part 190 requires the trustee to use all reasonable efforts to promptly notify any customer whose account includes specifically identifiable property, other than open contracts, which has not been liquidated, that such property may be liquidated on and after the seventh day after the order for relief (or such other date as is specified by the trustee with the approval of the CFTC or the applicable court) if the customer has not instructed the trustee before the deadline specified in the notification to the customer to return the property. If the customer instructs the trustee to return specifically identifiable property, the customer generally must provide "substitute customer property" (consisting of cash or cash equivalents) with a value equal to the property returned. The purpose of this requirement, under which customers must effectively "buy back" their specifically identifiable property by depositing substitute customer property, is to preserve the *pro rata* distribution principle. If the specifically identifiable property consists of securities, but the customer has no open contracts, the customer may request that the trustee purchase or otherwise obtain the largest whole number of like-kind securities (*i.e.*, securities of the same class and series of an issuer), with a fair market value (inclusive of transaction costs) that does not exceed that portion of the funded balance of such customer's allowed net equity claim that constitutes a claim for securities, if like-kind securities can be purchased in a fair and orderly manner.

Transfer of customer contracts that the trustee elects to treat as specifically identifiable property

1.34.2 The trustee has the right, but not an obligation, to treat as specifically identifiable property open contracts of public customers held in hedging accounts designated as such in the FCM's records, after consulting with the CFTC and when practical under the circumstances. In the case of open contracts that the trustee elects to treat as a public customer's specifically identifiable property, Section 190.03(a)(2) of Part 190 provides that the trustee must use reasonable efforts to promptly notify the customer of its determination. If the FCM's books and records reveal a clear preference of the customer with respect to the contracts' transfer or liquidation, the trustee must endeavor, to the extent reasonably practicable, to comply with the preference. If the customer's preference cannot be clearly discerned from the FCM's books and records, the trustee must request instructions from the customer with respect to transfer or liquidation, specify a deadline for providing the instructions and further inform the customer that (i) if it does not provide the instructions by the deadline, the customer's open contracts will not

be treated as specifically identifiable property, (ii) any transfer of the contracts is subject to certain terms for distribution (described below), (iii) absent compliance with any terms imposed by the trustee or the court, the trustee may liquidate the contracts and (iv) providing instructions may not prevent the contracts from being liquidated. If the customer fails to provide the instructions to the trustee by the specified deadline, the contracts will not be treated as specifically identifiable property and they will be subject to bulk transfer or, failing that, to liquidation, as described above in paragraph 1.33. Section 190.09(d)(2) of Part 190 provides that any specifically identifiable contracts that are not required to be liquidated, and are not otherwise liquidated, may be transferred on the customer's behalf, but the customer must first deposit an equivalent value of substitute customer property to ensure full implementation of the *pro rata* distribution principle.[37]

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[37] Subchapter IV's provisions requiring *pro rata* distribution of customer property and facilitating transfers of customer contracts and funds to other FCMs reflect CFTC recommendations to address concerns that it had, prior to the enactment of Subchapter IV, with inequities in the distribution of funds to customers in cases involving inadequate segregation and the ability of customers to port open contracts and supporting margin and thereby maintain hedges (which was of particular importance to smaller customers, such as farmers or other producers of physical commodities, using futures to hedge their positions in the cash markets because they needed to keep their futures positions open as long as their cash positions were open). The CFTC believed that under then current law, only two alternative approaches were available for use by an FCM's bankruptcy trustee to distribute customer contracts and funds.

Strict tracing. Under the first approach, typically employed by trustees prior to the enactment of Subchapter IV, a trustee would, to the greatest extent possible, trace and return all specifically identifiable assets to customers to whom the assets were identified and then make a *pro rata* distribution to all customers of whatever residual remained after the initial distribution. The CFTC viewed this approach as preserving the hedging mechanism because specifically identified contracts and specifically identified funds margining those contracts could be readily transferred to another FCM (so long as the contracts were adequately margined). However, this strict tracing approach frequently resulted in serious inequities in the recovery of margin by (often larger, more sophisticated) customers who deposited margin in the form of securities (which were not considered fungible by the CFTC and were treated as specifically identifiable property returnable directly to such customers) versus (generally smaller, less sophisticated) customers who deposited margin in the form of cash (whose fungible nature often precluded tracing). If an FCM was inadequately segregated at the time of bankruptcy or otherwise not in a position that allowed tracing of all the cash deposited by customers, smaller cash-margin customers might recover only a small percentage of their investments upon the residual *pro rata* distribution while large customers who had posted securities margin could recover their entire investments through the return of specifically identifiable securities. This outcome was exacerbated by the Customer Property Rules in effect at the time, under which FCMs could accept securities as margin from customers but were not allowed to deposit customer securities as margin with DCOs (due to the CFTC's concern that a DCO would have no way of knowing which contracts were margined by a particular customer's securities and could not ensure against an unwitting violation on the prohibition of using one customer's assets to secure another customer's liabilities). Thus, securities posted by customers as margin remained at the FCM and were readily traceable and returned to those customers, while the cash deposited with the DCO was typically exhausted satisfying variation margin calls in the run-up to the FCM's bankruptcy, leaving little cash available to distribute to the FCM's cash customers. The CFTC stated that "the possibility that [an FCM's bankruptcy trustee] may use a strict tracing approach to distribute commodity customers' funds prevents any interpretation [or amendment] of [the Customer Property Rules] to permit a [DCO] to use the net equity in the securities deposited on behalf of one customer to margin or secure the trades of another." *Bagley* at 2395.

Strict pro rata distribution. Under the second approach, the trustee would liquidate and distribute to customers all applicable customer property in a single, strictly *pro rata* distribution. Such strict *pro rata* distribution eliminated the inequities that resulted from strict tracing, but it required the liquidation of all customer property, including the closing out of open contracts. In doing so, it destroyed the hedging mechanism for many customers since it left them with unhedged cash positions and prevented them from re-establishing hedge positions in the futures market until distribution of the FCM's estate.

CFTC recommendations. To address the shortcomings of these approaches, the CFTC recommended a third approach, as a combination of the other two approaches, which the CFTC doubted could be utilized under then current law but believed could both preserve the hedging mechanism and result in an equitable distribution of assets in the event of inadequate segregation. Subchapter IV, as enacted, reflects the CFTC's recommendations, which included, among other things, (i) *pro rata* distribution of customer property based on allowed net equity claims, (ii) a broad grant of authority to the CFTC to define by rule or regulation the customer property specifically identifiable to individual customers, (iii) tracing and return of specifically identifiable property to individual customers to the extent of each customer's *pro rata* share or, in the case of open contracts and corresponding margin, transfer to another FCM to the extent of each customer's *pro rata* share or liquidation upon the instruction or inaction of such customer, (iv) to the extent the value of specifically identifiable property, including open contracts, exceeded the value of a customer's *pro rata* share, opportunity for the customer to deposit sufficient cash to account for the differences and thereby gain the return or transfer of all such specific property. As the CFTC explained to Congress, "This [recommended approach] require[d] the return of specifically identifiable assets to the appropriate customers of the bankrupt without destroying the equity of a *pro rata* distribution, thereby protecting the unique ownership interests of commodity customers in specifically identifiable assets." *Bagley* at 2408.

1.34.3 The CFTC has recently signaled that the treatment of hedging contracts as specifically identifiable property is less likely in future FCM bankruptcies. In 2021, the CFTC amended Part 190 to provide, among other things, that an FCM's trustee has the option, and not an obligation, to designate customer contracts in a hedging account as specifically identifiable property and that to the extent that it elects not to do so, it must treat such contracts the same as other customer property subject to a bulk transfer. In its final adopting release for the amendment, the CFTC explained that giving the trustee this optionality reflected the policy preference to port all positions of all public customers. "Requiring a trustee to identify hedging accounts and provide hedging account holders the opportunity to keep their positions open may be a resource and time intensive process, which the [CFTC] believes could interfere with the trustee's ability to take prudent and timely action to manage the debtor FCM's estate to protect all of the FCM's customers."[38]

Implications of Subchapter IV and Part 190

Administration within the FCM's estate

1.35 Subchapter IV's requirement that customer property be administered in the FCM's bankruptcy proceedings and its characterization of customer property as property of the FCM's estate and of customers as creditors (rather than owners of the customer property) should not be viewed as inconsistent with the Customer Property Rules and the statutory trusts those rules establish.[39] Indeed, Subchapter IV should be considered as providing a clear basis under US federal law for ensuring the efficacy of the Customer Property Rules in an FCM's bankruptcy. Administering customer property as provided in Subchapter IV and Part 190 facilitates a trustee's pursuit of avoidance actions to recover property for distribution to customers and provides a basis for assuring that customers receive priority claims that are coextensive with their ownership interests in property held by the FCM pursuant to the Customer Property Rules.[40] Additionally, the *pro rata* distribution requirement and the customer property transfer provisions assure equality of treatment of all customers and promote customer portability in a manner that could not be achieved through application of the Customer Property Rules alone.

Customer margining

1.36 Because they eliminated the risk that a customer might receive a disproportionate share of the customer funds held by the FCM in its bankruptcy simply because that customer had provided margin in the form of securities, Subchapter IV and Part 190 also allowed the CFTC to modify the Customer Property Rules so that FCMs could repledge customer securities to DCOs to secure the FCM's obligations in respect of customer contracts it clears through the DCO. Today, the FCM has significant flexibility to use an individual customer's securities margin. For example, securities deposited with the FCM as margin by a customer may be deposited by that FCM with a DCO that does not clear the customer's contracts (so long as the contracts at the DCO secured by the customer's securities are in the same account class as the customer's contracts on other DCOs), and the FCM may rehypothecate customer securities margin for cash under repo agreements (but the FCM must maintain such cash in segregation and bears sole responsibility for any losses in respect of the repos).

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[38] 86 Fed. Reg. 19324, 19343 (April 13, 2021).

[39] A similar treatment occurs under SIPA, which governs the liquidation of broker-dealers who carry customer accounts. Under SIPA, cash and securities (except customer name securities delivered to a customer) received, acquired or held by or for the account of a failed broker-dealer from or for the securities accounts of the customer, and the proceeds of any such property, are allocated to customers *pro rata* in accordance with their respective net equities. 15 U.S.C. §§ 78fff-2(c)(1)(B), 78lll(4). This treatment of net equity claims in the bankruptcy of the broker-dealer does not call into question the characterization of the customer's rights prior to the bankruptcy as a property right under applicable law. *See also* note 423.

[40] The Code turns to applicable state or other non-insolvency law, in the first instance, to determine whether property is property of the bankruptcy estate. To the extent that property held by the FCM for customers were viewed as property of the customers under the CEA and applicable state law, it would not be recoverable by the bankruptcy trustee in an ordinary bankruptcy.

Customer Collateral

1.37 Under the terms of the customer agreement,[41] the customer typically grants to the FCM a first priority security interest in, lien on and right of set-off against, all the rights and interests of the customer in respect of the following property, whether at the time of the grant or thereafter existing (collectively, "**Collateral**"):

(i) the customer account, the contracts carried in or credited to the customer account and all rights to payments and deliveries in respect of such contracts;

(ii) all cash, securities and other property credited to or held in the customer account (including any such property that is held by any DCO, FCO, foreign futures broker or other person acting for or on behalf of any of the foregoing);

(iii) all other property of the customer received, acquired or held by or for the FCM or any DCO, FCO, foreign futures broker or other person acting for or on behalf of any of the foregoing, or due or deliverable to the FCM or customer (including amounts due from any DCO, FCO, foreign futures broker or other person acting for or on behalf of any of the foregoing), in respect of the customer account or the customer's contracts; and

(iv) all proceeds of the foregoing.

1.38 This security interest secures all liabilities of the customer to the FCM under the customer agreement. It may also secure liabilities of the customer to the FCM other than under the customer agreement. Furthermore, like any security interest, the security interest serves the additional purpose in the US of preventing third parties from gaining an intervening interest, or otherwise interfering, in the customer's contracts or other property credited to the customer account.

The customer account and customer contracts

1.39 Under the New York Uniform Commercial Code (the "**UCC**"), a customer's US futures account and foreign futures account are categorized as a "commodity account" maintained for the customer, which is "commodity customer," by the FCM as the customer's "commodity intermediary," and the US futures and foreign futures carried in the customer account constitute "commodity contracts" (as each such term is defined in Article 9 of the UCC).[42] If the FCM and customer elect to treat the customer's cleared swaps as "financial assets," and the customer account constitutes a "securities account" maintained for the customer by the FCM as the customer's "securities intermediary," then the indirect holding provisions in Part 5 of UCC Article 8 apply, and when the FCM credits cleared swaps to the customer account, the customer obtains, and is treated as an "entitlement holder" of, "security entitlements" to such cleared swaps (as each of those terms is defined in the indirect holding provisions of Article 8 of the UCC).[43] Commodity contracts and security entitlements are types of "investment property" and are not

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[41] Even prior to the adoption of the relevant provisions of the UCC, an FCM generally was viewed as having a common-law "broker's lien" on its customers' accounts and any property credited to those accounts.

