December 27, 2022

Securities and Exchange Commission
100 F St 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 Fund Advisers (File No: S7-23-22)

Secretary Countryman,

The Americans for Financial Reform Education Fund ("AFREF") appreciates this opportunity to comment on the Securities and Exchange Commission's (the "Commission" or "SEC") proposals to require Covered Clearing Agencies (CCAs) to require new policies and procedures in place to collect more data on transactions in the secondary market of U.S. Treasuries, arguably one of the most critical and important securities markets in the world.

Background and Summary

The proper functioning of the $24 trillion US Treasury market as well as the $6 trillion repurchase agreement (repo) market are critical to ensuring the stability of the world's foremost safe asset, one whose safety is due in large part to its backing by the full faith and credit of the U.S. Government.

Despite that however, the U.S. Treasury market currently operates in a very outdated regulatory environment.

The regulatory regime is fragmented across several different agencies, with no single agency taking a clear lead on regulating the market.[1] As it stands, the Department of Treasury issues rulemaking and guidance on U.S. Treasuries, the SEC is responsible for overseeing the secondary market trading of Treasuries, the Commodity Futures Trading Commission (CFTC) the derivatives markets and futures tied to Treasuries, and the Federal Reserve Bank of New York conducts Treasury auctions in conjunction with the major "primarily dealers". The Interagency Working Group (IAWG) on the Treasury Market found that no single regulator or even market participant has a comprehensive view of the entire market.[2]

As steps to introduce more clarity and accountability we support the Commission's proposals to mandate that covered clearing agencies (CCAs) establish rules to require direct participants to report Treasury trades conducted with indirect participant clients and the Commission's

[1] Yadav, Yesha. Columbia Law Review. The Failed Regulation of U.S. Treasury Markets. May 2021. https://www.columbialawreview.org/wp-content/uploads/2021/05/Yadav-The_Failed_Regulation_of_US_Treasury_Markets.pdf

[2] Id. pg. 1186

proposal to require margin related to Treasury trades to be collected from both indirect and direct participants.

The Commission would also be able to gain greater insight into the Treasury market by finalizing its proposal earlier this year that would require principal trading firms engaging in a certain amount of buying and selling of U.S. Treasury securities and performing functions very similar to broker-dealers to officially register as broker-dealers with the SEC and become a member of a self-regulatory organization (SRO).[3]

We also want to reiterate our support for the SEC and CFTC's joint proposal earlier this year to require large hedge fund advisers to better reconcile a fund's net position from better cash and derivatives reporting over the SEC's Form PF and CFTC's Form CPO-PQR.[4]

Covered Clearing Agencies (CCAs) should require Treasury trade reporting from both direct and indirect participants to gain more insight into the Treasury market

We support the Commission's proposal to amend Rule 17Ad-22(e)(18) of the Exchange Act in order for CCAs to implement policies for direct participants, who are primarily banks and broker dealers. CCAs in turn would require direct participants to report much more of their secondary trading (currently limited to direct participants transactions with other direct participants) to direct participants' transactions with their customers and clients ("indirect participants") who often include hedge funds, mutual funds, and other end investors.

Specifically, we support the Commission's proposals to require CCAs to set policies on the collection of secondary market trading of U.S. Treasuries that include:

- All repurchase agreements (repo) and reverse repurchase agreements (reverse repo) collateralized by U.S. Treasuries involving direct participants as a counterparty
- All purchases and sales facilitated with direct participants acting as interdealer brokers (IDBs)
- All purchases and sales of U.S. Treasuries between direct participants and

As the Commission itself has found, it is shocking that a majority (68%) of trading in U.S. Treasuries is still not cleared through a central clearing agency (CCA). More trading done through CCAs would help reduce systemic risks in the U.S. Treasury market, provide regulators with much more data on trading in the Treasury markets, and also help clearinghouse participants better manage their risks.

The Commission and the Financial Stability Oversight Council (FSOC) need more information on the trading activity of indirect participants in CCAs especially because indirect participants include hedge funds who often employ significant leverage using the repo markets on their U.S. Treasuries holdings. The Financial Stability Oversight Council for example published recently that the average macro hedge fund takes on 32.9x of gross notional exposure to the fund's net

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[3] Hall, Stephen and Farnin, Scott. Better Markets. Re: Further Definition of "As Part of Regular Business" in the Definition of Dealer and Government Securities Dealer (File No: S7-12-22/RIN 3235-AN10). May 27, 2022. s71222-20129906-296068.pdf (sec.gov)

[4] Park, Andrew. Americans for Financial Reform Education Fund. Re: Amendments to Form PF to Amend Reporting Requirements for All Filers and Large Hedge Fund Advisers (File No: S7-22-22/RIN 3038-AF31). Oct 11, 2022. https://www.sec.gov/comments/s7-22-22/s72222-20145428-310648.pdf

asset value, and for funds employing a relative value strategy, 27.1x their total gross notional exposure to their net asset values.[5]

Such high levels of leverage were present leading up to March 2020 when several large hedge funds were engaged in trying to capture the small difference between the price of Treasury futures and their underlying cash bonds and using additional leverage to magnify those gains. Estimates of the total size of this trade range anywhere from $400 to $500 billion.[6]

