DocuSign Envelope ID: CCECF1F4-2837-41F2-B49D-59BC9583A20E

Brian W. Steele
Managing Director
President, Clearing & Securities Services

570 Washington Boulevard
Jersey City, NJ 07310

November 10, 2023

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. 95763, File No. S7-23-22, 87 Fed. Reg. 64610 (Oct. 25, 2022)

Dear Ms. Countryman:

The Depository Trust & Clearing Corporation ("DTCC") and its subsidiary the Fixed Income Clearing Corporation ("FICC") submit this supplementary comment letter on the above-captioned proposal (the "Proposal") for the limited purpose of requesting that the Commission provide greater clarity regarding the interplay of the proposed amendments to the broker-dealer customer protection rule with the Commission's covered clearing agency standards (the "CCAS").[1]

The Proposal would amend SEC Rule 15c3-3a in order to allow a broker-dealer to record a debit in the customer or broker-dealer proprietary account ("PAB") reserve formula for margin collected from a customer and posted to a covered clearing agency that clears Transactions in U.S. Treasury securities (a "Treasury CCA"), subject to certain conditions (the "Debit Conditions"). As we discuss in our December 27, 2022 letter on the Proposal, it is unclear whether a Treasury CCA's use of customer margin for liquidity purposes in accordance with the CCAS would satisfy the Debit Conditions. We ask that the Commission clarify this ambiguity in any final rule so that FICC can adopt rule changes that both satisfy the Debit Conditions and uphold our obligations under the CCAS. We believe that such clarity can be achieved in a manner that provides broker-dealer customers with equivalent (if not superior) protection to that applicable to customer margin under the SEC's customer protection rule. Specifically, we ask that the Commission make clear that the Debit Conditions would not preclude a Treasury CCA from

[1] DTCC, through its subsidiaries, is the largest post-trade market infrastructure for the U.S. securities industry and supports clearance and settlement activities in the U.S. 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"). FICC's GSD also clears and settles certain transactions on securities issued or guaranteed by U.S. government agencies and government sponsored enterprises.

entering into a repurchase transaction involving customer cash margin, so long as the purchased securities under such repurchase transaction consist of Treasury securities held in a segregated account for the benefit of customers and satisfy certain other requirements.

I. Background

Currently, in contrast to the treatment of margin posted to a number of other central counterparties, SEC Rule 15c3-3a does not permit broker-dealers to record a debit in their customer or PAB reserve formulas for margin collected from customers and posted to a Treasury CCA. The Proposal would amend SEC Rule 15c3-3a to permit broker-dealers to take such a debit, so long the Debit Conditions are satisfied. These Debit Conditions include that the Treasury CCA has adopted, among other rules:

> (ii) Rules limiting the qualified clearing agency from investing cash delivered by the broker or dealer to margin U.S. Treasury security transactions of the customers of the broker or dealer or cash realized through using U.S. Treasury securities delivered by the broker or dealer for that purpose in any asset other than U.S. Treasury securities with a maturity of one year or less; [and]
>
> (iii) Rules requiring that the cash and U.S. Treasury securities used to margin the U.S. Treasury securities positions of the customers of the broker or dealer be held in an account of the broker or dealer at the qualified clearing agency that is segregated from any other account of the broker or dealer at the qualified clearing agency and that is:
>
> (A) Used exclusively to clear, settle, novate, and margin U.S. Treasury securities transactions of the customers of the broker or dealer;
>
> (B) Designated "Special Clearing Account for the Exclusive Benefit of the Customers of [name of broker or dealer]";
>
> (C) Subject to a written notice of the qualified clearing agency provided to and retained by the broker or dealer that the cash and U.S. Treasury securities in the account are being held by the qualified clearing agency for the exclusive benefit of the customers of the broker or dealer in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the broker or dealer or any other clearing member at the qualified clearing agency; and
>
> (D) Subject to a written contract between the broker or dealer and the qualified clearing agency which provides that the cash and U.S. Treasury securities in the account are not available to cover claims arising from the broker or dealer or any other clearing member