[42] A "**commodity account**" is defined in UCC Section 9-102(a)(15) as "an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer." A "**commodity contract**" is defined in UCC Section 9-102(a)(15) as a "commodity futures contract, an option on a commodity futures contract, a commodity option, or another contract if the contract or option is (A) traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to federal commodities laws; or (B) traded on a foreign commodity board of trade, exchange, or market, and is carried on the books of a commodity intermediary for a commodity customer." A "**commodity intermediary**" is defined in UCC Section 9-102(a)(17) to include a person that "is registered as a futures commission merchant under federal commodities laws," and "**commodity customer**" is defined as a "person for which a commodity intermediary carries a commodity contract on its books."

[43] ***UCC Article 8***. The indirect holding provisions of Article 8 of the UCC set out rules that govern how interests in securities and other financial assets that persons indirectly hold through intermediaries are evidenced and transferred. Holding financial assets indirectly means that ownership of the financial assets is evidenced by book entries in accounts maintained by securities intermediaries for their customers.

See R. Hakes, *UCC Article 8: Will the Indirect Holding of Securities Survive the Light of Day*, 35 Loy. L.A. L. Rev. 661, 664 n.2 (2002) [hereinafter ***Hakes***].

Financial asset. A "**financial asset**" is defined in UCC Section 8-102(9) to include a security, as well as "any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under . . . Article 8" and so long as the UCC does not prohibit the treatment of the type of property in this manner. In this regard, UCC Section 8-103(f) provides that a "commodity contract" as defined in UCC Section 9-102(a)(15) is not a "security" or a "financial asset" as defined in UCC Article 8. Accordingly, because futures are commodity contracts, they may not be treated as financial assets. Cleared swaps, however, do not meet the definition of "commodity contract" (because they are not traded on boards of trade or exchanges) and they are not otherwise precluded from treatment as financial assets, and FCMs and their customers typically agree in Customer Agreements that the customers' cleared swaps will be treated as financial assets.

Securities account maintained by securities intermediary. In order for any financial asset to be subject to the indirect holding provisions in Part 5 of Article 8, the financial asset must be held in a securities account maintained by the FCM as a securities intermediary of the customer, and this is the case regardless of whether the financial asset is a security or is some other type of property, such as a customer's cleared swaps, that the parties affirmatively elect to treat as a financial asset. A "**securities account**" is defined in UCC Section 8-501(a) as "an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights comprising the financial asset." UCC Section 8-102(14) defines a "**securities intermediary**" to include "a person, such as a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity."

Customer account – a hybrid account. A customer's futures, cleared swaps and securities and cash margin will all be credited to the customer account, which is viewed by the parties as a "commodity account." This raises the question, given that futures are commodity contracts credited to a commodity account and cannot be financial assets credited to a securities account, of whether the customer account can be both a commodity account and a securities account. In this regard, the S&C Memo concludes that "[t]here is no reason under the UCC that a single account cannot be a 'hybrid' account addressed by both the commodity account and securities account provisions of Article 9 of the UCC." *See* S&C Memo at 80-81.

Security entitlement. When a financial asset (whether a security or any other financial asset, such as a cleared swap, that the parties have elected to treat as a financial asset) is credited to the customer account, and the customer account constitutes a securities account maintained for the customer by the FCM as its securities intermediary, the customer acquires, and becomes an "entitlement holder" of, a "security entitlement" to the financial asset. UCC Section 8-102(17) defines a "**security entitlement**" as "the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5 [of Article 8, which contains Article 8's provisions on security entitlements]." An "**entitlement holder**" is defined in UCC Section 8-102(7) as "the person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary."

Nature of security entitlement. Official Comment 1 to UCC Section 8-503 makes it clear that "[a] security entitlement is not a claim to a specific thing; it is a package of rights and interests that a person has against the person's securities intermediary and the property held by the intermediary." The rights that are part of a security entitlement are the entitlement holder's rights under UCC Sections 8-505 through 8-508, which are the provisions that set out the duties of an intermediary to see to it that an entitlement holder receives all of the economic and corporate rights that comprise the financial asset. These duties include, among other things, duties to obtain and pass through to the entitlement holder payments and distributions in respect of the financial asset, to exercise ownership rights with respect to the financial asset on behalf of the entitlement holder if directed to do so by it, to obtain and maintain the financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset and to comply with entitlement orders and directions of the entitlement holder.

Pro rata property interest. A customer's property interest with respect to a particular financial asset is a *pro rata* property interest in all interests in that financial asset held by the FCM as a securities intermediary for all its customers that have security entitlements to that financial asset. UCC Section 8-503(a) states, "To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders . . . ." UCC Section 8-503(b) adds that "[a]n entitlement holder's property interest with respect to a particular financial asset . . . is a *pro rata* property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the securities intermediary acquired the interest in that financial asset." Official Comment 1 explains that "[UCC Section 8-503(b)] makes clear that the property interest described in [UCC Section 8-503(a)] is an interest held in common by all entitlement holders who have entitlements to a particular security or other financial asset . . . [and] all entitlement holders have a *pro rata* interest in whatever positions in that financial asset the intermediary holds."

Issue-by-issue basis. Official Comment 1 to UCC 8-503 further specifies that "[a]n entitlement holder's property interests under this [Section 8-503] is an interest with respect to a specific ***issue*** of securities or financial assets." [Emphasis added.] "For example," Official Comment 1 states, "customers of a firm who have positions in XYZ common stock have security entitlements with respect to the XYZ common stock held by the intermediary, while other customers who have positions in ABC common stock have security entitlements with respect to the ABC common stock held by the intermediary." Hakes explains:

> Subsection 8-503(b) describes the entitlement holder's property interest in a financial asset as a '*pro rata* property interest' in all interests in that financial asset held by the securities intermediary. Although it is not explicitly stated, the *pro rata* interest is implicitly limited

"general intangibles" as those terms are defined in UCC Article 9.[44] As such, the FCM's security interest in them may be perfected by control, which it has automatically by virtue of its status as commodity intermediary with

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to the amount of the financial asset credited to the securities account. In other words, if the security entitlement is to 100 shares of IBM stock and the securities intermediary holds 100,000 shares of IBM stock, the security entitlement is a 1/1000 interest in each share of IBM stock held by the intermediary. It is important to note that this *pro rata* interest extends to financial assets acquired by the securities intermediary before the entitlement holder acquired the security entitlement as well as to those acquired thereafter. Thus, the fungible bulk in which an entitlement holder has a *pro rata* interest regularly changes. This *pro rata* interest in the fungible bulk of a particular financial asset, however, is not a claim to a specific asset held by the financial intermediary.

Hakes, *supra*, at 688. Both the examples provided by Official Comment 1 to UCC Section 8-503 and by Hakes suggest a customer holds a property interest only in cleared swaps that the FCM clears on behalf of the customer. Neither example suggests that the customer has a property interest in *all* cleared swaps of *all* customers of the FCM, including cleared swaps that are not cleared on behalf of the customer. The conclusion that a customer has property interests only in cleared swaps cleared on its behalf comports with Kettering's observation that "[the indirect holding provisions of UCC Article 8] provide that each customer . . . of a securities intermediary has a proportionate property interest in financial assets held by the intermediary for the customer's account (determined on an issue-by-issue basis, rather than by throwing all securities into a single pot as per the model of former [and current statutes governing the liquidation of bankrupt securities brokers])." Kettering, *supra* note 34, at 107.

Enforcement of entitlement holder's property interest. Official Comment 2 to UCC Section 8-503 states, "Although [UCC Section 8-503] recognizes that the entitlement holders of a securities intermediary have a property interest in the financial assets held by the intermediary, the incidents of this property interest are established by the rules of Article 8, not by common law property concepts." Article 8 provides that the property interest included in a security entitlement may be enforced against the intermediary only by the entitlement holder's exercise of its rights against the securities intermediary arising from its duties under UCC Sections 8-505 through 8-508. Additionally, the entitlement holder can look only to its intermediary for the performance of these duties. Official Comment 2 to Section 8-503 states, "The entitlement holder cannot assert rights directly against other persons, such as other intermediaries through whom the intermediary holds the positions, or third parties to whom the intermediary may have wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the wrongdoing [and the intermediary is in insolvency proceedings]." Creditors of a debtor entitlement holder are similarly precluded from "looking through" the holder's securities intermediary (UCC Section 8-112(c) states, "The interest of a debtor in a security entitlement may be reached by a creditor only by legal process upon the securities intermediary with whom the debtor's securities account is maintained . . . .").

Insolvency of securities intermediary. Official Comment 1 to Section 8-503 makes it clear that if a securities intermediary is insolvent, applicable insolvency law, and *not* Article 8, will determine how its assets are to be distributed. Official Comment 1 states:

> Although [UCC Section 8-503] describes the property interest of entitlement holders in the assets held by the intermediary, it does not necessarily determine how property held by a failed intermediary will be distributed in insolvency proceedings. If the intermediary fails and its affairs are being administered in an insolvency proceeding, the applicable insolvency law governs how the various parties having claims against the firm are treated. For example, the distributional rules for stockbroker liquidation proceedings under the [Code and SIPA] provide that all customer property [protected by the SEC's customer protection regime] is distributed *pro rata* among all customers in proportion to the dollar value of their total positions, rather than dividing the property on an issue-by-issue basis. For intermediaries that are not subject to the [Code and SIPA], other insolvency law would determine what distribution rule is applied.

As discussed above in paragraphs 1.32 through 1.36, in the case of an FCM's bankruptcy, the distribution of its customer property, including financial assets, such as cleared swaps, that it holds for its customers as their securities intermediary under Article 8, would be governed by Subchapter IV and Part 190; the property would be distributed *pro rata* among all customers in proportion to their allowed net equity claims.

US Federal book-entry security regulations. To the extent that securities credited to the customer account consist of bills, notes and bonds issued by the U.S. Treasury Department or securities issued by government-sponsored enterprises such as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, US federal regulations may supersede the UCC with respect to certain matters. Such regulations define and use the terms "security entitlement" and "securities intermediary" in a manner that parallels the corresponding definitions in Article 8. *See* Section X of the S&C Memorandum.

Hague Convention. Section X of the S&C Memo discusses the treatment of a customer's futures and cleared swaps as "securities" within the meaning of the Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, July 5, 2006, 46 I.L.M. 649 (the "**Hague Convention**"). If applicable, the Hague Convention specifies the choice of law to govern certain aspects relating to the attachment and perfection of the security interest. The S&C Memo addresses those matters under New York law. The status of the cleared swaps as "securities" under the Hague Convention will be determined by the provisions of that treaty, whether or not the FCM and the customer make a financial asset election with respect to the customer's cleared swaps. The S&C Memo explains that the Hague Convention defines "securities" to include not only "shares" and "bonds," but also "other financial instruments or financial assets (other than cash), or any interest therein," and that while the Hague Convention does not define "financial instruments" or "financial assets," the *Explanatory Report on the Hague Convention on the Law Applicable to certain Rights in Respect of Securities Held with an Intermediary* "states that exchange-traded financial futures and options, and credit derivatives, '[c]learly fall[] within the definition.'" S&C Memo at 83.

[44] UCC Section 9-102(a) defines "**investment property**" as "a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity contract." "**General intangible**," as defined in UCC Section 9-102(a), is a residual

respect to the customer's futures and as securities intermediary with respect to the customer's cleared swaps. If the FCM has control of all security entitlements or commodity contracts carried in a securities account or commodity account, the FCM has control of the securities account and the commodity account and its security interest in each of them is perfected by virtue of such control.

Cash Collateral

1.40 Section X of the S&C Memo discusses different ways by which the FCM may perfect its security interest in the customer's Collateral consisting of cash (which may represent cash deposited by the customer with the FCM as margin, as well as cash accruing to the customer as a result of its futures or cleared swaps). The S&C Memo observes, as an initial matter, that under the common law upon which the FCM-customer relationship is based, the commingling of customer funds on an account class basis by the FCM converts the customer's property interest in its cash margin to a debt claim against the FCM for its repayment of the cash, which may be set off against amounts owed by the customer to the FCM, including amounts to indemnify or reimburse the FCM for trading losses. Additionally, as a consequence of the Customer Property Rules relating to permitted uses and the operation of the three statutory trusts, the FCM generally need not rely upon its security interest in order to utilize the customer's cash to satisfy obligations to DCOs and foreign futures brokers arising in the course of liquidating the customer account.

1.41 Nevertheless, it is market practice for the FCM to perfect its security interest in the customer's rights and interests in respect of Collateral consisting of cash, and there are several methods by which it may do so.

