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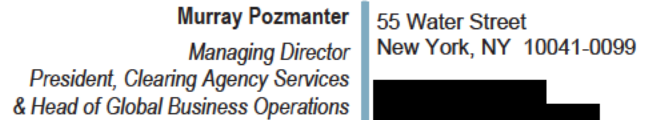

December 27, 2022

VIA ELECTRONIC TRANSMISSION
rule-comments@sec.gov

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, Exchange Release No. 95,763, File No. S7-23-22, 87 Fed. Reg. 64,610 (Oct. 25, 2022)

Dear Ms. Countryman:

The Depository Trust & Clearing Corporation ("DTCC") and its subsidiary the Fixed Income Clearing Corporation ("FICC") appreciate the opportunity to comment on the above-captioned proposal (the "Proposal") by the Securities and Exchange Commission (the "Commission") to amend (1) the standards applicable to covered clearing agencies that clear transactions involving U.S. Treasury securities ("Treasury CCAs") and (2) the broker-dealer customer protection rule in relation to margin required and on deposit with Treasury CCAs.[1]

DTCC is the parent company of FICC, which is currently the only registered Treasury CCA. Through its Government Securities Division ("GSD"), FICC provides real-time trade matching, clearing, risk management, and netting for cash purchases and sales of U.S. Treasury securities as well as repurchase and reverse repurchase transactions involving U.S. Treasury securities ("repos").[2]

Market participants created DTCC and FICC as utilities designed to facilitate efficiency and effective risk management for the markets they serve through central clearing and settlement of transactions. To preserve this central mission, private investors are not permitted to purchase or sell shares of DTCC. Instead, DTCC is owned exclusively by the participants that DTCC serves. In addition, DTCC's and FICC's boards of directors are primarily composed of

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[1] *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 (proposed Oct. 25, 2022) [hereinafter Proposed Rule].

[2] FICC's GSD also clears and settles certain transactions on securities issued or guaranteed by U.S. government agencies and government sponsored enterprises.

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representatives of their buy- and sell-side participants as well as individuals from other self-regulatory organizations.[3]

As a covered clearing agency, FICC is subject to the Commission's covered clearing agency standards (the "CCAS").[4] In addition, the Financial Stability Oversight Council has designated FICC as a systemically important financial market utility ("SIFMU") pursuant to Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").[5] In accordance with the CCAS, FICC's Rules and Procedures (the "Rules") are publicly available on FICC's website.

DTCC and FICC appreciate the Commission's consideration of measures to improve the resilience and accessibility of the U.S. Treasury market, including steps to increase central clearing. As numerous policymakers, academics, and market participants have recognized, greater central clearing of U.S. Treasury transactions would improve the safety, soundness, and efficiency of the U.S. Treasury market, promote competition, enhance transparency, and facilitate all-to-all trading. Increased central clearing can also reduce clearing costs and credit risk by incentivizing direct participants to submit more balanced portfolios that have a lower risk profile and thus carry lower clearing fund and liquidity facility requirements. Furthermore, through balance sheet netting and favorable regulatory capital treatment, central clearing has the power to increase dealers' capacity to transact and thereby ameliorate some (though not all) of the constraints on market liquidity. Indeed, FICC has found that, during times of market stress, such as in March 2020, market participants submit a *greater* volume of transactions for clearing, presumably to benefit from multilateral netting, increase their trading capacity, and limit their credit risk.

As the Commission considers whether the benefits of central clearing merit amendments to the CCAS that would require direct participants to submit certain transactions for clearing (the "Membership Proposal"),[6] DTCC and FICC would recommend that the Commission take steps to ensure that the scope of any such requirement is clear. We therefore appreciate the Commission's use of well-established and -understood terms in the Membership Proposal.[7] However, we believe further clarifications would be advisable.

DTCC and FICC also applaud the Commission's consideration of ways to further facilitate access to clearing. Since their founding, DTCC and FICC have worked to find ways to increase access to clearing in a manner consistent with safety, soundness, and the other goals of the CCAS. The cornerstone of FICC's efforts in this regard has been to support an open-access approach. Under this approach, FICC offers a variety of different models through which direct and indirect participants can clear transactions. This variety ensures that institutions of all types

[3] DTCC and FICC have the same boards of directors. Of the twenty-two directors that sit on the boards, fourteen represent participants; four are non-participant directors; two are designated by the Intercontinental Exchange (ICE) and Financial Industry Regulatory Authority ("FINRA"); and the last two are DTCC's Non-Executive Chairman and its President and Chief Executive Officer.

[4] 17 C.F.R. § 240.17Ad-22 (2021).

[5] 17 C.F.R. § 240.17Ad-22(a)(5) (2021); 12 U.S.C. § 5463.

[6] Proposed Rule, *supra* note 1, at 64619.

[7] *See, e.g.*, the definitions of "sovereign entity" and "international financial institution." *Id*. at 64681.

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and sizes are able to access central clearing and that direct participants and indirect participants can select clearing arrangements that are most compatible with their respective goals, regulatory constraints, and trading activities. In addition, DTCC and FICC provide market participants and the public with various informational resources regarding their activities, including a U.S. Treasury clearing microsite that provides an overview of the services FICC provides, how market participants may access central clearing for U.S. Treasury transactions, and how FICC manages risk.[8]

FICC's open-access approach has allowed an extremely diverse group of market participants to access central clearing: FICC's direct and indirect participants include not only banks, broker-dealers, foreign financial institutions, interdealer brokers ("IDBs"), and other intermediaries, but also mutual funds, money market funds, public and private pension plans, sovereign wealth funds, hedge funds, and other clearing organizations. Maintaining this open-access approach is critical because, as we explain in further detail below, a number of the above-listed institutions either cannot access clearing in markets for which there is only a single access model or do so in reliance upon special regulatory exemptions that are not applicable to the U.S. Treasury market.

Accordingly, DTCC and FICC firmly believe that promoting open access must be at the heart of any initiative to increase clearing of U.S. Treasury transactions. Were the Commission instead to prescribe that Treasury CCAs and their participants adopt certain access models, such limitation would likely close off access to a number of market participants, force direct and indirect participants to adopt models that are incompatible with their needs or goals, reduce the capacity of direct participants to use clearing as a means of facilitating market liquidity, give rise to concentration, and increase the costs of clearing. DTCC and FICC therefore wholeheartedly agree with the Proposal's approach of not dictating a single access model, but instead requiring that Treasury CCAs conduct initial and annual reviews to identify ways to facilitate access to clearing.[9]

As part of its initial and annual reviews, FICC would anticipate engaging with a wide range of stakeholders, including direct participants, indirect participants, industry associations, and regulators, to identify opportunities to lower barriers to clearing. FICC would also consider whether structures, models, or policies used in other markets, such as the cleared derivatives market, may make it easier for market participants to access clearing and facilitate all-to-all trading. At the same time, however, DTCC and FICC believe it is critical to bear in mind the important differences between the U.S. Treasury market and other markets. For example, unlike the cleared swaps market, the cleared U.S. Treasury market has evolved organically for nearly four decades and has a wide variety of participants. In addition, most U.S. Treasury transactions are short-dated, physically-settled transactions that present lower credit risk as compared to long-dated derivatives transactions. Accordingly, rules, procedures, and structures from the cleared swaps or other markets may not be necessary, and may instead be harmful, for the U.S. Treasury market.

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[8] *U.S. Treasury Clearing*, DTCC, https://www.dtcc.com/ustclearing.

[9] Proposed Rule, *supra* note 1, at 64635-36.

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In addition, FICC must remain cognizant of safety, soundness, and its obligations under the CCAS. In no instance should the Proposal, if adopted, require, or permit, FICC or its direct participants to provide access to central clearing at the expense of sound risk management or compliance with FICC's other CCAS obligations.

From its engagement with market participants over the years, DTCC and FICC have found that some of the impediments to clearing arise from regulatory constraints, including SEC Rule 15c3-3. DTCC and FICC therefore applaud the Commission's proposal to amend the broker-dealer customer protection rule to permit broker-dealers to record a debit in the reserve account formula for margin required and posted to a Treasury CCA in relation to a customer position (the "Debit Proposal").[10] As the Commission has identified, this amendment is necessary to place broker-dealers on a level playing field with other direct participants and to reduce the costs of clearing indirect participant transactions. The Debit Proposal would also align the treatment of FICC margin under the Commission's customer protection rule with the treatment of margin posted to other clearing organizations. The Debit Proposal would achieve these benefits without exposing customers to additional risk since FICC holds clearing fund at the same (and safer) locations as are permitted for broker-dealers.

DTCC and FICC observe, however, that a number of proposed requirements in the Debit Proposal appear more onerous than those applicable to margin posted to the Options Clearing Corporation ("OCC") and derivatives clearing organizations ("DCOs"). For example, the Debit Proposal would require that FICC push excess margin to a broker-dealer within one business day of the calculation of such excess, regardless of whether the broker-dealer makes a demand for such excess. It would also require gross margining of customer positions. The Proposal does not explain the rationale for imposing these requirements on margin posted to FICC but not to other clearing organizations. We encourage the Commission to consider whether these inconsistencies are appropriate or would needlessly make it more difficult and costly for broker-dealers and their customers to access clearing. At minimum, the Commission should ensure that the requirements of the Debit Proposal are implemented practically so that operational or interpretive issues do not undermine the benefits the amendment aims to achieve.

DTCC and FICC also support the Proposal's requirement that Treasury CCAs calculate, collect, and hold margin posted in relation to indirect participant transactions ("Indirect Participant Margin") separately from that posted for a direct participant's proprietary transactions (the "Segregation Proposal"). However, we ask that the Commission clarify whether the Segregation Proposal or the Debit Proposal would also preclude Treasury CCAs from using Indirect Participant Margin or customer margin for liquidity and loss mutualization purposes. In considering these issues, we suggest that the Commission bear in mind that, unlike in the cleared derivatives market, indirect participants are not required to post margin to FICC. Rather, the posting requirement rests exclusively with the direct participants. As a result, ring-fencing Indirect Participant Margin or customer margin may not actually benefit indirect participants or customers. However, it would likely increase costs for all participants because it would likely

[10] *Id*. at 64618-19.

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require Treasury CCAs to collect more margin from direct participants and have such participants pre-position more liquidity resources.[11]

With regard to implementation, FICC has a long history of monitoring its participants' compliance with its Rules in accordance with the CCAS. FICC would anticipate monitoring participants' compliance with the Membership Proposal consistent with that practice. DTCC and FICC therefore applaud the Commission's use of the well-established covered clearing agency standard of "identify and monitor" in the Proposal.[12] This standard is used multiple times in the CCAS and is familiar to both Treasury CCAs and market participants. This familiarity should facilitate implementation of the Membership Proposal and limit confusion and uncertainty.

However, even with a clear scope and clear implementation mechanism, it will take FICC and the U.S. securities industry as a whole substantial time to make the documentation, operational, organizational, and systems changes needed to comply with the Proposal. In addition, FICC will need to amend its Rules, which amendments the Commission will need to approve. And FICC and market participants will need to conduct substantial testing to ensure that the systems and operational changes are effective and secure.

Given the complexity and extent of changes that will be necessary to implement the Proposal, DTCC and FICC believe it would be advisable to engage in a consultative process regarding the implementation timeline. DTCC and FICC further believe such consultative process should occur after any Commission rule is finalized because it is difficult for market participants to assess how long it will take to implement a requirement when they do not yet know with clarity the scope of the final requirement. Accordingly, DTCC and FICC recommend that, if the Commission adopts the Proposal, it also require Treasury CCAs to submit to the Commission a proposed rule change containing an implementation schedule by no later than 180 days after the publication of the final rule in the *Federal Register*. Such proposed rule change should be submitted pursuant to Section 19 of the Securities Exchange Act of 1934 (the "Exchange Act"). This would provide market participants with the ability to comment on the timing and requirements set forth in the proposed rule change with the benefit of knowing the Membership Proposal's full scope. The Commission and FICC could then consider those comments in adopting a final implementation schedule. DTCC and FICC believe that this kind of deliberative and consultative approach would facilitate the adoption of a realistic timeline and thereby avoid the need for successive extensions and the attendant uncertainty and disruption such shifting timelines present.

As a preliminary matter, DTCC and FICC believe that it would be advisable for FICC to adopt a phased implementation schedule, under which different requirements of the Proposal become effective, beginning with the customer segregation requirement. DTCC and FICC preliminarily believe that, depending on when any final rule is adopted, FICC and market participants may be able to implement the segregation requirement by 2025. This would give market participants a full year after the expected implementation of T+1 to focus on the

[11] FICC would need additional data from market participants to assess with confidence the effects that a ring-fencing requirement would have on FICC's risk management practices, including the additional margin that FICC would need to collect.

