Michael Lovendusky
Vice President & Associate General Counsel

11 July 2020
Mr. Christopher J. Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre 1155 21st Street NW
Washington, DC 20581

Re: Part 190 Bankruptcy Regulations (Proposed Amendments – RIN 3038-AE67)

Dear Mr. Kirkpatrick:

The American Council of Life Insurers (ACLI) appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (Commission) on its proposal (Proposal) to amend the Commission's bankruptcy regulations contained in part 190 of title 17 of the Code of Federal Regulations (Part 190).

We support the Commission's efforts to comprehensively update Part 190 to reflect current market practices and lessons learned from past commodity broker bankruptcies, as well as its efforts to address, *ex ante*, issues that may arise during the course of a derivatives clearing organization (DCO) bankruptcy. As you know, life insurers are considered financial entities under governing derivatives law and are therefore compelled to use the centralized clearing system, including commodity brokers and DCOs for most of their derivatives transactions. Consequently, life insurers are sensitive to the risks posed by the centralized clearing regime, generally, and its individual components, specifically.

We appreciate the opportunity to provide our thoughts on certain aspects of the Proposal below.

Section 190.03(c)(2): Open commodity contracts carried in hedging accounts

As proposed, §190.3(c)(2) allows a commodity broker's bankruptcy trustee discretion to treat open positions (including swaps) as "specifically identifiable [customer] property." When the trustee exercises such discretion, the customer will have an opportunity to instruct the trustee whether to liquidate the customer's open positions or to port them to a successor commodity broker.

Life insurers, as financial end-users, must use DCOs for certain standardized derivatives such as interest rate swaps in order to hedge financial risks in their portfolios, and it is their strong preference that such positions be transferred in accordance with the customer's instructions to a successor futures commission merchant rather than be liquidated. Liquidation would break the hedge, create risk and require costly re-establishment of the position. For this reason, we believe that the rule should express a preference for transfer over liquidation of specifically identified property that are identified as hedging positions. Instead, as currently

drafted, the proposed rule merely states that the trustee "may" treat open positions as, in effect, hedge positions to be transferred. We submit that hedge positions should have the benefit of the doubt and be transferred *unless* in consultation with the Commission it is determined that it would be unreasonable to do so.

Further, we note that under the proposed rule a trustee may liquidate a hedge position even *after* it has solicited and received instructions to transfer the position (see sub-clause (iv) "providing instructions may not prevent open commodity contracts from being liquidated.") In this context, the proposed rule provides no guidelines governing the trustee's exercise of discretion. We respectfully recommend that the rule add a threshold such as "impossibility" or "exigent circumstances" before a trustee can decide to thwart a transfer that has been already considered reasonable and practicable – the pre-requisites for asking for the customer's instructions – and where the customer has requested the transfer and met the required terms for doing so. Here, too, Commission oversight should be specifically mandated.

Subpart C – Clearing Organization as Debtor – Proposed §§ 190.11-190.19

We are generally supportive of the addition of proposed subpart C and believe that it will help provide *ex ante* clarity to market participants evaluating the risks presented by the potential insolvency of a DCO and effectuate fair and expedient outcomes in the event of a DCO bankruptcy. However, we do have some important concerns respecting proposed Subpart C. We believe that, as proposed, new subpart C requires the trustee to grant too much deference to a DCO's recovery and wind-down plans (that are not public and might be insufficiently directive in any event) and to a DCO's own implementation of its own rules, procedures and plans.

It is our position that a DCO's rules, procedures and plans should not be given deference by the trustee unless they are produced in a transparent process that gives customers such as ourselves an opportunity for meaningful consultation and input. Thus, in both proposed §190.15(a) and (c) we respectfully suggest that the Commission require that recovery and wind-down measures referred to therein include as a prerequisite that they were originally adopted with public input at the DCO level and made public for a reasonable period before the bankruptcy proceeding. Otherwise, the trustee will not be expected to defer to any recovery and wind-down measures that were not publicly vetted or as to which the public had limited or no prior notice.

