Dear Chair Gensler, the Commissioners Several, and Those Considering the Proposed Rule,

The question of to what extent, and how, intraday margin positions and intraday shocks are considered in the broader set of solvency or viability appraisal activities is an area where I've spent substantial time and thought. My hope is to share some helpful subset of those thoughts on entity solvency here.

I'm an economist at the University of Chicago Booth School of Business and have in the past submitted comments and testimony regarding Dodd-Frank's implementation; my comments on Dodd-Frank and proposed rules have been cited by Secretary Countryman, Commissioner Aguilar, and others. I thank the Commission for taking notice of my past comments, citing them in various recent Proposed Rules (see, e.g., Release Nos. 34-88616, 33-11013, 34-93782), Guidance (see, e.g., Release Nos. 34-87780), and Final Rules (see, e.g., Release Nos. 33-10428, 34-88616, 33-9877, and 34-75610).

I've also worked on orderly wind-down plans for various entities, including being a primary creditor negotiator on the wind-down of a NASDAQ-listed (soon thereafter NASDAQ-delisted) bank under FDIC supervision; my comments here also draw upon this experience with entities holding complex assets.

Wind-down plans of covered clearing agencies pose special challenges that are different from the considerations in play in a traditional bank wind-down, primarily because the group of counterparties affected is more heterogeneous and because the relationships between the wind-down entity and the counterparties may be opaque, especially in the case of a securities depository holding thinly-traded or obscure assets that are difficult to price or may not have reliable intraday arms-length values. The represented value of underlying assets may change radically over time or erode due to other obligations.

In these scenarios, the underlying assets may be difficult to value and, even more troubling, may be hard to assess in terms of vulnerability to the primary categories of risk: legal, credit, liquidity, operational, general business, investment, and custody. As Chair Gensler has noted, in the case of exotic assets like counterparty risk contracts that behave more like insurance policies or in the case of exotic assets like cryptocurrencies that may be extraordinarily intraday volatile, other risks may be present that contain dependencies or prerequisites that are not obvious even to a sophisticated risk management team.

Insofar as the current revision or clarification of the rules regime is meant to enjoy inertia from the Congressional intent of 17A of the Exchange Act (1975 and as amended), it is correct and proper for the Commission to take note of contemporary deliberations, reports, and testimony, such as the desire for "a fully integrated national system for the prompt and accurate processing and settlement of securities transactions[.]" See 15 U.S.C. 78q-1; Report of the Senate Committee on Banking, Housing & Urban Affairs, S. Rep. No. 94-75, at 4 (1975).

However, the complexity of settlement transactions and the complexity of the underlying assets that may be held by a covered clearing agency are materially different today than in 1975. These differences and nuances are apparent in the 2016 work to describe modern covered clearing agencies in the Covered Clearing Agency Standards. See Standards for Covered Clearing Agencies Adopting Release, Exchange Act Release No. 78961 (Sept. 28, 2016), 81 FR 70786, 70808-09 (Oct. 13, 2016) (and as amended; further amendments proposed).

The primary tension today is that between standardizing the process for restructuring or winding-down these entities while recognizing that each entity's situation–and the set of managerial decisions, prerequisite transactions, and ambient market conditions leading to that situation–is empirically unique.

In 2014-16, the SEC and Congress correctly recognized the sui generis nature of these events and was hesitant to standardize the process. See CCA Standards Adopting Release, 81 FR at 70808, and contemporary debate and discussion of same. However, more guidance may be needed.

Circa 2016, the Commission suggested a covered clearing agency should periodically (meaning regularly) consider whether (i) it can identify scenarios that may potentially prevent it from being able to provide its critical services as a going concern and assess the effectiveness of a full range of options for recovery or orderly wind-down; (ii) it has prepared appropriate plans for its recovery or orderly wind-down based on the results of that assessment; and (iii) it has provided relevant authorities with the information needed for purposes of recovery and resolution planning.