[12] *See* Proposed Rule, *supra* note 1, at 64629.

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Proposal.[13] However, DTCC and FICC would welcome participants' feedback as part of the consultative process described above.

We discuss these issues and other considerations in greater detail below.

[13] *See* Securities and Exchange Commission, *Shortening the Securities Transaction Settlement Cycle*, 87 Fed. Reg. 10,436 (Feb. 24, 2022).

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DISCUSSION

I. DTCC and FICC Appreciate the Commission's Consideration of Measures to Improve the Resilience and Efficiency of the U.S. Treasury Market, Including Steps to Increase Central Clearing

A. Central Clearing's Role in Strengthening the U.S. Treasury Market

In the Proposal, the Commission notes that recent disruptions in the U.S. Treasury market have led many to examine the dynamics of the market and identify possible reforms.[14] DTCC and FICC applaud these efforts and agree with the diverse array of market participants, regulators, and scholars that have concluded that greater adoption of clearing would improve the resilience and strength of the U.S. Treasury market. As these commentators have identified,[15] central clearing provides numerous interrelated benefits to the market that not only reduce risk but also improve the efficiency and stability of the market. Increased central clearing of U.S. Treasury transactions would augment these benefits, reduce costs, and limit the instances and severity of market disruptions. In addition, greater central clearing can address some of the constraints on market liquidity and facilitate all-to-all trading. Accordingly, increased central clearing should be a key, though certainly not the only, component of any effort to reform the U.S. Treasury market.

1. Risk Reduction from Multilateral Netting

One of the core benefits of central clearing is multilateral netting. Under FICC's Rules, each participant's payment obligations and entitlements are netted down into a single, net payment obligation or entitlement.[16] Likewise, for each security, each participant's delivery obligations and entitlements in a given security are netted down into a single delivery obligation or entitlement for that security. For example, if a direct participant runs a matched book in a security such that it is obligated to pay $100 million for 100 of those securities and entitled to receive $105 million for 105 of those securities, FICC will net down the obligations and entitlements to a single entitlement

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[14] Proposed Rule, *supra* note 1, at 64614.

[15] *See* Treasury Markets Practice Group, *White Paper on Clearing and Settlement in the Market for U.S. Treasury Secured Financing Transactions*, Federal Reserve Bank of New York (Nov. 9, 2022), https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/CS_SFT_2022.pdf [hereinafter TPMG 2022]; Group of 30 Working Group on Treasury Market Liquidity, *U.S. Treasury Markets: Steps Toward Increased Resilience*, G-30 (July 2021), https://group30.org/images/uploads/publications/G30_U.S_._Treasury_Markets-_Steps_Toward_Increased_Resilience__1.pdf [hereinafter G-30]; *see* Nellie Liang & Pat Parkinson, *Enhancing Liquidity of the U.S. Treasury Market Under Stress*, Hutchins Center on Fiscal & Monetary Policy at Brookings (Dec. 16, 2020), https://www.brookings.edu/wp-content/uploads/2020/12/WP72_Liang-Parkinson.pdf [hereinafter *Enhancing Liquidity*]; Michael Fleming & Frank Keane, *The Netting Efficiencies of Marketwide Central Clearing*, Federal Reserve Bank of New York (Staff Reports No. 964) (Apr. 2021), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr964.pdf; FIA Principal Traders Group, *Clearing a Path to a More Resilient Treasury Market*, FIA (July 2021), https://www fia.org/sites/default/files/2021-07/FIA-PTG_Paper_Resilient%20Treasury%20Market_FINAL.pdf.

[16] *See* FICC Rule 5, § 8 (regarding novation and guaranty of compared trades) and Rule 11, §§ 1, 4, 6 (regarding general rules; calculation of net settlement positions; netting of obligations). FICC's recently adopted Sponsored GC Service only provides for such netting in a default scenario as it is designed to facilitate settlements directly between the accounts of the sponsoring member and sponsored member. *See* FICC Rule 3A, §§ 7, 8 (regarding the netting system, novation and guaranty of settlement; securities settlement).

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to receive $5 million and a single obligation to deliver five securities. This netting is generally not possible to a similar degree in bilaterally cleared transactions, since parties are practically and legally only able to net amounts they owe and are owed by the same counterparty and running a matched book necessarily involves trading with multiple counterparties.

Multilateral netting substantially reduces the buildup of credit exposure and the knock-on effects such risk can have on the market. Instead of a default by the direct participant in the example above giving rise to $100 million in failed payment obligations and 105 undelivered securities, a default would result in no payment failure and a delivery failure of only five securities. This reduction substantially limits the possibility for a cascade of losses and the market disruption that could result from multiple market participants selling $100 million of securities and buying in 105 of the same securities. It also reduces settlement risk because it converts a party's $100 million payment and 105 securities delivery obligations into a single five securities delivery obligation. Indeed, as the Commission notes, researchers have found that wider central clearing of U.S. Treasury transactions could have reduced dealers' daily settlement obligations by 70% during the March 2020 market disruption.[17] Accordingly, central clearing serves to *reduce* risk.

2. Ameliorating Liquidity Constraints Through Multilateral Netting

Multilateral netting can also ameliorate one of the principal constraints on market liquidity. As a number of commentators have identified, one factor that has contributed to lower liquidity in the U.S. Treasury market over the past decade is a retreat by bank-affiliated dealers from the market.[18] Among the reasons for this retreat are the capital requirements associated with U.S. Treasury repos as well as the balance sheet impact of such transactions. Higher capital requirements and balance sheet impacts make it more expensive for bank-affiliated dealers to engage in U.S. Treasury transactions. These expenses, in turn, limit the capacity of dealers to participate in the market to the same extent as would otherwise be feasible based on economic fundamentals alone. This results in fewer intermediaries standing ready to execute transactions and thus less market liquidity.

As the Commission notes, multilateral netting mitigates these constraints by allowing direct participant dealers to calculate their exposures under U.S. Treasury repo transactions on a net basis for both balance sheet and regulatory capital purposes.[19] In the absence of multilateral netting, a dealer that provides $10 million of repo financing to one counterparty and receives nearly identical repo financing from a different counterparty must reflect two separate $10 million

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[17] Proposed Rule, *supra* note 1, at 64662 (citing Michael Fleming & Frank Keane, *Netting Efficiencies of Marketwide Central Clearing* (Staff Report No. Staff Report No. 964), Federal Reserve Bank of New York (Apr. 2021), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr964.pdf).

[18] G-30, *supra* note 15, at 1-2; Treasury Markets Practice Group, *White Paper on Clearing and Settlement in the Secondary Market for U.S. Treasury Securities*, Federal Reserve Bank of New York 6-7 (July 2019), https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/CS_FinalPaper_071119.pdf [hereinafter TPMG 2019]; Peter Ryan & Robert Toomey, *Improving Capacity and Resiliency in the US Treasury Markets: Part II*, SIFMA (Mar. 30, 2021), https://www.sifma.org/resources/news/improving-capacity-and-resiliency-in-us-treasury-markets-part-2/.

[19] For discussion of balance sheet treatment of U.S. Treasury cash transactions, *see* DTCC, More Clearing, Less Risk (May 2021), https://www.dtcc.com/-/media/Files/PDFs/DTCC-US-Treasury-Whitepaper.pdf [hereinafter *More Clearing*].

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exposures on its balance sheet and hold regulatory capital against each such exposure. These large figures can have a substantial impact on a dealer's balance sheet and carry sizable capital requirements. By contrast, through multilateral netting, the dealer can net these virtually offsetting exposures against each other.[20] The resulting exposure amount is less impactful on the dealer's balance sheet and carries much smaller capital requirements.

As the Commission notes, multilateral netting can reduce balance sheet exposures arising from repo transactions by 60–80%.[21] This can have a significant impact on market liquidity. If the capital and balance sheet implications of repo transactions are less impactful, the costs the dealer incurs in entering into such transactions will be much lower and the dealer can use the savings to engage in additional transactions. Indeed, this is arguably one of the reasons why direct participant dealers submit a substantially greater volume of transactions to FICC during market dislocations and liquidity crunches.

Accordingly, through multilateral netting, central clearing can help free up market liquidity to the extent the constraints on such liquidity arise from direct participants' capital or balance sheet limitations. However, we agree with the Commission, that central clearing is a not a panacea for all liquidity constraints.[22] FICC's central clearing cannot free up liquidity to the extent liquidity constraints arise from regulatory requirements or mismatches between supply and demand among end-users. We therefore support efforts by industry, academics, and regulators to examine whether there are mechanisms to address these mismatches.

3. Centralized, Standardized, and Transparent Risk Management

As discussed above, central clearing reduces risk by concentrating multiple transactions in a single counterparty and then using multilateral netting to reduce or eliminate the exposures under the transactions. Although some risk remains after such multilateral netting, FICC reduces and manages that remaining risk through a comprehensive risk management program that is centralized, standardized, transparent, and subject to extensive regulatory oversight.

FICC's risk management program has multiple components with a core set of common principles and processes for identifying, assessing, measuring, monitoring, mitigating, and reporting risk. Most importantly, FICC collects margin, called "clearing fund," from each direct participant at least twice daily using a Value-at-Risk ("VaR") model that evaluates the potential market price risk of the direct participant's portfolio of FICC-cleared transactions. FICC's VaR model is dynamic and evolves based on market data. However, it uses a ten-year time horizon.[23]

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[20] To the extent the direct participant dealer's transactions arise from sponsored member transactions or other transactions for which the direct participant acts as guarantor of an indirect participant's obligations, the direct participant would (like any carrying clearing member) need to hold capital against that guarantee exposure. However, the direct participant would still be able to net down its exposure arising from its role as a principal under such transactions.

[21] Proposed Rule, *supra* note 1, at 64662.

[22] *See id*. at 64614 ("The Commission believes that, although this proposal will not, by itself, necessarily prevent future market disruptions, the proposal will support efficiency by reducing counterparty credit risk and improving transparency.").

[23] This ten-year horizon is consistent with the anti-procyclicality tool set forth in the European Market Infrastructure Regulation. Commission Delegated Regulation (EU) No 153/2013, Article 28(1)(c). FICC utilizes a 10-year lookback

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As a result, short-term volatility does not result in sudden increases in clearing fund requirements. This stability helps mitigate the risk of procyclical effects of margin.

Second, FICC's liquidity risk management strategy and objectives are designed to ensure that FICC maintains sufficient liquid resources to meet the potential amount of funding required to settle outstanding transactions of a defaulting direct participant and its affiliated direct participants in a timely manner.[24] FICC separately maintains a rules-based committed repo facility, the Capped Contingency Liquidity Facility or "CCLF," that requires direct participants to have contingent liquidity resources available that FICC may require in the event of a participant default. As with clearing fund, the amount of liquidity a direct participant must have available depends on the amount of liquidity risk embedded in the direct participant's portfolio of cleared transactions. To the extent a direct participant's portfolio presents greater liquidity risk to FICC, it is generally subject to greater liquidity requirements.

FICC also requires certain direct participants to participate in operational, business continuity, and disaster recovery testing. This testing is designed to limit the likelihood that operational issues or unforeseen events give rise to further market impacts.

FICC's centralized risk management, which is overseen by the Commission in consultation with the Board of Governors of the Federal Reserve System and, by delegation of authority, the Federal Reserve Bank of New York ("FRB"), aims to ensure that FICC will have sufficient resources and capabilities to handle a default scenario under extreme but plausible market conditions. It also aims to make sure that those participants whose portfolios give rise to credit and liquidity risk cover those risks *ex ante* instead of externalizing them to market participants or the official sector in the context of a default or market stress.[25] This internalization not only appropriately allocates costs, reduces risk, and preserves market stability, but it also promotes an alignment of interests, as it incentivizes participants with directional portfolios to flatten out their positions. Indeed, FICC has worked with direct participants in a number of situations to identify mechanisms for reducing the risk of their portfolio and attendant liquidity and clearing fund requirements. For example, FICC has helped direct participants reduce their CCLF requirements by identifying opportunities to match the duration of the participants' repo and reverse repo transactions. FICC has also worked with a number of dealer direct participants to find ways to

period that incorporates an additional stress period if FICC determines that the historical look-back period does not contain adequate shocks.

[24] Liquidity risk is the risk that FICC would not have sufficient funding resources to complete settlement obligations of a defaulting direct participant's unsettled transactions.

