



December 27, 2022

**VIA ELECTRONIC SUBMISSION**

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 (File Number S7-23-22)**

Dear Sir or Madam:

CME Group Inc. (“CME Group”) appreciates the opportunity to comment on the Securities and Exchange Commission’s (“SEC” or “Commission”) Proposed Rule regarding 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 (the “Proposed Rule”).<sup>1</sup>

CME Group, a corporate holding company, wholly owns Chicago Mercantile Exchange Inc. (“CME”). CME is registered as a derivatives clearing organization (“DCO”) (“CME Clearing”) with the Commodity Futures Trading Commission (“CFTC”). CME Clearing offers clearing and settlement services for futures and options contracts, including those listed on CME Group’s CFTC-registered designated contract markets (“DCMs”), and cleared swap derivatives transactions. These DCMs are CME, Board of Trade of the City of Chicago, Inc. (“CBOT”), New York Mercantile Exchange, Inc. (“NYMEX”), and the Commodity Exchange, Inc. (“COMEX”) (collectively, the “CME Group Exchanges” or “Exchanges”). Through the Exchanges, CME Group offers the widest range of global benchmark products across all major asset classes based on interest rates, equity indexes, foreign exchange, energy, agricultural products, and metals.

BrokerTec Americas LLC (“BrokerTec”), a wholly-owned subsidiary of CME Group, is registered as a broker-dealer with the SEC and is also a member of the Financial Industry Regulatory Authority (“FINRA”). BrokerTec’s primary offering is a fully electronic trading platform that provides a central limit order book (“CLOB”) for the trading of U.S. Treasury securities to the professional trading community of banks, dealers, and proprietary trading firms. This includes purchases and sales of U.S. Treasury securities as well as repurchase agreements involving U.S. Treasury securities. BrokerTec also offers a direct streaming platform for U.S. Treasury securities and a request for quote (“RFQ”) platform for repurchase agreements involving U.S. Treasury securities. BrokerTec averages approximately 100,000 trades per day with an average total volume (single-sided) of approximately \$130 billion per day in cash U.S. Treasury securities and \$230 billion per day in U.S. Treasury repurchase agreements on the

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<sup>1</sup> 87 FR 205 (October 25, 2022).



CLOB. As a result, BrokerTec’s CLOB provides an important source of liquidity for many of the most critical participants in the U.S. Treasury securities markets, and the spreads are one of the best indicators for how robust U.S. Treasury securities’ liquidity is at any given moment.

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## I. BENEFITS OF CENTRAL CLEARING

CME Group has long supported initiatives that recognize the time-tested benefits of centralized clearing. Among other benefits, central clearing provides markets with enhanced resiliency, greater transparency, efficiencies via multilateral netting, standardized settlement processes, and a reduction in counterparty credit risk.

Specific to the Proposed Rule, more centralized clearing of U.S. Treasury securities could substantially reduce the number of settlement fails. Trades that do not settle on their scheduled date can produce a daisy-chain effect, whereby a firm fails to deliver to another firm, and that firm fails to deliver to another, and so on. Centralized clearing reduces these daisy-chain effects, with research indicating that centralized clearing could reduce settlement fails by 74% in certain segments of the U.S. Treasury securities market.<sup>2</sup> In fact, it has been estimated that during one of the most recent periods of market stress—March 2020—dealers’ gross settlement obligations might have been 60% lower had they been able to centrally clear all of their dealer-to-customer transactions.<sup>3</sup> Central clearing also provides regulators with greater transparency by simplifying data collection and improving visibility into market conditions.<sup>4</sup> Given that only 13% of the U.S. Treasury securities cash market is currently centrally cleared, even a modest increase in scope would provide the Commission with significantly more insight into the U.S. Treasury securities market.<sup>5</sup>

## II. IMPORTANCE OF THE U.S. TREASURY SECURITIES MARKET

The U.S. Treasury securities market is vitally important to the U.S. economy, representing the deepest and most liquid government securities market in the world. Preserving those high levels of liquidity is of paramount importance. Further, U.S. Treasury securities play a unique role in the global economy, serving as the primary means of financing the U.S. federal government, a conduit for the Board of Governors of the Federal Reserve System’s implementation of monetary policy, a critical store of value and hedging vehicle for global investors and savers, and the key risk-free benchmark for other financial

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<sup>2</sup> The Netting Efficiencies of Marketwide Central Clearing, Federal Reserve Bank of New York Staff Reports no. 964, Michael Fleming and Frank Keane (April 2021) (“Fleming & Keane”) at page 25, *available at* [https://www.newyorkfed.org/medialibrary/media/research/staff\\_reports/sr964.pdf](https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr964.pdf)

<sup>3</sup> Fleming & Keane at page 2.