Further, we believe it is critical that trustees have discretion to override a DCO's recovery or wind-down actions if they violate proposed Part 190's goal of protecting customer property on no worse than a pro rata basis. Life insurers depend on cleared derivatives to protect the value of assets that assure their ability to meet their obligations to policy holders. It would be unreasonable, for example, for a DCO or its trustee to prefer any class or public customer over another when applying recovery or wind-down measures.

DCO recovery and wind-down plans include such drastic measures as Variation Margin Gains Haircutting (VMGH) and Partial Tear-Up (PTU) of open positions. These measures are part of DCO rules that are submitted to the Commission but are not subject to routine public input at the DCO level or at the Commission.[1]

Subpart C should provide clearly that, to the extent gains-based haircutting has been utilized by a debtor DCO, the debtor DCO's customers should be given credit for any of their gains that were haircut during such gains-based haircutting when such customers' net equity claims are determined.

Also, subpart C should provide that if a debtor DCO either (i) does not have "reverse the waterfall" rules or (ii) has "reverse the waterfall" rules that do not address each level of the debtor DCO's waterfall, the net equity claims of the debtor DCO's customers will be calculated as though the debtor DCO in fact has "reverse the waterfall" rules that address each level of the DCO's waterfall.

Further to the deference purportedly owed to a DCO'S own rules, proposed §190.15(a) and (c) are particularly troublesome. Each requires the trustee to defer to the DCO's recovery and wind-down plans, which as described above are routinely adopted without public input. Pursuant to the proposed rules, for example, a DCO's decision to apply VMGH as a means of recovery before bankruptcy would not be reversed by the trustee and, further, the trustee might itself use tools such as VMGH and PTU in its discretion "in consultation with the Commission."

Proposed § 190.15(a) provides a debtor DCO with too much flexibility in implementing its own recovery and wind-down plans, and the trustee is stripped of too much authority as a result. We believe that the trustee should be able to avoid or prohibit any DCO action that it determines, in consultation with the Commission, is not reasonable and practicable. This position is consistent with proposed § 190.15(b), which instructs the trustee to implement, in consultation with the Commission, the default rules and procedures maintained by the debtor DCO "… subject to the *reasonable discretion* of the trustee and to the extent that implementation of such default rules and procedures is *practicable*" (*emphasis added*).

Bearing in mind the potentially systemic implications posed by a failing DCO, we believe that there should be greater transparency and stronger guard rails designed to protect the interests of market participants such as life insurers who have little choice but to use centrally cleared financial instruments. We believe that the Proposal may not adequately allow for consideration of the core concepts set forth in proposed § 190.00 and for the mitigation of

[1] We endorse the initiative of other market participants aimed at amending Parts 39 and 40 of the Commission's regulations to ensure that DCO customers have an opportunity to provide meaningful input during the development and application of recovery and wind-down rules, including VMGH and PTU.

systemic risk in connection with the implementation of a DCO's rules, procedures and plans. Prior to taking a particular action to implement a DCO's rules, procedures and plans, the trustee might determine that such action may burden the DCO's clearing members and customers to the point of posing additional systemic risk. In this situation, we believe that the trustee, in consultation with the Commission, should be able to take an action contrary to that which is prescribed in the debtor DCO's default rules and procedures (or recovery and wind-down plans) to the extent necessary to mitigate systemic risk or to adhere with the core principles.

~*~

Thank you for your consideration. Please know that The American Council of Life Insurers is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. Ninety (90) million American families rely on the life insurance industry for financial protection and retirement security. ACLI member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. The 280 member companies of the ACLI represent 94 percent of life insurance industry assets in the United States.

Sincerely,

Michael Lovendusky, Vice President & Associate General Counsel
Telephone 202.624.2390
michaellovendusky@acli.com