1.41.1 Cash margin delivered to the FCM is initially deposited in a segregated account or separate account of the FCM maintained with its settlement bank. For purposes of the UCC, given that the cash is subject to immediate withdrawal by the FCM, the segregated account or separate account constitutes a "deposit account," and the FCM may perfect its security interest in the cash pursuant to the UCC's rules applicable to deposit accounts. Those rules specify that perfection of a security interest in a deposit account may be achieved by obtaining control over the deposit account, which the FCM obtains by virtue of the fact the segregated account or separate account is maintained by the FCM's settlement bank in the name of the FCM. Perfection of the FCM's security interest in cash would cease when the cash is disbursed from the segregated account unless the FCM's control is maintained in some. However, when the cash is transferred to the FCM's omnibus customer margin account at a DCO or the FCM's account at a foreign futures broker, the DCO or foreign futures broker, by crediting the cash margin to the FCM's omnibus customer margin account, acknowledges that it controls the funds on behalf of the FCM, thereby granting the FCM control over the funds while credited to that account.

1.41.2 Furthermore, by perfecting its security interest in the customer's US futures account or foreign futures account, each of which, as noted above, is a commodity account under the UCC, the FCM should perfect its security interest in all cash balances credited to the account, without further action. Official Comment 4 to UCC Section 9-108 states that "given the broad definition of 'securities account' . . . a security interest in a securities account also includes all other rights of the debtor against the securities intermediary arising out of the securities account [including] credit balances due to the debtor from the securities intermediary, whether or not they are proceeds of a security entitlement." Thus, the UCC acknowledges, in the case of a securities account, that cash balances credited to that account are an indivisible part of that account, perfection of a security interest in which is achieved when the security interest in the securities account is perfected. There is no reason that the same analysis would not apply to a commodity account.

1.41.3 If the FCM and customer elect to treat the customer's cleared swaps account as a "securities account" in respect of which the FCM acts as the customer's "securities intermediary" and they further elect to treat

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category of personal property that is not included in the other types of collateral (including investment property) defined in UCC Article 9. If, for some reason, the FCM and its customer did *not* make a financial asset election with respect to cleared swaps, then the customer's cleared swaps would be "general intangibles" under the UCC.

all cash credited thereto as a "financial asset," the customer will obtain a security entitlement to the cash and the FCM's security interest in such security entitlement will be perfected as long as the FCM has control over the account (as described in paragraph 1.39). If the FCM and customer elect to treat the cleared swaps credited to the customer's cleared swaps account as financial assets credited to a securities account maintained by the FCM as the customer's securities intermediary, but the parties do not make a financial asset election with respect to cash credited to the account, it is arguable that by obtaining control over the account and perfecting its security interest in the account, the FCM should perfect is security interest in all cash credited to the account as described in paragraph 1.41.2.

Securities Collateral

1.42 If the customer delivers margin in the form of securities, the FCM will credit the securities to the customer account, and if the customer account constitutes a securities account maintained for the customer by the FCM acting as the customer's securities intermediary, the customer will obtain security entitlement(s) to the securities. As the security entitlements are investment property (rather than general intangibles) for purposes of UCC Article 9, the FCM's security interest in them may be perfected by control, which the FCM has automatically by virtue of its status as the customer's securities intermediary.[45] UCC Section 9-314 provides that the security interest remains perfected until the FCM does not have control, *and* the customer is or becomes the entitlement holder; accordingly, rehypothecation or other disposition of the security entitlement does not affect the perfection of the FCM's security interest unless the customer once again has control of the security entitlement.[46]

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[45] Securities held through an intermediary are also "securities" within the meaning of the Hague Convention.

[46] UCC § 9-314(c).

FCM's rights and practices with respect to repledge and rehypothecation. The terms of a base account agreement typically grant the FCM broad rights to repledge, rehypothecate or dispose of the customer's Collateral consisting of securities (although such rights are subject to "applicable law," including the Customer Property Rules, which require the FCM to segregate or set aside any proceeds from rehypothecating or disposing of the securities). Base account agreements also typically provide that the FCM is under no obligation to return to a customer the same securities it deposited as margin (*e.g.*, a security with the same ISIN/CUSIP number), but the FCM may agree to provide equivalent securities, if practicable. For example, if the customer deposited with the FCM 5-year US Treasuries, the FCM would endeavor to return 5-year US Treasuries if practicable, of the same aggregate value but not necessarily the same ISIN/CUSIP. Additionally, under the Customer Property Rules, when the FCM makes its daily computations of the amount of US futures customer funds required to be in Segregated Accounts, it is required, as a condition to offsetting any net deficit in a customer's futures account against the current market value of readily marketable securities credited to the account, to maintain a security interest in the securities "including a written authorization to liquidate the securities at the [FCM's] discretion." CFTC Rule 1.32(b). As noted in paragraph 1.36, the Customer Property Rules also permit the FCM to repledge customer securities margin to DCOs as margin to secure the FCM's obligations to the DCOs in respect of customer contracts cleared through the DCOs and afford the FCM significant flexibility to repledge a customer's securities margin to a DCO that does not clear the customer's contracts and to rehypothecate customer securities for cash in repo agreements.

When a customer deposits securities margin with the FCM, the customer will cause its securities intermediary to transfer the securities to the FCM's securities intermediary, which will credit a securities entitlement to the securities to the FCM's own securities account maintained by the intermediary. The FCM will also credit a securities entitlement to the securities to the customer account it maintains for the customer, which is a securities account maintained for the customer by the FCM as its securities intermediary to the extent that it relates to assets other than commodity contracts. If the FCM repledges the securities to a DCO, the FCM will cause the FCM's securities intermediary to transfer the securities to the DCO's securities intermediary, but the FCM will not debit the securities from the customer account. As a result, an imbalance may be created between the securities of a particular issue that are credited to the FCM's securities account maintained at the FCM's securities intermediary and the securities of that issue that are credited to the FCM's customer accounts. However, securities repledged to the DCO are held in segregation by the DCO and they continue to constitute segregated funds of the FCM. Similarly, if the FCM rehypothecates customer securities margin (*e.g.*, by means of repo transactions), the FCM will cause its securities intermediary to transfer the securities to the relevant transferee (or its securities intermediary) but the FCM will not debit the securities from the customer accounts. Similar to a repledge, the rehypothecation may create an imbalance between the securities of a particular issue credited to the FCM's securities account at its securities intermediary and the securities of that issue credited to its customer accounts. In contrast to repledged securities, however, the rehypothecated securities will not continue to constitute segregated funds of the FCM. But, as described in note 19, the FCM is required by the Customer Property Rules with respect to permitted investments to maintain the proceeds of the rehypothecation in segregation to ensure that there is sufficient value in the FCM's segregated funds to cover all customer claims, including in the FCM's bankruptcy.

2 Legal relationships between FCM, customer and DCO (or foreign futures broker) post-customer default and the customer account liquidation process

2.1 As noted in paragraph 1.11, the FCM holds the customer's contracts as agent-trustee under the direction of its principal, the customer, subject to and in accordance with the customer agreement. When the customer defaults (including upon an insolvency), the FCM is no longer obliged to follow the customer's instructions[47] and is permitted to act in its own interest. In essence, the FCM is no longer bound to act as agent of the customer, although it continues to hold the contracts in trust for the customer and the customer funds in accordance with the Customer Property Rules. The FCM may close out or otherwise liquidate the customer's contracts and liquidate any related margin or Collateral, as described below. Although the FCM's right to take these actions arises out of the same contract (the customer agreement) that establishes the agency relationship, the FCM does not take these actions as the customer's agent. Rather, the FCM exercises the authority given to it under the CEA, the contractual rights given to it in the customer agreement, the relevant DCO rules (or the clearing agreement between the FCM and its foreign futures broker) and the common law of agency, to protect itself from the liabilities and losses that it would otherwise suffer as a result of having entered into the contracts and acted as the customer's agent. In doing so, the

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Repledge and rehypothecation and FCM's duties as securities intermediary. The imbalances described above that result from the FCM's repledge and rehypothecation of customer securities would appear, at first blush, to be inconsistent with UCC Section 8-504(a), which imposes upon a securities intermediary a duty to obtain and maintain a financial asset "in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset." However, UCC Section 8-509 additionally provides that if a duty of a securities intermediary under Part 5 of Article 8, including a duty under UCC Section 8-504, is the subject of some "other statute, regulation, or rule, compliance with that statute, regulation, or rule satisfies the duty." As the Official Comment to UCC Section 8-509 explains:

> [UCC Article 8] is not a comprehensive statement of the law governing the relationship between . . . securities intermediaries and their customers. Most of the law governing that relationship is the common law of contract and agency, supplemented or supplanted by regulatory law. [UCC Article 8] deals only with the most basic commercial/property law principles governing the relationship. Although [UCC Article 8 specifies] certain duties of securities intermediaries to entitlement holders, the point [of such specification] is to identify what it means to have a security entitlement, not to specify the details of performance of these duties. For many intermediaries, regulatory law specifies in great detail the intermediary's obligations on such matters as safekeeping of customer property . . . and the like. To avoid any conflict between the general statement of duties in [UCC Article 8] and the specific statement of intermediaries' obligations in such regulatory schemes, [UCC Section 8-509] provides that compliance with applicable regulation constitutes compliance with the duties specified in [UCC Article 8].

The Customer Property Rules constitute such a regulatory scheme. The FCM's compliance with the segregation requirements of the Customer Property Rules (including the requirement to maintain the proceeds of rehypothecation in segregation) satisfies the FCM's duty under UCC Section 8-504(a). Additionally, UCC Section 8-504(b) prohibits a securities intermediary from granting any security interests in a financial asset it is obligated to maintain pursuant to UCC Section 8-504(a), "[e]xcept to the extent otherwise agreed by its entitlement holder." The FCM's repledge of customer securities to a DCO is consistent with its duty under UCC Section 8-504(b) because it is authorized by the customer in its customer agreement. Thus, by complying with the Customer Property Rules and with the Customer Agreement, the FCM abides by its duties as a securities intermediary with respect to a customer's securities margin, including its duties pursuant to UCC Section 8-504.

Repledge and rehypothecation and customer's property interest. Official Comment 3 to UCC Section 9-314 states that "[i]n a transaction in which a secured party who has control grants a security interest in investment property or sells outright the investment property, by virtue of the debtor's consent or applicable legal rules, a purchaser from the secured party typically will cut off the debtor's rights in the investment property or be immune from the debtor's claims." Official Comment 3 continues, "If the investment property is a security, the debtor normally would retain no interest in the security, and a claim of the debtor against the secured party for redemption . . . or otherwise with respect to the security would be a purely personal claim." Official Comment 3 adds that "[i]f the investment property transferred by the secured party is a financial asset in which the debtor had a security entitlement credited to a securities account maintained with the secured party as a securities intermediary, the debtor's claim against the secured party could arise as a part of its securities account notwithstanding its personal nature [and] would be analogous to a credit balance in the securities account [assuming the parties have not made a financial asset election with respect to cash credited to the customer account], which is a component of the securities account even though it is a personal claim against the intermediary . . . ." Kettering, however, posits that an alternative view might be that, following the repledge or sale by the secured party/securities intermediary, the debtor has a security entitlement to the secured party's redemption obligation, which is its personal obligation, to the debtor. *See* Kettering, *supra* note 34, at 219.

[47] The FCM's obligation to follow the customer's instructions is not unconditional even before the customer's default. It is common for Customer Agreements to provide that the FCM may decline to accept customer orders in certain circumstances, *e.g.*, when doing so would result in a breach of a trading or position limit. Furthermore, an agent (including an agent-trustee) may take action to protect itself in the case of its principal's default. The FCM may also be entitled to liquidate the customer contracts in some non-default scenarios.

FCM is entitled to prefer its own interest to that of its customer and to act without seeking customer consent with respect to the self-protective steps it takes.

2.2 As the FCM holds the contracts for the benefit of the customer, the FCM must account to the customer (as the beneficial owner) for all profits and losses (on a net basis) arising out of the contracts. As described in paragraphs 1.19 and 1.20, it is also entitled to reimburse itself for any losses or costs incurred or indemnification rights to which it is entitled out of segregated funds (or separate account funds) pursuant to the CEA and the terms of the customer agreement, consistent with the terms of the applicable statutory trust, including the provisions of the Customer Property Rules that authorize the FCM to use the customer funds held subject to the statutory trust for permitted uses.

Default and remedial provisions

2.3 The base account agreement contains a section identifying one or more events of default (whether or not described in the agreement as "events of default"), the effect of which is to give the FCM the right to exercise remedies in respect of the contracts and customer funds credited to the customer account. In general, those defaults include defaults predicated on (i) the customer's filing under applicable bankruptcy or similar insolvency laws, (ii) the filing of a petition for the commencement of involuntary proceedings in respect of the customer under applicable bankruptcy or similar insolvency laws, which filing results in a judgment of insolvency or bankruptcy or an order for relief, and (iii) the appointment of an administrator, conservator, receiver or similar official in respect of the customer or all or substantially all of its assets. The CDA provides that a default, event of default or other similar condition or event under the terms of the base account agreement gives the FCM the right to exercise remedies in respect of the cleared swaps and cleared swaps customer funds credited to the customer account.

