May 2, 2016

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re **Notice of Proposed Rulemaking Implementing Section 205 of the Dodd-Frank Act**[1]

RIN 3064–AE39; File No. S7-02-16

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("**SIFMA**"), The Clearing House Association ("**TCH**") and the Financial Services Roundtable ("**FSR**") (collectively, the "**Associations**")[2] appreciate the opportunity to comment on the notice of proposed rulemaking jointly issued on March 2, 2016 by the Federal Deposit Insurance Corporation ("**FDIC**") and the Securities and Exchange Commission (the "**SEC**" and, collectively, the "**Agencies**") to implement Section 205 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").[3]

Section 205 contains special provisions for the orderly liquidation of certain U.S. brokers and dealers,[4] and paragraph (h) of Section 205 requires the Agencies, in consultation with the Securities Investor Protection Corporation ("**SIPC**"), to jointly issue rules to implement Section 205.[5] The purpose of the proposed rule is to clarify certain aspects of those special provisions.

We believe that the proposed rule includes a number of useful clarifications that would facilitate the orderly liquidation of covered broker-dealers under Title II of the Dodd-Frank Act, including Section 205. In particular, the proposed rule clarifies a number of important details regarding the transfer of customer accounts and customer property from a covered broker-dealer in receivership to a bridge broker-dealer, including the role of SIPC and SIPC advances in

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[1] Notice of Proposed Rulemaking, Covered Broker-Dealer Provisions Under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 81 Fed. Reg. 10798 (Mar. 2, 2016) ("**NPR**").

[2] *See* Annex for a description of each of the Associations.

[3] 12 U.S.C. § 5385.

[4] Section 205 only applies to covered brokers and dealers, 12 U.S.C. § 5385, and the term "covered broker or dealer" is limited to brokers and dealers "incorporated or organized under any provision of Federal law or the laws of any State." *See* 12 U.S.C. § 5381(a)(7), (8) and (11).

[5] 12 U.S.C. §§ 5385(h).

connection with the allocation of customer property to customer accounts at the bridge broker-dealer. Such transfers further the goal of assuring the continuity of operations and prompt access by customers to their customer accounts and customer property. At the same time, the proposed rule preserves the ability of a covered broker-dealer to transfer customer accounts and customer property to another qualified broker-dealer, which is one of the traditional tools available for the protection of customers under the Securities Investor Protection Act of 1970 ("**SIPA**").

While the Associations believe that the proposed rule provides useful clarification, we believe that certain aspects of the proposed rule and the accompanying preamble raise potential concerns that merit further consideration. In addition, we believe that some elements of the proposed rule would benefit from further clarification, either through additional rulemaking or interpretative statements, in order to provide the market with greater legal certainty. Our comments can be summarized as follows:

- The proposed rule is likely to have an extremely narrow scope of application.
- The final rule should describe the covered broker-dealer as being liquidated by SIPC under SIPA instead of under Title II, which otherwise creates legal uncertainty by conflicting with the plain language of the statute.
- The Agencies should coordinate with the U.S. Commodity Futures Trading Commission (the "**CFTC**") to clarify how the orderly liquidation process would operate if a covered broker-dealer were also a futures commission merchant ("**FCM**").
- The Agencies should clarify that they do not intend to depart from past SIPC practices with respect to the treatment of customers whose accounts have been transferred to another institution.
- The final rule should clarify that if customer accounts are transferred to a bridge broker-dealer the FDIC, in consultation with SIPC, will endeavor to transfer to the bridge broker-dealer any liabilities that are secured by customer property that has been rehypothecated by the covered broker-dealer.
- The Agencies should clarify that the FDIC will cooperate with SIPC in allocating property from the broker-dealer's general estate to the pool of customer property if shortfalls in customer property resulted from regulatory compliance failures.
- The final rule should clarify that any reference to SIPA also includes the rules of SIPC in 17 C.F.R. Part 300.

1. The proposed rule is likely to have an extremely narrow scope of application.

As an initial matter, we wish to observe that the proposed rule is likely to have an extremely narrow scope of application. Indeed, the circumstances under which it can be legally invoked are so narrow as to call into question the value or necessity of the proposed rule. First, Section 205 and the proposed rule would only apply if the Secretary of the Treasury upon

recommendation by two-thirds of the members of the Board of Governors of the Federal Reserve System (the "**Federal Reserve**") and two-thirds of the members of the SEC, and in consultation with the President, determines that resolving a covered broker-dealer under SIPA "would have serious adverse effects on financial stability in the United States" and resolving the firm under Title II, including Section 205 and the proposed rule, "would avoid or mitigate such adverse effects."[6] Those conditions are unlikely to be met except with respect to the most systemically important broker-dealers under the most severely adverse financial conditions.

