

June 28, 2019

Regulators Eye “Opportunistic Credit Strategies”

In an interesting development, on June 24, the leaders of the U.S. Securities and Exchange Commission, the U.S. Commodity Futures Trading Commission, and the U.K. Financial Conduct Authority issued a [Joint Statement on Opportunistic Strategies in the Credit Derivatives Market](#). The Statement announces a joint initiative to study and address the impact of “various opportunistic strategies in the credit derivatives market, including but not limited to . . . ‘manufactured credit events,’” on “the integrity, confidence and reputation of the credit derivative markets, as well as markets more generally”, noting that “[t]hese opportunistic strategies raise various issues under securities, derivatives, conduct and antifraud laws, as well as public policy concerns.” The Statement highlights the regulators’ concern for market “transparency, accountability, integrity, good conduct and investor protection” and implies the possibility of future regulatory, investigative or enforcement actions.

We do not know at this stage the timetable or work-product of this joint initiative. The only practice specifically mentioned is “manufactured credit events” (e.g., deliberate/strategic defaults), but the Statement’s sweeping language and invocation of “opportunistic strategies” broadly suggests the potential scope is much wider. We have previously called to your attention the growing phenomenon of investors purchasing debt on the thesis that the borrower is already in default, and then seeking to profit from that default through derivatives (see our prior memos on this topic, including [The Rise of the Net-Short Debt Activist](#) and [Default Activism in the Debt Markets](#)). We have also observed the stirrings of private-law, market-based solutions to the conflict of interest issues raised by such practices (see [Debt Default Activism: After Windstream, the Winds of Change](#)) and, similarly, note that the Statement of the three agencies follows the efforts of the International Swaps and Derivatives Association, the trade organization of participants in the market for over-the-counter derivatives, to address manufactured credit events on a contractual basis (see [here](#)).

The Statement signals that greater scrutiny may come to all of these practices, and on a multi-national basis. We will watch both legal and market developments closely.

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