<sup>4</sup> Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report, Staffs of the U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Reserve Bank of New York, U.S. Securities and Exchange Commission, and U.S. Commodity Futures Trading Commission (November 2021), (“Inter-Agency Working Group for Treasury Market Surveillance (“IAWG”) Report”) at page 30, *available at* <https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf>.

<sup>5</sup> The Treasury Market Practice Group estimated that, as of the first half of 2017, 13% of the overall volume in U.S. dollars of U.S. Treasury cash transactions were centrally cleared. Proposed Rule at 64613.

instruments.<sup>6</sup> In addition, U.S. Treasury securities are generally regarded as the world’s premier safe or “risk-free” asset. It is therefore critical to have an appropriate regulatory framework which supports this market and does not jeopardize its liquidity.

While, as noted above, the U.S. Treasury securities market is currently one of the most liquid markets in the world, CME Group believes it is prudent for the SEC and other policy-makers to work together to study this market and carefully evaluate whether any regulatory policy changes would enhance its resilience. It is critical that any significant change to the current market structure be closely evaluated in a manner that considers both the high levels of liquidity under normal market conditions and the potential threats to liquidity that have arisen during past market disruptions. Accordingly, we would recommend a cautious and deliberate approach. While expanding centralized clearing U.S. Treasury securities transactions is a worthy goal, it must be accomplished in a manner that does not risk diminished liquidity or cause adverse implications for the broader interconnected financial markets, including derivatives markets.

### **III. PROPOSED RULE**

The Proposed Rule can be divided into two distinct, but related, initiatives. First, the Proposed Rule would require covered clearing agencies that provide central counterparty services for U.S. Treasury securities (“Treasury CCAs”)—which currently includes only the Fixed Income Clearing Corporation (“FICC”)—to have certain policies and procedures with respect to indirect participant margin and appropriate access to Treasury CCAs, including for indirect participants. The Proposed Rule would also amend an SEC rule to permit broker-dealers to include as a debit item in the customer reserve formula certain margin on deposit at a Treasury CCA. We classify the foregoing proposals as “infrastructure enhancements” for purposes of this comment letter. Second, the Proposed Rule would expand the scope of transactions that Treasury CCAs must require their direct participants to clear, which we classify as an “expanded clearing requirement.”

### **IV. PROPOSED RULE — INFRASTRUCTURE ENHANCEMENTS**

The proposed infrastructure enhancements would:

- Require Treasury CCAs to have policies and procedures to calculate, collect, and hold margin for a direct participant’s proprietary positions in U.S. Treasury securities separately from margin posted by that participant for U.S. Treasury securities transactions by an indirect participant.
- Require Treasury CCAs to have policies and procedures to ensure that they have appropriate means to facilitate access to clearing and settlement services for all eligible secondary market transactions in U.S. Treasury securities, including those of indirect participants.
- Amend the broker-dealer customer protection provisions in Securities Exchange Act Rule 15c3-3a to permit margin required and on deposit at a Treasury CCA to be included as a debit item in

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<sup>6</sup> See Joint Staff Report: The U.S. Treasury Market on October 15, 2014, *available at* <https://www.sec.gov/files/treasury-marketvolatility-10-14-2014-joint-report.pdf> (“October 15 Staff Report”).



the customer reserve formula, thereby freeing up resources that could be used to meet the margin requirements of a Treasury CCA.

CME Group supports the proposed infrastructure changes, consistent with our support of regulatory initiatives that appropriately incentivize centralized clearing. Certain proposed features, such as customer segregated accounts, resemble the successful agency clearing models with which CME Group is familiar in the futures markets. Effective customer segregation regimes are time tested, and recent events have once again underscored their value.

CME Group recommends a two-phase approach under which the Commission would adopt the enhancements before moving forward with expanded clearing requirements. In our view, this sequencing is appropriate because not only are the proposed infrastructure enhancements quite significant, but they also are essentially a condition precedent to the success of expanded clearing requirements. The Proposed Rule calls for FICC to ensure that it has “appropriate means to facilitate access to clearance and settlement services of all eligible secondary market transactions in Treasury securities, including those of indirect participants.”<sup>7</sup> However, the Proposed Rule does not prescribe exactly how this is to be accomplished. This uncertainty is a principal reason why it is important to implement the infrastructure enhancements—which are intended to facilitate greater access to clearing—first.

