BETTER MARKETS

By Electronic Submission

September 26, 2023

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

Re: Derivatives Clearing Organizations Recovery and Orderly Wind-Down Plans: Information for Resolution Planning (RIN 3038-AF16)

Dear Mr. Kirkpatrick:

Better Markets[1] appreciates the opportunity to comment on the proposed rule ("Proposed Rule") issued by the Commodity Futures Trading Commission ("CFTC" or "Commission"), which is proposing to amend the requirements related to recovery and orderly wind-down and resolution planning for Derivatives Clearing Organizations (DCOs) that have been designated as systemically important (SIDCOs) as well as other DCOs that elect to comply with DCO core principles by satisfying the higher standards for SIDCOs (Subpart C DCOs).[2]

The 2008 financial crash exposed the vulnerabilities inherent in the opaque and unregulated derivatives market, where complex financial instruments had been traded without proper oversight or transparency. These derivatives played a significant role in exacerbating the crisis by amplifying risks and facilitating the spread of contagion throughout the financial system. In direct response to the cataclysmic economic fallout triggered by the crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act emerged as a comprehensive solution.[3] It was crafted with the explicit aim of addressing the systemic vulnerabilities that had pushed the financial system to the precipice of collapse, and it set out to enact sweeping changes in the derivatives landscape to prevent such a calamity from recurring.

A cornerstone of Dodd-Frank's derivatives reforms was the introduction of central clearing for derivatives contracts. By mandating that certain derivatives be cleared through regulated

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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 that protects and promotes Americans' jobs, savings, retirements, and more.

2 Derivatives Clearing Organizations Recovery and Orderly Wind-Down Plans; Information for Resolution Planning; 88 Fed. Reg. 48,968 (July 28, 2023).

3 Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

clearinghouses, the legislation aimed to bring greater transparency and risk mitigation to a previously murky and perilous market. The central clearing requirement ensured that these contracts would be processed and settled through intermediaries, known as DCOs, which would act as guarantors of trades, effectively standing between counterparties. DCOs can be likened to the financial system's plumbing, often overlooked but nonetheless indispensable.[4]

One of the pivotal provisions of Dodd-Frank was granting authority to the Commission to promulgate and enforce regulations governing DCOs. These regulations were pivotal in establishing the rules and standards by which DCOs would operate.[5] They laid the foundation for the safety and soundness of DCOs, ensuring they could effectively manage risk, provide stability to the financial system, and respond to market stress with resilience. Indeed, these regulations were indispensable in bolstering the stability and resilience of the financial system, particularly in times of economic turbulence and stress.

DCOs play an indispensable role within our financial markets, serving as the linchpin for essential clearing and settlement market infrastructure. During moments of heightened stress and uncertainty, DCOs assume a critical role by providing the vital services necessary for maintaining continuity in the financial markets they serve. The global adoption of the central clearing mandate has ushered in a notable escalation in clearing volumes across the swaps market. However, the act of clearing, despite its many advantages, is not devoid of inherent risks. In recognition of this, market regulators must take proactive measures to ensure that clearinghouses are not merely commercially viable entities but are also well-prepared to operate effectively and provide their indispensable services as anticipated, even when confronted with extreme market stressors.

This critical role of DCOs in maintaining market stability during challenging times underscores Better Markets' support for the Proposed Rule. The proposal seeks to codify and expand upon existing staff guidance, setting forth explicit requirements for SIDCOs and Subpart C DCOs in terms of providing information to the Commission for resolution planning. By enhancing risk management, bolstering resilience, and fortifying contingency planning across these vital entities, the Proposed Rule ensures a greater level of predictability in the event of unforeseen disruptions to DCO operations.

Clearinghouses should have a robust recovery and wind-down plan as part of maintaining a sound risk management framework.[6] Recovery and wind-down plans are essential to prevent losses across our markets and any spillover effects into other markets. An effective wind-down plan promotes the goal of ensuring, at a minimum, that the DCO has sufficient resources,

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4 Sam Schulhofer-Wohl, Externalities in securities clearing and settlement: Should securities CCPs clear trades for everyone?, FEDERAL RESERVE BANK OF CHICAGO (Mar. 2021), *available at* https://www.chicagofed.org/publications/policy-discussion-papers/2021/2021-02

5 Derivatives Clearing Organizations General Provisions and Core Principles, 76 FR 69,333 (Nov. 8, 2011).

6 *See* Better Markets' Comment Letter, Covered Clearing Agency Resilience and Wind-Down Plans; 88 Fed. Reg. 34708 (May 30, 2023), *available at* https://bettermarkets.org/wp-content/uploads/2023/07/Better_Markets_Comment_Letter_SEC_Covered_Clearing_Agency_Resilience_Recovery_Wind_Down_Plans.pdf

capabilities and legal authority to implement the tools and procedures for orderly wind-down activities. It is imperative that DCOs, not just the largest ones, have orderly wind-down plans in place to prevent significant market disruptions throughout our financial system. The Commission's commitment to ensuring the integrity of all DCOs aligns with Better Markets' support for these measures to safeguard the financial system's stability. The scenarios outlined in the Proposed Rule would necessitate a comprehensive assessment of a broad range of relevant risks.

