November 12, 2024

Via Electronic Mail: rule-comments@sec.gov

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

Re: SR-FICC-2024-005 and SR-FICC-2024-007

Dear Ms. Countryman:

MFA[1] appreciates the opportunity to provide further comments to the Securities and Exchange Commission ("**SEC**" or the "**Commission**") on the above-captioned proposed rule changes ("**Proposed Rules**")[2] filed by the Fixed Income Clearing Corporation ("**FICC**"). These comments supplement our previous comments on the Proposed Rules,[3] as well as our comments on the related FICC proposed

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1 Managed Funds Association (MFA), based in Washington, DC, New York, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 member fund managers, including traditional hedge funds, credit funds, and crossover funds, that collectively manage over $3.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

2 Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing and Extension of Review Period of Advance Notice To Modify the GSD Rules (I) Regarding the Separate Calculation, Collection and Holding of Margin for Proprietary Transactions and That for Indirect Participant Transactions, and (II) To Address the Conditions of Note H to Rule 15c3-3a ("**SR-FICC-2024-007**"); Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change, as Modified by Partial Amendment No. 1, To Modify the GSD Rules to Facilitate Access to Clearance and Settlement Services of All Eligible Secondary Market Transactions In U.S. Treasury Securities, 89 Fed. Reg. 21,362 (Mar. 27, 2024) ("**SR-FICC-2024-005**").

3 *See* Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, MFA, to Vanessa Countryman, Secretary, SEC (Apr. 17, 2024) ("**MFA Comment Letter**"), available at: https://www.mfaalts.org/wp-content/uploads/2024/04/MFA-Comment-Letter-re-FICC-Rule-Propoals-As-submitted-4.17.24-1.pdf.

rules governing the trade submission requirement,[4] and should be read in light of those comments.

We support FICC's desire to offer a flexible range of clearing structures and enhance protection of customer margin, and we appreciate FICC's attempt to respond to commenter concerns regarding the Proposed Rules.[5] However, we do not believe FICC's response adequately addresses the concerns raised by MFA and other commenters that the Proposed Rules are insufficient measures to ensure that customers will actually receive safe and effective access to clearing at FICC.[6] With the compliance date of the Treasury clearing mandate rapidly approaching, it is imperative that the Commission take a more active role in ensuring an efficient market transition to central clearing, especially in light of the critical role that the U.S. Treasury market plays in the U.S. and global economies.[7] Promoting confidence in the Treasury markets is especially important now when there are demand weaknesses, which could jeopardize the U.S. government's ability to issue and refinance its debt efficiently.[8]

EXECUTIVE SUMMARY

For the reasons set forth below and given the critical importance of the U.S. Treasury markets to the U.S. and global economies, it is imperative that the Commission ensure that FICC follows through with these amendments well in advance of the mandate and take other steps to the extent necessary to

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4 *See* Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, MFA, to Vanessa Countryman, Secretary, SEC (Aug. 13, 2024) ("**MFA Supplemental Letter**"), available at: MFA-Comment-Letter-on-FICC-2024-009-As-submitted-8.13.24.pdf.

5 *See* Letter from Laura Klimpel, Managing Director, Head of Fixed Income and Financing Solutions, The Depository Trust & Clearing Corporation, to Vanessa Countryman, Secretary, SEC (Aug. 1, 2024) ("**FICC Reply Letter**"), available at: https://www.sec.gov/comments/sr-ficc-2024-007/srficc2024007-500915-1465682.pdf.

6 The Proposed Rules are intended to address new SEC rules concerning the separation of house and customer margin, margin subject to the broker-dealer customer protection rule, and access to FICC's Treasury clearing services by indirect participants, which the Commission adopted as part of its rulemaking to expand clearing of U.S. Treasury securities transactions (the "**Treasury Clearing Rules**"). SEC Release No. 34-99149 (Dec. 13, 2023), 89 Fed. Reg. 2714 (Jan. 16, 2024).

7 In promulgating the Treasury Clearing Rules, the Commission stressed the "critical and unique role" that U.S. Treasury securities play in the United States and global markets and emphasized that "confidence in the U.S. Treasury market, and in its ability to function efficiently, even in times of stress, is critical to the stability of the global financial system." *Id.* at 2715-16.