2.4 The base account agreement typically provides that upon the occurrence of an event of default, the FCM has the right to, among other things, (1) close out or otherwise liquidate the customer's open positions in its contracts, and hedge risk incurred by the FCM in connection with such event of default, by any reasonable method, including by means of entering into offsetting contracts, risk-reducing contracts or hedging contracts, and by valuing any contracts entered into by the FCM ("**Position Liquidation**"), (2) treat the customer's obligations to the FCM to be due and immediately payable and net or set off any obligations of the customer to the FCM with or against any obligations of the FCM to the customer, and (3) sell, liquidate or otherwise dispose of the customer's collateral consisting of securities and other non-cash assets and apply the proceeds therefrom to, or net or set off the value of such proceeds with or against, any amounts due from the customer to the FCM ("**Margin Liquidation**").[48] The CDA provides the FCM with comparable remedies upon the occurrence of an event of default. See the S&C Memo, Section XI.

Position Liquidation and Margin Liquidation

2.5 There are multiple Position Liquidation methods available to the FCM to close out or otherwise liquidate the customer's open positions in futures or cleared swaps contracts. Each of the methods seeks to "remove" or "close out" the position from the relevant omnibus customer positions account (whether at a DCO or FCO).

2.5.1 For example, subject to DCO or FCO rules and operational feasibility, a FCM may close out an open position by:

(i) offsetting it with an equal and opposite contract (an "**offsetting contract**") executed by or on behalf of the FCM (or by the FCM's foreign futures broker upon the instruction of the FCM), which contract may be either (x) directly credited to the FCM's omnibus customer positions account with the DCO (or the foreign futures broker's omnibus customer positions

[48] As used herein, "Margin Liquidation" refers to sale, liquidation or other disposition of the customer's securities or other non-cash Collateral other than the customer's contracts.

account maintained by the FCO) in which the customer's open position is carried or (y) initially credited to the FCM's house account and subsequently transferred to the FCM's omnibus customer positions account resulting, in either case, upon recordation in the omnibus customer positions account, in cancelation of both the original position and the offsetting contract; or

(ii) causing the relevant DCO or FCO to debit or otherwise remove the position from the FCM's omnibus customer positions account (or the foreign futures broker's omnibus customer positions account maintained by the FCO) by book-entry transfer of the position to either the FCM's house account or a third party's account, which in either case may be completed as a single position transfer or as part of a transfer of a portfolio of open positions.

2.5.2 In addition to the close-out methods available to the FCM, some of which are described above, the FCM also may enter into (or cause the FCM's foreign futures broker to enter into) one or more contracts in order to hedge or otherwise manage risks it incurs in connection with the liquidation of the customer account. These hedging contracts may be executed in either the FCM's omnibus customer positions account or the FCM's house account, or the foreign futures broker's omnibus customer positions account maintained by the FCO, in each case, as necessary.

2.5.3 Under all close-out and hedging methods, the FCM must determine the related gains and losses realized and make corresponding debits or credits to the cash balance of the customer account. The Position Liquidation method has implications for the determination of gains and losses realized in connection with the close-out, which may or may not correspond to the value of such positions recorded by the applicable DCO or foreign clearing organization.

2.6 In addition to Position Liquidation, the FCM will exercise its Margin Liquidation rights to liquidate the securities and other non-cash assets credited to the customer account (to the extent necessary to generate cash proceeds to cover any deficit or debit balance). If the non-cash property has been deposited as margin with a DCO, or has been rehypothecated, then the FCM may either retrieve such property by exercising rights of substitution (or closing open positions) and liquidate it, or determine the value of the property by reference to market prices or in some other commercially reasonable manner, and credit the customer for that value.

Legal characterization of Position Liquidation and Margin Liquidation

2.7 In effecting Position Liquidation, the FCM exercises its contractual rights as principal vis-à-vis the DCO under the relevant DCO rules (or the clearing agreement between the FCM and its foreign futures broker), as permitted under the customer agreement. In doing so, the FCM acts as principal in the exercise of its contractual rights under the customer agreement (and in accordance with the terms of the applicable DCO rules or clearing agreement with the foreign futures broker), and not as agent of the customer or pursuant to any power of attorney granted by the customer. This process is also not a foreclosure, and the FCM need not rely on its security interest in the customer's rights and interests in respect of the contracts to effect their close-out or liquidation.[49]

2.8 Similarly, in using customer funds, including the customer's securities and other non-cash margin, to satisfy amounts due to the DCO, or to other parties, in the course of liquidating the customer's contracts, the FCM is exercising its right, granted under the Customer Property Rules, to "withdraw[] and appl[y]" customer funds to "to margin, guarantee, secure, transfer, adjust, or settle the contracts or trades of such customers, or resulting market

[49] In other words, the FCM, as the contractual counterparty to the DCO (or foreign futures broker) under, and the holder of legal title to, the customer's contracts, will exercise contractual rights granted to it by the DCO (or foreign futures broker) to close the customer's open positions in the contracts, which will thereby terminate the customer's beneficial interest in the contracts. However, as noted in paragraph 1.37, the FCM also has a perfected security interest in the customer's rights and interests in respect of the contracts and it could elect to exercise its rights as a secured party under the UCC to enforce the security interest and sell, liquidate or otherwise dispose of the customer's contracts.

positions, with the clearinghouse organization of such contract market or derivatives transaction execution facility or with any member of such contract market or derivatives transaction execution facility." Again, this process is not a foreclosure, and the FCM need not rely on its security interest in the customer funds consisting of securities to effect their liquidation or use them in this manner.[50]

Determination of account

Calculation of (i) a credit or debit balance in respect of each account class within the customer account and (ii) an aggregate credit or debit balance in respect of all account classes within the customer account on a combined basis

2.9 Upon any Position Liquidation, the net cumulative gain (or loss) realized with respect to each position in the customer's contracts, and any related payments to or from the customer account, will increase (or decrease) the customer's cash balance. Upon any Margin Liquidation, as the customer's securities and other non-cash assets are liquidated, or the value of such non-cash assets credited to the customer account is determined, the resulting liquidation proceeds or values will also increase the cash balance. The cash balance will also be increased or decreased by other applicable credits and debits, including credits in respect of close-out amounts paid to the FCM's house account and other amounts due to the customer and debits in respect of amounts payable to the FCM, including chargeable costs, including reimbursements to the FCM for close-out amounts paid by the FCM with its own funds to third parties and other costs and expenses incurred in connection with the FCM's exercise of remedies.[51]

2.10 The FCM will determine a single cash balance based on such debits and credits (the "**Determination of Account**"). A negative cash balance will constitute a debit balance payable by the customer to the FCM. A positive cash balance will constitute a credit balance payable by the FCM to the customer.[52] If the customer account includes only one account class, then there is a single Determination of Account. If the customer account comprises multiple account classes, then there will be a separate Determination of Account for each account class and, unless the customer agreement provides otherwise, the FCM will aggregate or offset the credit balances or debit balances of all account classes to determine a single aggregate credit or debit balance in respect of the customer account.

Legal characterization of the Determination of Account

Contractual accounting

2.11 Consistent with the status of the customer account as a mutual open account, the customer account is established on the basis that the individual debits and credits in the customer account represent a connected series of entries of reciprocal charges and allowances that are not to be considered independently but rather as a continuation of a related series generating a running balance, and that upon the liquidation and closing of the customer account, the final cash balance in the customer account constitute a single indivisible debt claim by one

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[50] Although the FCM may effect Margin Liquidation pursuant to the authority granted to it under the Customer Property Rules and the customer agreement, the FCM may also exercise its rights as a secured party under the UCC, enforce its security interest in the customer's rights and interests in respect of collateral consisting of securities and other non-cash assets and sell, liquidate or otherwise dispose of that collateral in a commercially reasonable disposition (UCC § 9-610(a), (b)), and may itself purchase (or "buy in") the collateral at a public disposition or, if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations, at a private disposition (UCC § 9-610(c)).

[51] Any funds received from a DCO or other parties in connection with Position Liquidation or Margin Liquidation must be held in accordance with the Customer Property Rules. As discussed in paragraph 1.19, the Customer Property Rules expressly permit the FCM to apply such funds to permitted uses, including to guarantee, transfer and settle the customer's contracts.

[52] Section 7 of the CDA, which covers events of default and remedies, sets out how a "net termination amount" would be calculated. However, the events of default and remedies section in a base account agreement will typically not specify how the cash balance is calculated when the customer's futures account is liquidated (because the process for that calculation would presumably be part of the operation of the customer account inferred from the course of dealing between the parties prior to the customer's default, industry practice and applicable law, including the margining standards). See paragraphs 1.28 through 1.31.

party against the other, as discussed in paragraph 1.6. Accordingly, the FCM's Determination of Account may be viewed as merely an accounting procedure to ascertain what that debt claim is, by calculating the result of applying the debits and credits made to the customer account cash balance, rather than the set-off of independent obligations to bring about a single debt claim. This characterization would apply both to the calculation of the final cash balance for each account class within a customer account, and to the calculation of the final cash balance for all the account classes on a combined basis.[53]

Enforcement of the FCM's security interest in the customer's Collateral, netting and set-off

2.12 Alternatively, the FCM could achieve a final Determination of Account pursuant to its right to enforce its security interest in the credits made to the customer account to satisfy the customer's obligations in respect of the debits made to the customer account, or by exercising its rights of setoff or netting, or some combination of these remedies. As noted in paragraph 2.4, all of these are available remedies under the customer agreement and the customer agreement provides that that these remedies are cumulative and not exclusive and that the FCM is entitled to elect the remedy or remedies it uses.

2.13 As noted in paragraph 1.37, the FCM is granted a security interest in the customer Collateral, which includes any cash credited to the customer account (including the customer account's credit balance payable to the customer). The FCM may enforce that security interest to apply trading gains against trading losses or other chargeable costs, to apply the aggregate cash balance in the customer account, or the customer accounts relating to the different account classes, to amounts owed to the FCM and to apply credit balances against debit balances across account classes. See the S&C Memo, Section XI.

2.14 The Determination of Account with respect to the customer account could be viewed as involving netting or set-off of the FCM's obligation to account for the net gains on the customer's contracts against the customer's obligations. For example, the realization of cumulative trading gains and losses upon Position Liquidation could be viewed as the determination of the respective obligations of the FCM to pay the trading gains and any other profits derived from its activities on behalf of the customer under the customer agreement against the obligations of the customer to indemnify the FCM against any trading losses or other costs or losses incurred in carrying out that activity. As discussed in paragraph 1.40, deducting any net cumulative loss realized in Position Liquidation could also be viewed as reflecting a set-off of the FCM's obligation to repay the customer the cash balance of the customer account (which may include net cumulative gains realized in Position Liquidation and proceeds from Margin Liquidation) against the customer's obligation to pay the FCM an amount equal to any net cumulative losses as well as any chargeable costs.

2.15 The combination of the cash balances across account classes could also be viewed as contractual set-off. See the S&C Memo, Section XI. Although the permitted uses provisions of the Customer Property Rules support set-off within an account class, at first blush, they would not appear to provide support for set-off of credit and debit balances of different account classes. However, customer agreements authorize FCMs to offset these balances against one another. A debit balance in one account class may be applied as a Chargeable Cost to another account class with a credit balance, thereby reducing the customer's claim to, and increasing the FCM's residual interest in,

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[53] Stated differently, under this characterization, the Determination of Account is the calculation of a running-account balance of all debits and credits to the customer account, which is a determination of the overall value of the single course of dealing between the FCM and the customer represented by the customer account, rather than the set-off of distinct claims arising under separate transactions between the FCM and customer corresponding, on a back-to-back basis, to the contracts between a DCO and the FCM (which would be a structural feature characteristic of principal-to-principal model and inconsistent with the nature of the FCM model as a type of agency model). Additionally, the final cash balance of an account class calculated in the Determination of Account represents the overall position between the FCM and customer with respect to the segregated funds or separate account funds subject to the statutory trust imposed by the applicable Customer Property Rules, and the balance reflects the results of the FCM's withdrawal and application of the segregated funds or separate account funds for permitted uses in connection with its Position Liquidation. As noted in paragraph 2.8, in applying the segregated funds or separate account funds, the FCM is not foreclosing on or enforcing its security interest, or exercising set-off, but rather is acting pursuant to express authority granted it under such Customer Property Rules.

the segregated funds or separate account funds of the account class with the credit balance. In other words, by debiting the customer account for the debit balance of one account class, the FCM reduces the customer's claim against the segregated funds or separate account funds for the other account class, as described in paragraph 1.19.[54]

The question of mutuality if the Determination of Account involves set-off

2.16 The S&C Memo addresses the question of whether the FCM's obligation to treat customer funds (including amounts accruing on any of the customer's contracts) as "belonging to" the customer, or the characterization of the FCM as a "statutory trustee," would prevent the FCM from debiting the customer account of an insolvent customer or setting off customer funds credited to the customer account (including in respect of trading gains) against the customer's payment obligations to the FCM (including in respect of trading losses) because they act in different capacities and the obligations of each to the other are not mutual. This question is posed because under New York law, the general rule is that when a creditor's obligations to a debtor arise from a fiduciary duty or in trust, the creditor may not set off those obligations against obligations of the debtor to the creditor. Such a set-off is generally viewed as inconsistent with the fundamental principle that a fiduciary may never deal for its own profit with the subject matter of its trust. An alternative statement of the grounds for prohibiting the set-off is that if the creditor's obligation is in respect of the debtor's property that the creditor holds "without color of lien," then the debtor's claim is a claim to property that cannot be set off against the creditor's debt claim against the debtor. The S&C Memo concludes the FCM's set-off of customer funds to or against the customer's payment obligations to the FCM should not be prohibited for the following reasons:

2.16.1 Any element of trust in the FCM-customer relationship derives either from the requirements under the Customer Property Rules to segregate or set aside customer funds[55] or from the mere fact that the FCM holds title to the customer's property. To the extent that the applicable Customer Property Rules give rise to a statutory trust for the relevant account class, that statutory trust is – by its own terms – subject to the FCM's right to use customer funds for permitted uses. It is, in fact, specifically intended to ensure that funds are available for those uses. Additionally, the duties and rights of an agent, including an agent that holds title to property of its principal, can be varied by agreement, usage and practice, and by other laws and regulations, such as the Customer Property Rules.

