sifma
asset management group

MANAGED FUNDS ASSOCIATION

***Submitted via portal***

July 13, 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 Securities Industry and Financial Markets Association's Asset Management Group ("**SIFMA AMG**")[1] and the Managed Funds Association ("**MFA**")[2] appreciate the opportunity to provide comments to the Commodity Futures Trading Commission (the "**Commission**" or the "**CFTC**") on its proposal (the "**Proposal**")[3] to amend the Commission's bankruptcy regulations contained in part 190 of title 17 of the Code of Federal Regulations ("**Part 190**").

We strongly 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.

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1 SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The customers of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

2 MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has cultivated a global membership and actively engages with regulators and policymakers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

3 85 Fed. Reg. 36000 (June 12, 2020).

The Commission should prioritize finalizing this rulemaking as soon as possible, as methodical, transparent and expedient bankruptcy proceedings provide stability and protect market participants and investors.

While we generally support the Proposal, we want to highlight three particular areas of concern we have with it:

- First, regarding the authority of the trustee and the Commission in the context of a DCO bankruptcy:
    - The trustee should not be required to defer to a debtor DCO's recovery and wind-down plans when implementing such plans, because such plans are not sufficiently prescriptive, are not created with Commission approval or enough market input, and are not publicly disclosed;
    - deference should not be granted to a debtor DCO's implementation of its own recovery and wind-down plans—adding this layer of deference will not enhance *ex ante* certainty; and
    - more explicit authority should be granted to the trustee to conduct the DCO bankruptcy in accordance with the core principles of proposed § 190.00 and the reduction of systemic risk generally.
- Second, regarding customer net equity claims and debtor DCO property:
    - When determining net equity claims,
        - explicit credit should be given to customers for any gains that were haircut during gains-based haircutting; and
        - such claims should be calculated as if a debtor DCO has "reverse the waterfall" rules that address each level of the DCO's waterfall.
    - Further, customer property should always include the property a debtor DCO contributes to its default waterfall (such property, the debtor DCO's "**skin in the game**"), and all of a debtor DCO's property should be available to satisfy customer claims in respect of gains haircut and non-default losses ("**NDLs**") that were not explicitly allocated under the debtor DCO's rules.
- Finally, with respect to the determination of the under-margined status of a customer of a debtor futures commission merchant ("**FCM**"):
    - It is critical to provide the customer the opportunity to demonstrate that a margin payment was made;
    - to the extent any of its gains were haircut, the customer should be given credit for such gains; and

- the timeframe to meet margin calls should reflect what is provided for in the applicable underlying agreements.

We appreciate the opportunity to provide our detailed thoughts on the Proposal below. We begin with general comments, noting in particular certain elements of the Proposal we support, and then specify areas of concern, first in relation to the Proposal's sections on the FCM as debtor, and then in relation to its sections on the DCO as debtor.

## I. General Comments and Areas of Support

We want to highlight our thoughts and support for a few specific aspects of the Proposal as it relates to the insolvency of a commodity broker. We believe the addition of proposed § 190.00 is helpful in providing the background and framework for Part 190. Setting forth the core concepts is useful guidance, and the core concepts themselves, as well as the definitions and discussions for each core concept, are appropriate in scope. We particularly support the Commission's approach in proposed § 190.00(d)(2)(ii) declining the exclusion of property held in a constructive trust from customer[4] property. We agree both with this principle, which serves to preserve the integrity of customer property, and with the clarity afforded by the direct approach that the Commission adopted on this issue.

We also support most elements under proposed § 190.04(b), subject to the concerns expressed below regarding calculation of customer positions and timing of margin calls. In particular, we approve of the inclusion of transfers in addition to liquidation, and the clarification to apply the proposed regulation to any open commodity contracts.

We strongly support the addition of proposed § 190.04(d)(3), intended to assure that customers using letters of credit to meet original margin obligations will be treated no differently from customers depositing other forms of non-cash margin or excess cash margin deposits. We agree that most letters of credit currently in use by the industry follow the Joint Audit Committee forms and we believe that the impact of these additional requirements concerning letters of credit will result in clearer guidance for more equitable treatment of customers within each account class. However, we do question the one-year transition period and urge the Commission to shorten it in the interest of investor protection. For example, if an FCM were to enter bankruptcy proceedings during the one-year transition period, how will letters of credit be treated in such proceeding?

