By Electronic Mail: rule-comments@sec.gov

December 23, 2022

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington DC 20549–7010

Re: File Number S7–23–22 – 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 (Oct. 25, 2022)

Dear Ms. Countryman:

The Futures Industry Association ("**FIA**")[1] welcomes the opportunity to submit this letter in response to the Securities and Exchange Commission's ("**SEC**") request for comment on proposed rules establishing standards for covered clearing agencies for U.S. Treasury securities ("**Proposed Rules**").[2] The Proposed Rules would amend the standards applicable to covered clearing agencies[3] to require covered clearing agencies for U.S. Treasury securities to have written policies and procedures in place reasonably designed to require that every direct participant of the covered clearing agency submit for clearance and settlement all "eligible secondary market transactions" in U.S. Treasury securities to which it is a counterparty.

As proposed to be defined, "eligible secondary market transactions" would include: (i) any repurchase or reverse repurchase agreement (each, a "**repo**") collateralized by U.S. Treasury

[1] FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington DC. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's core constituency consists of firms that operate as clearing members in global derivatives markets, including firms registered with the Commodity Futures Trading Commission ("**CFTC**") as futures commission merchants (**"FCMs"**), the majority of which are also registered with the SEC as broker-dealers ("**FCM/BDs**").

[2] *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 (Oct. 25, 2022).

[3] *Standards for Covered Clearing Agencies*, 72 CFR § 240.17Ad-22.

securities, in which one of the counterparties is a direct participant; and (ii) a purchase and sale of a U.S. Treasury security between a direct participant and specified counterparties, including (a) an interdealer broker, (b) certain hedge funds, and (c) a registered broker-dealer, government securities broker or government securities dealer. As noted above, the majority of FCMs are dually registered FCM/BDs. The definition excludes from the clearing requirement only transactions in which the counterparty is a central bank, sovereign entity, international financial institution, as defined, or a natural person.[4]

Because the Proposed Rules do little more than to require clearing agencies to adopt policies and procedures to requires their direct participants to clear all eligible secondary market transactions in U.S. Treasury securities, the full impact of the proposal cannot be assessed without an opportunity to analyze the policies and procedures that the clearing agency adopts to implement the Proposed Rules.[5] Nonetheless, we are concerned that the Proposed Rules have the potential to disrupt significantly the secondary market for U.S. Treasury securities transactions, which, as the SEC acknowledges, currently are generally executed and cleared bilaterally.

In particular, the Proposed Rules conflict with provisions of the Commodity Exchange Act ("**CEA**")[6] and the CFTC's rules thereunder[7] to which FCMs are subject that provide for the comprehensive protection of customer funds and otherwise interfere with core FCM risk management activities. For this reason, if the SEC chooses to adopt the Proposed Rules, FIA respectfully requests the SEC to include a clear exemption for FCMs (and their counterparties) from the clearing requirement when transactions in U.S. Treasury securities (repos and direct purchases and sales) are entered into by an FCM to facilitate its business as such.

A clear exemption, tailored to enable FCMs to continue their activities in their capacity as such, would not adversely affect the purposes underlying the Proposed Rules and would relieve the SEC and FICC, as well as the CFTC, of having to consider what additional amendments to their respective rules and policies and procedures may be necessary to accommodate FCMs' transactions in U.S. Treasury securities.[8]

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[4] Proposed Rule 17Ad-22(a). As discussed below, the Proposed Rules would also amend (i) the standards for clearing agencies to protect investor assets, and (ii) the broker-dealer customer protection rule to permit margin required and on deposit with covered clearing agencies for U.S. Treasury securities to be included as a debit in the reserve formulas for accounts of customers and proprietary accounts of broker-dealers, subject to certain conditions.

[5] The Fixed Income Clearing Corporation ("**FICC**") is the only SEC-registered clearing agency that provides clearing services for U.S. Treasury securities transactions.

[6] 7 USC §§ 1 - 26.

[7] 17 CFR §§ 1.1 - 190.19.