[25] In certain cases, these requirements will apply to institutions that are acquiring U.S. Treasury securities to post margin pursuant to the uncleared swaps margin rules (the "UMR"). 17 C.F.R. § 23.156 (CFTC); 12 C.F.R. § .6 (prudential regulators); and 17 C.F.R. § 240.18a-3(c)(4) (SEC). However, that should not generally give rise to "double" margin requirements. As noted above, unlike derivatives transactions, FICC-cleared U.S. Treasury transactions are short-dated and physically-settled. Accordingly, an institution acquiring a U.S. Treasury security for the UMR will do so quickly (typically T+1). Once the institution performs its obligation to deliver the purchase price and receives the security, the liquidity and clearing fund requirements associated with that transaction will be released. Thus, by the time the security is posted to the swap counterparty under the UMR, no margin or liquidity requirements will apply to the transaction to acquire the U.S. Treasury security.

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bring the second leg of a dealer direct participant's matched book into central clearing, *e.g.*, through the Sponsored Member Service discussed below.

Furthermore, FICC's risk management is standardized and transparent and the result of a consultative process with its regulators and market participants. FICC does not separately or confidentially negotiate individualized clearing fund or liquidity requirements with direct participants based on "relationship" considerations, as may occur in the bilateral space.[26] Instead, each direct participant's clearing fund and liquidity requirements are based on FICC's Rules. Those Rules apply to all participants, are approved by the Commission after notice and an opportunity for comment, are reviewed by the FRB, and are publicly available. This standardization and transparency ensures that all of FICC's participants, its regulators, and the public at large not only understand FICC's risk management rules, but also have the opportunity to consult and advise on those rules such that they appropriately manage risk without unduly burdening the market.

Lastly, FICC assesses its fees based in part on the risk embedded in each participant's portfolio. This further incentivizes responsible risk management.

4. Preserving Market Stability and Limiting Fire Sale Risk Through Centralized Default Management

In the event of a default in the bilateral space, each of the bilateral counterparties to the defaulted market participant must separately take market action to close out the defaulter's positions. This can often result in fire sales or price surges as market participants must race against one another to sell or buy the relevant securities.[27] This is particularly the case when bilateral market participants have not collected sufficient margin or have failed to pre-position enough liquidity to address a default scenario. These fire sales and surges can create substantial market dislocation, with a variety of knock-on effects, including increased margin calls and defaults for market participants that have no connection with the defaulter.

By contrast, as a central counterparty, FICC centrally manages any default. It can therefore take market action in a more orderly manner and, in certain instances, in coordination with other market utilities, such as through its cross-margining arrangement with the Chicago Mercantile Exchange ("CME"). FICC also has certain established, uniform processes that are transparent to market participants and mitigate the uncertainty caused by bespoke risk management practices.[28] This centralized management may limit losses to FICC and its participants and reduce the

[26] Basel Committee on Banking Supervision *et al.*, *Review of Margining Practices*, Bank for International Settlements (Oct. 2021), https://www.bis.org/bcbs/publ/d526.pdf.

[27] *See* Michael S. Gibson, *SR 21-19: The Federal Reserve Reminds Firms of Safe and Sound Practices for Counterparty Credit Risk Management in Light of the Archegos Capital Management Default*, Federal Reserve Board of Governors (Dec. 10, 2021), https://www.federalreserve.gov/supervisionreg/srletters/SR2119 htm. *See also* Matt Scuffham *et al.*, *In Archegos Fire Sale, Credit Suisse, Nomura Burned by Slow Exit*, Reuters (Mar. 30, 2021), https://www.reuters.com/world/asia-pacific/archegos-fire-sale-credit-suisse-nomura-burned-by-slow-exit-2021-03-31/; Eric Platt *et al.*, *Banks Face Regulators' Scrutiny on Handling of Archegos Fire Sale*, Financial Times (Mar. 30, 2021), https://www ft.com/content/c771ad24-24ca-4002-ab8f-17719e4c32da.

[28] *See* TMPG (2022), *supra* note 15, at 29.

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likelihood of market disruption. For example, when FICC ceased to act for one of its direct participants during market volatility in March 2020, FICC successfully coordinated the direct participant's orderly wind-down with the CME and regulators.[29] As one market analyst firm noted, "over 200 financial institutions [were] only 2 degrees of separation from [the direct participant], and all of them could have incurred losses related to [the direct participant's] failure."[30] However, "FICC default management processes worked as intended" and no losses were imposed on other participants as a result of the liquidation.[31]

5. Transparency and Consultation

Central clearing promotes transparency and consultation, and thereby furthers predictability, enhances deliberation, and limits the likelihood of systemic issues arising from hidden concentrations of risk. As noted above, unlike bilateral contracts, FICC's Rules, including the terms of the CCLF, clearing fund methodology, default management processes, operational testing requirements, and membership criteria, are available to the public. Moreover, before adopting or amending any of its Rules, FICC must submit the proposed change to the Commission so that the Commission, the FRB, FICC's participants, and the public can review and comment on the change. FICC may only adopt such a change if the Commission, after considering any public comments and applicable law, approves or does not object to the change. This consultation and publication ensure that market participants are not only aware of how FICC operates but also given the opportunity to frame and improve those operations.

Furthermore, central clearing gives the Commission and the FRB visibility into U.S. Treasury market activity, including potential systemic causes of disruption. Through their monitoring of FICC, the Commission and the FRB can identify the types of transactions FICC is clearing and whether the data on those transactions, combined with other information available to the Commission, FRB, and other regulators, indicate a concentration of risk, market manipulation, or other disruptive activity. This transparency limits the likelihood of disruptions or nefarious actions and preserves market stability.

6. Facilitating All-to-All Trading Through Comparison and Novation

When a direct participant of FICC submits a transaction for clearing, FICC will first engage in its comparison process, whereby it will confirm that the transaction data provided by the two counterparties (or the direct participants submitting the transaction on their behalf) match. If the data match and the transaction otherwise satisfies the requirements of FICC's Rules, FICC will "novate" the transaction, meaning that it will become the buyer to the seller and the seller to the buyer.

As many commentators have recognized, this novation can reduce risk and facilitate all-to-all trading by allowing market participants to execute transactions with one another without

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[29] *DTCC Important Notice to Government Securities Division Members*, GOV864-20 (Mar. 25, 2020), https://www.dtcc.com/-/media/Files/pdf/2020/3/25/GOV864-20.pdf.

[30] Ivana Ruffini, *Related Party Analytics: How Close Were You to Ronin Capital?*, FNA (Apr. 14, 2020), https://fna fi/insights/related-party-analytics-how-close-were-you-to-ronin-capital/.

[31] *Id*.

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concern for counterparty credit risk of their trading counterparties.[32] Indeed, FICC's novation and guarantee of settlement currently allow all-to-all trading among dealers on IDB platforms. Direct participants can execute transactions on these platforms without concern for the IDB's or its users' financial wherewithal since the direct participants know that FICC will step into the transaction as the ultimate credit counterparty.

FICC's comparison and novation can also facilitate all-to-all trading among end-users. As part of its "open-access" approach to clearing, FICC has developed the Prime Brokerage Clearing and Correspondent Clearing models. These models aim to allow an indirect participant to enter into a transaction with a third party and then "give up" the transaction to a direct participant for clearing, much in the same manner as an end-user in the cleared derivatives market can execute derivatives with third parties and then give them up to their futures commission merchant (an "FCM") for clearing. The direct participant may then elect to carry the transactions at FICC in the same account as the direct participant's proprietary positions (and have clearing fund and liquidity requirements calculated on a net basis). Or it may elect to maintain indirect participant transactions in a separate account.

In addition, FICC has developed the Sponsored Member Service, which allows direct participants (called "sponsoring members") to sponsor indirect participants into clearing as limited-purpose direct participants. These indirect participants (called "sponsored members") become the legal counterparty to FICC, with the sponsoring member guaranteeing to FICC the performance of the sponsored member and acting as the sponsored member's processing agent. The Sponsored Member Service permits the submission of both "done away" transactions (*i.e.*, transactions between the sponsored member and a third-party direct participant) and "done with" transactions (*i.e.*, transactions with the sponsored member's sponsoring member).

As discussed below, FICC has found that, notwithstanding the various models of "done away" or FCM-style trading under FICC's open-access approach, many indirect participants elect to trade under a "done with" model. This is often for regulatory, operational, and legal reasons. In addition, many end-user indirect participants prefer the lower costs that are often associated with "done with" trading due to their favorable treatment under the regulatory capital rules and lower CCLF requirements. Further, many market participants may not fully understand how the Prime Brokerage Clearing and Correspondent Clearing models function and their ability to facilitate all-to-all trading. However, FICC intends to take steps to both clarify these models and provide informational resources to market participants. In addition, to the extent the Commission takes steps to increase the scope of transactions submitted for clearing, FICC would expect end-users that prefer to trade with third parties, and that are not subject to constraints on their ability to post margin or pay reasonable clearing fees, to use FICC's "done away" or FCM-style models.

B. Increased Clearing May Lead to Decreased Costs

DTCC and FICC wholeheartedly agree with the Commission that increased clearing will augment the above-mentioned benefits and promote the prompt and accurate clearance and settlement of U.S. Treasury transactions. More clearing would lead to greater multilateral netting and thus lower credit and settlement risk and more trading capacity for dealers. Increased clearing

[32] TMPG (2019), *supra* note 18, at 17; TMPG (2022), *supra* note 15, at 4 n.4.

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would also ensure that liquidity and credit risks are responsibly managed and that the costs of such risks are borne *ex ante* by those market participants that give rise to them. Further, increased clearing would improve transparency, limit disruptive market action in a default context, and expand the ability of direct and indirect participants to trade with one another.

As the Proposal notes, the Commission must weigh these benefits against any costs that could arise from more central clearing. In that regard, the Commission posits that more central clearing may increase FICC's exposure to its largest direct participants and thereby increase the amount of liquidity resources (*i.e.,* CCLF commitments) and clearing fund that FICC requires direct participants to have available to address a default scenario.[33] The Commission suggests that these increased commitments and resources would increase the costs of the Proposal to market participants, relative to the costs that participants currently incur in entering into bilateral transactions.

As discussed above, FICC requires direct participants to post margin and have liquidity available to support the transactions they submit for clearing. This is a notable departure from the bilateral space. As recent data from the Office of Financial Research indicate, 75% of bilateral U.S. Treasury repos are not subject to any initial margin.[34] FICC's CCLF and clearing fund requirements seek to quantify the impacts of liquidity exposure and credit risks that arise from centrally cleared transactions *ex ante* and internalize those risks to those whose activities give rise to them. The fact that bilateral clearing arrangements do not generally impose some kind of liquidity costs generally means that those costs, when they come to fruition in a default scenario, are externalized to the broader market or the official sector, often during a period of market disruption.

Accordingly, DTCC and FICC caution against viewing the absence of liquidity pre-positioning or comprehensive margining in the bilateral space as suggesting that bilateral transactions do not present liquidity and credit risks and attendant costs. Rather, bilateral transactions present the same, and in many cases greater, liquidity and credit risks as compared to centrally cleared transactions. In conducting any cost-benefit analysis, the Commission must consider these risks and the costs of not addressing them and how these costs compare to the costs of FICC's risk management techniques. In addition, DTCC and FICC do not believe it is correct to assume that increased central clearing would necessarily result in greater CCLF or clearing fund requirements in all cases. Rather, more central clearing may cause direct participants that currently engage in hybrid clearing to submit more balanced portfolios that present lower market and liquidity risks and thereby give rise to lower margin and CCLF requirements.

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[33] *Id.* at 64668.

[34] As the Federal Reserve's emergency liquidity assistance in March 2020 indicates, bilateral U.S. Treasury transactions carry substantial liquidity risk as well as credit risk. Given the absence of multilateral netting, centralized risk management, and centralized default management, these risks, and the costs of managing them, often exceed those that arise in the context of central clearing. In addition, preliminary conclusions from the Office of Financial Research's bilateral repo pilot data collection found two major distinctions between bilateral trades and centrally cleared trades: (1) bilateral trades have longer maturities, and (2) almost 75 percent of repo transactions collateralized by U.S. Treasury securities are traded at a zero percent haircut. Under Secretary for Domestic Finance Nellie Liang, Remarks at 2022 Treasury Market Conference (Nov. 16, 2022), https://home.treasury.gov/news/press-releases/jy1110.

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1. Overview of FICC Resources to Manage Liquidity Risk

Unlike banks, FICC does not have access to the Federal Reserve's discount window or its Standing Repo Facility, and therefore must look to other liquidity resources to ensure that it can continue performing to non-defaulting participants in the event of a participant default. These resources include clearing fund posted by participants. More specifically, in the event a participant due to pay cash in exchange for securities defaults, FICC can use the cash clearing fund posted by such participant and other participants to satisfy the cash payment obligation due to the non-defaulting participants. FICC can also obtain additional liquidity resources, for example, by repoing out or pledging to third parties securities due to be delivered to the defaulting participant. Once FICC settles with the non-defaulting participants using this cash, it will liquidate the securities received from these non-defaulting participants to replenish the clearing fund and pay back any liquidity providers.