COMMENTS

I. The Commission should adopt the proposed amendments to Regulation 39.39 to ensure the financial integrity of all transactions subject to the Commodities Exchange Act, mitigate systemic risks, and improve the quality of information received from SIDCOs and Subpart C DCOs for resolution planning purposes.

Recovery Plan and Orderly Wind-Down Plan: Required Elements.

Regulation 39.39(c)(1) presently mandates that SIDCOs and Subpart C DCOs create both recovery and orderly wind-down plans. These plans must encompass various scenarios that might impede their ability to meet obligations, deliver critical services, and assess recovery or wind-down options effectively. Initially, when the Commission introduced § 39.39(c)(1), there were requests from stakeholders for more explicit requirements regarding recovery plans.[7] However, the Commission refrained from providing such specifics because the relevant international guidance had not been finalized when the regulation was adopted in 2013.[8]

Subsequently, after international guidance became more defined, the CFTC issued CFTC Letter No. 16–61, offering informal guidance on these elements.[9] Notably, the Proposed Rule highlights that the Commission's supervisory experience suggests that the recovery and orderly wind-down plans of SIDCOs and Subpart C DCOs tend to be in accordance with the principles outlined in Letter No. 16–61.[10] Consequently, most, if not all, of the requirements proposed are already incorporated into the plans submitted by DCOs currently under the purview of § 39.39.[11] The Commission is proposing to formally include staff guidance in the Commission's part 39 regulations, thereby specifying the necessary elements that SIDCOs and Subpart C DCOs must include in their recovery and orderly wind-down plans.

Better Markets strongly encourages the Commission to adopt the proposed changes, specifically the replacement of § 39.39(c) and the introduction of new requirements in proposed § 39.39(c). These changes align with international standards for recovery plans and orderly wind-

7 *See* Proposed Rule at 48,976.
8 *Id.*
9 CFTC Letter No. 16–61, Recovery Plans and Wind-down Plans Maintained by Derivatives Clearing Organizations and Tools for the Recovery and Orderly Wind-down of Derivatives Clearing Organizations (July 21, 2016), available at https://www.cftc.gov/LawRegulation/CFTCStaffLetters/letters.htm?title=16-61&field_csl_letter_year_value=.
10 *See* Proposed Rule at 48,976.
11 *Id.*

down plans while also drawing upon relevant DCR staff guidance outlined in CFTC Letter No. 16–61. The new requirements encompass critical elements such as the identification of a DCO's critical operations, staffing arrangements, stress scenario analyses, descriptions of governance arrangements, and more.[12]

These proposed enhancements are essential for ensuring the viability and effectiveness of these plans, reflecting the minimum standards that SIDCOs or Subpart C DCOs should include in their recovery and orderly wind-down plans. By formalizing these requirements, the Commission will promote clarity, transparency, and consistency in risk management practices across the industry. This, in turn, will contribute to the overall resilience and stability of the financial system. Better Markets fully supports the adoption of these changes to safeguard the integrity of our markets.

Information for Resolution Planning

Better Markets firmly supports the Commission's proposal to update its regulations, specifically § 39.39(c)(2) transformed into new § 39.39(f), aligning with international standards and guidance on resolution planning for systemically important Financial Market Infrastructures (FMIs).[13] In the United States, the Federal Deposit Insurance Corporation (FDIC) would be designated as the receiver for a failing SIDCO or other covered financial company under Title II of the Dodd-Frank Act.[14] This bifurcation of responsibilities between the FDIC and the Commission creates complexities, emphasizing the need for advanced preparation to ensure a seamless transition to FDIC receivership in case of resolution, thus promoting the success of a Title II resolution.