Next, we believe the proposed use of residual interest as contemplated by proposed §§ 190.05(f) and 190.09 is appropriate, and we agree with the Commission that the residual interest provisions contained in § 1.11 remain important.

Finally, we understand the Commission's decision, due to limited resources, not to amend certain key definitions and concepts outside Part 190, as proposed by the Part 190 Subcommittee of the Business Law

[4] The term "customer" is used herein in the same manner as it is used in the Proposal, as appropriate given the context.

Section of the American Bar Association in its model set of Part 190 rules, at this time.[5] However, we urge the Commission to make these amendments as soon as possible, given the beneficial impact such changes will have on the administration of an FCM or DCO insolvency.

## II. Subpart B – Futures Commission Merchant as Debtor – proposed §§ 190.03-190.10

We support most of the substantive amendments to current Part 190 in proposed subpart B. We believe these changes are generally helpful both for purposes of reducing risk for market participants and allowing the trustee to act as efficiently as possible. However, we suggest the following refinements:

- With respect to a debtor FCM's treatment of under-margined customers, we request that the Commission amend proposed § 190.04(b) to:
    - provide customers with the opportunity to demonstrate that a margin payment was made even if the FCM's books and records do not yet reflect its receipt;
    - clearly state that, to the extent gains-based haircutting has been utilized by a DCO in respect of customer positions, the trustee should give customers of an FCM credit for any gains that were haircut during such gains-based haircutting; and
    - require the trustee to defer to the margin call timings present in the applicable underlying agreements entered into by the customer pursuant to § 39.13 when determining a reasonable time for meeting margin calls.
- The Commission should consider amending proposed § 190.08(b)(2)(xii) to treat accounts of the same principal or beneficial owner maintained by different agents or nominees as separate accounts and not all held in the individual capacity of such principal or beneficial owner.
- We request adding language to proposed § 190.07(d)(2) explicitly providing that the amount of any partial transfer that does increase a customer's net equity claim be added to such customer's residual claim.
- The Commission should explicitly clarify that proposed § 190.03(c)(2) is not intended to affect the treatment of hedging accounts under part 39 of title 17 of the Code of Federal Regulations ("**Part 39**"), and that, to the extent reasonably practicable, the trustee's goal will be to maximize value to the public customer. Additionally, in its treatment of hedging accounts, the trustee should first consult the instructions (regarding preferences with respect to transfer or liquidation of open commodity contracts) provided by a public customer to the debtor at the time of opening the relevant hedging account, and only if such

[5] These amendments include, *e.g.*, the definitions of foreign option and variation margin, as well as regulations concerning non-swap and non-futures over-the-counter transactions cleared by a DCO and concerning leverage transaction merchants.

instructions are missing or unclear should the trustee require such customer to provide it with written instructions as contemplated by proposed § 190.03(c)(2).

**a. Treatment of Under-Margined Customers – proposed § 190.04(b)**

We generally support proposed § 190.04(b), but have concerns regarding calculation of whether a customer is under-margined, and the timing of margin calls. We question whether the trustee will be able to accurately calculate whether a customer is under-margined, particularly if the FCM's books and records do not accurately reflect margin amounts transferred by such customer to the FCM, and we request further clarification from the Commission as to how the trustee will try to protect customers from being called upon to provide duplicate margin amounts.

Our recommendation is that the customer be given the opportunity to demonstrate that a margin payment was made even if the FCM's books and records do not yet reflect its receipt. Furthermore, we believe proposed § 190.04(b) should clearly state that to the extent gains-based haircutting has been utilized by a DCO in respect of customer positions, the trustee should give customers of an FCM credit for any gains that were haircut during such gains-based haircutting.

In addition, we do not agree that "absent exigent circumstances, a reasonable time for meeting margin calls made by the trustee shall be deemed to be one hour, or such greater period not to exceed one business day, as the trustee may determine in its sole discretion."[6] The necessary assets may not be readily available to customers, and we urge the Commission to require the trustee to defer to the margin call timings present in the applicable underlying agreements entered into by the customer pursuant to § 39.13. This is a reasonable level of deference, since the trustee will have access to these agreements (which are already in compliance with Commission regulations), and it will allow for customers to satisfy margin calls without causing needless market panic.

