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

Submitted electronically via the SEC's Online Form

December 22, 2022

Dear Ms. Countryman:

Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With Respect to U.S. Treasury Securities (File No. S7-23-22)

The Alternative Investment Management Association (AIMA)¹ appreciates the opportunity to comment on the U.S. Securities and Exchange Commission's (SEC or Commission) proposed rule to amend the standards applicable to covered clearing agencies (CCAs)² for U.S. Treasury securities to require such CCAs to have written policies and procedures reasonably designed to require that every CCA direct participant (i.e., a FICC clearing member) submit for clearance and settlement all eligible secondary market transactions in U.S. Treasury securities to which it is a counterparty (the "Proposal").³ AIMA's

¹ AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than \$2.5 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programs and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage \$600 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialized educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

² The Fixed Income Clearing Corporation (FICC) is currently the only registered CCA that provides central counterparty (CCP) services for U.S. Treasury securities transactions. In this letter, we use FICC and CCA interchangeably.

³ SEC, Proposing Release, Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With Respect to U.S. Treasury Securities, [87 Fed. Reg. 64610](https://www.federalregister.gov/documents/2022/10/25/2022-20710-standards-for-covered-clearing-agencies-for-u-s-treasury-securities-and-application-of-the-broker-dealer-customer-protection-rule-with-respect-to-u-s-treasury-securities) (Oct. 25, 2022) (the "Proposing Release").

The Alternative Investment Management Association Ltd (New York Branch)

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members include institutional investment managers, most of whom are active indirect participants (i.e., customers⁴) in the cash Treasury and repo markets, and will therefore be impacted by the Proposal.

The U.S. Treasury market is the deepest and most liquid government securities market in the world. It plays a central role in both the U.S. and global economies, finances the federal government, provides a safe and liquid asset and facilitates the implementation of monetary policy. It is therefore essential that changes to the clearing framework and process be crafted to support, and not limit or discourage, activity in the cash Treasury and repo markets. AIMA supports central clearing because, when calibrated appropriately, it has increased resiliency, liquidity and transparency in financial markets.

Although we broadly support the Proposal and several of the changes contemplated therein, we disagree with the Commission's approach to implement a clearing mandate before resolving issues with the current clearing framework. Specifically, prior to establishing a clearing mandate, the Commission should require FICC to make several changes to its rules that address many customers' concerns regarding "done away" trades.

We believe that unless these issues are resolved, the expansion of central clearing, as contemplated in the Proposal, will be accompanied by outsized costs for indirect participants as they are forced to arrange numerous, expensive clearing relationships with direct participants to ensure that all of their trades that are required to be cleared can, in fact, be cleared. If faced with these new costs, indirect participants may begin to curtail their cash Treasury and repo trading, a result that would further harm overall market liquidity and undermine many of the benefits central clearing can provide.

This core concern and our other comments on the Proposal are discussed in further detail below in the attached annex with relevant data points provided. We would be happy to elaborate further on any of the points raised in this letter. For further information, please contact Daniel Austin, Director of U.S. Policy and Regulation, by email at [REDACTED].

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Jiří Król".

Jiří Król
Deputy CEO, Global Head of Government Affairs
AIMA

Cc: The Honorable Gary Gensler, Chair

⁴ We use the terms indirect participant and customer or client interchangeably in this response.



The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner
Dr. Haoxiang Zhu, Director, Division of Trading and Markets

ANNEX

1. The Commission should require changes to FICC’s policies and procedures to address “done away” trades and other issues before implementing a clearing mandate for cash Treasury and repo transactions.

Currently, FICC direct participants are only required to submit for clearing their cash and repo transactions entered into with other direct participants, i.e., they are not required to submit for clearing either cash or repo transactions with persons who are not direct participants.⁵ The Proposal would direct FICC to establish policies and procedures that require its direct participants to submit for clearing and settlement all “eligible secondary market transactions” (“ESMTs”) to which they are a counterparty (the “Membership Proposal”).⁶ ESMTs subject to the Membership Proposal would be defined to include:⁷

1. Repos and reverse repos in which one of the counterparties is a direct participant (“ESMT 1”);
2. Any purchases and sales entered into by a direct participant if it brings together multiple buyers and sellers using a trading facility⁸ and is a counterparty to both the buyer and seller in two separate transactions, i.e., an interdealer broker (IDB) (“ESMT 2”);⁹
3. Any purchases and sales of Treasuries between a direct participant and a counterparty that is (i) a registered broker-dealer, government securities dealer or government securities broker; (ii) a hedge fund;¹⁰ or (iii) an account at a registered broker-dealer, government securities dealer or government securities broker where such account may borrow an amount in excess of one-half of the value of the account or may have gross notional exposure of the transactions in the account that is more than twice the value of the account (altogether “ESMT 3”).¹¹

