November 4, 2014

Via Electronic Mail

Mark Carney
Chairman
Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Financial Stability Board Initiative to Suspend Counterparty Early Termination Rights during Resolution and Bankruptcy Proceedings

Dear Chairman Carney:

We submit this letter on behalf of Managed Funds Association ("**MFA**"), the Alternative Investment Management Association Limited ("**AIMA**"), the American Council of Life Insurers ("**ACLI**"), the Association of Institutional INVESTORS ("**AII**"), the Commodity Customer Coalition ("**CCC**"), and the Commodity Markets Council ("**CMC**") (collectively, the "**Associations**")[1], and each Association's respective members. The Associations are aware that the Financial Stability Board ("**FSB**") remains concerned about the impact of the exercise of early termination rights on the insolvency or resolution of a globally systemically important financial institution ("**G-SIFI**"). In response, the FSB tasked the International Swaps and Derivatives Association, Inc. ("**ISDA**") with drafting a protocol to amend its standard ISDA Master Agreement that would impose a market-wide suspension on market participants' exercise of early termination rights due to the resolution of a G-SIFI or the insolvency of one of its related entities ("**ISDA Protocol**").[2] Moreover, to compel market participants in the global derivatives market to waive their early termination rights, each FSB member expects to finalize prudential regulation by the end of 2015. Such prudential regulations would require, at least, G-SIFIs and certain of their related entities to cease trading with any counterparty unless such counterparty has agreed to the suspension of their early termination rights during a resolution action in an FSB member jurisdiction or a U.S. insolvency proceeding.

[1] A description of each of the Associations is set forth in Annex A to this letter.

[2] *See* ISDA Press Release, *Major Banks Agree to Sign ISDA Resolution Stay Protocol* (Oct. 11, 2014), available at: http://www2.isda.org/news/major-banks-agree-to-sign-isda-resolution-stay-protocol, announcing the completion of, and G-SIFI adherence to, the ISDA Protocol.

The FSB outlines the details of both the ISDA Protocol and the contemplated prudential regulations in its consultative document on "Cross-border recognition of resolution action" dated 29 September 2014 ("**FSB Consultation**").[3] This letter is not in direct response to the FSB Consultation. However, because the Associations' members represent a substantial number of buy-side participants in the derivatives market, in this letter, we set forth our concerns with respect to the FSB's effort to suspend counterparties' early termination rights with respect to insolvency proceedings under the U.S. Bankruptcy Code as briefly referenced in the FSB Consultation.[4] The Associations have significant concerns with the elimination of counterparties' existing early termination rights during U.S. bankruptcy proceedings. Thus, we urge FSB members to reconsider the proposed waiver of customer rights under the U.S. Bankruptcy Code because it could lead to market uncertainty and disruptions that could exacerbate the contagion in the financial system during such insolvency proceedings.[5]

The Associations hope that this letter will foster a further dialogue between FSB members and the Associations and our members on this critical matter.

I. Executive Summary

The Associations share the FSB's concerns regarding ensuring the stability of the financial system in the event of a G-SIFI's failure. We also recognize that by finalizing the ISDA Protocol and adopting prudential regulations to impose a market-wide suspension of early termination rights, FSB members are seeking to stabilize the liquidation of a large institution.

As a general matter, the Associations support efforts to facilitate orderly liquidations and improve financial stability. In particular, we have been generally supportive[6] of legislative efforts to strengthen the financial system[7] and to resolve failing institutions because some failures have had severe consequences for our members. For example, many of our members' investors lost significant amounts of their collateral in the liquidation of Lehman Brothers International (Europe) ("**Lehman**"), and years later, they are still trying to recover these funds.

However, despite sharing the FSB's concerns, for the following two reasons, the Associations respectfully disagree with the FSB's proposal to finalize provisions in the ISDA Protocol and have its members adopt prudential regulations that effectively amend our members' protections under the U.S. Bankruptcy Code:

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[3] Available at: http://www.financialstabilityboard.org/publications/c_140929.pdf.