**b. Separate Accounts – proposed § 190.08(b)(2)(xii)**

The Commission has previously considered the question of how to treat accounts of the same principal or beneficial owner maintained by different agents or nominees. For example, in Letter No. 19-17, dated July 10, 2019, containing, in part, time-limited no-action relief with respect to the treatment of separate accounts by FCMs ("**Letter 19-17**"), the Commission's Division of Clearing and Risk and Division of Swap Dealer and Intermediary Oversight provided that a DCO may permit its FCM clearing members to treat separate accounts of a customer as accounts of separate entities for purposes of § 39.13(g)(8)(iii) where the FCM clearing member's written internal controls and procedures require it to, and the FCM in fact does, comply with the conditions for the relief as set forth in Letter 19-17.

We believe that the Commission should consider amending proposed § 190.08(b)(2)(xii) to treat accounts of the same principal or beneficial owner maintained by different agents or nominees as separate accounts and not all held in the individual capacity of such principal or beneficial owner. This would reduce the administrative difficulties the trustee would face in consolidating all accounts of the same principal or beneficial owner, and it would have the further benefit of avoiding any confusion as to treatment of separate accounts that could arise with the overlay of the time-limited relief provided by Letter 19-17. Finally, we

[6] *See* proposed § 190.04(b)(4).

note that this change would be similar to the approach taken by the Commission in proposed § 190.08(b)(2)(xiv), which provides that accounts held by a customer in separate capacities shall be deemed to be accounts of different customers.

### c. Partial Transfers – proposed § 190.07(d)(2)

We note, and strongly support, that the Commission has added language to proposed § 190.07 cautioning against partial transfers that would result in an increase in the amount of any customer's net equity claim, as well as language clarifying that property should be transferred with the associated contracts. We also wish to emphasize the point that in making any partial transfer of a customer's positions, the trustee should be particularly sensitive to subsets of those positions managed by different managers, a subset requiring special attention as we noted above.

We request that additional language be added to proposed § 190.07(d)(2) explicitly providing that any partial transfer that does make a customer worse off by increasing its net equity claim shall be added to such customer's residual claim.

### d. Hedging Accounts – proposed § 190.03(c)(2)

We agree generally with proposed § 190.03(c)(2), namely, the grant to the trustee of the authority (that is, the option but not the obligation) to treat open commodity contracts of public customers held in hedging accounts designated as such in the debtor's record as specifically identifiable property. We understand that, under this proposal, some customers may no longer be treated on a bespoke basis, but we believe that permitting the trustee this flexibility (subject to the additional customer protections described below) serves the interest of customers as a whole by facilitating a more rapid transfer of customer positions and property.

However, we do request that the Commission explicitly clarify that this provision is not intended to affect the treatment of hedging accounts under Part 39[7], and that, to the extent reasonably practicable, the trustee's goal will be to maximize value to the public customer. In addition, if the trustee exercises the authority it is granted in this section, we ask the Commission to require that the trustee first consult the instructions (regarding preferences with respect to transfer or liquidation of open commodity contracts) provided by a public customer to the debtor at the time of opening the relevant hedging account, and only if such instructions are missing or unclear, to then require such customer to provide the trustee with written instructions as contemplated by proposed § 190.03(c)(2). The notice sent by the trustee to the customer can still provide that existing or provided instructions may not prevent the open commodity contracts from being liquidated. In our view, adding this first step will further the goal of expediency.

## III. Subpart C – Clearing Organization as Debtor – proposed §§ 190.11-190.19

We broadly support the addition of proposed subpart C and believe that it will, in most instances, (i) help provide *ex ante* clarity to market participants evaluating the risks presented by the potential insolvency of

[7] This is consistent with the Commission's clarification in the preamble to the Proposal, that, with respect to designation of hedging accounts under proposed § 190.10(b), "hedging treatment for these bankruptcy purposes would not be determinative for any other purpose."

a DCO and (ii) effectuate fair and expedient outcomes in the event of a DCO bankruptcy. However, we do a have a few concerns:

- We believe that, as proposed, new subpart C requires the trustee to grant too much deference to:

  - a debtor DCO's recovery and wind-down plans (which are not public and may be insufficiently directive in any event); and

  - a debtor DCO's own implementation of its own recovery and wind-down plans.

