By Electronic Mail

October 28, 2020

Mr. Christopher J. Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

Re: Part 190 Bankruptcy Regulations - RIN 3038–AE67
85 Fed. Reg. 60110 (September 24, 2020)

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**")[1] welcomes the opportunity to submit this letter in connection with the Commodity Futures Trading Commission's ("**Commission**") request for comment on its supplemental notice of proposed rulemaking ("**Supplemental Proposal**") with regard to its proposed amendments to Part 190 of its rules governing the bankruptcy of commodity brokers ("**Proposed Amendments**").[2] The Supplemental Proposal responds to comments filed by FIA and others expressing concern that the provisions of proposed Rule 190.14(b)(2), in particular, would call into question the enforceability of closeout netting provisions set out in the rulebooks of the several derivatives clearing organization ("**DCOs**").[3] As the Commission notes, and as FIA argued, it is essential that such closeout netting provisions are enforceable, if DCO rules are to constitute "Qualified Master Netting Agreements" ("**QMNA**").[4] QMNA status, in turn, assures that, in calculating bank capital requirements, the

[1] FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington DC. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's core constituency consists of firms that operate as clearing members in global derivatives markets, including firms registered with the Commodity Futures Trading Commission as futures commission merchants ("**FCMs**").

[2] *Part 190 Bankruptcy Regulations*, 85 Fed. Reg. 36,000 (June 12, 2020).

[3] Letter from Walt L. Lukken, President and Chief Executive Officer, FIA, to Christopher J. Kirkpatrick, Secretary of the Commission, dated July 20, 2020 ("**Original Letter**"). We hereby reaffirm the views expressed in the Original Letter and incorporate the analysis and arguments set out in the Original Letter herein by reference.

[4] 85 Fed. Reg. at 60111 (September 24, 2020).

banks and bank holding companies with which clearing members are affiliated may net the exposures of their contracts cleared with the DCO.

To address these concerns, the Commission, by means of the Supplemental Proposal, has withdrawn proposed Rule 190.14(b)(2) and (3).[5] In its place, the Commission has proposed that the final amendments to the Part 190 Rules would include a rule that that Commission believes would (i) provide for a limited stay of a systemically important derivatives clearing organization's ("**SIDCO**") closeout netting rights under its rules,[6] while (ii) not adversely affecting the status of DCO rules as a QMNA.[7]

Specifically, in the event a SIDCO is the subject of a bankruptcy, the rule contemplated by the Supplemental Proposal would impose a temporary stay on the termination of the SIDCO's derivatives contracts. Consistent with the stay permitted with regard to non-cleared qualified financial contracts ("**QFCs**") under the rules adopted by the Prudential Regulators – *i.e.*, the Board of Governors of the Federal Reserve System ("**FRB**"), the Federal Deposit Insurance Corporation ("**FDIC**"), and the Office of the Comptroller of the Currency –the length of the stay period would be the shorter of: (i) the period of time beginning on the commencement of the proceeding and ending at the later of 5 p.m. (EST) on the business day following the date of the commencement of the proceeding and 48 hours after the commencement of the proceeding; or (ii) the shortest such period specified in the action by any of the Prudential Regulators.[8] Initial or variation margin would not be collected or paid during the stay period. Importantly, however, the Supplemental Proposal would become effective only if the Commission first finds, after an opportunity for public comment, that the Prudential Regulators have "publicly taken action sufficient to make such a stay provision consistent with the QMNA status of DCO rules".[9]

The Supplemental Proposal is inconsistent with FIA's position that the trustee's primary objective should be to ensure that the DCO's closeout procedures are promptly followed. FIA recognizes the significant effort that the Commission and its staff have devoted to developing the Proposed Amendments and, therefore, especially appreciates the Commission's willingness to withdraw proposed Rule 190.14(b)(2) and (3), thereby removing a significant impediment to legal certainty that those provisions caused. However, for the reasons explained below, we cannot support the substitute set out in the Supplemental Proposal.

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5 FIA understands that proposed Rule 190.14(b)(2) and (3) has been withdrawn, without regard to whether the Commission elects to adopt a rule that would impose a limited stay as discussed below.

6 In contrast to proposed Rule 190.14(b)(2), the Supplemental Proposal would be applicable only to SIDCOs, *i.e.*, the Chicago Mercantile Exchange and ICE Clear Credit.

7 The text of the proposed rule was not set out in the Supplemental Proposal.

8 *See, e.g.*, 12 CFR 382.4.

9 85 Fed. Reg. at 60113 (September 24, 2020).

