

Improving Risk Management and Increasing Clearing in U.S. Treasuries



The Securities and Exchange Commission proposed rule amendments that would:

- Require covered clearing agencies that provide central counterparty services for U.S. Treasury securities to have policies and procedures to require their direct participants to submit for clearing certain eligible secondary market transactions;
- Require that covered clearing agencies for U.S. Treasury securities have policies and procedures to calculate, collect, and hold margin for their direct participants' proprietary transactions separately from transactions submitted on behalf of indirect participants;
- Require covered clearing agencies for U.S. Treasury securities to have policies and procedures to ensure that they have appropriate means to facilitate access to clearance and settlement services of all eligible secondary market transactions, including those of indirect participants; and
- Amend the broker-dealer customer protection rules to permit margin required and on deposit at a covered clearing agency for U.S. Treasury securities to be included as a debit item in the customer reserve formula, subject to certain conditions.

Why This Matters

A clearing agency that serves as a central counterparty acts as the buyer to every seller and the seller to every buyer in a securities transaction. It can help increase the safety and efficiency of securities trading and reduce costs. A clearing agency also mitigates the potential for a single market participant's failure to destabilize other market participants or the financial system. Central clearing also addresses concerns about counterparty risk by substituting the clearing agency's liquidity and creditworthiness for each counterparty.

The U.S. Treasury market plays a unique role in the U.S. and global economy, as an investment instrument and hedging vehicle, a risk-free benchmark for other financial instruments, and a mechanism for the Federal Reserve's monetary policy implementation.

How the Rules Apply

The proposed amendments to Exchange Act Rule 17Ad-22 would impose requirements on covered clearing agencies providing central counterparty services for U.S. Treasury securities. First, a covered clearing agency would be required to have policies and procedures designed to require its direct participants to submit for clearing all eligible secondary market transactions.

Eligible secondary market transactions would include:

- All repurchase and reverse repurchase agreements collateralized by U.S. Treasury securities to which a direct participant is a counterparty;
- All purchase and sale transactions of U.S. Treasury securities for direct participants who are acting as interdealer brokers. This occurs when the participant brings together multiple buyers and sellers using a trading facility and is a counterparty to both the buyer and seller in two separate transactions; and
- All purchases and sales of U.S. Treasury securities between a direct participant and a registered broker-dealer, government securities dealer, or government securities broker; a hedge fund; and a levered account.

Eligible secondary market transaction would not include 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.

The proposal would also require covered clearing agencies 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 in connection with U.S. Treasury securities transactions by an indirect participant.

Further, the proposal would require a covered clearing agency to have policies and procedures to ensure 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, and that those policies and procedures are reviewed by the covered clearing agency's board of directors annually.

The proposal would amend the broker-dealer customer protection provisions in Exchange Act Rule 15c3-3a. Currently, Rules 15c3-3 and 15c3-3a do not permit broker-dealers to include a debit in the customer reserve formula equal to the amount of margin required and on deposit at a covered clearing agency for U.S. Treasury securities. Therefore, increases in the amount of margin required to be deposited at a covered clearing agency for U.S. Treasury securities as a result of the recommended additional membership standards would result in corresponding increases in the need to use broker-dealers' cash and securities to meet these requirements.

The amendment to Rule 15c3-3a would permit margin required and on deposit at a covered clearing agency for U.S. Treasury securities to be included as a debit item in the customer reserve formula, subject to certain conditions designed to ensure maximum protection of a broker-dealer's customers. This new debit item would offset credit items in the Rule 15c3-3a formula and, thereby, free up resources that could be used to meet the margin requirements of a covered clearing agency.

Additional Information:

The public comment period will remain open for 60 days following publication of the proposing release in the Federal Register.