  Our position is that a debtor DCO's rules, procedures and plans should not be given deference unless they are produced with the benefit of meaningful input from customers and clearing members.

  In addition, subpart C should be more explicitly guided by the principles articulated in proposed § 190.00 and by the goal of minimizing systemic risk generally.

- Subpart C should provide clearly that, to the extent gains-based haircutting has been utilized by a debtor DCO, the debtor DCO's clearing members and customers should be given credit for any of their gains that were haircut during such gains-based haircutting when such clearing members' and customers' net equity claims[8] are determined.

- 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 clearing members and 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.

- Subpart C should more clearly provide that customer property includes a debtor DCO's skin in the game.

- Subpart C should provide clearly that all of a debtor DCO's property (except the property excluded from customer property under proposed § 190.18(b)(2)) will be available to satisfy claims of clearing members and customers in respect of (i) gains haircut during gains-based haircutting and (ii) NDLs that were not explicitly allocated to such clearing members and customers under the debtor DCO's rules.

- Subpart C should more clearly address how conflicts between United States ("**U.S.**") and non-U.S. law should be resolved if a DCO located outside the U.S. (a "**non-U.S. DCO**") becomes insolvent.

[8] When we refer to customers' net equity claims in Section III of this letter, we are referring to clearing members' net equity claims based on their (public) customer accounts.

### a. Scope of deference to DCOs' default management rules and procedures and recovery and wind-down plans – proposed § 190.15

#### i. The trustee should not be required to defer to a debtor DCO's recovery and wind-down plans

Proposed § 190.15(a) and proposed § 190.15(c) both require the trustee to defer to DCOs' recovery and wind-down plans.[9] Requiring the trustee to defer to these plans is inadvisable and, in some cases, unworkable, for several reasons. First, these plans tend to be drafted as a menu of options rather than a clearly defined set of actions. As a result, they likely would not provide the trustee with clear direction in any event. A policy of deferring to a mere menu of options would effectively cause the trustee to defer to the judgment of the debtor DCO itself. Second, although these recovery and wind-down plans may have been reviewed by the Commission, they do not require Commission approval and they do not reflect any significant level of input from customers. As may become apparent only in the situation where a trustee attempts to oversee the recovery and wind-down plans effect on an actual DCO insolvency, these plans may not sufficiently account for interests of the debtor DCO's creditors; forced deference to them may lead to unforeseen and undesirable results. Third, because DCOs are not required to make these plans public, they cannot be relied upon as a fair reflection of the *ex ante* expectations of a DCO's stakeholders. Fourth, requiring the trustee in a DCO insolvency to defer to the debtor's resolution plans would be inconsistent with other regimes for the resolution of systemically important financial institutions.[10]

For these reasons, we believe that the trustee should not be required to defer to a debtor DCO's recovery and wind-down plans, and that reference to such plans should be removed from these sections. Instead, to the extent necessary, references to recovery and wind-down plans should be replaced with references to the DCO's publicly disclosed default rules and procedures,[11] as these, at least to some extent, benefit from public input.[12] To the extent a DCO wishes to have any elements of such plans granted deference in

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[9] Proposed § 190.15(a) provides that the trustee shall not avoid or prohibit any action taken by a debtor DCO that was reasonably within the scope of, and was provided for, in any recovery and wind-down plans maintained by such debtor and filed with the Commission pursuant to § 39.39, subject to title 11 of the United States Code (the "**Bankruptcy Code**"), section 766; proposed § 190.15(c) instructs the trustee to, in consultation with the Commission, take actions in accordance with any recovery and wind-down plans maintained by a debtor DCO and filed with the Commission pursuant to § 39.39, to the extent reasonable and practicable. See Proposal at 36095.