[4] *See* FSB Consultation at 12, footnote 13, where the FSB references that the ISDA Protocol also" provides for a stay that would apply in the context of a U.S. Bankruptcy Code proceeding".

[5] The Associations are not taking a position herein on requiring suspensions of early termination rights during insolvency proceedings under the Federal Deposit Insurance Act ("**FDIA**").

[6] The Associations note that throughout this letter we make general statements expressing concerns about the proposed changes to early termination rights. It is worth noting that as the Associations represent a wide range of market participants, there are varying degrees of concern regarding different aspects of the proposal.

[7] For example, many of the Associations generally have been supportive of the goals of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("**Dodd-Frank**"), Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010), available at: http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm.

(1) Policy – The Associations do not believe that the changes the FSB is seeking to implement with respect to counterparties' early termination rights under the U.S. Bankruptcy Code constitute sound public policy. As discussed further below, it would be contrary to the U.S. Bankruptcy Code and to the goals of protecting investors and the functioning of the financial markets to suspend counterparty rights' under "qualified financial contracts"[8] during certain U.S. bankruptcy proceedings.[9] It is the Associations' view that it is not wise for FSB members' to use prudential regulation to eliminate this exclusion because such action will incentivize certain market behaviors that will exacerbate the contagion in the financial system during a stressed market. Therefore, we respectfully submit that, from a policy perspective, compelling non-defaulting fiduciaries to waive early termination rights (*i.e.*, rights that protect their investors by allowing those investors to reclaim their assets) could harm, rather than protect, the financial system during U.S. bankruptcy proceedings.

(2) Process – The Associations also disagree with the process that the FSB has employed to institute these changes. As explained in greater detail below, the ISDA Protocol and contemplated prudential regulations would seek to deprive the Associations' members of rights that they enjoy resulting from certain cross-defaults[10] under the U.S. Bankruptcy Code. From a process standpoint, in seeking fundamentally to change counterparties' rights during U.S. bankruptcy proceedings, we do not believe that it was appropriate for the FSB to: (i) consult only a small group of market participants on the ISDA Protocol; (ii) finalize the ISDA Protocol prior to adoption of final (or issuance of proposed) prudential regulations; or (iii) use the ISDA Protocol to provide the substance for its members' prudential regulation.

In addition, the Associations disagree with FSB members issuing prudential regulation to require waiver of counterparties' rights with respect to U.S. bankruptcy proceedings, rather than petitioning U.S. Congress ("**Congress**") to enact appropriate legislation to amend the U.S. Bankruptcy Code.[11] The suspensions of counterparties' rights that currently exist under the U.S. Bankruptcy Code resulted from Congress enacting

[8] *See* U.S. Bankruptcy Code, 11U.S.C. § 362(b)(6), (7), and (17), which excludes contractual rights related to certain "qualified financial contracts" from the automatic stay in § 362(a). The term "qualified financial contracts" includes commodity contracts, forward contracts, securities contracts, repurchase agreements, and swap agreements, which for each excluded contract or agreement also includes the right to offset or net out any termination value, payment amount, or other transfer obligation.

[9] The Associations' understanding is that the exclusion for "qualified financial contracts" under § 362(b) of the U.S. Bankruptcy Code from the automatic stay under § 362(a) applies to rights resulting from direct defaults as well as rights arising from some (but possibly not all) cross-defaults (*e.g.*, default rights related to a guarantor's failure are excluded but default rights related to the failure that is a "specified entity" under the counterparty's ISDA Master Agreement may not be excluded).

[10] By rights arising from "cross-defaults", the Associations mean rights that a party to a contract has as a result of the bankruptcy or insolvency of an entity that is not its direct counterparty, but that is related to its direct counterparty. *See supra* note 9.