In our Original Letter, we explained our position with respect to Subpart C of the Proposed Amendments as follows:

> In our view, upon a DCO's bankruptcy, the trustee's primary objective should be to ensure that the DCO's closeout procedures are promptly followed and that netting (and any related loss allocation) provisions in the DCO's rules are effectively applied in furtherance of the timely administration of the estate and the liquidation and distribution of the DCO's assets. We submit that the Commission's proposed Subpart C should be carefully tailored to support this objective. To this end, we further submit that proposed Subpart C should ensure that the rights and obligations of clearing members as set forth in the rules of a bankrupt DCO, including, where applicable, the right to have all open positions promptly closed and clearing members to receive the benefit of netting, are not adversely affected. Such deference is appropriate, as DCOs are regulated under, and their default rules must be consistent with, Part 39 of the Commission's rules.[10]

The Supplemental Proposal is inconsistent with this position. To the contrary, it introduces the concept of a stay of DCO closeout netting provisions where, arguably, no stay was contemplated under proposed Rule 190.14(b)(2). As the Commission is aware, proposed Rule 190.14(b)(2) provided that a trustee could seek the Commission's permission to continue to operate a DCO for a period of six days following an order for relief only if the trustee believed, *inter alia*, that continued operation would be practicable, *i.e.*, that the rules of the DCO "do not compel the termination of all or substantially all of the outstanding contracts under the circumstances then prevailing". As we noted in our Original Letter, all but four DCOs (and certainly the SIDCOs that potentially could become subject to Title II proceedings) have closeout netting provisions that would compel the termination of all or substantially all outstanding contracts. The Supplemental Proposal, on the other hand, would potentially impose a stay, albeit no more than 48 hours, only with regard to the two DCOs that are SIDCOs.

The Supplemental Proposal exposes DCOs, clearing members and their clients to unnecessary risks. The potential risk to DCOs, clearing members and their clients will increase during this stay period. Under the Supplemental Proposal, neither initial nor variation margin would be collected or paid during the stay period. The markets, however, will continue to move and will likely be highly volatile in reaction to the DCO's failure. The resultant losses to DCOs, clearing members and their clients, therefore, could be significant. Further, as the Commission acknowledges:

> For the duration of the stay period, clearing members and clients will be uncertain whether their contracts will continue (as part of a Resolution) or be terminated (and thus would need to be replaced). That uncertainty would mean

[10] Original Letter, p. 3.

> that clearing members and clients would be disadvantaged in determining how best to protect their positions.[11]

We believe the above risks far outweigh any potential benefits that the Supplemental Proposal may provide. This is particularly the case since we believe it is highly unlikely that its provisions will ever have to be called on in any event.

A determination with regard to invoking Title II will almost certainly be made before a SIDCO is subject to an order for relief. In the Supplemental Proposal, the Commission explains that the proposed stay is intended to address the risk that a SIDCO in financial distress could file for bankruptcy before the process to place the SIDCO into a Title II Resolution would have been completed and thereby undermine the potential success of such subsequently initiated Title II Resolution if the bankruptcy filing were to "immediately and irrevocably result in the termination of the SIDCO's derivatives contracts with its members . . ." As an initial matter, we would note that the closeout netting provisions in the rules of neither SIDCO provides for the immediate termination of its open contracts upon its bankruptcy filing. One SIDCO's rules provide that its open contracts will be terminated automatically – but not until 5 p.m., Eastern Time, on the second business day following its bankruptcy.[12] The other DCO's rules provide that its contracts will be terminated "promptly" (but not immediately).[13]

Moreover, if a SIDCO is experiencing such financial distress that it is considering filing for bankruptcy, the events leading to such distress will take place over a number of days, not overnight. In this case, we fully anticipate that the Commission, the FRB, the FDIC, and the Department of the Treasury will be making an assessment regarding the necessity and feasibility of recommending that the President invoke Title II and taking appropriate action before the SIDCO concludes that it must file a petition for bankruptcy.[14] We do not believe that Subpart C should be structured based on an assumption that they will fail to act in a timely fashion to cause the commencement of Title II proceedings with respect to a SIDCO prior to its filing for bankruptcy.[15]

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[11] 85 Fed. Reg. at 60114 (September 24, 2020).

[12] ICE Clear Credit Rule 810(b)(ii).

[13] Chicago Mercantile Exchange Rule 818.A.

[14] In this regard, we note that Commission Rule 39.19(c) assures that the Commission should have sufficient notice if a DCO is experiencing financial distress. The rule requires a DCO to notify the Commission whenever, *inter alia*, the DCO experiences a decrease in financial resources or liquidity resources of 25 percent or more in the total value of the financial resources or liquidity resources, as applicable, available to satisfy the DCO's obligations under Part 39, either from the last quarterly report submitted under Commission Rule 39.11(f) or from the value as of the close of the previous business day.