The Proposal would further require FICC to establish policies and procedures designed to ensure that it has the appropriate means to facilitate access to clearing and settlement services of all ESMTs, including those of indirect participants.¹² The Commission explains that this proposed requirement would further expand current rules regarding participation, which “permit fair and open access by direct and, where relevant [,] indirect participants.”¹³ Despite this belief, the Proposal concludes that concerns regarding “done away” transactions are “based on decisions of FICC’s direct participants

⁵ Proposing Release, *supra* note 3, at 64619.

⁶ *Id.* at 64620.

⁷ Transactions (either cash or repo) where the direct participant’s counterparty is a central bank, sovereign entity, international financial institution or a natural person would be excluded from the definition of an ESMT. *Id.*

⁸ *E.g.*, a limit order book. *Id.*

⁹ The Commission believes that this aspect of the Membership Proposal will address the potential for contagion risk associated with hybrid clearing. *Id.* at 64622.

¹⁰ The definition of hedge fund is consistent with the Form PF definition. *Id.* at 64623.

¹¹ *Id.* at 64620.

¹² *Id.* at 64635.

¹³ *Id.*

rather than operation of FICC's Rules" and that direct participants are not therefore required to accept such customer transactions.¹⁴ This unfortunate reality lies at the heart of our concerns with the Proposal.

As the Commission explains, done away trades are transactions which a FICC direct participant clears on behalf of its customer in which the direct participant is not an execution counterparty.¹⁵ While FICC's rules technically permit direct participants to clear done away transactions, they do not prohibit direct clearing members from compelling clients to bundle execution and clearing services. Specifically, FICC rules permit direct participants to limit its customer's executing counterparties by only accepting for clearing transactions that are also executed by the direct participant.¹⁶

The Proposal cites one industry group's concerns with the current FICC model and some direct participants' unwillingness to clear done away trades,¹⁷ yet these concerns are shared among many market participants that wish to clear Treasury transactions, including AIMA members. Ultimately, if the Commission does not first require FICC to amend its rules to address concerns with done away trades before implementing a clearing mandate, the goals it hopes the Proposal will achieve will prove unattainable.

For example, direct participants limiting their customers' counterparties undermines one of the primary benefits of central clearing – enabling market participants to transact with a broad range of counterparties. If central clearing is to achieve its most effective ends, direct participants should be indifferent with whom their customers execute a trade. Continuing to permit this practice to occur will undermine the SEC's stated goal of facilitating all-to-all trading and the emergence of additional liquidity providers. This practice also undermines the netting efficiencies associated with greater central clearing, given that market participants will be forced to clear various positions with different direct participants to reduce transaction costs.

Without a done away model, clients will be forced to incur additional costs¹⁸ to establish new clearing relationships with all the dealers with whom they wish to trade. If customers are required to clear certain transactions, they want to be able to do so with a single (or at least a limited number of) clearing members, not split up their counterparty relationships. Alternatively, an indirect participant could seek to become a direct participant; however, the total costs to become a direct FICC member, including licensing, FINRA approval and more, can reach almost \$2 million, according to discussions

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ FICC's rules also do not prohibit a direct participant being notified of a client's executing counterparty for a transaction a client wishes to clear.

¹⁷ Proposing Release, *supra* note 3, at 64635, n. 220-21.

¹⁸ These new costs include clearing fees and increases in margin due to the indirect participant's fragmented portfolio among multiple clearing members. *See e.g., id.* at 64669.

with some AIMA members, and this does not include the capital required to meet a Capped Contingent Liquidity Facility (CCLF) event.

Notwithstanding the costs, direct membership plainly does not work for some market participants for a variety of business and regulatory reasons. For example, a fund manager must be able to redeem its client assets according to their governing documents, i.e., a fund could not lock-up assets in the CCLF or another default-like fund. Registered investment companies would face similar challenges because of the prohibitions on loaning and encumbering fund assets and the requirement to effect redemptions in a timely manner.

Therefore, when faced with these new costs or the impracticability of direct membership, market participants may exit or limit their cash Treasury and repo trading, leading to a further reduction in Treasury market liquidity, an issue that has garnered growing attention over the past several months, which we discuss further below.