[8] For example, as discussed below, we believe the SEC would be required to amend the Proposed Rules, and FICC would be required to amend its policies and procedures, to permit customer funds and securities to be

FCM Participation in U.S. Treasury Securities Market

In their role as intermediaries between futures and cleared swaps market participants, on the one hand, and the markets and clearing organizations through which transactions are executed and cleared, on the other, FCMs receive, and are required to manage the risks of holding, a significant amount of customer funds and securities.[9] The CEA and the CFTC's rules thereunder establish a comprehensive regulatory program designed to assure the protection of customer funds. Among other requirements, FCMs must hold such funds and securities in customer segregated accounts established in accordance with the provisions of CFTC Rule 1.20 (with regard to futures traded on U.S. futures exchanges) and Rule 22.2 (with regard to cleared swaps), which rules implement the requirements of CEA section 4d(a)(2).[10]

Specifically, an FCM must deposit futures customer funds with a bank or other permitted depository,[11] "under an account name that clearly identifies them" as futures customer funds and must obtain from the depository a letter in which the depository acknowledges that the FCM has deposited money or securities "of customers."[12] The depository acknowledges that such customer assets "will be separately accounted for and segregated" on the depository's books from the FCM's own funds "in accordance with the provisions of" the CEA and the CFTC's rules, and "must otherwise be treated in accordance with the provisions of section 4d of the [CEA]" and the CFTC's rules. Moreover, such funds may not be used by the depository

held in a customer segregated account established pursuant to CEA section 4d(a)(2), 7 USC § 6d(a)(2). Section 4d(a)(2) provides that an FCM must

> treat and deal with all money, securities, and property received by such [FCM] to margin, guarantee, or secure the trades or contracts of any customer of such [FCM], or accruing to such customer as the result of such trades or contracts, as belonging to such customer. Such money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such [FCM] or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held.

[9] An FCM is broadly defined to mean an entity (i) that is engaged in soliciting or in accepting orders, *inter alia*, for the purchase or sale of any commodity for future delivery or a swap and (ii) that, in connection therewith accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom. CFTC Rule 1.3, 17 CFR § 1.3.

[10] 7 USC § 6d(a)(2). Customer funds and securities received with regard to futures and options on futures contracts traded on a foreign board of trade are subject to a similar comprehensive regulatory program, modified to take account of the fact that customer funds are deposited as necessary in permitted depositories located outside of the U.S. *See* CFTC Rule 30.7, 17 CFR § 30.7, CEA section 4(b)(2), 7 USC § 6(b)(2).

[11] Such accounts may only be maintained at a bank or trust company, a derivatives clearing organization ("**DCO**") or another FCM. CFTC Rule 1.20(b), 17 CFR § 1.20(b); CFTC Rule 22.4, 17 CFR § 22.4. Importantly, an SEC-registered clearing agency is not a permitted depository of customer funds or securities.

[12] The form of the acknowledgment letter that each depository, including a DCO, must provide to an FCM is set out as Appendix A to CFTC Rule 1.20. CFTC Rule 1.20(d) further provides, however, that an FCM is not required to obtain a written acknowledgment from a DCO that has adopted and submitted to the CFTC rules that provide for the segregation of futures customer funds in accordance with all relevant provisions of the CEA, the CFTC's rules, and orders promulgated thereunder. 17 CFR § 1.20(d).

or by the FCM "to secure or guarantee any obligations" that the FCM might owe to the depository, and may not "be subject to any right of offset or lien for or on account of any indebtedness, obligations or liabilities" the FCM may owe the depository.[13]

As of October 31, 2022, the most recent date for which information is available, FCMs held in segregated futures accounts and cleared swaps collateral accounts the aggregate amount of approximately $525 billion, including approximately $23 billion of the FCMs' residual interest.[14] Although exact numbers are not available, FIA believes that a substantial percentage of funds are held in the form of U.S. Treasury securities, either deposited directly by customers or converted to Treasury securities by the FCM. In this latter regard, an FCM that receives Treasury securities from a customer may need to exchange those securities for cash to post with a clearing organization, *e.g.*, to meet variation margin requirements at a U.S. derivatives clearing organization or initial or variation margin requirements with regard to transactions on foreign markets.[15]

An FCM may also invest customer cash in U.S. Treasury securities in accordance with CFTC Rule 1.25. These investments serve at least two purposes. First, investments in securities provide additional protection to customer funds. This is because, in contrast to cash deposited with a bank, which is at risk in the event that the bank fails, securities are held by a bank in a custodial capacity and should not be at risk. Second, investments in securities provide an opportunity to earn interest on customer funds, which interest may be for the benefit of the customer, the FCM or shared between them.[16]

CFTC Rule 1.25 authorizes an FCM to invest customer funds in several different securities, which the CFTC has determined are consistent with the objectives of preserving capital and

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[13] CFTC Rule 22.2 imposes similar requirements with regard to cleared swaps customer collateral held by an FCM; CFTC Rule 30.7 imposes similar requirements with regard to foreign futures and option customer funds held by an FCM.

