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February 13, 2023

Ms. Vanessa Countryman
Secretary, Office of the Secretary
U.S. Securities and Exchange Commission
100 F St. NE
Washington, DC 20549-1090

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
11 55 21st Street NW
Washington, DC 20581

Copy: Morgan Stanley México, Casa de Bolsa, S.A. de C.V.; Goldman Sachs México, Casa de Bolsa, S.A. de C.V.; Casa de Bolsa Finamex, S.A.B. de C.V; Mr. Colin D. Lloyd, Cleary Gottlieb Steen & Hamilton LLP; Office of Credit Ratings, U.S. Securities and Exchange Commission; U.S. Commodity Futures Trading Commission Commissioners and Staff; and Harvard Law School I Bankruptcy Roundtable

Via Electronic Mail

Re: U.S. Securities and Exchange Commission
Petition for Rulemaking "File No. 4-790" ***("I seek a rulemaking by the Commission that prohibits a security-based swap dealer or other entity subject to Commission regulation from predicating a security-based swap or other financial instrument subject to Commission regulation on a flip clause, walk-away, or variable subordination.")***
AND
Petition for Rulemaking "File No. 4-799" ***("Petition for Policy Clarification on Credit Rating Agencies")***

U.S. Commodity Futures Trading Commission
§ 13.1 Petition for Rulemaking ("prohibit a swap dealer . . . from predicating a swap obligation on a flip clause, walkaway, or variable subordination")

AND
Mexico Swap Dealer Capital Comparability Determination
AND
Global Markets Advisory Committee

"Really Sayin' Somethin'"[1]

"If you see something, say something [emphasis added]"[2]

"When in doubt, if you see something, say something. Escalate to your supervisor, your Compliance officer, your Legal coverage, HR, Ethics Office, the anonymous hotline, or other channels—there was no excuse to not escalate [emphasis added]."[3]

"'If you see something, say something.' This applies to not only employees of our registrants, but also to the firms that we oversee. But when should you say something to the authorities'[emphasis added]"[4]

"So, if you see something that you think you should tell your regulator, say something to your regulator [emphasis added]."[5]

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1 Holland, Edward, Jr., Norman J. Whitfield, and William Stevenson, "He Was Really Sayin' Somethin'".
2 CFTC Commissioner Caroline D. Pham, "'If You See Something, Say Something': Remarks at the NYU Law Program on Corporate Compliance and Enforcement Fall Conference", November 14, 2022.
3 Ibid.
4 Ibid.
5 Ibid.

Dear Ms. Countryman and Mr. Kirkpatrick,

My name is Bill Harrington. I am senior fellow at the non-profit research and action entity Croatan Institute.[6] The Institute posts my work.[7]

The entirety of today's letter is a joint submission to the SEC and the CFTC on the five matters that the first two pages cite.

The fourth item — CFTC "Mexico Swap Dealer Capital Comparability Determination (CFTC Mexico Proposal)", December 13, 2022 — states the following.

> "*The Commission is soliciting public comment on an application dated September 28, 2021 and submitted jointly by Morgan Stanley Mexico, Casa de Bolsa, S.A. de C.V., Goldman Sachs Mexico, Casa de Bolsa, S.A. de C.V., and Casa de Bolsa Finamex, S.A. de C.V. [Footnote] 2*
>
> *"[Footnote] 2 The Mexico Application was submitted by Colin D. Lloyd, Cleary Gottlieb Steen & Hamilton LLP, on behalf of the Applicants*."[8]

The Mexico Application states.

> "*Additionally, a Mexican S[wap] D[ealer] is required to provide to the general public, on a publicly accessible website, along with its financial statements, information related to its regulatory capital structure, including its main components, its capital adequacy level and the amount of the assets subject to risk.* ***A Mexican SD must also disclose its risk level, according to the credit rating issued by two credit rating agencies authorized by the Mexican Commission, including for such purposes both ratings in the notes to their financial statements*** *[emphasis added]."*[9]

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6 (https://croataninstitute.org/).

7 (Injecting Accountability into the U.S. and Global Financial Systems - Croatan Institute) and https://croataninstitute.org/william-j-harrington/).

8 U.S. Commodity Futures Trading Commission, "Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Subject to Regulation by the Mexican Comision Nacional Bancaria y de Valores", Federal Register Volume 87, Number 238, Tuesday, December 13, 2022.

