ISDA Safe, Efficient Markets

July 13, 2020

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: 17 CFR Parts 1, 4, 41, and 190 Bankruptcy Regulations (RIN 3038-AE67)

Dear Mr. Kirkpatrick:

The International Swaps and Derivatives Association, Inc. (ISDA)[1] appreciates the opportunity to provide comments on the proposal (the Proposal) by the Commodity Futures Trading Commission (the Commission) to comprehensively update its Part 190 regulations governing the liquidation of a futures commission merchant (FCM) or derivatives clearing organization (DCO) and reflect current market practices and lessons learned from past commodity broker bankruptcies.[2] ISDA commends the Commission's desire to provide additional clarity and certainty regarding an FCM's or a DCO's insolvency to ensure safe and efficient financial markets. Below we describe some of the most beneficial aspects of the Proposal and make several recommendations for targeted revisions and further market engagement that we encourage the Commission to consider before issuing any final regulations.

Close-out Netting

Enforceable close-out netting rights provide the legal basis for netting of exposures between derivatives counterparties, which reduces costs, increases market liquidity and reduces credit and systemic risks. A firm's right to terminate outstanding transactions with a counterparty following an event of default and calculate the net amount due to one party by another is the primary means of mitigating credit risks associated with financial contracts, including derivatives. Without enforceable close-out netting rights, firms would need to manage their credit risk on a gross basis, dramatically reducing liquidity and credit capacity. Statistics published each year by the Bank for International Settlements consistently show that exposure netting reduces the gross mark-to-market value of outstanding derivative transactions across all asset classes by over 80 percent.

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 75 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

[2] https://www.cftc.gov/sites/default/files/2020/06/2020-08482a.pdf.

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ISDA has over 30 years of experience working with policy-makers and regulators across the globe on close-out netting legislation to ensure netting certainty. To date, we have published netting opinions for more than 75 countries to address the enforceability of the termination, bilateral close-out netting and multi-branch netting provisions in derivatives agreements, including agreements used for cleared derivatives.

FCMs and their customers net their cleared derivative exposures for purposes of risk management, regulatory capital determinations and financial and regulatory reporting, and such exposure netting is essential for the continued provision of clearing services in a safe and cost-efficient manner. Accordingly, it is critical that the Commission craft all aspects of its Part 190 regulations to support, and in no event be inconsistent with, such exposure netting.

In this regard, we believe it is helpful that the Proposal further enhances the foundation for FCMs and their customers to net their exposures by making clear that, in the event that an FCM or DCO enters insolvency proceedings, a customer, or an FCM for itself or on behalf of the customer, will have a net equity claim based on its aggregate net positions and associated margin. The Proposal also helpfully clarifies that in the case of an FCM insolvency proceeding, it would not be permissible to frustrate this netting by allowing a partial transfer of contracts or margin that would increase any customer's net equity claim.

With respect to DCOs, we take comfort from the fact that proposed §190.14(b)(2)(ii)(A) prevents the trustee from continuing operation of the DCO subsequent to the order for relief if the DCO's rules contain closeout netting provisions. We do believe it would be helpful to revise proposed §190.14(c)(1) so that the second sentence thereof is deleted and the first sentence affirmatively provides that, notwithstanding anything else to the contrary in Subpart C, the trustee shall liquidate all open contracts in accordance with the closeout netting provisions in the DCO's rules (or bylaws) and, in any event, no later than seven calendar days after the entry of the order for relief. The seventh calendar day should be the outside limit for completing liquidation of the DCO's open contracts.

DCO Insolvencies

ISDA has long supported enhanced recovery and resolution tools for DCOs and other central counterparties (CCPs) globally.[3] While CCPs reduce systemic risk in the markets they serve, CCPs also warehouse or concentrate risks that, if not properly managed in times of significant market volatility, could inflict major financial damage on clearing members, trading venues and other market participants. While we understand that recovery and resolution of a DCO are

[3] ISDA has published many papers and responses to consultations issued by the Financial Stability Board and regulators on CCP recovery and resolution. An example includes *Safeguarding Clearing: The Need for Comprehensive CCP Recovery and Resolution Framework*, available at http://assets.isda.org/media/85260f13-48/d1ef0ce0-pdf/, the response to the Financial Stability Board discussion paper "Financial resources to support CCP resolution and the treatment of CCP equity in resolution", available at https://www.isda.org/2019/02/01/fia-iif-isda-response-to-fsb-ccp-equity-dp/, an incentive analysis of recovery and resolution tools, available at https://www.isda.org/a/OdKME/CCP-RR-Incentives-Analysis.pdf and numerous other papers and responses on the ISDA website at www.isda.org.

outside the scope of Part 190 and the Proposal, we encourage the Commission to continue working on these important issues alongside the Federal Deposit Insurance Corporation (FDIC) in the United States, global standard setters such as CPMI-IOSCO and the Financial Stability Board and other CCP supervisors and resolution authorities globally.

We also believe it would be advisable to engage in workshops with both market participants (including DCOs, FCMs and other clearing members and customers) and the FDIC prior to finalizing the Proposal to develop worked examples illustrating both how net equity claims would be calculated in a hypothetical DCO insolvency under various loss scenarios and how the claims of creditors and equity would be treated in a resolution of the DCO under Title II of the Dodd-Frank Act. The Proposal's treatment of a DCO's insolvency contains significant subtleties and nuances that could have implications for the counterfactual in a DCO resolution. Further engagement could help ensure that these subtleties and nuances would not result in any unintended consequences and that they are broadly understood by all entities that could be impacted by a DCO's insolvency or resolution and.

We specifically note that in connection with a DCO's insolvency, the Proposal provides for incorporation of the DCO's loss-allocation rules into the calculation of members' proprietary and customer net equity claims. Some DCO rules provide that the authority of the DCO to require additional default fund contributions terminates upon the DCO's bankruptcy, and we believe that the implications of such termination would be a useful topic to explore with market participants and the FDIC prior to finalizing the Proposal.

Please reach out to Steve Kennedy (skennedy@isda.org) or Ann Battle (abattle@isda.org) if you have any questions.

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