8 *See, e.g.,* Wall Street Journal, *America's Bonds Are Getting Harder to Sell* (Apr. 14, 2024), *available at* https://ww.wsj.com/finance/americas-bonds-are-getting-harder-to-sell-c3fde4de.

facilitate done-away trading, cross-margining, and other critical improvements to the Treasury clearing ecosystem. In particular, we recommend:

- FICC and the Commission address the failure to address the forced bundling of clearing and execution services
- FICC and the Commission consider measures to facilitate broader cross-margining
- FICC immediately amend the Proposed Rules to recalibrate its minimum segregated margin requirement for indirect participants
- FICC immediately address porting of customer positions and other default management practices
- The Commission address the narrowness of the inter-affiliate exception

DISCUSSION

I. Failure to Address the Forced Bundling of Clearing and Execution Services

FICC's responses regarding addressing the forced bundling of clearing and execution services specifically, and the availability of done-away trading more broadly, are contradictory and only exacerbate our concerns regarding the availability of a done-away clearing in time for the Commission's clearing mandates. FICC claims that there is data indicating that "the Treasury market is already shifting towards facilitating more done-away clearing" and that if the Proposed Rules are adopted, "this shift will become more permanent and profound."[9] FICC also claims that surveys of market participants show that "many Netting Members are preparing to offer done-away clearing services. . . .,"[10] although it provides no actual evidence beyond its survey responses that direct members will accept done-away transactions.

At the same time, FICC dedicates a significant portion of its response describing alleged impediments to adopting and scaling done-away clearing. For example, FICC argues that done-away Treasury transactions generally present additional liquidity risk to the clearing agency relative to done-with transactions, because done-away Treasury transactions are typically entered into between the customer of a clearing member and either a different direct participant or a different direct participant's customers.[11] FICC also argues that the fact that done-away Treasury transactions are negotiated and executed away from direct participants may give rise to additional regulatory and economic risks and

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9 FICC Reply Letter at 5.

10 *Id.* at 5-6.

11 *Id.* at 11.

complications for such direct participants.[12] According to FICC, this contrasts with a "done-with" transaction, where a direct participant is able to assess the risk of the transaction and address any regulatory issues at the time the transaction is negotiated or executed with the customer.

FICC fails to provide a reasonable or coherent justification for failing to address the anti-competitive practice of the forced bundling of clearing and execution services. As we previously explained, it is critical for an indirect participant to be able to consolidate its clearing activities in a small number of direct participants to enhance the benefits of central clearing and minimize the costs, which requires a robust done-away clearing market.[13] Done-away clearing is also necessary in order for market participants to be able to continue to trade anonymously on inter-dealer broker platforms, given that the brokers who operate those platforms generally do not offer customer clearing and so platform participants who are not self-clearing will need to give up their trades for clearing to direct participants willing to clear those trades as done-away transactions. There are economic incentives for direct participants to bundle their execution and clearing services by favoring "done-with" transactions, that will persist unless additional steps are taken.

In the absence of FICC action, the Commission must take additional steps to address the practice of forced bundling and ensure the availability of done-away clearing. At a minimum, the Commission should require that if a clearing agency permits its direct participants to condition an indirect participant's access to clearing on the indirect participant also executing transactions with the direct participant or its affiliate, the clearing agency must specify in its rules when such conditional access is permitted, which should be limited to circumstances where the clearing agency can show such conditional access is consistent with the Exchange Act. We note that the Commodity Futures Trading Commission ("**CFTC**") adopted measures in connection with its implementation of a clearing mandate for swaps in order to address similar issues in the swaps market.[14] Without similar action by the Commission in the U.S. Treasury markets, robust down-away clearing will not happen, which will harm liquidity and participation in the U.S. Treasury cash and repo markets.[15]

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12 *Id.* at 12.

13 *See* MFA Comment Letter.

14 *See* Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21278 (Apr. 9, 2012).