> defaulting on an obligation to the qualified clearing agency or subject to any other right, charge, security interest, lien, or claim of any kind in favor of the qualified clearing agency or any person claiming through the qualified clearing agency, except a right, charge, security interest, lien, or claim resulting from a cleared U.S. Treasury securities transaction of a customer of the broker or dealer effected in the account . . . .[2]

As we discuss in our letter dated December 27, 2022 on the Proposal, DTCC and FICC strongly support amending the reserve formula to allow broker-dealers to include a debit for customer margin collected by the broker-dealer and posted to a Treasury CCA. 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 margin at the Federal Reserve Bank of New York (the "FRBNY"), such margin would be available to satisfy customer claims upon a broker-dealer insolvency.

However, as discussed in our December 27, 2022 letter, it is not clear whether the Debit Conditions would preclude a Treasury CCA from using customer margin for liquidity purposes. This is because there are ways to use customer margin for liquidity purposes that ensure that cash or Treasury securities having a value equal to or exceeding the posted customer margin remain in a segregated account for the benefit of customers. In particular, as we discuss in greater detail below, a Treasury CCA could enter into a repurchase transaction with a broker-dealer, as agent for its customers, pursuant to which the broker-dealer purchases Treasury securities using customer cash margin and holds such Treasury securities in a segregated account of the broker-dealer. This approach would provide broker-dealer customers with the same protection as (and actually greater protection than) what they currently receive when a broker-dealer deposits Treasury securities into the customer or PAB reserve account equal to net debits in the formula.

Given its obligations under the CCAS both to maintain sufficient liquid resources to satisfy its obligations, including in a default scenario, and to ensure "fair and open access," FICC requires that any final rule provide clarity as to whether using customer margin for liquidity purposes would be consistent with the Debit Conditions.

II. <u>FICC Requires Clarity to Implement any Final Rule and Comply with CCAS</u>

The CCAS are set forth in SEC Rule 17Ad-22 and impose a number of standards on covered clearing agencies, including Treasury CCAs, in order to protect investors, facilitate the prompt and accurate clearance of securities transactions, safeguard securities and funds, and maintain fair competition.3 These standards include a requirement to establish policies and procedures reasonably designed to maintain sufficient liquid resources to satisfy obligations,

---

[2] 87 Fed. Reg. 64610, 64680 (Oct. 25, 2022).
[3] 79 Fed. Reg. 29514 (May 22, 2014).

DocuSign Envelope ID: CCECF1F4-2837-41F2-B49D-59BC9583A20E

including in a default scenario. Specifically, CCAS Standard 7 provides that a covered clearing agency must

> effectively measure, monitor, and manage the liquidity risk that raises in or is borne by the covered clearing agency by . . . [m]aintaining sufficient [qualifying] liquid resources at the minimum in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes, but is not limited to, the default of the participant family that would generate the largest aggregate payment obligation for the covered clearing agency in extreme but plausible market conditions.

As discussed in our December 17, 2022 letter, FICC does not have access to the Federal Reserve's discount window and therefore must look to other qualifying liquidity resources to satisfy the CCAS requirements. One such resource is FICC's Capped Contingency Liquidity Facility (the "CCLF"), which requires direct participants to stand ready to provide FICC with liquidity in certain circumstances. As other commenters on the Proposal have identified, the requirements of CCLF can be costly.[4] FICC's own analysis of recent survey data was inconclusive as to whether the Proposal will increase or decrease CCLF requirements.[5] Accordingly, FICC believes that retaining the flexibility to look to other liquidity resources would serve the goals of the Proposal and the CCAS of promoting fair and open access to clearing.

One such resource is cash margin posted by direct participants. In a participant default, FICC can temporarily use cash margin posted by non-defaulting direct participants to settle obligations with the defaulting participant's pre-novation counterparties and then replenish that cash as it liquidates the securities delivered by such pre-novation counterparties. Importantly, any losses resulting from these liquidations are allocated through FICC's loss mutualization rules, not on the basis of the direct participant whose margin was used.