2.16.2 Furthermore, the FCM does have a lien or security interest (under both common law and the customer agreement) in the customer account and any property credited to it. See paragraph 1.37. Under both common law and the customer agreement, as well as under the Customer Property Rules, the FCM has the right, when accounting to its customer, to deduct any advances made from the balance of the account.

2.16.3 Interpreting the fiduciary obligations of the FCM in respect of customer funds to preclude the application of customer funds for permitted uses, or to offset those funds against the customer's obligations to the FCM for permitted uses, would turn the commodities regulatory scheme on its head. In the context of another statutory trust, the Second Circuit Court of Appeals, applying New York law, has held that if a deposit has been made for a particular purpose and would otherwise be available for set-off under applicable state law, a set-off should not be denied on the sole ground that the fund is held under a statutory trust created to protect the depositor's rights in the event no set-off is ever warranted.

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[54] Additionally, it can be argued that the Customer Property Rules permit any excess customer funds held in segregation or set aside for one account class to be applied to any other account class in the context of the customer's default. In the past several years, the CFTC has emphasized the critical role of CFTC Rule 1.56, which prohibits the FCM from guaranteeing its customers against losses arising from trading, in protecting customers generally from fellow-customer risk, and has described the prohibition on guaranteeing as one of its regulations concerned with the protection of customer funds.

[55] In a number of adjudicatory decisions over the years, CFTC staff has stated that the CFTC's view is that upon a futures customer's default, the FCM's duties to the customer under the Customer Property Rules are subject to, and can be superseded by, the FCM's duties to protect the financial positions of itself and its other customers by exercising remedies against the defaulter. This view undercuts the argument that set-off is inconsistent with the FCM's duties under the Customer Property Rules.

ANNEX 2

Instructions

Version 6-12-25

ENFORCEABILITY UPON A CUSTOMER'S INSOLVENCY OR OTHER DEFAULT OF THE POSITION LIQUIDATION, MARGIN LIQUIDATION AND DETERMINATION OF ACCOUNT PROVISIONS OF A CUSTOMER AGREEMENT PURSUANT TO WHICH A US FUTURES COMMISSION MERCHANT CLEARS FUTURES AND/OR CLEARED SWAPS FOR THE CUSTOMER

Dear Sir or Madam:

On behalf of the International Swaps and Derivatives Association, Inc. ("**ISDA**") and the Futures Industry Association ("**FIA**"), I write this letter to request that your firm prepare for ISDA and FIA a legal opinion regarding (1) the enforceability under the laws of [ ] ("**your jurisdiction**") of the Position Liquidation, Margin Liquidation and Determination of Account provisions (collectively, "**remedial provisions**") of a customer agreement (the "**Covered Agreement**") pursuant to which a futures commission merchant (the "**FCM**") registered with the Commodity Futures Trading Commission (the "**CFTC**") clears Futures and/or Cleared Swaps for a customer located in your jurisdiction (the "**Customer**") and (2) the validity, perfection and enforcement of the security interest granted the FCM by the Customer under the Covered Agreement in the Collateral (as defined below).

Capitalized terms used but not defined in this letter have the meanings given such terms in the memorandum of law, dated November 17, 2021, delivered by Sullivan & Cromwell LLP to ISDA/FIA (the "**S&C Memo**"), which provides an overview of the FCM clearing model in Sections I through XI (and which can be found here: Microsoft Word - FIA-ISDA 2021 Memorandum 4829-5794-1199 v.11.docx), and the annex attached to this letter (the "**Summary Annex**"), which provides a high-level overview and summary of the main concepts covered, conclusions reached and certain factual assumptions taken in the S&C Memo. We are providing the S&C Memo and Summary Annex to help you understand the FCM clearing model and applicable US laws and regulations.

If a Customer clears only Futures, the Covered Agreement will consist of a customer account agreement (the "**Base Account Agreement**"). If the Customer clears only Cleared Swaps or both Futures and Cleared Swaps, the Covered Agreement will consist of a Base Account Agreement together with a Cleared Derivatives Addendum substantially in the form published by FIA and ISDA in 2012 or 2018 (either, the "**CDA**"). As each of the Base Account Agreement and CDA has its own remedial provisions, your opinion should address the enforceability of the provisions of each of the Base Account Agreement and CDA that, upon an Event of Default with respect to the Customer, provide the FCM the right to engage in Position Liquidation, Margin Liquidation and a Determination of Account to determine a single balance of account as between the FCM and the Customer. As the FCM's exercise of the remedial provisions may involve the enforcement of the FCM's security interest in the Customer's rights and interests in respect of the Collateral, your opinion should also address the validity, perfection and enforcement of the FCM's security interest. The enforceability of the remedial provisions and the validity, perfection and enforcement of the security interest are of importance to FCMs that clear Futures and/or Cleared Swaps pursuant to Covered Agreements as a matter of both credit risk assessment and considerations of capital adequacy.

In connection with the preparation of your opinion, we enclose for your information the two forms of the CDA referred to above and a redline comparing the two. Your opinion should be based on the assumptions describing a CDA below rather than either published form of CDA, but you may assume that both of these

published forms meet those assumptions. Please note that there is not an industry-standard published form of Base Account Agreement.

Scope of Opinion

Our members have found that it is important (for example, for ensuring the enforceability of the remedial provisions for regulatory capital purposes) that the scope of the opinion be clear and certain, both in terms of the types of transactions covered by the opinion and the types of customers falling within the scope of the opinion.

Covered Transactions/Contracts

As explained above, the types of transactions that may be cleared for the Customer pursuant to the Covered Agreement include US Futures, Foreign Futures and Cleared Swaps (together, "**Covered Transactions**" or "**Covered Contracts**").

We do not describe herein the scope of transactions that may be Futures or Cleared Swaps (other than the requirements reflected in the definitions set out above).

Types of Customers to be Covered in your Opinion

Please indicate the types of Customers covered by your opinion in an appendix to your opinion substantially in the form of Appendix A to this letter. Your opinion should, at a minimum, cover customers falling within the categories "Bank/Credit Institution," "Corporation" and "Investment Firm/Broker Dealer," as described in Appendix A to this letter, and any other categories of entities covered in your netting and collateral opinions with respect to the ISDA Master Agreement and related credit support documents.

Appendix A sets out a series of commercial descriptions. We understand that these descriptions may not correspond precisely to legal categories under the laws of your jurisdiction. Please indicate, therefore, for each Appendix A category covered by your opinion, the precise legal form for each customer type falling within that category that is covered by your opinion. Please include, if relevant, any naming convention or rule that would help a reader of the opinion to identify and classify the entity (for example, the inclusion of a designation in the legal name of the entity such as "S.A.," "N.V.," "A.G.," "S.p.A," "Plc," "Limited" or the like or the mandatory inclusion of a word or words in the name, for example, "Bank" in relation to banks or "Insurance" or "Assurance" in relation to insurance companies).

In relation to each Appendix A category covered by your opinion, if your opinion does not cover all relevant legal forms of customer that are capable of falling within that category in your jurisdiction, please indicate clearly what is excluded. For example, if your opinion covers corporations that fall within the category "Investment Firm/Broker Dealer" but not partnerships that fall within that category, then please indicate that fact.

Finally, we understand that some types of customers may not fall clearly within only one of the category types in Appendix A or otherwise may be difficult to classify. As above, please indicate the precise legal form and any relevant naming conventions or mandatory naming rules for each additional category covered by your opinion.

An example of an entity difficult to classify would be a German Förderbank (development bank), which is owned by the Sovereign (the Federal Republic of Germany) or by a State of a Federal Sovereign (that is, a Bundesbank, such as Nordrhein-Westfalen). Therefore, it would be a Sovereign-Owned Entity. It would

also be a Bank/Credit Institution if its core business involves taking deposits and making loans. An entity type that is difficult to classify should be dealt with in your opinion as an additional category.

It is most helpful if all information relating to customer scope is presented in the appendix to your opinion in table form and the body of the opinion refers to the appendix without a separate discussion of customer scope. If you feel it is necessary to include a discussion of customer scope within the text of the opinion, please carefully reconcile it with the information presented in Appendix A so that the customer scope of the opinion is clear.

Additional customer types covered by your opinion and for which there is no category set out in the standard Appendix A should be added in additional rows to your appendix.

Assumptions

You may assume for purposes of your opinion that the statements contained in this letter, the Summary Annex and the S&C Memo are true and correct.

Additional assumptions you should take for purposes of your opinion are specified below, including in Sections I.A and II.B. If you make any assumptions other than those specified below, please state them explicitly in your opinion.

Instructions Regarding Analysis of Position Liquidation, Margin Liquidation and Determination of Account

As explained in Section XI.A.2 of the S&C Memo and paragraphs 2.3, 2.4, 2.9 and 2.10 of the Summary Annex, upon an Event of Default with respect to the Customer, the remedial provisions of the Base Account Agreement typically provide that the FCM would have a right to, among other things, (1) close out or otherwise liquidate the Customer's open positions in its Covered Contracts, and hedge risk incurred by the FCM in connection with the Event of Default, by any reasonable method, including by means of entering into offsetting contracts, risk-reducing contracts or hedging contracts, and by valuing any contracts entered into by the FCM ("**Position Liquidation**"), (2) treat the Customer's obligations to the FCM to be due and immediately payable and net or set off any obligations of the Customer to the FCM with or against any obligations of the FCM to the Customer and (3) sell, liquidate or otherwise dispose of the Customer's collateral consisting of securities and other non-cash assets and apply the proceeds therefrom to, or net or set off the value of such proceeds with or against, any amounts due from the Customer to the FCM ("**Margin Liquidation**"). In connection with exercising Position Liquidation and Margin Liquidation, the FCM would make a determination of a single balance or net termination amount due from one party to the other in respect of each Account Class and all Account Classes on an aggregate basis (a "**Determination of Account**"). The CDA provides the FCM with comparable remedies upon the occurrence of an Event of Default.

Position Liquidation

The Position Liquidation methods available to the FCM to close out or otherwise liquidate the Customer's open positions in Covered Contracts are described in Section XI.A.2 of the S&C Memo and paragraph 2.5 of the Summary Annex.

Part I Analysis – Position Liquidation by Contractual Enforcement

As explained in Sections XI.A.2 and XI.B.1 of the S&C Memo, the FCM could effect the close-out or liquidation of the Customer's open positions in Covered Contracts credited to the FCM's omnibus customer position accounts at DCOs and Foreign Futures Brokers by exercising its contractual rights under the rules

of such DCOs and provisions of its clearing agreements with such Foreign Futures Brokers that the FCM has by virtue of being the legal owner of, and the party in contractual privity with such DCOs and Foreign Futures Brokers, under the Covered Contracts cleared for the Customer. Additionally, in engaging in such Position Liquidation, the FCM would not act in its capacity as the Customer's agent. Rather, upon the Event of Default, the FCM would be viewed as acting in its principal capacity as it would no longer be required under the Covered Agreement to follow the Customer's instructions and would be permitted to act in its own interest (subject to any requirements of the Covered Agreement, which may require the FCM to act in a commercially reasonable manner). Such Position Liquidation would not be a foreclosure, and the FCM would not need to enforce its security interest in the Customer's rights and interests in respect of the Covered Contracts.