Much ink has been spilled, inside and outside the Congressional Record, on point (i) and I will not belabor it here; I will note, however, that the solvency safeguards created as a compliance matter are useful and generally reasonably-well-crafted in response to 17 CFR 240.17Ad-22(e)(15), which has succeeded in escalating solvency management to a General-Counsel-level compliance discussion in many organizations. Very recent discussion, particularly as to Silicon Valley Bank and other wind-downs of bank entities, will no doubt inform debate on point (ii) and what an "appropriate" plan might contain, which I hope will be more nuanced than the common industry rule of thumb of six months of typical operations.

Therefore, I will focus my brief comments on the less-discussed point (iii), where my combination of scholarship and first-hand expertise is likely of the most value. I want to be clear that my comments here do not refer to the compliance, management, or operations of any particular entity.

In part because of the complex Venn-diagram-esque relationship between financial regulators in terms of both activities and jurisdiction, management may be misinformed or uninformed as to when, how, and why to contact regulators who are the "relevant authorities" under the CCA Standards or what to communicate that would be illustrative as to the entity's predicament. In the case of publicly-traded entities in particular, management may be understandably hesitant to make forward-looking pessimistic statements that may be unearthed in future shareholder litigation or insolvency proceedings.

A complex cocktail of incentives familiar to the Commission but too labyrinthine to elucidate here causes management to 1) underestimate the risk of entity failure, 2) underestimate the range of scenarios that might threaten entity survival, and 3) underestimate the amount of information that needs to be communicated effectively to "relevant authorities" to illuminate threats to the entity's solvency, especially when those threats are high-magnitude, low-frequency risks (a simple example, again not as to any particular present case or entity, is a mismatch between debt obligations thought to be safely "held in the black" and unexpected movement of the prevailing interest rate).

It is possible to craft a warning that is so encompassing and vague that it communicates nothing useful to relevant authorities and amounts to "chilly weather expected near Titanic this evening." It is also possible to send a shotgun blast of tiny-in-scope, but dire-in-implication, warnings that never come to fruition. Neither is helpful, and neither is what was intended when the current regulatory regime was crafted. So, how can the Commission encourage frankness without inviting everyone to adopt an overly-conservative stance and to constantly cry wolf when risk of a real event is distant and miniscule?

The Covered Clearing Agency Standards encourage a behavior at 17 CFR 240.17Ad-22(e)(6) that should, at least in theory, provide the basic tools for a better reporting conversation. Specifically, 22(e)(6) requires the risk-based margin system within the entity use mark-to-market values and that these values be maintained and revised in the regular course of business as it updates other valuations of owned or custodied assets (in other words, on a basis and by a mechanism similar to how it typically marks counterparty assets it holds to market). At a minimum, this is to be done daily (for instance, at the close of the market in New York), and covered clearing agencies are at a minimum expected to charge margin interest according to industry norms and to make and enforce margin calls in a timely manner (margin operations are discussed in some detail at 22(e)(6)(ii)).

I agree with, and support, the proposed rule in that I dislike the altitude from which insolvency risk is today considered, whether by the Board of Directors, the Chief Risk Officer, or the General Counsel's office in organizations I've seen respond to crisis scenarios. The requirement of explicit consideration in the recovery plan of what might lead to each scenario's coming into being and how the scenario might take shape (including prerequisite contemplated market conditions) imposes a small burden on compliance and risk functions in the entity while creating greatly-enhanced transparency to investors and regulators around how, how quickly, and under what conditions the entity may fail to meet obligations. Section 2(i)(d) in the proposed rule publication ("Scenarios") is among the most detailed and best-crafted discussions of this disclosure I have seen in fifteen years of reviewing proposed rules.

I support Proposed Rule 17ad-26(a)(4), I support further development of the Rule as discussed and proposed, and I support the development of ex ante plenary mechanisms that are unusual and unstandardized today to anticipate a potential recovery or wind-down following a major event and to better-inform both management and stakeholders as to what steps will be taken in situations where the entity's ability to satisfy present or near-future obligations is meaningfully called into question.

I respectfully ask that my support for the regulatory activity and rules revision described in Release No. 34-97516 be added to File No. S7-10-23 as part of the discussion of this important issue.

Sincerely,

/s/

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The above comments may not reflect the views of the University of Chicago, of the Booth School of Business, or of any past or present client and are my personal opinions as to contemplated regulation.