In accordance with the CCAS, FICC has determined that a participant default could give rise to liquidity needs in excess of what is available through the clearing fund and FICC's other resources. It has therefore developed the CCLF.[35] Under this facility, FICC may require direct participants to provide FICC with temporary liquidity pursuant to repo transactions in the event of a direct participant default. However, that liquidity is not unlimited. FICC daily settlement requirements and the CCLF cap the amount of liquidity FICC may demand from each direct participant.[36] In addition, the CCLF does not require direct participants to provide FICC with this liquidity in advance. Nonetheless, because direct participants must have this funding available on short notice, it may give rise to financing costs.

FICC calculates the size of the CCLF based on the historical liquidity exposure of each direct participant.[37] Accordingly, a direct participant with a large, one-sided portfolio will generally have a greater individual contribution than a direct participant with a smaller, balanced portfolio.

Importantly, CCLF is not a mechanism to allocate losses to participants. FICC is required to return to participants all of the funds that FICC utilizes through the CCLF. As noted above, FICC obtains such funds by liquidating in an orderly manner the securities due to the participant whose default gave rise to the liquidity need. To the extent FICC incurs any losses in connection with such liquidation, those losses are allocated first to the defaulting participant and then to FICC's corporate contribution before being borne by non-defaulting participants.

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[35] FICC's CCLF also aligns with the principles for financial market infrastructures (the "PFMIs"), specifically Principle 7 on liquidity risk and Principle 13 on participant-default rules and procedures. Bank of International Settlement, *Principles for Financial Market Infrastructures* 57-63, 78-81 (Apr. 2012), https://www.bis.org/cpmi/publ/d101a.pdf [hereinafter BIS].

[36] *See* FICC Rule 22A §§ 2(a) and (b) (action by the corporation).

[37] *See Order Approving a Proposed Rule Change to Implement the Capped Contingency Liquidity Facility in the Government Securities Division Rulebook*, Exchange Act Release No. 82,090, File No. SR-FICC-2017-002, 82 Fed. Reg. 55,427 (Nov. 15, 2017).

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2. *Increased Clearing May Lead Market Participants to Submit More Balanced Portfolios that Carry Lower CCLF and Clearing Fund Requirements*

As the Commission notes, some direct participants run a matched book, but only clear one side of the book. Since uncleared transactions are not eligible for multilateral netting with cleared transactions, a direct participant engaging in this kind of "hybrid clearing" will have a directional portfolio vis-à-vis FICC. Directional portfolios present greater credit and liquidity risk and thereby lead to higher clearing fund and CCLF requirements.

For example, if a participant runs a matched book whereby it enters into one transaction to pay $100 million for 100 securities and another transaction to sell the same securities for $100 million, but only submits the first transaction to clearing, FICC will need to ensure it has enough liquidity resources to pay $100 million upon a participant's default. Similarly, its VaR model will need to calculate the value-at-risk associated with a $100 million trade for 100 securities. By contrast, were the participant to submit both transactions to central clearing, FICC would likely not need any liquidity resources because the participant's cash payment obligations net out, and FICC's VaR model would calculate the transactions' value-at-risk to be effectively zero.

Were increased clearing to lead direct participants of the sort described in the example above to submit their full portfolios, that may result in participants having more balanced cleared portfolios and thus lower CCLF and clearing fund requirements. It may also lead to lower CCLF requirements for other participants, since FICC would likely need fewer liquidity resources from other participants to cover a default scenario.

II. The Commission Should Further Clarify the Scope and Application of the Membership Proposal

The Commission proposes to amend Rule 17Ad-22 to obligate Treasury CCAs to "[r]equire that any direct participant of such a covered clearing agency submit for clearance and settlement all the eligible secondary market transactions to which such direct participant is a counterparty."[38] The Proposal generally defines an "eligible secondary market transaction" as:

> a secondary market transaction in U.S. Treasury securities of a type accepted for clearing by a registered covered clearing agency that is:
>
> > (i) A repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities, in which one of the counterparties is a direct participant; or
> >
> > (ii) A purchase or sale, between a direct participant and [certain counterparties].[39]

To the extent the Commission elects to adopt the Membership Proposal, it will be important that the scope of transactions subject to the requirement are clear. Such clarity will reduce the costs

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[38] Proposed Rule, *supra* note 1, at 64682.

[39] *Id.* at 64610.

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of the requirement by eliminating complicated legal analyses or prolonged engagement with Commission staff on interpretative issues. In addition, such clarity will assist FICC in fulfilling its responsibility to identify and monitor its direct participants' compliance with their obligations. It will also ensure that FICC can accurately calibrate its liquidity and clearing fund needs.

We therefore appreciate the Commission's efforts to leverage terms and definitions that appear elsewhere in regulations and have well-established meanings. For example, the Commission would propose to ascribe to "sovereign entity" and "international financial institution" the same definitions that the Commodity Futures Trading Commission ("CFTC") used in connection with the implementation of Title VII of the Dodd-Frank Act.[40] The Commission's use of such terms should allow market participants to leverage the scoping and interpretive work they conducted in connection with other regulatory regimes, such as Title VII of the Dodd-Frank Act, and thereby limit the costs of implementation.

However, the Membership Proposal does contain some ambiguities that we recommend the Commission address.

A. The Commission Should Clarify the Scope of Covered Repurchase Transactions

As noted above, the Proposal's definition of "eligible secondary market transactions" includes "repurchase or reverse repurchase agreement collateralized by U.S. Treasury securities, in which one of the counterparties is a direct participant."[41] This description presents a few ambiguities that the Commission should clarify.

First, it is unclear whether the description applies to repos for which U.S. Treasury securities are one, but not the only, eligible type of security. For example, under FICC's GCF Repo Service, direct participants can enter into transactions for which they may deliver U.S. Treasury securities or certain other securities. We do not believe that the Commission intends to cover these kinds of transactions. Rather, we understand the Membership Proposal to apply only to transactions for which U.S. Treasury securities are the only eligible securities. However, it would be helpful for the Commission to make that clear.

Second, the description does not define "repurchase or reverse repurchase agreement." As a result, market participants may not know whether transactions documented under a Master Securities Lending Agreement or Master Securities Loan Agreement are subject to the requirement. To address this ambiguity, it may be advisable for the Commission to define "repurchase or reverse repurchase agreement" using the definition of "Repo Transaction" in FICC's Rules. That definition covers:

> (1) an agreement of a party to transfer Eligible Securities to another party in exchange for the receipt of cash, and the simultaneous agreement of the former party to later take back the same Eligible Securities (or any subsequently substituted Eligible Securities) from the latter party in exchange for the payment of cash, or (2) an agreement of a party to take in Eligible Securities from another party in exchange for

[40] *Id.* at 64681; 17 C.F.R. §§ 50.75, 50.76 (2021).

[41] Proposed Rule, *supra* note 1, at 64610.

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> the payment of cash, and the simultaneous agreement of the former party to later transfer back the same Eligible Securities (or any subsequently substituted Eligible Securities) to the latter party in exchange for the receipt of cash . . . .

Importantly, this description is indifferent to the method of documentation. As a result, whether a transaction is subject to the requirement would not depend on the particular documentation the parties elect to use. However, this description would not serve to expand the scope of eligible secondary market transactions to most securities loans because securities loans generally require that the amount of posted cash exceed the value of the securities and FICC does not generally support these kinds of arrangements. As a result, this description would only serve to bring in scope those transactions that are economically identical to repos that FICC accepts for clearing.

B. The Commission Should Clarify the "Hedge Fund" Definition

As noted above, "eligible secondary market transactions" include cash market transactions with "hedge funds."[42] The Proposal defines "hedge funds" as private funds (other than securitized asset funds) with respect to which an investment adviser may be paid certain performance fees or allocations or that engages in certain borrowing or short-selling activity.[43]

As the Commission notes in the Proposal, the definition of "hedge fund" is consistent with the definitions applicable to Form PF.[44] We appreciate the Commission's use of an established definition. However, we note that the Proposal does not make clear that "private fund" or the other terms used in the hedge fund definition would be given the same meanings as apply for purposes of Form PF. It would therefore be helpful if the Commission expressly included all relevant definitions or simply cross-referenced Form PF.

C. The Definition of Eligible Secondary Market Transactions Should Cover Those Transactions that, from Time to Time, are Eligible for Clearing at Treasury CCAs

FICC's determination to accept a given transaction type for clearing involves a comprehensive review of the transaction's credit, liquidity, and other risks in accordance with FICC's obligations under the CCAS.[45] In addition, before accepting a new transaction type for clearing, FICC engages with participants, regulators, and stakeholders to identify the benefits and potential drawbacks and costs that may arise from making the system and model changes necessary to clear the transaction. This comprehensive and consultative process ensures that FICC can fully risk-manage the transactions it clears and that FICC only clears those transactions for which the clearing fund and liquidity costs are reasonably balanced against the benefits of clearing.

DTCC and FICC therefore fully agree with the Commission that any Membership Proposal should apply to the types of transactions that are eligible for clearing at Treasury CCAs, as those

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[42] *Id.* at 64610.

[43] *Id.* at 64681.

[44] *Id.* at 64624.

[45] This is also done in accordance with PFMI Principle 4 on credit risk and PFMI Principle 7 on liquidity risk. BIS, *supra* note 35, at 36-45, 57-63.

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eligibility criteria evolve over time.[46] Such an approach would ensure that the Membership Proposal does not inadvertently give rise to risk or undue costs by forcing into central clearing transaction types that have not gone through a methodical risk analysis or for which the costs may outweigh the benefits. At the same time, it would allow the Membership Proposal to evolve as Treasury CCAs, their direct participants, and their regulators identify transaction types that would benefit from central clearing. This dynamic approach would preserve the benefits of any Membership Proposal without creating undue risk.

III. DTCC and FICC Agree with the Commission's Approach to How FICC Should Monitor Compliance with Any Membership Proposal in Accordance with the CCAS

The Proposal would also amend Rule 17Ad-22 to require Treasury CCAs to establish written policies and procedures reasonably designed to "identify and monitor its direct participants' submission of transactions for clearing" and address any "failure to submit transactions."[47]

DTCC and FICC agree with the Commission that, to the extent the Commission adopts the Membership Proposal, Treasury CCAs will need to take steps to monitor compliance with the requirement, identify possible instances of non-compliance, and address any non-compliance.[48] DTCC and FICC further agree with the Commission that the existing CCAS framework should form the basis of any such efforts. We appreciate in this respect the Commission's use in the Proposal of the "identify and monitor" standard. That standard appears multiple times in the CCAS and its meaning is familiar.[49] Specifically, the Commission has made clear that it requires a clearing agency to engage in risk-based monitoring of its participants using information reasonably available to the clearing agency.[50]

Accordingly, if the Commission adopts the Membership Proposal, FICC would anticipate implementing the requirement in a manner similar to how it has implemented other requirements under its Rules. For example, FICC would consider requiring direct participants to submit to it information regarding their U.S. Treasury transactions as well as attestations from senior officials that the direct participant is in compliance with its obligations. In addition, FICC may plan to review publicly available information, such as that collected through TRACE reporting, and information made available to FICC by regulatory and self-regulatory organizations. FICC would also seek to identify opportunities to coordinate with market participants and self-regulatory organizations to examine collected data and identify possible instances of non-compliance.[51] Ultimately, the efficacy of any such reviews would depend on the quality and comprehensiveness

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[46] Proposed Rule, *supra* note 1, at 64620.

[47] *Id.* at 64682.

[48] Proposed Rule, *supra* note 1, at 64629.

[49] *See* 17 C.F.R. § 240.17Ad-22 (2021); *Standards for Covered Clearing Agencies*, Exchange Act Release No. 78,961, File No. S7-03-14, 81 Fed. Reg. 70,786, 70,840 (Oct. 13, 2016).

[50] *Standards for Covered Clearing Agencies*, 81 Fed. Reg. at 70,840.

[51] Proposed Rule, *supra* note 1, at 64629.

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of the available data. DTCC and FICC therefore applaud the official sector's continued review of steps to improve the quality and availability of data regarding U.S. Treasury transactions.[52]

Such efforts augment FICC's visibility into the market and would improve its ability, whether independently or possibly in coordination with other authorities (including other self-regulatory organizations like FINRA), to identify and monitor compliance with any Membership Proposal. In the event FICC determines a participant has not been compliant with its obligations, FICC would take steps to remediate such issue in a manner that is consistent with the CCAS and how it currently addresses breaches of its Rules.

DTCC and FICC note, however, that FICC's capacity to monitor non-compliance is limited. FICC does not have authority over non-member market participants that may seek to develop different transaction structures to evade any Membership Proposal, and FICC is only able to review the information available to it. DTCC and FICC would therefore encourage the Commission to utilize its supervisory authority to help support any Membership Proposal as well as any information reporting requirements.