[11] In accordance with U.S. practice, the Associations use the term "legislation" to refer to statutory enactments of Congress. In addition, the Associations use the term "prudential regulation" to refer to rules that FSB members adopt in accordance with their statutory authority. We distinguish our use of these terms from their usage in the European Union.

legislation (not regulation).[12] The Associations believe that changes to the effect of the U.S. Bankruptcy Code only may be addressed through the robust, open, and transparent legislative process. Therefore, we believe that, if the FSB desires to change the application of the U.S. Bankruptcy Code, procedurally it should petition Congress to enact appropriate amendments to the U.S. Bankruptcy Code that include necessary rulemaking directives to the relevant U.S. regulatory agencies.

For both the procedural and substantive reasons outlined above and discussed further below, the Associations urge the FSB to reconsider imposing the contemplated suspensions of early termination rights during insolvency proceedings under the U.S. Bankruptcy Code.[13]

II. Policy Concerns with FSB Amending U.S. Bankruptcy Code

The Associations do not believe that altering counterparties' early terminations rights under the U.S. Bankruptcy Code constitutes sound public policy. In particular, the Associations believe that imposition of these waivers to alter counterparty rights would harm investors in the market and would incentivize market behavior that could exacerbate instability in the financial markets during U.S. bankruptcy proceedings. Therefore, the Associations believe that imposing the U.S. bankruptcy suspensions is contrary to the goals of protecting investors and the functioning of the financial markets such that it would be detrimental, rather than beneficial, to systemic stability.

A. Importance of Fiduciary Duties, Investor Protection, and Preserving Counterparty Rights

The Associations' members have fiduciary duties to their investors. Therefore, our members have an affirmative duty to act in good faith and in the best interests of their investors.[14] Because early termination rights ultimately can protect investors, our members' fiduciary duties prevent them from voluntarily waiving these rights. Specifically, early termination rights protect

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[12] *See e.g.*, Title II of Dodd-Frank, which is also known as the Orderly Liquidation Authority ("**U.S. OLA**") and imposes a one business day suspension of rights; U.S. Bankruptcy Code, 11U.S.C. § 362(a), available at: http://www.law.cornell.edu/uscode/text/11/362, which imposes an automatic stay on creditor rights, but excludes rights under "qualified financial contracts"; and the European Union Bank Recovery and Resolution Directive, *Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms*, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014L0059&from=EN.

[13] The Associations note that, to the extent the ISDA agreements proposed to be amended give rise to payments subject to withholding tax under the U.S. Foreign Account Tax Compliance Act ("**FATCA**"), the proposed amendments may be deemed a material modification of those contracts for FATCA purposes. FATCA generally grandfathers payment obligations issued prior to July 1, 2014, meaning those obligations do not give rise to withholding or reporting requirements. However, those obligations lose their grandfathered status to the extent they are materially modified after July 1, 2014. The proposed amendments, therefore, could create significant uncertainty or administrative burdens under FATCA as market participants will have to determine which modified agreements might create additional FATCA compliance requirements.

[14] *See e.g.*, SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963); and In re Arleen W. Hughes, Exchange Act Release No. 4048, 27 S.E.C. 629 (Feb. 18, 1948), available at: https://www.sec.gov/litigation/opinions/ia-4048.pdf, which sets forth the specific obligations that the U.S. Securities and Exchange Commission has imposed on registered investment advisers in the U.S., which includes, among other things, a duty to be loyal to their clients and to obtain best execution for those clients' transactions.

a counterparty and its investors by ensuring that, when the counterparty transacts with a financial institution (*e.g.*, a G-SIFI) or its related entities (such financial institutions and related entities, together "**Applicable Entities**"), in the event of the Applicable Entity's default, the counterparty may be able to mitigate its exposure by recovering their investors' assets.

Protection of investors and their assets is a fundamental public policy goal.[15] The Associations are aware that the FSB views suspending customer rights during U.S. bankruptcy proceedings as protecting the financial system, and thus, as paramount to protecting investors. However, we do not believe that the financial system is protected when the market participants within the system are not so protected. Therefore, the Associations do not believe that altering rights under the U.S. Bankruptcy Code that protect investors (whether indirectly through the ISDA Protocol and FSB member prudential regulations or directly through amending the U.S. Bankruptcy Code) serves the interests of investors or the financial system. Rather, we believe that the FSB is setting a dangerous precedent that will cause more harm than good to the global economy as further discussed below.