[14] Forty-seven FCMs held U.S. futures and foreign futures customer funds, of which 17 also held cleared swaps customer collateral.

[15] It is important to note that such an exchange of collateral is not considered an investment subject to the requirements of CFTC Rule 1.25, 17 CFR § 1.25, discussed immediately below. In adopting amendments to Rule 1.25 in 2011, the CFTC distinguished such in-house transactions from collateral exchanges for the benefit of the customer. The CFTC noted that "a dually registered FCM/broker-dealer receiving customer collateral not acceptable at the DCO or foreign board of trade may exchange that collateral for acceptable collateral held by its dually registered broker-dealer to the extent necessary to meet margin requirement." *Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions*, 76 Fed. Reg. 78776, 78783 (Dec. 19, 2011).

[16] CFTC Rule 1.29 provides that an FCM may retain as its own any incremental income or interest income resulting from the investment of customer funds pursuant to Rule 1.25. The FCM also "bear[s] sole responsibility for any losses resulting from the investment of customer funds". 17 CFR § 1.29.

maintaining liquidity,[17] including U.S. Treasury securities.[18] Investments with U.S. Treasury securities may be made either by direct purchase or sale or by entering into repurchase or reverse repurchase transactions.

Repo transactions are subject to the requirements of CFTC Rule 1.25(d).[19] In particular, CFTC Rule 1.25(d)(2) provides that permitted counterparties are limited to a bank as defined in section 3(a)(6) of the Securities Exchange Act, a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation, and a securities broker-dealer.[20] Importantly, a clearing agency is not a permitted counterparty.

Importantly, too, CFTC Rule 1.25(d)(9) requires that securities transferred to the customer segregated custodial account must be made on a delivery versus payment basis in immediately available funds. The transfer is not recognized as accomplished until the funds and/or securities are actually received by the custodian of the FCM's customer funds or securities purchased on behalf of customers. The transfer or credit of securities covered by the agreement to the FCM's customer segregated custodial account must be made simultaneously with the disbursement of funds from the FCM's customer segregated cash account at the custodian bank. On the sale or resale of securities, the FCM's customer segregated cash account at the custodian bank must receive same-day funds credited to such segregated account simultaneously with the delivery or transfer of securities from the customer segregated custodial account.

Finally, CFTC Rule 1.25(d)(13) provides that the agreement between an FCM and a repo counterparty must make clear that, in the event of the FCM's bankruptcy, any securities purchased with customer funds that are subject to a repo agreement may be immediately transferred. Further, the counterparty has no right to compel liquidation of securities subject to an agreement or to make a priority claim for the difference between current market value of the securities and the price agreed upon for resale of the securities to the counterparty, if the former exceeds the latter.

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[17] Investments must be "highly liquid" such that they have the ability to be converted into cash within one business day without material discount in value. CFTC Rule 1.25(b)(1), 17 CFR § 1.25(b)(1).

[18] FCMs invest customer funds predominantly in U.S. Treasury securities. Other permitted investments include (i) general obligations of any State or of any political subdivision thereof (municipal securities), and (ii) certain money market mutual funds. CFTC Rule 1.25(a)(1), 17 CFR § 1.25(a)(1). With the exception of US Treasury securities, permitted investments are subject to concentration limits. CFTC Rule 1.25(b)(3), 17 CFR § 1.25(b)(3).

[19] 17 CFR § 1.25(d).

[20] CFTC Rule 1.25(d)(4); 17 CFR § 1.25(d)(4). Further, repos with a single counterparty or one or more counterparties under common ownership or control may not exceed 25 percent of total assets held in segregation.

The Proposed Rules

As noted, the Proposed Rules are relatively simple and would impose no direct substantive obligations on U.S. Treasury market participants. Rather, the Proposed Rules would require any clearing agency that provides clearing services for U.S. Treasury securities transactions to adopt policies and procedures that, *inter alia*, require any direct participant to submit for clearance and settlement all of the eligible secondary market transactions to which such direct participant is a counterparty.[21] As discussed earlier, eligible secondary market transactions include (i) repos collateralized by U.S. Treasury securities in which one of the counterparties is a direct participant, and (ii) purchases and sales between a direct participant and certain specified counterparties, including a registered broker-dealer.[22] Because most FCMs that are likely to enter into U.S. Treasury securities transactions are also registered with broker-dealers, we anticipate that most U.S. Treasury securities transactions in which FCMs engage with a direct participant would be subject to the clearing requirement.