Though this cash-futures basis trade was popular with industry participants, as the IAWG later found, no single regulator could easily see the full picture of what was happening. The CFTC only saw the short selling of the Treasury futures contracts while both the Commission and the Financial Industry Regulatory Authority (FINRA) saw the secondary market in US Treasury bonds. In addition, little to no data was being collected at the time on the Treasuries that were used in repo transactions, which the Treasury's Office of Financial Research has taken a lead on collecting now.[7]

In order to ensure that regulators and all market participants have a clearer, more comprehensive understanding of what is happening in the $24 trillion U.S. Treasury market as well as the repo markets associated with them, it is imperative for the Commission to finalize its proposed amendments to Rule 17Ad-22(e)(18) and require CCAs to set policies requiring direct participants to report both all of their Treasury secondary market transactions as well as those of the clients ("indirect participants").

Non-banks now account for a greater share of Treasury trading than primary dealers

The Commission's proposal to require CCAs to collect trading data from indirect participants is especially important given that non-banks now make up a significant portion of indirect participants, playing a much larger role in the secondary trading of Treasuries than they did in the past.

Since 2011, the Treasury market has grown larger than the assets of the six largest U.S. banks meaning that Treasury issuance can no longer rely just on balance sheets of banks to absorb the growth in issuance but must increasingly rely on non-banks who are indirect participants and whose Treasury trades are not currently being reported to a CCA.

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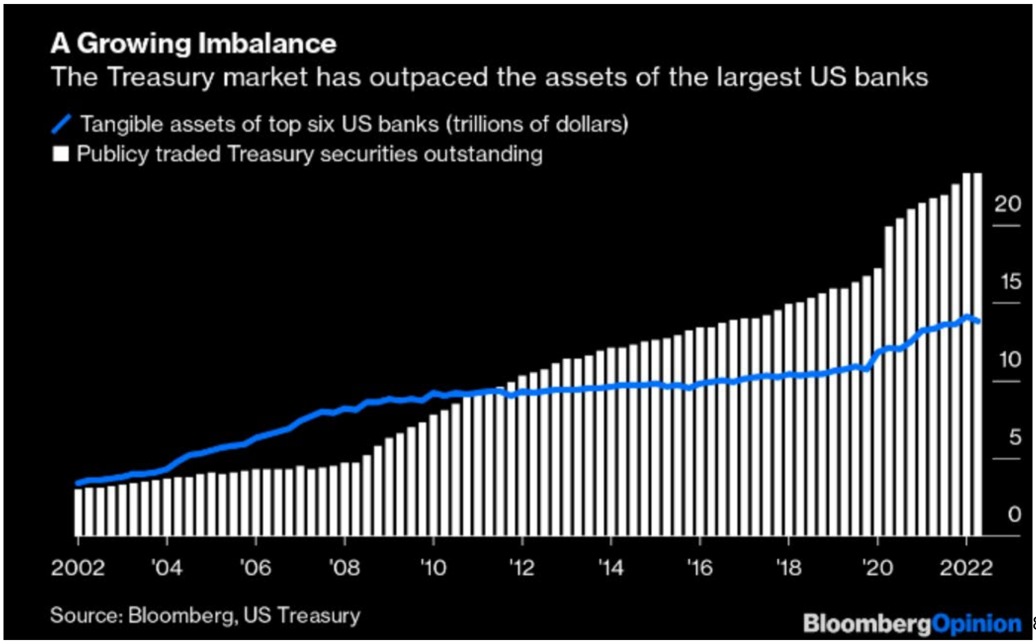
[5] Financial Stability Oversight Council. 2022 Annual Report. Dec 16, 2022. https://home.treasury.gov/system/files/261/FSOC2022AnnualReport.pdf

[6] Barth, Daniel and Kahn, Jay. Treasury Office of Financial Research. Hedge Funds and the Treasury Cash-Futures Disconnect. Apr 1, 2021. https://www.financialresearch.gov/working-papers/files/OFRwp-21-01-hedge-funds-and-the-treasury-cash-futures-disconnect.pdf

[7] Hempel, Samuel J; Kahn, Jay; Nguyen, Vy; and Ross Sharon Y. Treasury Office of Financial Research. Non-centrally Cleared Bilateral Repo. Aug 24, 2022. https://www.financialresearch.gov/the-ofr-blog/2022/08/24/non-centrally-cleared-bilateral-repo/