---

[4] Indep. Dealer & Trader Ass'n, Comment Letter on Proposed Rule on 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 (Sept. 1, 2023), https://www.sec.gov/comments/s7-23-22/s72322-253499-583502.pdf; Indep. Dealer & Trader Ass'n, Comment Letter on Proposed Rule on 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 (Dec. 27, 2022), https://www.sec.gov/comments/s7-23-22/s72322-20153762-321517.pdf; Sec. Indus. & Fin. Mkts. Ass'n., Comment Letter on Proposed Rule on 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 (Dec. 22, 2022), https://www.sec.gov/comments/s7-23-22/s72322-20153420-320842.pdf; Int'l. Swaps & Derivatives Ass'n, Comment Letter on Proposed Rule on 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 (Dec. 23, 2022), https://www.sec.gov/comments/s7-23-22/s72322-20153678-321252.pdf; ASL Capital Mkts. Comment Letter on Proposed Rule on 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 (Dec. 23, 2022), https://www.sec.gov/comments/s7-23-22/s72322-20153459-320857.pdf.

[5] DTCC, LOOKING TO THE HORIZON: ASSESSING A POTENTIAL EXPANSION OF U.S. TREASURY CENTRAL CLEARING 19 (Sept. 2023).

DocuSign Envelope ID: CCECF1F4-2837-41F2-B49D-59BC9583A20E

To the extent the Debit Conditions prohibit FICC from using customer margin in this manner, FICC might need to obtain liquidity resources from other sources. This could mean increasing direct participants' CCLF requirements[6] or increasing the cash margin requirements applicable to direct participants and/or other indirect participants. Either approach would be costly to direct participants and other indirect participants and would effectively require these participants to subsidize the clearing activity of broker-dealer customers. Essentially, these participants would be required to provide the liquidity resources on the basis of their own activity plus that of broker-dealers' customers.

Such subsidization would make it more difficult and costly to access clearing and place direct participants and indirect participants that are not broker-dealer customers at a competitive disadvantage relative to broker-dealer customers. FICC would need to balance these considerations against the CCAS requirement that covered clearing agencies take steps to promote "fair and open" access, as well as the requirement under Section 17A(b)(3)(I) of the Securities Exchange Act (the "Exchange Act") that clearing agencies not impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[7] Such balancing is difficult to do without clarity as to what the Debit Conditions require. Accordingly, in order to ensure it can implement any final rule and satisfy the requirements of the CCAS, DTCC and FICC ask the Commission, if it adopts a final rule, to clarify whether FICC's use of customer cash margin described below would be consistent with the Debit Conditions.

III. Overview of Possible Use of Customer Margin

As mentioned above, there are ways that FICC could use customer cash margin for liquidity purposes that are generally consistent with the Debit Conditions and extend to customers the same protections that apply to cash or securities maintained in the customer and PAB reserve accounts. However, given that these mechanisms may involve the temporary removal of the cash margin from a segregated account in order to discharge obligations unrelated to the broker-dealer customers, a question could arise as to their technical compliance with the Debit Conditions. For example, FICC could consider proposing self-regulatory organization ("SRO") rule changes that have the following general contours:

- As set forth in the Debit Conditions, FICC would generally maintain customer cash margin ("15c3-3 Funds") in a segregated account (the "Segregated CCA Account") at a Federal Reserve Bank or a federally regulated and insured bank, which account holds exclusively margin for customer Treasury transactions ("Customer Positions").

[6] As set forth in FICC's GSD rulebook ("GSD Rules"), today FICC generally looks to rely upon the CCLF in instances where it does not have the ability to obtain liquidity from other resources (i.e., the repo market) to satisfy the obligations of a FICC defaulted member. GSD Rule 22A, Section 2(b), *available at* *https://www.dtcc.com/~/media/Files/Downloads/legal/rules/ficc_gov_rules.pdf*.

