December 23, 2022

Via Electronic Submission

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

Re: 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. Release No. 34-95763; **File No. S7-23-22.**

Dear Ms. Countryman:

We appreciate the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") on its proposed rules to amend the standards applicable to covered clearing agencies for U.S. Treasury securities (the "Proposal").[1] Among other things, the Proposal would require that covered clearing agencies for U.S. Treasury securities have written policies and procedures 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.

ASL Capital Markets Inc. ("ASL") is one of 25 primary dealers, and we also trade U.S. government securities in the secondary market and finance U.S. government securities via repo transactions. Trading in these markets is virtually all that we do. Most of the other primary dealers are (or are affiliated with) global banking organizations, for which U.S. government security trading plays a minor role. As one of the only non-bank primary dealers added in the last 20 years, we have a better understanding than most of the costs and benefits of entering the market-making business in the U.S. Treasury space.

We participated in the discussions organized by SIFMA and the IIB in connection with the drafting of their joint comment letter ("The SIFMA/IIB Letter"), and we generally agree with the approach suggested therein. That is, additional data should be gathered, and analysis performed, prior to effecting any clearing mandate because (a) the impact of the Proposal on the U.S. Treasury markets is unclear (the U.S. Treasury markets play a hugely significant role in the global economy and any changes to these markets could have a substantial impact, with potentially unanticipated adverse consequences), and (b) it is not certain that the benefits of the Proposal outweigh the costs (the magnitude of the benefits that could be obtained by a clearing mandate are unclear, and the costs, while probably substantial, are impossible to quantify at this time).

We encourage the Commission to continue its work in modernizing the U.S. Treasury markets; however, given the potential risks, we would also encourage a method that is incremental rather than singularly

[1] 87 FR 64,610.

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transformative.[2] Taking incremental steps, the Commission can analyze whether the expected costs and benefits are realized and can further refine the overall approach (i.e., maximizing the benefits and minimizing the negative impacts to the market). After undergoing such a rigorous process, the resultant modernized market will give the Commission the desired benefits while reducing the potential negative outcomes. While this incremental rulemaking process may sacrifice speed of implementation, we believe that changes to the U.S. Treasury markets deserve this level of care. As a clearing member of FICC, we recognize that clearing agencies are integral to U.S. financial markets, managing the settlement process for trillions of dollars of transactions daily and provide the benefits of clearing, such as multilateral netting, centralized default management, and reducing counterparty risk, and we generally support policy measures that facilitate broader access to central clearing. Our concern lies solely with the potential for unforeseen consequences if the step sizes are overly assertive.

In response to some statements contained in the Proposal, a few points were raised in the SIFMA/IIB Letter that we wish to reiterate and are topics where we may have a unique perspective. Specifically, the Commission suggests that the Proposal "can enhance the ability of smaller participants to compete with incumbent dealers"[3] and "may encourage private-sector capital formation."[4] The SIFMA/IIB Letter observes that the Proposal is likely to have the opposite effect.

In 1989 there were 44 primary dealers. Today there are 25. This significant reduction in the number of -primary dealers was primarily caused by consolidation and acquisition of these firms by global banks and the ultimate elimination of most of the smaller and mid-sized market participants. Furthermore, the current trend of foreign banks retrenching to their domestic markets, as well as the increased costs likely to be imposed on dealers as a result of the Proposal, may result in the further reduction in both the number and balance sheet capacity of primary dealers. This would most likely result in additional concentration in the U.S. Treasury markets and decrease in liquidity.

As noted above, ASL was recently designated a primary dealer, and we are one of the few primary dealers not affiliated with a global banking organization. Approximately eight years ago, the firm was founded to establish a new broker-dealer dedicated to making markets in, and providing financing for, U.S. government securities. The pandemic notwithstanding, in a relatively short time, ASL has become a strong presence in the U.S. Treasury markets – participating in the primary market, actively making markets in both on-the-run and off-the-run U.S. Treasury securities in the secondary markets, and providing financing for U.S. Treasuries via repurchase agreements.

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[2] The SIFMA/IIB Letter proposed such an incremental rulemaking process by suggesting that the first such step be to incentivize clearing, and to the extent the Commission deemed appropriate, to limit the transactions that are subject to a mandatory clearing requirement to be Treasury cash transactions executed with an interdealer broker. If that is what the additional studies show would gain the most benefit (the greatest reduction in contagion risk, for example) with the least cost (taking into account not only the direct costs that will be incurred by market participants in connection with the build-out and ongoing costs and expenses incurred in connection with such change, but also – and perhaps more importantly – the costs or additional risks borne by the market that will result from such change), we would be supportive of such changes. On the other hand, if further studies show that the best first step would be to mandate clearing for some other set of entities or transactions that pose the greatest systemic risk, we would likely be supportive of that as well.

[3] 87 FR 64671.

[4] 87 FR 64671.