B. Overriding U.S. Bankruptcy Code Exclusion for Qualified Financial Contracts

The Associations urge the FSB not to mandate waivers of key customer rights during insolvency proceedings under the U.S. Bankruptcy Code. The Associations believe that the ISDA Protocol and forthcoming FSB member prudential regulations, in effect, would amend the U.S. Bankruptcy Code by eliminating protections afforded by Congress to "qualified financial contracts"[16].

The Associations recognize that, during insolvency proceedings of certain Applicable Entities, both the U.S Bankruptcy Code and FDIA suspend counterparties' early terminations rights that result from direct defaults[17] under certain types of contracts.[18] However, the U.S. Bankruptcy Code excludes "qualified financial contracts" from such suspensions during insolvency proceedings of certain Applicable Entities,[19] and such suspensions do not apply to rights arising from cross-defaults during certain Applicable Entities' bankruptcy proceedings. Therefore, the Associations request that the FSB reconsider imposing suspensions of rights during bankruptcy proceedings in any manner not currently provided for under the U.S. Bankruptcy Code.

In general, under the U.S. Bankruptcy Code, if a debtor files for (or is involuntarily placed in) bankruptcy, creditors' claims against such debtor are automatically stayed (*i.e.*, suspended).[20]

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[15] *See e.g.*, the text of Dodd-Frank, where Congress stated that the purpose of Dodd-Frank is "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes".

[16] *See supra* note 13.

[17] By rights resulting from "direct defaults", the Associations means rights that a party to a contract has resulting from the bankruptcy or insolvency of its direct counterparty.

[18] *See* U.S. Bankruptcy Code, 11U.S.C. § 362(a), which imposes an automatic stay on creditor rights.

[19] *See supra* note 8.

[20] *See supra* note 5.

However, under the U.S. Bankruptcy Code, Congress expressly provided an *exclusion* from this stay for "qualified financial contracts", including swap agreements and repurchase agreements.[21] In enacting these exclusions more than 24 years ago, Congress recognized the importance of providing legal certainty as to how and when market participants will terminate, net, and settle derivatives and other financial contracts during bankruptcy proceedings.

In particular, in 1990, Congress amended the U.S. Bankruptcy Code to exclude swap agreements from the automatic stay under Section 362(a). In reintroducing the related bill S.396 into the Senate in 1989, U.S. Senator Dennis DeConcini, who sponsored the bill and was a member of the Senate Judiciary Committee at the time, explained that this exclusion for swap agreements was necessary because:

> "upon termination of the agreement for default, all transactions between the parties are terminated, a single net amount is determined, and the amount due the nondefaulting party is paid by the defaulting party. The immediate termination for default and the netting provisions are critical aspects of swap transactions. The immediate termination of all outstanding transactions is necessary for the protection of all parties in light of the potential for rapid changes in the financial markets."[22]

In expressing the will of Congress in providing the exclusion, Senator DeConcini explained that, in the absence of such exclusion, "[c]ounterparties could be faced with substantial losses if forced to await a bankruptcy court decision on assumption or rejection of financial transaction agreements."[23] Therefore, Congress ultimately enacted the bill to exclude swap agreements from the automatic stay in the U.S. Bankruptcy Code because, as stated by Senator DeConcini: "[i]n this day of volatile financial markets, we cannot permit one bankruptcy to undermine the basic function of a market as large and important as the swaps market."[24]

In accordance with Senator DeConcini's remarks, the Associations emphasize that having legal certainty regarding termination, netting, and settlement rights is particularly important in the context of derivatives transactions, given the critical role they play in the U.S. financial markets and the management and hedging of credit and market risk. The legal certainty provided by excluding qualified financial contracts from the automatic stay under the U.S. Bankruptcy Code has helped to promote the growth, liquidity, and competitiveness of the U.S. financial markets. Therefore, the Associations disagree with the FSB efforts to change the effect of this exclusion, and extend the application of the automatic stay under the Bankruptcy Code.