15 Requiring a direct participant that offers clearing services to indirect participants to accept those indirect participants' done away transactions would be consistent with Section 17A of the Exchange Act, including in particular requirements relating to addressing unnecessary costs, maintaining fair competition, removing impediments to a national market system and promoting the public interest and protection of investors.

II. Additional Changes to the FICC Rulebook are Required

FICC states that it intends to continue to engage with market participants to propose certain amendments to the Proposed Rules, such as reducing addressing customer cross-margining, the $1 million minimum segregated margin requirement, facilitating porting, and improving default management practices. We agree and urge the Commission to ensure these changes are prioritized and adopted well in advance of the date of the mandate.

A. The Commission Should Consider Measures to Facilitate Broader Cross-Margining

In general, the Proposed Rules do not address considerations in respect of cross-margining programs and other measures that would reduce clearing costs. As discussed in the MFA Comment Letter, we recommend that the Commission consider measures to facilitate broader cross-margining with respect to repo transactions cleared at FICC and interest rate derivatives cleared on a clearing house registered with the CFTC. Cross-margining currently is available under CFTC and SEC orders only with respect to direct participants of FICC, not to indirect participants.

The Commission has recognized the benefits of cross-margining programs in prior orders.[16] Expanding FICC cross-margining programs to indirect participants would lower the costs of clearing to indirect participants and enhance market efficiencies more generally by permitting participants to calculate risk-based margin requirements across correlated positions that are cleared at different clearinghouses. This is particularly important in light of the significant increase in transactions in U.S. Treasury securities that would be cleared by FICC as a result of the Treasury Clearing Rules and the number of indirect participants engaging in U.S. Treasury repo transactions that will subject to mandatory clearing under the Treasury Clearing Rules. The unavailability of customer cross-margining before market participants are mandated to clear Treasury securities could lead to significant deterioration in market liquidity.

Given the criticality of expanding cross-margining, market participants cannot fully assess the Proposed Rules until they understand how they could access clearing at FICC under a cross-margining program. For example, FICC and the Chicago Mercantile Exchange ("**CME**") have informally proposed a customer cross-margining program that would involve the customer holding its margin and positions in a

[16] *See, e.g.*, SEC Release No. 34-98327, pp. 9-10 (Sept. 8, 2023) (noting that the Commission "has historically supported and approved cross-margining at clearing agencies and has recognized the potential benefits of cross-margining systems, which include freeing capital through reduced margin requirements, reducing clearing costs by integrating clearing functions, reducing clearing agency risk by centralizing asset management, and harmonizing liquidation procedures" and that cross-margining programs "enhance member liquidity and systemic liquidity both in times of normal trading and in times of market stress by reducing margin requirements for members, which could prove crucial in maintaining member liquidity during periods of market volatility, and enhancing market liquidity as a whole").

futures account at a dually registered broker-dealer/FCM and contractually opting out of securities customer protections. That proposal would involve an entirely different clearing and segregation model from what is envisioned by the Proposed Rules. But market participants cannot assess the relative benefits and risks of the Proposed Rules' clearing and segregation models without comparing them to what they would face under a FICC cross-margining program.

For this reason, it is inappropriate to split out cross-margining from the rule proposals that the Commission has mandated FICC to conduct around indirect access models and separation of house and customer margin. It makes good sense that the Commission required FICC to finalize those rulemakings sufficiently far in advance of clearing mandates for market participants to have time to analyze different access models and take appropriate steps to gain access to FICC. But given the centrality of cross-margining to the ultimate menu of access arrangements, splitting out cross-margining to some undefined point in the future undermines the Commission's well-thought-out plan. It therefore is essential that FICC, together with CME, the Commission, and the CFTC further expedite their plans around expanding cross-margining.[17]

B. MFA believes that FICC should amend the Proposed Rules to recalibrate its minimum segregated margin requirement for indirect participants, not delay such an amendment.