[7] *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, 55,437-38 (Nov. 15, 2017) (concluding that any burden on competition resulting from recent changes to CCLF was necessary or appropriate in furtherance of the purposes of the Exchange Act because, *inter alia*, "CCLF would allocate FICC's Historical Cover 1 Liquidity Requirement in a manner that is efficient in the sense that the CCLF allocation mechanism varies Netting Members' liquidity obligations as a function of the varying magnitudes of liquidity demands that Netting Members present to FICC").

DocuSign Envelope ID: CCECF1F4-2837-41F2-B49D-59BC9583A20E

- FICC would generally only be able to use 15c3-3 Funds to satisfy the obligations arising from Customer Positions.

- However, in the event FICC ceased to act for a direct participant (the "Defaulting Member"), FICC would be able to enter into a repurchase transaction involving the 15c3-3 Funds (a "Customer Repo").

- FICC would only be able to enter into a Customer Repo if FICC determined that it did not have the ability to obtain liquidity from other resources.

- The repo seller (i.e., the collateral provider) under the Customer Repo would be FICC, and the repo buyer (i.e., the collateral taker) would be the broker-dealer that posted the 15c3-3 Funds (the "Posting BD").

    - The Posting BD would enter into the Customer Repo as agent for its customers that posted the 15c3-3 Funds.

- The "Purchased Securities" under the Customer Repo would be Treasury securities destined for the Defaulting Member or held by FICC in its Clearing Fund (and not identified as having been contributed by broker-dealer customers).

- The "Purchase Price" for the Customer Repo, i.e., the 15c3-3 Funds transferred to FICC, would be no greater than the market value of the Purchased Securities minus a haircut.

    - The haircut applicable to a Purchased Security will be no less than the haircut for such security set forth in FICC's Schedule of Haircuts for Eligible Clearing Fund Securities.[8]

- Upon entry into the repo and either simultaneously with or prior to the transfer of the Purchase Price out of the Segregated CCA Account, FICC would transfer the Purchased Securities to an account of the broker-dealer for the benefit of its customers at a federally insured bank (the "Custodian") that satisfies the requirements for a special reserve account under SEC Rule 15c3-3 (the "Segregated Control Account").[9]

    - The Segregated Control Account would be subject to an industry standard custodial undertaking or control agreement. Under that agreement, FICC would be able to instruct the Custodian to withdraw the Purchased Securities against return to the Segregated Control Account or Segregated CCA Account of the Purchase Price plus interest calculated using a market interest rate.

    - Upon a Corporation Default under GSD Rule 22B or FICC's failure to perform its payment or delivery obligations under the Customer Repo, the Posting BD would be permitted to instruct the Custodian to withdraw the Purchased Securities from

[8] GSD Rules at 304.
[9] 17 CFR 240.15c3-3(f) (2019).

the Segregated Control Account and exercise the rights of a repo buyer under an industry-standard master repurchase agreement.

- FICC would only use the 15c3-3 Funds received under a Customer Repo to satisfy payment obligations owed by FICC to non-defaulting participants.

- The Customer Repo would be subject to mark-to-market margining, so that FICC would be required to post additional Purchased Securities or cash into the Segregated Control Account in the event the market value of the Purchased Securities declined. In the event the value of the Purchased Securities increased, FICC would be able to obtain additional financing.

- The "Repurchase Date" of the Customer Repo would be the date on which FICC settles any sale of the Purchased Securities. Prior to such time, FICC would seek to sell the Purchased Securities consistently with its general default management process. The proceeds of such sale will be used by FICC to settle the Customer Repo.

- The Customer Repo would be documented under an industry-standard master repurchase agreement incorporated by reference into FICC's rules, akin to how FICC documents CCLF repos.