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[21] *See supra* note 8. Congress enacted amendments to the U.S. Bankruptcy Code to exclude securities contracts, repurchase agreements, and swap agreements from the automatic stay in 1982, 1984, and 1990, respectively.

[22] 135 Cong. Rec. S1414 (daily ed. Feb. 9, 1989) (statement of Senator DeConcini).

[23] *Id.*

[24] *Id.*

C. Effects of Eliminating Exclusion under the U.S. Bankruptcy Code

As discussed above, the Associations believe that suspending counterparties' rights resulting from certain cross-defaults during U.S. bankruptcy proceedings represents a significant and meaningful change that will result in a number of detrimental, unintended consequences. In particular, the Associations are concerned that imposing such suspensions could incentivize behaviors that could exacerbate the harm to the financial systems during a stressed market.

As mentioned, when large financial institutions have previously failed (*e.g.*, Lehman), there were insufficient assets for all of the institution's creditors and counterparties to recover the full amount owed to them by the failed entity.[25] Fear of non-recovery during an Applicable Entity's bankruptcy proceeding creates incentives for market participants to move away from vulnerable institutions.

Specifically, for those market participants trading with a vulnerable Applicable Entity, in the period preceding such Applicable Entity's bankruptcy filing, its counterparties would be strongly incentivized to move their contracts away from the vulnerable Applicable Entity (*e.g.*, to fulfill their fiduciary duties to their investors). In particular, investors are conducting increasingly extensive due diligence on the fiduciaries with which they invest, including with respect to the counterparty credit risk taken on by those fiduciaries. In the event that an Applicable Entity was perceived by the markets to have become a vulnerable institution, fiduciaries whose rights would be suspended if the Applicable Entity became subject to a U.S. bankruptcy proceeding would likely receive considerable pressure from their concerned investors to move away from such vulnerable Applicable Entity as soon as possible.

The period after Lehman failed demonstrates the significant likelihood of this market behavior.[26] During that volatile period, market participants were fearful that certain of their other bank counterparties would also fail, and therefore, moved away from trading with these financial institutions.[27] The result was that it jeopardized the financial stability of banks that previously were not vulnerable as their counterparties transferred their positions to other financial institutions. This growing lack of confidence in the financial markets and certain bank counterparties contributed further to the cycle of market volatility.[28]

These "runs on the bank" prior to commencement of a U.S. bankruptcy proceeding are what the FSB is seeking to prevent. However, in practice, imposition of these suspensions would be

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[25] *See* Michael Fleming and Asani Sarkar, *The Failure Resolution of Lehman Brothers*, Federal Reserve Bank of New York Economic Policy Review, March 2014, available at: www.ny.frb.org/research/epr/2014/1403flem.pdf.

[26] *See e.g.*, Yalman Onaran, Michael J. Moore and Max Abelson, *Banks Seen at Risk Five Years After Lehman Collapse*, Bloomberg, Sept. 10, 2013, available at: http://www.bloomberg.com/news/2013-09-10/banks-seen-at-risk-five-years-after-lehman-collapse.html; and Nick Mathiason, *Three weeks that changed the world*, The Observer, Dec. 27, 2008, available at: http://www.theguardian.com/business/2008/dec/28/markets-credit-crunch-banking-2008.

[27] *See id.*

[28] *See id.*

procyclical (rather than countercyclical) and would have the opposite effect than what the FSB seeks to achieve.[29]

Because of the foregoing practical effects of amending the U.S. Bankruptcy Code to suspend counterparties' existing legal rights under "qualified financial contracts", the Associations believe that it is contrary to public policy, in particular the goals of reducing systemic risk and protecting the financial system, to alter the termination rights provided under the U.S. Bankruptcy Code.