9 Cleary, Gottlieb Steen, and Hamilton LLP, "Letter to U.S. Commodity Futures Trading Commission 'Re: Substituted Compliance Application for Mexico Swap Dealers from CEA Sections 4s(e)–(f) and Rules 23.101 and 23.105(d)–(e)'", September 28, 2021, p19. (https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm).

The Imperative: The CFTC and the SEC must prevent every regulated swap provider globally from providing a non-margined swap contract with a flip clause, walkaway, or variable subordination ("swap-contract-with-flip-clause").

Rationale: The zero-sum flip clause enables the two contracting parties to misclassify the clause as "win-win" and thereby grossly under-resource the respective contract exposures. With each swap-contract-with-flip-clause, the two counterparties undermine themselves, sap economic efficiency, and corrode financial stability.

Capital Rules: Must reinforce beneficial U.S. swap margin rules for the swap-contract-with-flip-clause and offset injurious non-U.S. swap margin rules for the contract.

Swap Margin Rules and the Swap-Contract-with-Flip-Clause: The five U.S. prudential regulators enforce a joint rule that is best-in-class globally.[10] The CFTC enforces an analogous rule that is second-best-in-class globally.[11] The SEC enforces an analogous rule that is third-best-in-class globally. The swap margin rules of most non-U.S. domiciles, including Mexico, are worst-in-class globally.

Beneficial U.S. Swap Margin Rules Viz-a-Viz Injurious Non-U.S. Swap Margin Rules:

1. U.S. swap margin rules oblige a U.S. swap provider to collect and post variation margin under a new swap contract with a financial end-user, including a securitization or structured debt issuer. Margin posting generates the immense benefit of inducing U.S. securitization and structured debt issuers to entirely forswear all swap contracts. As a very constructive result, no more than one, and possibly no, U.S. securitization or structured product issuer has entered a swap-contract-with-flip-clause since 2017.

   Non-U.S. swap margin rules de-facto exempt a swap provider from collecting or posting variation margin under a new contract with most securitization and structured debt issuers. As a result, swap providers outside the U.S., including CFTC-regulated providers, grossly undercapitalize themselves and non-U.S. issuers under-resource deals by entering the swap-contract-with-flip-clause.

2. U.S. swap margin rules generally exclude all private-label securitizations and structured debt from eligible collateral. In contrast, non-U.S. rules generally allow private-label securitizations and structured debt as eligible collateral.

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[10] Harrington, Bill, "US margin rule for swaps obliges securitization issuers to overhaul structures, add resources, and rethink capital structures", *Debtwire ABS*, 5 November 2015. (https://www.sec.gov/rules/petitions/2022/petn4-790-ex2.pdf).

[11] Harrington, Bill, "CFTC swap margin rule denies relief for ABS; shines light on 'flip clauses'", *Debtwire ABS*, 18 December 2015, (https://www.sec.gov/rules/petitions/2022/petn4-790-ex3.pdf).

Credit Ratings: Per the public good, economic efficiency, financial stability, and U.S. law, the CFTC and the SEC cannot cite, use, or otherwise rely on credit ratings.[12] Credit ratings, by design, exclude exposures to derivative contracts and minimize exposures to securitizations and structured products.

Seeing a Lot and Saying Nothing: Morgan Stanley and Goldman Sachs. The parents of respective applicants Morgan Stanley Mexico, Casa de Bolsa, S.A. de C.V. and Goldman Sachs Mexico, Casa de Bolsa, S.A. de C.V., have extensive, multi-decade experience in grossly undercapitalizing themselves by booking the swap contract-with-flip-clause.[13]

Seeing a Lot and Saying Nothing: Morgan Stanley and Goldman Sachs. The companies have extensive, multi-decade experience in inducing Nationally Recognized Statistical Rating Organizations (NRSROs) Fitch Ratings, Moody's Investors Service, and S&P Global Ratings to assign inflated credit ratings to all manner of instruments and derivative counterparties globally, not least to Morgan Stanley and Goldman Sachs entities that are parties to swap-contracts-with-flip-clauses.[14]

Seeing a Lot and Saying Nothing: Morgan Stanley and Goldman Sachs. The companies have extensive, multi-decade experience in successfully litigating to enforce flip clauses against the Lehman Brothers estate and thereby impose on it the maximum loss of 100% of contract values.[15] However, neither Morgan Stanley nor Goldman Sachs has written down its own portfolio of

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[12] Pimbley, Joe and Bill Harrington, "Federal Reserve Trashes Dodd-Frank Restrictions on Credit Ratings", *Croatan View*, May 20, 2020. (https://croataninstitute.org/2020/05/20/federal-reserve-trashes-dodd-frank-restrictions-on-credit-ratings/)