IV. DTCC and FICC Agree with the Commission that Treasury CCAs Should Take Steps to "Facilitate Access" to Clearance and Settlement in Accordance with an Open Access Approach

The Proposal would require a Treasury CCA to "[e]nsure that it has appropriate means to facilitate access to clearance and settlement services of all eligible secondary market transactions in U.S. Treasury securities, including those of indirect participants, which policies and procedures [the] board of directors of such covered clearing agency reviews annually."[53]

DTCC and FICC wholeheartedly agree with the Commission that Treasury CCAs should take steps to facilitate access to clearing in a manner consistent with sound risk management and that flexibility and open access must be at the heart of any such effort. Since its founding, FICC has sought to develop new clearing models, to expand programs, and to adopt novel structures and policies that reduce and fairly allocate the costs of clearing without sacrificing appropriate risk management. These efforts have allowed a wide variety of market participants to access clearing on terms that are consistent with such participants' regulatory obligations and operational restrictions and that meet their needs. Notably, many entities that do not or cannot participate in other cleared markets are able to clear U.S. Treasury transactions as a result of FICC's open-access approach. FICC is eager to continue these efforts in a manner consistent with its obligations under the CCAS.

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[52] Inter-Agency Working Group for Treasury Market Surveillance, *Enhancing the Resilience of the U.S. Treasury Market: 2022 Staff Progress Report* 7-11, U.S. Department of Treasury (Nov. 10, 2022).

[53] Proposed Rule, *supra* note 1, at 64682.

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A. FICC's Efforts to Facilitate Access

Over its four decades of existence, FICC has worked consistently to find ways to facilitate the ability of participants, including, in particular, indirect participants, to access clearing in a manner consistent with sound risk management and the CCAS. These efforts include:

- Development of Multiple Different Clearing Models: As discussed above, FICC has developed a variety of models, including its Prime Brokerage Clearing and Correspondent Clearing models and Sponsored Member Service, through which indirect participants can access central clearing. The variety of models aims to provide end-users and other indirect participants with the flexibility to select the model that most meets their regulatory, operational, and commercial needs.[54]

- Development of the Cleared Institutional Tri-Party Service ("CCIT") Service: In 2017, FICC developed the CCIT Service to allow repo cash providers to access central clearing as limited-purpose members without the sponsorship or intermediation of a direct participant.[55] These entities pledge to FICC the purchased securities under their repos in order to secure their obligation to perform under the transaction.

- Expansions of the Sponsored Member Service: Over the last decade, FICC has expanded the Sponsored Member Service on multiple occasions to facilitate the ability of more participants to submit a greater variety of transactions for clearing. Specifically, FICC has expanded eligible sponsoring members to include any direct participant that satisfies certain financial requirements. In addition, FICC has modified the service to facilitate the submission of term transactions and transactions with haircuts. And FICC has developed the Sponsored GC Service, which allows participants to submit for central clearing triparty general collateral repos.[56] This last development facilitates access to clearing for participants that do not have the authority or operational capability to make funds-only settlement payments or that may engage in repos through a triparty framework.

- Facilitating Risk-based Capital and Accounting Treatment: As noted above, the capacity of direct participants to clear transactions for indirect participants generally depends on the capital and accounting treatment of those transactions. FICC has therefore taken steps to facilitate the ability of direct participants to recognize favorable regulatory capital and netting treatment, including

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[54] *Id*. at 64636.

[55] We note that the Division of Investment Management has not yet approved registered investment companies to participate in CCIT. *See Order Granting Approval of Proposed Rule Change to Establish the Centrally Cleared Institutional Triparty Service and Make Other Changes*, Exchange Act Release No. 80,574, File No. SR-FICC-2017-005, 82 Fed. Reg. 21,439, 21,440 n.11 (May 2, 2017).

[56] *Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Add the Sponsored GC Service and Make Other Changes*, Exchange Act Release No. 92,808, File No. SR-FICC-2021-003, 86 Fed. Reg. 49,580 (Aug. 30, 2021).

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commissioning industry netting and novation opinions and developing a close-out liquidation process for sponsored member transactions.

- Updating of Fee Arrangements: As many commentators have observed, there has been a significant shift over the last decade and a half in not only the types of entities engaging in U.S. Treasury transactions but also the nature of that trading activity and the risks it presents. In 2018, FICC updated its GSD fee arrangements to address this evolution.[57] Specifically, in recognition that approximately 30% of GSD's costs arose from processing transactions and the remaining 70% arose from managing net positions, FICC shifted its fee structure away from a volume-driven approach to a position-based approach. These adjustments aimed to ensure that the clearing costs direct participants bear, and thus that they may pass on to indirect participants, align with the risks of their activities.[58] In addition, these adjustments aimed to promote prudent risk management, as they impose lower fees on balanced portfolios or matched books that present lower risks and higher fees on directional positions that present more substantial risks.

- Cross-Margining Arrangement: FICC has adopted a cross-margining arrangement with CME that allows eligible direct participants to recognize the risk mitigation effects of a balanced portfolio. Specifically, these arrangements allow certain direct participants to have FICC and CME calculate clearing fund and initial margin requirements based on the full portfolio of the direct participant's proprietary positions, rather than simply the siloed portfolio sitting at a single clearing organization. This generally allows a direct participant to reduce its clearing fund and margin obligations if it has interest rate futures that offset the risk of its U.S. Treasury transactions and vice versa. DTCC and FICC believe that expanding cross-margining to indirect participant positions would further reduce clearing costs and align incentives with risk. FICC continues to engage with the Commission and the CFTC on a potential expansion. However, Commission and CFTC regulations do not currently permit FICC and CME to offer cross-margining to such positions.

- Engagement with Regulators: FICC has engaged with the staffs and principals of the Commission, the CFTC, and other regulators to identify hurdles that may inhibit clearing and to find ways to address these limitations without increasing risk to the market, customers, or investors.

- Single Clearing Fund: Unlike DCOs and certain other clearing organizations, FICC does not require indirect participants to post initial margin for their transactions and direct participants to post a default fund to cover potential tail risks. Rather, FICC maintains a single clearing fund and applies clearing fund requirements exclusively to direct participants. This provides direct participants and their indirect

[57] *Order Approving Proposed Rule Change To Amend the Fee Structure of the Government Securities Division Rulebook*, Exchange Act Release No. 83,401, File No. SR-FICC-2018-003, 83 Fed. Reg. 27,812 (June 8, 2018).

[58] *Id*.

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participants with flexibility to select who will fund the clearing fund requirements that arise from indirect participant positions. In many cases, indirect participants may agree to fund some or all of the clearing fund requirements associated with their positions, much in the same way as they post initial margin in the cleared derivatives space. However, this is not feasible for many indirect participants as a result of their regulatory or operational limitations. For these indirect participants, the flexibility not to post margin, but instead to compensate their direct participant clearing members with a spread on "done with" transactions, is critical to allowing them to engage in clearing.

FICC's efforts have successfully opened clearing to a wide variety of market participants that would otherwise be unable to access clearing. As noted above, FICC's indirect participants include mutual funds, money market funds, pension plans, sovereign wealth funds, hedge funds, clearing organizations, and a host of other end-users. In the Sponsored Member Service alone, there are 1,986 different sponsored members served by 33 different sponsoring members. The average daily volume of sponsored member transactions in November 2022 was approximately $375 billion (the daily volume of sponsored member transactions peaked in March 2020 at approximately $564 billion).

DTCC and FICC also believe that FICC's efforts have both reduced costs and aligned any remaining costs a participant incurs with the risks its portfolio presents. These efforts have also facilitated the ability of direct and indirect participants to use the clearing models that most appropriately meet their needs.

Nonetheless, direct and indirect participants still face barriers to clearing and costs that do not align with risks. Some of these barriers arise from regulatory restrictions that FICC cannot address unilaterally. For example, as the Commission has identified, the absence of a debit in the Rule 15c3-3 reserve formula for margin posted to FICC means that broker-dealers must self-finance clearing fund requirements related to customer positions. This self-financing is costly, particularly given the current rate environment, and broker-dealers may address those costs by reducing the volume of transactions they clear, limiting the types of transactions they clear, or passing the costs on to customers. In addition, CFTC Rule 1.25 limits the ability of DCOs and FCMs to enter into FICC-cleared repo transactions using customer property. These limitations not only prevent DCOs and FCMs from accessing clearing, but they also deny the benefits of clearing to these entities' counterparties. This means that the counterparties cannot apply balance sheet netting to their transactions with DCOs and FCMs and therefore must bear higher costs. Moreover, as discussed above, Commission and CFTC regulations do not yet permit FICC and CME to offer cross-margining to indirect participant positions, which means those positions still carry greater margin requirements and costs than is appropriate based on their risks.

As FICC continues to identify ways to facilitate access to clearing in accordance with sound risk management and the CCAS, it would encourage the Commission to take steps, such as the Debit Proposal, to eliminate barriers to clearing that arise from regulatory restrictions.

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B. Open Access Is Crucial to Increasing Competition and Promoting Market Liquidity

The Proposal notes that the Commission would expect Treasury CCAs to consider ways to provide "access in as flexible a means as possible, consistent with its responsibility to provide sound risk management" and comply with regulatory obligations.[59] In this regard, the Proposal notes:

> The Commission understands indirect participants may have significantly different preferences with respect to how they access and obtain clearing services from direct participants of U.S. Treasury securities CCAs. For example, certain market participants may tend to prefer to bundle trading and execution services with a single entity that is a U.S. Treasury securities CCA member for regulatory, operational, and other reasons.[60]

DTCC and FICC fully agree with the Commission that flexibility and an open-access approach are critical to facilitating access to clearing. As described in greater detail below, dictating a single model of clearing would close off clearing to many market participants, force indirect participants to bear additional clearing costs, increase concentration, reduce competition, and negatively impact market liquidity.

1. *Open Access Ensures All Participants Can Access the Market*

As noted above, FICC's open-access approach has led it to develop a wide array of clearing models. One of the principal reasons for this is that a single model approach would likely prevent a number of indirect participants from accessing clearing. For example, certain money market funds, mutual funds, pension plans, and other repo cash providers face legal, regulatory, and operational limits on their ability to pay fees to direct participants and to post margin. For these funds, the only way they can access clearing is through FICC's "done with" model under the Sponsored Member Service. Through this service, money market funds, mutual funds, pension plans, and other cash providers enter into transactions with their sponsoring members, who in turn enter into offsetting transactions with other sponsored members or with third-party collateral providers. The sponsoring member earns a spread by running the matched book, which compensates it for guaranteeing its sponsored members' obligations and covering the requisite clearing fund, CCLF, and other clearing costs. The spread is economically equivalent to a fee, but its legal form allows sponsored members who cannot pay fees or post margin to access clearing.

If these entities were not able to access clearing, it would have a detrimental impact on market competition and liquidity. For example, money market funds are crucial cash providers in repo markets—a role that has only increased over the last 20 years—accounting for nearly 22% of total repo assets.[61] As the Commission notes, as of June 2022, money market fund repo investments amounted to

[59] Proposed Rule, *supra* note 1, at 64635-36.

[60] *Id.* at 64635.

[61] Viktoria Baklanova, Isaac Kuznits & Trevor Tatum, *Primer: Money Market Funds and the Repo Market* 2, U.S. Securities and Exchange Commission (Feb. 18, 2021), https://www.sec.gov/files/mmfs-and-the-repo-market-021721.pdf ("MMF Primer"). According to the MMF Primer, most money market fund repos "are executed through

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approximately $2.3 trillion.[62] Were these entities unable to access clearing, it would staggeringly increase the costs of transacting with these entities, since dealers would need to record their exposures on a gross basis. Particularly during times of balance sheet constraints, it may significantly limit the capacity of dealers to trade, which in turn may reduce market liquidity and increase costs.

We note that the role of money market funds and the greater restrictions applicable to mutual funds and pension plans is one of the key structural differences between the U.S. Treasury market and the U.S. cleared derivatives market. As a general matter, money market funds do not transact in futures or cleared derivatives. Furthermore, although certain mutual funds, pension plans, and other institutions do participate in the cleared derivatives market, they often face operational and legal constraints, such as custodial requirements, in the context of the U.S. Treasury market that are generally not relevant to their activity in the cleared derivatives market. In many cases, this is because these institutions benefit from certain exemptions (*e.g.*, allowing them to custody positions and margin at FCMs) in the cleared derivatives market that do not apply in the U.S. Treasury market.[63] In the absence of action by the Commission and other regulators to provide similar exemptions to allow money market funds, mutual funds, and pension plans to post margin and clearing fees for FICC-cleared transactions, these institutions are unable to access clearing through FCM-style and other "done away" models. Accordingly, FICC's open-access approach, and in particular its provision of a "done with" model, is critical to ensuring these crucial liquidity providers are able to access central clearing for U.S. Treasury securities.