III. Process Concerns with FSB Approach

A. Use of ISDA Protocol

The Associations have substantial concerns with the process that FSB is employing to suspend counterparties' early termination rights under the U.S. Bankruptcy Code. As discussed below, we are concerned that the reversal of the normal rulemaking process means that the substance of the prudential regulations will have been finalized through the ISDA Protocol negotiations and that the public will have minimal input at this stage of the process.

First, the Associations are troubled that the FSB proceeded with having ISDA finalize, and begin G-SIFI adherence to, the ISDA Protocol, prior to normal prudential rulemaking. Typically, FSB members would undertake a consultative process required in each FSB member jurisdiction prior to adopt prudential regulations. As the FSB knows, in the ordinary course, regulatory authorities follow a legally prescribed process to adopt prudential regulation.[30] In the U.S., that process generally involves the regulators first issuing proposed prudential regulation. Following issuance, the public has the opportunity to consider carefully and comment on such proposal.[31] Then, only after expiration of the public comment period and the regulators' thoughtful consideration and analysis of such comments may the regulators finalize the regulations.[32] In the past, ISDA has developed protocols in response to final derivatives regulations to ease the market's transition into compliance with those regulations, and parties have become subject to those protocols only when they have agreed to adhere to them on a voluntary basis.

However, in this case, the FSB has reversed the process in that FSB members have worked with ISDA to complete, and begin G-SIFI adherence to, the ISDA Protocol prior to adoption of final (or even issuance of proposed) regulations.

Second, the Associations are dismayed that the FSB consulted only a small group of market participants on the ISDA Protocol, and the contemplated waivers with respect to the U.S.

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[29] Indeed, such a change in early termination rights could create a self-fulfilling prophecy. If rumors in the marketplace caused counterparties to novate their derivative contracts and withdraw their collateral from a G-SIFI, it could trigger the failure of that G-SIFI, which was otherwise stable.

[30] *See e.g.,* U.S. Administrative Procedure Act, 5 U.S.C. § 552, available at: http://www.law.cornell.edu/uscode/text/5/part-I/chapter-5, which provides the legal procedures that U.S. regulators must follow to adopt new regulation.

[31] *See id.*

[32] *See id.*

Bankruptcy Code therein, when the ISDA Protocol will provide the substance for FSB members' proposed prudential regulations, and the suspensions during U.S. bankruptcy proceedings (if imposed) would broadly affect the market when complete.

The ISDA working group is comprised of only a small number of market participants such that the vast majority of buy-side market participants only recently became aware of the FSB's efforts to suspend their rights during U.S. bankruptcy proceedings, and did not have the opportunity to comment on the ISDA Protocol prior to completion. The Associations understand that market participants will have an opportunity to comment on any FSB member's proposed prudential regulations, and their application to the U.S. Bankruptcy Code through the usual notice and comment process. However, as discussed above, the FSB reversed the usual rulemaking process, and the FSB expects its members' prudential regulations largely will mirror the final ISDA Protocol. Therefore, completion of the ISDA Protocol effectively represented the expiration of market participants' opportunity for meaningful input into these crucial issues, which is, to the best of our knowledge, unprecedented approach.

Lastly, the FSB has put pressure on G-SIFIs to adhere to the ISDA Protocol and agree to the waivers with respect to the U.S. Bankruptcy Code, which results in undue pressure being placed on other market participants similarly to become subject to the suspensions of their rights. Specifically, in the course of reviewing G-SIFI "living wills", U.S. banking regulators recently stated that, unless the G-SIFIs renegotiated contracts with their counterparties to include these U.S. Bankruptcy Code suspensions of their rights, regulators would likely reject their living wills.[33] This threat would have substantial consequences for G-SIFIs, as failure to obtain approval of their living wills may lead to increased capital charges, restrictions on their banking and trading activities, and/or possible forced divestiture of certain of their businesses. As a result, G-SIFIs are strongly incentivized to participate in developing, and adhere to, the ISDA Protocol that they announced their agreement to waive their rights even before the substance of the ISDA Protocol was final.[34] Requiring G-SIFIs to proceed with waiving their rights with respect to the U.S. Bankruptcy Code ahead of the remainder of market participants, has resulted in the G-SIFIs increasing the corresponding pressure on FSB member regulators to issue rules that will effectively require counterparties to adhere to the ISDA Protocol as well.