We agree that Section 17 and regulations promulgated thereunder enable the Commission to establish a clearing mandate as it contemplates here. This same regulatory authority equips the Commission with the ability to require FICC to “establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, ensure that it has appropriate means to facilitate access to clearance and settlement for all ESMTs . . . *including those of indirect participants.*”¹⁹ When taken together, we believe that the Commission also has the authority to prohibit anticompetitive practices at all CCAs; therefore, we encourage the Commission to go further in this rulemaking to require FICC (and any future CCAs) to prohibit the anticompetitive, unequal access practices regarding we discuss above.

Separately, FICC’s rules permit only direct participants to utilize cross-margining arrangements, i.e., between FICC and CME. When calculating margin, cross-margining arrangements can lower clearing costs through the consideration of offsetting positions, e.g., futures cleared at CME. FICC has not moved forward with permitting indirect participants to utilize this same benefit despite its repeated insistence of its plan to do so. FICC should establish a clear timeline and plan for obtaining necessary approvals to allow for indirect participants to cross-margin positions.

We believe it is essential that prior to the establishment of any clearing mandate, like the one contemplated in the Proposal, the Commission first require FICC to amend its rules to: (i) prohibit the disclosure of a customer’s executing counterparty; (ii) require the direct participant to operate independently and without undue influence from an affiliated trading business; and (iii) permit indirect participants the ability to utilize cross-margining arrangements.

2. We support ESMTs 1 and 2 but disagree with the Commission’s determination to single out

¹⁹ *Id.* at 64635 (emphasis added).

hedge funds' cash Treasury transactions in ESMT 3.

The Proposal would direct FICC to establish policies and procedures that require direct participants to submit for clearing and settlement all ESMTs to which they are a counterparty.²⁰ ESMT 1 requires all repos and reverse repos in which one of the counterparties is a direct participant to be cleared.²¹ In other words, ESMT 1 applies to all market participants and their repo and reverse repo trading and clearing. It does not take a piecemeal approach in terms of its applicability, i.e., excluding a segment of market participants from having to clear their repo and reverse repo transactions.

Similarly, ESMT 2 applies to all transactions executed on an IDB and does not exclude certain market participants' trading activity. We support ESMTs 1 and 2 and the Commission's approach to require the clearing of all repo and reverse repo transactions in which a direct participant is involved and all purchases and sales on an IDB. ESMT 3, on the other hand, does not take the same approach for cash Treasury transactions.

As proposed, ESMT 3 would require to be cleared any purchases and sales of Treasuries between a direct participant and a counterparty that is, among other parties, a hedge fund.²² We disagree with the Commission's preliminary approach to arbitrarily single out hedge funds' cash Treasury transactions among those that are required to be cleared. This determination leaves out other important market participants' cash Treasury transactions that also comprise a large segment of Treasury market liquidity. Accordingly, the Commission should require other market participants' cash Treasury transactions in which a direct participant is involved to be cleared. In doing so, the benefits of central clearing that the Commission cites throughout the Proposal will accrue throughout the broader cash Treasury market.²³

3. We support the proposed amendments that would require the segregation of a direct participant's margin from that of its customers.

The Commission is proposing to require all CCAs to establish policies and procedures designed to calculate, collect and hold margin from a direct participant's proprietary positions separately from the margin calculated and collected from the direct participant in connection with Treasury transactions by an indirect participant that relies upon the direct participant to access the CCA.²⁴ The Proposal explains that this change should allow FICC to better understand potential risk that may arise from transactions it clears.²⁵ These policies and procedures must also provide that margin collateralizing customer positions be collected separately from margin collateralizing a direct participant's

²⁰ *Id.* at 64620.

²¹ *Id.*

²² *Id.* at 64620.

²³ *See id.* at 64626-28.

²⁴ *Id.* at 64633.

²⁵ *Id.*

proprietary positions.²⁶ Finally, FICC would be required to have policies and procedures to ensure that any customer margin of a direct participant is held in an account separate from that of the direct participant.²⁷

We agree with the Commission's proposed amendments to segregate customers' margin from that of FICC direct participants. Doing so, as the Proposal notes, will further the risk management benefits associated with central clearing and help avoid a direct participant's disorderly default because FICC would have a more holistic view of the market than currently available.²⁸ Furthermore, because a direct participant's margin would be calculated, collected and held separately and independently than that of its customers, the direct participant's trades with its customers can be netted against the direct participant's trades with other direct participants.²⁹

The Proposal does not prescribe a specific amount of margin a direct participant would be required to collect from its customers or determine customer margin in a particular manner; instead, this determination would be left to other applicable regulations and/or bilateral negotiations between the direct participant and its customer.³⁰ Clearing agencies may often maintain opaque fee and governance policies, including policies around margin models. This lack of transparency can undermine market participants' confidence in the CCP. Accordingly, the Commission should encourage FICC to hear and consider input from indirect participants regarding potential changes to fee and governance models. Additionally, the Commission should specify that client initial margin should not be included as part of a clearing agency's default waterfall and subject to loss mutualization.