Under Section 8a(5) of the Commodity Exchange Act (CEA), the Commission possesses the authority to make and promulgate rules and regulations deemed reasonably necessary to achieve the goals of the CEA, including the avoidance of systemic risk.[15] This is particularly relevant in the context of aiding the FDIC in its resolution preparations under Title II, where placing a DCO into resolution requires a determination that its failure and resolution under other applicable laws would have serious adverse effects on U.S. financial stability.[16]

Moreover, under Title VIII of the Dodd-Frank Act, the Commission can establish risk management standards for SIDCOs, emphasizing robust risk management, safety, soundness, reduced systemic risks, and support for broader financial system stability.[17] These standards cover

12 *See* Proposed Rule at 48,976.
13 *See* Proposed Rule at 48,983.
14 *See* Section 202(a) of the Dodd-Frank Act; 12 U.S.C. 5382(a).
15 Section 3(b) of the CEA, 7 U.S.C. 5(b).
16 Section 203(b)(2) of the Dodd-Frank Act, 12 U.S.C. 5383(b)(2).
17 12 U.S.C. 5464(b).

areas such as risk management policies, margin requirements, participant default procedures, timely clearing and settlement, capital and financial resources, and more.[18]

Just as thorough preparation for recovery and orderly wind-down planning is crucial, advanced planning for resolution is equally vital for mitigating adverse effects on financial stability and instilling market and international confidence.[19] While the Proposed Rule acknowledged that the likelihood of a SIDCO requiring resolution under Title II is exceedingly low, comprehensive planning remains essential.[20] The proposal also recognizes that Subpart C DCOs may require similar information during extreme market stress, and as such, the proposed § 39.39(f) would apply to both SIDCOs and Subpart C DCOs to ensure effective resolution planning.[21]

Furthermore, as resolution planning standards are often principle-based and require cooperation between resolution and supervisory authorities, the Proposed Rule acknowledges that DCOs may possess information necessary for resolution planning that may not typically be reported to the Commission or publicly disclosed.[22] Therefore, specifying the types of information SIDCOs and Subpart C DCOs may be required to provide for resolution planning, in line with international standards established since 2013, represents a prudent and necessary step, one that Better Markets supports.

Better Markets supports the Proposed Rule, as it fosters comprehensive resolution planning, enhances the stability of financial markets, and ensures effective cooperation between regulatory authorities.

II. <u>The Commission should adopt the proposed amendments to require DCOs that are neither SIDCOs nor Subpart C DCOs to maintain and submit to the Commission plans for orderly wind-down.</u>

The Commission is proposing a requirement for DCOs that are not SIDCOs or Subpart C DCOs to maintain and submit viable plans for orderly wind-down in cases of default and non-default losses.[23] This is crucial because such losses can render a DCO unable to fulfill its obligations or continue its critical functions, potentially necessitating a sudden wind-down. Wind-down plans are essential to ensure an orderly and swift wind-down process. Planning includes considering trigger circumstances, implementing necessary tools, governance arrangements, and evaluating the effects on clearing members and financial markets.[24] These plans enhance risk management practices, provide legal certainty, and boost market confidence, aligning with DCO Core Principles' objectives.

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18 *See* Proposed Rule at 48,983.
19 *Id.*
20 *See* Proposed Rule at 48,984.
21 *Id*.
22 *Id.*
23 See Proposed Rule at 48,987.
24 *Id.*

To advance these critical objectives, the Commission's proposal to introduce new § 39.13(k)(1)(i) is commendable.[25] This section would mandate that any DCO not falling under the classification of a SIDCO or Subpart C DCO must establish and, in accordance with the proposed revisions outlined in § 39.19(c)(4)(xxiv), furnish the Commission with a robust plan for the orderly wind-down in the face of default losses and non-default losses.[26] Additionally, this submission should include the necessary supporting information. Better Markets fully supports this proposed addition, recognizing its potential to strengthen the resilience and stability of our financial system.

Orderly Wind-Down Plan: Required Elements.

Better Markets strongly supports the Commission's approach to requiring comprehensive orderly wind-down plans, which should apply universally, including to DCOs that are not designated as SIDCOs or Subpart C DCOs. The Proposed Rule outlines a structured framework for these plans, encompassing vital elements that each DCO should include.

These elements should consist of a summary followed by a detailed description of the plan's implementation.[27] This detailed section should encompass critical aspects such as the identification and description of the DCO's critical operations and services, its reliance on service providers, interconnections, and staffing arrangements.[28] It should also address obstacles to success, cost estimates, stress scenario analyses, criteria for triggering orderly wind-down, monitoring processes, information-sharing protocols, and factors considered by the board of directors during wind-down decision-making.[29] Furthermore, the Proposed Rule highlights the importance of scenario identification, tools utilization, maintenance of agreements, governance arrangements, and testing.[30] These elements are essential to ensure that DCOs effectively manage the risks associated with their responsibilities, particularly under Core Principle D.

In light of these comprehensive requirements, Better Markets fully supports the Commission's proposal to introduce new § 39.13(k)(2). It represents a critical step in enhancing the resilience and risk management practices of all DCOs, contributing to the overall safety and stability of our financial system.

CONCLUSION

We hope these comments are helpful as the Commission finalizes its Proposed Rule.

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[25] *See* Proposed Rule at 48,987.
[26] *Id*.
[27] *See* Proposed Rule at 48,988.
[28] *Id.*
[29] *Id.*
[30] *Id.*

Sincerely,

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