Further, as discussed in footnote 15 above, the CFTC has advised that in-house transactions in which an FCM/BD receiving customer collateral that is not acceptable at a DCO or foreign board of trade may, independent of CFTC Rule 1.25 requirements, exchange that collateral for acceptable collateral to the extent necessary to meet margin requirements. In our view, such in-house transactions would not be subject to the clearing requirement established by the Proposed Rules, since there is no counterparty. Nonetheless, we ask the SEC to confirm our view. If such transactions would be subject to the clearing requirement, the Proposed Rules would further interfere with an FCM's conduct of its business and ready access to liquidity.

However, for the reasons noted above, absent relief, the conflict between CFTC rules and the Proposed Rules would effectively prohibit FCMs from entering into U.S. Treasury security transactions pursuant to Rule 1.25.[23] As a clearing agency, FICC novates transactions between two counterparties, effectively becoming the buyer to every seller and the seller to every buyer, and guarantees the settlement of the novated transactions. Consequently, FICC would be a counterparty to every transaction the FCM enters into. Since a clearing agency is not a permitted counterparty under Rule 1.25, the securities transaction would be prohibited by the rule. Moreover, to the extent that customer funds or securities are held by FICC for any period of time, whether as part of a repo or purchase and sale, FICC would likely be deemed a

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[21] Proposed Rule 17Ad-22(e)(18)(iv)(A).

[22] As noted above, only transactions in U.S. Treasury securities in which one counterparty is a central bank, a sovereign entity, an international financial institution, or a natural person are excluded from the definition eligible secondary market transactions. Proposed Rule 17Ad-22(a).

[23] A potential unintended consequence of the Proposed Rules, therefore, may be to cause FCMs to engage in transactions under CFTC Rule 1.25 permitted investments other than U.S. Treasuries, *e.g.*, securities issued by Fannie Mae or Freddie Mac.

depository under CFTC rules. As noted, however, FICC is not a permitted depository under CFTC Rules.

Further, based on our conversations with FICC representatives, we understand that FICC offers a repo clearing structure that provides for DVP. However, we would need to understand the structure better to assure that it complies with the requirement in CFTC Rule 1.25(d)(9) that on the sale or resale of securities, an FCM's customer segregated cash account at the custodian bank must receive same-day funds credited to such segregated account simultaneously with the delivery or transfer of securities from the customer segregated custodial account. Finally, it is not clear whether FICC, as the novated counterparty to all transactions, would be able to comply with the requirements of CFTC Rule 1.25(d)(13) in the event of an FCM's bankruptcy.

Separately, the Proposed Rules would require a clearing agency to establish a regime to segregate customer funds used to margin customer cleared positions in accordance with Note H of the proposed amendment to Exhibit A of SEC Rule 15c3-3. In this regard, we understand that FICC rules would currently permit an FCM/BD to establish a separate account structure for FCM customer transactions. However, to the extent that customer funds are being used to margin permitted transactions under CFTC Rule 1.25, this account would likely not satisfy CFTC rules. CFTC rules would require that this margin be held in a customer segregated account established under CFTC Rule 1.20, Rule 22.2 or 30.7, as applicable, and that the depository sign an acknowledgment required under the rules. The account contemplated under Note H would not be consistent with CFTC Rules.

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If the SEC chooses to adopt the Proposed Rules, FIA respectfully requests the SEC to include a clear exemption for FCMs (and their counterparties) from the clearing requirement when transactions in U.S. Treasury securities (repos and direct purchases and sales) are entered into by an FCM to facilitate its business as such. As explained in detail above, the Proposed Rules conflict with provisions of the CEA and the CFTC's rules thereunder to which FCMs are subject that provide for the comprehensive protection of customer funds. Without a clear exemption, tailored to facilitate FCMs' activities, FCMs will lose ready access to liquidity and the ability to conduct core risk management activities for themselves and customers. It is important that the exemption apply clearly and equally to an FCM's counterparty in connection with U.S. Treasury transactions, as any ambiguity would likely have a detrimental effect on an FCM's ability to find a counterparty for these products which are important to the operation of its business.

Thank you for your consideration of these comments. If the SEC or any member of the staff have any questions regarding the matters discussed herein or need any additional information, please contact Allison Lurton, FIA's General Counsel and Chief Legal Officer at [redacted] or [redacted].

Respectfully submitted,

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President and Chief Executive Officer

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