[10] 12 CFR § 243.11(a) and 12 CFR § 381.11(a), which are parts of the regulations issued by the Board of Governors of the Federal Reserve System (the "**Federal Reserve**") and the Federal Deposit Insurance Corporation (the "**FDIC**") that govern the resolution plans certain financial companies (including the U.S. global systemically important banks ("**G-SIBs**")) must submit to the Federal Reserve and FDIC in accordance with section 165(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5365(d)), each provide that "[a] resolution plan submitted pursuant to this part ***shall not have any binding effect*** on: (1) A court or trustee in a proceeding commenced under the Bankruptcy Code; (2) A receiver appointed under title II of the Dodd-Frank Act (12 U.S.C. 5381 et seq.); (3) A bridge financial company chartered pursuant to 12 U.S.C. 5390(h); or (4) Any other authority that is authorized or required to resolve a covered company (including any subsidiary or affiliate thereof) under any other provision of Federal, state, or foreign law." (***emphasis added***).

[11] We note that default procedures are required to be public pursuant to Part 39 (*see* § 39.21(c)(6)). However, in practice, we do not believe that all DCOs make such procedures public. Therefore, we believe that Part 190 would benefit from the clarification that, when the trustee is to rely upon default procedures for any purpose, such procedures must be publicly disclosed.

[12] *See*, *however*, our discussion below.

bankruptcy, it should incorporate these elements in its public rules and public procedures. The Commission's goal of establishing through new subpart C a clear counterfactual to resolution of a DCO under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act[13] is undermined by deferring to plans that are not clear or visible to market participants.

While we support requiring the debtor DCO to share its recovery and wind-down plans with the trustee as required by proposed § 190.11 – as such plans may provide helpful guidance – we do not believe they should be deferred to, and therefore, we request that the Commission remove proposed §§ 190.15(a) and 190.15(c).

**ii. <u>If some level of deference to DCOs' recovery and wind-down plans is retained, the trustee should not be required to defer to a debtor DCO's implementation of its own plans.</u>**

Proposed § 190.15(a) provides a debtor DCO with too much deference 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 (or, as requested in sub-section (iv) below, is contrary to the principles articulated in proposed § 190.00). 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*).

Should the Commission choose to retain proposed § 190.15(a), we believe that, at a minimum, proposed § 190.15(a) should be amended to (i) remove the words "was reasonably within the scope of and", and to (ii) replace the references therein to recovery and wind-down plans with references to the debtor's default rules and procedures. By removing the words "was reasonably within the scope of and", the Commission would effectively remove a layer of discretion that the debtor DCO may exercise in the implementation of its own rules that may detract from the *ex ante* certainty intended to be provided by deference to the DCO's rules, and which in any event may not be consistent with the principles articulated in proposed § 190.00.

**iii. <u>If deference to debtor DCOs' default management rules and procedures and recovery and wind-down plans is mandated, customers must be afforded greater opportunity to participate in the development and application of such rules, procedures and plans</u>**

We believe that if the deference to DCOs' default management rules and procedures and recovery and wind-down plans mandated in proposed subpart C is preserved, then the Commission should amend Part 39 and part 40 of title 17 of the Code of Federal Regulations ("**Part 40**") of its regulations to ensure that customers have the opportunity to provide meaningful input during the development and application of

[13] *See* Proposal at 36002 (". . . the Commission is proposing to establish ex ante the approach to be taken in addressing [the bankruptcy of a clearing organization], in order to foster prompt action in the event such a bankruptcy occurs, and in order to establish a clear counterfactual (i.e., 'what would creditors receive in a liquidation in bankruptcy?') in the event of a resolution of a clearing organization pursuant to Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act[.]").

such rules, procedures and plans. Accordingly, we request that the Commission take each of the following actions:

- Amend Part 39 to require that each DCO create an advisory committee comprising market participants, including customers, to provide feedback on proposed rules and procedures, rule and procedure changes, new product and product changes and recovery and wind-down plans (each such committee, an "**Advisory Committee**").
- Amend Part 40 to require that each DCO obtain market feedback (including feedback from the Advisory Committee) prior to filing any proposed rule, rule change, new product or product change.
- Amend Part 40 to require that each DCO, in connection with the submission for any proposed rule, rule change, new product or product change: (1) certify that it solicited market feedback (including feedback from the Advisory Committee); (2) summarize all material views received from market participants and the Advisory Committee, supportive and opposing; and (3) delineate whether such views are from clearing members or customers.[14]

#### iv. The trustee and the Commission should explicitly be required to consider the core concepts set forth in proposed § 190.00 and systemic risk in implementing a debtor DCO's rules, procedures and plans