Your responses to questions I.B.2 and I.B.7 in Part I below should analyze Position Liquidation assuming the FCM would seek to characterize itself as (i) effecting the closeout or liquidation of the Customer's open positions by exercising its rights provided to it in the rules of a DCO or the clearing agreement with a Foreign Futures Broker as the legal owner of, and the party in contractual privity with the DCO or Foreign Futures Broker under, the Customer's Covered Contracts and (ii) acting in a principal capacity and not as the Customer's agent in exercising such rights.

In providing your responses to the Part I questions, please confirm whether such characterization would be recognized by a court in your jurisdiction and explain the reasoning for your conclusion. For example, would the FCM's characterization as legal owner of, and the party in contractual privity with the DCO or Foreign Futures Broker under, the Customer's Covered Contracts be subject to recognition by a court in your jurisdiction of the FCM as holding the Covered Contracts as an "agent-trustee," and if that were the case, would such recognition depend upon the court concluding that there would need to be a valid trust under either New York law or the law of your jurisdiction? Could the characterization of legal ownership and contractual privity be viewed as based on an alternative arrangement, such as a commission agency?

Part II Analysis – Position Liquidation by Collateral Enforcement

As noted in paragraph 2.7 of the Summary Annex, the FCM also has a perfected security interest in the Customer's rights and interests in respect of the Customer Account and the property credited thereto, including the Customer's open positions in the Covered Contracts cleared for it, and the FCM could alternatively seek to characterize itself as effecting the close-out or liquidation of the Covered Contracts by electing to exercise its rights as a secured party to enforce its security interest and sell, liquidate or otherwise dispose of the Customer's Covered Contracts.

Your responses to the questions posed in Section C of Part II below should analyze Position Liquidation assuming it is viewed as involving the FCM's enforcement of its security interest to sell, liquidate or otherwise dispose of the Customer's Covered Contracts.

Margin Liquidation

You may assume for purposes of your opinion that Margin Liquidation refers to the sale, liquidation or other disposition of securities only (and not also to any non-cash assets other than securities).

Part I Analysis – Margin Liquidation by FCM's Exercise of its Permitted Uses Rights Under Customer Property Rules

As explained in Sections XI.A.2 and XI.B.2 of the S&C Memo and paragraph 2.8 of the Summary Annex, Margin Liquidation may be viewed as involving the FCM's exercise of its rights under the applicable Customer Property Rules (which have been characterized by US courts and the CFTC as operating to

impose a "statutory" trust over an FCM's Customer Funds) to withdraw and apply Customer Funds for Permitted Uses (the FCM's "**Permitted Uses Rights**"), including to satisfy amounts due to a DCO, or to other parties, in the course of liquidating a Customer's Covered Contracts. This process would not be a foreclosure, and the FCM would not need to enforce its security interest in the Customer's rights and interests in respect of Collateral consisting of securities to effect their liquidation or use them in this manner.

Your responses to questions I.B.3 and I.B.7 in Part I below should analyze Margin Liquidation assuming the FCM would seek to characterize itself as effecting Margin Liquidation based on the exercise of its Permitted Uses Rights under the Customer Property Rules rather than the FCM's enforcement of its security interest in Customer's rights and interests in respect of Collateral consisting of securities.

Your responses should confirm whether a court in your jurisdiction would recognize such characterization and should explain the reasoning for such conclusion. For example, would such recognition be based on the FCM's status as legal owner of the Segregated Funds or Separate Account Funds of the applicable Account Class? Would such legal ownership depend on whether there was a statutory trust over Customer Funds under US law that is recognized as a valid trust under the laws of your jurisdiction?

Part II Analysis – Margin Liquidation by Collateral Enforcement

As explained in Section XI of the S&C Memo and paragraph 2.8 of the Summary Annex, the FCM may also effect Margin Liquidation by exercise of its rights as a secured party to enforce its security interests in the Customer's rights and interests in respect of Collateral consisting of securities and sell, liquidate or otherwise dispose of such securities.

Your responses to questions posed in Section C of Part II below should analyze Margin Liquidation assuming the FCM would seek to characterize itself as effecting Margin Liquidation based on the FCM's enforcement of its security interest in Customer's rights and interests in respect of Collateral consisting of securities rather than the exercise of its Permitted Uses Rights.

Determination of Account

As explained in Sections XI.A.2 and XI.A.3 and paragraph 2.11 of the Summary Annex, a Determination of Account by the FCM may be viewed, consistent with the intention of the parties that the Customer Account constitute a mutual, open and running account, as an accounting procedure to determine a running account balance that does not involve netting or set-off of distinct independent obligations of the parties or the FCM's enforcement of its security interest in the Customer Account or cash credited thereto to bring about a single debt claim of one of the parties. However, if the intention of the parties is not honored, the Determination of Account could also be viewed as involving netting or set-off (of, for example, the respective obligations of the FCM to account for trading gains or to repay the positive cash balance of the Customer Account against the Customer's obligations to pay an amount equal to trading losses and other chargeable costs) or enforcement of the FCM's security interest in the rights and interests of the Customer in the Customer Account or cash credited thereto or otherwise due to the Customer.

Your responses to questions I.B.4 and I.B.7 should analyze Determination of Account assuming the FCM would seek to characterize the Determination of Account either as (i) a determination of a running account balance that is an accounting procedure not involving netting or set-off or enforcement of the security interest or (ii) involving netting or set-off. Would a court in your jurisdiction recognize each such characterization. If a particular characterization would not be recognized or could be challenged for any reason (or such recognition would depend on whether there was a statutory trust over Customer Funds under U.S. law that is recognized as a valid trust under the laws of your jurisdiction), please provide further detail and explain the reason for this.

Your responses to questions posed in Part II below should assume the FCM would seek to characterize a Determination of Account as involving the enforcement of its security interest in the Customer's rights and interests in the Customer Account and the cash credited thereto.

PART I

POSITION LIQUIDATION, MARGIN LIQUIDATION AND DETERMINATION OF ACCOUNT

A. *Additional Assumptions*

1. The FCM and Customer enter into a Covered Agreement (consisting of a Base Account Agreement and CDA) pursuant to which the FCM maintains one or more accounts in the name of the Customer on the FCM's books and records, and the Customer authorizes the FCM, to execute, clear and carry US Futures, Cleared Swaps and/or Foreign Futures on behalf of the Customer (individually or collectively, the "**Customer Account**" or the "**Account**").

2. Each of the Base Account Agreement and the CDA is governed by New York law.

3. On the basis of the terms and conditions of the Covered Agreement and other relevant factors and acting in a manner consistent with the intentions stated in the Covered Agreement, over time, open positions are established for the Customer in Covered Contracts that are cleared and carried in or credited to the Customer Account.

4. Some of the Covered Contracts cleared for the Customer provide for an exchange of cash and others provide for the physical delivery of shares, bonds or commodities in exchange for cash.

5. After commencing clearing and while the Customer has open positions in Covered Contracts, the Customer, which is organized in your jurisdiction, becomes the subject of a formal bankruptcy, insolvency, liquidation, reorganization, administration or comparable proceeding (collectively, the "**insolvency**") under the insolvency laws of your jurisdiction and, as a result, an Event of Default occurs under each of the Base Account Agreement and CDA.

If there are different types of insolvency proceedings under the laws of your jurisdiction (for example, bankruptcy or liquidation proceedings where an entity does not emerge as a going concern, on the one hand, and a reorganization or administration proceeding where an entity is restructured and does continue as a going concern, on the other hand), please briefly describe the different types of proceedings and answer each question with respect to each such proceeding.

6. Subsequent to the commencement of the insolvency, either the Customer or an insolvency official seeks to challenge or otherwise prevent Position Liquidation, Margin Liquidation or a Determination of Account (by, for example, seeking to assume the profitable open positions, and to reject unprofitable open positions, in Covered Contracts cleared for the Customer.

B. *Questions*

1. Would the parties' agreement on governing law and submission to jurisdiction set out in each of the Base Account Agreement and CDA be given effect by a court in your jurisdiction, and what would be the consequences if they were not?

2. Would the Position Liquidation provisions of each of the Base Account Agreement and the CDA be enforceable under the laws of your jurisdiction and each of the Position Liquidation methods described in Section XI of the S&C Memo and paragraph 2.5 of the Summary Annex be recognized and upheld by a court in your jurisdiction? If a particular Position Liquidation method would either not be upheld or could be challenged, please provide further detail and explain the reason for this. Are there any circumstances in your jurisdiction, including any moratorium, stay, freeze or other consequence of the commencement of an insolvency proceeding, that might affect the FCM's ability to exercise Position Liquidation?

3. Would the Margin Liquidation provisions of each of the Base Account Agreement and CDA be enforceable under the laws of your jurisdiction and the FCM's Margin Liquidation in respect of each Account Class be recognized and upheld by a court in your jurisdiction? Are there any circumstances in your jurisdiction, including any moratorium, stay, freeze or other consequence of the commencement of an insolvency proceeding, you can foresee that might affect the FCM's ability to exercise Margin Liquidation?

4. Would the Determination of Account provisions of each of the Based Account Agreement and CDA be enforceable under the laws of your jurisdiction and the FCM's Determination of Account in respect of (a) each Account Class and (b) all Account Classes on a combined basis be recognized and upheld by a court in your jurisdiction? Are there any circumstances in your jurisdiction, including any moratorium, stay, freeze or other consequence of the commencement of an insolvency proceeding, you can foresee that might affect the FCM's ability to exercise a Determination of Account in respect of an Account Class or the overall Customer Account (comprising the three Account Classes)?

6. Assuming the parties have entered into the Covered Agreement, an Event of Default has occurred with respect to the Customer and the FCM has determined a lump-sum cash balance or net termination amount in a currency other than the currency of the jurisdiction in which the insolvent customer is organized:

(a) Outside the context of insolvency proceedings, would a court in your jurisdiction enforce a claim for the cash balance or net termination amount in the currency in which it was determined?

(b) Can a claim for the cash balance or net termination amount be proved (*i.e.*, filed) in insolvency proceedings in your jurisdiction without conversion into the local currency?

If in either case the claim must be converted to local currency for purposes of enforcement or proof in insolvency proceedings, please set out the rules governing the timing and exchange rate for such conversion.

7. Are there any other local law considerations that you would recommend the FCM to consider in connection with the exercise of Position Liquidation, Margin Liquidation or a Determination of Account?

PART II

VALIDITY, PERFECTION AND ENFORCEMENT OF FCM'S SECURITY INTEREST IN CUSTOMER'S RIGHTS AND INTERESTS IN RESPECT OF COLLATERAL

A. *Fact Patterns Regarding Location of the Customer and Collateral*

Please address the questions below in your opinion even if you have concluded (a) in your response to question I.B.3 above, that Margin Liquidation would be recognized by a court in your jurisdiction as the FCM's exercise of its Permitted Uses Rights under the Customer Property Rules and (b) in your response to question I.B.4 above, that a Determination of Account would be characterized as contractual accounting or as involving netting or set-off.

We set out below three principal fact patterns we would like you to consider in answering the questions posed in Section C below.

The three principal fact patterns concern (a) whether or not the Location (as defined below) of the Customer is in your jurisdiction and (b) whether or not the Location of the Collateral (as defined below) is in your jurisdiction.

In particular, when responding to each question, could you please distinguish between the following three fact patterns:

I. The Location of the Customer is in your jurisdiction and the Location of the Collateral is outside your jurisdiction.

II. The Location of the Customer is in your jurisdiction and the Location of the Collateral is in your jurisdiction.

III. The Location of the Customer is outside your jurisdiction and the Location of the Collateral is in your jurisdiction.

For the foregoing purposes:

(a) the "Location" of the Customer is in your jurisdiction if it resides, is incorporated or otherwise organized in your jurisdiction and/or if it has a branch or other place of business in your jurisdiction; and

(b) the "Location" of Collateral is the place where an asset of that type is located under the private international law rules of your jurisdiction.

"**Located**" when used below in relation to a Customer or any Collateral should be construed accordingly.

In relation to (a), if under the laws of your jurisdiction, the Location of an entity would be determined on a different basis and this would affect your conclusions, please set out the relevant rules and explain their consequences.

In considering fact patterns I and II, please indicate whether and, if so, in which circumstances it makes a difference whether the Customer (i) is incorporated or otherwise organized in your jurisdiction or (ii) is a foreign entity with a branch or other place of business in your jurisdiction.

If the location of the FCM would affect your response to any question, please make this clear in the relevant response.

B. *Additional Assumptions*

Please assume the same facts as set forth in Section A of Part I above (as applicable) with the following modifications:

1. Please assume that under the terms of the Covered Agreement, the Customer grants to the FCM a first-priority security interest in, lien on and right of set-off against, all the rights and interests of the Customer in respect of the following types of property, whether at the time of the grant or thereafter existing ("**Collateral**"): (1) the Customer Account (*i.e.*, the account in the name of the Customer that is maintained

by the FCM on its books and records), (2) the Covered Contracts carried in or credited to the Customer Account, (3) cash credited to or held in the Customer Account and (4) the types of securities identified below that are credited to the Customer Account and that are Located or deemed Located either (i) in your jurisdiction or (ii) outside your jurisdiction.