Second, the most systemically important U.S. broker-dealers are likely to be part of a U.S. global systemically important banking group ("**U.S. G-SIB**") or a foreign G-SIB.[7] Such groups are likely to be resolved under a single-point-of-entry ("**SPOE**") resolution strategy.[8] Under an SPOE strategy, the top-tier parent of a U.S. or foreign G-SIB would be put into a bankruptcy, resolution or similar proceeding, and its operating subsidiaries, including any of its U.S. broker-dealer subsidiaries, would be recapitalized and kept out of their own bankruptcy, resolution or similar proceedings.[9] Even in the case of a foreign G-SIB that would be resolved under a multiple-point-of-entry ("**MPOE**") strategy,[10] its U.S. operations are likely to be resolved pursuant to an SPOE strategy. The reason is that all foreign banking organizations with $50 billion or more of U.S. non-branch assets are required to establish a U.S. intermediate holding company ("**U.S. IHC**") and move all of their U.S. subsidiaries, including their U.S. broker-dealer subsidiaries, accounting for 90% of their U.S. assets under the U.S. IHC by July 1, 2016 and the rest by July 1,

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[6] 12 U.S.C. § 5383(b)(2) and (5).

[7] A G-SIB is a banking group that has been designated as such by the Financial Stability Board. As of November 3, 2015, there were eight U.S. G-SIBs and twenty-two foreign G-SIBs. See Financial Stability Board, *2015 update of list of global systemically important banks (G-SIBs)* (Nov. 3, 2015).

[8] *See, e.g.*, Martin J. Gruenberg, Chairman of the FDIC, A Progress Report on the Resolution of Systemically Important Financial Institutions, Speech at the Peterson Institute for International Economics (May 12, 2015); FDIC, Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013); Public Summaries of the 2015 Resolution Plans Submitted under Title I of the Dodd-Frank Act by Bank of America, Citigroup, Goldman Sachs, JP Morgan Chase, Morgan Stanley and State Street, available at https://www.fdic.gov/regulations/reform/resplans/; Public Summaries of the 2015 Resolution Plans Submitted under Title I of the Dodd-Frank Act by Barclays, BNP Paribas, Credit Suisse, Deutsche Bank, MUFG and UBS (identifying SPOE as the preferred global strategy for resolving the foreign G-SIB by its home country resolution authority), available at https://www.fdic.gov/regulations/reform/resplans/; Notice of Proposed Rulemaking, Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for Investments in Certain Unsecured Debt of Systemically Important U.S. Bank Holding Companies ("**Proposed TLAC Rule**"), 80 Fed. Reg. 74926, 74928, 74941 (Nov. 30, 2015).

[9] *See, e.g.,* FDIC, Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013); FDIC and Bank of England, Resolving Globally Active, Systemically Important, Financial Institutions (December 10, 2012); Bipartisan Policy Center, *Too Big to Fail: The Path to a Solution*, A Report of the Failure Resolution Task Force of the Financial Regulatory Reform Initiative of the Bipartisan Policy Center (May 2013).

[10] An MPOE strategy is a strategy that involves putting more than a single top-tier parent of a G-SIB into bankruptcy, resolution or similar proceedings.

2017.[11] The Federal Reserve has also issued a proposed rule that would require the U.S. IHCs of foreign G-SIBs to have sufficient total loss-absorbing capacity ("**TLAC**") to support an SPOE resolution strategy for the U.S. IHCs.[12] The FDIC and the Federal Reserve are likely to encourage foreign G-SIBs to develop SPOE strategies for their U.S. IHCs in their Title I resolution plans in order to align those plans with the SPOE strategies that the FDIC is likely use if Title II were invoked for such U.S. IHCs.[13]

Under such circumstances, the U.S. broker-dealer subsidiaries would be kept out of their own bankruptcy, resolution or similar proceedings, including Title II, and so the proposed rule would not come into play.