B. Use of Prudential Regulation to Regulate Indirectly the Derivatives Market and Non-Prudentially Regulated Entities

The Associations appreciate the FSB's concerns and its need to assist the G-20 countries in their commitment to reduce systemic risk on a global basis. We also understand that the FSB believes that in determining how best to prevent the potentially disorderly insolvency of Applicable

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[33] *See* Peter Eavis, Fight Brews on Changes That Affect Derivatives, NYTimes Dealbook, available at: http://dealbook.nytimes.com/2014/08/14/fight-brews-on-changes-that-affect-derivatives/ (Aug. 14, 2014), stating that "[j]ust last week, the Fed and the F.D.I.C. sharply criticized the banks' living wills. In laying out some of the improvements that regulators wanted to see, Martin J. Gruenberg, the F.D.I.C.'s chairman, said that the banks had to make 'amendments to their derivatives contracts to prevent disorderly terminations during resolution.'".

[34] *See* ISDA Press Release, *Major Banks Agree to Sign ISDA Resolution Stay Protocol*, dated October 11, 2014, available at: http://www2.isda.org/news/major-banks-agree-to-sign-isda-resolution-stay-protocol, where G-SIFIs agreed to adhere to the ISDA Protocol, even though as of the date of this letter, the substance of the ISDA Protocol is not final.

Entities it must strike a balance between protecting the financial system and protecting its market participants.[35] However, the Associations have substantial concerns about requiring counterparties to waive their early termination rights during U.S. bankruptcy proceedings because these rights protect non-defaulting fiduciaries and their investors' assets. We are further concerned that the manner in which the FSB is imposing these waivers with respect to the U.S. Bankruptcy Code will harm (rather than strengthen) the financial system.

In particular, the Associations understand that, as national regulators, FSB members have an expansive, regulatory tool kit available to them to manage any systemic risk created by any financial institution subject to their regulatory authority (*e.g.*, imposition of capital, margin, risk management, and other requirements).[36] However, we are concerned that, by FSB members using those regulatory tools to require Applicable Entities that are subject to their regulation to cease trading with any market participant that has not agreed to waive its early termination rights with respect to the U.S. Bankruptcy Code, FSB members are indirectly and unilaterally regulating the financial markets and market participants. In particular, in the FSB Consultation, the FSB acknowledges the intended indirect application of its members' prudential regulation.

> "Many counterparties of prudentially regulated firms, such as asset managers and non-financial corporates, are not subject to prudential regulation. The options for reaching such entities by regulatory or other official action are thus reduced to indirect means through requirements on firms that are subject to prudential regulation (which might have the effect of inducing counterparties to such firms to adhere to contractual stay provisions in order to be able to trade with prudentially regulated firms)."[37]

As a result, the FSB's contemplated suspension of counterparties' early termination rights would impose restrictions on counterparties of Applicable Entities that would fundamentally alter the financial markets and have adverse effects on how the financial markets would function going forward. To the extent that legislators and other relevant governmental authorities have not given FSB members direct regulatory authority over such markets or counterparties, the Associations believe that it is inappropriate for the FSB to assert such regulatory authority indirectly.

In the U.S., the U.S. Bankruptcy Code as enacted by Congress governs counterparties' exercise of their early termination rights during U.S. bankruptcy proceedings.[38] To the extent that the FSB has concerns regarding the exercise of these rights during an Applicable Entity's U.S. insolvency, the Associations believe that it is more appropriate for the FSB to petition Congress to address such concerns by enacting legislation to amend the U.S. Bankruptcy Code.