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 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. Therefore, we request that the Commission add a new clause to proposed § 190.15 that provides the following:

> The trustee and Commission must, in the implementation of this § 190.15, consider whether implementation of the debtor's default rules and procedures [and recovery and wind-down plans][15]

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[14] SIFMA AMG has previously requested that the Commission (i) require DCOs to create advisory committees comprised of market participants, including customers, "with a view of obtaining feedback of the relevant firms on proposed rules, rule changes, new products and product changes" and (ii) "specifically require DCOs to obtain market feedback prior to filing any proposed rule, rule change, new product and product change." *See* Section I(b) of SIFMA AMG's Letter to the CFTC on Derivatives Clearing Organization General Provisions and Core Principles (dated September 13, 2019), *available at* https://www.sifma.org/resources/submissions/derivatives-clearing-organization-general-provisions-and-core-principles-proposed-amendments-rin-3038-ae66/. In Section I(c) of the same letter, SIFMA AMG expressed the following:

> . . . DCOs should provide a summary of the feedback it receives from the advisory committee and other market participants and include <u>both</u> supporting as well as opposing views. DCOs should include in their submissions a certification that they solicited market feedback and that the summary provided includes all material views, supportive and opposing. The summary should also delineate whether the views were received from members or customers.

[15] The bracketed language in this proposed clause should not be present if the Commission adopts our recommendation to delete proposed §§ 190.15(a) and 190.15(c).

may undermine the core principles set forth in § 190.00 or may pose additional systemic risk and, if they determine that such implementation would do so, the trustee may override such rules and procedures [and plans] to the extent necessary to avoid such consequences.

**b. Treatment of gains haircut during gains-based haircutting – proposed §§ 190.17 and 190.18(b)(1)**

We believe that to the extent gains-based haircutting has been utilized by a debtor DCO, the debtor DCO's clearing members and customers should be given credit for any of their gains that were haircut during such gains-based haircutting when their net equity claims are determined. Therefore, we request that the Commission amend proposed §§ 190.17 and 190.18(b)(1) to explicitly make clear that any gains that were haircut during gains-based haircutting will be treated as customer property and included in the net equity claims of the clearing members and customers whose gains were haircut.

**c. Allocation of recoveries against debtor DCOs' defaulting clearing members and others – proposed § 190.17**

While we appreciate that proposed § 190.17(b)(2) would implement a debtor DCO's pre-existing "reverse the waterfall" rules through adjusting clearing members' and customers' net equity claims in light of recoveries against the debtor DCO's defaulting clearing members and others, we are concerned with the potential case in which 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.[16] Therefore, we request that the Commission amend proposed § 190.17 to 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 clearing members and 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.

**d. DCO property available to satisfy claims of clearing members and customers generally – proposed § 190.18**

Our position is that a debtor DCO's skin in the game should be available to satisfy the net equity claims of the debtor DCO's clearing members and customers.[17] While we believe the intention of proposed § 190.18(b)(1)(ii)(E), which provides that customer property includes property of a type described in proposed § 190.09(a)(1)(ii)(H) ("property of the debtor that any applicable law, rule, regulation, or order requires to be set aside for the benefit of customers"), is to provide that customer property includes a debtor

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[16] For example, a DCO that employs gains-based haircutting might have "reverse the waterfall" rules that do not allocate recoveries on claims against defaulting clearing members and others to those clearing member and customer accounts for which gains were haircut during gains-based haircutting.

[17] We agree with the Committee on Payments and Market Infrastructures' ("CPMI") and the International Organization of Securities Commissions' ("IOSCO") guidance that "a [central counterparty ("CCP")] should determine and expose an amount of its own financial resources to absorb losses resulting from a participant default and the custody and investment of participant assets that would enhance confidence that the CCP's design, rules, overall strategy and major decisions reflect appropriately the legitimate interests of its participants and other relevant stakeholders." See Section 6.2 of CPMI-IOSCO, Resilience of central counterparties (CCPs): Further guidance on the PFMI – Final report (July 2017), available at https://www.bis.org/cpmi/publ/d163.pdf.

DCO's skin in the game, we request that the Commission amend proposed § 190.18 to explicitly provide that customer property includes property a debtor DCO contributes to its default waterfall. We also reiterate the point made above regarding the DCO's skin in the game in the context of daily settlement, and the need to clarify proposed § 190.19(b)(1).