2. Open Access Reduces Costs and Furthers Competition

Another reason FICC implements an open-access approach is to reduce the cost of clearing to all participants. Certain direct participants are subject to regulations, such as the Basel III capital requirements, that make it more expensive to provide clearing services under a "done away" model or FCM-style model as compared to a "done with" model. This is because many direct participants are able to conclude that they can recognize accounting and capital benefits of close-out netting under the "done with" model, but not under the "done away" or FCM-style model. This recognition allows these firms to hold less capital in relation to the "done with" positions and thereby carry them for a lower cost. In addition, the CCLF requirements associated with "done with" transactions are necessarily lower than those associated with "done away" transactions because FICC is able to elect to liquidate both sides of a "done with" transaction in the event of a sponsoring member default.

Direct participants are still able to agree with indirect participants to clear under a "done away" or FCM-style model. They simply may require greater fees to address the greater costs they incur in operating under those models. In addition, other direct participants that are not subject to the Basel III capital requirements should be able to offer "done away" and FCM-style clearing for fees that are largely commensurate with the spreads applicable under "done with" trading.

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a third party that provides settlement and collateral management services and are often referred to as triparty repos." *Id*. at 3.

[62] Proposed Rule, *supra* note 1, at 64660.

[63] *See, e.g.*, Securities and Exchange Commission, *Custody of Investment Company Assets With Futures Commission Merchants and Commodity Clearing Organizations*, 61 Fed. Reg. 66,207 (Dec. 17, 1996).

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DTCC and FICC firmly believe that an open-access approach is the most appropriate way to address the different costs of the various clearing models. The flexibility it affords allows indirect participants and direct participants to select the clearing model that serves both their needs and goals.

Under FICC's open-access approach, many indirect participants have elected to clear through bank-affiliated direct participants in exchange for lower costs. FICC does not believe it would be appropriate to force these indirect participants into a model that would require them either to pay higher fees or to engage a new direct participant. Doing so would not serve to benefit these indirect participants, and would simply burden them with costs and risks. It could also result in market concentration, since bank-affiliated direct participants may elect to drop out or reduce their clearing volume in lieu of bearing higher costs. Indeed, many observers have identified regulatory capital costs as one of the prime drivers of banks' retreat from the U.S. Treasury market.[64] A decline in direct participants, which has occurred in other cleared markets,[65] would diminish market liquidity, increase costs, and make both FICC and the market as a whole substantially more fragile.

C. FICC Supports All-to-All Trading Through Its Open Access Approach

In the Proposal, the Commission states that Treasury CCAs should consider whether there are steps they can take to clear transactions between two indirect participants.[66] DTCC and FICC fully agree that, in connection with their initial and annual reviews, Treasury CCAs should consider possible ways, consistent with sound risk management and the other goals of the CCAS, to clear transactions between indirect participants. Indeed, academics, market participants, and regulators have all observed that all-to-all trading would foster greater market liquidity and limit the likelihood of market disruption.[67]

DTCC and FICC believe that expanding and clarifying FICC's existing models under its open-access approach would be an effective way to advance these goals. Indeed, FICC's Prime Brokerage Clearing and Correspondent Clearing models currently support clearing of transactions between indirect participants. As noted above, these models allow an indirect participant to give up a transaction to its direct participant for clearing at FICC. Accordingly, two indirect participants that each have prime brokerage or correspondent clearing relationships with direct participants may enter into a transaction with one another and give up the transaction to their respective direct participants. This is similar to how futures and cleared swaps customers can execute transactions with one another and give up such transactions to their FCMs.

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[64] G-30, *supra* note 15, at 2.

[65] *See generally* Hester Peirce, *Dwindling Numbers in the Financial Industry*, Brookings (May 15, 2017), https://www.brookings.edu/research/dwindling-numbers-in-the-financial-industry/. *See also* CFTC, *Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management*, RIN 3038-0092, -0094, 77 Fed. Reg. 21,278 (Apr. 9, 2012).

[66] Proposed Rule, *supra* note 1, at 64636.

[67] *See* G-30, *supra* note 15, at 13; Jonathan S. Sokobin, *Remarks at the North American Bond Trading Forum*, FINRA (May 10, 2016), https://www.finra.org/media-center/speeches-testimony/remarks-north-american-electronic-bond-trading-forum; *Enhancing Liquidity*, *supra* note 15, at 9-10; Alain Chaboud *et al.*, *All-to-All Trading in the U.S. Treasury Market*, Federal Reserve Bank of New York (Staff Reports No. 1036) (Oct. 2022), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr1036.pdf.

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As part of its efforts to facilitate access, FICC would anticipate examining whether there are steps it can take to clarify that its Prime Brokerage Clearing and Correspondent Clearing models support all-to-all trading. FICC would also consider whether to revise the descriptions of these models in its Rules to resemble more closely the "Agent Clearing Member" model recently adopted by the National Securities Clearing Corporation for the SFT Service.[68] This model was heavily based on the FCM model and is designed specifically to foster transactions between indirect participants.

In addition, FICC would consider whether to make adjustments to the "done away" model of the Sponsored Member Service. Currently, FICC's Sponsored Member Service only accepts for clearing sponsored member transactions that a sponsored member enters into with its own sponsoring member or with a third-party netting member. FICC does not currently accept "done away" transactions between sponsored members and other sponsored members. However, FICC has the operational capability to handle such transactions, and the risk of those transactions would be substantially the same as other sponsored member transactions FICC clears. As a result, FICC could amend its Rules to provide expressly for it to clear such transactions.

DTCC and FICC are hopeful that expanding and clarifying these models will allow indirect participants to assess the benefits these models offer. To date, a number of indirect participants have not found these benefits sufficiently valuable to pay the fees necessary to induce direct participants to clear transactions using them. However, if it is clear that indirect participants can use these models to transact with other indirect participants, they may be willing to pay such fees. And if indirect participants are willing to pay reasonable compensation for such "done away" or FCM-style clearing, we are confident that sponsoring members and other direct participants would be willing to provide such clearing services.

In addition, if the Commission adopts the Membership Proposal or otherwise takes steps to encourage central clearing, such efforts may further increase the use of these models. For example, indirect participants that currently transact in high volumes on an uncleared basis with a wide variety of counterparties may find it preferable to use clearing models that allow them to continue transacting with multiple counterparties. As noted above, these participants would need to compensate their direct participant clearing members for the costs, including any CCLF costs, of providing these clearing services. However, these costs serve to protect FICC and the market as a whole by reducing credit and liquidity risks and ensuring those risks are internalized to the parties that create them. These efforts serve to promote the prompt and accurate clearance and settlement of transactions and foster competition by aligning costs with risks. Accordingly, the Commission may well find that such costs "'disadvantag[e] certain participants while simultaneously enhancing competition in the market.'"[69]

D. <u>FICC Cannot Dictate the Terms on Which Direct Participants Accept Transactions</u>

In the Proposal, the Commission notes that it would expect a Treasury CCA to consider, as part of their steps to facilitate access to clearing, "whether to include in its policies and procedures

[68] *See* Securities and Exchange Commission, *Order Approving Proposed Rule Change to Introduce Central Clearing for Securities Financing Transaction Clearing Service*, Release No. 34-95011; File No. SR-NSCC-2022-003 (May 31, 2022).

[69] *Compare Opinion at 15, NASDAQ Stock Market LLC v. Sec. and Exch. Comm'n*, No. 21-1100 (May 24, 2022), *with* Opinion, *New York Stock Exchange LLC v. Sec. & Exch. Comm'n*, No. 19-1042 (June 16, 2020).

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nondiscrimination principles, similar to those the CFTC promulgated to foster the clearance and settlement of swaps."[70] Those principles are set out in CFTC Rule 39.12(a)(1)(vi), which provides:

> (vi) No derivatives clearing organization shall require as a condition of accepting a swap for clearing that a futures commission merchant enter into an arrangement with a customer that:
>
>> (A) Discloses to the futures commission merchant or any swap dealer or major swap participant the identity of a customer's original executing counterparty;
>>
>> (B) Limits the number of counterparties with whom a customer may enter into trades;
>>
>> (C) Restricts the size of the position a customer may take with any individual counterparty, apart from an overall limit for all positions held by the customer at the futures commission merchant;
>>
>> (D) Impairs a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available; or
>>
>> (E) Prevents compliance with [certain] time frames.[71]

FICC's Rules do not include any provisions of the sort that CFTC Rule 39.12(a)(1)(vi) prohibits, and DTCC and FICC do not believe it would be appropriate to include any such provisions in FICC's Rules. Nonetheless, DTCC and FICC believe that the CCAS and the Exchange Act counsel allowing a direct participant to identify and agree with an indirect participant the types of transactions the direct participant is able to clear, what kind of information the direct participant needs about such transactions, and whether there are other terms or conditions that would allow the direct participant to clear the transactions consistent with sound risk management.

Among other requirements, the CCAS requires Treasury CCAs to:

> Establish objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access by direct and, where relevant, indirect participants and other financial market utilities, require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency, and monitor compliance with such participation requirements on an ongoing basis.[72]

FICC seeks to satisfy this standard under its open-access approach by allowing a wide variety of indirect participants to access clearing, so long as a direct participant is willing to stand behind the indirect participant's obligations (*e.g.*, through a sponsoring member guarantee). FICC has adopted and monitors a number of fair, objective, risk-based, and publicly-disclosed criteria designed to ensure that

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[70] Proposed Rule, *supra* note 1, at 64636.

[71] 17 C.F.R. § 39.12(a)(1)(vi) (2021).

[72] 17 C.F.R. § 240.17Ad-22(e)(18) (2021).

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each direct participant has the "financial resources and operational capability" to meet these obligations, including capital, margin, liquidity, and operational standards.

However, neither FICC nor any clearing organization is able to assess whether, and on what terms, an individual direct participant can safely clear a particular transaction for an individual indirect participant. Each direct participant must assess for itself whether it has the financial resources and operational capacity to clear a particular transaction for an indirect participant as well as the terms, including the fees and margin, it must collect from such indirect participant to ensure it has such financial resources. To the extent that clearing certain transactions or agreeing to certain terms would threaten a direct participant's ability to satisfy its obligations, FICC depends on the participant to decline the transaction or modify the particular terms.

Furthermore, we agree with the Commission that any requirement that FICC make direct participants accept transactions for clearing pursuant to certain commercial terms would be inconsistent with Section 17A(b)(3)(D) of the Exchange Act, which prohibits a clearing agency from imposing any schedule of prices, or fixing rates or other fees, for services rendered by its participants. Such a requirement would also burden competition by forcing out of the market those direct participants that cannot responsibly or profitably accept such transactions or terms. Other direct participants may find it necessary to increase fees or spreads to accommodate such terms or transactions, even for those indirect participants who do not desire such provisions. This burden on competition would be at odds with the CCAS and would reduce, rather than expand, market liquidity.

We also note that FICC's GSD has over 177 direct participants, including banks, broker-dealers, and other U.S. and non-U.S. financial institutions.[73] The size and diversity of this group helps to ensure robust competition and limit the possibility of uncompetitive behavior. For example, if one direct participant is unwilling to accept a transaction or agree to a term for a reasonable price, there are many other banks, broker-dealers, and non-U.S. financial institutions available to accept that business. Although some of these direct participants may be competitors of indirect participants, others, such as FICC's prime brokers or correspondent clearers, do not compete with these firms, and so should be willing to accept transactions as long as the indirect participant offers reasonable terms. Accordingly, provided that indirect participants are willing to provide reasonable compensation, FICC expects that they should not have difficulty finding a direct participant willing to provide access to clearing.

If an indirect participant cannot find a direct participant willing to carry its transactions, it could consider becoming a direct participant itself. While FICC is not able to dilute its robust membership criteria for direct participants without running afoul of the CCAS and sound risk management,[74] FICC has taken steps, where possible, to facilitate the ability of market participants to access clearing without the intermediation of a direct participant (*e.g.*, through FICC's CCIT Service). Moreover, if the Commission expands the dealer registration requirements to certain principal trading firms as currently proposed, that should also increase the number of firms eligible to become full-purpose direct participants of FICC.[75]

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[73] More Clearing, *supra* note 19, at 6.

[74] *See also* BIS, *supra* note 35, at 36-45, 57-63, 88-91 (PFMI Principles 4, 7 and 15).

[75] Proposed Rule, *supra* note 1, at 64661.

