

Public Statements & Remarks

Statement of Commissioner Rostin Behnam Regarding Part 190 Bankruptcy Regulations

December 08, 2020

I respectfully support the Commodity Futures Trading Commission's (the Commission or CFTC) final rule amending Part 190 of its regulations, which governs bankruptcy proceedings of commodity brokers. First and foremost, I want to thank Commission staff for all of their hard work on the final rule. This is the first major update of the CFTC's existing Part 190 since 1983, when it was originally implemented by the Commission.^[1]

The final rule is the product of years of staff analysis and engagement with market participants, including the Part 190 Subcommittee of the Business Law Section of the American Bar Association, which provided a detailed submission of suggested model Part 190 rules in response to a prior Commission request for information.^[2] Several agency Chairs going back many years deserve recognition and thanks for pushing to update Part 190 and starting this process. Customer protections are at the heart of the Commodity Exchange Act, and it is imperative that the Commission have clear rules that direct how proceedings occur during a commodity broker bankruptcy.

The revision is designed to recognize the many changes in our industry over the past 37 years. Most importantly, it is informed by the Commission's experience with past bankruptcies. More recently, the MF Global bankruptcy in 2011 was the eighth largest corporate bankruptcy in American history.^[3] It gave the Commission first hand experience with what worked, what did not, and what could be improved.

I was a lead advisor during the U.S. Senate's investigation of the MF Global bankruptcy, and during the Senate investigation, I learned the intricate contours of Part 190, its relationship to the Bankruptcy Code, and how the larger puzzle of creditors, customers, and equity holders, among others, fits together. It was during those frenzied days that I truly appreciated the regulatory principle that customer margin is sacrosanct property. Because of my experience during those few months, I have made customer protections an absolute priority in my time as a Commissioner. Having spoken with many market participants throughout the MF Global bankruptcy proceedings, including those whose money disappeared in the days immediately following, customer protection is my most pressing responsibility.

Just a few months later in early 2012, the bankruptcy of Peregrine Financial Group (PFG), the catastrophic culmination of a fraudulent scheme by a futures commission merchant (FCM) involving over \$220M in customer funds,^[4] further laid bare the strengths and weaknesses of the Commission's bankruptcy regime. Important lessons have been learned, both in terms of what works and what does not, and I believe today's final rule implements the lessons learned in both of those events, and those that preceded them.

Many of the changes to Part 190 in today's final rule further support provisions that have worked in prior bankruptcies. One of the themes of this refresh is clarity. The goal is to be as clear as possible about the Commission's intentions regarding Part 190 in order to enhance the understanding of Designated Clearing Organizations (DCOs), FCMs, their customers, trustees, and the public at large. Changes in this final rule will foster the longstanding and continuing policy preference for transferring (as opposed to liquidating) the positions of public customers – an important customer protection aimed at preserving the status quo/asset value. Other changes further support existing requirements including that shortfalls in segregated property should be shored up from the FCM's general assets, and that public customers are favored over non-public customers. The new provisions provide trustees with enhanced discretion based upon prior positive experience, and codify practice adopted in past bankruptcies by requiring FCMs to notify the Commission of their intent to file for voluntary bankruptcy.

Other changes address what has not worked or become outdated. In light of lessons learned from MF Global, the Commission is enacting changes to the treatment of letters of credit as collateral, both during business as usual and during bankruptcy, in order to ensure that customers who post letters of credit as collateral have the same proportional loss as customers who post other types of collateral.

The final rule also addresses a number of changes that have naturally occurred in our markets since the original Part 190 finalization in 1983. The Commission is promulgating a new subpart C to part 190, specifically governing the bankruptcy of a clearing organization. As DCOs have grown in importance over time, including being deemed systemically important by the Financial Stability Oversight Council following the financial crisis^[5], the Commission believes that it is imperative to have a clear plan in place for exactly how a DCO bankruptcy would be resolved. The final rule also addresses changes in technology over the past 37 years, and the movement from paper-based to electronic-based means of communication – a lesson learned from the PFG bankruptcy.

In many ways, this final rule is exactly how the rulemaking process should work. It looks retrospectively at major relevant events, and applies important lessons learned regarding what works in the existing Part 190 rules, what does not, and what can be improved. But it also looks forward in a sense, recognizing changes in market structure and thinking ahead to the possibility of the bankruptcy of a clearing organization. This is a stark contrast to the risk principles final rule that we consider today. While the bankruptcy final rule looks back at the Commission's past experiences with MF Global and PFG, the risk principles final rule seems to ignore past events. While the bankruptcy final rule looks ahead and plans for the possibility of addressing a DCO bankruptcy, the risk principles final rule ignores future events such as climate change.

My only concern regarding the bankruptcy rule, and it is a relatively small one, is one of timing. The proposal for this rule was issued this past April.^[6] The comment period just closed on July 13. The Commission then issued a supplemental notice of proposed rulemaking in September.^[7] That comment period ended October 26. Particularly for a rule of this size and intricacy, the time that staff had to review and analyze the comment letters and draft the final rule and preamble has been incredibly short. Staff has worked tirelessly on this rule to get to the finish line. However, I think both the Commission and the public might well have benefited from more time for review and reflection before issuing such an important rule.

On that note, I would like to close by again thanking staff for all of their hard work in producing this refresh of the Commission's part 190 rules to provide important customer protections.

^[1] Bankruptcy, 48 FR 8716 (March 1, 1983).

[2] 82 FR 23765 (May 3, 2017). The ABA Submission can be found at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61331&SearchText>; the accompanying cover note (ABA Cover Note) can be found at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61330&SearchText>.

[3] John Gapper and Isabella Kaminska, Downfall of MF Global, Financial Times, Nov. 4, 2011, available at <https://www.ft.com/content/2882d766-06fb-11e1-90de-00144feabdc0>.

[4] See Press Release Number 6300-12, CFTC, CFTC Files Complaint Against Peregrine Financial Group, Inc. and Russell R. Wasendorf, Sr., Alleging Fraud, Misappropriation of Customer Funds, Violation of Customer Fund Segregation Laws, and Making False Statements (July 10, 2012), <https://www.cftc.gov/PressRoom/PressReleases/6300-12>.

[5] https://www.federalreserve.gov/paymentsystems/designated_fmu_about.htm

[6] Bankruptcy Regulations, 85 FR 36000 (June 12, 2020). <https://www.cftc.gov/LawRegulation/FederalRegister/proposedrules/2020-08482.html>.

[7] Bankruptcy Regulations, 85 FR 60110 (September 24, 2020). <https://www.cftc.gov/LawRegulation/FederalRegister/proposedrules/2020-21005.html>

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