CME Group is aware that FICC has already established certain modes of access for indirect participants. However, we imagine that these modes may need to be amended or supplemented with additional pathways to pave the way for the significant expansion of clearing envisioned in the Proposed Rule. Some participants in the U.S. Treasury securities market have called for expanded access models in various forms and noted limitations on the existing models.<sup>8</sup> For the proposed clearing requirements to be workable, it is important that all indirect participants that may be brought into scope have an access model that is efficient and fit for purpose before any such requirements become effective.

A two-phase approach would also be the most effective path to increase voluntary clearing, while minimizing the risk of unintended market disruptions or a decrease in liquidity that may result from a mandate. Once those infrastructure enhancements have been adopted, the SEC will be better positioned to consider whether those enhancements alone might provide the increased resiliency the SEC is seeking to achieve. To the extent, after such an evaluation, the SEC determines it is still necessary to move forward with the expanded clearing requirement, it would be better situated to do so.

## **V. PROPOSED RULE — EXPANDED CLEARING REQUIREMENT**

As proposed, the amendments to Securities Exchange Act Rule 17Ad-22 would require Treasury CCAs to have policies and procedures designed to require their direct participants to submit for clearing all eligible secondary market transactions, which would include the following transactions:

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<sup>7</sup> Proposed Rule at 64610.

<sup>8</sup> Clearing a Path to a More Resilient Treasury Market, FIA Principal Traders Group (July 2021), *available at* [https://www.fia.org/sites/default/files/2021-07/FIA-PTG\\_Paper\\_Resilient%20Treasury%20Market\\_FINAL.pdf](https://www.fia.org/sites/default/files/2021-07/FIA-PTG_Paper_Resilient%20Treasury%20Market_FINAL.pdf).

- (i) All repurchase and reverse repurchase agreements collateralized by U.S. Treasury securities to which a direct participant is a counterparty;
- (ii) All purchase and sale transactions of U.S. Treasury securities for direct participants who are acting as interdealer brokers (“IDBs”);<sup>9</sup> and
- (iii) All purchases and sales of U.S. Treasury securities between a direct participant and (i) a registered broker-dealer, (ii) government securities dealer, or government securities broker; (iii) a hedge fund; and (iv) a leveraged account.

Certain transactions would be exempted, including purchase or sale transactions or repurchase or reverse repurchase agreements in which one counterparty is a central bank, a sovereign entity, an international financial institution, or a natural person.

As noted above, CME Group supports the Commission’s goal of increasing the number of U.S. Treasury securities trades that are centrally cleared. To the extent the Commission determines to move forward with its expanded clearing requirement, it is important that it does so carefully. In particular, clearing requirements that are uneven in their application could have important and unintended consequences. We do not believe the Proposed Rule would produce such negative results and, in fact, appears to have been drafted carefully to avoid them. However, if the Commission ultimately adopted a clearing requirement that allowed market participants to shift their trading activity away from certain venues to avoid mandatory clearing, the Commission should expect that they would do so, with potential damaging effects to liquidity.

We raise this concern because we anticipate that some might argue that the scope of the proposed clearing requirement should be significantly narrowed. For example, certain commenters may contend that the costs of clearing certain trades brought into scope by the Proposed Rule (e.g., a dealer-to-client over-the-counter trade) do not justify the benefits. These same commenters might also endorse the proposed requirement to centrally clear transactions on IDB platforms. If the Commission accepted this uneven approach, market participants that currently trade on an IDB CLOB would be incentivized to execute their transactions bilaterally and away from the IDB in order to avoid the clearing requirement. Such a result would severely damage liquidity on these important venues, which provide critical price discovery in the U.S. Treasury securities market. This harmful impact on liquidity would contravene the objective of the Commission’s Proposed Rule. Any clearing requirement should apply to the category of market participants that the Commission wishes to capture rather than turn on the nature of the transaction execution venue.