2. Please assume that Collateral in the form of cash is denominated in a freely convertible currency and is credited to an account (as opposed to physical notes and coins) under the "control" of the FCM for purposes of the New York Uniform Commercial Code (the "**UCC**"), as described in paragraph 1.41 of the Summary Annex. Additionally, please assume the following:

As explained in Section X of the S&C Memo and paragraphs 1.14, 1.16, 1.18, 1.19, 1.20 and 1.28, when the Customer delivers cash margin to the FCM, the FCM credits the cash to the Customer Account (which is not a deposit account, but rather a securities account, commodity account or hybrid securities/commodity account on the books and records of the FCM) and deposits the cash in one or more deposit accounts maintained in the name of the FCM with the FCM's settlement banks (which are banks or trust companies that satisfy CFTC requirements). Such deposit accounts are segregated omnibus accounts in which the cash delivered by the Customer is commingled with cash margin delivered to the FCM by its other customers in the same account class (as well as the FCM's own funds representing its residual interest, which is a buffer intended to ensure the FCM has segregated or set aside sufficient funds to cover the positive net liquidating equities of accounts of customers in the same account class). Such deposit accounts are titled under account names that clearly identify the cash therein as belonging to the FCM's customers in the applicable account class. The FCM's settlement banks maintaining such deposit accounts are permitted to comply with the FCM's withdrawal instructions without further inquiry as to their compliance with the Customer Property Rules (so long as the depositories does not have notice of or actual knowledge of a potential violation by the FCM), and the FCM's customers have no right to access the accounts.

Under the Customer Property Rules, the FCM is expressly permitted to use funds held in such deposit accounts to, among other things, margin or secure the obligations of the FCM to DCOs or Foreign Futures Broker in respect of Covered Contracts of the Customer and/or other customers in the applicable Account Class that are cleared through the DCOs or Foreign Futures Brokers. When cash is withdrawn from such deposit accounts and transferred to DCOs or Foreign Futures Brokers, the transferred cash is credited to omnibus customer margin accounts maintained by the DCOs or Foreign Futures Brokers on their books and records. Such accounts may not be accessed by customers of the FCM.

Additionally, as explained in paragraphs 1.16 and 1.20 of the Summary Annex, under the Customer Property Rules related to permitted investments of customer funds (the "**Permitted Investment Rules**"), the FCM may invest (including by means of reverse repurchase transactions) Customer Funds consisting of cash in certain types of permitted investment specified by the CFTC. The FCM may retain as its own profits resulting from such permitted investments, but it is required to segregate them and it must bear (and not allocate to customers) any losses with respect to them.[1]

3. Please assume that the any securities provided by the Customer as Collateral are held in one of the following forms, are denominated in either the currency of your jurisdiction or any freely convertible currency and consist of (i) corporate debt securities whether or not the issuer is organized or located in your

[1] As explained in paragraphs 1.28 and 1.30 of the Summary Annex, neither transfers of customer cash to DCOs and Foreign Futures Brokers nor investment of customer cash in permitted investments pursuant to the Permitted Investment Rules results in adjustments to the cash balance of the Customer Account. The Customer Account's cash balance is adjusted when (i) trading gains or losses are realized in respect of its Covered Contracts when they are closed or settled, (ii) cash is delivered by the Customer to the FCM or is withdrawn by the Customer from the Customer Account, (iii) the Customer's securities margin if liquidated (other than in connection with making permitted investments) and (iv) any other amounts due to the FCM (*e.g.*, commissions and fees) or due to the Customer (*e.g.,* interest) under the Covered Agreement are debited from or credited to the Account.

jurisdiction; (ii) debt securities issued by the government of your jurisdiction or another jurisdiction; (iii) debt securities issued by multilateral development banks and international organizations; and (iv) equity securities whether or not the issuer is organized or located in your jurisdiction:

(i) directly held bearer securities: by this we mean securities issued in certificated form, in bearer form (meaning that ownership is transferable by delivery of possession of the certificate) and, when held by the FCM as Collateral under the Covered Agreement, held directly in this form by the FCM (that is, not held by the FCM indirectly through an intermediary (as defined below));

(ii) directly held registered securities: by this we mean securities issued in registered form and, when held by the FCM as Collateral under the Covered Agreement, held directly in this form by the FCM so that the FCM is shown as the relevant holder in the register for such securities (that is, not held by the FCM indirectly with an intermediary);

(iii) directly held dematerialized securities: by this we mean securities issued in dematerialized form and, when held by the FCM as Collateral under the Covered Agreement, held directly in this form by the FCM so that the FCM is shown as the relevant holder in the electronic register for such securities (that is, not held by the FCM indirectly with an intermediary); or

(iv) intermediated securities: by this we mean a form of interest in securities recorded in fungible book-entry form in an account maintained by a securities intermediary or custodian (which could be a central securities depositary ("**CSD**") or a custodian, nominee or other form of securities intermediary or custodian, in each case an "**intermediary**") in the name of the FCM where such interest has been credited to the account of the FCM in connection with a deposit of Collateral by the Customer with the FCM under the Covered Agreement.

Our expectation is that the FCM will normally hold securities in the form of intermediated securities rather than directly in one of the three forms mentioned in (i), (ii) and (iii) above.

You should assume that in this case, and as explained in footnote 46 of the Summary Annex, when the Customer delivers margin to the FCM in the form of intermediated securities, the Customer will cause its intermediary to transfer the securities to the FCM's intermediary, which will credit them to the securities account maintained by the intermediary for the FCM, and the FCM will credit the securities to the Customer Account. As the FCM and Customer typically agree in the Covered Agreement to treat the Customer Account as a "securities account" maintained for the Customer by the FCM as the Customer's "securities intermediary," the Customer will obtain "security entitlement(s)" to the securities when they are credited to the Customer Account (as each such term is defined under Article 8 of the UCC). The security interest granted by the Customer to the FCM is in such security entitlement(s).

As explained in paragraph 1.36 and footnote 46 of the Summary Annex, under the Customer Property Rules, the FCM has significant flexibility to repledge, rehypothecate or otherwise dispose of customers' securities margin, subject in all cases to compliance with the segregation and other requirements of the Customer Property Rules. For example, with the Customer's agreement, the FCM may repledge securities margin delivered by the Customer to a DCO to secure the FCM's obligations to the DCO in respect of contracts cleared through the DCO for the Customer and/or for other customers of the FCM in the same Account Class (for example, securities deposited with the FCM by the Customer may repledge such securities to DCOs that do not clear the Customer's Covered Contracts, so long as the contracts at the DCO secured by the securities are in the same Account Class as the Customer's Covered Contracts). Also, under the Permitted Investment Rules, with the Customer's agreement, the FCM may rehypothecate (including by means of securities repurchase agreements) the Customer's securities margin for cash and may retain for itself the profits resulting from such permitted investments (but the FCM must segregate the

rehypothecation proceeds and must bear (and not allocate to any customers) any losses in respect thereof). Additionally, under the Customer Property Rules, if the FCM wishes to offset any net deficit in the Customer's Futures Account against the current market value of securities credited to the Account in its daily segregation computations, the FCM must have written authorization from the Customer to liquidate the securities in the FCM's discretion. You should assume that the Covered Agreement grants the FCM broad rights to repledge and rehypothecate the Customer's securities Collateral, subject to "applicable law" (which includes the Customer Property Rules), and to liquidate the securities in its discretion.[2]

4. Please note the following point regarding substitution of Collateral consisting of cash or securities. We understand that Base Account Agreements typically provide that, following closure of an open position by a customer, a FCM is under no obligation to return the same assets (*e.g.*, a security with the same ISIN/CUSIP number) posted by the customer, but the FCM may agree to provide equivalent assets, if practicable. For example, if the customer posted 5-year treasuries, the FCM would endeavor to return 5-year treasuries if practicable, but not necessarily the same ISIN/CUSIP. In some cases, the FCM might agree to a more stringent obligation to return equivalent assets, if practicable. However, it is not market practice for a Base Account Agreement to provide for an unqualified obligation on a FCM to return the same asset (contrast this position with paragraph 4(d) of either the 1994 ISDA Credit Support Annex (Bilateral Form) or the 1995 ISDA Credit Support Deed (Bilateral Form – Security Interest)).

We also understand that, as a matter of market practice, FCMs often offer their customers the ability to manage the collateral posted by the customer, for example by allowing the customer to post 10-year treasuries and returning 5-year treasuries to the customer. However, this is purely a matter of market practice, not a right of the customer explicitly provided in the agreement.

As Base Account Agreements typically do not include a right to substitute collateral, this letter does not include a question regarding the effect of substitution rights on the validity, continuity, perfection or priority of the security interest. However, please let us know if you think the market practice described above raises any questions that should be addressed in the opinion.

5. In the case of questions II.C.11 through II.C.14 below, if relevant, please also assume that after the Customer commences clearing under the Covered Agreement and while it has open positions in Covered Contracts, an Event of Default occurs with respect to the Customer, and/or, if applicable, the FCM has designated a date to begin closing out or otherwise liquidating the Customer's open positions in Covered Contracts cleared for it as a result thereof (however, an insolvency proceeding has not been instituted, which is addressed separately in Additional Assumption II.B.6 and questions II.C.15 through II.C.17 below).

6. In the case of questions II.C.15 through II.C.17 below, if relevant, please assume that the Customer has become subject to insolvency proceedings in your jurisdiction.

C. *Questions*

Validity and perfection of the security interest

1. Under the laws of your jurisdiction, what law governs the contractual aspects of the security interest in the Customer's rights and interests in respect of the various types of Collateral? Would the courts of

[2] As explained in footnote 46 of the Summary Annex, the FCM does not debit securities from the Customer Account when they are repledged to a DCO or Foreign Futures Broker or rehypothecated pursuant to the Permitted Investment Rules. The FCM debits securities from the Customer Account when (i) they are returned to the Customer or (ii) they are liquidated (including in connection with Margin Liquidation).

your jurisdiction recognize the validity of a security interest created under the Covered Agreement, assuming it is valid under New York law (as the governing law of the Covered Agreement)?

2. Under the laws of your jurisdiction, what law governs the proprietary aspects of the security interest in the Customer's rights and interests in respect of the different types of Collateral (*i.e.*, the formalities required to protect the security interest against competing claims) granted by the Customer (for example, the law of the jurisdiction of incorporation or organization of the Customer, the jurisdiction where the Collateral is Located (or deemed Located), the jurisdiction of the location of the FCM's intermediary or the jurisdiction of the location of the FCM as the Customer's securities intermediary, in relation to Collateral in the form of intermediated securities)? What factors would be relevant to this question? If the Location (or deemed Location) of the Collateral is the determining factor, please briefly describe the principles governing such determination under the law of your jurisdiction with respect to the different types of Collateral. If relevant, please describe how the laws of your jurisdiction apply to each form in which securities Collateral may be held as described in Additional Assumption II.B.3 above.

3. Would the courts of your jurisdiction recognize a security interest in the Customer's rights and interests in respect of the different types of Collateral? In answering this question, please bear in mind the different forms in which securities Collateral may be held, as described in the Additional Assumption II.B.3 above. Please indicate, in relation to cash Collateral, if your answer depends on the Location (or deemed Location) of the Customer Account or the account in which the relevant deposit obligations are recorded and/or upon the currency of those obligations.

4. What is the effect, if any, under the laws of your jurisdiction of the fact that the amount secured or the amount of the Collateral subject to the security interest will fluctuate under the Covered Agreement (including as a result of establishing open positions in additional Covered Contracts from time to time)? In particular:

(a) Would the security interest be valid in relation to future obligations of the Customer?

(b) Would the security interest be valid in relation to future Collateral (*i.e.*, cash and securities Collateral not yet delivered to the FCM and open positions not yet established in Covered Contracts at the time of entry into the Covered Agreement)?

(c) Is there any difficulty with the concept of creating the security interest over a fluctuating pool of assets, for example, by reason of the impossibility of identifying in the Covered Agreement the specific assets deposited by the Customer with the FCM?

(d) Is it necessary under the laws of your jurisdiction for the amount secured by the security interest to be a fixed amount or subject to a fixed maximum amount?

(e) Is it permissible under the laws of your jurisdiction for the FCM to hold Collateral in excess of its actual exposure to the Customer under the Covered Agreement?

In relation to (a), it is understood that the security interest in the Customer's rights and interests in respect of any specific Collateral would only be relevant in relation to future obligations, if ever, at the time such future obligations arise and then only in relation to Collateral held at that time. This question concerns whether it would be necessary for either party to perform any action at such time in order to ensure the effectiveness of the security interest as security for such obligations or whether the security interest would take effect in relation to those future obligations without further action by either party.