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E. Initial and Annual Reviews

The Commission states in the Proposal that it would expect a Treasury CCA to conduct an initial review of its access models.[76] Thereafter, the Proposal would require the board of a Treasury CCA to perform annual reviews of the Treasury CCA's policies and procedures to examine whether they facilitate access to clearance and settlement services for eligible secondary market transactions.[77]

DTCC and FICC fully support these proposed reviews as a means to facilitate access to clearing. FICC has consistently worked with direct and indirect participants to identify and remove potential impediments to clearing and would anticipate continuing this engagement as part of any initial and annual reviews. In undertaking these reviews, FICC would be mindful of its obligations under the CCAS, including in particular the risk management provisions set forth in the CCAS 4, 6, and 7.[78] FICC would not plan to make any changes to its policies or procedures that would impair its ability to satisfy these standards or generally increase risk to FICC and its participants.

FICC would plan to consider the following issues, among others, in its initial and annual reviews:

- Differential Treatment Based on Identity of Participant or Method of Execution. DTCC and FICC agree with the Commission that Treasury CCAs should carefully consider the appropriateness of rules that provide for differential treatment based on the identity of a participant or the method of a transaction's execution. In many instances, this differential treatment is necessary because different types of participants and transactions present different risks. For example, FICC's Rules apply different CCLF requirements to "done with" transactions as compared to "done away" transactions because "done with" transactions do not generally create liquidity risk for FICC. However, there may be instances when differential treatment may not be necessary. For example, FICC currently limits the scope of eligible sponsored members to those entities that satisfy the financial thresholds necessary to be a qualified institutional buyer under Commission rule 144A. As part of its reviews, FICC would anticipate considering whether this requirement remains appropriate.

- Facilitating All-to-All Trading. As noted above, FICC would anticipate clarifying its Prime Brokerage Clearing and Correspondent Clearing models and expanding its "done away" model under the Sponsored Member Service in order to facilitate the ability of indirect participants to use these models to clear transactions with other indirect participants.

- Risk and Default Management. In its initial and annual reviews, FICC would anticipate examining whether its risk and default management policies and procedures appropriately allocate costs to those participants whose activities give

[76] *Id*. at 64635-36.

[77] *Id*. at 64636.

[78] *See also* BIS, *supra* note 35, at 36-45, 57-63, 88-91 (PFMI Principles 4, 7 and 15).

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rise to them. As noted above, FICC has taken a number of steps, including the development of CCLF and the recalibration of its fee structure, to allocate costs and liquidity requirements equitably. Nonetheless, it would be appropriate to continue reviewing these features, particularly if transaction volumes increase in connection with a clearing requirement. In addition, FICC would consider whether any new components of its default management procedures could facilitate greater access to clearing. For example, FICC would plan to consider whether expressly providing for porting a defaulting direct participant's indirect participant positions may increase confidence among indirect participants and facilitate greater clearing.

V. DTCC and FICC Agree that Treasury CCAs Should Separately Calculate, Collect, and Hold Indirect Participant Margin Consistent with Sound Risk Management

A. The Segregation Proposal Would Protect Customers While Preserving Flexibility

The Proposal would require U.S. Treasury CCAs to calculate, collect, and hold Indirect Participant Margin separately from margin posted in respect of that direct participant's proprietary positions.[79] The Commission notes that this limitation would protect indirect participants and Treasury CCAs by preventing netting of indirect participant positions against direct participant positions for margin calculation purposes. The Proposal would not, however, preclude Treasury CCAs from netting indirect participant positions against one another for margin calculations. Rather, Treasury CCAs and their participants would retain the freedom to decide whether to use a model that calculates margin on an indirect participant-by-indirect participant basis (often referred to as "gross margining") or one that nets indirect participant positions together for margin calculation purposes (known as "net margining").

DTCC and FICC support these amendments as a measure to limit losses to an indirect participant arising from the default of its direct participant clearing member. DTCC and FICC also agree with the Commission that participants should retain the freedom to use a model that provides for net margining of indirect participant positions rather than gross margining. FICC's Sponsored Member Service currently provides for gross margining—FICC calculates a sponsoring member's clearing fund requirements as the sum of the clearing fund required for each sponsored member portfolio guaranteed by the sponsoring member. By contrast, FICC margins positions under its Prime Brokerage Clearing and Correspondent Clearing models on a net basis, with all positions netted together.

DTCC and FICC believe that this flexibility allows market participants to select the margining approach that best fits their preferences and the nature of their relationship. Indirect participants that are used to net margining arrangements of the sort adopted by the OCC may prefer net margining, as it may translate into lower costs. This may particularly be the case if a direct participant does not pass through the margin requirements to their indirect participants such that its indirect participants do not have any of their own funds at risk. By contrast, participants that are used to the gross margining applicable to the U.S. futures market may prefer to clear through the Sponsored Member Service to limit fellow customer risk. In addition, if indirect participants that use (or wish to use) the Prime Brokerage Clearing or Correspondent Clearing models express a preference for gross margining, FICC would be willing to establish accounts for these models that enable gross margining.

[79] Proposed Rule, *supra* note 1, at 64682.

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B. The Commission Should Clarify Whether the Segregation Proposal Precludes Treasury CCAs from Using Indirect Participant Margin for Liquidity or Loss Mutualization Purposes

The Proposal does not address whether the Segregation Proposal would limit the ability of Treasury CCAs to use Indirect Participant Margin for liquidity purposes. As noted above, FICC's Rules allow it to use clearing fund temporarily upon a participant default to complete settlement with non-defaulting participants. FICC then liquidates the securities received in such settlements to replenish the clearing fund, with losses resulting from such liquidation borne first by the defaulting participant and then through FICC's own corporate contribution. Any remaining losses are allocated through FICC's loss mutualization Rules, rather than on the basis of whose clearing fund was used for liquidity purposes.

DTCC and FICC ask the Commission to make clear whether, if adopted, the Segregation Proposal would limit FICC's ability to use Indirect Participant Margin for this purpose. In making such a determination, we recommend the Commission carefully consider both the costs and benefits of such a limitation. With respect to costs, we note that FICC does not have access to the Federal Reserve's discount window or its Standing Repo Facility and therefore developed CCLF to ensure it can continue performing in the event of a participant default. Although CCLF imposes costs on participants, FICC's ability to use clearing fund for liquidity purposes allows it to calibrate lower CCLF requirements and thereby limit these costs. Were FICC unable to use a significant portion of its clearing fund for liquidity purposes, it may need to increase CCLF requirements. Such an increase would increase costs to direct participants, which such direct participants may pass on to their indirect participants. In terms of benefits, DTCC and FICC note that FICC's decision to use the clearing fund of a participant to cover its liquidity needs does not expose such participant to material risk; rather, any losses incurred in connection with such usage are allocated first to the defaulting participant, then to FICC's corporate contribution, then in accordance with FICC's loss mutualization provisions. Accordingly, inhibiting FICC's ability to use clearing fund would not appear to provide significant protection to indirect participants.

We also ask the Commission to make clear in any final rule whether the Segregation Proposal limits Treasury CCAs' ability to use Indirect Participant Margin for loss mutualization purposes. Pursuant to the CCAS and in consultation with its participants and regulators, FICC has developed a loss mutualization methodology to ensure that FICC is able to continue performing in the highly unlikely event that the clearing fund and other assets of a defaulting direct participant plus FICC's corporate contribution are insufficient to cover losses resulting from the default. FICC's loss mutualization methodology aims to allocate any such losses fairly and equitably to direct participants based on the size of their clearing fund deposits, and thus the amount of risk they bring into clearing. To the extent a direct participant fails to perform its obligation to pay the amount of losses allocated to it, FICC is permitted under its Rules to cease to act for the participant and use its clearing fund to cover such losses.

DTCC and FICC ask the Commission to make clear in any final rule implementing the Segregation Proposal whether Treasury CCAs would be permitted to continue using Indirect Participant Margin in this manner or would instead need to ring-fence such margin. To the extent the Commission requires ring-fencing, it should make clear whether such ring-fencing allows Treasury CCAs to apply Indirect Participant Margin posted by a direct participant (i) to any indirect participant obligations carried by that direct participant or (ii) only to those obligations of the indirect participant on whose

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behalf such margin was posted. In considering these issues, the Commission should bear in mind the differences between FICC's margin collection practices and those of other clearing organizations. As discussed above, unlike other clearing organizations, FICC does not require indirect participants to post clearing fund in respect of their positions. Rather, FICC imposes the clearing fund posting obligation directly on the direct participant. Accordingly, if indirect participants do not wish to be exposed to the risk of loss on margin, they need not take on such risk. Instead, they may agree with their direct participant that the direct participant will fund such margin and bear any losses on such margin.

Each of these options has different implications for clearing costs. An indirect participant that elects not to post any clearing fund will need to compensate its direct participant both for providing the funding necessary to cover the margin requirements associated with the positions and for bearing the risk of loss on such margin. By contrast, an indirect participant that has and is willing to fund the clearing fund required for its positions and to bear the risk of loss on such margin will be able to clear its transactions for a much lower cost. Currently, some indirect participants elect to post clearing fund to support their positions and reap the associated cost reductions, while others either cannot post such margin for regulatory or other reasons or simply elect not to post such margin and pay higher spreads or fees. DTCC and FICC expect that this split will continue if the Commission adopts the Membership Proposal.

Were the Commission to prohibit Treasury CCAs from using Indirect Participant Margin for loss mutualization purposes, FICC would likely need to collect additional clearing fund from direct participants in order to fill the gap left by the unavailable Indirect Participant Margin. FICC would likely need to collect even more clearing fund were the Commission to provide that a Treasury CCA may only use Indirect Participant Margin for the obligations of the specific indirect participant on whose behalf the margin was posted.

Direct participants would incur funding, capital, and credit risk costs on such additional clearing fund, which costs they may pass on to indirect participants, either through increased clearing fees or reduced clearing capacity. Those indirect participants who post clearing fund to support their positions would receive corresponding benefits in exchange for these costs. However, others, such as those who do not (or cannot) post clearing fund, may realize no benefits and may only incur additional spreads and fees. The Commission should carefully consider these respective costs and benefits and their effects on FICC's open-access model. At the very least, both FICC and market participants require clarity so that they can implement the Segregation Proposal consistently with the Commission's intent.

VI. Any Final Rule Adopting the Membership Proposal and Segregation Proposal Should Be Subject to an Appropriate Implementation Timeline

If the Commission adopts the Membership Proposal and Segregation Proposal in any form, that will significantly increase the number of transactions that market participants must submit for clearing and change the way in which they collect and post Indirect Participant Margin. It will take market participants substantial time to scope the transactions subject to the requirement, execute the documentation necessary to submit such transactions for central clearing, implement internal procedures and systems to monitor and ensure compliance, and establish the relevant accounts and operational integrations with a Treasury CCA. Concurrently, FICC will need to develop and test the systems, operations, and documentation needed to accommodate a far greater volume of transactions, create a strategy and framework to identify and monitor compliance, and establish margin segregation

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arrangements. FICC will also need to prepare and submit to the Commission amendments to its Rules to implement any such changes. The Commission, the FRB, and market participants will need to review and comment on such proposed amendments and the associated systems, operations, and documentation arrangements.

Based on our preliminary analysis, and in light of other fundamental systematic changes in the securities market, including the shift to a T+1 settlement cycle for most broker-dealer securities transactions, DTCC and FICC believe market participants will need until at least 2025 to implement any final rule. In addition, given the scope of the required changes, we believe it would be sensible to implement any final rule in phases, whereby different requirements become effective successively, commencing with the Segregation Proposal.

Ultimately, however, it will be difficult to predict how long it will take to implement any final rule until the details of such final rule are clear. Accordingly, DTCC and FICC believe it would not be advisable for any final rule to set out a definitive implementation timeline. As past experience with Title VII of the Dodd-Frank Act and other major regulatory initiatives demonstrates, such prescriptive timelines often require frequent adjustment and result in uncertainty. Instead, DTCC and FICC believe that it would make sense for the Commission to prescribe a consultative approach to developing a timeline. Specifically, DTCC and FICC recommend that, if the Commission adopts the Proposal, it also require Treasury CCAs to submit to the Commission a proposed rule change containing an implementation schedule by no later than 180 days after the publication of the final rule in the *Federal Register*. Such proposed rule change should be submitted pursuant to Section 19 of the Exchange Act.

Such an approach would give market participants, regulators, and the public the ability to comment on the timing and requirements set forth in the proposed rule with the benefit of knowing the Membership Proposal's full scope. The Commission and FICC could then consider those comments in adopting a final implementation schedule. DTCC and FICC believe that this kind of deliberative and consultative approach would facilitate the adoption of a more realistic timeline and thereby avoid the need for successive extensions and the attendant uncertainty and disruption such shifting timelines present.