In fact, the Proposed Rule evaluated an IDB-only approach but correctly rejected it.<sup>10</sup> Thus, as the Proposed Rule is drafted, there is no incentive for the market participants the proposal seeks to cover to

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<sup>9</sup> The Proposed Rule defines IDBs as electronic platforms that bring together buyers and sellers anonymously using order books or other trading facilities supported by advanced electronic trading technology, where the IDB is principal or counterparty to the buyer and the seller in two separate transactions. The Proposed Rule clarifies that the term IDB, as used in the Proposed Rule, does not include platforms that provide voice-based or other non-anonymous methods of bringing together buyers and sellers of U.S. Treasury securities. Proposed Rule at 64615.

<sup>10</sup> As the Proposed Rule correctly notes, such an approach would be limited in terms of operational and balance sheet efficiency. Further, the Proposed Rule recognizes that such an approach would not capture types of

trade away from the CLOB to avoid a clearing requirement. The Commission should not deviate from that approach.

## **VI. LIMITED EXCLUSIONS**

### **A. DCO Repurchase Transactions**

While CME Group would strongly caution against paring back the expanded clearing requirement in the manner set out above, we recognize that limited exceptions are appropriate. For example, the proposed Official Sector Exclusions appear reasonable. We recommend further expanding the exclusions to include U.S. Treasury securities transactions entered into by DCOs registered with the CFTC. We recognize that DCOs are not specifically enumerated as an entity type subject to the expanded clearing requirement. However, in practice, it would be impractical for DCOs to avoid repurchase transactions with direct participants of Treasury CCAs, which would be included in the expanded clearing requirement. Because DCOs cannot reasonably avoid becoming subject to the expanded clearing requirement with respect to these transactions, CME Group believes a limited exclusion is necessary and appropriate.

Generally speaking, DCOs may engage in U.S. Treasury securities repurchase or reverse repurchase transactions for either default management or cash management purposes. DCOs maintain relationships with a diverse set of counterparties for these purposes. From a default management perspective, DCOs may determine it is necessary to enter into repurchase transactions to access liquidity to manage a clearing member's default. These relationships—particularly having access to multiple counterparties—can therefore be paramount. Further, DCOs need flexibility to set bespoke terms with respect to settlement timing. For example, a clearing member's default could be successfully managed by a DCO in the following manner:

If a clearing member were declared in default for failing to meet its payment obligation to CME Clearing, CME Clearing could enter into a same-day starting repurchase transaction to meet its payment obligations to non-defaulting clearing members. To illustrate, assume that for an end-of-day settlement cycle for settlement variation, a settlement bank did not confirm a debit from the defaulting clearing member's U.S. Dollar variation account by the 7:30 AM CT deadline. One default management action available to CME Clearing is to execute a same-day starting repurchase transaction using the defaulting clearing member's U.S. Treasury securities posted as margin and settle it within 60 minutes, allowing CME Clearing to make its settlement variation payment to non-defaulting clearing members (and thus, settlement banks could confirm debits from CME Clearing's accounts for credit to these non-defaulting clearing members' accounts by the standard 8:30 AM Chicago deadline).

It is important to allow DCOs to retain the flexibility necessary to effectively manage risk, with respect both to access to the appropriate counterparties and to pressing time considerations. In sum, requiring DCOs—including those that have been deemed systemically important—to centrally clear their U.S.

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participants that are usually leveraged and therefore, as stated in the Proposed Rule the “benefits of the rule with respect to financial stability, margin offsetting and visibility of risk would be curtailed.” Proposed Rule at 64672.

Treasury securities repurchase or reverse repurchase transactions could undermine the effectiveness of their default management practices.

Applying the clearing requirement to DCOs would also threaten their effective cash management. DCOs regularly receive U.S. Dollar cash as margin from clearing members and are permitted by the CFTC to enter into reverse repurchase transactions involving U.S. Treasury securities. But such transactions must meet the conditions set out in CFTC Regulation 1.25, some of which (e.g., permissible counterparties and counterparty concentration limits) would appear to be in tension with the Proposed Rule. Specifically, permitted counterparties are limited to banks, domestic branches of foreign banks, securities brokers or dealers, or government securities brokers or government securities dealers.<sup>11</sup> Notably, a clearing agency is not a permitted counterparty. However, should the transactions be centrally cleared, the clearing agency would novate the transactions and, in fact, become the counterparty. Thus, the transactions would be prohibited by the rule. Because reverse repurchase transactions are important for DCOs to manage their U.S. Dollar cash effectively, while also promoting diverse counterparty exposures and preserving operational capabilities for potential default management needs, the proposed clearing requirements should not apply to DCOs.