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[35] As noted above, the Associations do not believe that it is necessary to diminish investor protection in furtherance of reducing systemic risk.

[36] As discussed previously, in adopting regulations to manage those risks, regulatory authorities are required to engage in an open rulemaking process without which the impact of those regulations on the effective functioning of the capital markets and the impact on market participants, including corporations and end users, is not appropriately or completely considered.

[37] FSB Consultation at 13.

[38] *See supra* note 13.

The Associations appreciate that, by urging the FSB to petition Congress to enact legislation to achieve its goals, we are not suggesting a modest undertaking. However, we do not agree that it is appropriate to forego legislation due to concerns about the time required to implement such statutory changes,[39] even if the proponents believe that their objectives are noble. Although some people express frustration with the difficult and lengthy process of enacting legislation in the U.S., this process is longstanding and intended to be difficult.[40] Because of the broad significance and applicability of issues typically addressed by legislation in the U.S., the lawmaking process is necessarily challenging to ensure that Congress has heard and carefully balanced all relevant policy considerations and that any law that Congress enacts has undergone a robust, open, and transparent legislative process. Therefore, the Associations stress that, if the FSB desires to change the application of automatic stays during U.S. bankruptcy proceedings, it must do so by petitioning Congress to make the necessary statutory changes.

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The Associations thank FSB and its members for considering our views on this important matter. The Associations respectfully urge the FSB to reconsider both the objectives it seeks to achieve and the means it is using to achieve them. We welcome the opportunity to discuss our views with you in greater detail. Please do not hesitate to contact the Associations or their respective staffs with any questions the FSB, its members, or their respective staffs might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
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[39] *See* FSB Consultation at 11, where the FSB explained that given that "very few jurisdictions currently have such frameworks in place" and "the time required to implement the necessary statutory changes, which are likely to be complex, the FSB agreed to develop contractual solutions" as an interim solution.

[40] For example, in the U.S., the U.S. Constitution creates a system of government that is cumbersome by design, and thus, in our view, it is not sufficient to forego the U.S. legislative process because it is inconvenient for current circumstances. *See* The Federalist Papers, Federalist No. 62 (Feb. 26, 1788), available at: http://thomas.loc.gov/home/histdox/fed_62.html.

/s/ Carl B. Wilkerson

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ANNEX A
DESCRIPTIONS OF THE ASSOCIATIONS

Managed Funds Association 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. MFA has cultivated a global membership and actively engages with regulators and policymakers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

The **Alternative Investment Management Association**, founded in 1990, is the global representative of the hedge fund industry. We represent all practitioners in the alternative investment management industry – including hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. Our membership is corporate and comprises over 1,400 firms (with over 7,000 individual contacts) in more than 50 countries. AIMA's manager members manage a combined $1.5 trillion in assets (as of March 2014).

The **American Council of Life Insurers** is a Washington, D.C.-based trade association with approximately 300 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums.

The **Association of Institutional INVESTORS** is an organization of the oldest, largest, and most trusted federally registered investment advisers in the United States. Collectively, the Association's members manage investments for more than 80,000 ERISA pension plans, 401Ks, and mutual funds on behalf of more than 100 million American workers and retires who rely on our firms to prudently manage participants' retirement savings and investments in part due to the fiduciary duty we owe these organizations and families.

The **Commodity Customer Coalition** is an advocate for customers of commodity brokers, as well as the professionals who service them. A 501(c)(4) non-profit organization which formed in response to the bankruptcy of commodity broker MF Global, the CCC remains the commodity industry's only association with an exclusive focus on customer rights, protection and advocacy.

Commodity Markets Council is the leading trade association for commodity futures exchanges and their industry counterparts. CMC provides the access, forum, and action for exchanges and exchange users to lead our industry in addressing global market and risk management issues. CMC advocates an open, competitive marketplace by combining the expertise, knowledge, and

resources of our members to develop and support market-based policy. CMC addresses industry issues focusing on agriculture, energy, finance, infrastructure, and transportation.