2. The Agencies should revise the proposed rule to describe the covered broker-dealer as being liquidated by SIPC under SIPA instead of under Title II, which otherwise creates legal uncertainty by conflicting with the plain language of the statute.

As the preamble acknowledges,[14] the proposed rule conflicts with the plain language of certain provisions of Section 205. Section 205 states that upon the FDIC's appointment as receiver for a covered broker-dealer, the FDIC "shall appoint . . . [SIPC] to act as trustee for the liquidation *under [SIPA]* of the covered broker or dealer."[15] Thus, the statutory text of Section 205 clearly states that the liquidation of the covered broker-dealer would be conducted *under SIPA,* even if Title II is invoked with respect to the covered broker-dealer and all or some of its assets, customer accounts and customer property are transferred to a bridge broker-dealer by the FDIC as receiver.

Section 205 also provides that upon such appointment, SIPC shall file, in federal district court, an application for a "protective decree *under [SIPA].*"[16] Further, Section 205 provides that "following the entry of the protective decree, and except as otherwise provided in this section, the determination of claims and the liquidation of assets retained in the receivership of the covered broker or dealer and not transferred to the bridge financial company shall be *administered under [SIPA] by SIPC, as trustee for the covered broker or dealer."*[17] Thus, the statute plainly states that the key elements of the liquidation of the covered broker-dealer (as opposed to any bridge broker-dealer) will be conducted by SIPC under SIPA.

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[11] Final Rule, Enhanced Prudential Standards for Banking Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17240, 17271 (Mar. 2014).

[12] Proposed TLAC Rule, 80 Fed. Reg. 74926 (Nov. 30, 2015).

[13] *See, e.g.,* FDIC, Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013).

[14] 81 Fed. Reg. at 10800-10801.

[15] 12 U.S.C. § 5385(a)(1) (emphasis added).

[16] 12 U.S.C. § 5385(a)(2)(A) (emphasis added).

[17] 12 U.S.C. 12 U.S.C. § 5385(a)(2)(B) (emphasis added).

The proposed rule conflicts with the statutory text by eliminating reference to the liquidation being conducted, and the protective decree being issued, "under SIPA." The preamble explains that this omission was deliberate and was intended to clarify that a Title II receivership of a covered broker-dealer is not a liquidation under SIPA, which is a judicial process conducted under bankruptcy court supervision, but rather is an orderly liquidation of the broker-dealer through an administrative process under Title II that incorporates the customer protection provisions of SIPA under which SIPC, as trustee, would operate.[18]

While the approach taken in the proposed rule might have some appeal if the rules were being written on a blank slate, we believe that this conflict with the plain language of the statute could give rise to legal challenges that could create legal uncertainty in a time of financial distress, which would not have existed in the absence of such a conflict.

One example of the sort of conflict that could give rise to legal challenges involves Section 205(a)(1). Under Section 205(a)(1), SIPC is required to file promptly with any federal district court of competent jurisdiction an application for a protective decree "under SIPA," and SIPC and the FDIC, in consultation with the SEC, must jointly determine the terms of the protective decree to be filed.[19] Thus, under the terms of the statute, the district court would have the authority to issue a protective decree providing for all of the protections available under SIPA.[20] By contrast, the NPR indicates that the application for a protective order is not filed under SIPA, but rather under Title II, and that the primary purpose of the filing is simply to give notice to interested parties that an orderly liquidation proceeding for the covered broker-dealer has been initiated, including making parties aware of applicable stays *under Title II*.[21] This calls into question the ordinary powers of the district court to include the types of protections typically included in a protective decree or order issued under SIPA, such as an indefinite stay on actions by third parties to assert control over customer property, except as otherwise specifically provided under Title II.[22]

Another example of the type of conflict that could give rise to legal challenges involves the provision in the proposed rule stating that the FDIC as receiver would determine all non-customer claims against the covered broker-dealer.[23] This directly conflicts with the plain language of Section 205, which provides that "as trustee for the covered broker-dealer, SIPC shall determine and satisfy, consistent with this title and with [SIPA], *all* claims against the covered broker-dealer arising on or before the filing date."[24] The proposed rule further provides that a claimant may seek de novo judicial review of a disallowed claim, in whole or in part, in accordance with the provisions of Title II, including customer claims that are disallowed based on a

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[18] 81 Fed. Reg. at 10800-10801.

[19] 12 U.S.C. § 5385(a)(1).