[13] Harrington, William J. "Joint Submission to SEC and CFTC 'Re: SEC Petition for Rulemaking Number 4-790 AND CFTC § 13.1 Petition ('prohibit a swap dealer . . . from predicating a swap obligation on a flip clause, walkaway, or variable subordination') AND 'Japan Swap Dealer Capital Comparability Determination', AND 'Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 'Collection Number 3038–0111'', AND 'Market Risk Advisory Committee', AND 'Request for Information on Climate-Related Financial Risk'", October 20, 2022, pp10-11, 19 and 24-25. (https://www.sec.gov/comments/4-790/4790-20147063-312602.pdf). Also, Harrington, William J, "Joint Submission to SEC and CFTC 'Re: SEC Petition for Rulemaking Number 4-790 AND CFTC § 13.1 Petition ('prohibit a swap dealer . . . from predicating a swap obligation on a flip clause, walkaway, or variable subordination') AND S&P Global Ratings Presale: 'Black Diamond CLO 2022-1 Ltd./Black Diamond CLO 2022-1 LLC'"", December 19, 2022, p2. (https://www.sec.gov/comments/4-790/4790-20153256-320720b.pdf).

[14] Harrington, William J., "Electronic Letter to the SEC 'Re: Rule Comment Number 4-661'", June 3, 2013. See "Morgan Stanley", "Goldman Sachs", and "GSMMDP" throughout. (https://www.sec.gov/comments/4-661/4661-28.pdf).

[15] Harrington, William J. "Joint Submission to SEC and CFTC", October 20, 2022, pp24. (https://www.sec.gov/comments/4-790/4790-20147063-312602.pdf).

swap-contracts-with-flip-clauses by even a little to recognize the potential loss of 100% of contract values.

Seeing a Lot and Saying Nothing: Cleary Gottlieb Steen & Hamilton LLP. The law firm, and at least another 27 firms, have extensive, multi-decade experience in representing one or more of 200-plus defendants, including Morgan Stanley and Goldman Sachs entities, that successfully litigated to enforce flip clauses against the Lehman Brothers estate and thereby impose on it the maximum loss of 100% of contract values.[16]

Seeing a Lot and Saying Nothing: Cleary Gottlieb Steen & Hamilton LLP and the 29 other law firms listed on the following three pages. All have first-hand experience with my best-in-world analyses and critiques of the swap-contract-with-flip-clause. In 2019, I submitted a motion to file a proposed amicus curiae brief to the U.S. Court of Appeals for the Second Circuit regarding what proved to be the conclusion of multi-decade litigation to enforce flip clauses against the Lehman Brothers estate and thereby impose on it the maximum loss of 100% of contract values.[17] To perfect each court submission, I hand mailed a physical copy to one or more attorneys at each firm.[18]

Seeing a Lot and Saying Nothing: Four attorneys at Freshfields Bruckhaus Deringer US LLP and the Structured Finance Association. The four attorneys have first-hand experience with my best-in-world analyses and critiques of the swap-contract-with-flip-clause owing to their having filed an amicus curiae brief with the Second Circuit on behalf of the SFA. The SFA brief urged the Second Circuit to rule in favor of the 200-plus defendants, including Morgan Stanley and Goldman Sachs entities, and uphold the enforcement of flip clauses against the Lehman Brothers estate and thereby impose on it the maximum loss off 100% of contract values.[19] To perfect each court submission, I hand mailed a physical copy to each of the four Freshfields attorneys.

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[16] Harrington, William J. "Joint Submission to SEC and CFTC", October 20, 2022, p4. (https://www.sec.gov/comments/4-790/4790-20147063-312602.pdf).

[17] Harrington, William J, "Motion to File Proposed Amicus Curiae Brief to the US 2nd Circuit 'Re: Case No. 18-1079 (Lehman vs 250 Financial Entities Re Flip Clause Enforceability)'", 25 June 2019. (https://croataninstitute.org/wp-content/uploads/2021/06/WJH-Motion-to-File-Amicus-Brief-in-2nd-Circuit-Case-18-1079-bk-Lehman-Brothers-vs-the-World.pdf).

[18] Harrington, William J, "Proposed Amicus Curiae Brief to the US 2nd Circuit 'Re: Case No. 18-1079 (Lehman vs 250 Financial Entities Re Flip Clause Enforceability)'", 25 June 2019, Title pages 1-6. (https://croataninstitute.org/wp-content/uploads/2021/06/18-1079-bk-WJH-08-08-19-Letter-to-US-Court-of-Appeals-for-Second-Circuit-Proposed-Amicus-Curiae-Brief-Re-Case-No-18-1079.pdf).

