

MEMO# 32860

October 27, 2020

ICI Files Comment Letter on CFTC Supplemental Proposal on Part 190 Bankruptcy Regulations

[32860]

October 27, 2020 TO: ICI Members

ICI Global Members

Derivatives Markets Advisory Committee

ICI Global Regulated Funds Committee

ICI Global Trading & Markets Committee SUBJECTS: Derivatives

International/Global

Investment Advisers

Trading and Markets RE: ICI Files Comment Letter on CFTC Supplemental Proposal on Part 190 Bankruptcy Regulations

ICI has filed a comment letter with the Commodity Futures Trading Commission ("Commission") on the Commission's September supplemental notice of proposed rulemaking ("Supplemental Proposal"). The Supplemental Proposal was intended to address a concern raised by commenters about whether certain of the amendments to Part 190 that the Commission proposed in April ("April Proposal") could potentially undermine the enforceability of derivatives clearing organization (DCO) rules regarding close-out netting.[\[1\]](#) ICI's comment letter is attached, and is summarized below.

ICI Supports the Commission's Withdrawal of Proposed Regulation 190.14(b)(2) and (3)

ICI supports the Commission's withdrawal of proposed Regulation 190.14(b)(2) and (3). Several DCOs and a futures commission merchant (FCM) expressed concern that operation of proposed Regulation 190.14(b)(2) and (3) could undermine the enforceability of certain DCO closeout netting provisions and questioned whether, for bank-affiliated clearing members, the proposed regulation would cause these arrangements to no longer qualify as a "qualifying master netting agreement" (QMNA) for purposes of the bank capital requirements that have been established by the US prudential regulators. Proposed Regulation 190.14(b)(2) and (3) would have allowed a DCO to continue operating for six or fewer days after an order for relief was entered where, among other things, continued operation would facilitate resolution under the Dodd-Frank Act's Orderly Liquidation Authority (OLA) special resolution regime, or transfer of clearing operations to another DCO and all or substantially all of the clearing members of the DCO would be able to, and

actually would, continue making variation margin payments.

The continued operation of a DCO has the potential to result in significant continued losses for customers and exacerbate stress. The comment letter explains that the withdrawal of proposed Regulation 190.14(b)(2) and (3), without additional measures, is sufficient to address the concerns of commenters regarding enforceability of DCO close-out netting provisions. The elimination of these provisions will leave no doubt that, upon a DCO insolvency, clearing members will be able to close out and net in accordance with the DCO rules. Accordingly, as a result of the Commission withdrawing these provisions, Part 190 should not act as a barrier to a QMNA determination.

The Commission Should Not Adopt a Stay Under Part 190

ICI urges the Commission to withdraw its proposed stay under Part 190. The Commission's intention in proposing a stay that would apply to contracts of systemically important DCOs (SIDCOs) for a brief time after bankruptcy is to provide the FDIC, the Federal Reserve Board, and the Secretary of the Treasury with enough time to initiate proceedings under OLA. ICI asserts that the Commission's proposed stay is not necessary to achieve this objective and its negative consequences far outweigh any potential benefits.

The Commission's proposed stay could be as long as 48 hours. In addition, it could be followed by OLA's one-business day stay. As a result, the two stays, applied consecutively, could prevent the liquidation of a SIDCO's derivatives contracts for as long as three business days or five calendar days. The comment letter explains that suspension of close-out rights for up to three business days or five calendar days is unacceptably long, and could result in significant loss of value to public customers such as regulated funds, causing irreversible harm to these funds and their shareholders. The letter notes that such an extended stay threatens to cause significant losses to customers and create additional uncertainty at a time of unprecedented market distress. These concerns are greatly exacerbated by the Supplemental Proposal's prohibition on continued collection or payments of initial margin or variation margin during the stay. Rather than facilitating a resolution, the Commission's proposed stay, especially when imposed in conjunction with the OLA stay, would likely make it more difficult to resolve a failing DCO, contrary to the Commission's objectives in this rulemaking.

The Commission's proposed Part 190 stay also would undermine US and global efforts to reduce uncertainty and ensure fair treatment of regulated funds in the event of a CCP resolution, as it would significantly increase uncertainty and customer loss exposure. In addition, the Supplemental Proposal would create substantial legal uncertainty, as it is unclear how the Commission's proposed stay would interact with the safe harbors for close-out rights set out in the Bankruptcy Code or the clearing organization netting provisions of the Federal Deposit Insurance Corporation Improvement Act (FDICIA).

The Commission Has Provided Inadequate Public Notice and Opportunity for Comment

ICI's comment letter asserts that the Supplemental Proposal does not provide the public with adequate notice of the Commission's rule text or an opportunity for comment. The Supplemental Proposal does not include proposed rule text and the Commission suggests that it does not intend to publish draft rule text for notice and comment before finalizing it. Rather, it states that it will provide public notice and comment once the prudential regulators have taken actions sufficient to make the Part 190 stay provision consistent with the QMNA status of SIDCO rules. Public comment would be limited to whether the

prudential regulators' actions are sufficient to achieve that objective.

The comment letter also explains that the Commission's economic analysis is inadequate. We question how the Commission can undertake an accurate economic analysis that considers the potential costs and benefits of the rule without proposed rule text. Further, the Commission's economic analysis does not consider the significant costs to market participants of a stay that could, in conjunction with the OLA stay, extend for as long as three business days or five calendar days. Nor does the Commission's economic analysis take into account that the Supplemental Proposal withdraws the provision in the April Proposal that permits exchange of margin, replacing it with an explicit prohibition on exchange of margin. The inability to exchange margin during the stay period increases risks and potential costs to regulated funds. The letter asserts that the Commission must address these procedural deficiencies before adopting any final rule.

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[Attachment No. 1](#)

[Attachment No. 2](#)

endnotes

[1] For a summary of the Supplemental Proposal, *please see* ICI Memorandum No. 32783 (Sept. 25, 2020), *available at* https://www.ici.org/my_ici/memorandum/memo32783.