

MEMO# 32481

May 22, 2020

CFTC Proposes Amendments to Part 190 Bankruptcy Regulations - ICI Member Call June 3

[32481]

May 22, 2020 TO: Derivatives Markets Advisory Committee RE: CFTC Proposes
Amendments to Part 190 Bankruptcy Regulations - ICI Member Call June 3

On April 14th, the CFTC unanimously approved proposed amendments to its Part 190 bankruptcy regulations.^[1] The CFTC's proposal, which is based on a 2017 submission by the Part 190 Subcommittee of the Business Law Section of the American Bar Association ("ABA recommendations"),^[2] is intended to comprehensively update Part 190 for the first time in 37 years to reflect current market practices and lessons learned from past commodity broker bankruptcies. Comments on the proposal are due on July 13th.

ICI plans to submit comments on the proposal. We will hold a member call on Wednesday, June 3rd, from 4-5 pm ET, to discuss potential ICI comments on the proposal. We are pleased to be joined on the call by our outside counsel from Cleary Gottlieb. We will send you an Outlook invitation for the member call that will include dial-in information. To facilitate discussion, prior to the June call, we will send you: (i) a list of issues for discussion and potential comment; (ii) ICI's 2018 comments to the CFTC staff on the ABA recommendations. We look forward to your comments and questions.

Themes of Part 190 Proposal

On our member call, we will discuss the proposed amendments that are most relevant to regulated funds, as participants in the derivatives markets. The proposed amendments are highly technical. Rather than enumerating them here in detail, we note below the ten major themes of the proposed amendments, as summarized in the fact sheet for the proposal:^[3]

Improvements to Customer Protection

1. Many of the proposed changes are designed to enhance the protection of customer property by: (i) strengthening the rules requiring that shortfalls in property segregated for customers be made up from a futures commission merchant's (FCM's) general assets, (ii) clarifying that claims of public customers come before proprietary and affiliate claims, and (iii) clarifying that public customers are entitled among

themselves to a pro rata distribution based on their respective claims.

2. Other changes would foster the policy preference for transferring positions of public customers, and those customers' proportionate share of associated collateral, to a solvent FCM instead of liquidating those positions. The CFTC explains that transferring or "porting" positions both protects customers, who get to retain their hedging and other positions, and protects markets, by avoiding the forced liquidation of a large volume of positions.
3. By clarifying the trustee's discretion to make reasonable estimates under conditions of imperfect information, the proposed amendments support distributing more funds to customers more promptly.

A Modernized Rule Set

4. Many of the proposed changes reflect technological developments, including significant changes to the speed of transactions, changes from paper-based to electronic-based communication and recording of "documents of title," and increased incidence of deliverable assets that are intangible (including digital currencies).
5. Many of the changes are intended to update Part 190 in light of shifts in the regulatory framework over the past three decades, including addressing the interaction between Part 190 and recent revisions to the CFTC's customer protection rules.
6. Many of the proposed changes also recognize the actual practice in prior FCM bankruptcies.

Enhanced Clarity and Transparency

7. A new section is proposed to be added to set out core concepts for Part 190, in order to enhance the understanding of derivatives clearing organizations (DCOs), FCMs, their customers, bankruptcy trustees, and the public at large.
8. The proposal clarifies that Part 190 is applicable in the context of proceedings under the Securities Investor Protection Act in the case of FCMs that are also broker-dealers, and resolution of a derivatives clearing organization under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Addressing Challenges to Financial Market Infrastructures

9. The CFTC proposes a new subpart C to Part 190, governing the bankruptcy of a DCO. This would establish, in advance, the approach to be taken 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 liquidation in bankruptcy?") in the event of a resolution of a DCO. /li>
10. The proposed framework allows the trustee appropriate discretion in dealing with this type of bankruptcy, which has never occurred.

endnotes

[1] See <https://www.cftc.gov/media/3761/federalregister041420/download>.

[2] The ABA subcommittee submitted its suggestions on Part 190 in response to the CFTC's "Project KISS" initiative. The ABA submission can be found at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61331&SearchText> and the accompanying cover note can be found at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61330&SearchText>.

[3] The fact sheet on the proposal is *available at* https://www.cftc.gov/media/3731/NPRM_FactSheet_FormCPO-PQR_041420/download.

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