Through an arrangement such as this, there would at all times be segregated for the benefit of the Posting BD's customers cash or Treasury securities with a value equal to or greater than the 15c3-3 Funds. This cash and securities would be "customer property" under SIPA.[10] Accordingly, the customers would face no greater risk arising from the Posting BD's failure (the risk against which SEC Rule 15c3-3 is designed to protect) than in the absence of the Treasury CCA's use of such funds.

IV. Conclusion

As discussed above, FICC and other Treasury CCAs would be able to use customer cash margin for liquidity purposes in a way that is broadly consistent with the Debit Protections and provides customer with protection similar to those set forth in SEC Rule 15c3-3. If the Commission adopts a final rule, it should make clear that such usage does not violate the Debit Conditions.

In our view, the Commission need not lay out in detail the requirements for a Customer Repo set forth above, as that is simply an example of a possible structure that FICC could seek to refine and ultimately propose to the Commission and the public for further consideration and input in the form of an SRO rule change subject to the required notice and comment periods set forth under Section 19 of the Exchange Act.[11] Rather, we think it would be sufficient for the Commission to add language to proposed Note H of SEC Rule 15c3-3a stating that a Treasury CCA's use of cash margin for liquidity purposes will not cause Item 15 to cease to apply, so long as (i) the Treasury CCA only uses the cash margin after FICC determines that it does not have the ability to obtain liquidity from other resources in order to satisfy the cash

[10] 15 U.S.C. § 78*lll*(4).
[11] 15 U.S.C. § 78s.

DocuSign Envelope ID: CCECF1F4-2837-41F2-B49D-59BC9583A20E

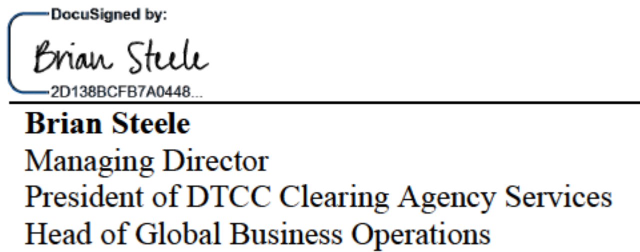
payment obligations that were originally due to be paid by the defaulting member, (ii) in connection with any such usage, the Treasury CCA deposits into and maintains in an account of the broker-dealer that generally satisfies the requirements for a special reserve account Treasury securities or cash that at all relevant times have a value no less than the value amount of used cash, and (iii) the Treasury CCA replenishes the cash margin promptly after the liquidity need is satisfied. Assuming such a modification were made in a final version of the Proposal, FICC and the broader market would then have the necessary regulatory clarity to consider further, as the cleared Treasury market structure evolves, the appropriate time to put forward proposed SRO rule changes designed to both satisfy the Debit Conditions and uphold FICC's obligations to manage liquidity risk under Section 17A of the Exchange Act and the CCAS.

*   *   *

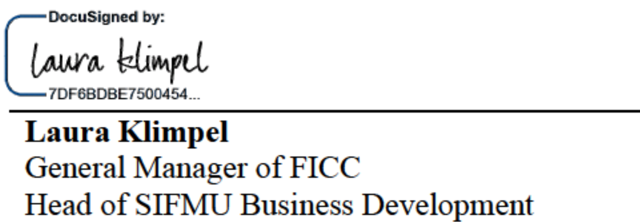
DocuSign Envelope ID: CCECF1F4-2837-41F2-B49D-59BC9583A20E

We appreciate the opportunity to submit this limited supplementary comment letter 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,



Brian Steele
Managing Director
President of DTCC Clearing Agency Services
Head of Global Business Operations



Laura Klimpel
General Manager of FICC
Head of SIFMU Business Development

cc:

Honorable Gary Gensler, Chairman, Securities and Exchange Commission

Honorable Hester M. Peirce, Commissioner, Securities and Exchange Commission

Honorable Caroline A. Crenshaw, Commissioner, Securities and Exchange Commission

Honorable Mark T. Uyeda, Commissioner, Securities and Exchange Commission

Honorable Jaime Lizárraga, Commissioner, Securities and Exchange Commission