The Proposed Rules would require an indirect participant to post at least $1 million in cash in any segregated margin account that it establishes with a direct participant. FICC based this minimum amount on its requirements for direct participants, without sharing any analysis addressing why that is the correct baseline. FICC is considering an amendment to provide it with the ability to adjust the minimum segregated customer margin requirement if a lower minimum would suffice to reduce backtesting deficiencies comparably to what the proposed $1 million floor would achieve under current market conditions.[18]

MFA believes that FICC should amend the Proposed Rules to recalibrate its minimum segregated margin requirement for indirect participants, not delay to a later date. By failing to recalibrate its minimum segregated margin requirements in the Proposed Rules, FICC is unnecessarily delaying an important amendment that will significantly improve the clearing ecosystem. FICC's delay will impose an impediment to central clearing.

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[17] In addition, to fully realize the benefits of cross-margining programs, it is critical that any amendments to the capital requirements for larger banking organizations and those banking organizations with significant trading activities ("**Covered Institutions**") by U.S. banking regulators recognize the risk off-sets associated with cross-product netting arrangements and related margining, as appropriate.

[18] FICC Reply Letter at 2-3.

Given the generally smaller portfolios and activity levels exhibited by indirect participants relative to direct participants and the additional credit support FICC receives for indirect participants via the guarantees provided by their direct participants, the baseline is incorrect and this minimum requirement is arbitrary. It also would discourage smaller indirect participants from selecting a segregated clearing model, which is not consistent with the customer protection objectives of the Securities Exchange Act of 1934 ("**Exchange Act**") or FICC's obligation to facilitate access. Instead of a blanket $1 million minimum, FICC's rules should take a risk-based approach to setting a minimum requirement for any particular indirect participant based on that participant's particular risk profile, including its planned and historical clearing activity.

C. FICC Should Not Defer Addressing Porting of Customer Positions & Other Default Management Practices

FICC is deferring addressing porting and default management issues until after the Commission considers the Proposed Rules. MFA believes these are important issues for customers and extremely relevant to improving the Treasury clearing ecosystem. We encourage FICC to propose additional rules to address porting and default management as soon as possible.

In connection with this, we believe that indirect participants of FICC should be able to port positions to other direct netting members rather than having them closed out. Porting of done-with positions should be available, not only in the event of a direct netting member default, but also in the ordinary course, in other words, in both default and non-default situations. Given the fast-approaching compliance date, we urge FICC to make porting of positions and default management a priority.

III. The Commission's Inter-Affiliate Exception is Too Narrow

MFA reiterates that the adopted inter-affiliate exception is too narrow. The Commission did not put forward the inter-affiliate exception in the final rule for public comment, and the exemption the Commission ultimately adopted does not afford sufficient flexibility to address MFA member needs. Specifically, we are concerned that the inter-affiliate exception is available only to certain defined "affiliated counterparties," which include only banks, brokers-dealers, FCMs, or entities regulated as any of the foregoing in their home jurisdiction. The Commission explained in the preamble to the Treasury Clearing Rule that its definition of affiliated counterparty "is consistent with how [FICC] defines the terms for purposes of its rule regarding its participants' obligation to clear transactions with certain affiliates, and this consistency should be helpful to direct participants when considering compliance with this conditional inter-affiliate exemption."[19] However, this was an incorrect reference to FICC rules, which do not currently require any repos between a Netting Member and an affiliate that is not also a Netting member to be cleared. In the absence of this relief, the inter-affiliate exception will be of limited

[19] Treasury Clearing Rule at 2738.

use, resulting in a less stable and more expensive financial market, as market participants with Direct Participant affiliates will struggle to move liquidity and collateral efficiently within their organizations.

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We appreciate the opportunity to provide our comments to the Commission regarding the Proposed Rules, and we would be pleased to meet with the Commission and its staff to discuss our comments. If the staff has questions or comments, please do not hesitate to contact Matthew Daigler or the undersigned at (202) 730-2600 with any questions regarding this letter.

Respectfully yours,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President
Chief Counsel and Head of Global Regulatory Affairs
MFA

cc: The Hon. Gary Gensler, Chair
The Hon. Hester M. Peirce, Commissioner
The Hon. Caroline A. Crenshaw, Commissioner
The Hon. Mark T. Uyeda, Commissioner
The Hon. Jaime Lizárraga, Commissioner
Dr. Haoxiang Zhu, Director, Division of Trading and Markets