[19] Harrington, William J. "Joint Submission to SEC and CFTC", October 20, 2022, pp25-26. (https://www.sec.gov/comments/4-790/4790-20147063-312602.pdf).

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Seeing a Lot and Saying Very, Very Little: Cleary Gottlieb Steen & Hamilton LLP and the 10 other law firms listed below. Each firm:

(1) avidly reported the Second Circuit decision of August 11, 2020, that upheld 200-plus defendants, including Morgan Stanley and Goldman Sachs entities, in enforcing flip clauses against the Lehman Brothers estate and thereby imposing on it the maximum loss of 100% of contract values

(2) WHILE ENTIRELY ELIDING that the Lehman Brothers estate incurred the maximum loss of 100% of contract values.

- Boccuzzi, Carmine D. Jr., Lisa M. Schweitzer, Sean A. O'Neal, Emily Balter, and Brandon Hammer, "Second Circuit Rules that Provisions in Lehman CDOs Setting Payment Priorities Are Protected", Cleary Gottlieb, *Alert Memorandum*, August 18, 2020.
- Vasser, Shmuel (Dechert) "Second Circuit Affirms Enforceability of Swaps' Flip Provisions", *The Harvard Law School Bankruptcy Roundtable*, September 22, 2020.
- Shelley, Scott C. (Quinn Emanuel Urqhart & Sullivan LLP), "Second Circuit Upholds Swap Termination in Flip Clause Litigation: In re Lehman Brothers Holdings Inc., 970 F.3d 91 (2d Cir. 2020)", ChaseCambria, Vol 18 (2021) – Issue 1.
- Douglas, Mark G. and Charles M. Oellermann, "'Flip Clause' Payments to Lehman Brothers Noteholders After Termination of Swap Agreement Safe Harbored in Bankruptcy", Jones Day, *Insights*, September-October 2020.
- Darwin, Armanda, "Good news for CDO trustees in the Lehman flip clause litigation", Nixon Peabody, *Alert*, October 29, 2020.
- Carruzzo, Fabien and David E. Blabey, Jr. "Second Circuit Holds That So-Called Flip Clause Priority Provisions Are Protected by the Swap Safe Harbor under the Bankruptcy Code", Kramer Levin, *Broken Bench Bytes*, September 8, 2020.
- Forrester, J. Paul, "Second Circuit: Lehman Brothers 'Flip Clause' Payments Are Protected Settlement Payments and Not Void as Ipso Facto Bankruptcy Provisions", Mayer Brown, *Perspectives and Events*, August 11, 2020.
- Selbst, Stephen B., "Second Circuit Does Not Flip Flop on Enforceability of Flip Clauses", Herrick, I*nsights*, September 29, 2020.
- "Second Circuit's Lehman Flip Clause Decision Continues the Expansion of the Bankruptcy Code Safe Harbors", Cadwalader, *Clients & Friends Memos*, September 2, 2020.
- "Second Circuit Confirms 'Flip Clauses' Protected by Bankruptcy Code's Swap Safe Harbor", Seward & Kissel, LLP, August 19, 2020.
- Rubens, Daniel A., "Second Circuit Affirms Enforceability of Flip Provisions in Swap Agreements Under Bankruptcy Code Safe Harbor", Orrick, September 2, 2020.

Seeing a Lot and Saying Very, Very, Very Little: The Structured Finance Association in its capacity of friend of many courts but enemy of the American people. SFA:

(1) ***immediately*** **reported the Second Circuit decision of August 11, 2020**, that upheld more than 200-plus defendants, including Morgan Stanley and Goldman Sachs entities, in enforcing flip clauses against the Lehman Brothers estate and thereby imposing on it the maximum loss of 100% of contract values

(2) WHILE ENTIRELY ELIDING that the Lehman Brothers estate incurred the maximum loss of 100% of contract values**.**

- **"**Court Rules in Favor of Investors in Lehman 'Flip Clause' Case," Structured Finance Association, August 11, 2020.