4. We support the amendments to Rule 15c-3a to permit margin on deposit at FICC to be included as a debit item in the customer reserve formula.

We agree with the proposed change to Rule 15c3-3a to permit margin required and on deposit at FICC to be debited from the customer reserve formula, subject to certain conditions.³¹ This change would make clearing more efficient by offsetting certain credit items in the 15c3-3a formula and therefore freeing up resources that could be used to meet FICC's margin requirements, i.e., a direct participant could use a customer's funds to meet margin requirements generated by the customer's trades, which can lower the cost of clearing.³² Furthermore, this amendment will, to an extent, help direct participants' balance sheet restraints as they clear more transactions.

5. The Commission should set a compliance date of 30 months from the publication of a final

²⁶ *Id.* at 64634.

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.* at 64667.

³⁰ *Id.* The Proposal explains that the contemplated segregation requirement would be similar to that currently used in the listed options and cleared swaps markets.

³¹ *Id.* at 64637.

³² *Id.*

rule in the Federal Register.

The Commission explains that FICC, its direct participants and their customers will need sufficient time to implement the changes contemplated in the Proposal and has therefore determined not to propose a specific compliance date.³³ FICC and its direct participants will need to expend the necessary time and resources to account for the increase in cleared transactions and other changes contemplated in the Proposal. Unless the Commission solves our concerns regarding the FICC model and done away trades described above, AIMA's members (and many other indirect participants) will shoulder incredible costs as they establish numerous, costly clearing relationships to ensure that all trades required to be cleared can, in fact, be cleared. This task will take a significant amount of time. Accordingly, if a final rule is adopted pursuant to the Proposal, the Commission should provide a compliance date of, at least, 30 months after the final rule's publication in the Federal Register.

6. The Commission should re-open the comment period for its proposed rule to amend the definition of 'dealer' and 'government securities dealer' (the "Dealer Proposal")³⁴ in light of this Proposal so that it may reassess the necessity of the former.

As we explain in our supplemental response to the Dealer Proposal,³⁵ this Proposal is broadly designed to address the same purported regulatory objectives motivating the Commission's questionable decision to extend the application of the Dealer Proposal to private funds. In the Dealer Proposal, the Commission asserted that extending the dealer regulatory framework to apply to certain private funds would enhance market integrity, resiliency and transparency in the Treasury market.³⁶ This Proposal seeks to achieve many of the same goals.³⁷

It therefore follows, and we believe, that the Dealer Proposal's Economic Analysis is incomplete because it fails to consider this Proposal, as well as others³⁸ currently pending before the Commission. Without a complete analysis, the Commission risks overstating the potential benefits of the Dealer

³³ *Id.* at 64641.

³⁴ SEC, Proposing Release, Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer, 87 Fed. Reg. 23054 (Apr. 18, 2022) (the "Dealer Proposing Release").

³⁵ See Letter from Jiri Krol, Deputy CEO, Global Head of Government Affairs, AIMA, to Vanessa Countryman, Secretary, SEC (Nov. 20, 2022), available at <https://www.sec.gov/comments/s7-12-22/s71222-20151467-319997.pdf>.

³⁶ See e.g., Dealer Proposing Release at 23060 ("the rules will support transparency; market integrity and resiliency; and investor protection; across the U.S. Treasury and other securities markets . . ."); *id.* at 23072 ("the operation of proposed Rule 3a44-2 will support transparency; market integrity and resiliency; and investor protection across the U.S. Treasury market"); *id.* at 23078 ("The Commission believes the Proposed Rules will support orderly markets and protect investors by addressing negative externalities that may arise in relation to market participants' financial and operational risks").

³⁷ This Proposal "could be particularly significant in times of market stress, as CCPs would mitigate the potential for a single market participant's failure to destabilize other market participants, destabilize the financial system more broadly, and/or reduce the effects of misinformation and rumors." Proposing Release, *supra* note 3, at 64662. Moreover, the Proposal explains the use of CCPs "would address concerns about counterparty risk by substituting the creditworthiness and liquidity of the CCP for the creditworthiness and liquidity of counterparties." *Id.*

³⁸ See e.g., SEC, Proposing Release, Amendments Regarding the Definition of "Exchange" and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities, 87 Fed. Reg. 15496 (Mar. 18, 2022).

