



July 13, 2020

By Electronic Submission

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Bankruptcy Regulations (RIN 3038-AE67)

Ladies and gentlemen,

Better Markets, Inc. (“Better Markets”)¹ commends the Commodity Futures Trading Commission (“CFTC”) for its proposed and well-considered technical amendments clarifying the bankruptcy framework for futures commission merchants (“FCMs”) and derivatives clearing organizations (“DCOs”).² Despite its critical importance, the CFTC’s proposal is unlikely to capture the public imagination, in particular as its technical amendments extend 134 single-spaced, three-columned Federal Register pages and address bankruptcy issues immediately decipherable to a relatively small number of bankruptcy lawyers and other experts.³ For this reason, unfortunately, we suspect that the CFTC’s proposal may receive the most helpful and impartial public scrutiny only after the amended framework has been finalized and tested in a real-world proceeding.

Nevertheless, Better Markets supports the CFTC’s responsible reconsideration of its part 190 bankruptcy framework, which has not been comprehensively reviewed, much less revised, in light of evolving market practices in almost 40 years. That has left customers of FCMs and clearing members, not to mention the public, too exposed to the ambiguities of certain elements of the CFTC’s bankruptcy framework for too long. We seek to provide only high-level context at this time, in the interest of supporting the CFTC’s prompt action to address and finalize issues in the proposal before an inevitable bankruptcy occurs. We fundamentally agree, in this regard, that the worst time to deliberate about such technical matters would be once an FCM or DCO failure has occurred, especially because hundreds of millions of dollars of customer funds (or more) would be impacted by consequential provisions addressed in the proposal.

¹ Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans’ jobs, savings, retirements, and more.

² CFTC, Bankruptcy Regulations, 85 Fed. Reg. 36000 (June 12, 2020), available at <https://www.cftc.gov/sites/default/files/2020/06/2020-08482a.pdf>.

³ In fact, a Part 190 Subcommittee of the Business Law Section of the American Bar Association has played a constructive role in spurring the CFTC to reconsider its bankruptcy framework.

The M.F. Global and Peregrine Financial bankruptcies provide insightful case studies and demonstrate both the complexity of bankruptcy issues and the need for as little ambiguity as possible in the CFTC's bankruptcy framework.

The CFTC implemented significant improvements to U.S. customer protections in the aftermath of the Peregrine Financial Group, Inc. (“PFG”) and M.F. Global, Inc. (“MFG”) failures, each of which involved a significant loss of U.S. customer funds. Those cases demonstrate the critical importance of U.S. bankruptcy law protections for U.S. customers of FCMs, especially with respect to claims priority and the need for minimal ambiguities with respect to the application of the CFTC’s bankruptcy framework to complex cross-border and intra-firm transactions and related legal matters. The CFTC’s proposal, in part, rightly addresses lessons learned from the administration of those FCM failures. For example, the CFTC proposes clarifications that customers relying on letters of credit (like ConocoPhillips in the MFG case⁴) must carry the same proportional losses as customers posting other forms of acceptable collateral. Resolving ambiguities with respect to that question—as just one example in hundreds of pages—could affect the recovery of hundreds of millions of dollars of customer funds in the event of the failure of another significant FCM.

Time is, therefore, of the essence.

Consider the extent of losses in the PFG case. Russell R. Wasendorf, Sr., PFG’s owner and chief executive officer, misappropriated at least \$215 million in customer funds from 13,000 U.S. customers by unlawfully withdrawing funds from the FCM’s segregated customer accounts.⁵ For decades, Wassendorf inflated FCM segregated customer balances on forged bank statements—which included a false P.O. Box to intercept regulatory communications to the bank that held the segregated account—and then used the fraudulent bank statements as a basis for filing false periodic FCM reports with the CFTC and the National Futures Association. PFG filed for bankruptcy once the extent of the fraud became known, as is inevitable in large scale misappropriation cases, leaving U.S. customers dependent on the U.S. bankruptcy framework to recover a percentage of losses.⁶

Less than one year earlier, U.S. customers had a similar fate when MFG raided segregated funds in the lead-up to its bankruptcy, which turned out to be the eighth largest in U.S. history. MFG reportedly “leveraged more than \$1 billion of customer funds into its own enormously risky \$6.3 billion repo bet on European sovereign debt,” but “[o]nce MF Global disclosed the risky trades on European sovereign debt, revealed associated margin calls, and announced significant financial losses for the quarter, the firm collapsed abruptly with an estimated \$1.6 billion in customer funds missing.”⁷ This left MFG’s customers,

⁴ See, e.g., V. Hughes, The Two Hundred Million Dollar Question: Were Letters of Credit as Good as Cash in the MF Global Liquidation, 93 N.C. L. Rev. 276 (2014), available at <https://scholarship.law.unc.edu/cgi/viewcontent.cgi?referer=https://duckduckgo.com/&httpsredir=1&article=4705&context=nclr>.

⁵ See, e.g., U.S. Attorney’s Office, Peregrine Financial Group CEO Sentenced to 50 Years for Fraud, Embezzlement, and Lying to Regulators (Jan. 31, 2013), available at <https://archives.fbi.gov/archives/omaha/press-releases/2013/peregrine-financial-group-ceo-sentenced-to-50-years-for-fraud-embezzlement-and-lying-to-regulators>.

⁶ On July 10, 2019, a U.S. district court issued an order appointing a temporary receiver, which also authorized the receiver to “[i]nitiate [a] bankruptcy proceeding on behalf of Defendant Peregrine Financial Group, Inc.” See United States District Court, Northern District for Illinois, U.S. Commodity Futures Trading Commission v. Peregrine Financial Group, Inc. and Russel R. Wasendorf, Sr., Order Appointing a Temporary Receiver, Civil Action No. 1:12-cv-05383 (July 10, 2012), available at <https://www.cftc.gov/sites/default/files/groups/public/@lrenforcementactions/documents/legalpleading/enfperegrineorder071012.pdf>.

⁷ See, e.g., L. Goldsmith, The Collapse of MF Global and Peregrine Group: The Response from the Futures Industry, Regulators, and Customers, *Developments in Banking Law*, 25, 26 (2012-13).

like PFG's, dependent on the U.S. bankruptcy framework, including the CFTC's regulations, to recover a percentage of losses.

These examples demonstrate the importance of U.S. bankruptcy protections to U.S. customers and the criticality of the CFTC's proposed revisions to part 190. They also demonstrate the importance of a number of FCM requirements that facilitate disposition of an FCM's assets in bankruptcy and prevent bankruptcy in the first place.⁸

Conclusion

In the midst of the continuing COVID-19-induced economic downturn, an unexpected bankruptcy of a significant FCM would not be beyond imagination. Thus, we encourage the CFTC to prioritize finalization of the proposal in the coming months.

Sincerely,



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⁸ These also explain why Better Markets opposed the CFTC's two recently proposed registration exemptions for non-U.S. DCOs and FCMs. For brief description of the importance of customer protections under U.S. law for customers of DCOs and FCMs, see Better Markets, Comment Letter to CFTC, Re: Exemption from Derivatives Clearing Organization Registration (RIN 3038-AE65) (Nov. 22, 2019), available at https://bettermarkets.com/sites/default/files/Better_Markets_Inc._Letter_on_Exemption_from_Derivatives_Clearing_Organization_Registration_%28RIN%203038-AE65%29_%28November_22_2019%29.pdf.