[15] We also do not believe that it is prudent to build in a stay that might give any relevant decision-maker a false sense that initiation of a Title II Resolution could be safely delayed until after the SIDCO's bankruptcy filing, particularly given that the one business day stay of the Title II Resolution would be tacked onto the Subpart C stay

The Supplemental Proposal also raises new questions regarding legal certainty, which should be resolved before the Commission takes any action to adopt the Supplemental Proposal. Specifically, section 404(a) of the Federal Deposit Insurance Corporation Improvements Act ("**FDICIA**") provides that "*[n]otwithstanding any other provision of law*, the covered contractual payment obligations and covered contractual payment entitlements of a member of a clearing organization to and from all other members of a clearing organization shall be netted in accordance with and subject to the conditions of any applicable netting contract." Further, sections 556, 560 and 561 of the Bankruptcy Code ("**Code**") except from the automatic stay provisions of section 362 of the Code "the exercise of any contractual right . . . to cause the termination, liquidation, or acceleration of or to offset or net termination values, payment amounts, or other transfer obligations arising under or in connection with one or more" financial contracts, including commodity contracts (section 556), swap agreements (section 560) and master netting agreements (section 561). A "contractual right" includes, *inter alia*, a right set forth in a rule or bylaw of a DCO. Whether a stay contemplated under the Supplemental Proposal would conflict with section 404(a) of FDICIA and these provisions of the Code is unclear, and we believe further analysis is required before the Commission takes any action to adopt the Supplemental Proposal.[16]

Commenting on the Supplemental Proposal presents procedural challenges. We take no position at this time with regard to whether the Supplemental Proposal satisfies the strict procedural requirements of the Administrative Procedure Act. Nonetheless, we wish to note that the Supplemental Proposal places commenters in a very difficult position procedurally. First, the proposed rule amendments are not set out, limiting commenters' ability to provide meaningful comments. The amendments may contain terms that commenters could not reasonably anticipate. Exacerbating this problem, any rule that the Commission may adopt will be subject to rules that the Prudential Regulators have yet to propose, let alone adopt. The terms of any rules that the Prudential Regulators adopt would necessarily inform our comments on the Commission's rules. Without having an opportunity to consider the rules, if any, that the Prudential Regulators may adopt and the analysis supporting their adoption, it is by no means clear that the Supplemental Proposal is sufficiently descriptive to evaluate and comment on the approach being considered.[17]

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contemplated in the Supplemental Proposal, which would further increase the exposure of clearing members and their clients to losses during the extended stay period.

[16] We appreciate that section 20(a) of the Commodity Exchange Act authorizes the Commission to adopt rules "[n]otwithstanding title 11 of the United States Code". However, it is no means clear that the Commission has authority to adopt rules that conflict with section 404(a) of FDICIA.

[17] Statement of Commissioner Dan M. Berkovitz, 85 Fed. Reg. at 60115 (September 24, 2020).

Conclusion. For all of the above reasons, we believe the better course is for the Commission to decline to adopt the Supplemental Proposal at this time.[18] The Commission should wait until the Prudential Regulators have acted. Then, if the Commission determines that a further amendment to Part 190 is appropriate, the Commission should propose specific rule text that will be subject to public comment. Since the Commission intends on soliciting public comment on any order implementing the Supplemental Proposal, proposing specific rule text at that time should not unnecessarily delay implementation.

Notwithstanding the foregoing, we note that, in its comment letter, the Chicago Mercantile Exchange ("**CME**") suggested that, if the Commission believes that some mechanism is necessary to accommodate placing a failing SIDCO into a Title II resolution proceeding before commodity contracts terminate, the Commission could add a provision to proposed Subpart C to require a DCO to notify the Commission in advance of filing a voluntary petition for relief, or of plans to present a resolution to the DCO's board seeking approval to file such a petition. Although we have not had an opportunity to analyze the CME's suggestion in detail, we believe it is one that deserves the Commission's strong consideration.[19]

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Thank you for your consideration of these comments. If the Commission or the staff have any questions regarding the matters discussed herein, please contact Allison Lurton, FIA's Chief Legal Officer and General Counsel, at 202.466.5460 or alurton@fia.org.

Respectfully submitted,

Walt L. Lukken
President and Chief Executive Officer

cc: Honorable Heath P. Tarbert, Chairman
Honorable Brian Quintenz, Commissioner
Honorable Rostin Benham, Commissioner
Honorable Dan Berkovitz, Commissioner
Honorable Dawn DeBerry Stump, Commissioner
M. Clark Hutchison, Director, Division of Clearing and Risk
Robert B. Wasserman, Chief Counsel and Senior Advisor

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[18] As noted above, however, FIA understands that proposed Rule 190.14(b)(2) and (3) has been withdrawn, without regard to whether the Commission elects to adopt a limited stay as set out in the Supplemental Proposal.

[19] Letter from Sunil Cutinho, President, CME Clearing, to Christopher J. Kirkpatrick, Secretary of the Commission, dated October 26, 2020.