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If the costs of mandatory clearing are prohibitive (and, as described above, the expected direct costs cannot be known without the CCA's proposed implementation scheme), it is not unreasonable to expect some smaller and mid-sized dealers to remove themselves from the U.S. Treasury market. As noted earlier, in addition to significant legal and operational builds that would be required in connection with any clearing mandate, there is also the potential for significant margining costs, CCLF fund costs, capital costs, and costs that cannot yet be known.[5] These costs are likely to disproportionately impact smaller and mid-sized businesses that do not have the resources to meet these new costs. A reduction in activity from these dealers will result in reduced competition, less liquidity in the market, and further concentrating exposures in the largest GSIBs and SIFIs.

In addition to increasing costs and potentially causing smaller and mid-sized participants to decrease their activities in the U.S. Treasury securities markets, the additional costs of mandated clearing required by the Proposal may also create an additional barrier to entry and act as a disincentive to the capital formation of non-bank broker dealers that would otherwise add to liquidity in this space. With the goal to increase liquidity in the U.S. Treasury markets, it may be worthwhile simultaneously trying to attract capital into the space. As mentioned above, as a result of our unique experience and position in the market, we have a better understanding than most of the costs and benefits of entering the market-making business in the U.S. Treasury space. Why aren't more broker dealers willing to make active markets in U.S. Treasury securities and improve market liquidity and integrity through their capital base? The Proposal may make initiating a business to trade U.S. Treasury securities more costly. By explicitly considering capital formation and ease for new broker dealers to enter this space, the Commission will foster more competition with additional participants and will also increase liquidity.

If the increased costs that will accompany the mandatory clearing required by the Proposal do, if fact, cause existing dealers to exit the U.S. Treasury securities markets and/or cause new capital to be redirected to other markets, where might any such existing capital and new capital go? We can see a couple of potential alternatives. One possibility is that instead of trading US Treasuries, such entities shift their operations/plans to trade U.S. Agency securities. These securities present a similar credit profile, but are not required to be cleared, and therefore will not be subject to the same costs as U.S. Treasury security trading. Another possibility is to start trading other sovereign bonds as mandatory clearing is not widespread in the global sovereign bond markets. In short, unless a global approach is taken and clearing is required for all 'similar' securities, there is a risk that market participants (both dealers and end-users) leave the U.S. Treasury market entirely, which could have a significant adverse impact on the U.S. Treasury markets and could systematically decrease the competitiveness of the U.S. to finance itself in the global capital markets.

[5] Another cost may be incurred as a result of the Proposal's requirement to segregate proprietary and customer positions and margin because such segregation would likely significantly increase the amount of collateral required by FICC. Any such additional collateral requirement may act as a drain on liquidity and a disincentive to clear. In addition, if a dealer entered into one transaction with a customer that was required to be cleared and an offsetting trade that was not cleared, the segregation requirement would preclude the dealer from using the margin it would receive on the cleared trade to deliver as margin on the bilateral trade, thus creating an inefficiency that would disproportionately impact small and mid-sized dealers. This is another issue that is deserving of further study prior to implementing change.

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The FSB's recently published Liquidity in Core Government Bond Markets report[6] contains some informative results. The study examined the impact of the pandemic in March 2020 on government bond markets and concluded that the amount of clearing did not significantly impact the severity of the market dislocation, and that the benefits of changes to the underlying market structure seem to be context-specific and jurisdiction-dependent. Amongst the FSB recommendations are that additional work should be done to gather more data and perform analyses in respect of central clearing and the impact any such initiative would have on the resilience of liquidity supply in stress. The report specifically notes, "central clearing can increase costs for market participants so they are not incentivised to use it even when it is available – so its scope, incentives and modalities vary across jurisdictions and need to be considered for the specific market in question."[7] We concur with the conclusions of this report and the recommendations SIFMA/IIB Letter – collect more data and study the potential impacts and incentives related to additional clearing in the U.S. Treasury markets specifically – and then apply findings toward designing a modernized U.S. Treasury market.

Finally, to reiterate, we believe the Commission is taking the right steps to modernize the U.S. Treasury market through its various proposed rulemakings,[8] and we encourage the Commission to continue gathering feedback to the various proposals. Our suggestions are more about prudence of pace, potential externalities and a focus on capital formation to increase competition.

We would be pleased to provide further information or discuss any questions you may have about our comments. Thank you for your consideration.

Very truly yours,

/s/ Evan Gerhard
Evan Gerhard
President and CEO, ASL Capital Markets Inc.

[6] FSB, *Liquidity in Core Government Bond Markets* (October 20, 2022), https://www.fsb.org/wp-content/uploads/P201022.pdf ("FSB Report").
[7] FSB Report, Page 29.
[8] In addition to the Proposal, the Commission has also proposed rules that would require certain principal trading firms to register as dealers (87 FR 23054) and subject interdealer brokers to regulation under Reg ATS (87 FR 15496), and there are several initiatives to increase transparency, including the Commission's proposed amendments to Form PF (87 FR 53832) and the OFR's pilot program collecting data on non-cleared repo transactions.

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