**e. <u>DCO property available to satisfy claims of clearing members and customers in respect of gains haircut and NDLs – proposed § 190.18</u>**

We take the view that all of a debtor DCO's property (except the property excluded from customer property under proposed § 190.18(b)(2)) should be available to satisfy the claims of the DCO's clearing members and customers in respect of (i) gains haircut during gains-based haircutting and (ii) NDLs that were not explicitly allocated to such clearing members and customers under the DCO's rules. In this regard, we are concerned with the Commission's decision not to map over proposed § 190.09(a)(1)(ii)(L) to proposed § 190.18(b)(1)(ii).[18] As currently drafted, proposed § 190.18(b)(1)(ii) does not include any provision that protects DCOs' clearing members and customers from shortfalls in customer property. Therefore, we request that the Commission map over proposed § 190.09(a)(1)(ii)(L) to proposed § 190.18(b)(1)(ii) (with necessary modifications to apply to DCOs), with the statement that it only applies with respect to (i) any gains haircut during gains-based haircutting and (ii) NDLs where the debtor DCO's rules do not already address what resources are available to pay for such NDLs.

We also request that the Commission amend proposed § 190.19(b)(1) to make it clearer that the debtor's recovery and wind-down plans shall only apply with respect to proposed § 190.19(b)(1)(ii) – the debtor's skin in the game (which we believe is the Commission's intention) – and not with respect to the other sub-parts of proposed § 190.19(b)(1).

**f. <u>Conflicts between U.S. and non-U.S. law in event of insolvency of non-U.S. DCO</u>**

We believe that Part 190 should include a clear statement of public policy to the effect that if an insolvency proceeding is commenced in respect of a DCO located outside the United States, such home country proceeding should take precedence over any case under the Bankruptcy Code. Some of the most systemically important DCOs are located outside the U.S. If one of these non-U.S. DCOs becomes insolvent, there would presumably be a proceeding undertaken in such non-U.S. DCO's home jurisdiction. However, because such non-U.S. DCO would likely also have property in the U.S., it may well be possible for a creditor (or even the non-U.S. DCO itself) to begin a case under the Bankruptcy Code. The relevant U.S. bankruptcy court would then need to decide whether such a case would proceed in parallel with the proceeding in the non-U.S. DCO's home jurisdiction or whether the non-US proceeding should take the primary role. Although one might expect that the non-U.S. DCO or some other party would bring an action in the U.S. Bankruptcy Court (for example under Chapter 15 of the Bankruptcy Code) to establish the

[18] Proposed § 190.09(a)(1)(ii)(L) provides that the term "customer property" in the context of an FCM bankruptcy includes any cash, securities, or other property in the debtor FCM's estate, but only to the extent that the customer property under the other definitional elements of proposed § 190.09(a)(1) is insufficient to satisfy in full all claims of the debtor FCM's public customers. The Commission explains that proposed § 190.09(a)(1)(ii)(L) was not mapped over to proposed § 190.18(b)(1)(ii), which relates to the scope of the term "customer property" in the context of a DCO bankruptcy, because proposed § 190.09(a)(1)(ii)(L) "would not be applicable based on the differences in business models, structures, and activities between FCMs and of DCOs." *See* Proposal at 36039.

primacy of the home jurisdiction's proceeding, such a case would be a case of first impression under the Bankruptcy Code. Assuming that the Commission believes that the home jurisdiction's proceeding should take the primary role, a statement to that effect in subpart C would create greater legal certainty as to the treatment of clearing members' and customers' claims in such a foreign proceeding. Such action by the Commission would provide comfort to market participants who are concerned about litigation regarding which courts and laws should govern questions related to the insolvency of a non-U.S. DCO.

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We commend the Commission for undertaking the effort to modernize and improve Part 190. We thank the Commission for providing SIFMA AMG and MFA the opportunity to comment on the proposed amendments. Should you have any questions, please do not hesitate to contact Jason Silverstein at (212) 313-1176 or jsilverstein@sifma.org on behalf of SIFMA AMG, or Jennifer Han at (202) 730-2600 or jhan@managedfunds.org on behalf of MFA.

Respectfully submitted,

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