[20] *See* 15 U.S.C. §78eee et. seq.

[21] 81 Fed. Reg. at 10801.

[22] For example, under Section 205 the treatment of qualified financial contracts ("**QFCs**") is governed exclusively by Section 210 of Title II. *See* 12 U.S.C. 5385(b)(4).

[23] Proposed Rule § 380.64(b).

[24] 12 U.S.C. 5385(a)(2)(D) (emphasis added).

determination by SIPC.[25] Under the proposed rule, this review would be conducted at the district court level. If the liquidation of the covered broker-dealer were conducted under SIPA, a claimant would be entitled to the same level of judicial review as would be available under SIPA. Under established SIPA practice, a claimant that disagrees with a determination of SIPC, as trustee, will be afforded the opportunity to have the matter heard as a contested matter by the bankruptcy court, which may have greater experience with such determinations than a district court.

The Associations respectfully request that the Agencies reconsider whether it is truly necessary for the proposed rule to conflict with the plain language of Section 205 with respect to the role of SIPC and SIPA. We are not convinced that the conflicts are necessary and we are concerned that they could give rise to legal challenge and create unnecessary legal uncertainty during periods of financial distress.

3. The Agencies should coordinate with the CFTC to clarify how the orderly liquidation process would operate if a covered broker-dealer were a joint broker-dealer/FCM.

Many broker-dealers in the United States are both broker-dealers registered with the SEC and FCMs registered with the CFTC. FCMs fall under the definition of "commodity broker" under the Bankruptcy Code. In the event a joint broker-dealer/FCM were to become subject to liquidation proceedings under SIPA, the trustee appointed by SIPC would be subject to the same duties as a trustee in a commodity broker liquidation under subchapter IV of chapter 7 of the Bankruptcy Code, to the extent consistent with SIPA.[26] Based on recent precedent, while the proceeding itself would be conducted under SIPA, there would likely be a parallel claims process in which the rules for determining what constitutes "customer property" with respect to commodity customers and the satisfaction of commodity customer claims through account transfers or distributions of customer property would be determined under the commodity broker liquidation provisions of subchapter IV of chapter 7 of the Bankruptcy Code and the CFTC Part 190 Rules.[27]

While Section 210(m) of the Dodd-Frank Act addresses the resolution of a commodity broker in Title II,[28] the provisions are fairly skeletal. For example, there are no provisions specifically addressing the transfer of commodity customer accounts and customer property to a bridge institution in a manner comparable to what is provided for broker-dealers under Section 205. In addition, both the statute and the proposed rules are silent as to how an entity that is a joint broker-dealer/FCM would be resolved under Title II. Section 205(b)(1) provides that except as provided in Section 205, upon its appointment as trustee, SIPC shall have all of the powers and duties provided by SIPA, which would ordinarily include the powers and duties of a trustee under subchapter IV of Chapter 7 of the Bankruptcy Code. However, the interaction of this provision with Section 210(m) is not entirely clear. In addition, under the proposed rule, which eliminates the concept of the liquidation of the covered broker-dealer being conducted under SIPA, it is

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[25] Proposed Rule § 380.64(d).

[26] 15 U.S.C. §78fff-1(b).

[27] 17 C.F.R. Part 190.

[28] 12 U.S.C. § 5390(m).

unclear whether SIPC would have any powers or duties in respect of commodity customers. Moreover, "commodity contracts" generally fall within the definition of QFCs. Section 205 provides that the exercise of rights and performance of obligations of parties to QFCs are governed exclusively by Section 210 of Title II.

Since the principal goal of the proposed rule is to provide the market with greater certainty as to how the resolution process would operate in the event Title II were ever invoked to resolve a major broker-dealer, the Associations believe that the Agencies should coordinate with the CFTC to clarify how Title II would be applied in the case of a joint broker-dealer/FCM.

4. The Agencies should affirmatively clarify that they intend to follow past SIPC practices with respect to the treatment of customers whose accounts have been transferred to another institution.

To aid in affording customers rapid access to their accounts at the bridge broker-dealer, the proposed rule allows the initial allocation of customer property to the bridge broker-dealer to be derived from estimates based on the books and records of the covered broker-dealer.[29] The Associations support the goal of a rapid transfer of customer property to a bridge broker-dealer unless transfer to another qualified broker-dealer is imminent, and agree that the ability to rely on initial estimates of customer property could be an important tool in facilitating such a rapid transfer.