In relation to (b), it is understood that the security interest in the Customer's rights and interests in respect of the different types of Collateral to be delivered at some point in the future after the time of entry into the Covered Agreement would not take effect in relation to such Collateral until it had been delivered to the FCM in accordance with the Covered Agreement. This question concerns whether it would be necessary for either party to perform any action at such time in order to ensure the effectiveness of the security interest in the Customer's rights and interests in respect of such Collateral or whether the security interest in relation to the Customer's rights and interests in respect of such Collateral would take effect without further action (other than the delivery) by either party.

In relation to (c), you may assume that each specific delivery to the FCM and return by the FCM of Collateral consisting of cash or securities under the Covered Agreement from time to time would be properly recorded by the FCM, so that, while the pool of Collateral would change from time to time, at any specific time the composition of the pool of Collateral could be clearly identified by the FCM.

5. Assuming that the courts of your jurisdiction would recognize the security interest in the Customer's rights and interests in respect of each type of Collateral, is any action (filing, registration, notification, stamping, notarization or any other action or the obtaining of any governmental, judicial, regulatory or other order, consent or approval) required in your jurisdiction to perfect the security interest? If so, please indicate what actions must be taken and how such actions may differ, if at all, depending upon the type of Collateral in question.

6. If there are any other requirements to ensure the validity or perfection of the security interest in the Customer's rights and interests in respect of each type of Collateral, please indicate the nature of such requirements. For example, is it necessary as a matter of formal validity that the Covered Agreement be expressly governed by the law of your jurisdiction or translated into any other language or for the Covered Agreement to include any specific wording? Are there any other documentary formalities that must be observed in order for the security interest in the Customer's rights and interests in respect of any type of Collateral to be recognized as valid and perfected in your jurisdiction?

7. Assuming that the FCM has obtained a valid and perfected security interest under the laws of your jurisdiction, to the extent such laws apply, by complying with the requirements set forth in your responses to questions II.C.1 through II.C.6 above, as applicable, will the FCM or the Customer need to take any action thereafter to ensure that the security interest continues to be and/or remains perfected, particularly with respect to additional cash or securities Collateral transferred from time to time when required pursuant to the Covered Agreement?

8. Assuming that (a) pursuant to the laws of your jurisdiction, the laws of another jurisdiction govern the validity and/or perfection of a security interest in the Customer's rights and interests in respect of any type of Collateral (*e.g.*, because the Collateral is Located or deemed Located outside your jurisdiction) and (b) the FCM has obtained a valid and perfected security interest in the Collateral under the laws of such other jurisdiction, will the FCM have a valid security interest in the Collateral so far as the laws of your jurisdiction are concerned? Is any action (filing, registration, notification, stamping or notarization or any other action or the obtaining or any governmental, judicial, regulatory or other order, consent or approval) required under the laws of your jurisdiction to establish, perfect, continue or enforce the security interest? Are there any other requirements of the type referred to in question II.C.6 above?

9. Are there any particular duties, obligations or limitations imposed on the FCM in relation to the care of the Collateral held by it pursuant to the security interest?

10. Do the laws of your jurisdiction recognize the right of the FCM to use cash or securities Collateral (as described in Additional Assumptions II.B.2 and II.B.3 above) pursuant to an agreement with the

Customer? In particular, how does such use of the Collateral affect, if at all, the validity, continuity, perfection or priority of the security interest otherwise validly created and perfected prior to such use? Are there any other obligations, duties or limitations imposed on the FCM with respect to its use of such Collateral under the laws of your jurisdiction?

Enforcement of the security interest in the Customer's rights and interests in the Collateral in the absence of an insolvency proceeding

Note Additional Assumption II.B.5 above, which applies to questions II.C.11 through II.C.14 below.

11. Assuming that the FCM has obtained a valid and perfected security interest under the laws of your jurisdiction, to the extent such laws apply, by complying with the requirements set forth in your responses to questions II.C.1 through II.C.6 above, as applicable, what are the formalities (including the necessity to obtain a court order or conduct an auction), notification requirements (to the Customer or any other person) or other procedures, if any, that the FCM must observe or undertake in enforcing its security interest as a secured party under the Covered Agreement? For example, is it free to sell the Collateral (including to itself) and apply the proceeds to satisfy the Customer's outstanding obligations under the Covered Agreement? Do such formalities or procedures differ depending on the type of Collateral involved?

12. Assuming that (a) pursuant to the laws of your jurisdiction, the laws of another jurisdiction govern the validity and/or perfection of a security interest in the Customer's rights and interests in respect of any Collateral (*e.g.*, because such Collateral is Located or deemed Located outside your jurisdiction) and (b) the FCM has obtained a valid and perfected security interests under the laws of such other jurisdiction, are there any formalities, notification requirements or other procedures, if any, that the FCM must observe or undertake in your jurisdiction in exercising its rights as a secured party under the Covered Agreement?

13. Are there any laws or regulations in your jurisdiction that would limit or distinguish a creditor's enforcement rights with respect to the security interest in the Customer's rights and interests in respect of any type of Collateral depending on (a) the type of transaction underlying the creditor's exposure, (b) the type of Collateral or (c) the nature of the creditor or the debtor? For example, are there any types of "statutory liens" that would be deemed to take precedence over the security interest?

14. How would your response to questions II.C.11 through II.C.13 above change, if at all, assuming that an insolvency proceeding above has occurred with respect to the FCM (notwithstanding that the Covered Agreement may not provide for any events of default in respect of the FCM) rather than or in addition to the Customer (for example, would this affect this ability of the FCM to enforce its security interest in the Customer's rights and interests in the Collateral)?

Enforcement of the security interest in the Customer's rights and interests in Collateral after the commencement of an insolvency proceeding

Note Additional Assumption II.B.6 above, which applies to questions II.C.15 through II.C.17 below.

15. How are competing priorities between creditors determined in your jurisdiction? What conditions must be satisfied if the FCM's security interest in the Customer's rights and interests in each type of Collateral is to have priority over all other claims (secured or unsecured) of an interest in the Collateral?

16. Would the FCM's enforcement of its security interest in the Customer's rights and interests in any type of Collateral be subject to any stay, moratorium or freeze or otherwise be affected by commencement of the insolvency?

17. Will the Customer (or its administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official) be able to recover any transfers of Collateral consisting of cash or securities made to the FCM during a certain "suspect period" preceding the date of the insolvency as a result of such a transfer constituting a "preference," fraudulent transfer or transaction at an undervalue (however called and whether or not fraudulent) in favor of the FCM or on any other basis? If so, how long before the insolvency does this suspect period begin? Would the posting of additional margin (which could be required when the Customer Account's net liquidating equity has fallen below the required margin level for the Customer Account due to trading losses in respect of one or more Covered Contracts cleared for the Customer) during the suspect period be subject to avoidance, either because the Collateral was considered to relate to an antecedent or pre-existing obligation or for some other reason?

Miscellaneous

18. If relevant in your jurisdiction, please analyze whether or not the Covered Agreement, and the collateral arrangements contemplated thereby, would constitute a financial collateral arrangement under the local implementation of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

19. Are there any other local law considerations that you would recommend the FCM to consider in connection with enforcing its security interest in the Customer's rights and interests in respect of any Collateral?

20. Are there any other circumstances you can foresee that might affect the FCM's ability to enforce its security interest in the Customer's rights and interests in respect of Collateral in your jurisdiction?

Very truly yours,

[INSERT NAME]

APPENDIX A
SEPTEMBER 2009

CUSTOMER TYPES[3]

Description	**Covered by opinion**	**Legal form(s)**[4]
Bank/Credit Institution. A legal entity, which may be organized as a corporation, partnership or in some other form, that conducts commercial banking activities, that is, whose core business typically involves (a) taking deposits from private individuals and/or corporate entities and (b) making loans to private individual and/or corporate borrowers. This type of entity is sometimes referred to as a "commercial bank" or, if its business also includes investment banking and trading activities, a "universal bank". (If the entity only conducts investment banking and trading activities, then it falls within the "Investment Firm/Broker Dealer" category below.) This type of entity is referred to as a "credit institution" in European Community (**EC**) legislation. This category may include specialised types of bank, such as a mortgage savings bank (provided that the relevant entity accepts deposits and makes loans), or such an entity may be considered in the local jurisdiction to constitute a separate category of legal entity (as in the case of a building society in the United Kingdom (**UK**)).	[Yes][No]	
Central Bank. A legal entity that performs the function of a central bank for a Sovereign or for an area of monetary union (as in the case of the European Central Bank in respect of the euro zone).		
Corporation. A legal entity that is organized as a corporation or company rather than a partnership, is engaged in industrial and/or commercial activities and		

[3] In these definitions, the term "legal entity" means an entity with legal personality, other than a private individual.

[4] If appropriate, please indicate, as discussed in the instruction letter, any naming convention or rule that would help a reader of the opinion to identify and classify the entity.

Description	Covered by opinion	Legal form(s)[4]
does not fall within one of the other categories in this Appendix B.		
Hedge Fund/Proprietary Trader. A legal entity, which may be organized as a corporation, partnership or in some other legal form, the principal business of which is to deal in and/or manage securities and/or other financial instruments and/or otherwise to carry on an investment business predominantly or exclusively as principal for its own account.		
Insurance Company. A legal entity, which may be organised as a corporation, partnership or in some other legal form (for example, a friendly society or industrial & provident society in the UK), that is licensed to carry on insurance business, and is typically subject to a special regulatory regime and a special insolvency regime in order to protect the interests of policyholders.		
International Organization. An organization of Sovereigns established by treaty entered into between the Sovereigns, including the International Bank for Reconstruction and Development (the World Bank), regional development banks and similar organizations established by treaty.		

Description	Covered by opinion	Legal form(s)[4]
Investment Firm/Broker Dealer. A legal entity, which may be organized as a corporation, partnership or in some other form, that does not conduct commercial banking activities but deals in and/or manages securities and/or other financial instruments as an agent for third parties. It may also conduct such activities as principal (but if it does so exclusively as principal, then it most likely falls within the "Hedge Fund/Proprietary Trader" category above.) Its business normally includes holding securities and/or other financial instruments for third parties and operating related cash accounts. This type of entity is referred to as a "broker-dealer" in US legislation and as an "investment firm" in EC legislation.		
Investment Fund. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide investors with a share in profits or income arising from property acquired, held, managed or disposed of by the manager(s) of the legal entity or arrangement or a right to payment determined by reference to such profits or income. This type of entity or arrangement is referred to as a "collective investment scheme" in EC legislation. It may be regulated or unregulated. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by general law and/or, typically in the case of regulated Investment Funds, financial services legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Investment Fund (for example, a trustee of a unit trust) contract on behalf of the Investment Fund, are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.		

Description	Covered by opinion	Legal form(s)[4]
Local Authority. A legal entity established to administer the functions of local government in a particular region within a Sovereign or State of a Federal Sovereign, for example, a city, county, borough or similar area.		
Partnership. A legal entity or form of arrangement without legal personality that is (a) organised as a general, limited or some other form of partnership and (b) does not fall within one of the other categories in this Appendix B. If it does not have legal personality, it may nonetheless be treated as though it were a legal person for certain purposes (for example, for insolvency purposes) and not for other purposes (for example, tax or personal liability).		
Pension Fund. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide pension benefits to a specific class of beneficiaries, normally sponsored by an employer or group of employers. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by pensions legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Pension Fund (for example, a trustee of a pension scheme in the form of a common law trust) contract on behalf of the Pension Fund and are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.		
Sovereign. A sovereign nation state recognized internationally as such, typically acting through a direct agency or instrumentality of the central government without separate legal personality, for example, the ministry of finance, treasury or national debt office. This category does not include a State of a Federal Sovereign or other political sub-division of a sovereign nation state if the sub-division has separate legal personality (for example, a Local Authority) and it does not include any		

Description	Covered by opinion	Legal form(s)[4]
legal entity owned by a sovereign nation state (see "Sovereign-owned Entity").		
Sovereign Wealth Fund. A legal entity, often created by a special statute and normally wholly owned by a Sovereign, established to manage assets of or on behalf of the Sovereign, which may or may not hold those assets in its own name. Such an entity is often referred to as an "investment authority". For certain Sovereigns, this function is performed by the Central Bank, however for purposes of this Appendix B the term "Sovereign Wealth Fund" excludes a Central Bank.		
Sovereign-Owned Entity. A legal entity wholly or majority-owned by a Sovereign, other than a Central Bank, or by a State of a Federal Sovereign, which may or may not benefit from any immunity enjoyed by the Sovereign or State of a Federal Sovereign from legal proceedings or execution against its assets. This category may include entities active entirely in the private sector without any specific public duties or public sector mission as well as statutory bodies with public duties (for example, a statutory body charged with regulatory responsibility over a sector of the domestic economy). This category does not include local governmental authorities (see "Local Authority").		
State of a Federal Sovereign. The principal political sub-division of a federal Sovereign, such as Australia (for example, Queensland), Canada (for example, Ontario), Germany (for example, Nordrhein-Westfalen) or the United States of America (for example, Pennsylvania). This category does not include a Local Authority.		