VII. DTCC and FICC Strongly Support Allowing Broker-Dealers to Record a Debit in the Reserve Account Formula for Margin Posted to Treasury CCAs, But Recommend the Commission Not Condition Such Debit on Requirements that Do Not Apply to Other Clearing Organizations

The Proposal would amend Rule 15c3-3a to permit broker-dealers to record a debit in the reserve formulas for customer accounts and proprietary accounts of broker-dealers ("PABs") equal to the margin required and on deposit at a Treasury CCA in relation to customer U.S. Treasury transactions, subject to certain conditions.[80] DTCC and FICC strongly support amending the reserve formula to allow broker-dealers to include a debit for customer margin. Such a change would facilitate access to clearing by reducing costs, place broker-dealer customers on a level playing field with other indirect participants, and extend to margin held at FICC the same treatment as margin posted to other clearing organizations. In addition, since margin posted to FICC in relation to customer positions would be "customer property" under the Securities Investor Protection Act ("SIPA"), and FICC maintains such

[80] Proposed Rule, *supra* note 1, at 64619.

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margin at the Federal Reserve Bank of New York (the "FRBNY") and federally regulated banks, such margin would be available to satisfy customer claims upon a broker-dealer insolvency.

However, DTCC and FICC note that many of the Proposal's conditions for recognizing the debit are more onerous than those that apply to margin posted to other clearing organizations. For example, one condition is that the Treasury CCA must calculate customer margin on a gross basis, even though other clearing agencies whose margin is eligible for a debit engage in net margining. In addition, FICC, like other clearing agencies and DCOs, currently provides broker-dealers and other direct participants with statements showing any excess clearing fund and allows broker-dealers to withdraw such excess. The Proposal, however, would condition the debit on a Treasury CCA pushing such excess to broker-dealers regardless of whether they make any request.

We suggest that the Commission carefully consider these proposed inconsistencies and ensure that they are appropriate and would not unnecessarily restrict customer choice or expose customers to risk. Furthermore, we ask that the Commission ensure that the requirements applicable to the debit are interpreted in a practical manner consistent with well-established and accepted clearing organization practices. Lastly, we ask that the Commission clarify whether a Treasury CCA's use of customer margin for liquidity and loss mutualization purposes would preclude a broker-dealer from recording a debit in the formula and, if so, whether a Treasury CCA would need to apply customer margin strictly to the obligations of the customer on whose behalf such margin was posted.

A. Amending the Reserve Formula Would Allow Broker-Dealer Customers to Access Clearing at a Lower Cost

DTCC and FICC agree with the Commission that the proposed amendment to Rule 15c3-3a "alone, could create incentives for greater clearing."[81] This is because it would substantially reduce the costs that broker-dealers incur and may pass on to customers in relation to clearing customer positions.

Under the existing customer protection rule, broker-dealers are able to (and under the margin rules required to)[82] collect collateral from a customer to secure such customer's obligations under the cleared U.S. Treasury securities positions the broker-dealer carries for the customer. However, the broker-dealer is not able pass that margin through to the clearing organization. Instead, the broker-dealer must hold that margin in a good control location or in a reserve account and redirect the broker-dealer's own funds, or borrow funds, to provide margin to FICC. This is notably different from the treatment of margin posted to the OCC and DCOs. Broker-dealers are generally able to record a debit in the formula for margin posted to these clearing organizations and thereby both collect the margin from customers and pass it on to the clearing organization.

The requirement for a broker-dealer to self-finance customer margin makes it substantially more expensive for the broker-dealer to provide access to FICC. Effectively, in order to clear a customer position, the broker-dealer must borrow (either from itself or from third parties) all of the clearing fund required for customer positions, even though the broker-dealer may have received such clearing fund

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[81] *Id.* at 64668.

[82] It is generally understood that a broker-dealer's guarantee of a customer's cleared and unsettled securities positions is an extension of credit for purposes of Regulation T and FINRA Rule 4210 and thus subject to initial and maintenance margin requirements thereunder.

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from the relevant customers. Customers are likely ultimately the ones that bear the cost of this financing in the form of higher spreads and fees, plus reduced clearing capacity. As interest rates rise, these costs rise as well. For example, if a broker-dealer direct participant were carrying customer positions having a clearing fund requirement of $100 million and the broker-dealer's cost of funding were 8%, the broker-dealer would need to spend $8 million per year to cover the clearing fund, even if customers had posted $100 million of collateral to the broker-dealer.

These costs not only increase the costs of, and close off access to, clearing, but they also put broker-dealers and broker-dealer customers at a distinct competitive disadvantage. Other direct participants of FICC, such as banks, are not subject to the same limitations. Rather, they are able not only to collect margin from customers, but also to pass on such margin to FICC. As a result, allowing broker-dealers to record a debit in the reserve formula would facilitate greater access to clearing and eliminate an undue burden on competition.

Moreover, margin posted to FICC would, just like margin posted to the OCC or a DCO, benefit from protection under SIPA. Such margin would constitute "customer property" under the SIPA since it is "cash and securities . . . received, acquired, or held . . . for the account of a [broker-dealer] . . . from or for the securities accounts of a customer."[83] In addition, customer claims for the return of such margin would be "customer claims" under SIPA because they are "on account of securities received, acquired, or held by [a broker-dealer] in the ordinary course of its business as a broker or dealer from or for [a securities account]. . . as collateral," and cash deposited with a broker-dealer for the purpose of purchasing securities.[84] As a result, in the event of a broker-dealer insolvency, customers would be subject to the same SIPA protections that apply to other cash and securities held with the broker-dealer.

In addition, margin maintained at FICC would be subject to stricter safekeeping requirements than apply to margin held at other locations permitted under Rule 15c3-3. FICC holds its clearing fund consisting of securities at banking organizations that are subject to comprehensive federal regulation. Such banks are a good control location under Rule 15c3-3 and a permitted depository for the customer reserve account. FICC maintains clearing fund consisting of cash, meanwhile, strictly at the FRBNY.[85] Not only is this a permitted depository for the customer reserve account, but it also presents substantially less credit risk than other permitted depositories. Other such depositories, such as commercial banks, lend out funds they have on deposit, which exposes customers to the bank's insolvency. By contrast, cash held at the FRBNY does not carry any credit risk. Accordingly, maintaining margin at FICC should provide broker-dealer customers with substantially similar, and arguably greater, protection than maintaining such collateral in a commercial bank account.

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[83] 15 U.S.C. § 78lll(4).

[84] 15 U.S.C. § 78lll(2).

[85] Although FICC's investment policy allows cash clearing fund to be held in overnight deposits at commercial banks subject to credit oversight, as a practical matter FICC maintains all cash clearing fund at the FRBNY.

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B. The Conditions Applicable to the 15c3-3a Debit Should be Practical and Protective of Customers

The Proposal includes a number of conditions that a Treasury CCA must satisfy in order for a broker-dealer to record a debit in the reserve formula.[86] Many of these conditions are consistent with conditions that apply to other margin and serve to protect customers. For example, we agree with the Commission that customer margin should be held in segregated accounts when such is possible and that Treasury CCAs should not apply customer margin to obligations arising from the broker-dealer's proprietary positions.

However, the Proposal also contains conditions that do not apply to margin posted to other clearing organizations and that do not appear to protect customers. For example, the Proposal would condition the availability of the debit on the Treasury CCA using gross margining methodology for customer positions, even though other clearing agencies whose margin is eligible for a debit use net margining.[87] As noted above, some of FICC's clearing models provide for gross margining, while others utilize net margining. This is designed to allow indirect participants that prefer gross margining to opt into gross margining and those that prefer net margining to utilize a net margining arrangement. Although FICC would be able to build systems that allow broker-dealers to use the Prime Brokerage Clearing and Correspondent Clearing models on a gross margined basis, DTCC and FICC believe the Commission must clearly explain why such changes should be made at Treasury CCAs but not other clearing agencies in order for broker-dealers to record a debit in the formula.

In addition, the Proposal would require that Treasury CCAs return excess customer margin to a broker-dealer by no later than the close of the next business day after the day that such excess arises.[88] This requirement does not apply to margin posted to other clearing agencies or DCOs and does not seem to serve any customer protection benefit, considering that FICC holds clearing fund in the same or safer locations than is permitted under Rule 15c3-3. Furthermore, it would be challenging to implement this requirement because FICC does not have a mechanism to push excess margin to direct participants and direct participants do not have the capability of accepting unsolicited excess. Rather, similar to other clearing organizations, FICC regularly notifies direct participants of excess margin every time margin is calculated and then allows such direct participants to demand a return of such margin. Furthermore, some direct participants prefer to leave excess margin with FICC to serve as a buffer for future margin calls; as such, a mandatory return of excess would deprive direct participants of this buffer, potentially imposing procyclical stress on them. Therefore, we recommend that the Commission reconsider this aspect of the Proposal and instead seek to align the treatment of excess margin at Treasury CCAs with the approach used at other clearing agencies and DCOs.

If the Commission elects to condition the debit on Treasury CCAs returning excess customer margin to broker-dealers within a specified time period, DTCC and FICC would propose to satisfy that condition by amending FICC's Rules to require broker-dealer participants to make such demands as would be necessary to ensure a return within that time period. So long as the broker-dealer participant makes a demand within the timeframes set by FICC, FICC would return any excess margin by the

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[86] Proposed Rule, *supra* note 1, at 64680.

[87] Proposed Rule, *supra* note 1, at 64639.

[88] *Id*. at 64640.

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deadline required under Rule 15c3-3a.[89] Any other approach would require FICC and its broker-dealer direct participants to overhaul their systems, thereby increasing costs without providing any material benefits to customers.

Lastly, the Proposal would limit the availability of the debit to those specific assets that a broker-dealer collects from a customer and then on-posts to the Treasury CCA. This limitation, which does not apply to margin posted to other clearing organizations, could substantially undercut the benefit of the Debit Proposal. This is because FICC collects clearing fund on a faster timeline than broker-dealers are practically able to collect margin from their customers. Specifically, FICC collects margin from direct participants on an overnight and intraday basis, while most broker-dealers generally provide their customers with a full business day to post margin. As a result, most broker-dealers generally post clearing fund to FICC and then subsequently collect that clearing fund from their customers. Under the Debit Proposal, a broker-dealer would not be able to record a debit in the formula for this margin, even after the broker-dealer had received the margin from the customers. This restriction would not seem to serve any benefit, since by the time the broker-dealer receives the margin from the customer, it and the customer are in the same exact position as if the customer had posted the margin to the broker-dealer and then the broker-dealer had on-posted it to FICC. We therefore encourage the Commission to consider carefully whether this limitation is appropriate.

C. The Commission Should Clarify Whether Treasury CCAs May Use Customer Margin for Liquidity Risk Management and Loss Mutualization Purposes

As with the Segregation Proposal, we ask the Commission to make clear in any final rule whether the Debit Proposal would permit Treasury CCAs to use customer margin for liquidity risk management or loss mutualization purposes. DTCC and FICC ask that the Commission carefully consider the benefits and costs of any such limitations, particularly given FICC's lack of access to the Federal Reserve's discount window and Standing Repo Facility, and provide clear guidance. To the extent the Commission conditions the availability of the debit on a Treasury CCA ring-fencing customer margin, it should make clear whether such ring-fence allows a Treasury CCA to apply customer margin posted by a broker-dealer (i) to any customer obligations carried by that broker-dealer or (ii) only to those obligations of the customer on whose behalf such margin was posted. In our view, the costs and benefits of these possibilities are substantially the same as those that apply to similar limitations on Indirect Participant Margin. We discuss these limitations in Part V.B above. As with Indirect Participant Margin, limiting Treasury CCAs' ability to use customer margin for liquidity or loss mutualization purposes would require Treasury CCAs to seek greater liquidity and loss mutualization resources from direct participants, the costs of which may be passed on to customers. Such costs would likely further rise if the Commission were to prohibit customer margin from being used to cover the obligations of other customers. Such costs must be carefully balanced against the benefits of ring-fencing customer property. At minimum, we ask that the Commission provide clarity on these issues.

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[89] Of course, if market movements reduce or eliminate the excess between the date of the demand and the deadline under Rule 15c3-3a, FICC would only return the excess, if any, remaining following such market movements.

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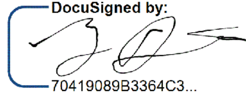
We appreciate the opportunity to comment on the Proposal and the Commission's consideration of our views. We look forward to continuing dialogue with the Commission regarding central clearing.

Very truly yours,



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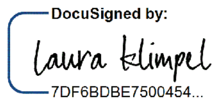

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Honorable Gary Gensler, Chairman, Securities and Exchange Commission

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Honorable Jaime Lizárraga, Commissioner, Securities and Exchange Commission