Seeing a Lot and Saying Nothing: The U.S. Commodity Futures Trading Commission. The CFTC has first-hand experience with the best-in-world analyses and critiques of the swap-contract-with-flip-clause that I have provided directly to Commissioners and staff since January 30, 2014. In response to the best-in-world analyses and critiques of the swap-contract-with-flip-clause, the CFTC employs world-class dissembling to pretend that it does not know what plain common sense and all evidence shows: Each flip clause exposes a derivative contract provider to the maximum loss of 100% of contract value of each swap-contract-with-flip-clause.[20]

Clear and Simple Conditions for Mexico Swap Dealer Capital Comparability Determination: (1) No Flip Clauses; and (2) No Reliance on Credit Ratings.

> "*One of my guiding principles throughout my career, both as a regulator and in the private sector, is that markets work best when there are clear and simple rules with common standards. Ensuring that these rules are harmonized minimizes operational complexity that can otherwise increase risks and costs.*"[21]

II

"*With each swap contract with flip clause, a swap provider intentionally undercapitalizes to the maximum extent possible, namely by 100% of asset value should the provider become bankrupt, insolvent, or otherwise unable to perform. For all swaps with flip clauses, the degree of undercapitalization is 100% cumulative, i.e., the sum of 100% of asset value for 100% of contacts should the provider become bankrupt, insolvent, or otherwise unable to perform.*

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[20] Harrington, William J. "Joint Submission to SEC and CFTC", October 20, 2022, in total, including all footnotes and links therein. (https://www.sec.gov/comments/4-790/4790-20147063-312602.pdf).

[21] U.S. Commodity Futures Trading Commission, "Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Subject to Regulation by the Mexican Comision Nacional Bancaria y de Valores", "*Appendix 5—Concurring Statement of Commissioner Caroline D. Pham*", Federal Register Volume 87, Number 238, Tuesday, December 13, 2022.

"*'The flip clause subjects a swap dealer to its own credit risk, in addition to the credit risk of a structured debt counterparty. In fact, the rating of structured debt depends on the* flip clause imposing a [total] loss on the swap dealer.'

"*'Moreover, the correlation of activation of all flip clauses, walkaways or similar provisions will be 100%, i.e., 100% of counterparties to uncleared swaps and uncleared security-based swaps with these clauses and provisions that are in-the-money to an SD will simultaneously activate them against the SD when it is bankrupt, insolvent, non-performing or similarly impaired.'*"[22]

II

"*With each swap contract with flip clause, an underwriter and issuer knowingly structure and sell under-resourced securitizations or structured debt with inflated credit ratings. The extent of deal under-resourcing is '1%, 3%, 7% . . . [or more] of deal size', depending on contract parameters. Compounding the systemic destruction, all manner of entities including banks and all manner of investors including the entire gamut knowingly buy the undercapitalized, overrated securitizations and structured debt. Compounding the systemic destruction exponentially, many entities routinely exchange the undercapitalized, overrated securitizations and structured debt as collateral.*"[23]

II

"*In domiciles where a regulated entity can enter the swap contract with flip clause—for instance Australia, Canada, the European Union, Japan, and the United Kingdom—the entity exposes itself to enormous losses and undermines all financial systems, local, U.S., and global. Flip-clause friendly domiciles operate deficient financial regulation both on an outright basis and compared to the U.S. The domiciles compound systemic risk by specifying under-resourced securitizations and structured debt, both with and without swap contracts, as good collateral, and by using credit ratings to calculate collateral eligibility and haircuts.*"[24]

II

"*In a closely-related instance of financial practitioners devoting resources to offload CSE exposures onto the U.S. public, the IIB, SIFMA, and ISDA urge the CFTC to not only approve a deficient comparability determination for Japan capital rules, but also* ***to produce 'the same answer in reference to the currently pending capital substituted applications for Mexico, the***

[22] Harrington, William J. "Joint Submission to SEC and CFTC", October 20, 2022, p6. (https://www.sec.gov/comments/4-790/4790-20147063-312602.pdf).

[23] "Ibid.", p7.

[24] "Ibid.", p9.

European Union and the United Kingdom *[emphasis added].' Meanwhile, SIFMA and ISDA have also devoted significant resources to advocate that the flip clause impose 100% loss of contact value on a defaulted swap provider. The logical conclusion of the latter SIFMA-ISDA argument supports the entirety of this submission. Every SIFMA and ISDA member that provides the swap contract with flip clause anywhere in the world negligently undercapitalizes itself since no member offsets the 100% loss of mark-to-market asset that each contract imposes."*[25]

II

"*The CFTC Must Eradicate the Flip Clause.*" [26]

Best regards,

Bill Harrington

[25] "Ibid.", p15.
[26] "Ibid.", p31.