Proposal relative to the significant costs – to both market participants and markets generally. At a minimum, it is incumbent on the Commission to re-evaluate the Dealer Proposal’s Economic Analysis and therefore its impact on markets and market participants, taking into consideration this Proposal as well as other related rulemakings.

We would also urge the Commission to reconsider the Dealer Proposal in light of recent market developments and concerns expressed by both the official sector and market participants regarding the decline of liquidity in the U.S. Treasury markets. In the recent semi-annual Financial Stability Report, for example, the Federal Reserve noted that it is reviewing the conditions affecting the stability of the U.S. financial system. The report recognizes that the Treasury market is experiencing liquidity strains, and persistent strains could have serious negative effects on the market and the U.S. economy. The report further notes that “between about October 2021 and the end of April 2022, market depth fell notably.”³⁹

The following reports and comments also highlight concerns regarding the growing decline in Treasury market liquidity:

- 10/31/22 – The *Financial Times* reported that Treasury Market liquidity has deteriorated to the “worst levels since March 2020.”⁴⁰
- 10/30/22 – The *Wall Street Journal* reported that “The ranks of traders ready to buy and sell Treasuries are shrinking. Individual trades are moving prices more. Treasury securities with similar characteristics are trading at larger-than-normal price differences. *Major players, including the big banks and asset managers that have long been significant buyers, are in retreat.*”⁴¹
- 10/24/22 – Secretary of the Treasury Janet L. Yellen remarked “The Treasury market today is reflecting greater uncertainty about the economic outlook” and recent Treasury market episodes “underscore the importance of enhancing [Treasury market] resilience.”⁴²
- 10/14/22 – *Bloomberg* reported that liquidity in the Treasury market is “quickly evaporating. Volatility is soaring. Once unthinkable, even demand at the government’s debt auctions is becoming a concern.”⁴³

³⁹ *Id.* at 9.

⁴⁰ Kate Duguid and Colby Smith, *Investors urge US Treasury to boost bond market liquidity with buyback scheme*, FINANCIAL TIMES (Oct. 31, 2022), available at <https://www.ft.com/content/3218c8b4-76bc-4690-9a17-1cfa52eeb0ac> (emphasis added).

⁴¹ Sam Goldfarb and Matt Grossman, *Rocky Treasury-Market Trading Rattles Wall Street*, WALL ST. J. (Oct. 30, 2022), available at <https://www.wsj.com/articles/rocky-treasury-market-trading-rattles-wall-street-11667086782> (emphasis added).

⁴² Janet Yellen, “Remarks by Secretary of the Treasury Janet L. Yellen at the Securities Industry and Financial Markets Association’s Annual Meeting” (Oct. 24, 2022), available at <https://home.treasury.gov/news/press-releases/jy1045>.

⁴³ Robert Burgess, *The Fed’s Next Crisis Is Brewing in US Treasuries*, BLOOMBERG (Oct. 14, 2022), available at <https://www.bloomberg.com/opinion/articles/2022-10-14/fed-s-next-crisis-is-brewing-in-us-treasuries#xj4y7vzkg> (emphasis added).

- 10/12/22 – Secretary Yellen stated that her Department is “*worried about a loss of adequate liquidity*” in the Treasury market.⁴⁴

The current reduction in Treasury market liquidity will only be exacerbated if the Commission adopts a final rule consistent with the Dealer Proposal.⁴⁵ We again encourage the Commission to make the much-needed changes to that rulemaking so that even further harm to market liquidity, efficiency and integrity can be avoided. If not, this market-wide impact could be extremely damaging if this Proposal is finalized as is because, as discussed in Section 1 above, indirect participants may limit their cash Treasury and repo trading due to the costs associated with establishing numerous clearing relationships to address done away trade issues.

⁴⁴ Chris Anstey, *Yellen Worries Over Loss of 'Adequate Liquidity in Treasuries'*, Bloomberg, available at <https://www.bloomberg.com/news/articles/2022-10-12/yellen-worries-over-loss-of-adequate-liquidity-in-treasuries>.

⁴⁵ See Letter from Jiri Krol, Deputy CEO, Global Head of Government Affairs, AIMA, to Vanessa Countryman, Secretary, SEC (May 27, 2022), available at <https://www.sec.gov/comments/s7-12-22/s71222-20129909-296079.pdf>.