Finally, requiring DCOs to clear U.S. Treasury securities transactions would be inconsistent with the spirit, and we believe the letter, of the Commodity Exchange Act (“CEA”). CEA Section 5b(f)(1) states that “under no circumstances shall a [DCO] be compelled to accept the counterparty credit risk of another clearing organization.”<sup>12</sup> As noted above, DCOs cannot avoid entering into U.S. Treasury securities repurchase or reverse repurchase transactions with direct members of Treasury CCAs. If those transactions are subject to a clearing requirement, they would novate to the Treasury CCA and, as a result, CME Clearing would be compelled to accept the counterparty credit risk of the CCA, contrary to the CEA.

For all of these reasons, any U.S. treasury securities clearing requirement should exclude repurchase and reverse repurchase agreements entered into by DCOs. Such an exclusion would not be problematic from a financial stability perspective, because DCOs, like the entities covered by the proposed Official Sector Exclusions, engage in U.S. Treasury securities transactions that present limited to no risk of contagion.

## **B. Physically-Settled Treasury Futures Contracts**

While an exclusion from the proposed clearing requirements would be needed for DCOs, CME Group requests that the Commission simply make clear that any clearing requirement it adopts does not apply to final settlement under physical-delivery futures contracts on U.S. Treasury bonds or notes (“Treasury Futures”). As the Commission may be aware, one of the CME Group Exchanges—CBOT—lists these contracts for trading. These Treasury Futures are physically-settled. This means that, while only a small share of Treasury Futures actually go to physical delivery, should a participant hold a position in an expiring Treasury Future during its delivery month, it may be required to fulfill the contractual obligation either to deliver or to take delivery of contract grade U.S. Treasury securities. The Treasury Futures complex of course is neither intended nor organized to serve as a primary marketplace for the transfer of

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<sup>11</sup> 17 CFR 1.25

<sup>12</sup> 7 USC 7a-1(f)(1)



U.S. Treasury securities.<sup>13</sup> When market participants execute a Treasury Futures trade on a CLOB, it is anonymous. Similarly, market participants cannot exert control over who their counterparty is with respect to the delivery obligation. Deliveries are facilitated by and occur between clearing members, acting as agents for the given market participants or on behalf of a proprietary account; deliveries do not occur directly between the market participants themselves. Should a Treasury Futures contract go to delivery, CME Clearing would inform long clearing members of the details of the U.S. Treasury issues that will be delivered by the short position holders to whom they have been matched, and the invoice amounts that the short clearing members must receive in payment. Despite the broad scope of secondary market transactions in U.S. Treasury securities the Proposed Rule seeks to encompass, CME Group does not believe the Commission intended to cover the physical settlement under Treasury Futures due to the foregoing terms and conditions and, at risk of stating the obvious, the fact that Treasury Futures are already subject to a clearing requirement. CME Group asks the Commission to confirm that our understanding is correct.

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CME Group has long recognized that centralized clearing can bring fundamental improvements to financial markets. CME Group thus supports the Commission's objective to centrally clear more U.S. Treasury securities transactions. However, CME Group also recognizes that mandates can have unintended and disruptive consequences. In light of this concern, CME Group recommends that the Commission implement the infrastructure enhancements before moving forward with any expanded clearing requirements. And the Commission should not, under any circumstances, adopt any type of clearing requirement that would incentivize market participants to trade away from IDB venues at the cost of critical U.S. Treasury securities market liquidity. A careful, measured and balanced approach is imperative to achieve the Commission's policy objectives. Increased centralized clearing should not come at the cost of significantly diminished market liquidity, particularly on the platforms providing the most price discovery.

CME Group appreciates the opportunity to submit these comments to the SEC and looks forward to working with the SEC to strengthen the resilience of the U.S. Treasury securities market. If you have any comments or questions, please feel free to contact me at [REDACTED] or via email at [REDACTED].

Sincerely,

A handwritten signature in cursive script that reads "Jonathan Marcus".

Jonathan Marcus  
Senior Managing Director and General Counsel  
CME Group Inc.

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<sup>13</sup> See CME, *The Treasury Futures Delivery Process*, 7<sup>th</sup> Edition, available at <https://www.cmegroup.com/trading/interest-rates/files/us-treasury-futures-delivery-process.pdf>





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