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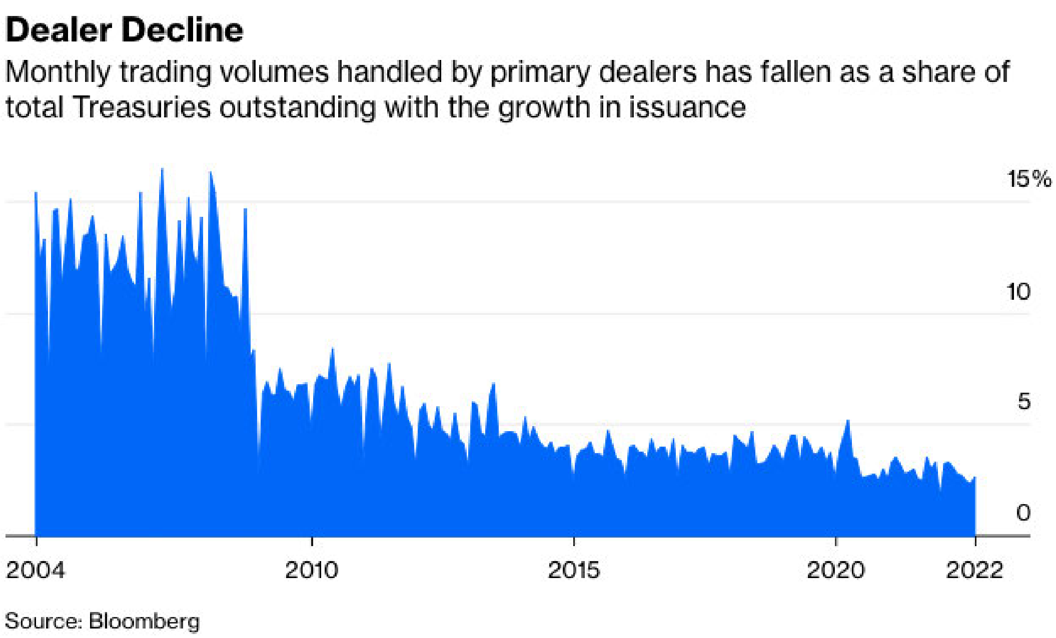
Data from Bloomberg shows that the 25 primary dealers responsible for participating in the Treasury auctions and making markets in Treasury securities play a much smaller role in recent years. According to Bloomberg, primary dealers now account for 3% of monthly secondary trading volume of Treasuries compared to 15% leading up to 2008.



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[8] Bloomberg Opinion. The World's Most Important Market Needs Some Work. Oct 3, 2022. https://www.bloomberg.com/opinion/articles/2022-10-03/the-world-s-most-important-market-needs-some-work
[9] Davies, Paul. Bloomberg Opinion. The $24 Trillion Treasury Market Needs More Than Just Clearing. Sep 19, 2022. https://www.bloomberg.com/opinion/articles/2022-09-19/the-24-trillion-treasury-market-needs-more-than-just-clearing

Uniform margin requirements for Treasuries would help better manage systemic risks

We also support the Commission's proposal to amend Rule 17Ad-22(e)(6)(i) of the Exchange Act to require CCAs to establish clear margin requirements for indirect participants separate from those for a direct participant.

By requiring CCAs to set clear and standardized margin requirements that direct participants must set for their clients (indirect participants) the Commission can help to migrate market participants to a more uniform set of margin requirements instead of a series of bilateral agreements involving special treatment or uneconomical practices in the pursuit of gaining market share.

The lack of clear and uniform margin standards has had particularly damaging impacts for the prime brokerage divisions of several banks that extended significant leverage to family office Archegos Capital and consequently lost billions of dollars, leading some such as Credit Suisse and Nomura to exit those businesses altogether.[10]

Uniform margin standards will also enable the CCAs to properly manage counterparty defaults in times of market stress. In contrast, the existing set of bespoke bilateral arrangements leads to concerns about counterparties heavily exposed to under-margined and over-leveraged clients which could then lead to further turmoil and contagion.

As a part of clear and uniform margin standards, it is important for the Commission to also require CCAs to clearly outline the conditions in which margin requirements would need to be raised.

The Chicago Mercantile Exchange's decision in late March 2020 to increase the margin requirements on existing Treasury futures positions for example led to a $75 billion sudden margin call that many hedge funds had only days to address at a time of immense broader market turmoil.[11]

Conclusion

The world's most important financial market will undoubtedly benefit from the greater level of transparency into its secondary trading combined with the Commission's previous proposal to collect more data and provide regulatory agencies with better insight into the net positioning of private funds.

The Commission's proposals would also help set the stage for sufficient transparency and centralized trading venues to allow for the Federal Reserve Bank of New York's proposal for All-to-All trading where market participants can to trade directly with one another and not have to use broker dealers.[12]

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[10] Walker, Owen and Noonan, Laura. Financial Times. Prime broking braced for new era after Archegos collapse. Nov 11, 2021. https://www.ft.com/content/d4e95d7e-5d44-43e8-9646-ae99d4b518c3

[11] Younger, Josh. Council on Foreign Relations. Revisiting the Ides of March, Part II: The Going Gets Weird. Jul 22, 2020. https://www.cfr.org/blog/revisiting-ides-march-part-ii-going-gets-weird

[12] Inter-Agency Working Group for Treasury Market Surveillance. Enhancing the Resilience of the U.S. Treasury Market: 2022 Staff Progress Report. Nov 10, 2022. https://home.treasury.gov/system/files/136/2022-IAWG-Treasury-Report.pdf

For any questions please do not hesitate to reach out to Andrew Park [redacted] or Renita Marcellin [redacted].

Sincerely,

Americans for Financial Reform Education Fund