Although the preamble indicates that the Agencies expect initial allocations to be made conservatively, it also notes that if initial estimates are excessive, customer funds "may need to be reallocated after customers initially gain access to their accounts, which could result in costs for customers."[30]

The Associations believe it is important for the stability of the financial markets that the Agencies affirmatively clarify that they intend to follow past SIPC practice with respect to the treatment of customers whose accounts have been transferred to another institution. In particular, the Agencies should clarify that any decisions regarding steps to be taken if the initial estimates prove to have been excessive shall be made by SIPC in accordance with its customary policies and practices, and that if SIPC determines that a reallocation of customer property is necessary, such reallocation would not result in the unwinding of any transaction that has already settled through the delivery of customer property from the customer's account at the bridge-broker dealer, or a requirement that customers return such property in kind to the receivership estate or the bridge broker-dealer.

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[29] Proposed Rule §§ 380.63(d), 302.103(d).

[30] 81 Fed. Reg. at 10812.

5. The final rule should clarify that if customer accounts are transferred to a bridge broker-dealer the FDIC, in consultation with SIPC, will endeavor to transfer to the bridge broker-dealer any liabilities that are secured by customer property that has been rehypothecated by the covered broker-dealer.

Under the proposed rule and Title II, the FDIC has the authority to transfer such other assets and liabilities of the covered broker-dealer (including non-customer accounts and any associated property) to the bridge broker-dealer as the FDIC may in its discretion determine to be appropriate.[31]

In order to facilitate access by customers to their customer property, including customers that have borrowed from the covered broker-dealer on margin, the Associations believe that the FDIC, in consultation with SIPC, should endeavor to transfer to the bridge broker-dealer any liabilities that are secured by customer property that has been rehypothecated by the covered broker-dealer, as permitted in accordance with applicable law and regulation, in order to put the bridge broker-dealer in a position as close as possible to the business-as-usual operations of the covered broker-dealer and enable it to return such property to the customer upon satisfaction of the customer's indebtedness.

6. The Agencies should clarify that the FDIC will cooperate with SIPC in allocating property from the broker-dealer's general estate to the pool of customer property if shortfalls in customer property resulted from regulatory compliance failures.

Under SIPA, the definition of "customer property" includes other property of the broker-dealer which would have been set aside or held for the benefit of customers in compliance with applicable laws, rules and regulations.[32] In past SIPA proceedings, the trustee appointed by SIPC has, in fact, allocated property from the broker-dealer's "general estate" to the pool of customer property to the extent shortfalls were found to result from regulatory compliance failures, which enhanced the recovery of customers.[33] The Associations believe that the final rule should clarify that if SIPC determines that a shortfall in customer property exists, the FDIC will cooperate with SIPC in allocating property from the broker-dealer's general estate to the pool of customer property to the extent shortfalls resulted from regulatory compliance failures.

7. The final rule should clarify that any reference to SIPA also includes the rules of SIPC in 17 C.F.R. Part 300.

The proposed rule provides that SIPC shall make claims determinations in accordance with SIPA.[34] The Associations suggest clarifying that the reference to SIPA also includes the rules

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[31] Proposed Rule § 380.63(c).

[32] 15 U.S.C. §78lll(4)(A).

[33] *See* In Re Lehman Brothers Inc. (Case No. 08-01420 (JMP) SIPA), Order Approving the Trustee's Motion for Allocation of the Property of the Estate, available at http://dm.epiq11.com/LBI/Docket.

[34] Proposed Rule §§ 380.64(a)(1), 302.104.

of SIPC in 17 C.F.R. Part 300, which address such matters as the treatment of accounts held in different capacities.

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We thank the Agencies for their consideration of our comments. If you have any questions, please do not hesitate to contact any of the undersigned.

Sincerely,

Carter McDowell
Managing Director and Associate General Counsel
Securities Industry and Financial Markets Association

John Court
Managing Director and Deputy General Counsel
The Clearing House Association

Rich Foster
Senior Vice President and Senior Counsel for Regulatory and Legal Affairs
Financial Services Roundtable

ANNEX

A DESCRIPTION OF EACH OF THE ASSOCIATIONS

The Securities Industry and Financial Markets Association. SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

The Clearing House. The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly $2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

Financial Services Roundtable. As advocates for a strong financial future™, FSR represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs.